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Dollar & Sense: The US needs updated sanctions programs for an era of great power competition

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DOLLAR: Hi, I'm David Dollar, host of the Brookings trade podcast [Dollar & Sense](#). Today we're going to talk about financial sanctions and their use against terrorist networks and rogue states. My guest is Michael Greenwald. He worked in the Treasury Department, played a key role developing these sanctions and implementing them, and now he's a fellow at the Harvard Kennedy School's Belfer Center for Science and International Affairs.

Welcome to the show, Michael.

GREENWALD: Great to be here, David. Thank you for having me.

DOLLAR: So since the 9/11 attacks on the United States, we've developed a powerful set of financial tools aimed at restricting finance to terrorist activities. And these tools were initially targeted at non-state actors like al-Qaida and later on ISIS. So let's start with the broad question: what are these sanctions? How do they work? Did they meet their objectives with those non-state actors?

GREENWLAD: Sure. So David, I think in the post 9/11 era the Patriot Act – and Section 311 of the Patriot Act – that was a key toolkit that was used to go after al-Qaida and its affiliates. And mainly to make the financial sector more transparent and to move al-Qaida and its affiliates away from the formal financial sector. Since that time, al-Qaida has been operating more through Hawala networks and outside of formal channels which has posed a challenge to law enforcement policy and intelligence in the U.S. and around the world.

DOLLAR: Right. But presumably just getting them out of the formal financial networks is an advance.

GREENWLAD: It is an advance. And as you remember, it was 500,000 dollars to conduct 9/11 attacks. Some of [that] money went through the banking sector into the U.S. Mohamed Atta and the whole cell of 9/11, they were able to move money through U.S. banks. And so that was priority number one. By doing that – and we did a very effective job of moving them out of the banks and sanctioning many of the actors around the world – we pushed them underground and ultimately into channels to move money outside of banks.

DOLLAR: So you have a lot of experience on the ground in the Middle East and Africa dealing with these financial sanctions. Could you give our listeners just a little bit more flavor for the reality of how does this play out in countries like Mali or elsewhere in Africa and the Middle East?

GREENWLAD: Sure. So I think the al-Qaida affiliates moved away from the strongholds in Afghanistan and Pakistan and they set up shops in Mali and in Somalia and AQAP in Yemen and so forth. And you had Boko Haram which has switched affiliates over the years in Nigeria. And the main sources of funding for these groups were criminal sources of funding. So you had kidnapping for ransom which were millions and millions of payments mostly for the release of European hostages. And you had bank robberies, you had extortion, you had all these different tools of criminal sources of funding. And so the Treasury would go after and sanction individuals in many of these organizations, but it required a whole host of financial diplomacy to try to work to convince many of these European governments to stop paying

ransoms. And, as you and I have discussed, the former Undersecretary David Cohen, pre-ISIS, called kidnapping for ransom the largest source of terrorism financing.

DOLLAR: So initially we were using these financial sanctions against non-state actors, but then things evolved and we started applying them against some rogue states. Iran is probably the best example – or one of the best two or three examples. And you worked with European countries to develop the Iran sanctions that led ultimately to the U.N. agreement. Go into a little bit of detail about that?

GREENWLAD: Sure. So I think the multilateral strategy of working with the E.U. was essential for us to really cash-strap Iran. Going after the central bank in Iran, taking them off the SWIFT network, those were key tools that...the U.S. was a very powerful player, but until we got the E.U. on board and Stuart Levy strategy of going around the world...of making a stark choice to these banks and countries.... you're either going to clear your dollars through New York or not. And I think once that choice was made you saw governments make a stark decision. And so it worked hand-in-hand with the Europeans. And mainly through the power of Section 311 of the Patriot Act. That calls a jurisdiction or financial institution a primary money laundering concern and that was a very powerful tool that we used against the central bank of Iran.

DOLLAR: So you emphasized the importance of working with allies. So that naturally leads to the question of what's happening now vis a vis Iran because the U.S. has pulled out of the U.N. agreement. And I think initially some of our partners in Europe and also China...they were not happy that the U.S. pulled out of the agreement. So what's happening with the financial sanctions against Iran at this point?

GREENWALD: The sanctions against Iran are still holding and pressuring Iran but we need that multilateral strategy to truly bring Iran fully back to the table. And I think just the symbolism of the Europeans setting up Instex – the financial arrangement to do trade with Iran – just that symbolism is dangerous. To think that our greatest allies, the ones that helped us bring Iran to the table, have set up a system as a financial Band-Aid to work with Iran is quite stark and dangerous. And I think with the 15 billion dollar loan that the European Central Bank is proposing giving it as a lifeline to Iran shows you that Instex is a failure, but that's a next step. Ultimately it's going to be on the back of Christine Lagarde and that narrative going forward – and we can talk about the power of the euro going forward under her leadership – but ultimately it's going to come down...you've seen that we have cut swift access again, we have gone after the central bank again in Iran, but it really goes back to our enforcement of the waivers with regards to China and others. And whether we really enforce the waivers with Iran, we need it to be a multilateral strategy. And right now it is us versus the world with regard to Iran.

DOLLAR: I noticed just in the last few days the big Chinese company – the China National Petroleum Corporation – pulled out of this gigantic gas deal in Iran. They had originally stepped in after the French company Total had pulled out in the face of these recent U.S. sanctions. Now the Chinese have pulled out, which I find kind of interesting. I imagine they're kicking and screaming about it. And the same thing if we

look at actually China's imports, [they] had become a major importer of oil from Iran once the U.N. deal was in place. And China hasn't cut to zero, but they've cut by about two thirds as I see it.

GREENWALD: They have cut back. I think you still have a shadow banking network in China that still is evading sanctions and I think that we have a visibility of China continuing to evade. Whether we implement that will be a key question for the administration going forward. But yes, China has cut it down and you do give the administration credit for that pressure. But just imagine how much more we could cut it down if the Europeans and others were fully on board.

DOLLAR: So how do you see the end game on Iran?

GREENWLAD: Well I think the end game with Iran has to deal with how much we're going to pressure China. And I think it really is tied in with the trade negotiations going on. So I think there's many buckets to those negotiations – whether it's Huawei or others – but I think that we're internally distracted that our implementation is going to be difficult.

DOLLAR: Right. So I think that's a good point that we've got these trade issues with China – we've discussed them on other podcasts with other guests so that's ongoing. But we have so many issues with China like Iran, North Korea, global climate change, the list goes on. It's hard to imagine making progress on those global issues if we're still at loggerheads with them on the trade side.

GREENWALD: Right. So I see us really being in a stalemate with regards to Iran. I think that we're using the same tools and going after the same targets with regard to Iran, but we're just turning up the volume a bit. And I think it's going to come down to are we going to take any more meaningful enforcement of the waivers going forward and what that looks like. In addition, I think you spoke about North Korea. I think the Trump administration's actions against Dai Dong bank was an important development. The question becomes whether there'll be other actions like that. As you know, in China the big four are key players and that People's Bank of China is considered too big to fail. So can we come up with a new set of toolkits using the dollar as a key powerful tool that can go into a PBOC or others in a scalpel-like way to be targeted but to not hurt us economically at home?

DOLLAR: I think that's a very good point. I'm not sure too many people appreciate this complicated dance going on between China and the U.S. As you say, we've sanctioned a few of their relatively minor banks that have been dealing with North Korea and Iran. [We've] sanctioned some companies. But as I see it – I don't know if you agree – we've been reluctant to sanction any of their big four banks, as you call them, or they're big petroleum companies or any of their flagship companies.

GREENWLAD: Yeah. We've been reticent I think mainly is because the sheer size of their banking system number one. They're important – they're large, important global banks. I think choosing smaller banks isn't always a greater fix. The second problem, I think, is the extensive role and influence of the state in the economy via state ownership as you know in view of the party. And so I think the strength of...the Chinese have higher capacity to respond to some of the past sanctions in the U.S. before. So I think their

market access could be weaponized. That would be an interesting turn. And it could be a potent tool that I'm not sure how the U.S. under our current sanctions respond to.

I think one of the key things to keep in mind is post-9/11 where we began this conversation and the Patriot Act is what set of tools under an umbrella of great power competition should the U.S. be employing using the dollar, weaponizing the dollar, but using it in a scalpel way. And I think as we saw in the best-case study is Russia when we were going after oligarchs and banks at the scale and size using debt and equity that we haven't seen before. Our greatest sanction wasn't one bank or one oligarch, it was the uncertainty of the market. And that was our greatest sanction going after the ruble at the time. The question is can we replicate that without hurting ourselves economically in China.

DOLLAR: Right. So as I understand the progression, we started using these tools against non-state actors, we moved on to medium-size economies like North Korea and Iran...not that important for the world system. Now we're moving toward Russia and perhaps China and now you've got firms and banks that are really quite central to the global system. So there is a risk that this all blows back on ourselves.

GREENWLAD: Indeed. And I think since 9/11 you've seen central banks, sovereign wealth funds, and economies of scale become more capitalized. And so now the question is what new toolkits can you use to really effectively go after central banks or sovereign wealth funds if they are the ones invading illicit actors. If they are evading the dollar. And as you've discussed on this show, the role of the dollar is central to our force. And I would argue it's one of our greatest national security resources, but we have to use it in a scalpel like way that's not overextended, that ultimately doesn't push the world too far. And I think the question we have to ask ourselves is how far can we push our allies before they begin evading as they've been doing. You've seen in Turkey, you've seen Venezuela moved to gold, you've seen China now on the precipice of doing a digital payment system, [and] you've seen Russia doing many more outside the dollar. And so that's the key question moving forward.

DOLLAR: Right. I think the strength of the dollar – it's partly that most transactions in the world are denominated in dollars and clearance takes place in dollars – but, actually, I think that's a rather small part of the story. You can imagine other players getting around clearance and dollars. It's the access to the U.S. financial market that's really essential. You know we have these uniquely deep well-functioning bond and stock markets. And so you're talking about big money...you might have a short period where you have a few extra hundred million dollars...what do you do with it? And if you're not in dollars there's not an easy answer to that. If you're in dollars then you can buy U.S. Treasury paper, you can buy corporate bonds, you've got all kinds of options. There really isn't an alternative to this dollar-based capital market.

GREENWLAD: No, and I think people have thought for years that the renminbi and others would overtake the dollar and I think that's not going to happen for a very long time. I think the question with Libra and digital payments is are there going to be enough alternatives there to be a choice. And so, one question is there a Belt and Road chapter two that with this digital payment system that creates enough

incentives for other countries to join with them to create alternatives. Not to rival or overtake the dollar, but for more countries to become baskets of currencies. And I think that's the question before us.

DOLLAR: Looking around the world at who might compete with the U.S. in terms of capital markets currency, I think if we were having this conversation a year ago or so [the] natural thing would have been to talk about Hong Kong and London as the two other really big capital markets in the world aside from New York. Right now, you've got very difficult political developments in both Hong Kong and London. It's just hard to see either one of them really rising up and in some sense replacing New York as the center of finance.

GREENWLAD: I think that just ... actions of wanting to IPO in Japan shows that. I think also Singapore has been rising, but I think ultimately Europe has an opportunity. And I think that Christine Lagarde appointment at the ECB will be very important. She is going to create, in my view, a very proactive, positive narrative for Europe to be much stronger and that could bring new opportunities to where there are other markets that are more unstable. And I think you're going to see less companies open in Hong Kong and potentially less IPO in New York because of that regulatory scrutiny.

DOLLAR: Right. And then London has its own problems with a lot of financial firms. I don't see them fleeing London, but they seem to be hedging – moving some of their staff to continental Europe or Dublin.

GREENWLAD: Yeah, I think you see that trend, and then I think before the oligarchs were well-planted in London. So the question is can the Chinese potentially replace the oligarchs in London, can they get more of a foothold, [and] how will the British react to that. And I think you've seen some mixed results as of late.

DOLLAR: Right. So I take your point that Europe really should be a bigger player given their weight in the world economy. And the euro -- I think it's gone through some stress, but it seems to be in a pretty good place right now. But for Europe really to play that role would take a number of things and one of the important ones is Germany would have to be willing to run a lot more debt and/or develop some kind of fiscal union across the European Union because as it stands you just really don't have enough high-quality Euro denominated assets. You can buy Italian or Greek bonds but there's a lack of confidence in those. People want to buy German bonds, in fact they're trading at negative interest rates, but they're just not a lot of them.

GREENWLAD: Yeah. I think in the long run given the development of European markets and the strength of its institutions the euro is best poised to share currency hegemony with the dollar. In order to do that though they'll have to embark upon politically difficult reforms on budgets, capital markets, and deposit insurance. And the question becomes is can Lagarde push those through. Can she use her strategic nature to push Europe forward on that. And that's going to be interesting to watch.

DOLLAR: What about China coming up in terms of internationalization of the renminbi. I mean they're going to be the biggest economy in the world – probably take another 15 years or so but they're

likely to be the biggest economy in the world. They're already the biggest trading nation. So do you see the renminbi coming up and challenging the dollar?

GREENWLAD: I don't in the short-term or even really yet in the medium-term because you know very well the currency has stalled since 2015 and hasn't been able to successfully internationalize. And I think there is concern under some in the banking sector that some of the smaller banks aren't as well-capitalized and they need PBOC and others to fill their coffers. So I think there's been some instability, some false starts, in that internationalization.

And even Belt and Road, as you know, is based out of dollars. And so that just is case in point that it's crown jewel right now globally is still based in dollars. So I think that's why when I was in China in October touring Tencent all I could think of was the Chinese are trying to isolate the U.S. from the dollar and ultimately create alternatives. And I think the key will be...you've seen many of their CEOs drop down. So usually it now is the number two or three who's the top CEO in China. And the question is whether they can have enough success to increase their currency. I don't see that rivaling the dollar anytime soon.

DOLLAR: Right. I think that's a really important point you made about the Belt and Road Initiative. Originally some of the narrative around that is that China has a lot of excess savings and that this is an opportunity to put those to use. They could have used it to really develop the renminbi as an international currency but in fact most of their lending is in dollars.

GREENWLAD: So that speaks to the core of their strategy. The fact that they couldn't do that...it doesn't speak well of their confidence yet of their currency. And the fact that they have to move now to a digital payment system just shows how strong the dollar has been. But we in the United States can't be too reliant upon that. I think countries around the world look to us for our military strength and to our use of our financial sector, and we have to adapt to countries around the world and not become complacent. My concern is that we're becoming complacent and we may be overextending or overusing or thrusting our financial might too much and mixing trade and national security and making it a very gray area.

DOLLAR: Right. So that kind of leads naturally to a last question. You've been deeply involved in this for a long time. What if anything would you change? What could we do better in terms of use of financial sanctions?

GREENWLAD: I think the biggest dilemma for sanctions policymakers will be crafting sanctions against players that are systemically important financially moving forward. So I think the update made last month at the Treasury due to Executive Order 13224, our terrorism executive order, was a forceful message against potentially restricting dollar clearing at foreign banks. The trade war has shown the potential consequences of ineffective coordination between different agencies and so I think that sanctions alone as we've discussed are not a strategy, but they are a primary response tool. So I think that we need to update our toolkit in this new era of great power competition. The national security strategy in this administration rightly talked about this new era of great power competition. Our tools need to now be more up-to-date. So I think you need an updated Patriot Act that brings together our market shops, our

national security shops, the folks working on China and Iran, linking more together to go after these systemically financially important players and figure out what are the economic consequences so that we can have a stronger national security toolkit moving forward.

DOLLAR: I'm David Dollar and I've been talking to Michael Greenwald about the use of financial sanctions. It's a very interesting story how they started out focused very much on the terrorists who perpetrated 9/11, and then spin off groups, and then we use them with Iran and North Korea. But now we're dealing with "superpower competition" as you put it. In this era we need to think carefully how we use these tools and we definitely need to update them.

So thank you very much Michael.

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