Iran Sanctions Are Damaging the Dollar

By Nick Cunningham
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Painful sanctions on Iran have demonstrated the long reach of the U.S. Treasury, forcing much of the globe to fall in line and cut oil imports from Iran despite widespread disagreement over the policy. Yet, we are only in the first few chapters of what may ultimately be a long story that ends with the erosion of the power of the U.S. dollar.

The role of the greenback in the international financial system is the reason why the U.S. can prevent much of the world from buying oil from Iran. Oil is traded in dollars, and so much of international commerce is based in dollars. In fact, as much as 88 percent of all foreign exchange trades involve the greenback.

Moreover, multinational companies inevitably have some commercial ties to the U.S., so when faced with the choice of business with Iran or losing access to the U.S. financial system and the American market, the choice is an easy one.

That means that even if European governments, for instance, support importing oil from Iran, the dominance of the U.S.-based financial system leaves them with very few tools to do so. European policymakers have scrambled to try to maintain a relationship with Iran and have tried to convince Iran to stick with the terms of the 2015 nuclear deal – and Iran is still complying – but that doesn't mean that European refiners, who are private companies, will run the risk of getting hit by U.S. sanctions by continuing to import oil from Iran. In fact, they began drastically cutting oil purchases from Iran months ago.

The dollar is supreme, it seems.

But that isn't the end of the story. In several ways, the Trump administration is contributing to a growing threat to the dollar, even if that is hard to see right now. After all, the dollar has strengthened this year, U.S. GDP has grown faster than other industrialized economies, and the world has had to adhere to U.S. sanctions on a growing list of countries and entities, the most notable of which are Russia, Iran and Venezuela.

However, the "America first" foreign policy, the trade wars and seemingly arbitrary nature of tariffs, trans-Atlantic tension and other geopolitical rivalries are all factors that could push the dollar off of its perch. **Related: The Altay Pipeline: A Geopolitical Game Changer**

But it is the extensive use of sanctions that stands out as arguably the most important factor that may ultimately undermine the dominance of the U.S. dollar, some experts say. That is especially true in the case of Iran.

> "In the Iran case, the United States is damaging sanctions as a tool of statecraft," **Kelsey Davenport,** an Arms Control Association analyst, told the Washington Post in August. "The United States has put a lot of states between a rock and a hard place."

The president of the European Commission, **Jean-Claude Juncker,** said a few days ago in a speech that the euro should be elevated as a reserve currency in order to break European dependence on the U.S. dollar. Juncker noted that the EU paid for 80 percent of its energy imports in dollars even though only 2 percent of imports come from the U.S.

> "There's no logic at all in paying energy imports in dollar not euro," an EU diplomat told Politico.

For instance, most dollar-denominated imports actually come from Russia and the Middle East. It speaks to the U.S.-oriented nature of the international financial system that a European refiner who wants oil from Iran, or Iraq, or Russia, has to buy that oil in U.S. dollars, and is subject to demands from Washington, even though no American entity has any role in that transaction.

Obviously, so long as European and American interests were aligned, that arrangement worked just fine. But their interests have diverged on a range of issues, including NATO, the Paris Climate agreement, and most significantly on the Iran nuclear deal.

The demands by the Trump administration that Europe cut imports from Iran to zero seems to have been the final straw. Some in Brussels are now calling for a departure from the Trans-Atlantic relationship.

The inability of Europe to blunt the impact of U.S. sanctions on Iran has demonstrated the dominance of the greenback, and has pushed European officials to look for solutions. Some have proposed a rival international payments system, others have suggested buying Iranian oil in euros. In August the EU announced an 18-million euro aid package for Iran.

Most recently, the EU – led by France, Germany and the UK – are working on setting up a "special purpose" financial company to help Iran skirt U.S. sanctions and continue selling its oil. The company would exist to process payments for transactions with Iran, bypassing the typical financing channels, as reported by Spiegel. The U.S. has a great deal of influence over and access to existing money-transfer systems.

There are plenty of reasons why this initiative may not get off the ground, or have only a limited impact. Private companies, for instance, would need to agree to play along and there is little evidence so far to suggest that European refiners are willing to take that risk. And the attempt to elevate the euro to the same status of the dollar will be extremely difficult, and would be a long-term project.

But a growing effort at elevating the euro, or conducting euro-denominated oil sales, combined with a smattering of other initiatives intended to weaken the influence of Washington's financial dominance, could chip away at the dollar over time.

Meanwhile, earlier this year, for its own reasons, China launched a yuan-denominated oil contract based in Shanghai. The move was intended to bolster China's currency, reduce foreign exchange risk, and in a broader sense, gain geopolitical and economic leverage at the expense of the dollar.

The dollar remains all-powerful, but the Trump administration's aggressive use of sanctions, crystallized by its zero-tolerance sanctions campaign against Iran, could undermine the greenback over the long-term if more countries begin to look for workarounds.

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Nick Cunningham *is a freelance writer on oil and gas, renewable energy, climate change, energy policy and geopolitics. He is based in Pittsburgh, PA.*

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