

Payments Power: The Overlooked Role of the Dollar as the Top International Payments Currency

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When people think of the dollar's dominance, its position as a reserve currency receives the bulk of the attention. On the one hand, this is sensible. It gives the issuing state immense political power, primarily by delaying the need for economic adjustment in the face of sustained external deficits (e.g., [Kirshner 2008](#), 420; [Norrlof 2010](#); [Cohen 2015](#), 94). On the other hand, focusing on the dollar's role as a reserve currency misses a key element of the dollar's power. The dollar is also the most widely used currency for international payments: dollars aren't just held, they are used. This contribution to the forum considers the role of the US dollar as the top international payments currency and how dominance in this arena is an important power resource for the United States. It will also consider how—perhaps paradoxically—use of this power may chip away at the dollar's supremacy in payments.

The dollar's central role in global payments greatly enhances the United States' ability to practice financial statecraft: “the intentional use, by national governments, of domestic or international monetary or financial capabilities for the purpose of achieving ongoing foreign policy goals, whether political, economic, or financial” ([Armijo and Katada 2015](#), 43). By virtue of the global dependence on its currency for international payments, the United States can employ financial sanctions to cut foreign governments, corporations, and individuals off from the global dollar-based financial system—a system upon which much of the world's trade and investment markets depend. Consistent with [Farrell and Newman's \(2019\)](#) concept of “weaponized interdependence,” global dependence on the dollar in payments gives the United States enormous power to coerce and punish its enemies.

Yet, despite the power the United States derives from its currency's role in cross-border payments, overuse of this capability may lead to its erosion. In its efforts to combat the illicit financing of terrorism and rogue regimes, the United States has sharpened its financial sanctions capabilities over the past two decades. As evidence of US financial power has grown, so too has a view that reliance on the dollar is becoming fraught with *political risk*. States adversely affected by US policies have sought out ways to reduce their exposure to such risk by attempting to limit their dependence on the dollar as a payments vehicle. Steps taken by Russia, China, and the European Union aimed at creating alternatives to the dollar-based payments system illustrate this point.

International Payments and the Dollar

Economic exchange requires the transfer of value between individuals, firms, or other entities. Cash is the simplest way that value can be transferred, but it has obvious limitations—typically requiring that both parties to an exchange be present in the same physical location. This is not realistic for international transactions. In lieu of cash, value is transferred via payments systems where parties exchange claims on banks. Mechanisms for such exchanges include things like checks, credit cards, and wire transfers. The last of these—electronic wire transfers—are the most common way international payments are executed, enabling firms and financial institutions to move large sums of money at high frequency ([Carter and Farha 2013](#), 905).

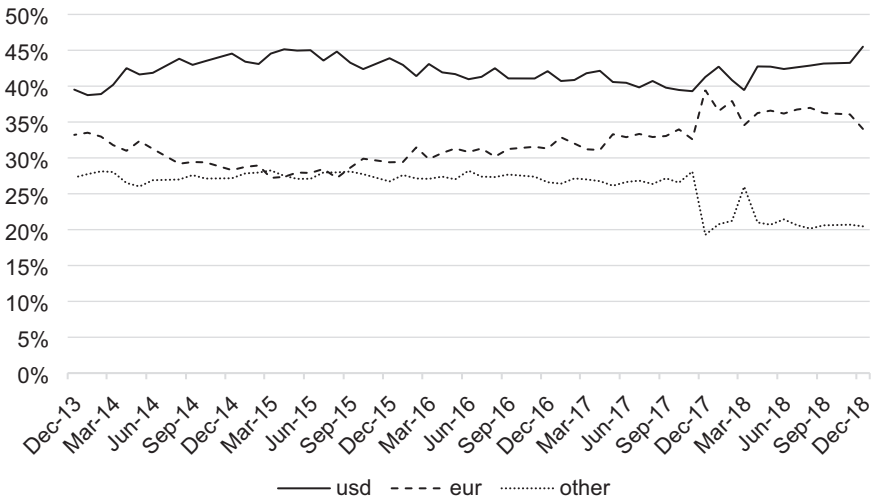


Figure 1. Cross-border payments by currency.

Note: Data were collected from documents available on SWIFT’s renminbi tracker website: <https://www.swift.com/our-solutions/compliance-and-shared-services/business-intelligence/renminbi/rmb-tracker>.

The very existence of a world economy depends on a functioning international payments system. Cross-border investment requires effective payments solutions where investors can transfer funds in exchange for foreign assets. Similarly, international debt markets depend upon debtors’ ability to transfer money from their own accounts to their foreign creditors’ accounts on a timely basis. Some 80 to 90 percent of international trade depends on a form of trade finance, where financial institutions play a critical role in ensuring that secure payments are made between importers and exporters (Auboin 2009, 1).

The global payments system is built on three basic components: a communication system, a medium of exchange, and a mechanism for clearing/settlement. Farrell and Newman (2019, 58–59) adeptly explain the communication component: “Businesses and banks depend on . . . reliable and secure communication between financial institutions regarding the multitude of transactions that occur globally on a given day.” The Society for Worldwide Interbank Financial Telecommunication (Swift) provides the telecommunications network through which payment instructions are sent from one financial institution to another in today’s world economy.¹⁶

Second, the global payments system is built on a select few currencies that operate as international mediums of exchange. The elevation of a small number of national monies to international payments currency status results from network effects: the more that other market actors make or accept payment in one currency, the more valuable it is for any single market actor to do the same. As Figure 1 reports, from 2014 through 2018, the US dollar accounted for roughly 40–45 percent of all international payments. The only other currency that comes close is the euro, hovering between 27 and 36 percent. The remaining share of international payments—between 20 and 30 percent—is divided among nearly 20 other currencies.

Though the dollar is the most widely used payments currency, most of these transfers do not directly involve a US individual or firm as either the originator (the entity requesting that a payment be made) or beneficiary (the entity receiving the payment). By way of example, while the US share of world trade is only about

¹⁶ See Farrell and Newman (2019) for a more detailed discussion of Swift’s role in the international payments system.

10 percent, roughly *half* of international trade is settled in dollars (SWIFT 2015, 6).¹⁷ In the same way that English has emerged as the dominant language in science, even for nonnative English speakers, the dollar is the dominant currency for cross-border payments, even for non-US individuals and firms.

The third component of the global payments system is a mechanism through which international payments can be cleared/settled. While Swift can send payment instructions, it cannot wire money from one account to another. Payments today are cleared through what are called correspondent banking relationships. A brief example will help illustrate the process.¹⁸

Imagine that the Argentine Widget Corp. (the originator of the transaction) wishes to transfer \$100,000 in funds from its account at Banco Patagonia to the account of Midwest Industrial LLC (the beneficiary of the transaction) at Intrust Bank, in Wichita, Kansas. Because Banco Patagonia and Intrust Bank hold no accounts with each other, there is no direct way to wire funds between the two. However, if both banks hold correspondent accounts with a third-party institution—say, J.P. Morgan Chase in New York City—that third-party bank can act as an intermediary between the smaller institutions. After receiving instructions via Swift, J.P. Morgan can debit Banco Patagonia’s account \$100,000 and credit Intrust’s account the same amount.

When it comes to payments in US dollars, nearly all (about 95 percent) are cleared through “Chips,” the Clearing House Interbank Payments System (Federal Reserve 2002). There are roughly 50 banks that participate in Chips as correspondent banks. In much the same way that a handful of major airports “hubs” connect thousands of smaller airports with one another, this small number of major global banks facilitate nearly all international dollar payments through their role as Chips correspondent institutions.

Dominance in Payments as a Power Resource

The preeminence of the dollar in cross-border payments enhances the pressure that the United States can apply through the application of financial sanctions—measures designed to influence a targeted individual’s, firm’s, or government’s behavior by restricting access to the financial system. As noted above, some 40 to 45 percent of all cross-border payments involve the US dollar. Ninety-six percent of these cross-border dollar-denominated payments involve a Chips participant institution as an intermediary between the banks representing the originator and beneficiary of the transfer. While not all Chips participants are US banks, they are all required to have a presence in the US market, meaning they operate a branch of office within the United States (US Treasury 2006, 62). Thus, this small group of Chips correspondent banks, which effectively facilitate the clearing of all dollar payments in the global financial system, are subject to US law.

Oversight and enforcement of US financial sanctions generally falls to the Office of Foreign Assets Control (OFAC) at the US Treasury. The most important tool in the OFAC toolbox is the Specially Designated Nationals (SDN) list. It contains the names of individuals, firms, or any other entity that the United States wishes to cut off from the global financial system.¹⁹ No financial institution subject to US law is permitted to transact with a Specially Designated National. Individuals found liable of participating in a transaction that violates OFAC rules face steep penalties, including up to 30 years in prison and fines as high as US \$20 million (Carter and

¹⁷ For instance, because oil and many other commodities are priced in dollars, trade in these goods is almost exclusively settled in dollars.

¹⁸ See US Treasury (2006, 55–69) for a detailed description of how correspondent banking relationships work.

¹⁹ Often, these targeted entities are part of a broader sanctions program targeting the behavior of a regime.

Farha 2013, 905). Financial institutions can also be fined for violations with penalties often in the billions of dollars.

The severity of the penalties is no accident; they are designed to encourage self-monitoring and self-reporting by the private sector. As Carter and Farha (2013, 908) explain, if a bank under US legal jurisdiction receives a payment instruction where the originator or beneficiary is a Specially Designated National, the institution is required to freeze the funds associated with the payment instruction and notify the Office of Foreign Assets Control of the full details of the actions taken and individuals involved. Most banks today use specialized software to screen all payment orders for SDN violations to avoid running afoul of OFAC rules. Loeffler (2009) refers to this as a “public-private feedback loop” where Treasury effectively mobilizes the financial sector, by threat of penalty, to enforce the laws on its own.

In recent years, Treasury has increased regulations on banks in order to enhance its ability to enforce financial sanctions and identify new leads regarding the illegal movement of funds. For instance, prior to 2010, all financial institutions were required to keep detailed records regarding all money transfers at or above a \$3,000 threshold. These records were available to Treasury at its request. Since 2010, new rules require that banks collect *and* report, in real time, information about all such payments requests to Treasury (Scott 2010).²⁰

Additionally, more recent rule changes put the onus on financial institutions to “obtain, verify, and record the identities” of the *ultimate beneficial owners* of any entity involved in a payments transaction (US Treasury 2016, 2). A beneficial owner is defined as any individual who holds a 25 percent equity stake in any entity as well as any individual with “significant responsibility to control, manage, or direct a legal entity customer,” such as a chief executive officer, a chief financial officer, and so on (US Treasury 2016, 3). By way of example, it is not enough for a bank under US jurisdiction to record and report that the Argentine Widget Co. is involved as an originator in a payments request. It must verify and report that neither the firm nor any “beneficial owner” therein is a Specially Designated National.

Recall that nearly all cross-border dollar payments are cleared by a small number of Chips participants. These institutions are careful to monitor all transfer requests for violations and strictly enforce US law. Thus, any entity on the SDN list will be blocked from making or receiving any payments in the world’s most widely used payments currency. These measures, though, are not enough to completely cut a targeted entity out of the international financial system. First, a small share of dollar payments is cleared outside of US legal jurisdiction where these rules do not directly apply.²¹ Second, despite the dollar’s dominance in payments, Specially Designated Nationals could seek safe haven by transacting in alternative currencies such as the euro or pound sterling. Yet, Treasury has developed effective ways to plug these loopholes.

Following the attacks of September 11, 2001, the United States reached agreement with Swift and the European Union that Treasury can access its payments’ communication records (Farrell and Newman 2019).²² This gives Treasury the ability to identify whether a Specially Designated National is making or receiving payments in dollars or other currencies outside of US control. While Swift provides the information, secondary sanctions provide an extraterritorial means of punishment.

²⁰ This information would include the name, address, and account numbers of the originator, the amount and currency of the funds, the date of the transfer, the originator’s financial institution, the beneficiary’s financial institution, as well as the name, address, and account number of the beneficiary.

²¹ There are four (legitimate) offshore dollar-clearing centers: Hong Kong, Manila, Singapore, and Tokyo. In these locations, dollar transfers can be settled outside of US legal jurisdiction through the Clearing House Automated Transfer System (Chats).

²² Swift is headquartered in Brussels, Belgium.

When applied, secondary sanctions prohibit banks operating in the United States, under threat of severe penalty, from maintaining correspondent banking accounts with foreign institutions found to be doing business with Specially Designated Nationals.²³

Recall that correspondent banking—especially Chips—is a fundamental component of the global payments system. The message this sends to foreign banks is clear: help enforce US sanctions or find yourself cut off from the dollar-based financial system. It should come as no surprise that foreign banks are quick to comply with these demands.²⁴ Thus, while primary sanctions cut off a target's access to the dollar, secondary sanctions allow Treasury to curtail its access to nondollar payments as well by threatening to cut off third parties from the dollar. The cumulative effect of these measures is near total financial isolation of the Specially Designated National.

Political Risk and the Growing Dollar Backlash

In a 2016 speech, then-Treasury Secretary Jack Lew (2016) warned of what he called “sanctions overreach.” While financial sanctions are a powerful tool of US foreign policy made possible by the dollar's dominance, he explained, it was important to be cautious about their use. Overuse, Lew warned, could weaken Treasury's ability to use them effectively: “The more we condition use of the dollar and our financial system on adherence to US foreign policy, the more the risk of migration to other currencies and other financial systems in the medium-term grows” (Lew 2016).

Lew was pointing out that the use of financial sanctions has the effect of increasing the *political risk* associated with international use of the dollar. Typically, the term political risk is used in the context of international investment, defined as the risk that a political decision might affect the value of a financial asset. Yet, the concept can be expanded to noninvestment forms of economic activity as well. In this context, political risk is understood to mean *the risk that a political decision will affect the economic attractiveness of using a specific currency for cross-border transactions*. In the same way that a government's decision to expropriate a foreign firm's property will affect the future risk calculus and investment decisions of multinational corporations, financial sanctions will impact the risk calculus and future decisions of entities involved in cross-border payments activities. Despite real economic benefits of using the dollar for international transactions, sanctions have a countervailing effect by raising the *political* costs associated with the using currency.

The effect of secondary sanctions on calculations of political risk should be especially strong. Because they are viewed as being extraterritorial in nature, secondary sanctions “often prove to be politically problematic” by provoking strong blowback from affected firms, financial institutions, and governments in third-party countries (Meyer 2009, 930). Indeed, Lew (2016) directly addressed this point, noting that because of such objections “secondary sanctions should be used only in the most exceptional circumstances.”

In recent years, elements of US sanctions policy have provoked just the kind of reactions against the dollar about which Lew warned. For example, US financial sanctions imposed on Russia in response to its unlawful annexation of Crimea and the Trump administration reimposition of sanctions on Iran have intensified antipathy toward dollar dominance in the targeted countries. At a 2017 meeting with Russian President Vladimir Putin, Iran's Supreme Leader Ayatolla Khameni asserted, “we can render US sanctions null by using methods such as eliminating the dollar and

²³ One method the United States can employ to impose such penalties is Section 311 of the USA Patriot Act.

²⁴ See Loeffler (2009).

replacing national currencies in bilateral or multilateral economic deals” ([Financial Tribune 2017](#)). Following the imposition of US financial sanctions targeting the Maduro regime, Russia assisted Venezuela in the launching of a cryptocurrency dubbed the *petro* ([Schuster 2018](#)). While there is little evidence to suggest the petro has proven successful, this example highlights the potential for cryptocurrencies—that rely on blockchain technology rather than correspondent banking relationship to transfer value—to undermine the effectiveness of US sanctions.

Meanwhile, influential voices in China have been paying close attention to the rising angst over dollar dependence. Former People’s Bank of China Governor Zhou Xiaochuan recently suggested that US financial sanctions would hurt the dollar’s role in international payments. He added that this might present an opportunity to speed up the international use of China’s currency, the yuan ([Harney 2018](#)). In a similar vein, influential Chinese economist Yu Yongding has argued that US sanctions against Russia and Iran “[allow] for us to move ahead with the yuan’s internationalization,” adding that Beijing should “seize the opportunity” to promote the use of the yuan in trade settlement with targeted countries ([Global Times 2018](#)).

Beijing’s interest in a nondollar based cross-border payments platform also reflects its own experience with US sanctions. In late 2017, Treasury enforced secondary sanctions against North Korea by barring all US banks from maintaining correspondent accounts with the Bank of Dandong, a Chinese financial institution believed to be laundering money for Pyongyang ([US Treasury 2017](#)). This action closely resembles those taken by Treasury against another Chinese bank—Banco Delta Asia—in 2005 for the same reasons ([Loeffler 2009](#)). In both cases, the Chinese government complained about the reach of US financial power.

While a specific strategy is difficult to pin down at this point, China has taken several steps in recent years that suggest it is carefully exploring its options when it comes to developing alternative payment channels that do not involve the dollar. For instance, China has started to explore the possibility of paying for its oil imports using its own currency ([Chatterjee and Meng 2018](#)). China has also been in discussions with Russia about setting up a system in which the two countries can settle cross-border trade in yuan, rather than dollars ([Yeung 2018](#)). In 2015, Beijing launched the Cross-Border Inter-Bank Payments System (CIPS) as its own answer to Swift messaging and Chips clearing. While this system is far from being a challenger to global dollar-clearing, it represents a starting point for yuan-based payments that could, in theory, provide rogue regimes refuge from US financial statecraft.

Perhaps most troubling for the dollar has been the European reaction to recent US financial sanctions targeting the Iranian regime. Fewer than two years after multilateral sanctions were lifted as part of the 2015 Iran nuclear deal, the Trump administration pulled out of the agreement. This decision resulted in the reimposition of US financial sanctions, including secondary measures. European financial institutions weighing involvement in financial and commercial exchange between Iranian and European companies could now be cut off from Chips if they transacted with an Iranian Specially Designated National.

Disgust with US policy has resulted in several prominent figures, including European Commission President Jean-Claude Juncker and German Foreign Minister Heiko Maas, issuing calls for the European Union to take steps to promote cross-border payments in euros rather than dollars. In an op-ed on the subject, [Maas \(2018\)](#) argued “it is . . . essential that we strengthen European autonomy by setting up payment channels independent of the [United States].” While it is unclear what European Union’s next steps will be, the continent has clearly woken up to the political risk embedded in a dollar-dominated global payments system.

The Enduring Value of Payment Power

Scholars of international political economy have rightly focused on the power that states derive from issuing the top global reserve currency. Yet, the focus on this one important role has left others overlooked. This essay has made the case that possessing the top payments currency is also an important power resource for the issuing state. By virtue of the dollar's central role in the cross-border transfer of value, the United States can exert great pressure through employing financial sanctions to cut off targeted entities from access to the global payments system.

Yet, as the examples cited here indicate, the use of this power may result, paradoxically, in its erosion. As the United States has sharpened its financial sanctions capabilities, it has raised the specter of political risk in the dollar payments system. Targeted states (and those that worry they may be targeted) are discussing ways they might conduct cross-border business outside of the dominant dollar-based payments platform. Moreover, the use of secondary sanctions has spread the discontent to third-party governments such as China and the European Union—both of whom are looking into promoting payments in their respective currencies.

Of course, talk is one thing, successful action and implementation is another. All these efforts may be doomed to failure. It is difficult to upend entrenched market behavior. Yet, the trend should not be lost on US policy-makers. If they wish to preserve US financial power, the best choice in some circumstances may be not to use it at all.