Why Cutting Russia Off From Global Banking Will Bite The United States

March 11, 2022

America cutting off Russia's central bank from its U.S. dollar reserves could carry huge consequences that the D.C. establishment hasn't considered.

Here's how the Wall Street Journal's Jon Sindreu framed what happened: "After Moscow attacked Ukraine last week, the U.S. and its allies shut off the Russian central bank's access to most of its $630 billion of foreign reserves. Weaponizing the monetary system against a Group-of-20 country will have lasting repercussions."

Reserves are globally accepted foreign currency that a foreign central bank holds to back and protect its own currency — the pound, the yen, and the euro are considered reserve currencies, but the primary reserve currency is the U.S. dollar. The dollar is the world's reserve currency because a large amount of global commerce is priced in dollars, and the U.S. legal system and open capital markets mean American dollars can buy American assets while the owner is protected by the rule of law.

This status as the world's reserve currency gives Washington immense power, because at the end of the day all dollar transactions must undergo clearing and settlement (fancy words for transferring ownership then recording who owns dollars) at U.S. banks connected to the institution that controls the U.S. dollar, which is the U.S. Federal Reserve.

That power from the global reserve status of the dollar allows America to sanction foreign countries even when they don’t do any trade with America, in part because foreign institutions — say, in Europe — trading with potentially rogue regimes desperately need access to this U.S. dollar system.

Increasingly, America has upped its use of this sanctions power. The latest examples are with Iran under the Obama and Trump administrations, and Afghanistan under the Biden administration after the American-backed government in Kabul collapsed. Again, use of the dollar abroad can violate sanctions even if no American is involved in the transaction, because clearing and settlement occur on American soil.

Russia Cut Off from the Dollar

After Russia’s invasion of Ukraine, the Biden administration cut off the Russian central bank’s ability to use its $630 billion in reserves. Money is only money if you can use it to buy something, and if it keeps its purchasing power. This is why Bitcoin, which trades more like a commodity with higher volatility and is correlated with the Nasdaq and inverse VIX volatility gauge, is not money, while gold is money.

According to the Journal’s Sindreu, the move will prompt Russia to shift its central bank holdings, which back the value of the ruble, toward Chinese assets and gold. Sindreu correctly points out this will lead to more trade regionalization and deglobalization.

It also boosts the Chinese renminbi's (RMB's) status as a competing reserve currency. Previously, the knock on the RMB was that China lacks rule of law and one might not actually be able to use the RMB to buy Chinese assets, or one might not be able to eventually get money out of China. Now, for many parts of the world, the dollar increasingly has similar problems.

D.C. Elites Don't Know What They're Doing

But the impacts could be even further reaching. Aside from simply making the RMB a slightly stronger competitor against the dollar, in a fight where the dollar still clearly has the upper hand, the move emboldens China and helps its economy.

Sanctioned countries, or countries that might get sanctioned, are now dependent on doing business with China, and the Western elite is likely too dependent on China to fully penalize or sanction China for being the central economic hub for the growing list of countries excluded from the West's economic system. This gives China a monopsony-like status to buy Russian or Iranian energy at a discount.

Lest you think the countries on the sanctions list are only the ones that keep neocons up at night, Europe ran the risk of being sanctioned because of trade with Iran. The Biden administration has also recently and stupidly threatened India with sanctions, because of its ties to Russia.

This overuse of this sanctions power, which increased also under Obama and Trump, risks much of the world losing confidence in the dollar as the world's reserve currency, and attempts to circumvent the current monetary system that gives the D.C. elite so much power.

Russia and China are already looking for ways to completely de-dollarize and trade outside of the dollar system.

Impact on Americans

The impact for normal Americans is complicated. The dollar's reserve status has been a drain on Middle America and a boost to D.C. elites, because it means D.C. politicians can overspend and boost the financialization of the economy even while America's manufacturing base has atrophied since the 1970s (which happens to be when the current system of the fiat dollar, not backed by gold, was started).

Normally, buying too much from countries like China would require American politicians to spend less, and the American economy to eventually import less and produce more here at home. Because the dollar is the world's reserve currency, foreign trading partners have sat on the dollars they received instead of demanding the U.S. produce goods in return. This is a bad setup, and clearly not sustainable.

Pursuing monetary reform to rectify these imbalances would be how a forward-thinking and well-informed political class transitioned America smoothly into something better. But that's not our political class, and most Republicans and Democrats are completely clueless on these issues. Instead, America's current corrupt political class behaves like the sanctions power and dollar's reserve status can never run out, treating it carelessly and rashly.

Far from ushering in a smooth transition away from a system that has benefited the coastal elite over Middle America, they are rushing Americans toward less purchasing power and massive shortages and price increases here at home. It's incredibly dangerous and shortsighted.

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