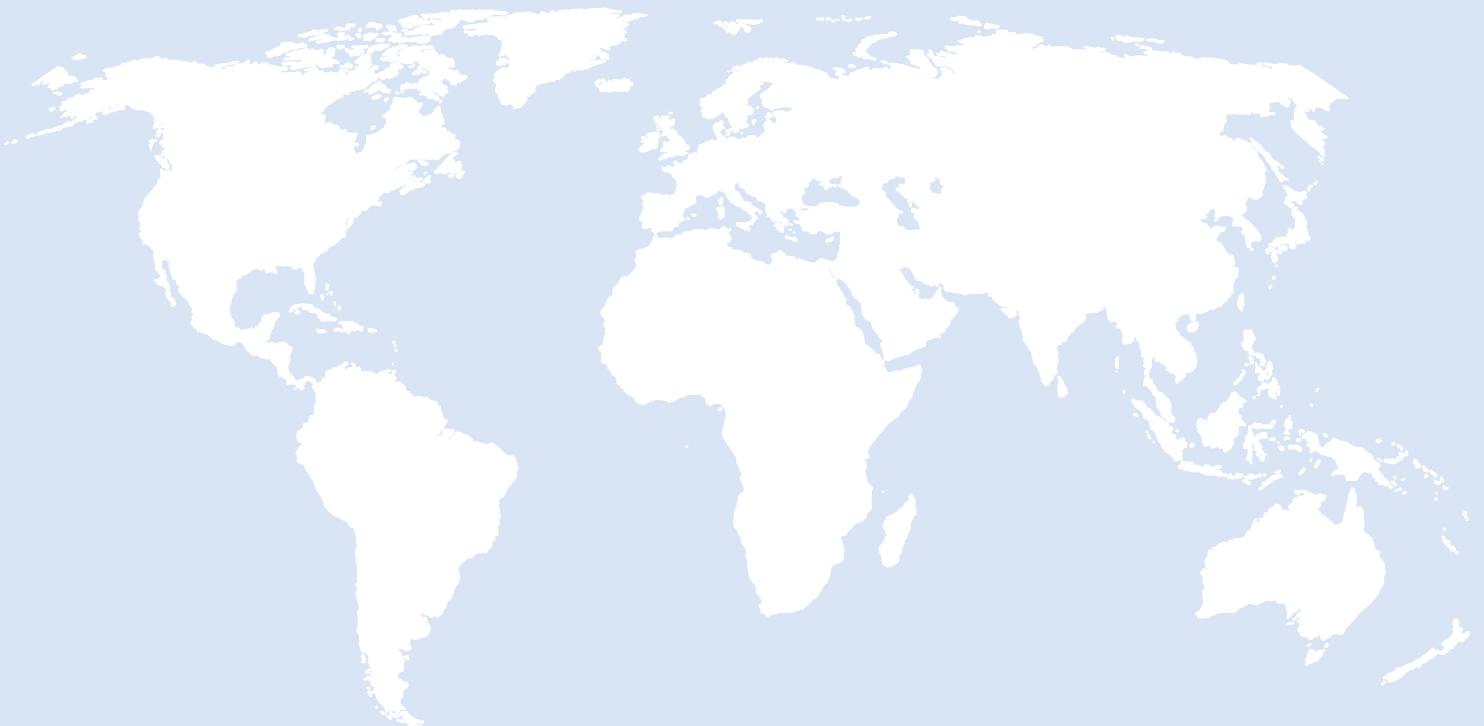




FAR-REACHING CONSEQUENCES OF U.S. FINANCIAL SANCTIONS

THE DOLLAR SHORTAGE AND THE “TRIFFIN MOMENT”

June 2019



CENTRO STUDI SUL FEDERALISMO



A watch on the international financial and monetary system

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RTI aims to preserve the intellectual heritage of the Belgian economist Robert Triffin (1911-1993) with the creation of a documentation centre and continuing his action directed to the reform of the international monetary system.

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by Miriam L. Campanella

June 2019

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CENTRO STUDI SUL FEDERALISMO

To My Mother

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Foreword

The RTI research programme started after the US financial crisis in 2007-2008. RTI supported the Palais Royal Initiative promoted by Tommaso Padoa-Schioppa, Michel Camdessus and Alexander Lamfalussy, whose report was presented at the 2011 G20, and continued to pursue the reform of the international monetary system with the “Triffin dilemma” at its core, still as relevant as ever in the broader sense, with a national currency performing the function of international currency. A high-level working group produced the report *Using the SDR as a Lever to Reform the International Monetary System*. The inclusion of the renminbi in the SDR basket, one of the priorities highlighted in the report, encouraged RTI to continue its research based on the idea that a multi-currency monetary system needs an anchor and that the SDR can play this role. Six SDR Notes and four Research Papers (this is the fifth one) have been published on the topic:

1. Elena Flor, Alfonso Iozzo, Valentina Tosolini, *The ECU and the SDR: Learning from the Past, Preparing the Future*, November 2014. This research allowed RTI to contribute to the preparation phase of the entry of the renminbi into the SDR based on the experience of the ECU basket, in which some problems similar to those of the SDR basket had been successfully solved.
2. Elena Flor, Valentina Tosolini, *Analysing Commodity Prices: Trend for Crude Oil and Wheat in US Dollars, Euro and SDR*, January 2017. The paper examined how the distortions of the price of the dollar affect the price of oil and wheat. Producing countries aim to defend the real value of commodities, leading to their financialisation, in particular through futures markets. Continued fluctuations in the dollar caused sharp fluctuations in the price of oil, often due to the attempts of producers to maintain the real value of their exports. This research shows that there is a strong reverse correlation between the exchange rate of the dollar and the price of oil, which would be less volatile if fixed in euros, or even more stable in SDR.
3. Valentina Tosolini, *The Triffin Dilemma on a Russian Perspective. The Fixing of Oil Price: Dollar, Euro, Ruble or SDR*, November 2017. At the Eurasian Economic Union meeting in Moscow, RTI then illustrated how the conclusions of the previous report could be applied to the case of Russian exports.
4. Miriam L. Campanella, *The Changing Geography of Finance. Shifting Financial Flows and new Hubs: Shanghai and Paris?* March 2018. With the Chinese economy resuming its pre-industrial revolution role in the world economy (“the great convergence”), Shanghai has become the leading financial hub in East Asia. This confirms the crucial importance of the hinterland for financial centres to take root and last. New York, Shanghai and Singapore can count on continental markets. London and Hong Kong seem destined to lapse into off-shore financial centres. In anticipation of Brexit, Paris seems to be winning in Europe.

This new research by Miriam Campanella responds to one of the issues aggravated by recent US isolationism: financial sanctions that exploit, more than in the past, the role and infrastructure of the dollar in order to prevent third countries from trading with the countries considered to be enemies of the US (e.g. Iran).

The US’s continued challenging of the WTO through bilateral agreements (*divide et impera*), their imposition of tariffs and the empty chair policy have triggered a widespread debate on reform and

the re-launch of the WTO, in addition to commercial policy responses reinforced by monetary policy. Threats to exit unilaterally from international treaties that have already been approved, such as the Paris Agreement on climate change, have encouraged the study of a renewed European Environment Agency, which could be a preparatory step to a World Agency. Therefore, the increasingly widespread and oppressive nature of financial sanctions also results in a further tightening of the area where the dollar is fully convertible. A national currency manipulated for power policy purposes cannot perform world currency functions. It always comes back to Triffin.

Recently, the de-dollarisation of the global economy has accelerated. First of all, the US – which has invested in fracking technologies instead of renewable energy – has gone from being an oil-importing country to an oil-exporting country. If oil is being supplied from Saudi Arabia to China, now the largest consumer since the US became a competitor to producers, why should it be paid for in the currency of a third power? A renminbi oil market has already been launched. The renminbi availability of oil-exporting countries can be reinvested in Chinese assets and contribute to the progressive internationalisation of the renminbi itself. Russia has reduced its dollar reserves, in favour of the euro, renminbi and yen, thus tending to build a basket similar to the SDR. China, after reducing its dollar reserves thus ranking second among holder countries after Japan, warned the US by stopping the Treasury bond purchase programme for a few hours. India and other emerging countries have diversified their reserves, favouring – according to local cultures – gold which, during risky times, does not fit into the role of the “barbarous relic”. Finally, the judgments in the recent IMF report on the US are very harsh: the US debt is unsustainable, income and wealth inequalities are no longer a concern of the ethical and social spheres alone, but make the sustainability of the economy itself critical.

The continuing and tougher sanctions towards some countries actually makes the dollar non-convertible in these areas. For countries and companies to avoid sanctions, they should neither use the dollar in transactions nor the US financial infrastructure. In fact, the coercive power of sanctions lies in the possibility of denying access to that platform, hence to the largest financial market in the world.

Although the euro is the only currency with wide commercial and financial distribution, that is fully convertible in the world, not subject to sovereign whims and has an active current balance of payments, the “Triffin dilemma” applies to it as already happened with the dollar and, in the future, will happen with the renminbi. None of the five currencies that make up the SDR basket (US dollar 41.73%, euro 30.93%, renminbi 10.92%, Japanese yen 8.33% and British pound 8.09%) can perform international currency functions alone. There are only two possibilities left, gold for mistrust (corresponding to what the Italian philosopher and federalist thinker Mario Albertini called “primitive law”) and the SDR basket for trust (Albertini’s “developed right”).

Europe should aim to strengthen the euro in its own area (which can also be expanded) and encourage pegging to the SDR in areas without a reserve currency: Africa, Russia, the Gulf, Western Asia and Latin America. Even Japan and ASEAN, to avoid having to choose between subordination to the dollar or the renminbi, could create a monetary area pegged to the SDR.

Elena Flor

Managing Director, Robert Triffin International

Far-Reaching Consequences of U.S. Financial Sanctions The Dollar Shortage and the “Triffin Moment”

*Miriam L. Campanella**

Abstract

The dollar's dominance in global finance and its cross-border political power confer on the United States control over directing, gating, and influencing capital flows.

These holds derive from the U.S.'s overwhelming metrics, in any sector of the economy, but also from its far-reaching jurisdiction over the dollar's financial infrastructures.

By threatening disconnection from capital markets, and imposing large fines on third parties, U.S. administrations have achieved full compliance with these measures. Yet, the use of these measures, and the uncertainty over access to dollar liquidity, have the potential of endangering the smooth functioning of capital markets that at a some point in time will turn to sub-optimal supply of liquidity, or an outright dollar shortage. This situation epitomizes the tipping point, or the “Triffin Moment”, which predicts that new national sources of liquidity should enter the market to repair the discontinuity of the payment system, and the obstruction of capital flows. So far, the Euro and the Chinese RMB, the most appropriate candidates for delivering alternative liquidity sources, are still in a “dangling mode”, a situation only favouring the dollar dominance by default.

With expanding volumes in financial markets, and increasing geo-political tensions, emergency situations call for strong political will to endow and equip the euro and RMB to bring about the Triffin Moment.

Key words: U.S. Financial Sanctions; Dollar Infrastructures; Euro and RMB; Triffin Moment

I would like to thank Henry Farrell, Adrien Faudot, Takatoshi Ito, Ricardo Reis for helpful comments and much needed encouragements. I also extend my appreciation to Elena Flor, Alfonso Iozzo, Antonio Mosconi for interesting insights. (M.L.C.)

Executive Summary

- ▶ The use of economic pressure to advance political goals has a long history in America's foreign policy. Since the first Act passed by the Congress in 1807, sanctions have taken on a prominent role in the national security strategy. Financial tools, pressure and market forces to leverage the banking sector, private-sector interests, and foreign partners in order to isolate rogue actors from the international financial and commercial systems and eliminate their funding sources have showcased these less invasive options to direct, military intervention.
- ▶ Over the last two decades the measure, scope, and complexity of those sanctions signalled a brand-new generation of U.S. foreign policy, with banking and finance infrastructures taking centre-place.
- ▶ In the last years of Obama's Administration, the Treasury Office of Foreign Assets Control (OFAC)¹ "invented an entirely new category of penalty, the Sectoral Sanctions Identifications (SSI) List, which prohibits certain kinds of financial transactions with a target company while allowing most others, enabling Washington to target large Russian companies where traditional sanctions could have created unacceptable collateral costs for both the United States and Europe (Harrell 2018). Procedures in charge of the OFAC – the dedicated agency of U.S. Treasury² – were designated to inflict the highest damage to foreign banking activity with disconnection from capital markets, particularly financial assets held outside the target countries. These measures create significant incentives for third parties to abide U.S. sanctions or risk severe consequences" (Rosenberg *et al.*, 2018).
- ▶ The scope and the frequency of U.S. financial sanctions are measures of broader applications of economic power, and differ from trade barriers or outright embargoes since "refusing commercial benefits has become diluted in an integrated world of many alternative suppliers, while the importance of financial instruments instead has grown" (Smart 2018) .
- ▶ America's share of world GDP currently sits around 20 percent, down from 30 percent at the end of World War Two. China's share, meanwhile, has quadrupled to 16 percent, and emerging markets constitute 60 percent of global output. In contrast, the U.S.' share of global finance is still growing. "The U.S. equities market is 2.4x and the U.S. bond markets are 1.6x the size of the EU, the #2 player globally for each segment. U.S. capital markets enable debt issuance – a more efficient, stable and less restrictive form of borrowing for corporations – to fuel growth, while bank lending is more prevalent in other regions (80%/20% in the U.S., reversed in other markets). U.S. capital markets provide 65% of total funding for economic activity and are multiples of U.S. GDP thereby driving economic growth for the country" (Sifma 2018).

¹ Juan Zarate *Treasury's War*, describes a new kind of warfare that "involves the use of financial tools, pressure and market forces to leverage the banking sector, private-sector interests, and foreign partners in order to isolate rogue actors from the international financial and commercial systems and eliminate their funding sources".

² OFAC administers a number of different sanctions programs. The sanctions can be either comprehensive or selective, using the blocking of assets and trade restrictions to accomplish foreign policy and national security goals. For more information visit: https://www.treasury.gov/resource-center/sanctions/Programs/Pages/faq_10_page.aspx

- ▶ Against this background, it is only natural for the U.S. Administrations to accomplish strategic objectives by leveraging the dollar's financial infrastructures,
 1. The Federal Reserve readily supplies liquidity to U.S. banking system to extend the reach of the dollar as a facilitator of exchange, lending activities, and anchor of the global financial interdependence.
 2. The dollar's global financial substructures project the U.S. far beyond its home jurisdiction, and sustain the U.S. Administration's hegemony over global finance.
 3. The U.S. Administration and Federal Reserve centralized oversight, and control over access to dollar financial and capital markets, enables its actions of directing, influencing, and gate-keeping international capital flows.
- ▶ The use of financial sanctions to hinder access to international capital markets inflicts major and enduring economic dislocations to target and third parties. By leveraging financial sanctions and causing disconnection from the dollar, a scenario of dollar shortage develops that leads to the situation typically described in the Triffin dilemma: that a national currency cannot combine domestic economic and political interests.
- ▶ The sub-optimal supply of liquidity and the arrival of alternate national sources to keep monetary markets going are factors shaping the new tri-polar currency regime. Nearly matching the scale of the dollar economy, the euro and the renminbi offer a convenient solution to the dollar shortage. Their clout at regional level is set to further expand. Recently, policymakers in Europe and China have started designing alternative cutting-edge financial infrastructures to support the internationalization of the two currencies.
- ▶ In order for the upcoming tri-polar currency system not to fall again into a locked-in system, Antonio Ocampo recently suggested the introduction of IMF SDRs to create a "true global currency". Intended to combat the flaws of dollar statecraft, a "true global currency" would act as a shock absorber, but only if alternative currencies were to weaken the power of the dollar.

1. The Strategic Features of U.S. Financial Sanctions

In a recent paper, Jill Jermano of the U.S. Treasury wrote that the objective and scope of economic and financial sanctions are among the coercive strategies often used by U.S. Administrations to address national security threats. Sanctions and other economic tools, she wrote, can be important elements of broader strategies to deter, coerce, and constrain adversaries. Their potency derives from U.S. economic power, and they generally involve lower cost and risk than the use of military force (Jermano 2018)

In the same way as threats of war, the use of sanctions aims to effect behavioural change. To change the target's behaviour the threat should be highly leveraged: "Sanctions aim to change a target's decision calculus about resisting pressure by increasing the cost and difficulty of the target's economic activity or financial transactions" (Jermano, 2018)

To accomplish the change of the target behaviour, financial sanctions require collaboration from banks and other financial institutions to restrict or deny a target's ability to obtain financial services or capital.

By banning foreign investment in key economic sectors or curtailing access to capital markets and hard currency, financial sanctions directly cut off liquidity to targeted firms, with the aim of reducing productivity, and eroding economic growth. Jermano frankly admits that financial sanctions should include cluster effects through a combination of prohibitions imposed on U.S. persons from conducting business or financial activity with sanctioned individuals or entities, and foreign entities that do business with a target. The double or second order effects emerge with private sector entities – or third parties – often opting to cut ties to avoid jeopardizing their reputation and market share and incurring penalties and fines.³

In the post-Cold War era, the U.S. Administration has largely increased the use of economic and financial sanctions against other states and non-state actors, and has refined their design to improve precision. Achieving desired effects with sanctions, however, requires careful assessment of target vulnerabilities, available U.S. leverage, orchestration with other policy tools, and potential obstacles and risks (Table 1).

Table 1: Examples of economic and financial sanctions

Economic Sanctions Target trade, other economic activity	Financial Sanctions Target access to capital, financial services
Restrict/ban specific imports/exports, associated services, guarantees, credits	Freeze/block assets and transactions*
Deny/withhold economic aid, debt relief	Restrict/deny access to capital markets
Restrict/prohibit investment in key economic sectors	Destabilize currency
	Restrict/deny access to multilateral financial assistance (e.g., International Monetary Fund, World Bank)

* Blocking an asset renders it inaccessible to the owner. Blocking a transaction prevents it from occurring.

Source: Jermano 2018

³ These U.S. sanctions against key Iranian banks beginning in 2006, followed by European Union (EU) sanctions and financial restrictions in a number of UN Security Council Resolutions led numerous global banks and other multinational firms to stop doing business with Iran, significantly diminishing its ability to trade and attract foreign investment.

The descriptions above offer an exhaustive picture of the objectives and technicalities of financial sanctions. The resulting picture, though, fails to consider the spillover effects that financial sanctions generate beyond the target entity and third parties. The frequent usage of these measures goes further; it impairs the working of the monetary system (see Chapter 3).

In the literature, financial sanctions are a province of economics and international politics, in both areas they are a highly controversial issue. In the early years of this century the case of Sudan involved a thoughtful discussion among American economists and policymakers over the impact of restrictions on capital markets of the targeted country.

At the time one major argument emerged: that prohibiting access to U.S. capital markets would call into question the U.S. pledge to open markets and the free flow of capital. In his testimony before the Senate Banking Committee on July 24, 2001, the Federal reserve Chairman Alain Greenspan argued that the “efficient and sophisticated U.S. capital markets are a crucial ingredient of U.S. economic success. Undercutting the viability of these markets has the potential to harm long-term U.S. growth”. And, he strongly warned that the predominance of U.S. capital markets, was no guarantee “to assume that the United States could successfully block the capability of China or any other country to raise capital at essentially the same terms abroad” (Greenspan in Hufbauer and Oegg 2002).

Despite these recommendations, in the wake of the 11 September tragedy, and in concert with its allies, the U.S. government launched an all-out effort to disrupt the financial infrastructure supporting terrorists and international criminals.

“This campaign focused on the gateways of the global financial system—international banks—and relied on a handful of new authorities granted to U.S. agents in the days after the attacks. On September 23, President George W. Bush signed EO 13224 that provided Treasury Department officials with far-reaching authority to freeze the assets and financial transactions of individuals and other entities suspected of supporting terrorism. Weeks later, Bush gave the Treasury broad powers (under Section 311 of the USA Patriot Act) to designate foreign jurisdictions and financial institutions as primary money laundering concerns.” (Masters 2017).

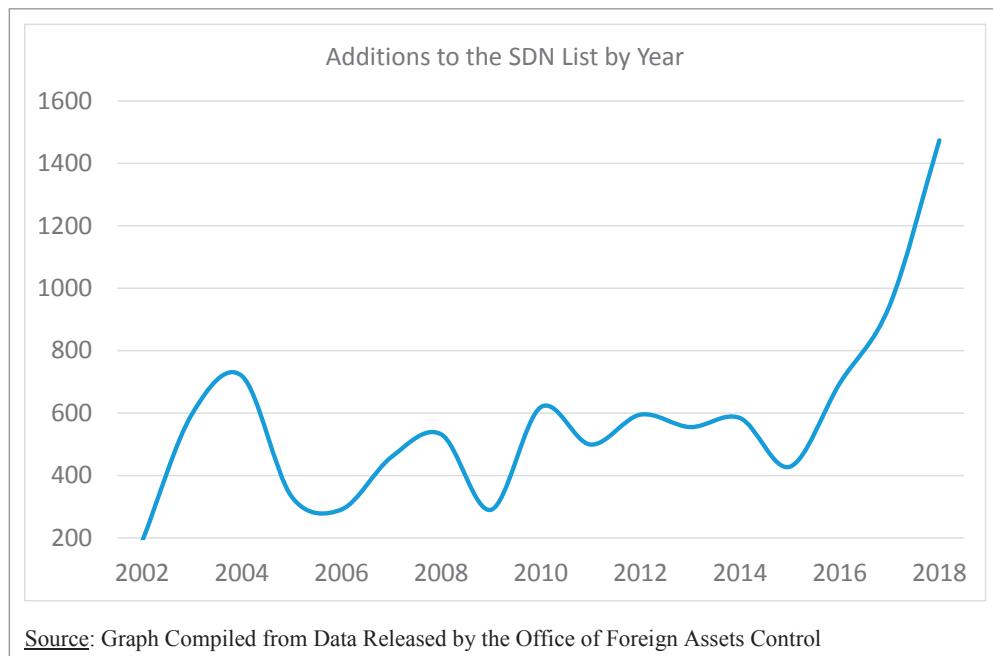
These measures fundamentally reshaped the financial regulatory environment, greatly increasing the risks for banks and other institutions engaged in suspicious activity, even unwittingly. The centrality of New York and the dollar to the global financial system meant that these U.S. policies were felt globally.⁴

A study by the law firm Gibson Dunn (GD Report 2019) confirms that from the millennium a new trend in the use of financial sanctions was fully embraced, with an acceleration under the Obama Presidency, and an explosion with the Trump’s Administration (Figure 1).

These surprising developments suggest that the increased use of financial sanctions is not an expression of U.S. statecraft, which had never failed before, rather that its inflated use speaks for the U.S.’ perception of diminishing supremacy in the global economy (Satyajit Das 2018). In reality, U.S. GDP accounts for just about twenty four percent of global GDP, in sharp contrast to the seventies when the share was more than thirty percent (Figure 2).

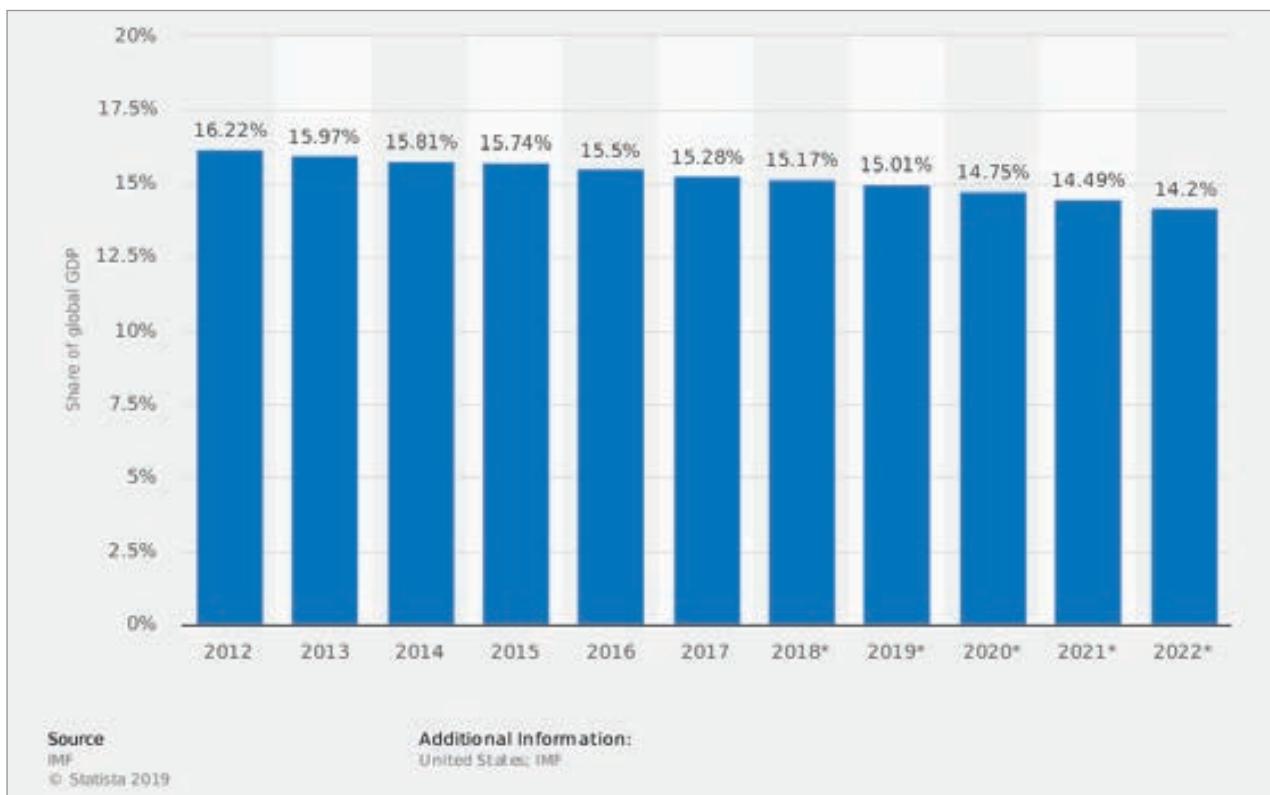
⁴ Notably, the Treasury needs only a reasonable suspicion – not necessarily any evidence – to target entities under these laws

Figure 1. Treasury's Office of Foreign Assets Control ("OFAC")



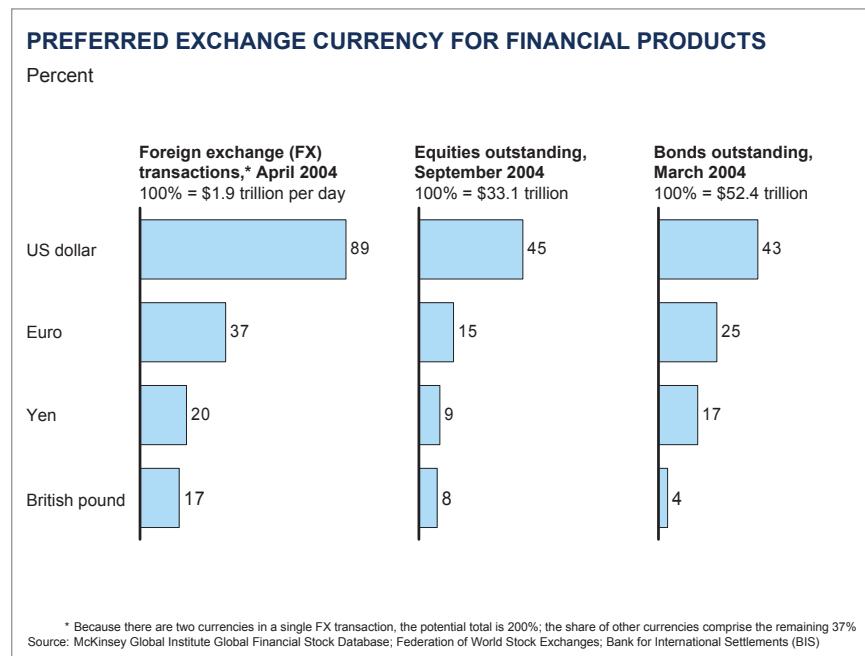
Source: Gibson Dunn 2019

Figure 2. United States' share of global gross domestic product (GDP) adjusted for purchasing power parity (PPP) from 2012 to 2022



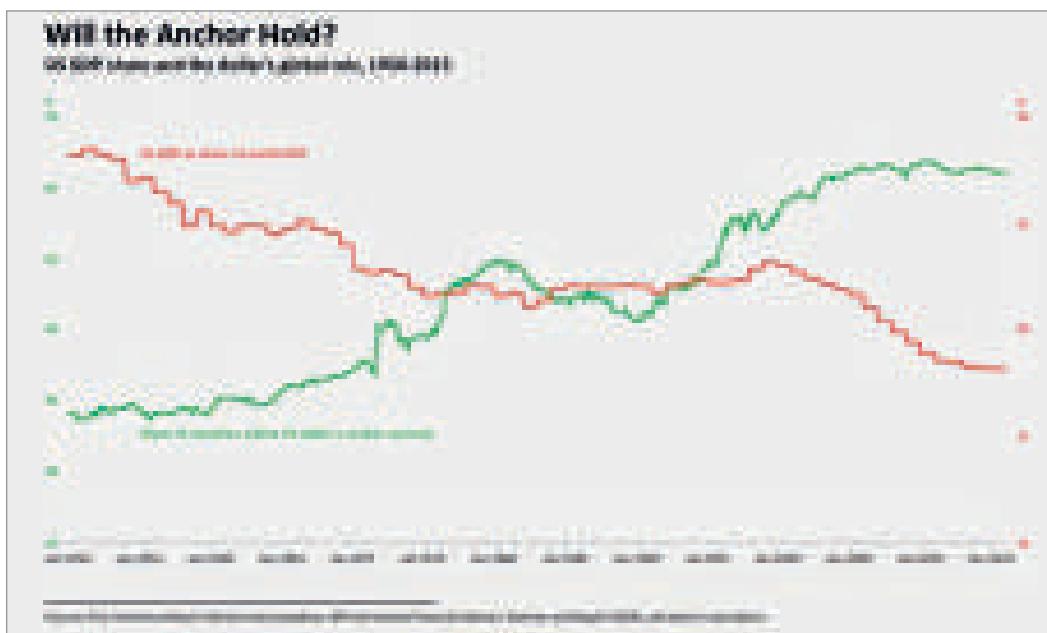
Inversely, the dollar and the U.S. finance form over 90 percent of daily exchanges in global financial markets (Figure 3)

Figure 3. Dollar the preferred currency of choice (McKinsey 118 trillion)



The data clearly hint to a mismatch of what Carmen Reinhart describes as “the divergence between the trends for production and finance” or monetary conundrum that “a relatively smaller U.S. economy supplies reserve assets in step with rising global demand from primarily emerging markets”.

Figure 4. U.S. GDP share and the dollar's global role 1950-2015.



Source: Carmen Reinhart (2018)

Under closer examination, we see that the right side of Figure 4 overlaps with Figure 1, this suggests that since the beginning of this century the increasing use of financial sanctions has matched the size of finance in the U.S. economy. The temporal correlation between lower economic share of global GDP, versus increasing relevance of finance may account for the U.S. policymakers' choice to leverage financial sanctions as the best way to preserve the country's global supremacy.

An assessment of the vulnerabilities of the targeted entity (Table 2) reveals the calculated precision and accuracy used to cause maximum damage to targeted entities, and third parties.⁵ This vulnerability assessment is critical to decide “if sanctions are an option, but it is also important to evaluate U.S. leverage over a target”. As U.S. leverage derives from the size of the U.S. economy and the U.S. dollar’s central role in global trade and capital markets, these factors enable the U.S. Administration “to wield considerable influence” (Jermano 2018). On March 26 2019, Treasury Department Secretary Steven T. Mnuchin commented on OFAC actions against third parties as the corollary of the target entity: “any foreign financial institution that knowingly facilitates a significant transactions for any of the individuals or entities designated today could be subject to U.S. sanctions” (U.S. Treasury March 2019).⁶

Table 2. Select Factors to Consider When Assessing Target Vulnerabilities

State Actors	Non-state Actors
Macroeconomic indicators: economic self-sufficiency, diversification, dependence on imported energy, industrial inputs, technology	Area of operations, relative permissiveness of jurisdiction(s)
Size of state sector; extent of direct/quasi-state/elite ownership in key industries	Operational chokepoints
Reliance on external markets, capital, credit	Primary revenue, funding sources
Corruption, state-criminal nexus	Revenue allocation, budgeting
Private sector economic stakeholders or other elites' access to, influence over state officials	Internal corruption, embezzlement
Market liquidity	Type, value of resources, assets
Strength and stability of financial sector, currency	Primary financial nodes, mechanisms
Type, level of foreign exchange reserves, sovereign wealth funds	Trust-based relationships within/outside of organization
Bank solvency; exposure and access to, reliance on global credit markets, financial services	Reliance on third-party brokers/service providers
Foreign presence in financial sector	Ties to national/local government/law enforcement
Trade financing, correspondent relationships	
Primary exports, imports	
Primary trading partners	
Reliance on trade-related services	
Reliance on types/sources of foreign direct investment	
Type, amount, sources of foreign government, private/non-profit sector aid	

Sources: Kirshner, 41–42; “Principles of Economic Coercive Action” against state and non-state actors in David L. Asher, “Pressuring Kim Jong Il: The North Korea Illicit Activities Initiative, 2001–2006,” in ed. David L. Asher, Victor D. Comras, and Patrick M. Cronin, Pressure: Coercive Economic Statecraft and U.S. National Security (Washington, DC: CNAS, January 2011), 35, 41–42, available at <<https://www.cnas.org/publications/reports/pressure-coercive-economic-statecraft-and-u-s-national-security>>.

Source: Jermano 2018

Dubbed “smart sanctions”, these measures, designed to exclude the use of dollar and disconnect entities from access to U.S. financial markets, are a double-edged sword: while they are a source of power for the realization of strategic or political objectives, they do create uncertainty in the operation of global markets.

⁵ US Treasury, Press Release 26 March 2019: “In addition, persons that engage in certain transactions with the individuals and entities designated today may themselves be exposed to sanctions or subject to an enforcement action. Furthermore, unless an exception applies, any foreign financial institution that knowingly facilitates a significant transactions for any of the individuals or entities designated today could be subject to U.S. sanctions” (US Treasury 2019).

⁶ <https://home.treasury.gov/news/press-releases/sm639>

2. The Geostrategic Relevance of Financial Infrastructures

"The dominance of U.S. currency gives the U.S. government 'the power to persuade and coerce.' At any moment, the government can choose to cut off a foreign bank's access to U.S. financial markets and thus push it to the periphery of global trade and finance. The government does so either by suspending a foreign bank's license to operate in the United States or by directing U.S. banks to shut down their correspondent and payable-through accounts for the foreign bank. This is, in effect, a death penalty for foreign banks" (Peter J. Katzenstein 2015, p. 314).

"The U.S. economy's size is not the primary reason its sanctions are so powerful: Countries without a significant trade relationship with the U.S. can still be severely damaged by bilateral sanctions. Though the European Union's gross domestic product almost matches America's, EU sanctions are much less devastating. This influence derives from America's central position in international finance—particularly its control over the invisible plumbing that allows money to move around the world" (Jarrett Blanc 2017).

The global financial system, through which banks and corporations exchange terabytes of financial data every day, has been enhanced by massive transnational telecommunications networks since the 1960s, largely dominated by U.S. led or controlled institutions (Shen 2018). Financial infrastructures "are not only decisive in empowering a currency to be adopted by international actors taking part in international trade but are also crucial for the smooth running of the U.S. dollar standard" (Faudot 2018).

The international U.S. banks, which are critical in the supply of dollars to investors and sovereign entities, could not have been as successful without an interoperable currency ecosystem necessary for savers, commercial end users, investors and financial service providers. The attractiveness and the performance of their clearing and payments institutions, making up the three payment systems operating in the U.S.: Fedwire, CHIPS and CLS Banks, are recognised by the IMF to "have in place state of the art and highly resilient arrangements to mitigate operational risk" (IMF 2010 quoted in Faudot 2018).

The well-designed dollar payment infrastructures and the strong oversight of the U.S. Federal Reserve are instrumental in giving official authorities the potential to rebuke and punish rival countries.

The large discretionary powers that financial infrastructures confer on U.S. authorities explain how none of the three most critical financial infrastructures have international or multilateral character. These financial infrastructures "merely convey national currencies transnationally, and along with them, the prying eyes of their issuing authorities" (Faudot, 2018).

The oversight and reach over sovereign financial infrastructures equally falls on private infrastructures. The Belgium-based global payments messaging service (SWIFT) has struggled to retain autonomy vis-à-vis U.S. pressure to exclude Iranian financial institutions from its platform. As Reuters reports "The purpose of U.S. sanctions against SWIFT is to pressure it thereby blocking Iran from a key international banking access point". Accordingly, SWIFT announced on November 5 its suspension of "certain Iranian banks" from its messaging system, "in the interest of the stability and integrity of the wider global financial system" (Reuters 2018).

"The dollar continues to be the world's reserve currency, and the U.S. Department of the Treasury has stepped up its role as a global financial cop – whether on trade with pariah states, policing money laundering, or enforcing tax laws. Foreign bankers and lawmakers bristle at what they call the "weaponization" of the dollar – how its dominance makes it harder for other countries to borrow and trade – and fear that Washington is indirectly giving Wall Street a boost by fining overseas banks billions of dollars" (E. Robinson in Bloomberg 2018).

Data contained in a new report shows that Europe's banks have paid a disproportionate share of the fines levied by US regulators, "with the average fine for European banks several times the amount U.S. banks have been served". The report released by Corlytics, the Dublin-based regulatory risk intelligence provider, shows 97% of the US\$38.4bn in fines levied by global regulators since January 2012 have been served by U.S. regulators. And of this amount, Europe's top 10 banks have paid US\$13.25bn, with UK, French, German and Swiss banks with branches in the U.S. having disbursed almost 40% of the fines related to economic crime in the U.S. (International Investment, 2017).

At the "Sanctions Compliance & Enforcement Forum" held in March 2019, panellists stressed that U.S. geopolitical motives were a prevailing factor of financial sanctions (Financier, 2019).

Box 1. Sanctions, Compliance and Enforcement

(Financier 2019)

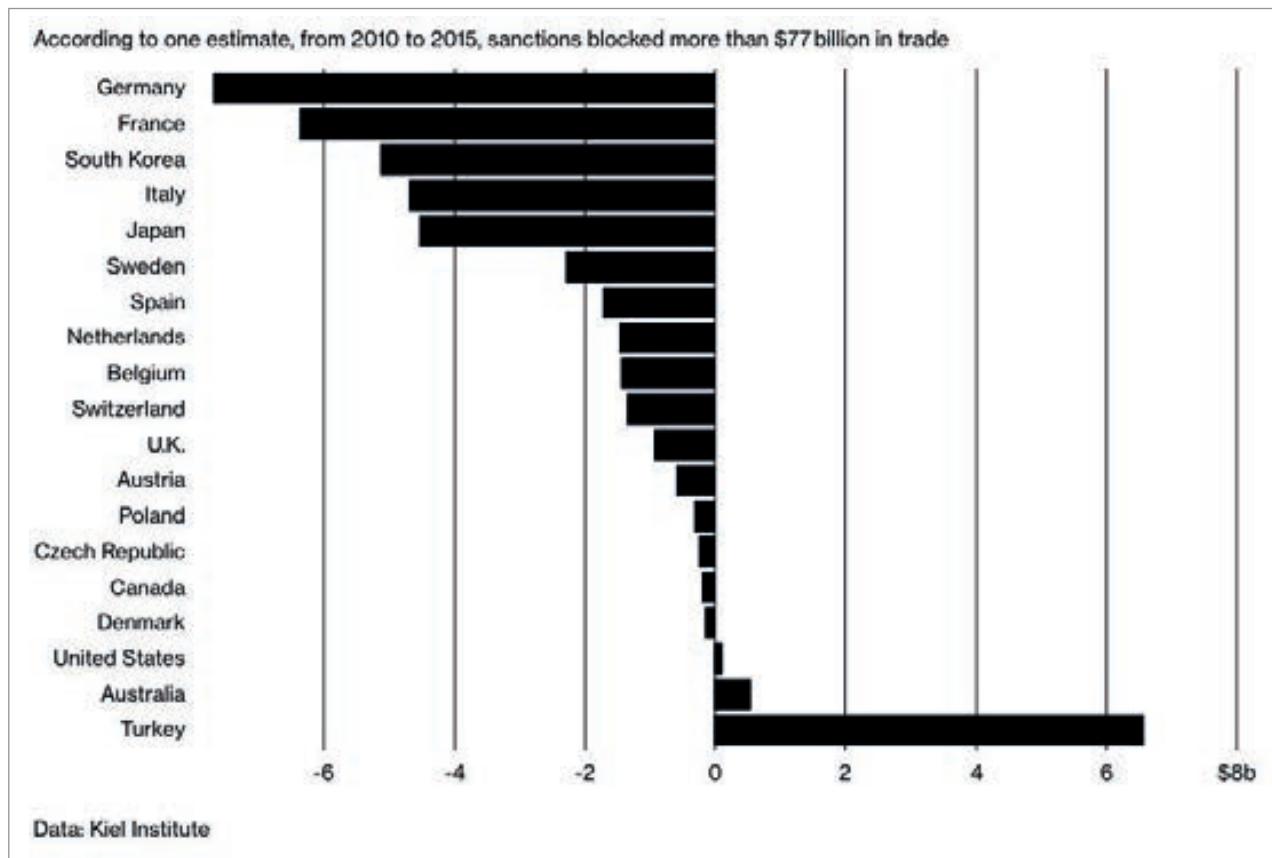
"Over the last 12 months, US has continued to actively enforce and expand its sanctions programs. Two main trends seem lately on the rise, an increase in targeted sanctions to achieve US strategic geopolitical goals, and several enforcement cases that indicate that OFAC is setting higher standards for how companies should conduct sanctions-related due diligence" (Bittner in Financier 2019)".

"Geostrategic competition makes UN Security Council consensus harder to achieve, and enforcement increasingly reflects geopolitical agendas. The US has expanded the scope and number of sanctions designations, and it is increasingly weaponising them, particularly secondary sanctions, for foreign policy aims. There is a divergence, though, between the executive and Congress about when to use sanctions, and what different country-specific sanctions attempt to achieve. The EU is taking steps to insulate European trade with very important markets, namely Iran and Russia, from US sanctions, and to increase its economic independence. Differences between the US and its traditional allies in the EU are making companies' decisions about whether to comply with different sanctions regimes more complicated. Country agnostic, extraterritorial sanctions regimes are emerging. 'Magnitsky' sanctions have been adopted in the US, UK and Canada, and are under consideration in the EU. These target individuals associated with human rights abuses and corruption" (Smith in Financier 2019)

These developments have added huge costs on domestic and foreign firms (Figure 5).

Foreign bankers and politicians, Satyajit Das wrote, are exasperated by the weaponized dollar. The dollar's dominance makes it harder for other countries to borrow and trade—and raise fears that U.S. sanctions are indirectly giving Wall Street a boost by charging overseas banks billions of dollars (Robinson *et al.* in Bloomberg December 2018).

The power to coerce other countries is not new. Yet, the U.S. financial outreach, in contrast to military force, is a feature of globalization and interdependence. The United States has developed powers to intimidate foreign firms into implementing its preferences, just by exercising unprecedented levels of interdependence, combined with continued manoeuvring of its power of disconnection from the global networks. Disconnection implies disinvestment and capital outflows. Foreigners sell off assets that they own in the target country and repatriate the proceeds, which gives rise to a capital outflow from the target country. Or, if mandatory disinvestment prevents foreigners from investing in the target country in the first place, there will be a decrease in capital inflows. Either way, an increase in the degree of disinvestment causes an increase in net capital outflows from the target country (Kaempfer and Lovenberg 2007).

Figure 5. The Cost of Sanctioning Iran (2010-2015)

Source: Holland, 2018 Bloomberg

That “weaponized interdependence”, Farrell and Newman argue, is instrumental in promoting U.S. interests abroad (2018). In their study of global networks they discover the extent to which “financial communication (such as the SWIFT financial messaging service) provide the United States and its European allies with the ability to monitor information flows to figure out what others are doing, and lock entire countries out of the international financial system” (2018,). And as global finance involves U.S. dollars, “international banks such as Citibank, security settlement systems such as Euroclear, consumer credit payment systems such as Visa/Mastercard, financial clearing houses such as CHIPS, and financial messaging services such as SWIFT have become crucial intermediaries in global financial networks, acting as middlemen across an enormous number and variety of specific transactions” (Farrell and Newman 2018).⁷ This U.S. “weaponized interdependence” – Farrell and Newman conclude – may encourage targeted states and companies, China, Russia, and even U.S. allies, to “diversify” away from the U.S. led global financial system.

The effectiveness of U.S. financial sanctions depends on dollar infrastructures, and relates to its operational and structural working. The governance of the Treasury and Federal Reserve, though, critical in the oversight, maintenance and preservation of the dollar extended global power “is a major attribute of the U.S. monetary might and a prerequisite for the ‘dollar unilateralism’” (Faudot 2017). The U.S. has exploited neo-liberalism to forge a “weaponized interdependence” (Farrell and Newman 2018).

⁷ There are three U.S. messaging payment infrastructures. Fedwire message works anywhere geographically across the Fedwire system. A SWIFT message works anywhere geographically across the SWIFT system. And a CHIPS message works anywhere across the CHIPS system. However, there are differences in the message formats and protocols for these three systems (Coker, HGExperts).

"Globalization has transformed the global liberal order, by moving the action away from multilateral talking shops, and towards networks of private actors. This has had crucial consequences for where state power is located in international politics, and how it is exercised." (Farrell and Newman 2018).

The coercive strength of financial interdependence has limits. When used for strategic ends, Farrell and Newman argue, "other states are likely to start considering economic networks in strategic terms too. Targeted states – or states who fear they will be targeted – may attempt to isolate themselves from networks, look to turn network effects back on their more powerful adversaries, and even, under some circumstances, reshape networks so as to minimize their vulnerabilities or increase the vulnerabilities of others. Hence, the more that privileged states look to take advantage of their privilege, the more that other states and non-state actors will take action that might potentially weaken or even undermine the interdependent features of the pre-existing system" (Farrell and Newman 2018).

U.S. financial sanctions, penalties applied to foreign countries, and the prevention of access to the U.S. payment system are not so much features of the strength of the dollar than an inertia by other monetary jurisdictions to remain in the dollar comfort zone.

Exiting the dollar comfort zone involves calculating trade-offs, and bearing the risks of an increasingly proprietary use of the dollar, or the costs of investing in doubling the alternate currencies' networks. A major incentive to act derives from the risks that a continued and intermittent dollar shortage would cause to capital flows (Chapter 3).

3. The Dollar Shortage, and the “Triffin Moment”

The term “dollar shortage” first used by Kindleberger (1950), and Triffin (1957) refers to the main structural monetary problem of the post-WWII period, namely the global shortage of gold and dollar assets which resulted from chronic U.S. current account surpluses. At the time, world economies were struggling to recover, yet stable currencies were in short supply. Part of the U.S.-sponsored Marshall Plan that began just after the war helped European countries rebuild their economies by providing enough U.S. dollars to relieve that shortage (Rojas 2016).

In the last two decades different types of dollar shortage have emerged. Examples of this are: the closure of monetary market in the wake of 11th September 2001; the interruption in the interbank market between 2007-2009; and the likelihood of a shortage of dollars, especially in those targeted countries and their third parties, due to the overuse of financial sanctions.

A dollar shortage, either caused by a sudden closure of monetary markets, or triggered by the interruption of interbank lending as in the case of the Great Financial Crisis, has in common the situation typically described by Triffin: that a national currency cannot play a global currency role.

Leveraging the use of financial sanctions, US Administration overtly aims at causing disconnection from the dollar, and the isolation of the target and third parties from capital markets. That stands for a dollar shortage, and brings to mind the situation typically described in the Triffin dilemma: that when a national currency cannot combine domestic economic and political interests, the sub-optimal supply of liquidity calls for alternate national sources to come in, to allow markets to continue to function (Eichengreen 2018).

The “Triffin Moment” was seen in the response to the drying up of dollars in the Great Financial Crisis. A freezing of access to short-term dollar funding became clear from August 2007, with the interbank lending squeeze lasting up to 2009. As Fleming and Klagge observed, credit risk and higher demand for liquidity generated fears in the global market over interbank funding in U.S. dollars, that almost destroyed interbank lending, and almost led to a halt in global trade.

To mitigate the dollar shortage, the Federal Reserve established a line of reciprocal currency arrangements, or “swap lines”⁸ with the European Central Bank and the Swiss National Bank⁹ in 2009 and later with all advanced central banks, to increase their capacity to deliver dollar funding directly to financial institutions in their jurisdictions (Fleming, Klagge 2010) .

The Fed’s swap lines, though, intended to reduce funding pressures on those institutions, and potentially improving conditions in the global funding and credit markets more generally, were limited – except Brazil – to the five developed central banks, leaving emerging central banks running out of dollars.

In Asia, emerging central banks, excluded from the Fed’s liquidity provisions, had no choice than to sign bilateral currency swap agreements (BSAs) to keep trade going on. In June 2010, the People’s Bank

⁸ “A currency swap line is an agreement between two central banks to exchange currencies. They allow a central bank to obtain foreign currency liquidity from the central bank that issues it – usually because they need to provide this to domestic commercial banks. For example, the swap line with the Federal Reserve System enables the ECB and all the national central banks in the euro area (Eurosystem) to receive US dollars from the Fed in exchange for an equivalent amount of euros provided to the Federal Reserve. These agreements have been part of central banks’ set of monetary policy instruments for decades” (ECB 2016).

⁹ The Fed introduced these measures in the six weeks after 11th September. “The Fed took steps to boost liquidity for foreign banks with offices or subsidiaries in the United States. To enable foreign central banks to provide these resources in U.S. dollars, the Federal Reserve quickly established “swap lines” with the European Central Bank and the Bank of England and augmented the swap line with the Bank of Canada. Swap lines are similar to lines of credit; they enable central banks to temporarily exchange currencies” (Neely 2002).

of China (PBOC) started signing currency agreements with its trade partners, which in 2014 amounted to over US\$426 bn. with 21 central banks worldwide, surpassing the Fed's swaps with the select five of US\$333 bn. The Central Bank of China's bilateral swap lines, mostly intended to facilitate trade and investment in the wake of the dollar shortage, highlighted the "Triffin Moment" in Asia, and brought about the internationalization of the RMB (Campanella 2014; Liao, McDowell 2014; Sheng 2014).

In spite of the limitations of RMB usage,¹⁰ the supply of liquidity by BSAs, the creation of RMB clearing houses in Asia and Europe, and the Belt & Road Initiative have boosted international usage of the redback.

Box 2. RMB in Asia

In Asia, the decline of the influence of the US dollar and a rise in that of the renminbi is seen even before the GFC. Henning (2012) detects a broadly declining trend for the US dollar weights and a rising trend for the renminbi weights in the exchange rate regimes of eight East Asian currencies. From 2010, the renminbi weight appeared to be higher than that of the US dollar for a number of main Asian currencies. Subramanian and Kessler (2013) believe that the renminbi has become the dominant reference currency in seven out of 10 East Asian currencies for the period 2010–12, outweighing the significance of the US dollar and euro in the region.

The events that occurred in 2010 share some similarities with the likely effects of financial sanctions, that the exclusion from capital markets puts in motion similar responses, with an extended usage of new currencies by BSAs, and an adoption of non-conventional policy (see footnote 11).

Box 3. The internationalization of the RMB via Bilateral Swap Agreements

The injection of liquidity via bilateral currencies swaps from China's central bank to distressed Asian countries in the 90s was the path taken by Japan with its currency's internationalization, and took place through lending and providing aid in Yen bilateral currency swaps. So, not surprisingly, in line with China's extended trade relations the internationalization of the renminbi through trade BSAs extended beyond Asia, touching Africa and Latin America (Sheng 2014).

By employing these measures at a larger scale China has increased trade settlement and payment in 32 countries, supplied through overseas deposits of Chinese currency in foreign central banks and institutions.

BSAs aim to facilitate trade and investment, as a 'credit line' at a predetermined exchange rate; however, when employed to bail out countries in a liquidity crisis, they may raise risks of devaluation, and damage the internationalization of the RMB (Iwata 2018).

In the case of China's launch of the international use of the RMB in a situation of dollar shortage, the question is not whether the dollar may continue to be the single and unique anchor-currency for the world, but whether new national currencies are getting ready for taking on the task.

¹⁰ RMB should be unsuitable to be employed in situations of liquidity shortage, since the RMB still is still not a fully convertible currency, as is the case with Federal Reserve's swap lines (Ito 2017; Iwata 2019).

4. The Euro and the RMB Still on the Sidelines?

The bilateral currencies swaps policy launched by the PBoC is more of an anecdotal event. It displays some of the organic characteristics of post-Bretton Woods monetary arrangements which allows new currencies to enter into monetary circuits, and at the same time the role of the Administration to repair disconnections caused by a shortage of liquidity.

Once proven effective, policies intended to repair obstructions and hitches in monetary circulation – bilateral swaps or other bypassing devices – could develop into new configurations of international monetary arrangements.

As Steil and Walker put it: “The take-away is that whereas the RMB is slowly becoming an alternative to the dollar for settling Chinese goods trade, it is still far from being a currency that anyone actually needs – except maybe as a substitute for Fed dollar swap lines, which few central banks currently have access to. If Russia’s dollar reserves continue to fall, therefore, China may be the first place it turns” (Steil and Walker 2015).

If the law of unintended consequences is right, “the U.S. fighting across multiple fronts drills home the point that the world needs an alternative to the U.S. dollar for trade and transfers” (KayVan Petersen 2018).

To encourage candidate currencies to enter the system, should the euro and RMB internationalization become European and Chinese policymakers’ top priority?

While there is a strong rationale for Europe and China to consider redoubling their efforts on the structural roll out of their currencies, matching the efficient and large-scale dollar’s financial infrastructures (Faudot 2018), implies that the parties put up money.

Even though they are located in continent-sized economies, have captured substantial shares of international trade, are intertwined into extensive and complex financial links, and moreover are homes to sizeable populations, the euro and the RMB, for different motives,¹¹ have still chosen to remain on the side-lines.

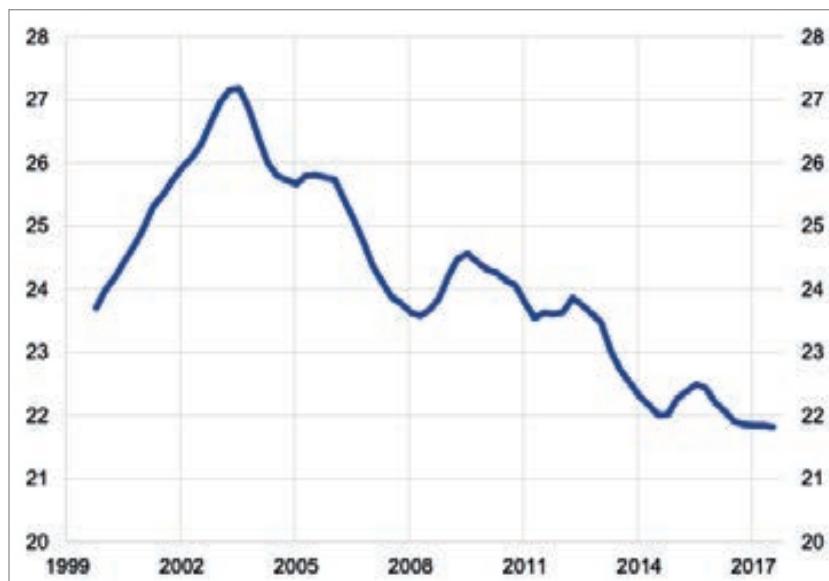
The case is especially puzzling for the euro. Its external dimension, or international role has declined since its introduction.

Recently, the European Commission (EC) (EC 2018) revealed that in global payments the euro holds a global share similar to the dollar, by more than 35 percent and is steadily growing (Figure 7). The above metrics, perhaps, are the only good news where the single currency brightens up. In the succeeding sections, the EC documents some disconcerting findings, the most worrying being that the euro is not fully used in the intra-European area and outside in global trade by European corporations.

“Despite the significant share of the euro in international payments, there is still scope to expand its use in key strategic sectors. In spite of their position as large buyers as well as major producers, European businesses still trade in U.S. dollar in key strategic markets, often even between themselves. This exposes businesses to currency risks and political risks, such as international sanctions that directly affect dollar denominated transactions” (EC 2018).

¹¹This topic is beyond the scope of this paper. Yet to list just few motives of the inertia, in Europe the sovereign debt crisis (2010-203), in China capital outflows (2015), and the pressures of European and Chinese exporters lobbies to enjoy a weaker exchange rate.

Figure 6. The euro's international role has declined since the mid-2000s
Index of the euro's international role
(percentages; four-quarter moving averages)



Source: Benoît Cœuré 2019

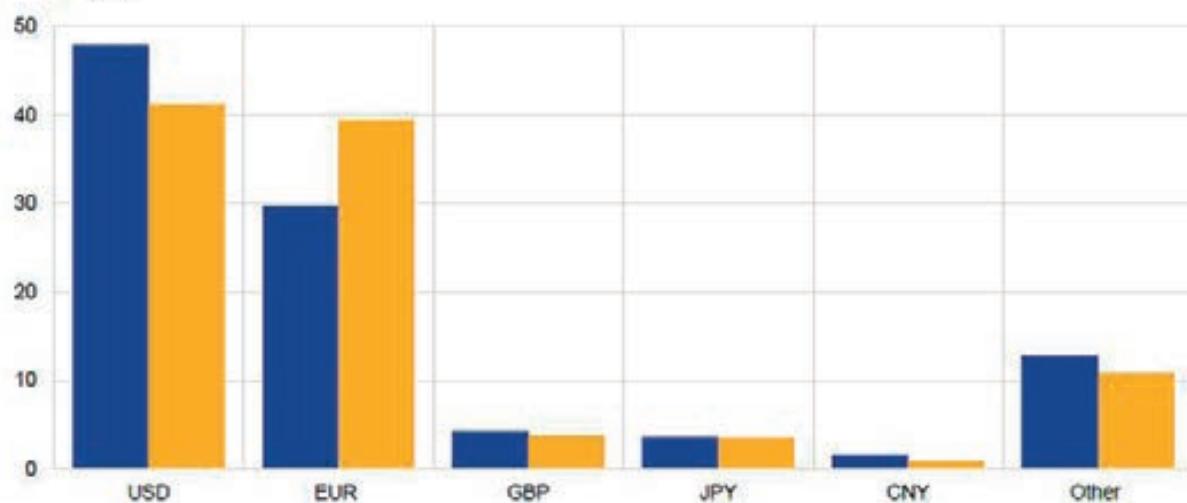
Figure 7. The share of the euro in global payments continued to increase

The share of the euro in cross-border payments is also higher

Currency composition of cross-border payments

(percentages)

■ 2015
■ 2017



Source: SWIFT.

Notes: Customer-initiated and institutional payments excluding intra-euro area payments. Estimates based on the value of MT 103 and MT 202 cross-border messages exchanged over SWIFT.

Selected sectors represent a strategic share of international exchange.

- ▶ “In the energy sector, over 80% of Europe’s energy imports are priced and paid for in U.S. dollar, despite supplies coming mainly from Russia, the Middle East and Africa, and the EU being the world’s largest energy importer. The EU’s annual energy import bill averaged EUR 300 bn. over the last 5 years. More than 93% of traded volumes in the domain of energy are accounted for by oil, where currently all contracts are dollar-denominated. For natural gas, about 70 % of EU imports are referenced in U.S. dollar. Gas contracts traded on EU gas hubs are denominated in euro.
- ▶ In the case of raw materials (metals and minerals) and food commodity markets, the situation is similar. Europe consumes about 10% of global raw materials and is a major importer. Nevertheless, the majority of raw materials are traded on global exchanges in U.S. dollar. This also applies to highly standardized food commodity markets, such as grains, oilseeds and sugar. Europe is an important exporter of soft wheat, sugar and olive oil but the use of the euro is mainly limited to intra-EU trade.
- ▶ In the transport sector, for example, a recent study concludes that nearly all invoicing in the aircraft manufacturing sector is done in U.S. dollar, even within the euro area. More than half of Airbus’ revenues are denominated in U.S. dollar with approximately 60% of such currency exposure “naturally hedged” by U.S. dollar-denominated costs” (EC Report 2018).

The frequency of financial sanctions imposed by the U.S. Administration is a factor of high risk to European firms. The negligible role of the euro in international markets, the widespread use of the dollar and its proprietary infrastructures, expose companies to currency and political risks as U.S. sanctions directly affect dollar denominated transactions (EC Report 2018).

Yet, the fact that after two decades large and strategic intra-European payments are still invoiced in dollars raises questions over the single currency, and its poorly “installed base” in its own jurisdiction, a critical factor that in the language of networks economics implies limited attractiveness as an aspirant global currency.

On the financial infrastructure front, specifically in respect of the design and implementation of an independent payment system, the European Commission has set up Instrument In Support Of Trade Exchanges (INSTEX) intended to circumvent U.S. financial sanctions and improve trade between Iran and the world, seemingly still on stand-by. On paper, the mechanism referred to as SPV (Special Purpose Vehicle) should work as a critical financial infrastructure, acting as a sort of euro-denominated clearing house for Iran to conduct trade with European companies.¹² However, in reality it falls well short of Europe’s initial plan: it merely enables Iran to conduct barter trade in return for selling oil to Europe, because of the sanctions.

“So far only France, Germany and UK (E3) countries are involved in INSTEX. While quick action is needed to undertake the necessary technical arrangements to operationalise INSTEX, the adhesion of business executives and policymakers to use the SPV, European banks are instrumental by settling accounts between European companies” (Geramayeh and Batmanghelidj 2019).

¹²Major European companies working with Iran left the Islamic Republic during the Summer of 2018 before the United States re-imposed its sanctions against Tehran following the United States’ pull-out from the 2015 nuclear deal. Their unilateral decision to leave was based on their greater business interests in the U.S. than in Iran.

In a commentary to the working of INSTEX, Iranian Radio *Farda* argued “Europe buys very little oil from Iran and the new financial channel would be good only for small and medium size companies as big companies would not want to have any transactions with Iran because of their business ties with the U.S.” (Radio Farda 2018).

On a critical tone, Koning comments that “INSTEX works as a barter arrangement operating outside of the U.S.-dominated global financial system. Trade is initially limited to the U.S. non-sanctioned essential goods such as humanitarian, medical and farm products and it is not expected to refer to oil-related transactions, which have dropped off since last year and are Iran’s primary source of foreign currency” (Koning 2019).

Notwithstanding the substantially failed attempt to include oil in the INSTEX, the European Commission has brought together “a wide-ranging industrial group to work on promoting the euro and fighting the monopoly of the U.S. dollar in oil and commodities trading, reflecting broader tensions with Washington over trade and sanctions” (Guarascio and Zhdannikov 2019).

As for the RMB, although still a managed floating exchange rate, in anticipation of the likelihood of U.S. financial sanctions policymakers have adopted a pro-active policy. In 2015 the People’s Bank of China started the “Cross-border interbank payment system” (CIPS), a new payments channel sheltered from U.S. extra-territorial actions, with the objective to further increasing the use of the national currency.

The strategic relevance of the Chinese CIPS has not gone unnoticed. A Report from the Government of Canada interprets the new payment infrastructure as part of overtaking the dollar (2018).

“A fully operational CIPS, which reduces the PRC’s reliance on SWIFT, has a number of other advantages. Beijing is mindful of the fact that U.S. and European banks dominate SWIFT’s governance and that their systems and networks are geared towards handling U.S. dollars (SWIFT is perceived as playing an important role in maintaining the global dominance of the dollar). It is also concerned by the fact that U.S. security and intelligence agencies looking to track international payments are allegedly able to access the system” (Government of Canada 2018).

The first phase of the CIPS, launched on March 2018 in Shanghai, provides capital settlement and clearing services for cross-border RMB transactions for financial institutions. Previously, cross-border RMB clearing had to be done either through one of the offshore RMB clearing banks, such as those in Hong Kong, Singapore or London, or with the help of a corresponding bank on the Chinese mainland.

Developed and administered by the central bank, CIPS hosts nineteen banks including four major Chinese banks, and HSBC Bank (China), Citibank China and Standard Chartered (China), all of which are allowed to open accounts with CIPS and receive services directly.

In addition, 38 Chinese banks and 138 foreign financial institutions have been approved as indirect participants. They are entitled to CIPS services indirectly through one or more of the direct participants.

The PBoC has designated 10 official RMB clearing banks last year, bringing the total to 14 globally, so CIPS will not only encourage the cross-border use of RMB as the system is now less complicated. A well-designed CIPS is set to mark an important milestone in China’s plans for the internationalization of the RMB and become a new device for global financial markets.

5. Acting in the Medium-Term

The power of U.S. financial sanctions derives less from the relative weight of the U.S. economy, than from open and free accessibility of the dollar, likened by market participants to a sort of "global public good".

Yet, these open and liberal features have resulted in these facilities being expensive, and highly prized proprietary assets of the U.S. Administration. In the same way that the dollar is a national currency, financial infrastructures are U.S. proprietary assets.

The networked structures that support the dollar's dominance are not immutable. "States are locked into existing network structures only up to that point where the costs of remaining in them are lower than the benefits, and should this change, we may see transitions to new arrangements" (Farrell Newman 2018).

U.S. strikes on target countries can drive them to launch rival electronic payment cards to Visa and Mastercard, and to develop alternative financial transfer system that would protect them from being shut out of Swift, the global interbank network.

That makes it all the more vital for Washington to use sanctions wisely. If not, instead of bolstering its power, it might only help hasten the decline of the U.S. led global political order and trading system.

In Europe and China, policymakers are boosting the internationalisation of the euro and RMB with ad-hoc measures.

A first line of policy points at leveraging monopsony power, given the large demand for commodities, especially energy (Rubikova 2019). This measure would rely on European and Chinese international banks facilitating credit and lending in their alternate currencies to oil-economies, which are targets of U.S. financial sanctions. Large savings deposits in the euro and RMB would intermediate in the payment system using privately-operated money. This approach would circumvent the dollar's disconnection triggered by U.S. sanctions, and advance the euro's and RMB's share in the international payment system via banking circuits.

On the institutional side, the ECB and PBoC have room to further enhance bilateral currency swap agreements, ideally matching the trade shares of the two economies. If the usage of the euro and the RMB were to reflect the scale of the trade shares, that would entice emerging central bankers to redeploy foreign exchange reserves in the trade partners' currencies. That approach would likely result in the currencies' internationalization and liquidity provision in the two alternate currencies at the expense of the dollar.

The central bank of China has since 2010 continued to retain in its tool-kit currency swap arrangements, while the ECB still seems to lag behind its potential. The Euro's bilateral swaps policy with partner's central banks is limited to highly developed central banks, with the addition of some

smaller neighbouring central banks, while Asia and other emerging economies are left off the list completely.¹³

The latter would grant a relevant advantage to the euro vis-à-vis the RMB, as these deals would entice the partner central banks to redeploy foreign exchange reserves into euro denominated assets,¹⁴ so as to allow partners central banks to use euros in situations of liquidity crisis.

¹³ "With which central banks does the ECB have currency swap agreements? In 2011 the ECB, along with the Bank of England, the Bank of Canada, the Bank of Japan, the Federal Reserve and the Swiss National Bank, set up a network of swap lines enabling the participating central banks to obtain currency from each other. As of December 2015, the swap lines have only been used to lend US dollars and Swiss francs to euro area banks. In the aftermath of the financial crisis, the ECB also set up arrangements to provide euros to the central banks of Denmark, Latvia, Hungary, Poland and Sweden. More recently, in 2013 the ECB established a currency swap agreement with China, reflecting the country's growing systemic importance and the rapid growth of trade and investment between the euro area and China. For the Eurosystem, the agreement serves as a liquidity backstop to reassure euro area banks that Chinese renminbi will continue to be available even if the market becomes impaired" (ECB 2016).

¹⁴ In the response to the author asking whether swap lines would help to circumvent dollar jurisdiction Professor Reis wrote: "the BSAs working as a liquidity line to circumvent the dollar jurisdiction . . . is a tricky question. A simple answer is that yes, they can, but in just the same way that any foreign aid or other government transfer between countries would. There is nothing special about the swap lines in this regard. In both cases this is not circumventing per se: it is one sovereign state deciding to transfer or lend to another sovereign state, so a third party's sanctions should not apply."

A little more complicated is if the country receiving the Euros from the ECB say, would like to sell them to get dollars to pay for some dollar imports or debts. A lot of currency trading is based in London so this might be fine, but the settlement financial institution are almost all large multinational institutions with a significant US presence that would risk US legal action if they were involved".

6. A Multi-Polar Monetary System in the Offing

Dollar statecraft, and the deployment of financial sanctions, has caused wide-spread consequences on target countries and connected third parties. The U.S.'s weaponized use of sanctions struck at the core of the global economy. Situations have emerged where non-U.S. banking industry in particular have had to deal with the U.S. and forced to set aside money in anticipation of huge U.S. fines.

Disconnects from financial markets, deviations of capital flows, and the levying of huge fines have generated randomized situations of dollar shortage. Inadequate alternative sources of liquidity have generated uncertainty over the reliability of dollar-oriented institutions, and point clearly to the flaws of current international monetary arrangements (Ocampo 2009).¹⁵

So far, currency inertia and a sub-optimal internationalization of alternative currencies – the euro or the renminbi – have left the international monetary regime still orbiting around the dollar, leaving global liquidity, in terms of dollar liquidity alone, inadequate.

A fully-fledged internationalization of the euro and the renminbi might alleviate this liquidity crisis, but would be no guarantee of financial stability.

In the transition away from a dollar-dominated system to a multi-polar system, exchange rate volatility will probably worsen due to the usage of multiple major reserve currencies, with dangers of financial instability for economic activity and development in all countries.

These developments make perfect sense of Robert Triffin's point that while reserve currencies are indispensable to expand global liquidity, they are also subject to crises of confidence, when their economies run balance of payments deficits. So, "whether considered in terms of the dollar alone or in terms of multiple currencies, there is nothing that ensures that the amount of liquidity in an expanding global finance is appropriate for the global economy" (Dalani and Masson 2009).

The emergence of a multipolar currency system is only just in the offing (Table 3).

The arrival of new currencies requires a more managed system. Here, Zhou Xiaochuan (2009), Governor of the People's Bank of China, has advanced a proposal of a greater role for the International Monetary Fund to issue a quasi-currency, the Special Drawing Rights (SDR).¹⁶ Recently, Ocampo developed the idea of the development of the quasi-currency into a true global currency. He argues that is time for SDRs to provide a multilateral substitute for the dollar and favour a "true global currency", which would strengthen the international monetary system (2019).

¹⁵ Ocampo identified three flaws that constitute recessionary pressures associated with the fact that the burden of adjustment to payments imbalances falls on deficit nations. The use of a national currency – the US dollar – playing as major global currency, formulated by *Triffin* in the 1960s, and the "*growing inequity bias*" due to foreign exchange reserves largely held by developing countries in view to protect their national currencies. Foreign exchange reserves mostly held in dollar assets (particularly US Treasury bills) and other developed countries, imply lending to rich countries at low interest rates.

¹⁶ Special Drawing Rights are not a currency, but they represent potential claims on the currencies of the IMF members, i.e. the SDR system is backed by the 'good faith' of the member countries. SDRs obtain their reserve asset power from the commitments of the IMF member states to hold and honour them for payment of balances. The IMF uses SDRs for its monetary unit of account

Table 3. SDR Basket October 2016

Currency	Weights determined in the 2015 Review	Fixed Number of Units of Currency for a 5-year period Starting Oct 1, 2016
U.S. Dollar	41.73	0.58252
Euro	30.93	0.38671
Chinese Yuan	10.92	1.0174
Japanese Yen	8.33	11.900
Pound Sterling	8.09	0.085946

Source: IMF 2019

The creation of a global currency on the basis of the IMF's SDRs, Ocampo specifies, works in parallel with the circulation of different national and regional currencies, as the latter could continue to circulate alongside growing SDR reserves (Ocampo 2019).

The proposal of multi-currency circulation matched with a global currency on the basis of SDR reserves is well-designed, and highly desirable, in the current dire international environment. Doubts arise over whether the U.S. Administration would consent to allowing the dollar primacy to be restrained or dissolved into the IMF's "true global currency".

Concluding Remarks

In today's expanding and ever-more integrated world economy the dependence on the dollar as the basis of both trade flows and financial reserves has not only become excessive, but also fundamentally imbalanced. The magnitude and objectives of U.S. financial sanctions show to what extend global finance is locked in a form of dollar *status quo* bias, which in the short term might result in the lowest risk for most players, but could also trigger trade flow disruption and exchange value losses.

These actions, though, have triggered new, transformational reactions, in the creation of devices or financial infrastructures indicating the entry of alternative currencies flowing through monetary circuits. Their increased usage would respond more flexibly to the demand for liquidity, and provide a way to diversify the accumulation of reserve assets.

These developments are more appropriate for the ongoing consolidation of large continental economic regions, especially in the Eurasia super-continent.

While worldwide dependence on the dollar has lured U.S. Administrations to use it as a weaponized asset to pursue strategic objectives, misallocation of capital, and dislocations in the workings of international finance are not temporary situations, and are more likely set to shape the "new normal" of the U.S. geo-economics.

According to some observers, EU reactions to the U.S. Administration's decision to reimpose sanctions on Iran may be still lukewarm as the measures adopted apply to non-sanctionable trade.

Yet, the decision to set up INSTEX as a Special Purpose Vehicle (SPV) marked Europe's most substantial step towards saving the Iran nuclear deal in the wake of the U.S.' withdrawal. The SPV provides for a new financial mechanism that would circumvent U.S. sanctions, making it easier for some European companies to do business with Iran. Indeed, these moves are just the nitty-gritty of major capabilities that policymakers in Europe and China should deliver to fend-off U.S. extraterritorial powers.

In the end, redoubling and strengthening the financial infrastructures of the euro and renminbi to constrain dollar statecraft, and introducing a "true global currency" are both instrumental to operational and proper objectives, among others supporting the next level of global economic growth.

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