With the record fine levied on BNP Paribas for evading sanctions, the US authorities have unleashed a powerful weapon to deter international banks from trying to break the rules, but there is a risk it could undermine the US financial system if it is overused.

As part of the $8.97bn settlement that the US justice department announced on Monday evening, parts of BNP Paribas’s operations will be barred for a year from conducting US dollar transactions – the first large international bank to suffer such a penalty for evading sanctions.

The punishment goes to the heart of why US sanctions have become so controversial among banks, because they allow the authorities to police business arrangements that do not involve Americans.

At a time of huge reluctance to take military action, sanctions are increasingly becoming the policy instrument of choice in Washington to try to shape the behaviour of other countries.

But with its embrace of financial sanctions, the US risks provoking a backlash against the role that the US dollar plays in the global economy at a time when emerging rivals such as China are claiming a bigger role in the international financial system.

“The reason US sanctions have such power is that they can touch transactions that do not involve US persons – as the BNP case highlights,” says Zachary Goldman, a former Treasury department official who worked on sanctions policy, now at New York University. “But as the costs of compliance rise, so the US also needs to be aware of the potential limitations of sanctions.”

BNP pleaded guilty on Monday to state charges that it processed billions of dollars of transactions on behalf of Sudan, Iran and Cuba that were in violation of US sanctions on those countries.

The French bank is the latest in a series of large financial institutions that have fallen foul of US sanctions policies. Justifying the record fine, the criminal complaint criticised the “bank’s cavalier – and criminal – approach to compliance with US sanctions laws”. James Cole, a senior Department of Justice official, said that BNP acted as the “de facto” bank to the Sudanese government.

Over the past decade, US authorities have increasingly used sanctions that target financial transactions – taking advantage of the centrality of the US financial system in the global economy. If US dollars are used in trade or investment, the transaction is eventually likely to involve a bank in the US, which allows the American authorities to claim jurisdiction.

That ability to dictate terms to banks outside of the US has become a running sore with many international financial institutions. According to the 2012 complaint that accused Standard Chartered of violating Iran sanctions, one of the bank’s executives complained to US officials: “You Americans. Who are you to tell us, the rest of the world, that we’re not going to deal with Iranians?”

A senior European official says: “Our governments all grumble but they realise there is not much we can do and they generally support the objectives of the sanctions. But the banks hate the sanctions. They really, really hate them.”

Michel Sapin, France’s finance minister, said that the BNP fine should give Europe reason to “mobilise” more transactions in euros, so that European banks are not so beholden to US regulators.
The increasingly aggressive enforcement by the US of financial sanctions also comes as China is pushing to increase the use of the renminbi in international trade and investment, part of a long-term plan for its currency to rival the US dollar. Russia has also called for greater use of currencies other than the greenback.

Obama administration officials acknowledge that sanctions are usually only effective when they are backed by significant number of countries, as was the case with Iran. The desire not to completely alienate friends and allies was one reason for the intricate negotiations that surrounded the BNP settlement – the ban on its US dollar clearing operations, for instance, was designed to affect only one part of the bank.

However, US officials believe that there is little immediate danger to the role of the US dollar from a sanctions backlash. “The US is the irreplaceable, unavoidable place where one needs to do business,” says Neal Wolin, former US Treasury secretary. “That means the US can say, ‘you can either deal with us or deal with X’.”

The dominant role of the US dollar is underpinned by the depth of US capital markets, the size of the economy and the system of contracts and rule of law.

“We should be constantly vigilant about what sustains the role of the US dollar…but the basic reasons for why the dollar is the principal reserve currency are not going to go away,” says Mr Wolin.