Paris failed to detect BNP Paribas’ violation of international norms, writes Barry Eichengreen

Michel Sapin is not the first French finance minister to complain about the dollar’s singular position in the international financial system. It is almost 50 years since Valéry Giscard d’Estaing coined the phrase “exorbitant privilege” to denote the dominant role of the greenback in global monetary affairs.

Nor is the BNP Paribas affair that irked Mr Sapin – the French bank has been fined $9bn for breaking US sanctions on Sudan and Cuba – the first time America has thrown around its financial weight to advance its political agenda. In 1956 it used Britain’s dependence on dollar credit to force London and Paris to roll back their invasion of Suez.

BNP Paribas fell foul of US law because the credit it provided to governments subject to American sanctions was denominated in dollars, which is what exporters in other countries customarily require. Once the dollars sourced by BNP’s New York branch passed through the US financial system – through Fedwire or another US-based network for clearing and settlement since there is no other convenient, low-cost way of making dollar payments – they came under US law.

In fact this is only the second recent effort by US authorities to use the dollar’s position to extend their legal reach. Last month the Supreme Court ordered Buenos Aires to compensate in full “holdout” creditors who rejected the debt restructuring after Argentina’s 2002 default, setting the international bankruptcy regime on its ear. The judges’ leverage was that payments to holders of Argentina’s dollar bonds were routed through the Bank of New York Mellon and again, therefore, through the US payments system.

They may not like it, but it is not clear what France and other critics can do to alter the status quo. They might try to set up dollar clearing offshore, an echo of the eurodollar market that sprang up in Europe in the 1960s in response to US controls on international transactions.

But low-cost clearing requires liquidity. The Federal Reserve provides the necessary liquidity to financial institutions that transact in dollars in the US, including subsidiaries of foreign banks. In theory, the Fed might provide dollar liquidity for offshore transactions, as during the global financial crisis, but it would not be inclined to provide liquidity to an offshore market established expressly to circumvent US sanctions.

The only feasible alternative, then, is to induce non-US exporters to take euros and renminbi in payment for goods and services. When Mr Sapin called for a “rebalancing” against the dollar using “the big currencies of the emerging countries”, there is no doubt which big emerging country he had in mind.

But for the euro and renminbi to be attractive to European and Asian companies exporting, say, pharmaceuticals to Cuba, markets in those currencies will need to be deep and liquid. Market participants will have to be able to buy and sell those currencies at a cost as low and predictable as they can for dollars.

Market liquidity requires a diverse clientele. Only if market participants include a wide variety of buyers and sellers who require a currency at different times will bid-ask spreads be low and stable – the hallmark of a liquid market. Building market liquidity therefore requires solving what economists call a “co-ordination problem”, inducing a diverse set of participants to enter the market at the same time. This, evidently, was what Mr Sapin was trying to orchestrate by exhorting companies in other countries to contemplate use of the euro and “big emerging currencies” in lieu of the dollar.
But France lacks the moral authority to orchestrate this process. Not only did one of its biggest banks egregiously violate international norms by doing business with Sudan and other unsavoury regimes. The government also failed to detect the violation or, worse, did not try.

Arbitrary and capricious use of US financial leverage would, in time, create widespread disaffection with the dollar. But steps by the US against BNP Paribas were hardly arbitrary and capricious. Such terms better describe Mr Sapin’s remarks.

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