



# THE NEW TOOLS OF ECONOMIC WARFARE

Effects and Effectiveness of Contemporary  
U.S. Financial Sanctions

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### Cover Photo

While sanctions as a policy tool have evolved, the framework to determine their effects, evaluate their effectiveness, and minimize their unintended consequences has not kept pace. As a result, sanctions have not been integrated into a strategic approach to solving foreign policy problems. This paper begins to bridge these gaps. (Adapted from Flickr)

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# **EXECUTIVE SUMMARY**

In the post-9/11 era, targeted financial sanctions have moved to the center of our national security discussion in a range of contexts. From the fight against terrorism to the struggle against the proliferation of weapons of mass destruction and territorial aggression, sanctions are often the tool to which U.S. policymakers turn first in responding to crises and managing threats on an ongoing basis. But as rapidly as the tools themselves have evolved, the framework for determining their effects, for evaluating their effectiveness, and for minimizing unintended consequences has lagged behind. The result is that financial sanctions often have not been integrated into overall strategic approaches to foreign policy problems.

This paper begins to fill those gaps. It first presents new research and data evaluating the effects of U.S. sanctions imposed on states. We demonstrate that, contrary to popular wisdom, 21st century sanctions do not have a significant effect on the GDP of target countries. They do, however, have a powerful impact on foreign investment, corruption, ease of doing business, governance, and other measures of a country's hospitality to engagement with the international financial community. It is substantially more difficult to measure the effects of sanctions on non-state actors such as narco-traffickers, terrorists, and cybercriminals because they operate clandestinely. Data on the balance sheets of terrorist groups or drug cartels generally isn't available, making the kinds of analysis we present with respect to states impossible to perform for non-state actors. Nevertheless, anecdotal evidence and repeated initiatives at every level of the international community serve as evidence that sanctions are having an impact there too.

The data we present on the effects of sanctions on states lead us to a series of conclusions about their effectiveness, which can be considered using three general criteria: (1) the ability to meaningfully shape the political environment and balance of political leverage, including through changed economic circumstances; (2) catalyzing relevant communities (domestic or international) to concerted action, including by messaging with respect to sanctions targets; and (3) achieving discrete political objectives in support of overall U.S. policy goals. Not all of these will be relevant to each case, but as a general matter these criteria should shape the development and deployment of U.S. sanctions in the future.

Effective sanctions policy also must take into account the negative effects that have emerged from the policy and enforcement landscape in the last several years. Phenomena like de-risking and efforts by countries like Russia and China to develop alternatives to the U.S. dollar-denominated foundations of the international financial system remind us that the size, liquidity, and integrity of the U.S. financial system are among the United States' most important strategic assets, including in the deployment of sanctions. As U.S. and allied policymakers develop sanctions policy, the structural features of the international financial system that have made sanctions such a potent weapon to this point should be front of mind.

We conclude by recommending a series of adjustments to the architecture of financial sanctions: greater coordination within the U.S. government, between federal, state, and local entities with jurisdiction over sanctions issues, and among America's allies; an improved framework for communicating and collaborating with the private sector; and greater integration with overall strategic objectives. Only then will the next generation of development in financial sanctions policy and practice be as successful as the last.

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# **INTRODUCTION**

The United States has had a long history with economic coercion, and in the years since 9/11, financial sanctions in particular have taken on a prominent role in the national security strategy of the United States and its allies. This era saw a remarkable expansion in the use of financial sanctions as a policy tool, and substantial innovation in the types of sanctions tools policymakers deployed to counter security threats. But central questions remain about the appropriate role and application of sanctions of various kinds – trade, financial, economic, and others. How can we measure the effects of sanctions with confidence? How can we anticipate and account for their unintended consequences? How do we translate an understanding of the effects of sanctions into improved effectiveness? And how can we translate these understandings into a refined strategy for when sanctions should be employed and when they should not be employed? This paper will pursue those questions, situated in the historical context of the post-9/11 evolution in sanctions policy and practice.

American policymakers used sanctions to advance political goals from the relatively early days of the Republic. In December 1807, with the strong support of the Jefferson administration, Congress passed the first American sanctions in the form of the Embargo Act. The law barred most trade with Great Britain and France to punish them for seizing American ships and impressing American sailors during the Napoleonic Wars. Unfortunately for the United States, the coercive effect of the Embargo Act was minimal. The sanctions hurt the U.S. economy at least as much as the British and French economies.<sup>1</sup> Neither country made any political concessions. Congress, frustrated by the self-inflicted cost and ineffectiveness of the sanctions, repealed the Embargo Act less than 18 months later.

Fast forward two centuries: The globalization of commercial markets, the spread of global finance and the desire for non-military options to protect American interests and advance U.S. global leadership have generated considerable innovation in the use of coercive economic measures. Proliferating transnational security threats, most pointedly highlighted by the 9/11 terrorist attacks, as well as the resurgence of great power competition also have driven a rapid recent push to use sanctions as a policy tool. Jeffrey Schott, who advises the State Department on economic statecraft, has described the evolution of their use as “from a sort of undergraduate sanctions approach to a postgraduate, where the sanctions are much more potent.”<sup>2</sup>

Nor is this merely the view of outside observers. In December 2014, David Cohen, then Under Secretary for Terrorism and Financial Intelligence, said, “compare, for example, Jefferson’s failure [of the Embargo Act] to our ongoing efforts to use sanctions to prevent Iran from obtaining a nuclear weapon. Together with partners around the world, we have imposed what many believe is the most effective set of financial and economic sanctions in history.”<sup>3</sup>

***The United States has had a long history with economic coercion, and in the years since 9/11, financial sanctions in particular have taken on a prominent role in national security strategy.***

The recently implemented Iranian nuclear deal offers some evidence that modern sanctions have a coercive impact. Observers also have given economic sanctions some credit for the ongoing democratic transition in Myanmar, as well as Russia’s economic woes.<sup>4</sup> Sanctions also play an important and prominent role in the 2015 U.S. *National Security Strategy*.<sup>5</sup> According to this new policy consensus in Washington, sanctions are one of the United States’ most potent and cost-effective tools for advancing foreign policy and national security objectives.

Despite this newfound enthusiasm for using the coercive tools of economic statecraft, questions remain about the utility and sustainability of economic sanctions as currently practiced, and about the role that they can and should play in national security strategy. Some scholars and practitioners are skeptical that sanctions are as potent or as effective as the conventional wisdom claims. Other observers are concerned about the negative externalities that sanctions can generate. And policymakers have publicly articulated concerns about the negative long-term consequences of financial sanctions on American predominance in global financial markets. Could economic sanctions cause greater harm than good?

The continued debate about the role and effectiveness of sanctions revolves around two central axes, which this paper treats in depth. The first is how to measure both the effects and effectiveness of sanctions. Discussions of the effects of sanctions seek to capture the real-world impact that particular measures have had on the targets.

This paper presents new research to suggest that U.S. sanctions targeting states have significant negative effects on foreign investment, corruption, ease of doing business, and other related measures in target states. These findings challenge widespread understandings of the impact that sanctions against states have had and provide principles for designing more effective sanctions programs in the future – programs that better advance security interests and policy objectives. We also discuss the ways in which the effects of sanctions aimed at non-state actors, particularly counterterrorism sanctions, are more difficult to measure but nonetheless are impactful.<sup>6</sup> While data about the impact of sanctions on illicit non-state actors is not available because these groups operate clandestinely, anecdotal evidence suggests their effect.

All sanctions programs are not designed with the same objectives in mind, and it is important to note the different strategic logics that may underlie the imposition of targeted sanctions in order to evaluate their effectiveness. When targeting states, coercive economic measures work primarily through *compellence*: punishing an actor to the point where the target reconsiders the costs and benefits of its problematic policies or activities. Such sanctions usually have an explicit quid pro quo, as the nuclear agreement with Iran illustrates. Compellence involves implicit or explicit bargaining and negotiation: The states imposing sanctions are effectively saying, “Change this policy, and we will stop imposing sanctions on you.”<sup>7</sup> And, as in the case of Russia/Ukraine sanctions and Iran sanctions, they often are imposed based on concerns about various state-sponsored behaviors (proliferation, territorial aggression, support for terrorism, denial of human rights) and in parallel with ongoing diplomatic processes designed to resolve conflicts and to add leverage to the negotiating dynamics.

***U.S. sanctions targeting states have significant negative effects on foreign investment, corruption, ease of doing business, and other related measures in target states.***

In the case of sanctions that target non-state actors like al Qaeda or Hezbollah, by contrast, financial sanctions work primarily through *denial*: preventing terrorists from using the financial system to advance the interests of the state imposing sanctions.<sup>8</sup> Such sanctions are designed to force behavior change by leaving no

alternative, and to constrain the target’s ability to achieve its objective. These sanctions generally carry no explicit quid pro quo; there is no bargaining with al Qaeda or the Islamic State of Iraq and Syria (ISIS) to receive relief, as there is no diplomatic process.

However, the distinctions between sanctions designed to compel and sanctions designed to deny or contain do not cleanly map onto the distinction between sanctions targeting states versus non-state actors. Sanctions against Iran, for example, were designed both to incentivize it to engage in good faith negotiations with the international community and to deny it access to the financing it needs to acquire goods and services related to its nuclear and ballistic missile programs and to sponsor acts of international terrorism. So too can sanctions against non-state actors – like narco-traffickers or terrorists – be designed to deter some actors, particularly the financiers and facilitators these groups require, from providing them with support. Sanctions are also used to stigmatize and/or deter undesirable behavior depending on the circumstances.

The point is that sanctions can be used to achieve different strategic objectives, and policymakers should keep these differences in mind when designing sanctions programs and selecting sanctions targets.

Beyond evaluating the effects and effectiveness of sanctions, our second main objective in this paper is to achieve a more nuanced understanding of the role that sanctions can play in national security strategy. We will discuss how policymakers can best use sanctions to shape the outcome of a particular strategic challenge and the diverse strategic roles that sanctions can play. Sanctions are, in this understanding, another lever of influence over a target – another way of manipulating its cost/benefit calculations or denying the target access to something it needs in order to achieve a desired outcome. Their potential use in any given situation must be balanced against the negative outcomes anticipated from their use and the likelihood that they will contribute, in concert with other measures, to the desired objective. To advance the effectiveness of sanctions and mitigate negative effects on the target, on the United States, and on the U.S. financial system, this paper will offer policy recommendations for decisionmakers.

In subsequent chapters the paper will describe briefly the evolution of targeted sanctions in the last two decades and then introduce new statistical results about



the effects of sanctions targeted against nation-states. The core finding is that sanctions have an important impact on measures of corruption, attractiveness to foreign investment, and other governance indicators. The paper will then focus on the effects of sanctions targeted against non-state actors, notwithstanding the fact that the absence of reliable data about the financial condition of non-state actors makes measuring the effects and effectiveness of sanctions substantially more difficult. The report concludes by highlighting some of the negative and unintended effects of the ways in which sanctions have been used in the post-9/11 era and by offering recommendations on the ways in which policymakers should implement sanctions strategy moving forward.

***Sanctions can be used to achieve different strategic objectives, and policymakers should keep these differences in mind when designing sanctions programs and selecting sanctions targets.***

Given how prominent sanctions have become as a foreign policy tool in recent years, and the pervasive public narratives about their effects or utility that lack empirical grounding or analysis, the research and findings laid out in this paper are particularly important to the public debate. The statistical findings presented in this paper constitute a major update to the scholarly work on effects of sanctions and bring policy-relevant analysis into the contemporary global affairs context. For current decisionmakers, as well as the candidates who will be elected in 2016 to formulate the foreign policy of the next White House and Congress, we hope that our recommendations for how to use sanctions in the future will be a valuable guide to avoid sanctions pitfalls of the past and to carry this set of coercive economic tools into the market and security conditions of the future.

# **01 CHAPTER**

## **The Contemporary Sanctions Landscape**

## The Turn to Targeted Sanctions

Just before the dawn of the 21st century, there seemed to be a strong policy consensus in Washington about economic sanctions: They didn't work.<sup>9</sup> A wide swath of policymakers and experts had internalized the hard lessons of the post-1991 Iraq sanctions.<sup>10</sup> Indeed, a powerful motivation behind the 2003 invasion of Iraq was the widespread, albeit mistaken, belief that the U.N. sanctions regime had failed to prevent Saddam Hussein from acquiring weapons of mass destruction.<sup>11</sup> The most widely-cited paper on economic sanctions in the 1990s was entitled, "Why Economic Sanctions Do Not Work," in which the author claimed that sanctions worked only 5 percent of the time.<sup>12</sup> Richard Haass decried "sanctioning madness" in the pages of *Foreign Affairs*. A Heritage Foundation backgrounder concluded in June 1997 that "historically, economic sanctions have a poor track record." Vice President Richard Cheney, before he became the vice president, penned a book chapter stressing the futility of economic sanctions.<sup>13</sup> By 2000, the policy consensus seemed remarkably clear: Economic sanctions were useless.

Over the past 15 years, the conventional wisdom inside the Beltway on sanctions has reversed itself. As the sanctions tool has evolved as an instrument of statecraft, many current and former officials now are wildly enthusiastic about economic sanctions. The economic effects of targeted sanctions on Iran and Russia have not gone unnoticed by policymakers in Washington. Juan Zarate, a former deputy national security advisor, argues that "the United States can call upon these techniques to confront its most critical national security threats." In 2014, a U.S. assistant secretary of the treasury publicly bragged to *Newsweek* that because of sanctions, the Treasury Department was now "at the center of our national security."<sup>14</sup> And indeed, one of the principal conservative criticisms of the 2015 Iran nuclear deal was that the sanctions were powerful enough to extract even more concessions from Tehran. The policy consensus seems remarkably clear: Economic sanctions are a powerful tool to advance American interests.

What changed over the past 15 years? The answer is that what "economic sanctions" means to policymakers has changed dramatically. Nowadays, economic sanctions are associated with targeted financial measures. This was not always the case.

Targeted financial sanctions emerged from an evolutionary policy process designed to address two different



President Hassan Rouhani meets Yukiya Amano, Director General of the International Atomic Energy Agency, in Iran following conclusion of a historic nuclear deal in July 2015. The United States has increasingly incorporated sanctions into its broader security strategy and succeeded, along with counterparts at the United Nations, in coercing Iran to abandon its nuclear weapons program as part of the 2015 nuclear deal. (Wikimedia Commons/Mahmood Hoseini)

problems that vexed American policymakers. The first problem was devising sanctions that mitigated the negative effects that came with comprehensive trade embargoes. The most well-known 20th-century sanctions cases were *trade sanctions*, and those embargoes often created negative side effects. The U.N. Security Council sanctions imposed on Iraq in the 1990s highlighted the problem. These measures were designed under a "brute force" theory of sanctions that assumed the greater the economic costs imposed on the target, the more likely the sanctions would lead to political concessions. Measured in terms of cost, these sanctions were, by far, the most comprehensive in history. According to one estimate, the pre-Gulf War trade sanctions cost Iraq half of its GDP.<sup>15</sup> The post-Gulf war sanctions were estimated to have cost Iraq between \$175 billion and \$250 billion in possible oil revenues.<sup>16</sup>

The comprehensive embargo was truly crippling in its economic and humanitarian effects. The price for a family's food supply for a month increased 250-fold over the first five years of the sanctions regime.<sup>17</sup> A related policy problem was the link between trade sanctions and the spread of corruption, as the U.N.'s oil for food scandal in Iraq made clear.<sup>18</sup>

***A powerful motivation behind the 2003 invasion of Iraq was the widespread, albeit mistaken, belief that the U.N. sanctions regime had failed.***

The blowback from the Iraq case, as well as other developments in the sanctions world,<sup>19</sup> led to a movement to devise policy alternatives to traditional trade sanctions. This impulse dovetailed with research suggesting a new way to think about coercive economic measures. Scholars argued that sanctions targeted specifically at key elites could be both more fruitful and more compassionate.<sup>20</sup> These scholarly developments paralleled the development of sanctions authorities in the United States in the 1990s that targeted narco-traffickers destabilizing Colombia and terrorist groups destabilizing the Middle East Peace Process.<sup>21</sup> In theory, such so-called *smart sanctions* would inflict costs on the target regime and its supporters (or targeted groups) while sparing the collateral damage that often came with trade embargoes. The most prominent examples of smart sanctions included asset freezes, travel bans, restrictions on luxury goods imports, and arms embargoes. Advocates also lobbied for the narrow targeting of individuals, corporations, or holding companies associated with the target government's leadership. Smart sanctions therefore would hamper the ability of leaders to offer crucial supporters rent-seeking opportunities.

The trouble with smart sanctions was that they seemed to be less successful at generating policy concessions than traditional trade embargoes, apparently because they did not impose significant costs on the target economy. In their edited volume on the topic, David Cortright and George Lopez wrote that "the obvious conclusion is that comprehensive sanctions are more effective than targeted or selective measures. Where economic and social impact have been greatest, political effects have also been most significant."<sup>22</sup> Another scholarly analysis concluded: "[T]he optimism

expressed in some academic circles and among decisionmakers at national and international levels appears largely unjustified."<sup>23</sup> Subsequent research into particular forms of targeted sanctions, aimed not just at regime elites but at any discrete individual or entity engaged in illicit behavior, were consistent with these initial assessments.<sup>24</sup>

The partial exception to this assessment came from *financial sanctions*. Financial sanctions are targeted financial restrictions designed to impede access to global banking activity and capital markets, particularly financial assets held outside the target countries. Financial sanctions existed during the Cold War era and prior; indeed, those measures were more effective and of shorter duration than trade sanctions.<sup>25</sup> At the turn of the century, the threat of targeted financial sanctions was also useful in coercing countries into changing their anti-money laundering rules.<sup>26</sup> In contrast to other variants of targeted sanctions, financial sanctions imposed significant costs on target economies.<sup>27</sup>

Imposing costs on target economies has not been simply a function of the target economies possessing sophisticated financial service sectors. Targeted financial sanctions also have affected less financially developed economies, such as Somalia, Sudan, or Zimbabwe, and they have enjoyed a boost from a few key exogenous factors. As Zachary Goldman and Elizabeth Rosenberg note, "[T]hese innovations in [coercive economic measures] 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."<sup>28</sup>

***Financial sanctions created significant incentives for third parties to abide by sanctions or risk severe consequences.***

Another way that financial sanctions seemed different was that they created significant incentives for third parties to abide by the sanctions or risk severe consequences. As previously noted, with trade sanctions, the incentive to act illicitly is considerable. With financial sanctions, the calculation of costs and benefits for the third parties (such as banks) that would facilitate circumvention changes because of the likelihood that doing so will subject those third parties to enforcement actions. By any metric, the United States has been the undisputed financial hegemon, and international

financial actors need access to U.S. capital markets – and U.S. dollars – to conduct cross-border transactions. This access matters more to banks and non-bank financial actors than the potential profits from violating U.S. regulations. Once banks factor in the potential implications of getting caught, the sanctions-busting incentive is much lower. In recent years the Justice Department, Treasury Department, and other regulatory bodies have fined BNP Paribas, HSBC, Credit Suisse, Barclays, Standard Chartered, and other financial institutions more than \$11 billion combined as a result of plea or settlement deals.<sup>29</sup> Banks are concerned about the reputational and financial costs of being prosecuted for violating sanctions. Additionally, the Department of Justice has prioritized holding individuals accountable for corporate misconduct to deter future illegal activity and provide incentives for changes in corporate behavior.<sup>30</sup> In 2014, the Department of the Treasury settled a civil liability case with Fokker Services B.V. for over 1,150 alleged violations of U.S. sanctions on Iran and Sudan. The settlement called for the payment of a \$10.5 million penalty to Office of Foreign Assets Control

(OFAC) and the Department of Commerce’s Bureau of Industry and Security, as well as a forfeiture of an additional \$10.5 million in an agreement reached with the Department of Justice’s U.S. Attorney’s Office for the District of Columbia.<sup>31</sup>

Not surprisingly, U.S. policymakers across the political spectrum have embraced sanctions warmly during the 21st century, particularly in recent years.<sup>32</sup> In the 2010 U.S. National Security Strategy, sanctions were mentioned only once and in passing. Sanctions are mentioned nine times in the *2015 U.S. National Security Strategy* in which they are a lynchpin: “[T]argeted economic sanctions will remain an effective tool for imposing costs on irresponsible actors and helping to dismantle criminal and terrorist networks.”<sup>33</sup>

Table 1 explains the different types of sanctions used by the United States through the years. Targeted financial and sectoral sanctions combine the narrower focus of smart sanctions with the greater costs to the target of trade sanctions.

**TABLE 1**  
**A TYPOLOGY OF U.S. SANCTIONS**

TYPE		DESCRIPTION	PERCEIVED PROS	PERCEIVED CONS
<b>TRADE SANCTIONS</b>		Curtail cross-border investment and trade of goods and services	Maximizes economic effect on target country	Negative effect on civilian population; easier to circumvent
<b>TARGETED SANCTIONS (AKA SMART SANCTIONS)</b>	<b>FINANCIAL</b>	Disrupt ability of individual or entity to access international financial system, rather than target economy as a whole	Maximizes effect on target; strong private sector participation amplifies economic and commercial effects and deters evaders and violators	May undermine dollar’s status in international financial markets; may have an impact on uninvolved third parties
	<b>NON-FINANCIAL</b>	Disrupt travel and visa rules for individuals	Minimizes collateral damage; narrow focus maximizes chances of multilateral cooperation	Lack of clear success at generating concessions; questions about due process rights of target
<b>SECTORAL SANCTIONS</b>		Prohibit specific transactions with specific economic sectors, rather than target the economy as a whole	Minimizes collateral damage; narrow focus maximizes chances of multilateral cooperation	Lack of clear success at generating decisive outcomes

## Contemporary Critiques of Sanctions

There are a number of negative side effects and critiques of modern smart sanctions that dampen the enthusiasm for this policy tool. These side effects and the critiques of the new sanctions landscape associated with them are different from those of a generation ago, which focused predominantly on the humanitarian impact of the types of comprehensive trade sanctions that were deployed most prominently against Iraq in the 1990s. The scholarly, commercial, and policy communities have advanced three main critiques of the current use of economic sanctions. They include the charge that sanctions cannot change behavior; that they have been too generously credited with success; and that they have substantial collateral costs that are undermining the preeminence of the U.S. financial system.

***[There] are three main critiques of economic sanctions: they cannot change behavior; they have been too generously credited with success; and they have substantial collateral costs.***

To begin with, some outside observers remain skeptical that any form of economic coercion can yield significant political concessions.<sup>34</sup> Even in a world of targeted financial sanctions, it is still possible for third-party “black knights” to circumvent such measures. According to this logic, scholars and policymakers have exaggerated the success of sanctions. As one Iran expert recently observed about that case, “Thirty-six years of sanctions did not lead to regime change; they did not drastically alter, but even worsened, Iran’s regional conduct. Reversing this trend will likely require engaging and inducing Tehran with fewer sticks and more carrots.”<sup>35</sup>

Similarly, Russia’s and Iran’s recent economic pain while under sanctions might be due as much, or more, to the 2014 collapse in oil prices and significant domestic economic mismanagement as the sanctions themselves.<sup>36</sup> Some scholars argue that analysts have failed to properly assess the actual cost of sanctions imposition versus other factors, leading researchers to “use more readily available aggregate measures that ... tend to exaggerate the apparent effectiveness of sanctions.”<sup>37</sup> Other research suggests that over time, the effect of economic sanctions on cross-border exchange wears off as firms adjust to the “new normal.”<sup>38</sup> Indeed, measuring the deterrent effect of economic sanctions is a difficult task, and the scholarly evidence on this question is decidedly mixed.<sup>39</sup> Perhaps the assertions that modern sanctions have greater potency have been exaggerated.

A second line of criticism agrees with Beltway optimists about the real-world impact of sanctions, but argues that policymakers and scholars have neglected the negative second-order and third-order effects of sanctions. As Peter Feaver and Eric Lorber argue, “[W]hile these sanctions can have significant economic impacts, policy makers overestimate their ability to calibrate and control these tools of economic statecraft.”<sup>40</sup> Sanctions scholars argue that even targeted measures can have long-lasting effects on the targeted economies. Especially in cases like Iran, sanctions measure upon sanctions measure accumulated to the point where they looked comprehensive in scope. The effects of economic sanctions on corruption, authoritarianism, and human development can be significant. And each of these effects can create policy problems down the road.

A related problem is ensuring that the lifting of economic sanctions brings about rewards for a change in behavior. In theory, sanctions work because private-sector actors are deterred from doing business in the target country. But private-sector actors may anticipate the recurrence of sanctions against longtime adversaries of the United States. Merely lifting sanctions might not ameliorate those concerns. The cases of Iran and Myanmar offer cautionary tales. In the case of Myanmar, fear of sanctions

re-imposition and residual concerns about corruption and money laundering have dampened the prospects for robust bilateral trade between the United States and Myanmar.<sup>41</sup> As for Iran, the available evidence suggests that Tehran did not reap significant benefits from the sanctions relief enacted in late 2013 under the interim nuclear deal.<sup>42</sup> Contrary to myriad public claims, the implementation of the Joint Comprehensive Plan of Action (JCPOA) did not lead to a \$100-\$150 billion immediate windfall for the Iranian regime and a rapid, groundswell of new investment revenue.<sup>43</sup> While the lifting of legal restrictions attendant with sanctions was sufficient to incentivize Iran to agree to a nuclear deal with the international community, the long-term viability of the deal remains uncertain.

A third and final strain of criticism focuses on the long-term effects of economic statecraft on American financial power.<sup>44</sup> A key reason for the perceived success of financial sanctions is the centrality of the United States to global capital markets.<sup>45</sup> A decline in either the relative size of American capital, debt, and commercial markets or the dollar's status as the global reserve currency would erode the utility of financial statecraft. Political risk analysts have predicted that this "weaponization of finance" could trigger a politically motivated diversification away from U.S. capital markets and the dollar.<sup>46</sup> Indeed, this contingency has been the subject of widespread speculation among policy analysts.<sup>47</sup> Policy principals have also acknowledged this problem. During the congressional battle over the Iran nuclear deal, both the secretary of state and the secretary of the treasury warned that rejection of the deal could threaten the dollar's status.<sup>48</sup> President Obama did the same, saying that rejecting the deal would "raise questions internationally about the dollar's role as the world's reserve currency."<sup>49</sup>

Diversification away from the dollar has also been the subject of discussion by the leaders of states that have been targeted for sanctions. After experiencing Western-based financial sanctions for a few months, Russian president Vladimir Putin called upon the other leaders from the BRICS (Brazil, Russia, India, China, South Africa) grouping of developing economies to develop "a system of measures that would help prevent the harassment of countries that do not agree with some foreign policy decisions made by the United States and their allies."<sup>50</sup> A few months later, Putin explicitly warned the United States about the blowback of sanctions on the dollar's status, and China has created alternative payment systems, the effect of which over time may be to erode the dollar's dominance (see below for additional discussion of this trend).<sup>51</sup> As Washington continues to use its financial muscle to impose sanctions, even close allies are beginning to question whether the United States is abusing its hegemonic privileges.<sup>52</sup> U.S. policymakers themselves have admitted in public and private that the strategic blowback from excessive use of sanctions is a growing concern.<sup>53</sup>

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## **02 CHAPTER**

# **New Data on the Effects of Sanctions Targeting States**



What are policy leaders to make of the enthusiasm for the targeted sanctions implemented in the last 15 years on the one hand, and some of the concerning critiques about their effects and utility on the other?

What lessons are they to draw about when sanctions, an increasingly integral element of U.S. security strategy, work and how to contemplate the costs and benefits of using them? These questions are central to the defense, security, and commercial communities. However, the policy discussion of such questions suffers from inadequate empirical analysis.

As a contribution to the policy debate about the role of sanctions, and to test some of the contemporary claims and counterclaims regarding the use of U.S. economic sanctions since the September 11 terrorist attacks in 2001, we conducted original quantitative research on the effects of sanctions. We chose to evaluate states targeted by sanctions and compiled a data set that compares such countries with “peer economies” that share similar regional, economic, and political profiles. Each sanctioned country then was compared with its peer group to see if sanctions imposition has significant effects on the target’s economy and polity. We designed this methodology, which is discussed in detail below, to help contemporary scholars and practitioners evaluate a much-lauded policy instrument, which is often deployed as a first resort against adversary governments. While the use of sanctions to target non-state actors like transnational organized crime networks or cells of terrorists, narco-traffickers, and proliferators is also commonplace, it is not the subject of the data analyzed in this chapter. We focus instead on states, given the availability of data and the relevance of this unit of measure in an international political milieu defined overwhelmingly by great power competition and state-based competition. Key findings of our study are listed below.<sup>54</sup>

## New Findings on the Effects of 21st-Century Sanctions

The results of our research are clear:

- Sanctioned countries do not suffer significant costs as measured by lost economic growth or greater inflation;
- Sanctioned countries *do* face significantly elevated levels of political risk, depressing investment in the target’s economy;
- Sanctioned countries experience significantly higher levels of corruption; and
- Sanctions affect the governance of target countries.

These results help to explain the persistent debate over the efficacy of sanctions. On the one hand, targeted economic sanctions clearly have potent effects on the economies of target states. On the other hand, the extant concerns raised about the negative externalities of coercive economic measures are valid. Sanctions contribute to higher levels of economic corruption and lower levels of investment in the targeted states.

The results also have implications for the development of strategies suggesting when sanctions should be deployed and when they will be most effective. This is because the data suggest that the types of financial sanctions that have been deployed against states in the last two decades should have a greater impact on the decisionmaking of states for which attractiveness to international trade and investment is strategically significant. The theory of compellance dictates that in order to achieve the desired results, a state must manipulate the cost/benefit calculations of its target such that the target of the compellant actions is motivated to abandon its chosen course of action.<sup>55</sup> States for whom foreign trade and investment is important are more likely to be impacted than those (like North Korea) that rely very minimally on external financial relationships for their economic well-being. These kinds of sanctions programs should identify those features of a target’s economic or commercial life that are most significant to the country or its leadership and design measures to target those interests directly.

The development of the Ukraine/Russia *sectoral sanctions* program in 2014<sup>56</sup> is one example of this strategy at work. In response to Russian aggression in Crimea and eastern Ukraine, the United States and European

Union imposed sanctions that made it harder for Russian banks and energy companies to issue equity and/or debt with a maturity longer than 30 days.<sup>57</sup> This measure was designed with these companies' significant exposure to U.S. and European capital markets and their extensive need for medium-term financing in mind. Significantly, it did not directly target the market for overnight lending to these companies, which might have effectively put them out of business (and had even more substantial side effects for their counterparties in Western European and North American financial markets). The sanctions also reduced the ability of Russian energy companies to secure energy technology, equipment, and services from the United States and the EU, effectively making partnerships with the world's most sophisticated and adept energy companies impossible for energy development in locations that are difficult to access, like the Arctic.

***In the Russia case the United States and Europe designed a sanctions program with unprecedented precision, albeit with non-trivial side effects.***

The sectoral sanctions therefore effectively identified the interests that were important to the Russian leadership and targeted those interests with as much precision as possible. Additionally, the sanctions were chosen to maximize the effect on Russian entities while limiting effects on other countries or companies with which Russia trades and banks. While Russia has not reversed its annexation of Crimea or removed its weapons or fighters from eastern Ukraine, the situation has stabilized somewhat since the signing of the Minsk II agreement, and the Kremlin's initial stated objectives – such as establishing Russian control over large swaths of Ukrainian territory (the “Novorossiya” project) – were abandoned.

Determining the effectiveness of this particular set of sanctions measures (and many others as well) is difficult as it depends fundamentally on a counterfactual that can never be proven – what would President Putin have done if the sanctions had not been imposed? While it is possible that he was contemplating more aggressive measures in Ukraine from which he refrained because of fears of more comprehensive sanctions, it is unlikely that the public record will ever definitively resolve that question. Nevertheless, in the Russia case the United

States and Europe designed a sanctions program with unprecedented precision, albeit with non-trivial side effects (explored below in greater detail). The Russia sanctions also marked the first time the United States and the EU created a sanctions program collaboratively from the start.

The point can be generalized. In much the same way as the trajectory charted above illuminates a path of increasing precision, the future of sanctions – both the effectiveness and legitimacy of the instrument – depends on increasing the proximity of the link between interests that the sanctioned country values and the means chosen to target those interests. The tools available to the United States and allied governments are broad. The main statute structuring the U.S. government's sanctions programs gives it authority to “investigate, regulate, or prohibit” a broad range of financial transactions in response to national security emergencies.<sup>58</sup> In the future this authority can – and should – be deployed with ever greater creativity and precision.

**The Testing Strategy**

To test the effects and effectiveness of 21st-century coercive economic measures, we gathered data on all instances in which the United States initiated economic sanctions since September 11, 2001.<sup>59</sup> Twenty-two sanctions cases were culled from three different sources: Rice University's Threat and Impositions of Sanctions (TIES) dataset, the Petersen Institute for International Economics (PIIE) dataset of 21st century cases, and the U.S. Treasury Department's OFAC sanctions website. The cases are listed in Table 2 in the appendix.

To code the outcomes of these 22 cases, we relied on the codings from the TIES and PIIE data sets that were available. There were still 13 cases that were ongoing, or in which significant developments justified taking another look at the effectiveness of sanctions. To code these outcomes, we surveyed more than 80 sanctions experts and asked them to code the success of recent cases. We received 25 responses, or a 30 percent response rate.

Combined, Table 2 shows that there were nine successful outcomes out of the 22 sanctions cases, or a 40.9 percent success rate. This is significantly higher than Robert Pape's very pessimistic 5 percent success rate, or the more generous 33 percent success rate calculated using Hufbauer, Schott, and Elliott's pre-1990 set of

sanctions cases.<sup>60</sup> At a minimum, it would appear that the policymaker enthusiasm for 21st-century coercive economic measures is somewhat justified.

To examine the effects of 21st-century economic sanctions on targeted economies, we adopt a methodology that the U.S. Government Accountability Office employed to assess the effect of U.S. sanctions on the Iranian economy.<sup>61</sup> Their approach “identified a group of peer economies, which helped ... to isolate economic changes that are unique to Iran but not necessarily to identify the impact of sanctions.”<sup>62</sup> The idea is to ensure that the imposition of economic sanctions, rather than other factors, is responsible for changes in the target economy and polity. For example, as the case of Russia makes clear, the imposition of sanctions in 2014 hurt the Russian economy. Even more painful to Moscow, however, was the collapse in oil prices in the fall of 2014, an event that was unrelated to sanctions. Since that effect was more pervasive than just on the Russian economy, it should be reflected in the changes in Russia’s peer group.

***It would appear that the policymaker enthusiasm for 21st-century coercive economic measures is somewhat justified.***

We have adapted that approach to our data set. For each instance of sanctions imposition, we searched for countries with similar economic size, trade portfolio, and regional proximity. For each sanctions episode, five peer countries were identified. Table 3 (in the appendix) lists the peer countries.<sup>63</sup>

We examine how well the sanctioned country performed across a wide range of economic and political measures, listed in Table 4. After selecting the cases and the peers, we collected data on the relevant economic and political indicators. We then compared whether the targeted country performed differently than its peer group after sanctions were actually imposed. To measure the staying power of economic sanctions, we conducted difference of means tests comparing the economic and political measures before sanctions imposition to how these countries fared the first year under sanctions, and then the third year under sanctions.

As Table 4 (in the appendix) shows, measures of economic performance include GDP growth, inflation, investment, imports, exports, and the current account balance. These data were obtained from the International Monetary Fund (IMF) for every year between 2001 and 2014.

The next set of indicators came from the Political Risk Services (PRS) group, a subscription-based service that provides data on foreign investment and country-specific political and economic factors.<sup>64</sup> PRS offers a welter of measures for possible risk factors for foreign investors. Annual data for both the targeted and peer countries was collected for the level of civil disorder, corruption, economic risk, financial risk, political risk, aggregate risk, government stability, popular support, risk for GDP growth, risk for inflation, risk for international liquidity, and socioeconomic conditions. The PRS data coverage is less comprehensive than the IMF, as it focuses much more on emerging market economies. Nevertheless, the coverage is still sufficient to run the necessary difference of means tests.

The Worldwide Governance Index (WGI) from the World Bank was used for six indicators: control of corruption, government effectiveness, rule of law, regulatory quality, political stability, and the absence of violence and voice and accountability. The WGI index was not available for the years 2001 and 2014, the first and last years of our study, but the rest of the years were available.

A final set of sociopolitical indicators were collected from multiple sources. Polity IV was used for annual polity scores – the measure of whether a regime is democratic or authoritarian in nature. The Human Development Index (HDI) was collected from the U.N. Development Program. The HDI was not available on an annual basis until 2008. Before 2008, data was available for the 2001 and 2005 years. In order to fill in the missing data, we interpolated a simple linear progression between 2001 and 2005 and between 2005 and 2008 and imputed the difference between the two over the missing years. Finally, for one final check on corruption in addition to the PRS and World Bank measures, we drew from the Corruption Perception Index from Transparency International for all the years under analysis.

## **The Statistical Results**

Tables 5, 6, and 7 (in the appendix) show the effects of sanctions imposition on the target country's economy and polity. Table 5 looks at the IMF measures of economic performance. It offers a mixed picture on the effectiveness of 21st-century sanctions at inflicting economic pain. On the one hand, there is no evidence that the imposition of sanctions affects the most obvious economic measures. The effect of sanctions on economic growth was predicted to be negative. Instead, sanctions are correlated with stronger growth relative to the target's peer economies, though this result is not statistically significant. Similarly, the effects on inflation, imports, and exports are all statistically insignificant as well. These results hold for both the one-year and three-year mark, so it is easy to see why some observers would infer that sanctions are ineffective in inflicting costs on the target economy.

Still, there are two significant and direct effects that economic sanctions have on target economies. First, the target's current account deficit is more likely to increase. Second, and more significantly, the imposition of sanctions causes investment to lag dramatically. These results are significant at the 0.1 percent level and hold at both the one-year and three-year mark. Intuitively, this is unsurprising; one would expect both domestic and foreign investors to be more risk-averse in the face of economic sanctions. So it would seem that the causal mechanism through which 21st-century sanctions impinge target economies is through deterring investment.

Table 6 shows the effect of sanctions on the political risk variables, which buttress the finding that economic coercion affects political risk, which in turn depresses investment. The imposition of sanctions does not have a significant effect on either civil disorder or aggregate government stability. Sanctions have a pronounced and significant effect on all of the perceptions of risk, however. Economic risk, financial risk, political risk, risk to GDP growth, and risk for international liquidity all go up for countries facing coercive economic measures. These are all significant at the 1 percent level. Given these findings, it is unsurprising that the composite risk rating also goes up in response to sanctions imposition. Sanctions have a negative and significant effect on the target country's socioeconomic conditions. Somewhat surprisingly – and in contrast to numerous “rally round the flag” arguments with respect to economic coercion – sanctions also have a negative and significant effect on popular support for the target regime.<sup>65</sup>

These results are interesting in light of the finding that sanctions do not appear to have a significant effect on GDP growth but do have a significant impact on investment. There are two possible – and not mutually exclusive – explanations for these findings. The first is that while modern sanctions might not have appreciable economic effects, the PRS variables are measuring perceptions of risk. The imposition of sanctions elevates perceptions of economic and political risk, which in turn affects investors, which in turn affects the target government. So even if the actual impact on GDP might not be great, the perceived costs are significant.

The second explanation is that sanctions do have an appreciable impact on the target economy, but target governments can partially compensate for that effect. The significant effects of sanctions on risk perception and investment suggest that the causal chain is that sanctions lead to elevated perceptions of risk, which leads to reduced investment. Governments can respond to this with greater fiscal spending or by subsidizing private consumption. Either of these actions can forestall lower rates of GDP growth for a few years.

### ***The causal mechanism through which 21st-century sanctions impinge target economies is through deterring investment.***

At the same time, such actions are not costless. The effect of sanctions on socioeconomic conditions and regime support further suggests that enduring sanctions generate negative political and economic effects that the target regime must consider. This is particularly true if the target relies on foreign trade and investment – or intends to do so as a way to boost economic growth.<sup>66</sup>

Twenty-first-century sanctions have significant effects on target economies and economic perceptions about the target country. What about negative externalities? A key argument made about modern sanctions is the precise nature of the sanctions tool – modern sanctions should have fewer deleterious effects than the trade sanctions of yesteryear. Table 7 examines the effect of sanctions on a host of sociopolitical factors. The results strongly suggest that 21st-century sanctions still have many negative second-order effects on the target country. All of the indicators suggest that sanctions may contribute to more autocratic forms of governance. The

Polity score, as predicted, moves in a more authoritarian direction, and is significant at the 0.1 percent level. At the same time, the World Bank measures of political stability, voice and accountability, government effectiveness, and regulatory quality all decline appreciably in the target countries, although the effect on political stability measure is insignificant after three years. Nevertheless, the aggregate effect of sanctions may move target regimes in a less democratic direction.

***Sanctions have a negative and significant effect on popular support for the target regime.***

Given the effect of sanctions on the target economy, this is not entirely unsurprising. Some scholars argue that as an authoritarian regime faces greater financial constraints, the ruling government will opt for repression over rewarding key members of the selectorate as a tactic for staying in power.<sup>67</sup> By definition, sanctions are designed to place such restrictions on the target government. It is therefore possible that even targeted financial sanctions are *more* likely to trigger repression. In other words, sanctions make authoritarian governments act in an even more authoritarian manner.

Another clear effect from these results is that 21st-century economic sanctions have a powerful effect on corruption in the target economy. Three different measures of corruption were used: the PRS corruption ranking, the Transparency International corruption perceptions index, and the World Bank's measure of control of corruption. All three measures trend in the predicted direction and are statistically significant after one year and three years. These three corruption measures were developed independently of each other; that all three are significant suggest the robustness of this particular finding.

Finally, sanctions also have a negative effect on the U.N.'s Human Development Index. Compared to peer economies, a sanctioned economy lags on this measure. Given the statistically significant effects previously discussed, this should not be too surprising. Sanctioned economies suffer from a lack of investment, an elevated perception of risk, more authoritarian regimes, a lower quality of government, and more corruption. Combined, it should not be too surprising that these would have a negative impact on human development more generally.

These sobering results make clear to any doubters that the use of sanctions does not come without costs. Furthermore, policymakers may take from this exposition that they would be wise to dedicate serious resources to rigorously modeling and anticipating the potential economic and political costs of sanctions before they impose them in order to determine when the acceptance of these costs will be in the broader U.S. interest and when it will not. To make such a policy evaluation, however, it is useful to fundamentally focus on the issue of sanctions effectiveness – that is, the value sanctions offer to advancing U.S. policy interests in whole or in part. Elevating this consideration in the decision of whether to undertake sanctions will make policy leaders more clear-eyed and better aware of their leverage points and vulnerabilities. Additionally, and usefully, it may motivate successive technical innovations in sanctions to achieve yet more narrowly focused targets and effects, and more transparent and transactional terms for the sanctions' quid pro quo to better compel rogue states to change their behavior and be freed of sanctions.

### **Case Studies of Effectiveness**

In order to consider the issue of the effectiveness (rather than just the effects) of sanctions, we examined several sets of sanctions case studies. The following cases examine high-profile instances of U.S.-led sanctions and are associated with key current and future U.S. security concerns. The cases include sanctions imposed over nuclear proliferation (Iran), territorial aggression (Russia), civil war (Syria), and political repression (Venezuela). Ultimately, we chose them for their political relevance to current and future policy leaders, prominence in scope and significance among the various sanctions regimes of the last 15 years and for the diversity of policy concerns they encompass.

In our analysis, the criteria for effectiveness of U.S. sanctions are the following: (1) the ability to meaningfully shape the political environment and balance of political leverage, including through changed economic circumstances; (2) catalyzing relevant communities (domestic or international) to concerted action, including by messaging with respect to sanctions targets; and (3) achieving discrete, high-level political objectives in support of overall U.S. policy goals. Our definition of sanctions effectiveness is predicated on the notion that sanctions alone generally cannot change regime behavior and must be used and evaluated along with

*Sanctions are almost never a costless policy tool; the question is whether on balance they are likely to do more good than harm.*

other tools of national power, such as military force, diplomacy, cyber capabilities, and intelligence activities. Furthermore, all three criteria for effectiveness may not be present in every case. Determinations of effectiveness need not mean that sanctions have no negative economic or political effects on the target, the international financial system, or the United States. As discussed, sanctions are almost never a costless policy tool; the question is whether on balance they are likely to do more good than harm.

Moreover, there is no generalizable timeline for measuring the effects and effectiveness of sanctions – each case embodying different objectives must be taken on its own terms. A challenge in looking at sanctions of the last 15 years is the relatively recent timeframes in which many targeted sanctions have been implemented and the tendency of targeted sanctions to have a lagged effect on economic output. This also may help explain the apparent limits of sanctions’ ability to coerce changes in political behavior in the short term. Over the longer term, however, a clearer picture may begin to emerge.

#### **IRAN: NUCLEAR PROLIFERATION**

U.S. foreign policy has restricted trade with the Islamic Republic of Iran since 1979, and some Iranian assets in the United States have remained frozen since the hostage crisis. The designation of Iran as a “state sponsor of terrorism” allowed the United States to impose a broader set of sanctions against the regime, including a ban on direct financial assistance, withholding of payments to countries or organizations that provided assistance to Iran, and a requirement to vote to oppose multilateral lending. In 1996, Congress passed the Iran-Libya Sanctions Act (ILSA, later modified to become the Iran Sanctions Act or ISA), which placed restrictions on major investments in Iran’s petroleum industry. However, Iranian oil exports retained their access to world markets, enabling the regime to continue selling the commodity and allowing the country to run a sizeable trade surplus due to dollar-denominated export earnings. Testifying before Congress on the results of the sanctions, Jeffrey Schott said, “Simply imposing costs on the target country may satisfy a thirst for retribution, but it does not necessarily promote the achievement of U.S. foreign policy goals.”<sup>68</sup>

After 2002, when evidence emerged that Iran was developing uranium enrichment capability, the United States attempted to restrict the growth of Iran’s nuclear program by dramatically increasing the scope of targeted economic sanctions. But it wasn’t until the 2007–2010 period that the use of targeted sanctions became the core of U.S. policy toward Iran.<sup>69</sup>

In 2010, the United States passed into law the Comprehensive Iran Accountability, Sanctions, and Divestment Act (CISADA). This expanded on the ISA, establishing broad new limitations on Iran’s energy industry and on financial transactions with Iranian institutions. The new law prohibited U.S. banks from maintaining correspondent accounts for foreign financial institutions that facilitate transactions for the Army of the Guardians of the Islamic Revolution (IRGC) or its affiliates, and that engage with designated Iranian banks. Following the implementation of CISADA, a series of statutes and Executive Orders issued through 2012 imposed secondary sanctions on those foreign entities that engage in business with sanctioned Iranian entities and further blocked Iranian access to the international financial system. In parallel to this tightening of U.S. sanctions, and after the adoption of UNSCR 1929, the European Union expanded its own Iran sanctions regime and with time instituted an embargo

on Iranian oil imports, increased targeted sanctions on financial ties with the Central Bank of Iran, and prohibited specialized financial messaging between institutions of its member states and designated Iranian financial institutions. Considered collectively, the variety of targeted financial measures levied by various jurisdictions against Iran amounted to a relatively broad multilateral trade embargo spanning a huge variety of Iran's economic activity.

The new sanctions proved far more effective than the previous restrictions on Iran, adversely impacting economic growth within short order. Consistent with our statistical findings, the targeted sanctions limited investment in Iran's oil sector. They also significantly raised the degree of difficulty of selling (and receiving payment for) its oil exports. Oil exports dropped from 2.5 million barrels per day (bpd) in 2011 to 1.1 million bpd in 2013; EU imports fell from approximately 600,000 bpd to effectively zero, and Iran's oil exports to OECD and non-OECD Asian countries (China, India, South Korea, and Japan) dropped by more than 525,000 bpd.<sup>70</sup> Although it continued to export oil to other buyers, Iran was barred from accessing most hard currency held in foreign accounts.<sup>71</sup> By 2013, Iran's oil minister acknowledged that falling exports were costing the country between \$4 and \$8 billion per month.<sup>72</sup> In an attempt to boost revenues, Iran sought new payment mechanisms, moving away from its traditional trading relationships with Europe and Russia and relatively closer to Turkey and the United Arab Emirates.<sup>73</sup>

*It wasn't until the 2007–2010 period that the use of targeted sanctions became the core of U.S. policy toward Iran.*



*The promise of sanctions removal was the principal motivation for Iran to strike a deal during the Joint Comprehensive Plan of Action (JCPOA) negotiations. In Lausanne, Switzerland, negotiators representing the P5+1, EU, and Iran agree on parameters for a JCPOA in April 2015. (U.S. Department of State/Flickr)*

The financial restrictions were so comprehensive that the Society for Worldwide Interbank Financial Telecommunication (SWIFT) was forced to bar from its system all transactions of Iranian banks named in the EU sanctions. According to U.S. Treasury Secretary Jacob Lew, these restrictions, combined with falling oil production, caused economic growth in Iran to fall by 9 percent over 2012 and 2013.<sup>74</sup> The restrictions also contributed to a drop in the value of the rial, rising Iranian inflation, growth in unemployment to approximately 20 percent, and a troubling increase in non-performing loans at Iranian banks.<sup>75</sup>

***Rouhani publicly acknowledged that the effect of sanctions on the Iranian economy was severe and required quick negotiations to settle the nuclear question.***

Despite the aforementioned criticisms regarding the ability of targeted sanctions to achieve political change, their use in Iran appears to have had at least some effect on the political system. Most notably, relatively moderate cleric Hassan Rouhani was elected president in 2013 after running on a platform of easing sanctions and ending Iran's international isolation following the two terms of his controversial predecessor, Mahmoud Ahmadinejad. Upon taking office, Rouhani publicly acknowledged that the effect of sanctions on the Iranian economy was severe and required quick negotiations to settle the nuclear question.<sup>76</sup> As Iran's subsequent negotiating behavior during the JCPOA suggests, the principal motivation for Iran to strike a deal was the promise of sanctions removal.

At the same time, however, conservative elements of Iran's government have been willing to act in a more repressive manner since the imposition of targeted financial sanctions. The regime suppressed a brief renewal of the Green Movement in early 2011. More intriguingly, repressive activities may have increased since completion of the nuclear agreement in July 2015. *The Wall Street Journal* recently reported that, "Tehran security forces, led by Supreme Leader Ayatollah Ali Khamenei, have stepped up arrests of political opponents in the arts, media and the business community."<sup>77</sup>

On balance, however, given the success of the international community in pursuing diplomacy to exact substantial nuclear concessions from Iran in exchange for relief from financial sanctions pressure, sanctions in the Iran case were demonstrably effective. Their imposition did compel behavior change by the Iranian regime and incentivized it to reach a deal that included substantial concessions on Iran's nuclear program. Through the economic pressure it generated, and the platform it provided for consistent and coordinated multilateral messaging, we judge the nuclear agreement of 2015 as a sign of Iran sanctions' success (even if it is impossible to say at this point whether the deal will decisively and permanently resolve the international community's concerns regarding Iran's nuclear program). This judgment also does not minimize the existence of other factors (such as pervasive corruption, economic mismanagement, and a low oil price) that may have contributed to Iran's economic woes. But it does offer a persuasive example of the effectiveness of sanctions in compelling change in line with U.S. interest on Iranian proliferation matters.



## RUSSIA: TERRITORIAL AGGRESSION

In response to the annexation of the Crimean Peninsula by the Russian Federation in March 2014, President Obama issued three executive orders that provided the Treasury and State Departments with broad authority to impose sanctions on Russian individuals and companies. Initially, the U.S. government used these authorities to sanction close associates of President Putin and individuals involved in undermining Ukraine's democracy. When the crisis worsened in the summer, the United States expanded restrictions to encompass sectoral sanctions, imposing targeted restrictions on Russia's banking, energy, and defense sectors. Following the downing of Malaysia Airlines Flight 17 on July 17, 2014, the EU followed suit and imposed sectoral sanctions of its own. When Russia doubled down and launched a full-scale invasion of eastern Ukraine in August 2014, the United States and the EU imposed another round of sectoral sanctions in September. Through the use of these sanctions, the United States and the European Union sought to deter Russia from further aggression and to compel Russia to respect Ukraine's sovereignty by making it more difficult for Russia to finance its economic development.

The main areas targeted by the sanctions were the energy, defense, and financial services sectors. Four state-owned energy companies were named as targets of the sanctions, and U.S. companies were restricted from providing technology, equipment, and services used to support exploration or production from deepwater, Arctic offshore, or shale oil projects.<sup>78</sup> In addition to hindering energy production, the sanctions restricted Russian access to the international financial system, particularly to U.S. and European capital markets. Further, individuals deemed to be "materially or financially supporting actions undermining or threatening Ukraine's sovereignty, territorial integrity and independence" or "benefiting from the annexation of Crimea or the destabilization of Eastern Ukraine" were subject to travel bans and asset freezes. These individuals included several large shareholders in Bank Rossiya, which has close ties to a number of Putin's political allies.<sup>79</sup> When Russia's largest financial institution, Sberbank, was added to the list of sanctioned entities in September 2014, former board member Sergei Guriyev predicted that the sanctions could raise borrowing costs for Russian banks in non-Western markets.<sup>80</sup>

According to the IMF, Russian GDP was expected to drop by 3.8 percent in 2015, and an additional 1 percent in 2016, as a result of falling real wages, higher borrowing costs, and low consumer confidence.<sup>81</sup> Russia also has

experienced significant capital flight. OAO Megafon, a wireless operator, decided to hold approximately 40 percent of its cash in Hong Kong dollars; Norilsk Nickel, the world's largest producer of nickel and palladium, also decided to keep substantial cash in Hong Kong dollars.<sup>82</sup> In response, the Hong Kong Monetary Authority had to intervene to defend the Hong Kong dollar's peg to the U.S. dollar.<sup>83</sup> Low global oil prices are widely considered the main driver of Russia's economic downturn over the past 18 months, although the sanctions were viewed as key contributors to the recession by limiting foreign investment's ability to make up for the shortfall in oil revenues.<sup>84</sup> IMF projections over the medium term indicate that lower investment in Russia could lead to a cumulative loss of output of up to 9 percent of GDP.<sup>85</sup>

Anders Åslund of the Peterson Institute for International Economics claims that financial sanctions on Russia have been "far more severe in their effect than anyone believed," including preventing the government from borrowing to make up for the shortfall in export revenues caused by low oil prices. In order to regain access to financial assets, several wealthy and prominent individuals targeted by the sanctions have been forced to return to Russia from living abroad.<sup>86</sup> These individuals have been rewarded with additional benefits from Putin. However, this has alienated members of the local elite outside of the inner circle, and could potentially lead to further destabilization if they choose to export significant amounts of their cash outside of Russia.<sup>87</sup>



*It may be too soon to judge the effectiveness of U.S. sanctions on Russia. While there is some evidence sanctions deterred President Putin from engaging more aggressively in Ukraine, Russia also officially annexed Crimea. Russian forces are stationed at the Perevalne military base in Crimea in 2014. (Wikimedia Commons/Anton Holoborodko)*

The political situation inside Russia also has deteriorated since the sanctions were imposed. The most prominent example of this was the murder of Russian opposition leader Boris Nemtsov in February 2015. There was widespread speculation that Putin was behind the assassination.<sup>88</sup> The frenzy that surrounded Vladimir Putin's disappearance from public view in March 2015 also highlighted the regime's growing degree of centralization and fragility.<sup>89</sup>

As for the effectiveness of sanctions on Russian actions in Ukraine, to date they must be characterized as modest. On the one hand, there is evidence that sanctions deterred Putin from taking more aggressive action in the rest of Ukraine, and beginning in August 2015, Russian proxies in eastern Ukraine acquiesced to a loosely-held ceasefire.<sup>90</sup> Through the second half of 2015, Russian presence in eastern Ukraine was not reported to have accelerated in aggression and no overt provocations were observed. Additionally, Russia agreed to cancel sham separatist elections that had been scheduled for October and November although it continued to block OSCE monitors from entering the conflict areas of eastern Ukraine.<sup>91</sup>

***Financial sanctions on Russia have been far more severe in their effect than anyone believed.***

On the other hand, Russia has officially annexed Crimea, and events outside the region have raised questions about Europe's commitment to maintaining the sanctions regime. French President François Hollande spoke out against sanctions during the summer of 2015 when local producers of food and luxury goods were particularly hard-hit by losing access to markets among the Russian elite due to Russian counter-sanctions. This compounded the original effects of diminished trade and export revenue for European manufacturers from implementation of the sanctions on Russia in 2014. During a closed-door meeting of EU delegates in December 2015 to discuss the sanctions regime, Italian representatives objected to a vote on extending the sanctions, reportedly due to their own desire for a broader debate encompassing Germany's championing of the Nord Stream II pipeline. Notwithstanding the uneven European political sentiment toward Russia, the European Council voted in December to extend sanctions on Russia through the summer of 2016.<sup>92</sup> And Secretary of State John Kerry voiced confidence that the United States and the EU would remain united on sanctions until their objectives are met.

It may be too soon to judge the ultimate effectiveness of U.S. sanctions on Russia. At this point, it is challenging to distinguish how much of Russia's slightly moderated behavior in Ukraine is due to the effectiveness of sanctions in fostering a more moderated Russian stance there versus Russia's efforts to inspire a more tolerant international view, particularly from the Europeans, for its aggressive posture in Syria. Moscow certainly is trying to generate some European support for its leadership in Syria, the source of Europe's refugee crisis, and to take advantage of the potential U.S.-EU divide over Russia sanctions. Nevertheless, both the United States and the EU have voiced a commitment to compartmentalizing Ukraine and Syria policy and maintaining Russia sanctions until Moscow fully implements the Minsk agreements.

#### **SYRIA: CIVIL WAR**

The United States first designated Syria as a state sponsor of terrorism in 1979, and subsequent sanctions were implemented in 2004 for its involvement in Lebanon's political crisis. However, the most recent set of targeted sanctions was implemented in response to the Arab Spring protests and the ensuing civil war that broke out in 2011. Executive Orders 13572 and 13573, signed in May 2011, targeted high-level Syrian government officials including President Bashar al-Assad and members of his cabinet, and subsequent measures targeted the energy sector and froze government assets.

In addition to the U.S. action, the European Union, Arab League, and Turkey all have instituted economic sanctions on Syria, including travel bans and asset freezes. The European Union also banned crude oil imports, prohibited trade in precious metals, and put an embargo on equipment that could be used for surveillance of the opposition or other forms of violent repression, though it did ease several trade restrictions in 2013 to help support opposition forces.

Europe had been Syria's largest trading partner prior to the sanctions, representing between one-fourth and one-fifth of total trade, followed by Iraq and Saudi Arabia.<sup>93</sup> Because oil revenues represented approximately 20 percent of Syrian GDP, the EU ban on oil imports has had a particularly important economic effect, as Europe imported over \$3 billion worth of crude oil from Syria in 2011.<sup>94</sup> In addition to the European ban, the civil war has ravaged Syrian production capabilities from 400,000 bpd in 2010 to 25,000 bpd in May 2015.<sup>95</sup> Remaining crude oil production is effectively out of Syrian

government control, leading to a transfer of oil revenue from the government toward ISIS, who smuggle oil into Iraq and Turkey as well as supply Syrian markets under their control.<sup>96</sup> As a result, the Syrian government has little incentive to make political concessions to reverse oil sanctions as their infrastructure is significantly destroyed and some functioning oil assets are no longer in their control.

***Because oil revenues represented approximately 20 percent of Syrian GDP, the EU ban on oil imports has had a particularly important economic effect.***

Mohsin Khan and Faysal Itani of the Atlantic Council wrote that the Syrian economy was in “total disarray” by 2013 and estimated that real GDP fell between 50 and 80 percent in 2012.<sup>97</sup> Hyperinflation is also rampant, with the Syrian pound losing 80 percent of its pre-war value, while foreign currency reserves are estimated to have dropped by nearly 90 percent over the same span of time as the government spends down to make up for the drop in foreign investment. The regime continues to rely on credit lines from its allies in Tehran, Moscow, and Beijing, while Russia continues to honor contracts providing several billion dollars worth of arms and military equipment.<sup>98</sup>

The performance of the Syrian economy in the five years prior to the popular uprising had been relatively solid, but members of the country’s business elite with close ties to the Assad regime captured many of those gains.<sup>99</sup> U.S. and European sanctions have attempted to isolate the regime by disrupting links between the state and its benefactors, but these efforts have not been particularly successful. According to Rashad al-Kattan, a research fellow at the University of St. Andrews, “Most of these businessmen have substantial investments in the country that outweighed their overseas assets and commercial interests. Their inextricable connections with the ruling political elite have made them highly invested in the survival of the regime,” and therefore less concerned with the present negative returns on investment than with the potential benefits of remaining once the conflict is ultimately resolved.<sup>100</sup> Regarding the profile of these investors, David Butter of Chatham House says, “One of the questions that will need to be addressed in the future is what role members of the business elite from the Assad era could play in rebuilding the Syria economy.”<sup>101</sup>

Seemingly, sanctions in the Syria case have not been effective. They did form a rallying point for some likeminded countries to articulate concerns about the al-Assad regime, and they did impose some economic costs on Syria. However, they were never truly multi-lateral and lacked the support of the U.N. Additionally, none of the positive sanctions outcomes materially advanced the policy aim of limiting or reversing Syrian support for terrorism or President al-Assad’s brutal campaign against rebels in Syria. Nor is there substantial evidence that they created more leverage for the United States and Europe in advancing these goals. There are undoubtedly a number of reasons for the failure of sanctions to compel change on behalf of the regime. One key shortcoming in the Syria sanctions is in the design. The sanctions do not target a major asset of the regime that cannot be replaced in some fashion and therefore do not create a large amount of leverage for the United States and the EU. If the United States and the EU cannot strike more directly at the financial vulnerabilities of the Syrian regime, then perhaps sanctions are a policy tool focused more on expressing condemnation of President Assad’s policy choices.

#### **VENEZUELA: POLITICAL REPRESSION**

After the government of President Nicolás Maduro was accused of violating political protesters’ human rights in 2014, the United States approved a visa ban and asset freeze targeting officials implicated in the crackdown. In March 2015, the White House issued Executive Order 13692, establishing an asset freeze and blocking travel to the United States for seven prominent government officials: armed forces commander (and former director of the National Guard) Antonio José Benavides Torres; intelligence chief Gustavo Enrique González López; former national guard commander Justo José Noguera Pietri; prosecutor Katherine Nayarith Haringhton Padron; national police director Manuel Eduardo Pérez Urdaneta; army commander Manuel Gregorio Bernal Martínez; and the inspector general of the armed forces, Miguel Alcides Vivas Landino.<sup>102</sup>

To enact the sanctions, the Obama administration was required to declare Venezuela an “extraordinary threat to the national security” of the United States. The act of doing so proved to be a case of bad political theater. President Maduro accused the United States of hypocrisy for approving the sanctions shortly after an announcement regarding the normalization of U.S.-Cuba relations.<sup>103</sup> He also used the sanctions imposition to rail against American imperialism in front of the

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National Assembly. Outside observers agree that while the sanctions might have been justified, the political optics were awful.<sup>104</sup>

Two organizations for regional integration, the Union of South American Nations and the Community of Latin American and Caribbean States, indicated that the sanctions could make it more difficult for the United States to garner the support of other Latin American countries in calling on the Venezuelan government to respect the opposition.<sup>105</sup> And within Venezuela itself, the opposition Democratic Unity Roundtable (MUD) disapproved of the unilateral sanctions.<sup>106</sup>

Petroleum makes up the vast majority of Venezuelan exports, so falling oil prices over the past two years cast a shadow on its economic outlook: Economic growth is expected to decline by 10 percent in 2015, while inflation will average 159 percent by the end of 2015.<sup>107</sup> Poverty has also been on the rise, reaching 32.1 percent in 2013 and with an expected increase to 48 percent by the end of 2015.<sup>108</sup> The economic downturn has also led to significant consumer goods shortages, with some analysts claiming that oil prices would need to reach

\$100 per barrel to resolve the problem.<sup>109</sup> Venezuela's economy has been projected to shrink by an additional 6 percent in 2016.<sup>110</sup>

Christopher Sabatini of Columbia University's School of International and Public Affairs has said that the Venezuelan central bank requires access to hard currency in order to finance the country's high level of spending on food imports. The government has continued to maintain an overvalued official exchange rate for the Venezuelan bolívar, presenting "huge opportunities for corruption."<sup>111</sup>

The sanctions were widely derided as ineffective, as few analysts concluded that sanctions themselves created any meaningful economic effect on Venezuela and therefore did not give the United States any new leverage on Venezuela.<sup>112</sup> They did not galvanize international coordination on policy toward Venezuela, and they did inspire tremendous national support for President Maduro. However, it should be noted that the worsening economy clearly had an electoral effect that was, coincidentally, in line with the policy objective underlying U.S. sanctions on Venezuela.<sup>113</sup> The opposition MUD secured a supermajority in the December 2015 parliamentary elections, which could significantly curtail President Maduro's ability to govern by executive fiat during the second half of his presidential term, which expires in 2019.

As the case studies in this section demonstrate, determining the effectiveness of sanctions in any particular instance is difficult. It may take time and the evolution of political and economic circumstances to make a fuller evaluation of sanctions effectiveness in some cases. Some design and execution flaws are immediately clear as factors undermining sanctions effectiveness, as discussed above. A difficulty in selecting highly effective sanctions targets may underscore the reality that sanctions are not always the ideal policy tool. But difficulties in determining effectiveness in some sanctions cases do not indicate a lack of their utility generally. With a rigorous ability to select targets that can deliver material economic impact and that can coalesce international allies around a coordinated sanctions regime, sanctions can prove effective at advancing U.S. policy aims in part or in whole.



After the Venezuelan government was accused of violating political protesters' human rights in 2014, the United States approved a visa ban and asset freeze targeting officials implicated in the crackdown. At a rally against political oppression in Venezuela, an opposition protester symbolically wears chains. (Flickr/CarlosDíaz)

## **03 CHAPTER**

# **The Effects of Sanctions Against Transnational Threats**

The previous chapter discussed new ways to conceive of and gauge the effects and effectiveness of country-based sanctions programs that are designed to change the behavior of rogue regimes. This chapter shifts focus to analyze the effects and effectiveness of sanctions principally targeted at non-state actors. These include sanctions programs focused on curtailing terrorism, narco-trafficking, transnational organized criminal activity, human rights abuses, malicious cyber activities, and other similar harms.

In our survey of sanctions experts, the strongest degree of consensus was that sanctions against non-state actors were less effective than sanctions against states. A remarkable 27 out of 30 survey respondents – 90 percent – agreed with the contention that sanctions against state actors like Iran were more effective than sanctions against non-state actors like al Qaeda. This may in large measure be because it is extremely difficult to measure and quantify the effects of sanctions on non-state actors. The targets of non-state sanctions programs are engaged in criminal activity, so determining their budgets with any degree of confidence based on public sources is extremely difficult. And these groups expend enormous effort to evade official scrutiny of all kinds and must hide the size, origins, and composition of their budgets to maintain their activities.

***In our survey of sanctions experts, the strongest degree of consensus was that sanctions against non-state actors were less effective than sanctions against states.***

But it also might be that the non-state category of sanctions programs is different in emphasis from sanctions programs targeting rogue regimes. Both types of sanctions have preventive and coercive goals. But whereas sanctions programs targeted at regimes often give primacy to the compellance function of sanctions, those targeted at non-state actors tend to have denial as their primary objective. To the extent that sanctions on non-state actors are focused on coercing a change in behavior, that strategy may have the greatest impact on the ecosystem of actual and would-be supporters of those groups, rather than on the groups themselves. As previously noted, there is no “bargaining” with groups like al Qaeda. The wealthy prospective financier or facilitator who is considering providing support to the group,

however, may be a different story. He or she likely has a reputation to be concerned about, ambitions to travel across borders, and a transnational business enterprise, and so the prospect of ending up on a sanctions list may deter him/her from providing support to terrorist or narco-trafficking groups.

***An important goal of sanctions targeting transnational illicit actors or groups is to freeze them out of the international financial system as completely as possible.***

An important goal of sanctions targeting transnational illicit actors or groups is therefore to freeze them out of the international financial system as completely as possible in order to make it more difficult for them to engage in illicit behavior. This will contain particular threats that operate outside of the bounds of acceptable international behavior and make it “costlier, riskier, [and] less efficient” for terrorist groups, organized criminals, and narco-traffickers to raise, store, move, and use funds.<sup>114</sup> The preventive function of sanctions therefore exists alongside the coercive function.

Because these groups predominantly operate clandestinely, the signaling function of sanctions is also critical to understanding the effects (and effectiveness) of sanctions against non-state actors.

This role of sanctions not only serves the basic function of informing the world about the actors and operations of deadly terrorist organizations and pernicious criminal groups, but also helps shape – and sometimes shift – the public narrative about the nature of their activities.

## Intended Effects of Sanctions on Non-State Actors

Of the wide range of non-state actors, counterterrorism sanctions programs are the most broadly adopted both by nations around the world and by international organizations like the United Nations. They also are often seen as key to counterterrorism efforts to name, shame, and impede the material underpinnings of terrorist activities. In the absence of comprehensive empirical data about the effects of such sanctions programs, we can describe three main effects that sanctions against non-state actors are designed to have. The first is the denial of funds to non-state actors and their exclusion from the formal financial system; the second is to compel supporters of illicit actors to stop doing so and to deter would-be supporters from becoming engaged in illicit activity; and the third is to shape the public narrative about non-state actors through the public pronouncements that typically accompany the imposition of financial sanctions.

Because terrorism sanctions are the most broadly adopted around the world, and furthermore broadly believed to be important to the counterterrorism effort, this section focuses predominantly on sanctions against terrorist groups. However, the three main categories of effects described below also are applicable to all other illicit non-state actors targeted by sanctions programs.

### EXCLUSION FROM THE INTERNATIONAL FINANCIAL SYSTEM

At their most basic level, sanctions imposed on terrorist groups are designed to deprive them of their access to funds and to the architecture of the international financial system used to move and store money. In the United States, the establishment of a financial sanctions program specifically directed at terrorist financing was one of the “first strike[s] on the global terror network” that the U.S. government took after 9/11.<sup>115</sup> The explicit purpose of the sanctions program was to “starve” terrorist groups of their funds,<sup>116</sup> and it froze assets that designated persons held in entities subject to U.S. jurisdiction. The program also barred U.S. persons from doing business with any designated individual or group.<sup>117</sup> Shortly after the United States acted, the United Nations Security Council adopted a resolution (UNSCR 1373) imposing an obligation on all states to criminalize the provision of financial support to terrorist groups. The Security Council also obligated states to deny safe haven to terrorists, bring them to justice, prevent the movement of terrorists, and prevent the financing of terrorism.

In doing so, the United States, the United Nations, and the rest of the international community were speaking the language of prevention. Put more broadly, “the United States is trying to eradicate terrorist organizations,” including by curtailing their funding, “and those organizations know it.”<sup>118</sup> The language used by senior U.S. government officials when they impose sanctions on persons for providing support to terrorist groups confirms this strategy. They speak about the need to “unravel and disrupt” funding schemes that support al Qaeda and the Nusrah Front;<sup>119</sup> the need to “deplet[e] the financial strength of violent terrorist organizations”;<sup>120</sup> to “maintain maximum pressure” on groups like Hezbollah;<sup>121</sup> and of the importance of “[d]enying ISIL [Islamic State of Iraq and the Levant] access to the international financial system.”<sup>122</sup> With respect to the groups themselves, then, the goal is clear. As President Obama has vowed, “We will destroy ISIL and any other organization that tries to harm us.”<sup>123</sup> The pursuit is absolute, not conditional, as it is with regime-based sanctions. And the same purpose applies with respect to narco-trafficking and transnational organized crime groups.<sup>124</sup> The objective in these contexts is to “disrupt [their] ... illicit activities”<sup>125</sup> and “cut off ... access to the international financial system.”<sup>126</sup>

***At their most basic level, sanctions imposed on terrorist groups are designed to deprive them of their access to funds and to the architecture of the international financial system.***

A corollary objective is to protect the integrity of the international financial system from abuse.<sup>127</sup> The international financial system fundamentally relies on trust. If terrorist financing and other forms of financial crimes are able to take place unchecked, confidence in financial markets can erode.<sup>128</sup> Imposing sanctions on parties that use the financial system to engage in unlawful activity is an effective way to impose accountability on criminals and to work toward the transparency necessary to continue the process of identifying and disrupting illicit financial networks.<sup>129</sup> Markets that are a haven for illicit activity can fail to attract trade and investment needed in a global economy. And conduct-based sanctions contribute to the goal of stable, effective financial markets by constraining the ability of nefarious actors to participate in them in the first instance.

**COERCION – SHIFTING THE BEHAVIOR OF SUPPORTERS AND WOULD-BE SUPPORTERS**

Terrorist groups exist within a larger ecosystem of financiers, facilitators, and others that provide them with the personnel, money, and materiel they need to function. Sanctions against terrorist groups therefore also aim to compel those already involved in illicit activity to cease and deter those sitting on the sidelines from becoming involved at all. It is perhaps with respect to these members of the counterterrorism ecosystem that financial sanctions are the most successful but least amenable to measurement – for it is impossible to tally those who consider becoming involved in illicit activity but refrain from actually doing so.

The importance of disaggregating terrorist financing networks into their component parts was one of the earliest insights of post-9/11 work on adapting Cold War era deterrence research to the challenge of terrorism. Thus, the *2002 U.S. National Security Strategy* proclaimed, “Traditional concepts of deterrence will not work against a terrorist enemy whose avowed tactics are wanton destruction and the targeting of innocents; whose so-called soldiers seek martyrdom in death and whose most potent protection is statelessness.”<sup>130</sup> But even at that early juncture, researchers already were hard at work developing frameworks that divided terrorist networks into those components that could not be deterred and those that were subject to influence. In this vein, Paul Davis and Brian Michael Jenkins suggested that terrorist systems must be examined at the level of their constituent parts, “some elements of which are potentially more vulnerable than others” to coercive influence.<sup>131</sup> Davis and Jenkins note specifically in that regard that “the wealthy Arabs who continue to finance [al Qaeda’s] activities ... *do* have something to lose,” and therefore can be swayed to stop providing support.<sup>132</sup>

***Sanctions against terrorist groups aim to compel those already involved in illicit activity to cease and deter those sitting on the sidelines.***

In other contexts, including narco-trafficking, the United States has presented the potential for delisting as an incentive for behavior change. And indeed, the regulations that govern OFAC prescribe a process according to which people can seek their removal from any sanctions list they may be on. In 2013, for example, after the Treasury Department delisted a Colombian

soccer team that had demonstrated its lack of continuing connection with sanctioned drug cartels, the then Under Secretary of the Treasury for Terrorism and Financial Intelligence David Cohen explained that “we will lift sanctions in cases where there has been a concrete change in behavior.” A year later, when the United States delisted the remaining sanctioned parties linked to the Cali cartel in its single largest delisting before “Implementation Day” under the JCPOA, the Treasury stated its strategy unequivocally: “The primary goal for sanctions is behavioral change,” and the removal was a result of “the people and entities delisted today credibly show[ing] that they have stopped engaging in sanctionable activities.”<sup>133</sup>

**MESSAGING – SHIFTING THE PUBLIC NARRATIVE**

A final goal of financial sanctions involves shaping the public narrative about a particular threat or individual in order to catalyze action by a domestic or international constituency. This “signaling aspect of sanctions is under-appreciated in the scholarly and policy literature on sanctions,” but is incredibly important to understanding the ways in which the tools of economic statecraft are actually used.<sup>134</sup> Financial sanctions can serve this role because designations are accompanied by press releases or statements that describe the reasons why sanctions are being imposed in a particular case. These narratives establish the factual predicate for a designation and inform the public debate and dialogue about the matter at hand. There are two subtly different motivations embedded within this rationale for imposing sanctions alone or in combination with others. The first involves increasing general public knowledge about the means, methods, and actors involved in facilitating the provision of support to illicit non-state actors. This helps banks, money transmitters, and other intermediaries recognize and stop the flow of illicit financial activity. The second is to engage in the war of ideas against these groups by introducing counter-narratives about their operations, operators, and support structures designed to undermine how these entities portray themselves and seek support within a larger context.

A clear example of the use of a sanctions designation to shape a public narrative about a particular terrorism problem is the case of Anwar al-Aulaqi, an American-born leader of al Qaeda in the Arabian Peninsula (AQAP) who was killed in a drone strike in Yemen in September



2011.<sup>135</sup> Aulqi posed a substantial challenge to the global counterterrorism community. He was an American citizen, fluent in English, whose preaching appeared to have a unique ability to inspire Westerners to commit themselves to al Qaeda.

But Aulqi was much more than a firebrand preacher. On Christmas Day 2009 Omar Farouk Abdulmutallab attempted to detonate a bomb hidden in his underwear on Northwest Airlines flight 253. The bomb did not work as AQAP had hoped and so disaster was averted. But during the course of his interrogation, it became clear that Aulqi had a substantial role in Abdulmutallab's recruitment and in the operational planning that preceded the attack. Indeed, "the detailed account given by Abdulmutallab when he started talking to his FBI interrogators in late January 2010 ... convinced intelligence analysts that al-Awlaki [sic] had evolved from a mere propagandist into a person who played a specific, operational role in plotting terrorist attacks."<sup>136</sup>

The press release that accompanied Aulqi's designation in July 2010 was the first time that the U.S. government described his operational role at length, and the United States used the occasion of the imposition of sanctions to shape the public narrative about Aulqi's operational significance to AQAP. In the press release, the government noted that:

*Aulqi has pledged an oath of loyalty to AQAP emir, Nasir al-Wahishi, and plays a major role in setting the strategic direction for AQAP. Aulqi has also recruited individuals to join AQAP, facilitated training at camps in Yemen in support of acts of terrorism, and helped focus AQAP's attention on planning attacks on U.S. interests.*

*Since late 2009, Aulqi has taken on an increasingly operational role in the group, including preparing Umar Farouk Abdulmutallab, who attempted to detonate an explosive device aboard a Northwest Airlines flight from Amsterdam to Detroit on Christmas Day 2009, for his operation. In November 2009, while in Yemen, Abdulmutallab swore allegiance to the emir of AQAP and shortly thereafter received instructions from Aulqi to detonate an explosive device aboard a U.S. airplane over U.S. airspace.<sup>137</sup>*

Similarly, in 2011 the U.S. government designated Yasin al-Suri, a prominent Iran-based al Qaeda facilitator who moved money and recruits from across the Middle

East, through Iran and into Pakistan, for the benefit of al Qaeda's senior leaders.<sup>138</sup> In the press release announcing the designation, the government revealed the existence of an agreement between al Qaeda and the Iranian government by which the terrorist group was permitted to "funnel funds and operatives through [Iran's] territory."<sup>139</sup> The link between the Iranian government and al Qaeda added a new dimension to the understanding of how both groups operate.

Finally, in designating four leaders of Hezbollah's external operations wing in 2013, the U.S. Department of the Treasury described some of the myriad ways in which the group supports terrorism throughout the world and is not simply a Lebanese "resistance" group.<sup>140</sup> These activities range from "assisting fighters from Iraq to support the Assad regime in Syria, to making payments to various factions within Yemen, and to military leaders responsible for terrorist operations in Egypt, Jordan, Turkey, Cyprus, Israel, the Palestinian territories, and Iraq."<sup>141</sup> The press release in that case was used to dispel a dimension of the group's self-constructed mythology and emphasize its role as a transnational terrorist organization involved in activities that destabilized a range of countries throughout the Middle East.



*By designating Hezbollah leaders in the last several years, the U.S. Department of the Treasury has shaped the public narrative regarding the group. The Treasury has described how the group is more than a Lebanese "resistance" group and in fact supports global terrorism. Here, the Hezbollah flag and logo fly in Baalbek, Lebanon. (Wikimedia Commons/yeowatzup)*

## Effects on Targets

Notwithstanding their centrality to the global campaign against illicit actors like terrorist groups and narco-traffickers, it has been difficult to measure and quantify the effects of sanctions targeting non-state actors in the same way this paper did for sanctions targeting states.

Nevertheless, government officials from the United States, United Nations, and elsewhere speak regularly about the importance and impact of curtailing the sources of financial support to terrorist groups in the overall struggle against terrorism. In this regard, David Cohen noted, “Through the application of powerful national and international sanctions, close cooperation with foreign partners and the private sector, and enhancements to international financial transparency, we have made it harder than ever for terrorist groups to raise, move, store, and use funds.”<sup>142</sup> And Daniel Glaser, also a senior Treasury Department official, similarly explained in 2011 that “[t]hrough the use of targeted financial measures, the development of innovative mechanisms for collecting financial intelligence and sustained engagement with key jurisdictions, we have systematically undermined terrorist financial networks across the globe, with notable success against core Al-Qa’ida [sic], our greatest threat.”<sup>143</sup>

In the post-9/11 period, scholars have noted the success of the international community in “significantly hobbling terrorist groups by restricting access to legitimate financial channels.”<sup>144</sup> Disrupting the sources of financial support to ISIS has been a core component of the global coalition’s approach to degrading and destroying the group.<sup>145</sup> Recent U.N. Security Council Resolutions designed to address the threat posed by ISIS emphasized “that sanctions are an important tool under the Charter of the United Nations in the maintenance and restoration of international peace and security, including in support of countering terrorism.”<sup>146</sup> Indeed, in the context of the counter-ISIS financing campaign, the U.N. Security Council hosted its first meeting chaired by national finance ministers in December 2015.

While it might be difficult to determine the impact of sanctions in the aggregate, it might still be possible to do so in the case of an individual group or at a specific interval of time. In the context of the battle against ISIS’s sources of support, for example, a senior U.S. official has noted a decline in oil production and diminished transportation capacity after a concerted U.S. effort to strike at valuable assets, ranging from

the destruction of costly oil production infrastructure to tanker trucks, where 400 have been destroyed, increasing transportation costs.<sup>147</sup>

With improved record-keeping and transparency at money exchange houses and other informal value transfer systems in certain parts of the world, it also might be possible to estimate the amount of financial activity that has moved from the formal to the informal financial system in response to sanctions measures.

***Some data supports the assertion that sanctions undermine the ability of terrorist groups to raise, store, move, and use funds.***

Thus, we have evidence based on public statements from government officials that financial sanctions are having significant effects on non-state actors,<sup>148</sup> and some data to support the assertion that sanctions undermine the ability of terrorist groups to raise, store, move, and use funds. Nevertheless, “[m]aking sanctions smarter, and measuring their impact, are constant challenges.”<sup>149</sup>

Shadowy terrorist groups and narco-trafficking networks will never generate the kind of data that would demonstrate the impact that financial sanctions have on their operations. And without such data, determining the effectiveness of such measures will be difficult. But by keeping in mind the purposes of sanctions imposed against non-state actors, and with some greater transparency in ways recommended below, the use of the tool can be refined further and with greater effect.

## **04 CHAPTER**

# **The Challenges of Contemporary Sanctions to the United States and on the Global Financial System**

In contrast to the previous chapters, which focused on the effects and effectiveness of sanctions imposed on the targets of those sanctions, this chapter will highlight some of the effects that modern financial sanctions have had on the United States, its allies, and the international financial system as a whole. Some of the dynamics described below are still beginning to take shape, and it is impossible to determine at this juncture whether they ultimately will have strategic significance. One key reason for this is the difficulty in gathering extensive data to systemically determine the scope and severity of these challenges. But because of the potential for these challenges to merit significant strategic concern, and in considering the long-range impact of financial sanctions, the sets of issues outlined below demand attention.

*As economic sanctions have become more targeted, innovative, and focused on the provision of financial services, some negative effects have emerged.*

As described above, the United States has innovated substantially in using financial sanctions in the post-9/11 era, with important successes in changing behavior, as in the Iran and Burma cases, and in choking off the ability of terrorist groups to raise, store, move, and use funds. As economic sanctions have become more targeted, innovative, and focused on the provision of financial services as the key intermediary for exerting pressure on sanctions targets, however, some negative effects have emerged for the United States and for the international financial system. Over time these externalities may undermine the availability and integrity of sanctions as a tool of American statecraft, and in so doing, also may undermine the ability of the United States to use sanctions as a way to exert pressure and shape the incentives of adversaries that can complement diplomacy without the recourse to military force in the future.

The first of three broad categories of impacts derived from the use of sanctions is related to the global financial sector. This includes the “de-risking” phenomenon, which is a process by which private companies prophylactically abandon activities they perceive to pose financial crimes compliance risk, for fear that they will be subject to substantial fines if they inadvertently engage in proscribed activities. De-risking can have an impact on other policy priorities, such as financial inclusion,<sup>150</sup> and on the sustainability of the enterprise of financial sanctions. It can reduce the reach of the formal financial sector, driving illicit activity to unregulated spaces, and may impugn the legitimacy of sanctions as a tool of statecraft. This category of risk also includes the possibility that the U.S. dollar’s global dominance – the jurisdictional source of America’s power in economic statecraft – will be reduced. The second category of challenge pertains to the U.S. government’s internal organization for the imposition of financial sanctions. As sanctions become more innovative, complex, and more closely integrated into the heart of U.S. national security strategy, the U.S. government will need to become better organized to create and implement sanctions policies. And finally, there have been challenges to the strategy of sanctions – namely the ways in which sanctions have been integrated into larger strategic approaches to particular foreign policy problems.

### **Impact on the Global Financial Sector**

In the face of extensive sanctions regimes and significant enforcement actions for sanctions violations, some elements of the private sector have begun to react preventively to mitigate their exposure to financial crimes risk. The regulatory fines and reputational harm that financial institutions can suffer as a result of violating sanctions, and ambiguities about the outer limits of sanctions enforcement strategy, have deterred the banking and finance sector in particular from opportunities abroad that they perceive as too risky. Additionally, some international companies and

governments are developing non-U.S. financial platforms or looking increasingly to non-U.S. currencies to avoid exposure to U.S. jurisdiction for the purpose of sanctions enforcement and compliance.

## DE-RISKING

De-risking has negative effects on policy priorities of the United States and thus demands sustained attention. It impedes the ability of the U.S. government to use sanctions as incentives – critical to the ability to compel changes in behavior, as discussed in chapter two – in two ways. First, it could limit the potency of sanctions measures in the future; if no financial relationships exist with a particular jurisdiction, prohibiting transactions and financing through sanctions will not generate leverage for behavior change. Second, de-risking could inhibit the government’s ability to unwind sanctions and create positive incentives for changes in behavior when it desires to do so because financial institutions will decline to re-engage in formerly sanctioned states.

In practice, de-risking occurs in several different ways: when banks choose to terminate accounts that might attract regulatory attention rather than potentially expose themselves to fines if they keep them open;<sup>151</sup> when, more broadly, banks pull out of and/or sever correspondent relationships with places like the Middle East exposed to potentially sanctionable or sanctioned bodies; or through “pre-risking” – not opening up any accounts at all with respect to certain categories of activity.<sup>152</sup> These actions make commercial sense to banks because civil penalties for sanctions violations are imposed on a strict liability basis, meaning companies can face liability even if they did not willfully violate sanctions regimes. In practice, a survey of 17 banks found that thousands of correspondent banking relationships have been terminated since 2011.<sup>153</sup> After HSBC was fined in 2012, for example, it reportedly began to terminate relationships in countries it deemed too risky.<sup>154</sup>

In November 2015, the World Bank published an initial report finding that half of the 110 banking authorities it surveyed worldwide<sup>155</sup> reported a decline in correspondent banking. The figure jumped to 75 percent of international banks; American banks were the most likely to have terminated correspondent banking relationships.<sup>156</sup> In early 2015, California Merchants Bank, which previously processed 60–80 percent of Somali

remittances from the United States, refused to transfer any more money to Somalia, which more broadly has experienced trouble receiving funds from the Somali diaspora in the West – a critical challenge for a country that relies heavily on remittances.<sup>157</sup> And domestically, in May 2015, major U.S. bank branches terminated their business in the border city of Nogales, Ariz., because their compliance departments believed it carried too much risk for money laundering.<sup>158</sup>

The World Bank, the Financial Action Task Force (FATF), and Federal Reserve have expressed particular concern for how de-risking might affect financial inclusion by making it difficult or impossible for migrants to make remittance transfers.<sup>159</sup> In one recent case, when de-risking imperiled significant remittances, a Somali money transmitter successfully fought a bank’s termination of banking relationships. In 2014, Barclays was the last major bank facilitating remittances to Somalia.<sup>160</sup> The bank attempted to cut off its relationship with Dahabshiil, a Somali remittance provider. Barclays had sought to eliminate Dahabshiil’s extensive business with Somalia as it sought to reduce risk in its relationships. But Dahabshiil obtained an injunction against Barclays and later a settlement to accommodate its business.<sup>161</sup> The Dahabshiil case may represent a rare public victory for financial institutions trying to stave off the de-risking phenomenon.

### ***De-risking impedes the ability of the U.S. government to use sanctions as incentives – critical to the ability to compel changes in behavior.***

De-risking also has implications for foreign policy and strategic interests of the United States and its allies. For countries like Jordan, Lebanon, and Turkey, which are close American allies but also financial markets that sanctioned parties are likely to use (and abuse) due to their proximity to terrorist groups like ISIS and Hezbollah, de-risking might have significant consequences for the stability and viability of their banking sectors (and, by extension, for their economic well-being more generally).<sup>162</sup>

The phenomenon also generated diplomatic challenges for the United States in 2010 and 2011, when banks in the United States closed accounts for diplomatic missions of countries like Angola for fear of inordinate

financial crimes compliance risk and/or cost.<sup>163</sup> In January 2011, diplomats from China, South Africa, and Turkey, among other nations, informed the Treasury and State Departments that the bank terminations had affected their diplomatic missions to the United States as well.<sup>164</sup> By 2012, the State Department began pressing banks to reopen these accounts because of the strain the withdrawal of banking services had on diplomatic relationships. The banks in effect asked for assurances that resuming embassy business would not lead to enforcement actions, but the State Department had no authority to grant them their request.<sup>165</sup> The situation was not resolved fully; in January 2015, the State Department gave a presentation on banking and compliance in which it emphasized it did not have the power to compel a banking relationship but allowed two banking representatives to discuss best banking practices with foreign diplomats.<sup>166</sup>

De-risking also might affect the United States' financial pre-eminence. Thomas C. Baxter, executive vice president and general counsel of the Federal Reserve, argued in February 2015 that de-risking might have problematic implications for the United States "with respect to the role of the dollar as the international medium of exchange."<sup>167</sup> And the financial exclusion of large numbers of people also pushes higher risk clients to banks that might have fewer resources to detect illegal activity.<sup>168</sup> Baxter has observed the trend of "adverse and unintended consequences" for the affected regions of the world and implored business leaders to rethink their compliance programs with the potentially affected populations in mind.<sup>169</sup>

***Although China has been fighting for economic parity with the United States in general, Russia also is taking steps to immunize its economy from sanctions.***

When analyzed closely, the de-risking phenomenon presents something of a paradox. While clearly there are changes occurring in the international banking system in response to these dynamics, it has proved challenging to identify the causal mechanisms with precision. Some commentators, for example, have noted that de-risking is in part a product of the significant fines to which banks have been subject in recent years.<sup>170</sup> In 2014 BNP Paribas was fined \$8.9 billion; in 2012 HSBC reached an

agreement with the U.S. government and paid nearly a \$2 billion penalty; and also in 2012, Standard Chartered paid nearly \$1 billion in fines to settle allegations of sanctions violations. These fines and settlements have significantly shaped the risk tolerance of global financial institutions – after all, they reason, almost no transactions or relationships generate enough profits to be worth the potentially significant fines and reputational damage that can result from these enforcement cases.

***While there are changes occurring in the international banking system in response to these dynamics, it has proved challenging to identify the causal mechanisms with precision.***

But when examined more closely, this explanation might not prove as persuasive as it seems at first glance. The magnitude of the fines levied against BNP Paribas, HSBC, Standard Chartered, and others were all criminal in nature, having emerged from willful violations of law, which often included measures to evade sanctions restrictions. They were not the kinds of inadvertent violations of sanctions restrictions that banks claim are driving the de-risking phenomenon. Further, the lack of full coordination and alignment between various financial regulators in the United States, which they believe and fear will increase the cost of the charges brought against them, creates yet more reason to avoid any transaction or relationship of concern.

Another paradox of the de-risking phenomenon is that it also may be attributed to concern about avoiding general financial crime, rather than sanctions violations. In Mexico and Central America, for example, where many financial institutions are canceling correspondent banking relationships, the concerns about avoiding money laundering and the financial flows of criminal activity, including drug, weapons, and human trafficking, are a key driver.<sup>171</sup> Additionally, in a period of cost-cutting and global retrenchment by banks, commercial decisions to lower exposure to potential financial risks of all kinds are understandable.

Finally, the de-risking phenomenon has been difficult to confront because it is difficult to gather sufficient data to measure with confidence how many global correspondent banking relationships have been canceled, or accounts closed or refused, due to concern

over sanctions as opposed to other activities. Even more difficult is the exercise of determining which canceled relationships or accounts can be attributed to true concern over sanctions or financial crime liability, versus a more prudential concern about inadequate profit margins from a certain line of business or customer constituency. The implication of this is that it may be difficult to ascertain exactly how much de-risking is truly de-risking as defined in this section, and how much canceled business is hiding behind this guise or mislabeled. Some so-called de-risking may actually be beneficial if financial institutions are making more careful decisions about managing, though not avoiding, risky counterparties. In any case, while research and industry analysis into this phenomenon is more anecdotal and qualitative than rigorously quantitative at this point, the severity of concern about the de-risking phenomenon has drawn the attention of global financial leaders and well-respected multilateral financial institutions.

Because de-risking poses a challenge for the international financial system, policymakers from a range of jurisdictions have made efforts to understand and address it, while regulators have encouraged banks to re-examine customer relationships rather than break them off.<sup>172</sup> As the then-Under Secretary of the Treasury for Terrorism and Financial Intelligence David Cohen explained in 2014, “[D]e-risking’ can undermine financial inclusion, financial transparency and financial activity, with associated political, regulatory, economic and social consequences.”<sup>173</sup> As banks exit a particular market, they reduce competitiveness, which increases costs and decreases banks’ motivation to enact best business practices. De-risking also undermines the trend toward adoption of a “risk-based approach” to the management of financial crimes compliance. A risk-based approach, which the FATF identifies as a best practice for financial crimes compliance activity,<sup>174</sup> requires banks to only terminate accounts or relationships where banks cannot manage the risks for terrorist financing, money laundering, or other illicit activity.<sup>175</sup> Ideally, businesses would make financial decisions based on the actual risk of the underlying activity, on a case-by-case basis, rather than as a result of the risk of potential regulatory enforcement. As Cohen stated, “[D]e-risking’ is the antithesis of an appropriate risk-based approach.”<sup>176</sup>

But despite the difficulties in identifying with precision the outer boundaries of the phenomenon and its underlying dynamics, de-risking is likely to remain a part of the financial crimes compliance landscape for the foreseeable future.

**ARCHITECTURAL CHANGES – SHIFTS IN THE STRUCTURE OF THE INTERNATIONAL FINANCIAL SYSTEM**

The second major impact of sanctions on the countries imposing them, as well as on the broader international financial system, involves a series of inchoate changes to the underlying architecture of the international financial system.

The ability to deploy and enforce financial sanctions fundamentally depends on the widespread use of the U.S. dollar for a significant proportion of global financial activity. Because the U.S. financial system is the largest and most liquid in the world, as well as fairly transparent, stable, and reliable, U.S. currency is used for a wide range of transactions that have little otherwise to do with the U.S. economy. These include, for example, the majority of the global trade in oil and almost all commodities. And because almost all U.S. dollar transactions of any significance must cross the U.S. financial system, they become subject to U.S. jurisdiction for the purpose of sanctions enforcement.

People and businesses all around the world therefore use U.S. dollars and U.S. dollar-denominated financial instruments for a wide range of purposes, fundamentally because of its perceived stability and because of the large liquid market for U.S. dollar securities. While the United States only produces 23 percent of global economic output, the dollar is responsible for 43 percent of cross-border transactions and 63 percent of known central bank reserves.<sup>177</sup> Trade finance is even more significantly dollar-denominated compared to global trade, with 80 percent of Letters of Credit, and a high proportion of the activities of global and local banks, denominated in dollars.<sup>178</sup>

***The ability to deploy and enforce financial sanctions fundamentally depends on the widespread use of the U.S. dollar for a significant proportion of global financial activity.***

Of late, however, changes have started emerging in the international financial system that may over time make fewer transactions subject to U.S. jurisdiction, and thus to the reach and power of U.S. economic sanctions. In October 2015, for example, China introduced its Cross-Border Inter-Bank Payments System (CIPS).<sup>179</sup> This mechanism of bank payment messaging is similar in

function to SWIFT, and is meant to establish an independent yuan-denominated payment clearing system. The establishment of CIPS was driven by a range of factors, many of which have to do with China's economic and commercial aspirations in East Asia, but also derives at least in part from concerns that SWIFT has an overly close relationship with Western security services and interests.<sup>180</sup> Creating an international clearing system that uses the yuan also makes the yuan more competitive with the dollar as a cross-border currency.<sup>181</sup>



*Prime Minister Dmitry Medvedev addresses the crowd at the Sochi-2014 International Investment Forum. This plenary session, "Russia between Europe and Asia: A New Regional Policy in Modern Circumstance," suggests Russia's shifting view toward the East following a weakened relationship with the West over sanctions. (Government of the Russian Federation)*

Transactions cleared through CIPS are not denominated in U.S. dollars, do not touch the U.S. financial system, and therefore may not be subject to U.S. jurisdiction for the purpose of sanctions enforcement (or, for that matter, for any other purpose). In theory, therefore, businesses outside the United States and in which U.S. persons are not involved could conduct transactions using CIPS that would be prohibited by U.S. sanctions laws if they were denominated in U.S. dollars.

Although China has been fighting for economic parity with the United States in general, Russia also is taking steps to immunize its economy from sanctions by creating an alternative to SWIFT.<sup>182</sup> Russia has been seeking to free itself from the confines of using SWIFT for some time; it has already created a domestic alternative to SWIFT, and is in the process of developing an international alternative with BRIC countries.<sup>183</sup> It also



has made other moves to more independent financial processing systems: MasterCard and Visa, for example, signed agreements to continue transactions in Russia despite sanctions levied by the United States as a result of Crimea.<sup>184</sup>

To be sure, CIPS faces limitations – in the liquidity of the yuan, confidence in the Chinese government’s fiscal and monetary policy, Beijing’s uncertain commitment to property rights and rule of law, and the system’s operational hours and geographic scope. For now, it is most useful for transactions into and out of China.<sup>185</sup> But the fear is that China and others are slowly replacing the fundamental architecture of the international financial system in a way that will make it more difficult for the United States to use the tools of economic statecraft to protect its interests and those of the international community in the future. Moreover, the United States and its allies fear that the extent of their powerlessness will be revealed after it is too late to do anything about it, and that it will have non-linear effects on the Western financial system. Even before this may occur, however, the phenomenon of global commerce shifting away from the dollar is concerning to those watching for sanctions evasion. The more adept that Russian and Iranian companies become at structured finance, commodity transactions, and trade transactions outside of the dollar, the more difficult it will be to toughen or snap-back sanctions if merited by policy priorities.

For now, at least, there are structural reasons relating to the operation of the international financial and commercial markets that will limit the extent to which the yuan or other currencies will be able to supplant the U.S. dollar’s dominance. First, and most important, the size and liquidity of the market for the U.S. dollar is unmatched by that of any other currency. For this reason, companies around the world use short- and long-term U.S. dollar denominated securities for cash management purposes in a way that no other currency will be able to supplant easily, at least not in the near term.

The size and liquidity of the U.S. dollar markets are likely to remain dominant as long as global commodities, particularly oil, are traded in U.S. dollars. Given the fact that the United States itself is currently one of the world’s largest oil producers, and that several of the next largest – Saudi Arabia, Iraq, the United Arab Emirates, and Canada – are under the security umbrella of the United States (and in the case of Saudi Arabia and the United Arab Emirates, they peg their currency

to the U.S. dollar), none of those states are likely to support a re-denomination of oil. Given their continued reliance on the United States for their security, and their substantial holdings of U.S. dollar foreign currency reserves, pushing to re-denominate oil would introduce significant political and economic risk to these countries at a time when the Middle East security situation is already precarious. Many of the world’s largest and most significant economies hold a significant portion of their foreign currency reserves in U.S. dollars, and almost all currency pegs in the world are to the U.S. dollar, making it considerably more difficult to shift away from the greenback in global commodity trading.

***Sanctions policy has become subject to the partisan disputes that have characterized a great many foreign policy challenges in the last several years.***

Not only is the U.S. dollar’s position firmly entrenched in the international system, but there are also important obstacles to the emergence of the yuan as a threat to the dollar’s dominance, not the least of which are concerns about the ability of the Chinese government to manage complex economic challenges.<sup>186</sup> Whether or not the position of the dollar is ever decisively threatened, it is important to keep in mind the relationship between the use of financial sanctions and the global strength and position of the U.S. dollar.<sup>187</sup>

### **Internal U.S. Government Structure for Sanctions Programs**

As sanctions have grown more complicated and more central to U.S. security strategy, the imperative to coordinate among agencies involved in sanctions policy and enforcement has grown more acute. Paradoxically, however, there has been substantial growth in the nature and number of entities at the federal, state, and local level with involvement in sanctions enforcement, resulting in a fragmentation of authority and a mismatch between policymaking responsibility with respect to sanctions and enforcement authority. The White House, for example, does not have a senior advisor in charge of sanctions policy as it increasingly overlaps with other important foreign policy tools – a person who might be able to advise when sanctions should be used and how

they should be combined with diplomatic, military, and intelligence initiatives to address particular problems. Instead, questions about sanctions are handled on a case-by-case basis.

Congress, too, has a role in the design of sanctions programs, and sanctions policy has become subject to the partisan disputes that have characterized a great many foreign policy challenges in the last several years. This dynamic has emerged recently in a number of cases. While President Obama was able to lift certain trade and travel restrictions on Cuba in 2015 relying on executive authorities, congressional action is required to fully restore economic relations.<sup>188</sup> Shortly after the president announced his initiative, leading congressional politicians from both parties took to the media to announce their resistance to Obama's plan,<sup>189</sup> and the legislation that would be required to fully lift the embargo against the island nation has not been enacted. A few months later, when the Obama administration introduced the JCPOA with Iran, congressional leaders announced their intention to extend a sanctions law that Iranian officials stated they would consider a violation of the nuclear agreement.<sup>190</sup>

Beyond partisan rhetorical challenges to the executive branch's authority, congressional leaders are increasingly inclined to intervene in the design and execution of sanctions programs at a tactical level, adding another complexity to the web of actors.<sup>191</sup> Congress has, for example, attempted to write the names of putative sanctions targets into statutes (and done so in at least one case: Islamic Republic of Iran Broadcasting<sup>192</sup>), adopted new definitions for ownership or control of sanctioned bodies, attempted to identify what constitutes the provision of material support to proscribed entities, and sought to prevent executive action from providing sanctions relief.<sup>193</sup> In the relatively recent past, several congressional measures on Iran further attempted to strengthen congressional oversight into economic sanctions. Congressman Steve Russell (R-Texas) sponsored the Iran Terror Financing Transparency Act, and Senator Benjamin Cardin's (D-Md.) draft bill on Iran sanctions further attempted to prevent the president from removing specially-designated nationals (SDNs) from sanctions lists without submitting a certification to Congress.<sup>194</sup>

This fragmentation of authority and competency exists between the federal government and its state and local counterparts as well. These policymaking

bodies, enforcement agencies, and regulatory groups shape sanctions enforcement, but do not generally have jurisdiction over sanctions policy. They have different agendas and authorities with which they approach sanctions-related issues, which can lead to a divergence between the goals that sanctions policy seeks to achieve and the enforcement actions that give teeth to regulatory measures. Most notably, new bodies, like New York's Department of Financial Services (DFS), have begun to undertake sanctions enforcement without coordinating with federal bodies.<sup>195</sup> In 2012, for example, the DFS levied fines on Standard Chartered Bank without notifying federal bodies of its actions, despite the fact that federal regulators were also pursuing cases for the same sanctions violations in collaboration with DFS.<sup>196</sup>

## Sanctions Strategy

Finally, the ways in which sanctions have been used by the United States and its allies in the post-9/11 era have generated changes in the international environment that the United States will have to address in the coming years. These changes fall principally into three categories. The first are challenges in unwinding sanctions, which will make it more difficult to reward target countries for complying with the wishes of the international community, thereby potentially undermining the effectiveness of sanctions as a foreign policy tool. The second has to do with relationships with U.S. allies on sanctions issues, and potential divergences between the United States and Europe on sanctions policy. And the



*President Obama delivers a speech at the University of Yangon in Myanmar on November 19, 2012. Despite easing sanctions on Myanmar, the lack of investors returning to the country evidenced the costs and unforeseen consequences of unwinding sanctions. (White House/Pete Souza)*

third has to do with the proliferating use of the tools of financial sanctions by other countries and the need to prepare for potential retaliation.

#### **CHALLENGES IN THE STRATEGY OF SANCTIONS – UNWINDING**

Difficulties in unwinding sanctions may lead to challenges in achieving the compellant benefits that sanctions against states are meant to achieve. Over the long term, if sanctions cannot be unwound in response to changes in behavior by the target state, future target states may lose their incentives for compliance, and sanctions will begin to look punitive (rather than coercive) in nature.

The key test for this dynamic will be Iran. Initial reactions to the JCPOA by the United States and its Western European allies embodied significantly different approaches to business with Iran. The United Kingdom expressed its desire to begin strong economic relationships,<sup>197</sup> France was actively courting Iranian businesses,<sup>198</sup> and Germany sent the first top Western official after the deal was concluded.<sup>199</sup> There are reports of American investors going individually, and at times surreptitiously,<sup>200</sup> as the vast majority of sanctions on U.S. persons that prevent them from doing business in Iran remain in place.

***If Iran does not see financial benefits from the JCPOA, it will no longer see an incentive to comply with the agreement's restrictions on its nuclear capabilities.***

This will complicate substantially the compliance landscape for large multi-national corporations seeking to re-engage with Iran, but also to avoid involvement with terrorist financing, money laundering, corruption, U.S. sanctions that remain in place, and other financial crimes compliance (and substantial reputational) risks in Iran.<sup>201</sup> Ultimately, some observers suspect that the cost of doing business in Iran will be too high for Western companies concerned to avoid risk, particularly if oil prices remain low for a sustained period of time. If Iran does not see financial benefits from the JCPOA, they fear, it will no longer see an incentive to comply with the agreement's restrictions on its nuclear capabilities.

Other countries where sanctions were lifted give some idea of what Iran can expect as nations tentatively begin

investigating economic opportunities. The aftermath of unwinding sanctions on Burma, for example, confirms that unwinding longstanding sanctions in situations of political uncertainty – in both the sanctioning countries and the sanctioned – is a challenge. After the United States lifted most sanctions on Burma, there were strong initial signs of interest by the private sector in re-engaging there, followed by disappointment a few years later when the hoped-for participation in the Burmese economy by Western investors failed to materialize.

Those who tested the waters accused the United States of simultaneously encouraging investment while making it difficult to do so by keeping a few important, well-connected businesses related to Burma's former junta sanctioned.<sup>202</sup> One American investor noted: "It is almost like [Washington is] telling us to invest with a wink and a nod"; as another bluntly put it, "U.S. companies are severely handicapped by our government's unclear policy."<sup>203</sup> The difficulties companies faced in navigating a complex financial crimes compliance environment and a country in which many significant economic players remained subject to sanctions (including, most prominently, the major banks and the operators of all major sea and airports) dampened substantially the willingness of private companies to engage with Burma after the opening in 2012.

At the same time that target states seek rewards for changes in behavior, so too must understand that there will be clear consequences for cheating on the deals that they signed in response to lifting financial sanctions. Only in this way can the international community do as much as possible to reinforce the target's desire to stand by a deal.

#### **THE UNITED STATES AND EUROPE – DIVERGENCES ON SANCTIONS POLICY**

The globalization of the economy and the proliferation of American sanctions regimes as a part of the administration's foreign policy have implications for U.S. relationships with allies. Globally, allied countries must collaborate with the United States on broad foreign policy objectives, and sanctions in particular, in order for them to be effective. Recently, though, the United States has struggled at times to ensure multilateralism in its sanctions and allied support for its sanctions decisions. After the United States imposed sanctions on Russia in 2014, Senator Chris Murphy (D-Conn.) tied the EU's support for the sanctions into the transatlantic diplomatic relationship in general, explaining that the

sanctions were a crucial test of the unity of the EU and the United States in the face of an international crisis.<sup>204</sup>

Although the EU did eventually join the United States in sanctioning Russia (most significantly after the shoot-down of Malaysian Airlines Flight 17 in July 2014), tensions surrounding divergent approaches to Russia remain (and may continue up until the EU must renew its current sanctions in June 2016). Jean-Claude Juncker, the president of the European Commission, continued to make statements resisting the pressure to conform the EU's foreign policy and sanctions regime to the United States', explaining, "We can't let our relationship with Russia be dictated by Washington."<sup>205</sup> The United States' relationship to allies in the Western Hemisphere is also challenging with respect to sanctions. After the United States imposed sanctions on Venezuela in 2015, Latin American and Caribbean countries registered their discontent with the policy, signifying the most resistance to a sanctions regime since the United States embargoed Cuba.<sup>206</sup>

Because sanctions have become a signature element of American foreign policy, alignment on sanctions is a sign of diplomatic goodwill in general. When the government pursues sanctions that do not have multilateral support, or requests sanctions from its allies, it has the potential to upend diplomatic relationships.

### **THE POTENTIAL FOR RETALIATION**

Finally, retaliation against sanctions measures by nation-states or other actors is a major concern for the future longevity and viability of sanctions as a national security tool. Most prominent have been a series of cyber-attacks apparently conducted in response to the use of financial sanctions. In 2012, for example, the Department of Defense attributed cyber-attacks launched against U.S. banks to Iran,<sup>207</sup> conducted as retaliation for sanctions.<sup>208</sup> One set of cyber-attacks also hit commercial affiliates of American allies – Saudi Aramco, the national Saudi Arabian oil company, and Qatar's RasGas, a natural gas producer and exporter in Qatar.<sup>209</sup>

North Korea, too, has used cyber-attacks to target U.S. economic interests, in the attack against Sony Pictures in late 2014. The attacks cost the company a significant amount in material and reputational damage, as the company's networks were taken offline for some time, computers were destroyed, embarrassing emails and payroll information were released publicly, and litigation

ensued.<sup>210</sup> After North Korea attacked Sony (and U.S. commercial interests by proxy), the government retaliated with more sanctions.<sup>211</sup>

The threat of retaliation is a serious concern in the context of the new cybersecurity sanctions program.<sup>212</sup> If and when the United States deploys these sanctions, banks or others may find themselves subject of significant retaliation efforts. But the consequences of this threat remain unexamined, and modes of communication between government and the private sector about potential threats from this form of retaliation have not been established. Policy on retaliation remains underdeveloped; it is not known if American businesses or the businesses of American allies will be helped in any way in the event of retaliation for the use of cyber sanctions.

Retaliation also could have implications for the U.S. commitment to – and growing imperative for – multilateral sanctions. In late 2014, after the United States and EU imposed sanctions, Russia threatened to create a bill that would allow the Russian government to confiscate foreign assets.<sup>213</sup> While this clearly would be punishing for American business, the announcement also had immediate consequences on the global stock market and put Russia's energy relationship with the EU in question.<sup>214</sup> As U.S. collaboration with allied countries becomes more important for the continued effectiveness of sanctions, the U.S. and EU's alignment of interests also has become more difficult to maintain because of the threat of retaliation that both feel but to which the EU is asymmetrically vulnerable.

Many of the trends identified in this chapter are developing, but represent a significant new type of effect of the financial sanctions enterprise as practiced since 9/11. While it is unlikely that there will be decisive resolution of any one of these challenges, they must be considered in the course of developing sanctions programs on an ongoing basis. Ultimately, the effectiveness of financial sanctions must be considered holistically, taking into account the effects on the targets, the ability of those effects to generate desirable policy outcomes, and the negative externalities on the larger ecosystem within which sanctions operate.

## **05 CHAPTER**

# **Policy Recommendations for the Future Use of U.S. Sanctions**

As previously discussed, the set of sanctions tools that policymakers can use to attack security threats has created profound economic and political effects and proved effective in some instances. Policymakers can improve on the efficacy of sanctions as a policy instrument to achieve national interests. But they will need to focus their attention on how to mitigate some of the negative effects of sanctions on U.S. policy goals and on the global financial system. Indeed, the task of updating and improving sanctions strategies and institutions is to retain the relevancy and cogency of these security measures.

Improving on the authorities and implementation of sanctions is a constant process in a dynamic global financial system and evolving set of security threats. However, given the prominence of sanctions among U.S. tools of deterrence and coercion, the need to ensure that the technical sophistication of sanctions tools is at least in step with rapid technological innovation in the movement of money and communications, and to counter the expected increase in use of sanctions by adversaries and competitors, U.S. leaders must expand their efforts to implement new sanctions policies and practices.

*Improving on the authorities and implementation of sanctions is a constant process in a dynamic global financial system and evolving set of security threats.*

A series of policy recommendations lays out steps to expand the institutional and strategic underpinning for the use of sanctions; to invest further in data generation and analysis, tool sharpening, and adaptation; and to develop long-range research and development assets. The recommendations roughly mirror the presentation of sanctions effects and challenges discussed in the prior chapters of this report. It is not an exhaustive list of suggestions. Furthermore, some of the ideas presented to address a specific challenge will, if implemented, help to address various other challenges discussed in this report.

## **Policy Recommendations:**

### **1. MINIMIZE THE UNINTENDED EFFECTS OF TARGETED SANCTIONS AND INCREASE THEIR EFFECTIVENESS.**

Perhaps the most meaningful changes that policymakers can implement to increase the precision of the coercive effects of sanctions on their target, and to increase their effectiveness, involve new measures in three areas: publicly clarify the explicit goals and uses of sanctions, expand the analytical work underpinning the use of sanctions in particular circumstances, and expand research and development on new sanctions tools, particularly in the area of digital finance. The following policy recommendations will help in the cases of targeting states, as discussed in chapter two, as well as in the targeting of transnational security threats not closely associated with a single governing regime, discussed in chapter three.

- **Present a clear framework for the use of U.S. sanctions in the future.** The national security advisor should publicly outline a framework or doctrine for the use of sanctions in a high-level speech or other document. This will clarify the strategy for the use of sanctions for the U.S. policymaking community and outline for critics and detractors that the costs of violation are severe, and that arbitrariness and ideology have no place in the decisions to use sanctions. This policy speech will signal to U.S. adversaries that sanctions are part of the long-term security policy arsenal for the United States and have an enduring place in coercive strategy against both rogue regimes and transnational criminal groups. It also will help to put the U.S. policy community on the same footing with regard to broad coordination and direction for future use. This policy speech should include the following elements:

- » Explicitly acknowledge and affirm the intent of sanctions to coerce and deter security threats, with the intent of shifting behavior.
  - » Declare the premise of the sanctions tool to be the advancement of stability, liberal norms, and rule of law. Furthermore, declare that U.S. policymakers are committed to refraining from using sanctions as a tool of punishment. This will help to ameliorate due process concerns in Europe.
  - » Declare a major research and development effort to pioneer the next generation of sanctions, tied to the denial of access to digital communication and financial platforms by terrorist groups and cyber criminals.
  - » Affirm that as security threats and policy priorities naturally shift in the future, sanctions tools and their applications also will adapt. The articulation of a clear framework for the use of sanctions will not constrain future presidents, but rather set a precedent for their successive articulations of the intent and execution of this policy tool.
- **Expand analysis and modeling of financial and political effects and effectiveness.** U.S. policymakers, particularly those at the Department of the Treasury, should expand the analysis and modeling of financial and economic effects of sanctions. At present, government capabilities to model and anticipate short- and long-term effects of financial sanctions, including on major economies such as Russia, are relatively limited. Robust analytical work can help policymakers to better select sanctions designations and adapt sanctions authorities, according to financial vulnerabilities of the target.

A greater capacity for analysis and modeling can help to narrow the effects of sanctions, thereby limiting unintended consequences and helping policymakers contemplate the best course of sanctions policy in an increasingly digital and anonymous environment with powerful cyber sanctions tools. In some instances, a more sophisticated ability to model a potential increase in corruption or increase in autocratic rule in the target country of sanctions may ultimately raise concerns that cause policymakers to refrain from using sanctions, choosing alternative policy options to advance security priorities. In addition, a more detailed analysis of de-risking activities among financial institutions, as well as more comprehensive understanding of the shift away from the U.S. dollar, will help to guide technical innovation and strategic decisionmaking when it comes to sanctions, including the decision not to use these tools against certain actors or in certain circumstances. Specific recommendations follow.

- » The Secretary of the Treasury should establish an office of the chief financial analyst within the Treasury Department's office of Terrorism and Financial Intelligence, the division responsible for sanctions targeting, implementation, and enforcement. A new chief financial analyst could lead a more systematic evaluation of the financial and economic vulnerabilities of U.S. adversaries in order to best match a tool to these vulnerabilities, and the broader impact of such targeting on the international financial system. This person would work closely with colleagues in Treasury's International Affairs and Domestic Finance Divisions, with the chief economist of the State Department, and with counterparts at the Department of Energy's Energy Information Administration, to evaluate near- and long-term effects of sanctions targeting. He or she also should expand

*Government capabilities to model and anticipate short- and long-term effects of financial sanctions, including on major economies such as Russia, are relatively limited.*

the ability to anticipate and limit unintended consequences, such as increased incidence of corruption and autocratic rule, helping to support more effective and calculated sanctions implementation. Additionally, this person should lead or co-lead an administration-wide research effort to understand the drivers and potential mitigating policy measures for the de-risking phenomenon.

- » Congress should call on the Congressional Research Service to model the economic effects of legislative sanctions proposals. Prior to legislating further sanctions against adversarial regimes or transnational security threats, legislators should draw on their in-house research service to evaluate the economic and financial implications of new sanctions policy. This unprecedented practice would help to expand sanctions effectiveness and limit unintended consequences, particularly when such unintended consequences seriously undermine other security or development goals.
- » The Under Secretary of Defense for Policy should expand the economic and sanctions focus in ongoing and future Defense Planning Scenarios. This expanded work should involve greater Defense Department subject matter expertise focus on sanctions as an element of warfare to be integrated into interagency contingency planning. It can also involve the inclusion of Treasury and State Department colleagues in some of the scenarios and planning work to offer unique operational perspectives. This greater sanctions focus in defense scenarios work will help defense planners to make more pragmatic and budget-conscious decisions about when to support financial sanctions implementation rather than use military force, which will help to limit deployments and save military expenditures where feasible. Such coordination also may offer more choices to defense strategists managing complex security competition with adversaries.

*The Treasury Department is the only national security agency without a policy and planning function, without which it faces a number of challenges.*

- **Create a new sanctions policy and planning office at the U.S. Department of the Treasury.** The Treasury Department is the only national security agency without a policy and planning function, without which it faces a number of challenges in crafting and coordinating long-term thinking and planning on sanctions policy. Such a policy and planning office would allow the lead U.S. government policymakers on financial sanctions, who shepherd one of our most significant tool of national power, to sustain a broader and more holistic view of their work, which would in turn support a stronger National Security Council planning and goal-setting process, and a deeper and more analytically rigorous engagement with Congress and other non-executive branch sanctions policymakers or enforcement officials. Such an office would also support a significantly improved ability to evaluate the costs and benefits of imposing sanctions in various instances, helping to avoid sanctions programs that may directly, or indirectly, undermine U.S. national objectives and security goals.
- **Create a new research and development initiative to create new sanctions tools.** The Treasury Department, in coordination with law enforcement counterparts such as the Secret Service, Drug Enforcement Agency, and Federal Bureau of Investigation, and the Defense Department, as well as the State Department's Bureau of International Narcotics and Law Enforcement (INL), should prioritize the development of a suite of new sanctions authorities to target the use of digital financial and communication platforms by illicit actors. This will help policymakers to adapt existing sanctions authorities focused on proliferation, terrorism,



narco-trafficking, and other illicit activity to digital innovations in the way that criminal networks communicate and move money. It also will build on the existing interagency work underpinning the new cyber sanctions Executive Order, enabling this new sanctions authority to be used to expose and deter criminal and destabilizing attacks on digital platforms. Additionally, it also should elevate this research and development work to an interagency level under the direction of the deputy national security advisor, and establish an external advisory group from the private sector to discuss data privacy, technological innovation, first amendment, and counterterrorism considerations.

## **2. IMPROVE THE FINANCIAL AND POLICY ECOSYSTEM FOR THE EFFECTIVE USE OF SANCTIONS TOOLS.**

Policymakers can undertake a variety of measures to improve the ecosystem for the use of financial sanctions as a policy tool. That is, administration and congressional leaders can work to mitigate the systemic banking sector issues, the institutional limitations within the sanctions policymaking community, and the intra-governmental agency communication and coordination challenges that undermine the efficacy of sanctions. Three key focus areas are discussed below: financial system improvements, U.S. government internal coordination, and international sanctions strategy implementation.

## **3. ADOPT FINANCIAL SYSTEM CHANGES TO IMPROVE SANCTIONS IMPLEMENTATION AND EFFECTIVENESS.**

- **Formalize and expand communication between federal policy agencies and the private sector.** Policy leaders at the Treasury and State Departments should expand and institutionalize communication mechanisms on sanctions issues with the private sector. This can help to ensure greater clarity and standardization in messaging, more effective information gathering from the private sector, and greater institutionalization of relationships. Critically, when U.S. policy leaders and regulators are able to communicate more clearly with the private sector, they may be able to better understand the de-risking phenomena. As a result of the knowledge they gain, they may be able to keep U.S. and foreign companies from shifting away from U.S. banks, trading platforms and the dollar toward foreign and often less well-regulated or capitalized institutions. In particular, it also may help to address a unique driver of de-risking resulting from non-governmental groups imposing pressure or shareholder threats, some of which translate into divestment or non-procurement provisions in many states. This will keep the reach of sanctions as broad and powerful as possible. And all together, greater public-private communication will improve sanctions implementation and achieve narrower economic effects more consistent with intended outcomes.

Pragmatic mechanisms by which to achieve more formalized, successful engagement could include:

- » The Treasury and State Departments should invite trade representatives from the banking, energy, and manufacturing sectors to establish a regular, high-level dialogue to focus on technical solutions and modifications to facilitate greater understanding and implementation of sanctions. This could parallel a successful partnership between the British Treasury and the British Bankers Association.
- » The Treasury Department should establish an external advisory body on sanctions to offer guidance and perspective on sanctions development and implementation to the Treasury Department. It should be comprised of members of

*Greater public-private communication will improve sanctions implementation and achieve narrower economic effects more consistent with intended outcomes.*

*The private sector is the first line of implementation for financial sanctions, and information sharing could expand the capacity of companies to halt illicit transactions while facilitating legitimate commerce.*

the banking and corporate community, academic experts on sanctions, attorneys, former sanctions officials, and others. This body can undertake or commission independent studies responding to acute sanctions policy or process concerns at the Treasury Department, to be published or submitted privately to the Treasury Department, and consider some of the longer-range challenges relating to sanctions implementation and enforcement described above. It also can serve as a confidential sounding board with which Treasury Department officials can consult as they are formulating sanctions policy and can mirror similar advisory boards that exist in the intelligence committee. Such a board can help mitigate unintended consequences of sanctions.

- » Treasury, State, Commerce Department, and intelligence community officials should invite industry trade groups to run seminars for working-level government professionals in these agencies on sanctions implementation processes and activities. No enforcement issues should be discussed in these information-sharing sessions to best facilitate free exchange of information.
  - » The Treasury Department's OFAC should adopt a standard time frame in which they will respond to private sector inquiries. If OFAC consistently does not meet this time frame over a period of six months, it will trigger a Treasury Review of the backlog of inquiries with an eye toward streamlining the process and/or expanding resources to engage with the private sector.
- **Share more financial analysis with the private sector.** Government financial data analysts, from the Department of Treasury and the intelligence community, should downgrade and share select information and analysis with the private sector, particularly the banking community, to offer more information on high-risk jurisdictions, transaction types, methodologies, and evasion tactics used by the entities targeted by sanctions. The private sector is the first line of implementation for financial sanctions, and such information sharing could expand the capacity of companies to halt illicit transactions while facilitating legitimate commerce.
    - » The Financial Crimes Enforcement Network (FinCEN), which administers the U.S. Bank Secrecy Act and serves as the Financial Intelligence Unit for the United States, should publish analytical reports that draw from Suspicious Activity Reports (SARs) and chart illicit financial activity in the United States. FinCEN also could pioneer a new outreach mechanism for the private sector, perhaps as an offshoot to the existing Bank Secrecy Advisory Group, to teach and learn from the private sector on effective tradecraft that can be used to sort through financial data in order to find illicit activity by sanctioned entities and their associates. Doing so also could help measure the effects of sanctions as analysts might be able to identify when transactions are moving from the formal to informal financial sector in response to sanctions.
    - » Congress should amend the Bank Secrecy Act to promote more information sharing. Congress should focus on promoting greater sharing of the data that underlies SARs, rather than the SARs themselves, among financial institutions.
    - » Federal authorities should work with foreign jurisdiction counterparts to harmonize financial information sharing with respect to financial crimes compliance issues, especially where foreign data privacy laws pose an obstacle to effective information sharing within global financial institutions. This could involve creating a series of discrete bilateral agreements, or a limited multi-lateral

agreement for financial data sharing, subject to effective auditing and oversight. It also could involve the creation of a discrete set of rules that would govern large multi-national financial institutions that operate in many jurisdictions to ensure that all branches of the same bank have access to the same information. This will have the effect of expanding U.S. sanctions targeting and enforcement capabilities in a highly dynamic threat environment in which illicit actors increasingly rely on digital currencies and hide behind extensive bank secrecy laws in certain jurisdictions.

- **Expand private sector licensing to engage in permitted business activities.**

Treasury Department officials should expand the guidance and licensing available to U.S. entities to engage in business permitted under sanctions but in which there is confusion about policy intent or legal restrictions. It is particularly important to “lean forward” in this way in instances of removal of sanctions, in order to give greater comfort to businesses considering new investment and trade with a formerly sanctioned country.

- » Expand licensing to keep U.S. companies involved in legitimate business wherever possible, including in Iran, Russia, Myanmar, Cuba, and elsewhere. An important secondary effect of such a policy will be to facilitate greater proximity between U.S. and European sanctions policy, an asset to sanctions effectiveness broadly contemplated.
- » Clarify the distinction between criminal and civil penalties for sanctions violations. This will help ameliorate the de-risking phenomenon by identifying when banks can be held criminally liable for sanctions violations.

- **Dedicate unique analytical capacity to a fusion center for understanding and countering foreign retaliatory responses to financial sanctions.**

U.S. intelligence community leaders at the Treasury Department’s Office of Intelligence and Analysis and at the National Intelligence Council should create a dedicated analytical cell to conduct and constantly update a threat matrix to evaluate U.S. vulnerabilities to the imposition of financial sanctions by foreign adversaries. These adversaries will seek to use their asymmetric advantages to counter the United States with sanctions and retaliatory measures, which in turn means that as part of the process of maintaining the ongoing effectiveness and utility of sanctions, the United States must seek to minimize vulnerabilities in the U.S. financial system, economy, and critical interests.

This cell should create strategies to minimize these vulnerabilities, particularly in the U.S. financial system. This cell will involve close coordination with DHS, the Treasury, Defense, and Commerce Departments, the U.S. Trade Representative, federal, and state and local, where feasible, financial regulators, and others on measures to promote resiliency in U.S. financial trading platforms and institutions, banks, and non-bank value transfer mechanisms. The work of this fusion cell should involve analysis of the kinds of measures that adversaries will use to target the United States, which are more likely to resemble denial of access to U.S. investors, traders, and business interests than the more conventional policy and regulatory measures used by the United States to sanction security threats. The measures employed by these adversaries also may involve disruptive cyber-attacks or an attack of U.S. critical infrastructure targets. In anticipation of such attacks, the U.S.

*The United States must seek to minimize vulnerabilities in the U.S. financial system, economy, and critical interests.*

government should consider warning businesses to make defensive preparations, providing technical or intelligence support in the case of an attack, or undertaking other measures to mitigate the effects of potentially devastating strikes.

#### 5. U.S. GOVERNMENT CHANGES TO IMPROVE SANCTIONS COORDINATION, IMPLEMENTATION AND ENFORCEMENT

*Congress is ... well placed to carefully consider the necessary adaptations for sanctions tools to remain nimble and effective into the future.*

- **Provide further opportunities for government sanctions professionals to stay current in a highly dynamic field.** Administration officials can implement programs to help current employees stay better abreast of technological innovations in digital money movements and new forms of sanctions evasion. This work will help government sanctions professionals think strategically about how to adapt and supplement existing sanctions authorities to address evolution in the global financial system and in the nature of the threats that sanctions seek to mitigate. Administration officials can help to expand indigenous banking and commercial knowledge through:
  - » Professional training courses for current employees.
  - » A robust recruitment program for skilled, technical banking and trading experts, as well as experts in non-bank value transfer and digital currencies, into public service through a directed use of Schedule A hiring authority.
  - » Establishment of a fellowship program in which financial institutions, companies and law firms send professionals to the Treasury Department or OFAC for a year, perhaps using authorities modeled on the Intergovernmental Personnel Act.

In the legislative branch, congressional sanctions leaders should establish a “Next Generation Sanctions” inter-committee working group to consider the innovative modalities of the next generation of U.S. sanctions, as well as the economic and security consequences of such consequences. This working group can solicit studies from the Congressional Research Service and the Government Accountability Office on sanctions threats and effectiveness. As Congress is both a creator of sanctions and an overseer of executive branch sanctions implementation, it is well placed to carefully consider the necessary adaptations for sanctions tools to remain nimble and effective into the future. A working group to fulfill this mission can assemble a community of legislators already committed to sanctions as a key foreign policy and security tool, and elevate the foreign policy strategy role of Congress and its leadership in constructive dialogue with the administration on sanctions tools of the future.

- **Offer training to bank regulators and supervisors on sanctions policy and enforcement priorities.** The White House should direct the Treasury and State Departments to regularly brief officials and supervisors at the federal banking agencies (FBAs) on the framework, intent, and enforcement posture for sanctions. This will ensure that these professions have a direct, informed understanding of the objectives of the sanctions foreign policy tool, which is crucial to the project of capable bank supervision to ensure compliance with policy intent. This should extend both to senior officials at the FBAs as well as to on-site supervisors who are on the front lines of bank supervisory issues.
- **Expand financial resources to sustain the mission.** The president should propose, and Congress should allocate and appropriate, further resources for the

State and Treasury departments to carry out the expanding sanctions development and implementation mission. The executive and legislative branches also must support additional resources for intelligence community elements that support the collection and analytical work essential to tracking the dynamic methods for money movement and communication by illicit actors. This is essential to ensuring that sanctions are nimble and that innovation in their application at least matches innovation in the insidious means by which illicit actors threaten U.S. interests and evade sanctions.

- **Improve communication and coordination among U.S. sanctions professionals.** The national security advisor should establish a clear leader on sanctions policy at the White House to coordinate federal work in the sanctions space, including the policy agencies, law enforcement agencies, and financial regulatory bodies. The independence of several of these entities makes such work very challenging, but also absolutely essential. This coordinator should be an NSC director or senior director reporting to the deputy national security advisor for international economics.

The federal sanctions coordinator should direct initiatives to align broad strategic objectives among executive branch agencies, which could take the form of an interagency policy coordinating body such as the Counterterrorism Security Group. This coordinator also should conduct outreach to state and local agencies that have some sanctions-related enforcement jurisdiction. Additionally, this coordinator should serve as the central coordinating point for federal and state enforcement actions linked to sanctions violations to help with standardization and broad alignment in the approach to enforcement posture. While this coordinator will not be able to exercise authority over independent regulators, particularly not at the state and local level, they will be able to use moral suasion to create policy coherence, and also may be able to encourage the use of conditional spending measures to encourage a specific model for policy implementation and enforcement.

Further examples of coordinated federal initiatives that this sanctions coordinator can lead include the following:

- » Establishment of a collaborative initiative between the FBAs and the Treasury Department to exchange information on the policy framework and purpose for sanctions, and the sanctions enforcement challenges and common misperceptions that banks encounter. Such unprecedented exchange will support more nuanced, pragmatic sanctions policy crafting and more sophisticated and effective sanctions enforcement. This forum can be linked to existing bodies that combine financial policymakers and the FBAs, such as the AML Working Group, or exist independently.
- » The coordinator can help harmonize the approach of agencies involved in sanctions-related investigations and enforcement actions (including at the state and local level) so that they are synchronized whenever possible. This would include helping to set enforcement priorities so that all relevant agencies are focused on the most egregious violations.
- » At the federal government level, expansion of fusion cells and interagency liaison relationships, and detailed rotations of sanctions professionals between and among executive branch agencies, law enforcement agencies, and financial regulatory bodies.

*The national security advisor should establish a clear leader on sanctions policy at the White House.*

- » Consolidation of the threat finance professionals within the Defense Department policy and combatant command communities.

Additionally, executive branch leaders should expand information sharing and coordination with congressional leaders on sanctions matters to engender a more constructive, technical relationship that can facilitate better coordination during times of particularly difficult political and partisan circumstances. The legislative affairs office of the next U.S. president's White House, and congressional leaders in the next Congress, should set a constructive tone of coordination on sanctions issues that will inevitably play an important role in foreign policy strategy in the future.

#### **6. U.S. GOVERNMENT CHANGES TO IMPROVE INTERNATIONAL SANCTIONS STRATEGY IMPLEMENTATION AND COORDINATION**

- **Seek greater international coordination on sanctions.** Treasury and State Department and National Security Council officials should embrace the premise that almost all successful sanctions against major security threats of the future will be multilateral, even if often led by the United States. Based on this foundation they should seek to expand international partnerships on sanctions development and implementation beyond some of the traditional transatlantic ties. This work will become harder as U.S. and European sanctions regimes diverge on Iran, and potentially also on Russia and elsewhere in more limited ways. The focus on new international sanctions partnerships also will be crucial as the Chinese economy succeeds in challenging some of the measures of preeminence of the U.S. economy, thereby shrinking the reach of U.S. financial measures. It should include the following specific modalities:
  - » Establishment of a U.S.-China bilateral forum on sanctions, to specifically cultivate strategies for collaboration to target shared threats. This will encourage China to take a responsible role in a rules-based international order and provide a constructive leadership example on international sanctions. It also may provide a forum in which the United States can address activities of concern in an effort to mitigate concerns, thereby avoiding the necessity of sanctioning Chinese entities.
  - » Establish a U.S.-EU high-level dialogue on sanctions policy. The White House should establish a high-level forum with EU counterparts on transatlantic sanctions policy coordination. On the U.S. side it should be co-led by the U.S. ambassador to the EU and the under secretary of the Treasury, and also include representation from the Internal Revenue Service, Department of Justice, and broader law enforcement community. U.S. leaders should encourage associate-member contribution from Moneyval, the European association of the FATF, and seek to build on, and possibly work within existing EU-wide working groups on EU sanctions policy coordination.

This dialogue will support the EU in development of greater indigenous sanctions licensing and enforcement capacity at the member-state level, and support the EU in limiting regulatory arbitrage by companies seeking more favorable sanctions licensing environments among various national jurisdictions. It also may help pragmatically address challenges to the EU's sanctions regime in the European court system.

*Almost all successful sanctions against major security threats of the future will be multilateral, even if often led by the United States.*

- **Establish a new sanctions focus in U.S. government foreign technical assistance work.** Treasury, State Department, and USAID officials should establish a new priority focus on sanctions development and implementation in their various technical assistance and international counterpart engagement activities. This will help to expand partner capacity to create parallel legal authorities to implement autonomous sanctions, as well as the regulatory and enforcement will and capacity to carry them forward in national-level policy. It should include direct training and support to national-level policy and regulatory officials in-country, as well as study delegations to the United States for trainings by U.S. Treasury, State Department INL officials, intelligence community, law enforcement, and regulatory officials. Collectively, this work will amplify the reach and effect of U.S. sanctions to target and undermine security threats.
- **Expand private sector guidance to foreign regulators and entities seeking to facilitate permitted business activities.** U.S. Treasury Department officials should expand the guidance, and licensing as appropriate, available to non-U.S. entities to engage in business permitted under sanctions but in which there is confusion about policy intent or legal restrictions.
  - » Offer specific guidance to foreign companies outside of U.S. jurisdiction about the reach of U.S. sanctions. Offering such information and guidance on the U.S. sanctions enforcement posture for foreign companies will provide useful guidance to foreign companies seeking to abide by sanctions but lacking the ability to seek clarification or licensing from U.S. regulators given their non-U.S. status.
  - » Create an memorandum of understanding with foreign financial regulators from allied countries expressing the intent to coordinate enforcement actions when possible. Such coordination may help prevent multiple, unrelated enforcement actions against the same entity for the same violations in multiple jurisdictions. It also can help stimulate information sharing on sanctions enforcement across national boundaries, some of which requires counterparts to overcome difficult cross-border data-sharing restrictions in the interest of combating transnational security threats. Additionally, it can facilitate a collaborative posture between financial sector regulators, who could be well served in their mission by building on common, rather than adversarial, sanctions interests.

*Treasury, State Department, and USAID officials should establish a new priority focus on sanctions development and implementation.*

The various policy recommendations outlined above can be of use implemented in whole or in part. They may support policy planning and execution at the executive and legislative level, and they also may be of use to the transition teams for the next U.S. president as they contemplate various policy choices on pressing security issues including Iran, Russia, and countering transnational terrorist threats.

# CONCLUSION



In recent years, sanctions have become a preferred and frequently used tool for advancing U.S. national and security priorities, often with significant effects and sometimes in a very effective manner. Sanctions may become one of the most important instruments of economic competition or hybrid warfare in the future, with undeniable staying power because of their utility in projecting power to achieve desirable policy outcomes. However, the use of contemporary sanctions has come with troubling costs and challenges, some of which undermine other U.S. policy goals and the strength and leadership of the United States as an economic and strategic player. How much corruption and autocratic governance will the United States allow the imposition of sanctions to foster in a target economy before policymakers judge that sanctions will not serve U.S. interests? In what circumstances is the imposition of sanctions worth the cost of eroding the preeminence of the U.S. dollar?

This paper does not purport to be the final word on these issues. We hope to continue a conversation that has taken place in the academic and policy communities for the last several decades, but to point it in the direction of promising new inquiries. Conducting the research laid out in this paper raised many questions, and underscored the need to gather more data on the conditions and criteria for sanctions effectiveness. In particular, there is a need to develop criteria for evaluating the effectiveness of sanctions against non-state actors, and a substantial deficit of data that are critical to answering more definitively a number of the questions we raise above, including on de-risking.

Another area that merits serious additional consideration is the mechanism for ensuring that sanctions retain their coercive potential. This entails more robust work on de-listing, which many practitioners view as having achieved great success in changing behavior in the narco-sanctions context. Can this be measured, and how can the value of de-listing to positively change behavior be translated into the terrorism sanctions context?

Policy leaders must be able to answer these questions to craft a truly coherent and holistic framework for the use of financial sanctions. Furthermore, finding answers to these questions is essential to national security and defense leaders' ability to evaluate when to use sanctions instead of, or in combination with, other national security tools. The findings and recommendations of this paper may go some distance to support sanctions

policymakers. However, they also should make clear the necessity and urgency of further analysis, both within and outside of the government, to further attune U.S. sanctions authorities and programs to a highly dynamic set of policy challenges and constellation of global financial system trends. This critical work will ensure that the next generation of sanctions is more effective, and less costly, in combating the security threats of the coming years.

# APPENDIX

TABLE 2  
**POST-9/11 U.S. SANCTIONS EPISODES**

TARGET	YEARS	SUCCESS*	OBJECTIVES
Belarus	2006-08; 2010-	No	Sanction electoral manipulation
Central African Republic	2003-05	Yes	Return to democracy and the rule of law
Democratic Republic of the Congo	2006-	No	Sanction operations by armed groups, human rights abuses, recruitment and use of child soldiers, attacks on peacekeepers, obstruction of humanitarian operations, and exploitation of natural resources to finance these activities
Cuba	1992-	N/A	Seek a peaceful transition to democracy and a resumption of economic growth; oppose human rights violations
Fiji	2006-	No	Sanction military attempt to overthrow the elected government
Guinea-Bissau	2003-04	Yes	Sanction military coup; facilitate restoration of (newly) elected leadership
Honduras	6/2009- 11/2009	Yes	Sanction military-backed coup d'état
Iran	2010-	Yes	Stop Iran's pursuit of nuclear weapons; isolate Iran from the global financial system; impede exports of petroleum to incentivize good faith negotiations with the P5+1.
Ivory Coast	2004-	Yes	Sanction for breaking 18-month ceasefire by attacking rebels controlling the northern half of the country and a French military camp
Lebanon	2007-	No	Sanction efforts to undermine democratic institutions, contribute to the deliberate breakdown in the rule of law, and reassert Syrian control or contribute to Syrian interference
Liberia	2004-	No	Sanction unlawful depletion of Liberian resources and their removal, thereby undermining transition to democracy and orderly development of institutions; sanction failure to implement 2003 Comprehensive Peace Agreement and related ceasefire; sanction illicit trade in timber products, linked to illegal arms trafficking
Libya	2/2011- 10/2011	Yes	Stop the armed suppression of protests; preserve assets for transition to opposition movement.
Burma (Myanmar)	2000-	Yes	Foster democratic elections and secure the release of Aung San Suu Kyi from house arrest

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TARGET	YEARS	SUCCESS*	OBJECTIVES
Nigeria	2003-4	Yes	Reduction of U.S. foreign aid in order to pressure extradition of former Liberian President Charles Taylor to face the U.N. war crimes tribunal for Sierra Leone
North Korea	2000-	No	Stop nuclear proliferation; sanction the export of military technology by DPRK government and companies
Russia [Ukraine]	2014-	No	Sanction assertion of governmental authority in the Crimean region without the authorization of the government of Ukraine and misappropriation of its assets
Serbia	2001-present	No	Sanction support for extremist violence in the former Yugoslavia, including actions that obstruct implementation of the Dayton Accords in Bosnia or UN Security Council Resolution 1244 in Kosovo
Somalia	2010-	No	Sanction piracy and violations of arms embargo
South Sudan	2014-	No	Sanction widespread violence and atrocities, human rights abuses, recruitment and use of child soldiers, attacks on peacekeepers, and obstruction of humanitarian operations
Sudan	2004-	No	Halt human rights abuses and genocide in the western region of Darfur
Syria	2004-	No	End support of terrorism and pursuit of missiles and weapons of mass destruction programs; end violent suppression of civilian demonstrations
Uzbekistan	2005-09	Yes	Sanction refusal to allow international investigation into deadly government crackdown on May 2005 protest
Venezuela	2015-	No	Sanction public corruption and repression of anti-government protests, including arbitrary arrest and detention of protestors, persecution of political opponents, and curtailment of press freedoms
Yemen	2012-present	No	Sanction actions and policies of certain members of the government of Yemen and others that threaten Yemen's peace, security, and stability, including by obstructing the implementation of the 2011 agreement between the government of Yemen and those in opposition to it, which provides for a peaceful transition of power that meets the legitimate demands and aspirations of the Yemeni people for change, and obstructing the political process in Yemen
Zimbabwe	2002-	No	Halt political repression and allow free elections

\*Success as assessed by IIE, TIES, or survey findings.

Note: sources for this table can be found on page 63.

TABLE 3  
PEER COUNTRY GROUPS

TARGET COUNTRY	PEER COUNTRIES				
<b>Belarus</b>	Albania	Moldova	Poland	Romania	Ukraine*
<b>Bosnia and Herzegovina [Balkans]**</b>	Albania	Bulgaria	Czech Republic	Hungary	Slovakia
<b>Central African Republic**</b>	Burkina Faso	Cameroon	Chad**	Republic of the Congo	Uganda
<b>Democratic Republic of the Congo</b>	Burundi**	Republic of the Congo	Malawi	Rwanda	Uganda
<b>Cuba</b>	Bolivia	Dominican Republic	Jamaica	Nicaragua	Myanmar*
<b>Fiji**</b>	Grenada**	Jamaica	Maldives**	Mauritius**	Sri Lanka
<b>Guinea-Bissau</b>	Burkina Faso	Guinea	Senegal	Sierra Leone	Liberia*
<b>Honduras</b>	Bolivia	El Salvador	Guatemala	Jamaica	Nicaragua
<b>Iran</b>	Algeria	Kazakhstan	Saudi Arabia	Turkey	Iraq*
<b>Iraq</b>	Algeria	Kazakhstan	Saudi Arabia	Turkey	Iran*
<b>Israel</b>	Cyprus	Estonia	Jordan	Lithuania	New Zealand
<b>Ivory Coast</b>	Benin	Burkina Faso	Ghana	Sierra Leone	Togo
<b>Lebanon</b>	Bahrain	Cyprus	Jordan	Oman	UAE
<b>Liberia</b>	Benin	Burkina Faso	Guinea	Sierra Leone	Togo
<b>Libya</b>	Algeria	Azerbaijan	Egypt	Morocco	Iraq*
<b>Myanmar</b>	Indonesia	Laos**	Thailand	Vietnam	Cuba*
<b>Nigeria</b>	Angola	Cameroon	Ghana	Mexico	Venezuela*
<b>North Korea</b>	Laos**	Mongolia	Turkmenistan**		Myanmar*
<b>Pakistan</b>	Bangladesh	India	Sri Lanka	Vietnam	Myanmar*
<b>Russia [Ukraine]</b>	Brazil	China	India	Kazakhstan	Belarus*
<b>Serbia [Balkans]</b>	Albania	Bulgaria	Czech Republic	Hungary	Slovakia
<b>Somalia</b>	Ethiopia	Malawi	Madagascar	Mozambique	Eritrea
<b>South Sudan**</b>	Chad**	Ethiopia	Mauritania**	Uganda	Central African Republic**
<b>Sudan</b>	Angola	Chad**	Ethiopia	Uganda	Nigeria*
<b>Syria</b>	Egypt	Jordan	Morocco	Turkey	Iraq*
<b>Ukraine</b>	Georgia**	Moldova	Poland	Romania	Turkey
<b>Uzbekistan**</b>	Armenia	Georgia**	Kyrgyzstan	Tajikistan**	Turkmenistan**
<b>Venezuela</b>	Bolivia	Colombia	Ecuador	Mexico	Trinidad & Tobago**
<b>Yemen</b>	Egypt	Jordan	Oman	Saudi Arabia	Libya*
<b>Zimbabwe</b>	Madagascar	Malawi	Mozambique	Tanzania	Zambia

\* Peer country was also the target of sanctions in the timeframe of the study

\*\* No PRS data available

**TABLE 4**  
**DATA DESCRIPTION**

INDICATOR	DESCRIPTION	SOURCE	TOTAL DATA POINTS*	SANCTIONS DATA POINTS**
GDP Growth (% change)	Annual percentages of constant price GDP increases.	IMF	420	186
Total Investment (% of GDP)	Ratio of total investment in current local currency and GDP in current local currency.	IMF	420	186
Volume of imports (% change)	Aggregate change in the quantities of total imports whose characteristics are unchanged. The goods and services and their prices are held constant, therefore changes are due to changes in quantities only.	IMF	416	182
Volume of exports (% change)	Aggregate change in the quantities of total exports whose characteristics are unchanged.	IMF	416	182
Inflation	Year-on-year change of average consumer prices.	IMF	420	186
Current Account Balance (% of GDP)	Current account consists of goods and services, income, and current transfers.	IMF	413	181
Corruption Perceptions Index	The perceived level of public sector corruption on a scale of 0-100, where 0 means that a country is perceived as highly corrupt and a 100 means that a country is perceived as very clean.	TI	410	181
Polity Score	A 21-point scale ranging from -10 (hereditary monarchy) to +10 (consolidated democracy).	Polity IV	405	183
Civil Disorder	The potential risk to governance or investment from mass protest, such as anti-government demonstrations, strikes, etc.	PRS	354	169
Composite Risk Rating	Composite political, financial, and economic risk rating for a country	PRS	419	186
Corruption	A measure of corruption within the political system that is a threat to foreign investment.	PRS	402	181
Economic Risk Rating	A means of assessing a country's current economic strengths and weaknesses. Risk ratings range from a high of 50 (least risk) to a low of 0 (highest risk).	PRS	345	150
Financial Risk Rating	A means of assessing a country's ability to finance its official, commercial, and trade debt obligations. Risk ratings range from a high of 50 (least risk) to a low of 0 (highest risk).	PRS	348	153
Government Stability	A measure of both of the government's ability to carry out its declared programs and its ability to stay in office.	PRS	334	149

INDICATOR	DESCRIPTION	SOURCE	TOTAL DATA POINTS*	SANCTIONS DATA POINTS**
Political Risk Rating	A means of assessing the political stability of a country on a comparable basis with other countries. Risk ratings range from a high of 100 (least risk) to a low of 0 (highest risk), though lowest de facto ratings generally range in the 30s and 40s.	PRS	349	153
Popular Support	The level of support for the government and/or its leader based on credible opinion polls.	PRS	294	139
Risk for GDP Growth	Risk points determined as a percentage of the average of the estimated total GDP of all the countries covered by PRS, then assigning risk points. The higher the points, the lower the risk.	PRS	336	149
Risk for Inflation	Ranging from high percent of 130+ with risk points at 0.0, to a low of 0.0 with 10.0 points. The higher the points, the lower the risk.	PRS	342	149
Risk for International Liquidity	Ranging from high percent of 15.0+ with risk points at 5.0, to a low of 0.0 with 0.0 points. The higher the points, the lower the risk.	PRS	338	148
Socioeconomic Conditions	A measure of the socioeconomic pressures at work in society that could constrain government action or fuel social dissatisfaction.	PRS	337	146
Control of Corruption	Perceptions of the extent to which public power is exercised for private gain.	World Bank	352	163
Government Effectiveness	Perceptions of the quality of public services and civil service, the degree of its independence from political pressures, the quality of policy formulation and implementation, and the credibility of the government's commitment to such policies.	World Bank	351	163
Rule of Law	Perceptions of the extent to which agents have confidence in and abide by the rules of society.	World Bank	351	163
Regulatory Quality	Perceptions of the ability of the government to formulate and implement sound policies and regulations that permit and promote private sector development.	World Bank	351	163
Political Stability & Absence of Violence / Terrorism	Perceptions of the likelihood that the government will be destabilized or overthrown by unconstitutional or violent means, including politically-motivated violence and terrorism.	World Bank	351	163
Voice & Accountability	Perceptions of the extent to which a country's citizens are able to participate in selecting their government, as well as freedom of expression, freedom of association, and freedom of the press.	World Bank	351	163
Human Development Index	A summary measure of average achievement in key dimensions of human development, including economic, health, and other measures of well-being.	UNDP	420	186

IMF: International Monetary Fund

TI: Transparency International

PRS: Political Risk Services/International Country Risk Guide

UNDP: United Nations Development Program

\* The total number of observations (country-year) for which data was available for all countries (both countries under sanctions as well as countries that were identified as peers for statistical comparison).

\*\* The total number of observations (country-year) for which data was available in countries that were under sanctions by the United States.

Note: sources for this table can be found on page 63.

**TABLE 5**  
**ECONOMIC EFFECTS OF SANCTIONS**

INDICATOR	PREDICTED EFFECT	ACTUAL EFFECT OF SANCTIONS AFTER FIRST YEAR	SIGNIFICANCE OF SANCTIONS AFTER FIRST YEAR	ACTUAL EFFECT OF SANCTIONS AFTER THIRD YEAR	SIGNIFICANCE OF SANCTIONS AFTER THIRD YEAR
<b>GDP Growth (% change)</b>	-	+		+	
<b>Inflation (% change in average consumer prices)</b>	+	+		-	
<b>Volume of imports of goods and services (% change)</b>	-	+		-	
<b>Volume of exports of goods and services (% change)</b>	-	+		+	
<b>Total Investment (% of GDP)</b>	-	-	***	-	***
<b>Current Account Balance (% of GDP)</b>	-	-	***	-	

\*5% significance    \*\*1% significance    \*\*\* 0.1% significance

Note: sources for this table can be found on page 63.

**TABLE 6**  
**EFFECT OF SANCTIONS ON PERCEIVED RISK**

INDICATOR	PREDICTED EFFECT	ACTUAL EFFECT OF SANCTIONS AFTER FIRST YEAR	SIGNIFICANCE OF SANCTIONS AFTER FIRST YEAR	ACTUAL EFFECT OF SANCTIONS AFTER THIRD YEAR	SIGNIFICANCE OF SANCTIONS AFTER THIRD YEAR
Civil Disorder	+	+		+	
Composite Risk Rating	+	+	**	+	**
Corruption	+	+	**	+	**
Economic Risk Rating	+	+	***	+	***
Financial Risk Rating	+	+	***	+	***
Government Stability	-	-		-	
Political Risk Rating	+	+	***	+	***
Popular Support	-	-	*	-	*
Risk for GDP Growth	+	+	***	+	**
Risk for Inflation	+	+	*	+	
Risk for International Liquidity	+	+	***	+	***
Socioeconomic Conditions	-	-	***	-	***

\*5% significance    \*\*1% significance    \*\*\* 0.1% significance

Note: sources for this table can be found on page 63.



TABLE 7  
**SOCIOPOLITICAL EFFECTS OF ECONOMIC SANCTIONS**

INDICATOR	PREDICTED EFFECT	ACTUAL EFFECT OF SANCTIONS AFTER FIRST YEAR	SIGNIFICANCE OF SANCTIONS AFTER FIRST YEAR	ACTUAL EFFECT OF SANCTIONS AFTER THIRD YEAR	SIGNIFICANCE OF SANCTIONS AFTER THIRD YEAR
Human Development Index <sup>a</sup>	-	-	*	-	*
Control of Corruption <sup>b</sup>	-	-	***	-	**
Government Effectiveness <sup>c</sup>	-	-	***	-	***
Rule of Law <sup>c</sup>	-	-		-	
Regulatory Quality <sup>c</sup>	-	-	***	-	***
Political Stability & Absence of Violence / Terrorism <sup>c</sup>	-	-	*	-	
Voice & Accountability <sup>c</sup>	-	-	**	-	*
Corruption Perceptions Index <sup>c</sup>	+	+	*	+	*
Polity Score <sup>c</sup>	-	-	***	-	***

\*5% significance \*\*1% significance \*\*\* 0.1% significance

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## Endnotes

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