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Biden shows he will wield US *financial system as foreign policy weapon*

President pushed for stronger response to Russia as team promises targeted use of sanctions

Katrina Manson in Washington

By using American banks as a cudgel against Russia, Joe Biden has shown his willingness to weaponise the US financial system against foes, continuing a tactic honed during the Obama years and dramatically ramped up under Donald Trump.

Biden's decision this week to ban US financial institutions from buying new sovereign Russian debt as punishment for an alleged cyber hacking campaign and other misdemeanours offered the first significant insight into the president's attitude to sanctions. It has prompted renewed concerns about their overuse.

"US financial institutions are being weaponised," a banking regulatory lawyer told the Financial Times, referring to the use of sanctions as foreign policy tools. Experts this week argued that the US government was "outsourcing US foreign policy" to US banks or deploying them as "forward basing" — military terminology for establishing an enduring armed presence beyond home turf.

Trump's imposition of thousands of sanctions made them the go-to foreign policy tool in his campaign against Iran, Syria, Venezuela, North Korea and China — and bipartisan pressure from Congress also forced sanctions on Russia.

Biden administration officials argue that they are developing a broader economic toolkit, will work more closely with partners and will be more discriminating in the use of sanctions.

Two people familiar with White House planning said sanctions against Russian debt were not initially contemplated as part of the package to address US frustrations with Moscow, but that there was pressure from senior government officials to come up with a stronger response that would not be seen, in the words of one person, as "totally toothless". Biden in particular pushed for a stronger response, both people said. A National Security Council official said the administration wanted to take the time needed to develop the right response and disputed the accuracy of concerns over appearing "toothless".

A senior administration official told the Financial Times the Biden team was looking at the "efficacy" of other punitive tools besides sanctions, such as tariffs, investment restrictions and export controls.

It was also considering positive inducements like bilateral assistance, multilateral assistance and debt relief. "There are a number of us at the White House who have thought deeply about economic statecraft," said the official.

At stake, said Andrea Kendall-Taylor, who was appointed Biden's NSC Russia director before declining for personal reasons, is the dominance of the US dollar and America's unassailed lead in the global financial system, which relies on New York as international dollar clearing house. Those targeted for sanctions could seek to shield themselves by turning from US banks and towards non-dollar holdings, a trend that if undertaken en masse could undermine the US dollar as primary reserve currency. "The risk is real, and I think it's something the United States needs to be extremely aware of and discriminating in its use of sanctions when possible," she said.

"We do see Russia and China really working together to reduce the centrality of the United States in the economic global system, and over the longer term that risks diluting the efficacy of our tools of financial coercion," she said. Last month, Russian foreign minister Sergei Lavrov renewed his calls for Moscow and Beijing to reduce dependence on the US dollar and western payment systems during a visit to China. China's central bank this year expanded its digital currency pilot to explore cross-border transactions. Burgeoning cryptocurrencies are another potential rival.

The senior administration official said the Biden team had carefully calibrated actions against Russia according to a "principle-based approach", defending its effort to impose "precise", targeted costs and avoid blowback to the dollar. "We wanted the package to be responsible to limit negative spillovers to the US and the global financial system," said the senior official, adding dollar primacy was "hugely important to us". "It's in our national interest because of the funding cost advantage it provides, it allows us to absorb shocks . . . and it gives us enormous geopolitical leverage," said the official.

Some in Biden's team who have previously worried about the overuse of sanctions have become more comfortable with them, including deputy national security adviser for international economics Daleep Singh. He told Congress in 2019 he was "cautious" about actions against Russian debt as a US Treasury official in 2014 due to "unpredictable spillover effects" but had since evolved his view, arguing Russia was better able to absorb the hit and investor exposure had reduced. Peter Harrell, senior director for international economics and competitiveness in Biden's NSC, wrote in 2018 that the use of sanctions had "exploded" over the past decade and become "a rare area of bipartisan consensus in Washington".

The Biden administration has yet to take on two of his recommendations — to publish periodically a cost-benefit analysis of the US sanctions programme or for US presidents to articulate, early on, explicit principles guiding sanctions use. But it is seeking a multilateral approach — another Harrell recommendation — marking a key distinction from Trump-era unilateralism that in 2018 triggered the European Union to expand a blocking statute limiting the impact of Washington's sanctions on Iran.

The Biden administration has undertaken joint targeted sanctions against Myanmar and Russia, although this week's move against Russian debt was unilateral. The senior official said the package "was carefully calibrated to increase the chance of partnering with allies." "We've often had to act first and then we have been successful in bringing our partners and our allies along with us over time, and here again we hope to have that same type of unity of purpose," said the official. For now, banking experts say risks to the primacy of the dollar remain far off, and that US sanctions remain effective, not least because non-US banks largely tend to follow them due to market linkages and penalty risks.

The Biden administration also excluded the secondary debt market and US individuals from this week's measures and included a wind-down period. Rachel Ziemba, an expert in coercive economic policies, was among those who did not see the latest actions as a "meaningful risk" to US dollar primacy, adding pandemic lock downs had seen people take additional comfort in dollar assets.