



In Weaponizing the Dollar Trump's Lieutenants Flunk Finance 101

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In a scoop, [Bloomberg](#) reported last week that Secretary of State Mike Pompeo and some of President Trump's top lieutenants are considering fully weaponizing the U.S. dollar to undermine Hong Kong's financial system. The idea has been hatched to punish China for its recent aggressions in Hong Kong.

Just what does the weaponization of the greenback entail? The U.S. dollar is the international currency. It is the major reserve currency held by central banks, the most prominent currency used to denominate debt, and the unit of account for invoicing goods and services in international trade. The dollar's stable value means that it is used widely for both international payment and interbank transactions, as well as for official intervention in foreign-exchange markets. In short, the dollar is entrenched at the center of the international financial system. This gives the United States an "exorbitant privilege," as the Frenchman Valéry Giscard d'Estaing pointedly put it. For the U.S., the benefits are incalculable.

The greenback becomes weaponized when Washington imposes financial sanctions on individuals, institutions, or nations. These sanctions are designed to cut off those targeted from the use of the dollar, and thereby from the use of the financial system.

Sanctions are, of course, nothing new. They have been weapons of war for centuries. In the U.S., many presidents have embraced them. President Woodrow Wilson went so far as to proclaim that sanctions could be a "deadly force" and a very effective diplomatic tool. Even though the evidence supporting the success of sanctions is threadbare at best, White House after White House has latched onto sanctions to no avail. Just consider how well the weaponized dollar sanctions have worked against Cuba, Iran, North Korea, and Venezuela. Sanctions are a fatal attraction that have become ever more prominent since the Twin Towers came tumbling down on September 11.

This brings us to the Trump administration. President Trump, the counter-puncher in chief, has become drunk on financial sanctions. Indeed, anybody or anything that Trump and his lieutenants dislike is at a very high risk of being sanctioned. Financial sanctions are clearly the president's weapon of choice. That is why Bloomberg's reportage is so credible, disturbing, and dangerous.

Hong Kong is one of the world's most important financial centers. It is not a Havana, Caracas, Tehran, or Pyongyang. Furthermore, Hong Kong is a uniquely dollar-based economy. Why? In 1983, Hong Kong established a currency board, which was designed by my colleague and

collaborator John Greenwood. Hong Kong's currency board is managed by the Hong Kong Monetary Authority.

Just what is a currency board? A currency board issues notes and coins convertible on demand into a foreign anchor currency at a fixed rate of exchange. As reserves, it holds low-risk, interest-bearing bonds denominated in the anchor currency. The reserve levels (both floors and ceilings) are set by law and are equal to 100 percent, or slightly more, of its monetary liabilities. A currency board generates profits from the difference between the interest it earns on its reserve assets and the expense of maintaining its liabilities.

By design, and unlike central banks, a currency board has no discretionary monetary power and cannot engage in the fiduciary issue of money. It has an exchange-rate policy (which is fixed) but no monetary policy. A currency board's operations are passive and automatic. The sole function of a currency board is to exchange the domestic currency it issues for an anchor currency at a fixed rate. Consequently, the quantity of domestic currency in circulation is determined solely by market forces; namely, the demand for domestic currency.

Since the Hong Kong dollar's anchor currency is the U.S. dollar, the HKD is a clone of the USD, and Hong Kong is part of a unified currency area with the United States. From a strictly monetary perspective, it is as if Hong Kong were part of the United States.

So, if the U.S. imposed financial sanctions on Hong Kong, it would be equivalent to cutting California's financial system off from access to the greenback. Such a maneuver would inflict a catastrophic blow on Hong Kong and a catastrophic blow on the U.S. and the greenback. Trust in the dollar would vanish.

It is clear that Trump's lieutenants who are brainstorming the idea of preventing Hong Kong's banks and the HKMA's currency board from accessing their holdings of dollars have either not taken a course in finance — or, if they have, that they failed.

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