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AMERICAN ECONOMIC POWER &

THE NEW FACE OF FINANCIAL WARFARE

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Center for a
New American
Security

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Economic Statecraft Series

This policy brief is the first in a CNAS series on the coercive tools of economic statecraft. Subsequent papers will address many of the specific issues that this policy brief raises.

The United States has long relied on its economic power to protect and advance its interests abroad. In an increasingly integrated international financial system, the U.S. economy and capital markets remain the largest in the world by almost every measure. This status affords the United States an important global leadership position and the ability to shape foreign policy outcomes with economic tools. The structure of the international trade and financial system, in which many significant banking and energy transactions as well as currency reserves are denominated in U.S. dollars, reinforces the central role of the United States.

During the last decade, U.S. policymakers have leveraged these structural advantages and turned with increasing frequency to coercive economic measures (CEMs) – such as financial sanctions and, to a lesser extent, trade and investment controls and other regulatory measures designed to protect the U.S. financial system – to counter illicit activity and project American power.

Policymakers turn to CEMs as a tool of first resort because of their powerful impact and a domestic environment characterized by war-weariness and austere budget conditions. The United States and its allies have used financial sanctions to great effect in acute crises, such as the 2011 Libyan uprising, as well as to help manage persistent security challenges, such as terrorism and the proliferation of weapons of mass destruction. In recent years, policymakers have significantly and rapidly innovated the nature of these tools and expanded the scope of challenges they are called upon to address. In just the past few years, for example, they created new authorities to counter malicious cyber activity and transnational organized crime.

However, the use of CEMs to protect American security interests does not come without costs, and the new ways in which the United States and its allies have used CEMs in the last decade have generated significant policy challenges. These

include difficulties in anticipating and mitigating some of the longer-term effects of CEMs on global trade, financial platforms, and energy sector development. Other challenges include the potential degradation of the financial sanctions framework resulting from challenges in court, particularly in Europe. Additional concerns include insufficient consideration for how these tools should be integrated into broader strategic approaches to particular problems and coordinated with military and diplomatic activities. A pressing new concern involves the manner in which adversaries are adapting themselves, and the international financial architecture, to limit the ability of the United States and its allies to use CEMs to project power internationally.

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In a dynamic period of global financial and energy sector transformation and multiple pressing international security challenges, officials in the United States and allied countries must address the challenges associated with the use of CEMs to ensure that these tools remain effective and available in the years ahead. This will require policy leaders to preserve the features of the U.S. economy and international financial system that give these tools their strength and to institute a balanced process for implementing and enforcing CEMs. Using coercive economic measures carefully and cultivating U.S. economic strength can also frustrate attempts by adversaries to challenge CEMs or to target America's economic interests. The ability of the United States to achieve these objectives will be a major test of U.S. leadership in the twenty-first century.

This policy brief describes the evolution of the use of CEMs in U.S. policymaking, as well as some of the key challenges currently associated with their use. It offers several principles to guide adaptation and use of CEM authorities to bolster their effectiveness and utility as a foreign policy tool. Subsequent papers in the CNAS series on the coercive tools of economic statecraft will address many of the specific issues that this policy brief raises.

THE UNITED STATES AND THE PROJECTION OF ECONOMIC POWER

Over the last several years, policymakers have turned increasingly to CEMs, including financial sanctions, trade controls, and investment restrictions, to advance American interests. But the American use of financial power to accomplish strategic objectives is as old as the Republic and has grown in step with the expansion of the U.S. economy and the development of the United States' view of its global role.¹

Structural features of the global economy give the United States asymmetric advantages in the projection of financial power and recent uses of CEMs, including sanctions on Iran, are viewed as successful and replicable. Policymakers now look to financial sanctions and other coercive economic measures as tools of strategic messaging, deterrence, constraint, and behavior change. They have become a central national security policy tool to address threats and unlawful activity.

While coercive economic tools have long been used to translate economic or commercial effects into political impacts, the predominant ways in which the tools were used to accomplish these goals have differed over time. The three main stages in their development are defined by technical and conceptual advances in how CEMs are used to focus more precisely their impact on targets and to generate more pronounced effects.

Broad Sanctions and the Early Stages of Coercive U.S. Economic Power

The first stage of the United States' use of coercive economic measures runs from the start of the Republic to the mid-1990s. During this time CEMs, often bold and broad, had a mixed record of achieving their objectives. Sanctions were used to supplement diplomacy and to shape outcomes in foreign conflicts, either apart from military intervention or as an adjunct to military force. But

they were generally blunt instruments, targeting the economic interests of broad swaths of activity or entire countries rather than specific individuals or entities engaged in wrongdoing. This quality of early CEMs reflects both a less globally integrated financial system and a less developed approach to the use of coercive economic levers.

In 1807, for example, the United States attempted to use trade restrictions to avoid further entanglement in military conflict. In a period of intense fighting between England and France during the Napoleonic Wars, President Thomas Jefferson placed “an embargo cutting off American commerce nominally with all of Europe.”² The embargo was designed to force both belligerents, especially the British, to respect the neutral rights of American ships and mariners, whom England and France had targeted in order to deprive the other of economic advantage.³ This use of trade restrictions did not have the desired effects: “British and French traders easily evaded the restrictions, and other European merchants were able to ‘backfill’ the business on the lucrative trade routes that American shippers had abandoned.”⁴

During the Civil War, the Union blockaded Confederate ports, seeking to starve the South of the materials necessary for the rebellious states to wage and win the war. In this case, the tactic proved to be “one of the Union’s most effective weapons, contributing significantly to the decline in the South’s home-front standard of living and in the Confederate army’s logistical support.”⁵

The early modern era of U.S. financial sanctions began with the 1917 adoption of the Trading with the Enemy Act (TWEA),⁶ which aimed to deprive Germany of the use of funds it might obtain from the countries it occupied during World War I.⁷ In 1940, the Department of the Treasury established the Office of Foreign Funds Control, the predecessor to the Office of Foreign Assets Control, which

today administers financial sanctions. The original aim of the Office of Foreign Funds Control was similar to the purpose for which Congress enacted TWEA, namely, to “prevent Nazi use of the occupied countries’ holdings of foreign exchange and securities and to prevent forced repatriation of funds belonging to nationals of those countries.”⁸

After World War II, the United States sought to use economic pressure to engineer shifts in the decisionmaking of foreign countries. In 1950, for example, the United States imposed a comprehensive embargo on North Korea in response to its invasion of the South.⁹ In 1956, the United States threatened the United Kingdom and France with economic restrictions during the Suez Crisis and refused to allow the International Monetary Fund to provide emergency assistance to the U.K. unless it called off the invasion of Egypt.¹⁰ The U.K. and France withdrew from territory they had occupied during the war more quickly than did Israel, whose delay “was at least partly because America was not able to exert the same kind of financial and energy pressure on Israel that it had been able to exert on Britain and France.”¹¹

Two of the most important, and controversial, uses of sanctions to change behavior are the cases of Cuba and Iraq. The United States imposed a broad trade blockade against Cuba in 1960, which it then accelerated in 1963, largely cutting off Cuba from any commerce with the United States.¹² Following Iraq’s invasion of Kuwait in 1990, the international community imposed comprehensive trade and financial sanctions against Iraq.¹³

Both sanctions programs shared a comprehensive focus on trade and transactions and yielded powerful economic effects. They also shared several key shortcomings, including their negative humanitarian effects and persistence – even while offering diminished returns. The unilateral nature of the sanctions on Cuba diminished their effectiveness,

and circumvention of the restrictions put in place by the international community plagued the Iraq program. The sanctions against Iraq took a particularly harsh humanitarian toll and also created many opportunities for corruption, such as the scandals associated with the Oil-for-Food program.¹⁴

The negative aspects of the Iraq and Cuba sanctions programs, particularly their perceived ineffectiveness, had serious international security implications. While the Cuba and Iraq programs were widely criticized, sanctions against the apartheid regime in South Africa were perceived to have contributed to significant change, helping push the apartheid government to relinquish power.¹⁵ These cases, among others, would later prompt substantial evolution in the design and implementation of financial sanctions.

Financial Measures Aimed at Specific Targets in the 1990s

The second period in the development and use of coercive economic tools began in the mid-1990s and lasted through 2010. During this time, instead of broad restrictions aimed at entire countries, CEMs focused more narrowly on specific illicit behavior and regime elites. These measures imposed travel bans, asset freezes, and other restrictions on individuals, groups, or entities rather than on entire countries. They attempted, as before, to put pressure on perpetrators and decisionmakers but to do so while mitigating broad social and humanitarian costs by narrowing the targets of CEMs. They were generally conduct-based, focused on specific unlawful activities such as terrorism, narcotrafficking, human rights abuses, and certain forms of extreme corruption rather than focused on individuals or companies based on their nationality or status (though they occasionally used these criteria).¹⁶

By aiming economic pain at specific individuals or groups, the “smart sanctions” that emerged in the 1990s represented attempts to make sanctions

more effective while avoiding the humanitarian consequences of the Iraq experience.¹⁷ Early examples include the 1995 sanctions program designed to target narcotraffickers centered in Colombia¹⁸ and a 1995 program that targeted terrorist groups disrupting the Middle East peace process.¹⁹ A 2004 program targeted the assets of former Liberian President Charles Taylor, along with those of his family and close associates and others who had expropriated Liberian state assets.²⁰ Although these targeted financial measures did not necessarily create broad economic effects, when many such measures were imposed on a variety of nodes in a financial network or criminal ring they had a significant impact.

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During the 1990s, economic sanctions became “the United States’ policy tool of choice.”²¹ This trend accelerated markedly after 9/11, when financial sanctions moved to the “center of our national security” discussion.²² International norms were developed by NGOs to counter illicit financial activity and the use of international financial institutions for criminal or destabilizing activity.²³ The activities of the U.N. and other international institutions complemented U.S. measures to degrade the ability of terrorists and other illicit actors to use the international financial system.

U.S. counterterrorism sanctions embodied in Executive Order 13224, adopted shortly after 9/11, established the broad authority to impose sanctions on individuals or companies providing support to terrorism. Former Under Secretary of the Treasury for Terrorism and Financial Intelligence David S. Cohen noted that, “By developing and deploying innovative financial tools, and marshaling the support of the domestic and international private sectors, multilateral fora, foreign regulators, and foreign ministries, we have made it harder than ever for terrorists to raise, move, store, and use funds.”²⁴

A powerful and effective use of CEMs during this period occurred in 2005, when the United States imposed restrictions on Banco Delta Asia, a small Macau-based bank that conducted a substantial amount of business with the North Korean government. U.S. policymakers imposed restrictions, using a money-laundering authority created by the USA Patriot Act, that delivered a substantial blow to North Korea by bringing new economic leverage to bear during the Six-Party Talks over its nuclear program. The powerful economic impact of this financial weapon influenced and inspired U.S. government officials who began to consider “the next large-scale initiative: the financial assault on Iran.”²⁵

Sanctions from 2010 to Present

The third phase in the United States’ use of coercive economic measures started in 2010. In the last five years, policymakers have created unprecedentedly powerful financial authorities to target adversaries and offer them incentives, both positive and negative, to change their behavior. During this period new types of CEM programs, and far more of them, targeted a rapidly diversifying array of illicit and objectionable activities. The recent expansion in the use of CEMs as a policy tool builds on a nearly 100-year-old history of modern CEM programs dating from the establishment of

TWEA; the Treasury Department now administers 40 sanctions programs, three of which were created in the last year alone.²⁶ Since 2010, Congress has passed at least half a dozen major sanctions bills, and the White House has issued an unprecedented 29 executive orders, establishing substantially expanded or entirely new sanctions authorities.²⁷ These innovations are generating significant, sometimes surprising, structural changes in the financial sector and in private-sector investment and commercial activity. They have also substantially altered investment and production expectations, particularly in international energy markets that have been substantially targeted by sanctions.

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The heart of this transformation stems from the use of secondary sanctions against Iran.²⁸ In 2010, the United States adopted a statute that effectively forced global financial institutions to choose between doing business with Iran and doing business with the United States.²⁹ The United States used these new authorities to isolate Iran financially in order to pressure its leadership to engage productively in talks over its illicit nuclear activities. It later added sanctions that squeezed Iran

out of almost half of its international oil trade, including by restricting Iran's access to shipping, insurance, and the use of ports and banks for its oil exports. In an unprecedented and highly successful step, the United States used sanctions to compel Iran's oil customers to dramatically reduce their purchases of Iranian crude oil. The United States also led a successful international effort to prevent Iran from using currency reserves held within Iran, and to restrict Iran's access to its hard currency reserves held abroad.

The multilateral nature of the sanctions on Iran was also essential to creating powerful constraints on Iran's economy. Policies adopted in the United States complemented (and in some cases prompted) similar measures by the U.N., the European Union, and allies in Asia and the Middle East. These are broadly believed to have brought Iran to the table to negotiate with the international community over its nuclear program. Virtually all multinational commercial actors implemented sanctions against Iran in order to preserve their access to the U.S. economy and to avoid violation of sanctions imposed by the United States, the EU, or at the U.N. The various multilateral and coordinated CEMs contributed to a 6.6 percent drop in Iran's Real GDP in 2012 and a 1.9 percent drop in 2013,³⁰ as well as a decline in the value of its currency of greater than 50 percent from January 2012 to January 2014.³¹ Iran's export of crude oil and condensate decreased from 2.5 million barrels per day to 1.1 million barrels per day from 2011 to 2013.³²

Another fundamental change in CEM design, use, and capacity for economic effect occurred when the United States and its allies developed micro-targeted CEMs in response to Russia's annexation of Crimea and aggression in eastern Ukraine in 2014. American and European officials designed these new "Sectoral Sanctions," adopted in March 2014, to accompany the use of more traditional sanctions in order to target specific individuals

and companies linked to destabilization in Crimea and Ukraine more broadly. These new tools were intended to target certain individuals and types of commercial activity with great precision, while sparing the United States and its allies from collateral economic consequences as much as possible.³³

Policymakers were able to achieve this precision by stopping short of blocking all assets of major Russian banks, energy companies, and defense firms and instead restricting access by these entities to long-term financing in U.S. and European capital markets. These restrictions forced Russian companies to petition the Kremlin for bailouts and crimped their expansion plans.³⁴ For several months, Russia's hard currency reserves depleted at a rapid rate, while the global economy was spared the financial shocks that could have resulted from cutting off large firms entirely.³⁵

These sanctions contributed to a massive economic contraction: Russian GDP is expected to fall by 3–4.5 percent in 2015.³⁶ The value of the ruble plunged 40 percent in 2014.³⁷ Russian President Vladimir Putin also has acknowledged declines in investment in Russia.³⁸ Some estimates of Foreign Direct Investment, for example, put the decline at nearly 70 percent between 2013 and 2014.³⁹ The Sectoral Sanctions program profoundly affected Russia's growth prospects in the medium and longer terms. This is particularly true in its energy sector, due to the specific targeting of this economic arena by sanctions, where frontier energy developments were dealt a very serious blow by restrictions on provision of critical technology, equipment, and services.

These innovations in CEM design and use took place against a backdrop of developments in the world of financial crime and sanctions enforcement that further magnified the effects of the sanctions measures. Specifically, over the last several years, U.S. regulators have imposed a series of civil and criminal enforcement penalties in cases where financial institutions violated sanctions

prohibitions. The first significant enforcement action, involving the Dutch bank ABN Amro, was announced in 2005.⁴⁰ Regulators later reached a \$1.9 billion settlement with the British bank HSBC for violating a range of anti-money laundering prohibitions,⁴¹ and a \$9 billion settlement with the French bank BNP Paribas for violating sanctions pertaining to Iran, Cuba, and Sudan.⁴² Regulators reached settlements with several other banks as well.⁴³

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These settlements created a penumbra of risk around certain kinds of commercial activity and, as a result, international financial institutions have developed a sense of caution regarding dealings that could transgress CEMs or other financial crimes restrictions. In response, and in some measure because of the high costs of creating adequate compliance programs, many banks have begun going well beyond their strict legal obligations so as to manage their sanctions risk exposure.⁴⁴

FUTURE CHALLENGES TO THE USE OF COERCIVE ECONOMIC POWER

CEMs have been more pervasive, innovative, multilateral, and precise in recent years, but their very successes have created uncertainty about whether their use can be sustained. Several cases from the recent history of CEM implementation and enforcement suggest that they are capable of generating significant economic impacts, and that, at least in some instances, these effects have driven the changes in policy that the United States and its allies sought. There is broad agreement, for example, that sanctions motivated Iran to make temporary concessions on its nuclear program and to agree to negotiate with the P5+1 about a long-term deal.⁴⁵ Sanctions on Russia similarly have had a significant economic impact since 2014. But there is disagreement about whether the sanctions have altered President Putin's political decisionmaking or Ukraine strategy. Even if there has been such an effect, there is uncertainty about the degree to which that can be attributed to the imposition of CEMs versus other forms of diplomatic signaling and strategic policy, such as the Minsk agreements, reinvigoration of discussions about NATO enlargement, and the provision of foreign assistance to Ukraine.

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Alongside persistent questions about the efficacy of sanctions and the best ways to calibrate their impact, there are a series of threats to the continuing effectiveness and availability of the sanctions measures themselves. These challenges may take on strategic significance as CEM use rises. As policymakers look to the future and consider ways to manage national security threats, they must confront these challenges with an eye toward preserving CEM tools for future use.

Preserve U.S. Economic Power

For policymakers, preserving the preeminence of the American economy is critical, not only because the lives and well-being of hundreds of millions of people depend on it, but also because the ability of the United States to use economic tools to protect its national security interests is derived directly from its economic primacy.

The features of the U.S. economy that underpin the ability to project power through the financial system include the preeminence of the dollar in global trade and finance, especially in the oil trade, and its attractiveness as a reserve currency. The size of the U.S. financial system, the liquidity of its capital markets, and its dominance of public and private lending for global investment serve as the foundation of U.S. economic strength. As a result of these structural features, nearly every U.S. dollar transaction of consequence, every non-U.S. company with an American bank account or investments, and every U.S. citizen employee, no matter where located, will be subject to U.S. jurisdiction and thus to the reach of CEMs imposed by U.S. policymakers.

A decline in U.S. economic power would undercut the U.S. ability to impose CEMs. There are signs that this process might already have begun. The nature and timing of these changes are extraordinarily hard to predict, and their effects may be non-linear and surprising for U.S. policymakers and economic planners. In the near term, it is

highly unlikely that the dollar will be “dethroned” as the most attractive currency for the oil trade or the international banking system. However, seeking greater global economic influence, China and others are challenging U.S. economic preeminence. For example, China recently announced the launch of the “China International Payment System,” which would make it easier to conduct international banking transactions in Chinese currency and elevate the yuan as a global currency.⁴⁶ China UnionPay, which emerged in 2002, is designed to help internationalize the yuan.⁴⁷ China is also launching the \$100 billion Asian Infrastructure Investment Bank in an attempt to take on a leadership role in public infrastructure lending.⁴⁸

Russia, too, has criticized the role of the U.S. dollar in global markets in the wake of sanctions linked to the Ukraine crisis.⁴⁹ It is not alone in its interest in seeing a basket of currencies replace the dollar in the conduct of some international commercial activity.⁵⁰ Following the imposition of sanctions on Russia in 2014, President Putin complained that “sanctions are . . . undermining the foundations of world trade” and pointed out that “more and more countries are looking for ways to become less dependent on the dollar and are setting up alternative financial and payment systems and reserve currencies.”⁵¹

Prevent Degradation of Sanctions Regimes

Several recent legal and commercial developments are degrading the availability of effective sanctions authorities.⁵² EU policymakers have seen the courts chip away at their sanctions programs in a series of successful recent challenges to EU counterterrorism and counterproliferation sanctions. EU entities have had difficulty maintaining their sanctions programs because of restrictions on their ability to use classified intelligence in judicial proceedings to support their sanctions designation decisions. But a less mature institutional culture devoted to developing and implementing financial sanctions, obligations

derived from the European Convention on Human Rights, and a judicial culture that does not accord as much deference to national security decisions taken by the executive organs contribute to an inhospitable climate toward financial sanctions in the European Union.

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This is problematic for the United States because multilateral cooperation on CEMs, such as parallel blacklisting in multiple jurisdictions, is critical to the success of sanctions in the energy, financial, and other commercial sectors. The erosion of EU sanctions has also made it more difficult for European leaders to develop new conduct-based sanctions programs or to impose restrictions on targets for whom they cannot declassify evidence of illicit activity. The lack of a licensing mechanism to exempt certain activities from the sanctions, or to adjust sanctions measures after they have been imposed, also makes it more difficult for member states to achieve the consensus that is required for the adoption of sanctions measures.

Improving the ability of the EU to maintain effective sanctions programs is critical; otherwise sanctions targets can evade U.S. measures simply by moving their commercial and financial activity to Europe. This will undermine the ability of the United States and the international community to

use financial sanctions for strategic purposes. The response to this problem has, thus far, focused too narrowly on evidentiary issues.⁵³ Policymakers should also consider broadening their focus to the institutional challenges sanctions reform efforts pose to national security interests. It will be important in this regard to develop and present potential reforms to the European Council and European Commission that could allow the EU to maintain an effective financial sanctions program that goes beyond the limited mechanisms for review of confidential information adopted in the European Court of Justice earlier in 2015.⁵⁴ But EU hostility to financial sanctions, which are understood as preventative measures imposed on individuals or entities based on less evidence than would be needed to secure a criminal conviction, might limit the change that is possible on the basis of policy reforms alone.⁵⁵

Another significant contributor to the degradation of sanctions regime effectiveness is the increasing tendency of major global financial institutions to withdraw from certain business in order to steer clear of sanctions risk and to minimize the cost of compliance programs. These “de-risking” practices may magnify the intended economic impact of sanctions, but they also have negative unintended effects on the ultimate reach of CEMs.⁵⁶ If international banks were to cease activities in high-risk jurisdictions such as Pakistan or Somalia, it would limit the ability of policymakers in the United States and Europe to target illicit activity in these jurisdictions via the formal financial system. This would limit the U.S. government’s ability to impose CEMs with the desired precision. A negative consequence of de-risking includes humanitarian concerns, such as the impact on financial inclusion for populations of these jurisdictions and an increased difficulty in sending home remittances from abroad.⁵⁷

Calibrate the Effects of CEMs

Given the difficulty of modeling and evaluating the impact and effectiveness of CEMs before they are implemented, policymakers risk over-using or under-using specific CEMs to shape policy outcomes. The relationship between the economic effects observed in sanctions cases and their political impact is highly variable and in general poorly understood. For example, while the Russia Sectoral Sanctions program was effective in creating significant economic effects, there is disagreement about whether this has influenced President Putin's cost/benefit calculations. It is extremely difficult to predict the future impact of that program on Russian capital markets, energy production, and on future Russian decisionmaking. Banks and oil companies targeted by these sanctions and trade restrictions, as well as their international partners, will all react to the sanctions in different ways. In turn, these responses will shape the future price of oil and the state of Russia's foreign currency reserves. Policymakers in the United States and the EU have limited knowledge of these high-stakes commercial decisions and there are few formal channels for information-sharing and feedback on how their policies are shaping the international financial architecture. This makes it very difficult to anticipate and calibrate the effects of sanctions or to match objectives of CEMs to effects and outcomes.

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Integrate CEMs into Broader Security Policy

Determining how to balance the use of CEMs with other national security measures, such as military force and diplomatic engagement, to achieve sustainable and effective results is a unique challenge and woefully understudied by policymakers and other stakeholders. It is essential, however, to appropriately target these tools to the policy objectives and effects that government officials seek. Over-compliance or aggressive de-risking by banks can cause unanticipated effects, which will require policymakers to coordinate and adjust the use of CEMs. Furthermore, given the extended period of time it can take for CEMs to generate an impact, banks and companies may reorganize their transactions and operations to avoid the effects of sanctions. It may therefore be appropriate to consider – and to communicate both to the public and the targets of CEMs – a more nuanced integration and pacing of the imposition of various security tools.

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Another challenge for integrating economic tools into broader security strategies is the coordination of various policymakers with authority in this domain. A number of different actors may be involved in sanctions implementation and enforcement in state and federal agencies, in the executive

and legislative branches of government, and in both the United States and abroad. The more these various officials coordinate their CEMs development and enforcement strategies, the more effective the measures can be. Furthermore, the way in which they make this coordination clear to the public will also be a fundamental metric of sanctions' effectiveness. Lack of coordination between policymakers and regulators, as in the Standard Chartered Bank case,⁵⁸ will have the effect of keeping the private sector far away from sanctioned entities. Private civil litigation relating to sanctions issues also shapes the ways in which banks manage risk with respect to their exposure to illicit financial activity.

While increasing the risk of doing business in a sanctions-heavy environment may be desirable from a public policy perspective, in certain circumstances it will make it very difficult to unwind sanctions if and when it becomes necessary to do so. When policymakers want to lift CEMs to facilitate normalization and economic reintegration, regulators must take a coordinated approach; otherwise, private sector actors may not reengage in previously prohibited business, which will undermine the policy goals of the CEMs.

Withstand Retaliation

A further challenge to the availability and continued effectiveness of CEMs includes the risk that targets may pursue retaliatory actions. For example, Iran and North Korea have conducted cyber attacks to attempt to retaliate for American financial coercion, as well as to manipulate U.S. decisionmaking.⁵⁹ Many observers are concerned that targeting Russia, a large and powerful economy, could result in similar retaliation.

Should future coercive economic measures directly target China, the United States will need to strengthen its defenses against anticipated countermeasures. Such countermeasures might be symmetrical, but might also include, for instance,

imposition of regulatory or other penalties on U.S. businesses operating in China, more disruptive cyber attacks on U.S. businesses than we have seen to date, or other threats to U.S. interests deriving from China's status as the United States' largest foreign creditor. Devising ways to protect American companies and increase the resiliency of the U.S. financial system is, therefore, fundamental to promoting U.S. national security and guarding against negative impacts from the "rise of the rest."⁶⁰

Challenges of Reintegration

One of the main purposes of CEMs is to induce a change in behavior. This requires clear criteria for removing these measures when an adversary complies with the demands of the policymakers imposing the CEMs. To paraphrase Thomas Schelling, "To be coercive, [pressure] has to be anticipated. And it has to be avoidable by accommodation."⁶¹ Many prior sanctions programs have suffered from too many competing objectives as the basis upon which sanctions were applied. The result is that there is no clear path for removal and no incentive or guidance for the target to change behavior. The Iran case offers a version of this problem; sanctions and trade controls have been imposed for a wide variety of

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objectionable Iranian activities. Stakeholders now have deep disagreements about which CEMs should be removed in exchange for Iran's nuclear concessions, although there is consensus that sanctions imposed because of Iran's support for terrorism and regional destabilization and its record of human right abuses will remain in place. The nature and sequencing of sanctions relief has thus become a critical part of the ongoing negotiations over Iran's nuclear program.

As a clear counterpoint to the problem of excessive objectives, there are examples of circumstances under which the United States established relatively clear criteria for the removal of CEMs and then, by and large, removed them when the criteria were met. Such examples include the removal of some of the sanctions on Myanmar (Burma) in 2012, the rollback of some sanctions on Libya after it abandoned its nuclear program in 2003 and others after its revolution in 2011, and the removal of sanctions after South Africa abandoned apartheid in 1993.⁶²

PRINCIPLES FOR SUSTAINED EFFECTIVE USE OF COERCIVE ECONOMIC POWER

Officials and legislators must address the challenges associated with the use and availability of CEMs so that these critical national security tools remain available and effective. The effort to do so will require changes to the development and implementation of CEMs, both substantive and procedural in nature. This policy brief does not attempt to offer specific policy recommendations to address each of these challenges. Rather, as an initial step toward such an effort and to organize the scope of further work, this brief offers several principles for the use of CEMs that are critical to their sustained effectiveness. Subsequent CNAS publications on the coercive tools of economic statecraft will treat these issues in greater depth.

Officials and legislators must address the challenges associated with the use and availability of CEMs so that these critical national security tools remain available and effective.

Key principles for sustained effectiveness of CEMs Include:

CALIBRATE EXPECTATIONS

CEMs are generally not intended or expected to achieve decisive outcomes on their own. They cannot by themselves force an adversary to capitulate. They are tools of risk management, and as such, should be a part of a broader national security strategy to address a particular problem. Expecting too much, too fast, from sanctions and related measures may lead to disappointment and to ineffective strategy.

ENSURE MULTILATERAL COORDINATION

To achieve broad effects and minimize the potential for circumvention, policymakers must coordinate CEMs with the broadest possible coalition of international allies. This coordination often should include a U.N. Security Council resolution, which will offer greater legitimacy for use of this tool and can help to address U.S. allies' concerns over consequences.

ALIGN ENDS AND MEANS

CEMs should be imposed when they can create incentives for the target to change its behavior. Generally, they should be temporary and removable. Amassing too many or competing goals when imposing CEMs may make it difficult for the target

to understand exactly what it must do to avoid consequences, which would undermine or eliminate the incentive to cooperate. Policymakers and regulators should coordinate, especially on public signaling, to achieve the desired end state.

MODEL, ANTICIPATE, AND MANAGE UNINTENDED EFFECTS

Policymakers should seek all available opportunities to understand the effects of CEMs through economic modeling and information sharing with private-sector compliance officials and enforcement authorities. Communicating with businesses and banks clearly about what is allowed and what is not will help policymakers to calibrate effects and to determine the right time and conditions for removal of the sanctions.

STAY A STEP AHEAD

Imposing CEMs invites illicit actors to seek opportunities for circumvention and cheating. The solution is to try to prevent these efforts before they occur. Keeping the U.S. economy stronger and more resilient than those of competitors will keep CEM tools sharp and available as a credible deterrent against acts of retribution by adversaries.

GO ON THE DEFENSIVE

Shoring up the integrity of CEMs against court challenges is crucial to help ensure that they remain effective. So too is the need to prepare for the likelihood that other states will seek to target the economic interests of the United States and its allies to achieve political objectives. Policymakers must be sensitive to U.S. vulnerabilities and plan for the day when adversaries attempt to exploit them.

CONCLUSION

There is now a broad consensus that the tools of financial warfare will form a central part of the national security arsenal of the United States and its allies into the future. Policymakers have expanded the kinds of conduct targeted by coercive economic measures over the last several years and have generated substantial innovation in the types of tools available to do so. The tools of economic warfare will only be credible if policymakers ensure that the measures themselves are kept nimble and innovative, and that the underlying strength of the U.S. economy is never in doubt.

CEMs will be most effective when the goals they seek to achieve are clearly defined and their use is integrated with broader strategic approaches to particular policy problems. Policymakers should elevate their analytical understanding and strategic approach to CEMs. They must make investing in the long-term integrity and availability of these tools a top priority by addressing these challenges systematically, seeking always to preserve the structural features of the international economic system from which the United States and its allies derive their strength. In this manner, they will ensure availability and sustainability of these tools to address the security challenges of tomorrow.

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