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Trump Is Rethinking Economic Power

CAPITAL ACCOUNT

By Greg Ip

In September, Donald Trump made an impassioned defense of the dollar's status as the world's reserve currency: "If we lost the dollar as the world currency, I think that would be the equivalent of losing a war." ?

That status is so important to Trump that this past weekend he threatened to impose tariffs of 100% on the Brics — a group of emerging economies led by Brazil, Russia, India, China and South Africa — if they created an alternative to the dollar. *

The warning might be a bit premature; a Brics currency has yet to go beyond the discussion stage.

Yet Trump's defense of the dollar is a window into how he thinks the U.S. should exercise its economic power. That power, he argues, has been undercut by its excessive use of financial sanctions that encourage other countries to avoid using the dollar. He thinks tariffs are a more flexible, less harmful way of achieving American foreign policy goals.

The theory remains untested. Yet Trump's approach merits serious study, because the current approach is hardly a shining success. Sanctions haven't yet forced Russia to leave Ukraine, Venezuelan President Nicolás Maduro to cede power, or Iran to give up its nuclear program.

The dollar became the preferred vehicle for foreigners to trade and invest across borders because of the size, depth and stability of the U.S. economy and financial system. Network effects—the tendency to use the dollar because everyone else does—makes it hard for a competitor to get traction. *

Reserve status enables the U.S. to borrow more, and at lower interest rates, than otherwise. It means a lot of international business flows through financial channels over which the U.S. has jurisdiction. The U.S. can cripple a foreign actor by cutting off their access to this system.

And it exercises that power with growing frequency. Almost every day the U.S. adds another entity to its sanctions list for criminal activity, terrorism, human--rights violations or association with a sanctioned regime. The U.S. currently has more than 17,000 designated sanctions targets.

But some worry the volume of sanctions could make them self-defeating. "The more that we use sanctions, we run the risk of degrading the use of the dollar as a national security tool," said Kimberly Donovan, who formerly served in the Treasury Department's Financial Crimes Enforcement Network and is now at the Atlantic Council.

In his September speech Trump attacked the ubiquity of sanctions: “Ultimately, it kills your dollar and it kills everything the dollar represents,” he said. “I want to use sanctions as little as possible.” He said he would hit any country that ditched the dollar with tariffs.

His weekend threat to do just that might be linked to the interest of some Brics leaders—in particular Brazilian President Luiz Inácio Lula da Silva—in creating an alternative to the dollar. But the South African government said this week the Brics aren’t planning a new currency.

“It’s hot air,” said Mark Sobel, a former Treasury official. “The unity isn’t there, the economic heft isn’t there, and the Brics are way too divided by geopolitical tensions.”

The dollar still accounts for 58% of global foreign exchange reserves, 54% of export invoicing, and 88% of foreign exchange transactions, according to the Atlantic Council.

But other countries, especially the Brics, have stepped up efforts to break the dollar’s dominance. Those efforts gathered force after the U.S. and European Union froze the Russian central bank’s foreign assets and barred several Russian banks from using Swift, the Belgium-based messaging system banks use to settle international payments, in the wake of Russia’s invasion of Ukraine.

Since then, Russia and China have boosted usage of their own, alternative, payment systems. Brics countries are issuing more debt to foreigners in their own currencies. Several emerging-market central banks are working on a platform to settle payments in their digital currencies.

The surging price of gold and bitcoin—which just topped \$100,000 for the first time—may reflect the search for dollar alternatives. *

Tariffs are less likely than sanctions to discourage use of the dollar. They can be calibrated, whereas sanctions are usually all or nothing. Western nations imposed sanctions barring the purchase, transport or insurance of Russian oil above a price cap. But the cap has been “very difficult to enforce,” Donovan said. “Tariffs probably would have been a more strategic and sophisticated approach.”

Tariffs can be used against friendly nations while sanctions generally cannot. Trump has threatened tariffs against Mexico and Canada over fentanyl and illegal immigration. In an October opinion column, hedge-fund manager Scott Bessent, now Trump’s pick to be Treasury secretary, described tariffs as a useful tool for “getting allies to spend more on their own defense, opening foreign markets to U.S. exports, se-curing cooperation on ending illegal immigration and interdicting fentanyl trafficking, or deterring military aggression.”

But tariffs have disadvantages. Like sanctions, if overused, they can drive down trade so much the U.S. has no leverage left. Tariffs can hurt the U.S., not just the target, by raising prices, disrupting production and inviting retaliation.

A different complication is that maintaining the dollar’s reserve status requires the U.S. to supply the rest of the world with dollar-based assets such as bonds. In other words, it must be a net borrower, which means it has to run a current-account deficit (the broadest measure of trade, covering goods, services and income).

Trump wants to reduce the trade deficit, which he blames on other countries, among other things, keeping their currencies low against the dollar. *

So long as the dollar remains the world’s reserve currency, some trade deficit might be the unavoidable trade-off.