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BOOK REVIEW

Daniel McDowell: *Bucking the Buck: US Financial Sanctions and the International Backlash against the Dollar*

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A decade ago, it was prescient to discuss the bargaining and structural power the United States holds through its dollar dominance, the possibility that sanctions could prompt diversification into competing currencies, and the potential threat to the dollar system—a subject now recognized to be of acute importance. Today, these relationships are described using terms like 'weaponizing' the dollar and the financial networks associated with it.

The US dollar is the most widely used currency for international transactions, and it serves as the world's primary reserve currency, held by governments in their foreign exchange reserves. This dominance affords the US with significant power and influence globally. Recent developments, such as Russia's 2022 invasion of Ukraine, China's growing assertiveness, and the emergence of digital currencies have added complexity, challenging the traditional dollar-centric system. Understanding the leverage and limitations of the dollar's dominance in shaping global policies and power balances is, therefore, crucial for policymakers, academics, and global strategists.

Bucking the Buck by Daniel McDowell, who is a Political Science Professor at Syracuse University, examines how the overuse of sanctions affects the dollar system. He warns that sanctions overreach could spur a move away from dollar dependency, potentially reshaping the international currency system and eroding the dollar's dominance.

McDowell's book offers valuable insights into this compelling topic though several weaknesses hinder its overall effectiveness. Like the author's criticism of US sanctions, the "theory" overreaches by being overly broad. The argument is that US foreign policy plays a critical role in shaping the dollar's international use. Policies which offer countries direct benefits enhance the dollar's global appeal. Conversely, actions such as the imposition of financial sanctions create political risk and encourage targeted states, or states concerned by them, to reduce their reliance on the dollar, potentially undermining its dominant position over time. As the theory stands, the mere assertion that overusing sanctions will harm the dollar's global standing is neither particularly novel nor useful. And despite the neglect of other foreign policy drivers of dollar dominance in subsequent chapters, the "theory" nonetheless includes them, e.g., defense commitments, foreign policy affinity.

The book offers a good discussion of several sanction episodes. The Russia case is familiar and the narrative around Turkey points to deteriorating relations between Ankara and Washington due to Turkey's military actions in Syria, its procurement of Russian S-400 missile defense systems, and the detention of Pastor Brunson.[1] The strategic response to the United States' growing use of financial sanctions for countries like Russia, Turkey, and Venezuela is to diversify their reserves away from the US dollar and towards gold. These countries have significantly increased gold reserves in response to US financial sanctions. By investing more in gold, they aim to hedge against the risks associated with US financial sanctions. Gold offers key benefits like being difficult to seize while easy to use in black market transactions and has become a form of insurance for sanctioned regimes.

McDowell also considers how sanctions incentivize governments to use other currencies and explore alternatives in the form of digital currencies and payment systems. He analyzes the composition of trade settlement and corporate debt, alongside the development of alternative payment systems

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[1] The detention of Pastor Andrew Brunson in Turkey on charges of espionage and terrorism in 2016 significantly strained US-Turkey relations, reflecting broader diplomatic and religious freedom concerns.

to point to varying degrees of successful de-dollarization. For example, Russia developed its own payment messaging system and sought non-dollar trade settlements with China and India. Turkey, facing a more limited sanctions impact, has shown modest efforts towards de-dollarization, primarily in trade settlements. Venezuela's case highlights the challenges of de-dollarization, as even supportive countries like China have hesitated to maintain non-dollar transactions. McDowell concludes that while US sanctions uniformly increase the political risk of dollar usage, they lead to varying degrees of successful de-dollarization. Russia shows the most significant shift, especially in corporate debt structures and trade with key partners. Turkey and Venezuela's efforts, however, have been less effective, underscoring the complexities and challenges of moving away from the dollar dominated global financial system.

The empirical findings in McDowell's book are based on unexplained modeling choices and selection effects, raising concerns about the validity of the results. Before turning to these aspects, McDowell should be commended for creating his own financial sanctions measure, a compilation of sanctions-related executive orders. However, he does not convincingly argue for the advantage of his measure over existing measures. His aim seems to be to isolate the sanctions' impact on government entities, whereas existing datasets combine data on both sanctioned government and non-governmental entities. This approach, however, results in a mismatch between the sanctions data, which focuses on government entities, and the foreign holdings of Treasury securities, which include both government and non-governmental entities. If isolating the sanctions' impact on government entities was not the goal, it remains unclear why McDowell did not use existing, more comprehensive, datasets. Further, McDowell does not say why he chooses to evaluate the sanctions impact specifically on foreign holdings of long-term Treasury securities, rather than on all Treasury securities, both short term and long term. The main variable of interest, foreign holdings of long-term Treasury securities, is also constructed as a *change* variable—a peculiar choice given the objective to examine the impact of financial sanctions on the dollar's global status. Typically, such a method is more suited for capturing short-term dynamic responses, not the long-term structural adjustments central to this analysis. Usually, employing yearly fixed effects is the most appropriate approach in this context, since it controls for annual shocks and policy shifts that could influence changes in foreign holdings of long-term Treasury securities, providing a clearer picture of underlying trends and year-specific events. Instead, McDowell uses a time trend, controlling for smooth and gradual changes over time, a choice which could obscure the true relationship between sanctions and the dollar's global standing. And unusually, McDowell omits variables normally included when studying the dollar's global role, potentially over-estimating the role of sanctions.[2] For example, consider Bernanke's insights into how global savings patterns, together with related factors such as inflation and exchange rates, influence the US economy and consequently the dollar's global role. Yet, McDowell overlooks the impact of these, as well as other factors—such as interest rates, inertia (or incumbency advantages), trade imbalances, and trade linkages with the United States—on foreigners' willingness to hold US Treasuries. Similarly, when analyzing the sanctions' impact on gold reserves, McDowell does not consider the role of crises. Failing to account for major events such as the 2008 financial crisis or the COVID-19 pandemic in McDowell's analysis could lead to a misrepresentation of the true factors driving the shift towards safe haven assets like gold during periods of economic instability.[3] By leaving out these factors, the book may incorrectly attribute the increased appeal of gold solely to the impact of sanctions, disregarding how these broader crises substantially influence gold reserve dynamics.

Despite these shortcomings, McDowell's work highlights the pressing need for research that rigorously examines how financial sanctions impact the dominance of the US dollar in the global economy.

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[2] For instance, even after the 2022 Russia sanctions, Bertaut et al. (2023) show that the dollar's reserve role and share of global transactions has remained relatively constant.

[3] See, for example, Li (2003), Bernanke (2005), or Chinn and Frankel (2008).