SYMPOSIUM ON UNILATERAL TARGETED SANCTIONS

THE DOLLAR AND THE UNITED STATES’ EXORBITANT POWER TO SANCTION

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With the Trump administration’s reimposition of financial sanctions on Iran, the power of the weaponized dollar is yet again making headlines—and putting distance between the United States and its allies. The dollar’s special status as the world’s key currency affords the United States an unrivaled sanctioning power. Because access to dollars is a near-necessity for multinational businesses and financial institutions, the United States can unilaterally impose costly sanctions by denying such access to a target—whether a state, company, or individual. This capability is one form of the “exorbitant privilege” afforded to the United States by the dollar’s international role. This essay considers why the dollar’s status affords the United States this sanctioning power and how the United States exercises it. I first summarize the nature of the dollar’s role. Next, I explain the means by which the United States has weaponized that role, especially through financial sanctions. I conclude by offering some potential limitations on that power and exploring the ways in which other countries might seek to erode it.

The Dollar’s Key Currency Role

Canonically, a key currency performs three interlocking roles in the global economy, each corresponding to one of the three functions of money. First, the key currency performs a medium of exchange role, functioning as a monetary lingua franca for foreign exchange trading, trade settlement, and exchange market interventions by central banks. Second, it performs a unit of account role and is used for trade invoicing and as the anchor currency for fixed and managed exchange rates. Third, it performs a store of value role and is used for investment denomination and national currency reserves. As Benjamin Cohen, the godfather of monetary politics, writes, the key currency is a highly internationalized currency “whose use dominates for most if not all types of cross-border purposes and whose popularity is more or less universal, not limited to any particular geographic region.”3 Today, that currency is unequivocally the dollar.

In practical terms, the consequences of the dollar’s special status are stark. The dollar represents 62 percent of allocated foreign exchange reserves.4 It is on one side of 88 percent of foreign exchange trades5 and 40 percent of...

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1 See Hillary Hurd, U.S. Reimposes the Second Round of Iran Sanctions, LAWFARE (Nov. 9, 2018).

2 See generally Barry Eichengreen, Exorbitant Privilege: The Rise and Fall of the Dollar and the Future of the International Monetary System (2011).

3 Benjamin J. Cohen, Currency Power 17 (2015).

4 International Monetary Fund, Currency Composition of Official Foreign Exchange Reserves (Jan. 8, 2019).

5 Triennial Central Bank Survey: Foreign Exchange Turnover in April 2016, Bank for Int'l Settlements 4 (2016).
international payments.6 62 percent of banks’ foreign currency local liabilities are denominated in dollars.7 And most estimates put the share of global trade invoiced in dollars around 50 percent and indisputably outsized relative to the U.S. share of global trade.8

These roles are mutually reinforcing. Commercial actors need banks to finance their activity and hold their deposits in dollars. Banks need investors and traders to whom they can lend in dollars, and so on. Together, these interconnected functions generate substantial network externalities that compound the dollar’s attractiveness relative to alternatives. It is cheaper and easier for one currency to predominate across all of these areas.9

For financial institutions operating across borders, access to dollars is even more essential. The dollar’s key currency role creates a need among firms worldwide for banks that can supply them with dollars.10 Banks, no matter where in the world they operate, need access to the U.S. financial market in order to adequately serve their clients and remain competitive. As David Cohen, formerly Deputy Director of the CIA and Treasury Under-Secretary for Terrorism and Financial Intelligence, put it:

For banks and businesses around the world, if they don’t have access to the U.S. financial system, don’t have access to the U.S. economy, it is a significant if not mortal wound. That gives us a huge amount of leverage, a huge amount of opportunity to project U.S. power through our financial measures.11

Foreign banks seeking access to a steady supply of dollars usually do so by opening a “correspondent account” with a U.S. bank. A correspondent account is like a bank account for a bank: it allows a foreign banking entity to hold deposits with another (U.S.) banking institution and receive dollar clearing services from them on behalf of foreign clients.12

The upshot of this system is that any business or bank worldwide that wants to regularly acquire dollars or provide dollar payment services (which clients of transnational or global scale will require) must at least maintain a commercial relationship with a bank subject to U.S. domestic banking law or a foreign bank that has such a relationship with a U.S. bank. Given the ubiquity and centrality of dollars in the international financial system, such access is not optional for a bank. It is life or death.

The Weaponized Dollar

Dollar-based sanctions are a unique form of what Oona Hathaway and Scott Shapiro call “outcasting”—a punishment that consists of “denying the disobedient the benefits of social cooperation and membership.”13 The potency of these sanctions derives from the exclusion of targeted actors from the dollar-based international financial system and the denial of the benefits associated with participation in it. Outcasting is generally cooperative—cooperation is often necessary to engender a network of sufficient importance to make exclusion from it a costly sanction. Dollar outcasting is not. The substantial network externalities resulting from wide use of the dollar are

6 RMB Tracker: Monthly Reporting and Statistics on Renminbi (RMB) Progress Towards Becoming an International Currency, Soc’y for Worldwide Interbank Fin. Telecomm. (Feb. 2019).
7 See Gita Gopinath & Jeremy C. Stein, Banking, Trade, and the Making of a Dominant Currency 2 (Mar. 28, 2018).
8 See John Williamson, The Dollar and US Power, in The Power of Currencies and Currencies of Power 75, 76 (Alan Wheatley ed., 2013); Gita Gopinath, The International Price System 9–11 (Jackson Hole Symposium Proceedings, 2015).
9 See Gopinath & Stein, supra note 7, at 5.
10 See Tom C.W. Lin, Financial Weapons of War, 100 MINN. L. REV. 1377, 1404 (2016).
11 William Mauldin, U.S. Treasury’s Top Terrorism Cop: How Financial Tools Fight Foes, WALL ST. J. (June 2, 2014).
12 See Committee on Payments and Market Infrastructures, Correspondent Banking, Bank for Int’l Settlements 9 (July 2016).
13 See Oona A. Hathaway & Scott Shapiro, Outcasting: Enforcement in Domestic and International Law, 121 YALE L.J. 252, 258–60 (2011).
organic and arise mostly from “voluntary” choices (even if, in practice, market dynamics leave little actual choice). There is no international arrangement mandating the dollar’s role. So long as commercial actors and nations opt into the dollar-based financial system (or lack a realistic alternative), the United States will be able to flex its financial muscles unilaterally.14

The United States has two primary legal tools for dollar outcasting: Section 311 of the Patriot Act and the Specially Designed Nationals and Blocked Persons (SDN) List. Section 311 empowers the Treasury Department to compel U.S. banks to deny services to any entity designated as a “primary money laundering concern.”15 In particular, Section 311(b)(5) allows the Treasury Department to ban U.S. banks from providing correspondent banking services to the designated entity, effectively cutting off its access to dollar clearing and denying it meaningful participation in the global financial system. Without this access, a bank is unable to provide its foreign clients with the dollar payments services they require. Critically, this tool can be brought to bear against an entire jurisdiction (e.g., Iran) or a single bank (e.g., one serving terrorist groups). It can function as a machete or a scalpel. As Juan Zarate writes, such action is a “virtual financial death penalty,” for the reasons discussed earlier.16

Moreover, the Treasury Department often uses Section 311 to coerce foreign financial institutions without even applying these measures directly. Section 311 requires the Department to issue a notice of proposed rulemaking (NPRM) before designating a primary money laundering concern, effectively a formal threat that implies a high risk of impending legal action. Doing so imposes reputational costs (and possible subsequent regulatory scrutiny) on any bank that continues to transact with the threatened entity and signals potential future regulatory action against the entity that could bar it—and potentially any of its counterparties—from the U.S. market.

The mere threat of Section 311 designation has been catastrophic for targeted institutions.17 In September 2005, Treasury designated Banco Delta Asia (BDA) as a primary money laundering concern and published an NPRM that would bar U.S. banks from providing correspondent banking services to BDA.18 The proposed rule cited BDA’s provision of banking services to facilitate a variety of criminal activities and violations of international law by the government of North Korea. The rule’s true target was North Korea, via BDA as a financial intermediary.19 The effect was immediate: 34 percent of BDA deposits totaling over US$130 million were withdrawn in days, and U.S. banks quickly ceased all business with BDA, cutting it off from dollar financing. The bank ultimately collapsed and was forced into receivership. Other banks around the world with links to the North Korean government swiftly cut ties and preemptively froze North Korean assets, accounts, and transactions.20 All of this unfolded within a year and without any actual sanctions. The final rule imposing the fifth Section 311 Special Measure (banning correspondent accounts) was not promulgated until March 2007.21

More recently, the Treasury Department’s publication in February 2018 of an NPRM that would prohibit Latvian ABLV Bank from maintaining a correspondent account under Section 311 led the bank to fold within

14 See Suzanne Katzenstein, Dollar Unilateralism: The New Frontline of National Security, 90 IND. L.J. 293 (2015).
15 31 U.S.C. § 5318A(b).
16 JUAN C. ZARATE, TREASURY’S WAR: THE UNLEASHING OF A NEW ERA OF FINANCIAL WARFARE 7 (2013).
17 See Barry E. Carter & Ryan M. Farha, Overview and Operation of U.S. Financial Sanctions, Including the Example of Iran, 44 Geo. J. Int’l L. 903, 910 (2013).
18 Imposition of Special Measure Against Banco Delta Asia SARL, 70 Fed. Reg. 55,217 (proposed Sept. 20, 2005) (codified at 31 C.F.R. pt. 103).
19 Finding That Banco Delta Asia SARL Is a Financial Institution of Primary Money Laundering Concern, 70 Fed. Reg. 55,214 (Sept. 20, 2005).
20 See ZARATE, supra note 16, at 241.
21 Special Measures Against Banco Delta Asia, 31 C.F.R. § 103.193 (2007).
days of the announcement. Accused of money laundering, including on behalf of North Korea’s nuclear missile program, ABLV faced immediate deposit outflows and a liquidity crisis following the announcement. On February 24, 2018, the European Central Bank announced ABLV would be wound down. For now, the United States’ exorbitant power to sanction remains as strong as ever.

The Treasury also engages in dollar outcasting using the SDN list—the list of individuals and entities with whom transactions by U.S. persons are blocked pursuant to sanctions programs under the International Emergency Economic Powers Act, Trading with the Enemy Act, and other particularized sanctions statutes. Inclusion on the SDN list requires U.S. banks and financial institutions to freeze the assets of the designated entity and to deny additional transactions with them, effectively limiting their access to existing financial resources and cutting off access to dollar financing (similar to Section 311).

Both of these tools rely on three interrelated features of global dollar finance for their efficacy. First, the interconnected nature of the global banking system means that continuing to do business with a designated entity, or an intermediary of a designated entity under Section 311, risks exposure to liability. The bank of a primary money laundering concern, after all, is also a money launderer.

Second, and consequent to the first, the choice between cutting ties with illicit actors, plus the banks that (allegedly) handle their money, and losing access to the U.S. financial market is an easy one. No bank will choose the illicit business of a single client (or even a country or set of clients) over access to dollar clearing services because to do so would kill the rest of their business. Consequently, dollar sanctions against a foreign financial institution under domestic law will often result in the isolation of the targeted institution not only by U.S. banks but by foreign banks who are concerned with maintaining their dollar market access.

The importance of U.S. financial market access for foreign banks means that U.S. unilateral financial sanctions often become de facto secondary sanctions. Indeed, the United States has encouraged this behavior by reaching out to foreign banks through nonbinding, diplomatic channels to “educate” them about the risks of continuing to do business with targeted entities. More often than not, it seems to work.

Third, and most critically for the success of dollar outcasting, illicit actors are heavily reliant on the dollar financing system for the same reasons as everyone else: there is no alternative. Criminals and rogue states need banks to conduct business and deposit their assets, and banks need dollars. But because (at least, most) banks need dollars more than they need illicit business, dollar outcasting effectively compels banks to cut off these actors and starve them of the financing they need. So long as the world relies on dollar-based finance, rogue actors will find it difficult to escape targeted dollar sanctions.

Potential Limits on Dollar Sanctions

Given the potency of the dollar’s role, the United States ought to do what it can to preserve it. That starts with avoiding dollar outcasting that alienates American allies. Other nations are far from oblivious to the United States’
exorbitant power to sanction. But without a viable alternative to the dollar-based international financial and payments system, critics of dollar-based sanctions are powerless to stop them. In 2016, however, Treasury Secretary Jack Lew warned that “[i]f foreign jurisdictions and companies feel that we will deploy sanctions without sufficient justification or for inappropriate reasons . . . we should not be surprised if they look for ways to avoid doing business in the United States or in U.S. dollars.” International rivals like China and Russia have made overtures at such measures for over a decade. More worryingly, the Trump Administration’s recent bout of dollar unilateralism has catalyzed opposition to dollar-based finance even among America’s European allies.

Since at least 2009, China has adopted a conscious policy of seeking to challenge the dollar’s key currency role through various means, including the internationalization of the renminbi and the creation of alternative financial and payments infrastructure. China has already begun to build these alternatives, including its own interbank messaging system to bypass the Belgium-based Society for Worldwide Interbank Financial Telecommunication (SWIFT). It is no coincidence that China’s dual efforts to internationalize its currency and build a competing financial infrastructure have followed several years of painful U.S. financial sanctions against Iran and Russia. Thus far, though, China’s efforts have met limited success.

More recently, the Trump Administration’s unilateral reimposition of financial sanctions on Iran has led European nations to call for measures similar to those China is pursuing. Last August, German Foreign Minister Heiko Maas penned an op-ed calling for Europe to “establish[] payment channels independent of the US, a European monetary fund and an independent SWIFT [payments] system.” And in February of this year, European Central Bank board member Benoît Cœuré called for policies to promote greater international use of the Euro because “the EU may be more exposed to the risk that the monetary power of others is not used in its best interests, or is even used against it.” The “other,” of course, is the United States. This is exactly the situation Secretary Lew feared, one in which American allies are so disillusioned with American unilateral dollar sanctions that they seek to blunt the instrument.

These developments suggest that the United States ought to tread carefully when it comes to dollar outcasting. International monetary arrangements are notoriously difficult to alter. It took two world wars for the dollar to fully displace the pound sterling as the world’s key currency. But that shift was largely organic. By contrast, the words of Chinese and European officials suggest a nascent, concerted effort to bypass the dollar-based financial system. That they feel emboldened to make these claims indicates the United States has nearly, or already, overstepped the international community’s tolerance for dollar unilateralism. Unfortunately, recent incidents like National Security Adviser John Bolton’s threat to sanction judges and prosecutors of the International Criminal Court suggest the Trump Administration is more likely to exacerbate the problem than proceed with greater caution.

Given the power of dollar outcasting measures, the prospect of seeing this power diminished is one the United States ought to avoid. Efforts to dethrone the dollar are unlikely to succeed in the near-term, or even in the next few decades. But that does not make it impossible to change the key currency, as the British learned in the early twentieth century. It is easy to take exorbitant privilege for granted until it is gone.

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30 Remarks of Secretary Lew on the Evolution of Sanctions and Lessons for the Future at the Carnegie Endowment for International Peace, U.S. DEP’T OF THE TREASURY (Mar. 30, 2016).
31 See Gabriel Wildau, China Launch of Renminbi Payments System Reflects Swift Spying Concerns, FIN. TIMES (Oct. 8, 2015).
32 See Elizabeth Rosenberg & Zachary K. Goldman, Opinion, How China Benefits from Global Sanctions, WALL ST. J. (Nov. 26, 2015).
33 Heiko Maas, Opinion, Making Plans for a New World Order, HANDELSBLATT TODAY (Aug. 22, 2018).
34 Benoît Cœuré, The Euro’s Global Role in a Changing World: A Monetary Policy Perspective, EUR. CENT. BANK (Feb. 15, 2019).
35 See Mark Landler, Bolton Expands on His Boss’s Views, Except on North Korea, N.Y. TIMES (Sept. 10, 2018).