

Bypassing the buck

Matthew Oresman warns that a weaponized dollar might endanger the currency's safe haven status

From a short-term perspective, the coronavirus pandemic has underscored the pre-eminence of the US dollar. A safe haven in otherwise choppy economic waters, central banks and investors have rushed to buy up ever-increasing amounts of the currency.

While the dollar is still king, there are increasing risks that United States' foreign policy could unintentionally cause an alternative currency to gain traction. The ubiquity of the dollar has been exploited by successive administrations to put pressure on states through coercive economic measures.

The Trump administration – which in 2018 alone imposed sanctions on a record 1,500 people, companies and entities – has vastly accelerated American foreign policy's reliance on sanctions. It has been able to achieve this largely because there are no alternatives to the dollar – a stable currency underpinned by a resilient economy.

To date, many of those pushing for alternatives to the dollar are linked to illicit, illegal or otherwise risky behaviour. Whether money launderers, corrupt politicians, criminal groups or the businesses of countries sanctioned by the US – for example Russia, Iran, Venezuela, Syria – their concerns will never bring about a change in the system.

However, an increasingly unilateral US foreign policy that weaponizes the dollar over the objections of allies could create incentives for more legitimate market participants to seek alternatives to the dollar.

This attitude is typified by the European Union, which last year said it intended to reduce its reliance on the dollar for commodity pricing and other energy contracts. The EU has also tried to work around the dollar dominance in foreign policy as seen with the creation of Instex – the Instrument in Support of Trade Exchanges – to allow the processing of payments with Iran outside of the US-controlled financial system, and thus side-step US sanctions. However, these efforts have not survived contact with reality.



Printing money: but America's increasingly unilateral foreign policy is accelerating the search for an alternative safe currency

Launched in January 2019, Instex was not able to process its first transaction until the end of March 2020. Moreover, the scope of Instex was limited to food and medicine, as opposed to the robust trade intended.

Where financial machinery might have failed, the EU could nevertheless still challenge the dollar by developing the euro as an alternative global currency. This remains unlikely, however, unless there are fundamental enhancements to fiscal and economic policies designed to support a stronger euro.

The story is even worse for sterling, which currently trades like an emerging market currency due to its rising debt and as a consequence of leaving the EU. Until Britain moves past Brexit and establishes a clear economic and political basis for global relevance, the pound will not offer any alternative to the dollar.

Another long-term threat to the dollar may come from China, which has been

stung in the past by US economic measures, including tariffs and, increasingly, financial sanctions against Chinese companies.

The renminbi only accounts for about 2 per cent of global payments, although this is a large increase from only a decade ago. China is pursuing policies to make the renminbi a global reserve currency and trade medium. It is even working with regional neighbours on the creation of a central bank-backed digital currency that could circumvent dollar clearing.

However, China's strict capital and exchange rate controls, the lack of independence and international trust in its domestic institutions and weakness of the rule of law undermine China's ability to guarantee the renminbi's value to international players. As a result, it is far from being considered a safe bet for international trade.

Cryptocurrencies could pose a threat to the dollar, but until users have confidence in the underlying vehicle, there will not be widespread adoption. Crypto coin versions that have the highest likelihood of succeeding are typically backed by states or major banks and will struggle to circumvent anti-money laundering laws or sanctions.

Clearly America's increasingly unilateral foreign policy and its consistent weaponization of the dollar is accelerating the search for alternatives, by friends and foes alike.

This is adding a source of demand for the euro, renminbi or cryptocurrencies, although it is equally clear that none offers a viable alternative to the dollar in the near to medium term.

Any change will be driven by macroeconomic and fiscal realities, not the foreign policy aspirations of the EU, China or anyone else.

America would be wise, however, to moderate its over-reliance on the dollar as a tool of foreign policy to avoid undermining its own strategic objective of ensuring dollar supremacy.

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