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Introduction

Chairman McHenry, Ranking Member Waters, and distinguished members of the House Committee on Financial Services, I am honored to appear before you today to discuss economic sanctions and the U.S.-China relationship.

I come before this committee as an expert on sanctions; I have served at the United States Department of the Treasury as a Senior Advisor to the Under Secretary for Terrorism and Financial Intelligence and in the private sector advising clients on sanctions compliance. These positions have afforded me perspective on how sanctions policy is made and implemented, as well as how companies around the world adjust their business models, strategies, and compliance programs to ensure they are meeting their obligations under the law. I am testifying today in my personal capacity, and not as a representative of any organization with which I am affiliated or employed.

Over the last three decades, economic sanctions have become a core tool of American foreign policy and national security. When properly calibrated and judiciously used, they can impact U.S. adversaries' behavior and reduce their ability to harm U.S. interests around the world. Nevertheless, sanctions are not a silver bullet and, as the recent Russia war in Ukraine has made clear, have real limits.

In recent years, policymakers in the United States have begun employing targeted sanctions against China as part of the broader U.S.-China competition. These sanctions have focused on China's increasing control over Hong Kong, its alleged human rights abuses in Xinjiang, and on limiting U.S. firms' ability to transact in securities of certain Chinese Military Industrial Complex ("CMIC") companies, among other areas. While the United States' use of sanctions against China has so far been limited, policymakers have increasingly focused on sanctions as a key foreign policy tool in the U.S.-China relationship.

In my testimony today, I will discuss key principles to consider when thinking through the use of sanctions, including what makes them more impactful, when they are likely to work (and not work), and how these general principles might apply as U.S. policymakers think through sanctions in the U.S.-China relationship.

I will focus my testimony today on three key topics. First, I will discuss the U.S. sanctions architecture broadly. Second, I will discuss the range of sanctions currently in place on China. Third and finally, I will provide a few considerations.

[1] The views expressed in this testimony are my personal views and do not represent the views of PricewaterhouseCoopers or any other organization with which I am affiliated. Pursuant to legal and ethical obligations, I cannot discuss internal deliberations that occurred during my tenure at the Treasury Department.

U.S. Sanctions Architecture

Over the last five administrations, the Treasury Department, the State Department, and other executive agencies, along with Congress, have significantly increased the number of both countries and illicit actors subject to U.S. sanctions, as well as the sophistication of these tools. In recent years, the United States has expanded the scope, intensity, and impact of these tools. For example, in the recent sanctions campaign against Russia, the Biden Administration has designated more than 1800 Russia-related targets.[2]

Beyond new targets and ramped-up programs, successive administrations have imposed novel and sophisticated types of sanctions to change state behavior and prevent terrorist organizations, weapons proliferators, corrupt actors, human rights abusers, and many others from accessing the international financial system. The United States now employs a range of sanctions to protect its national security interests, including:

- **Comprehensive Jurisdictional Sanctions**. Often referred to as "embargoes," comprehensive sanctions broadly prohibit U.S. persons from transacting with certain countries or territories, often as a means of pressuring the regime in that country. The United States currently maintains comprehensive sanctions programs on Iran, Cuba, Syria, and North Korea as well as on the Crimea, Luhansk, and Donetsk regions of Ukraine.

- **Conduct/List-Based Sanctions**. List-based sanctions focus on individuals and entities engaged in illicit activity such as terrorism, weapons proliferation, drug trafficking, corruption, human rights abuses, and malicious cyber activity, among many other illicit activities. These persons are often added to the Specially Designated Nationals and Blocked Persons (SDN) List, and U.S. persons are required to block their assets. These sanctions are generally imposed to cut these persons off from legitimate financial and business markets. They are often referred to as targeted sanctions because they focus on the specific individuals and networks engaged in the illicit activity, as opposed to an entire jurisdiction.

- **Regime-Based Sanctions**. Regime-based sanctions are list-based programs that target members of current and former regimes engaged in corruption, human rights abuses, and other malign activity. These programs are not fully comprehensive programs but target specific regimes. Examples include the U.S. sanctions programs on Libya, Yemen, and Zimbabwe. The sanctions and associated prohibitions apply only to specific persons identified by OFAC, even if the U.S. government has the legal authority to prohibit transactions with any member of a regime.

- **Sectoral Sanctions**. First employed against Russia following its annexation of Crimea and destabilizing activities in eastern Ukraine, sectoral sanctions were developed to impose costs on target companies in situations where designating those companies as SDNs was

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[2] *See, e.g.*, https://www.castellum.ai/russia-sanctions-dashboard, accessed February 5, 2023

viewed as too escalatory or would have too many negative collateral consequences. Whereas SDN designations prohibit U.S. persons from engaging in all transactions with the target, sectoral sanctions prohibit certain transactions with targets, such as transactions in new debt over a certain tenor or equity. The Russia sectoral sanctions program was subsequently expanded pursuant to the Countering America's Adversaries Through Sanctions Act as well as recent Biden Administration actions. The Trump Administration also extended these types of sanctions to a range of countries, including Venezuela and China. The Biden administration likewise enhanced these sectoral restrictions on China, as discussed further below.

- **Secondary Sanctions**. Secondary sanctions extend to non-U.S. persons who knowingly engage in significant transactions with SDNs or in prohibited sectors (e.g., in Iran's oil or shipping sectors). Secondary sanctions authorities target persons who engage in such activities by cutting them off from U.S. markets (including financial markets), among a number of additional penalties. Designed to pressure non-U.S. persons to cease engaging in unwanted activity with adversaries, they are often controversial with allies and partners given their so-called "extraterritorial" nature. Currently, the United States has secondary-sanctions authorities in the Iran, North Korea, Syria, Russia, Hizballah, Hong Kong, and terrorism programs.

It is important to note that the United States often imposes multiple types of sanctions to address a particular national security challenge. For example, Iran is subject to comprehensive jurisdictional sanctions, secondary sanctions, and list-based authorities. Likewise, Russia is subject to comprehensive jurisdictional sanctions, secondary sanctions, sectoral sanctions, and list-based sanctions.

The Current U.S. Sanctions Regime on China

To date, the United States maintains a range of targeted, list-based, sectoral, and secondary sanctions on Chinese persons designed to limit certain Chinese companies' access to U.S. capital markets, target certain Chinese companies and individuals accused of engaging in serious human rights abuse or corruption, disrupt efforts at sanctions evasion, and punish a number of persons for their involvement in the implementation of certain policies in Hong Kong. These sanctions are list-based programs designed to target specific individuals and entities and lock them out of the U.S. financial system and U.S. markets. To date, the United States has not imposed more sweeping sanctions on sectors of the Chinese economy nor any type of comprehensive jurisdictional sanctions that it maintains on countries such as Syria and Iran or jurisdictional regions such as Crimea.

Communist Chinese Military Companies and Chinese Military Industrial Complex Sanctions

Beginning under the Trump administration in November 2020, the United States prohibited certain transactions in publicly traded securities of designated "Communist Chinese Military Companies." The purpose of this sectoral-focused prohibition was to ensure that Chinese companies closely linked to the Chinese military — particularly those involved in China's military-civil fusion program — could not raise capital in U.S. markets.[3] Citing Beijing's efforts to leverage China's private sector to support military research and development, Executive Order 13959, titled "Addressing the Threat from Securities Investments that Finance Communist Chinese Military Companies," sought to restrict those companies' access to U.S. capital by barring U.S. persons from conducting certain transactions involving publicly traded securities of "any Communist Chinese military company."[4] As part of this effort to prevent Communist Chinese military companies from gaining access to U.S. capital markets, the U.S. government identified a number of such entities.[5]

Building on this initial effort, the Biden administration issued a new executive order to further refine these prohibitions. Like Executive Order 13959, Executive Order 14032 aims to prevent certain companies in the Chinese defense and surveillance technology sectors from benefiting from U.S. investment, and to prevent China's military-industrial complex from accessing U.S. capital markets.[6] The new executive order is more narrowly tailored than Executive Order 13959 in a number of ways.[7]

This approach — identifying specific Chinese entities the United States believes pose national security threats and preventing them from raising capital on U.S. markets — is narrowly tailored to limit those entities' ability to benefit from robust U.S. capital markets, while minimizing the risk that other companies will be unduly prevented from accessing U.S. markets. While these Chinese companies are not blocked persons and U.S. persons can continue to engage in certain business with them, they are now effectively cut off from U.S. capital markets.

Blocking Sanctions Against Certain Chinese Persons

The United States also has authorities in place to target individuals and entities with powerful blocking sanctions, which not only cut those persons off from U.S. capital markets but also prohibit U.S. persons from conducting any transactions with them. In recent years, the United States has

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[3] "DOD Releases List of Chinese Military Companies in Accordance With Section 1260H of the National Defense Authorization Act for Fiscal Year 2021," June 3, 2021 (https://www.defense.gov/News/Releases/Release/Article/2645126/dod-releases-list-of-chinese-military-companies-in-accordance-with-section-1260/)

[4] Executive Order 13959, "Addressing the Threat From Securities Investments That Finance Communist Chinese Military Companies," November 12, 2020 (https://home.treasury.gov/system/files/126/13959.pdf).

[5] Executive Order 14032, "Addressing the Threat from Securities Investments that Finance Certain Companies of the People's Republic of China," June 3, 2021. (https://home.treasury.gov/system/files/126/eo_cmic.pdf). Two listed companies, Luokung Technology Corporation and Xiaomi Corporation, challenged their designations, arguing that the U.S. government failed to develop a sufficient factual record to establish a linkage between them and the Chinese military. Both companies were successful in their challenges and were delisted shortly thereafter.

[6] Executive Order 14032, "Addressing the Threat from Securities Investments that Finance Certain Companies of the People's Republic of China,"

[7] For example, when Executive Order 13959 was issued, it caused considerable confusion in the markets due to ambiguity surrounding the application of the prohibitions to targeted companies and their subsidiaries. In particular, the prohibitions under the original executive order applied to entities whose name exactly or "closely" matched the name of an entity identified under the executive order. Executive Order 14032 leaves no room for ambiguity by removing the "closely matching" prohibition. In addition, Executive Order 14032 includes the full English-language names of the targeted companies rather than the shorthand English-language names that caused confusion following the issuance of Executive Order 13959.

used its authorities under the Global Magnitsky Human Rights Accountability Act,[8] signed into law in 2017, as well as authorities related to Hong Kong,[9] to target Chinese individuals and entities alleged to have engaged in human rights abuses or the suppression of rights.

For example, in July 2020, the U.S. Treasury Department's Office of Foreign Assets Control (OFAC) designated the Xinjiang Production and Construction Corps (XPCC) and two affiliated CCP officials under Executive Order 13818, the implementing executive order for the Global Magnitsky Human Rights Accountability Act.[10] The XPCC is a quasi-governmental paramilitary entity that was designated for its alleged connection to serious human rights abuses against ethnic minorities in Xinjiang.[11] According to the U.S. Government, the XPCC is involved in human rights abuses, including surveillance and detention of ethnic minorities.

Likewise, the U.S. government has targeted individuals in Hong Kong under Executive Order 13936, which authorizes the president to impose sanctions on non-U.S. persons involved or complicit in, *inter alia*, undermining democratic processes or institutions in Hong Kong; threatening the peace, security, stability, or autonomy of Hong Kong; censoring, prohibiting, or limiting the freedom of expression or assembly by citizens of Hong Kong; or limiting access to free media. On August 7, 2020, the Treasury Department imposed its first set of sanctions under Executive Order 13936, designating then-Hong Kong Chief Executive Carrie Lam and 10 other high-ranking Hong Kong or Chinese Communist Party officials for their role in implementing China's National Security Law.[12] Then, on December 7, 2020, the U.S. State Department announced the designation of 14 vice-chairs of China's National People's Congress Standing Committee who voted unanimously to adopt the National Security Law, thereby undermining "the ability of the people of Hong Kong to choose their elected representatives."[13] Relatedly, the Hong Kong Autonomy Act provides for secondary sanctions for certain persons engaging in knowing and significant transactions with individuals or entities designated pursuant to the Act.

Finally, the United States Government has used a number of non-China-related sanctions authorities to target certain Chinese companies and individuals. For example, in September 2019, the United States Government designated COSCO Shipping Tanker (Dalian) Co., Ltd, a Chinese shipping company, under Iran-related authorities for allegedly knowingly engaging in a significant

[8] *See* Executive Order 13818, "Blocking the Property of Persons Involved in Serious Human Rights Abuse or Corruption," December 20, 2017. (https://home.treasury.gov/system/files/126/glomag_eo.pdf). This executive order implements the legislation.

[9] *See* Hong Kong Autonomy Act, Pub. L. 116-149, codified as amended at 22 U.S.C. §5701.

[10] "Treasury Sanctions Chinese Entity and Officials Pursuant to Global Magnitsky Human Rights Executive Order," U.S. Department of the Treasury, Press Release, July 31, 2020. (https://home.treasury.gov/news/pressreleases/sm1073)

[11] *Id.*

[12] "Treasury Sanctions Individuals for Undermining Hong Kong's Autonomy," U.S. Department of the Treasury, Press Release, August 7, 2020. (https://home.treasury.gov/news/press-releases/sm1088)

[13] "Designations of National People's Congress Officials Undermining the Autonomy of Hong Kong," U.S. Department of State, Press Statement, December 7, 2020. (https://2017- 2021.state.gov/designations-of-national-peoples-congress-officials-undermining-the-autonomy-of-hongkong/index.html)

transaction for the transport of oil from Iran.[14] Similarly, the United States has targeted a number of Chinese persons for assisting North Korean sanctions evasion.[15]

Likewise, in September 2018 the United States imposed sanctions on China's Equipment Development Department for knowingly engaging in significant transactions with Rosoboronexport, an entity listed on the Countering America's Adversaries Through Sanctions Act ("CAATSA") Section 231(d), which identifies entities in the Russian Defense and Intelligence sectors.[16]

Overall, the United States maintains a limited patchwork of list-based and sectoral sanctions designed specifically to limit certain Chinese companies' access to U.S. financial markets and target particular Chinese persons whose actions are determined to threaten U.S. national security and foreign policy objectives.

Thinking Through the Use of Sanctions

As Congress and the Administration consider how to think through the use of sanctions to achieve national security and foreign policy objectives in the U.S.-China competition, a number of key lessons about what makes sanctions more or less likely to be impactful stand out:

1) **Defining the objective of sanctions is an important first step.** Over the last twenty years, the United States has deployed a wide range of sanctions types to combat national security threats. Any use of sanctions should be preceded by the definition of what those types of sanctions are meant to achieve. Are they meant to impact a company's ability to raise funds on U.S. markets while still allowing U.S. persons to conduct otherwise innocuous transactions with that entity? Are they designed to completely cut a target off from access to U.S. markets? Failing to answer these questions in the first instance could lead to situations where the wrong types of sanctions are deployed, with potential ineffective or unintended consequences.

2) **List-based, targeted sanctions can be impactful at disrupting particular threatening activity and making it harder, costlier, and riskier for adversaries to access U.S. markets**. A key objective of sanctions is to deny terrorists, human rights abusers, weapons of mass destruction proliferators, and others access to global and U.S. markets in order to make it more difficult for them to engage in malign activity. For example, successive administrations have used targeted sanctions against terrorist organizations to degrade their capabilities and make it more difficult for them to move money and earn illicit revenue. For example, the Obama and Trump administrations' efforts to constrict the Islamic State's

[14] *See, e.g.*, "The United States Imposes Sanctions on Chinese Companies for Transporting Iranian Oil," Press Release, United States Department of State, September 25, 2019 (https://2017-2021.state.gov/the-united-states-imposes-sanctions-on-chinese-companies-for-transporting-iranian-oil/index.html).
[15] *See, e.g.*, "Treasury Announces Largest North Korean Sanctions Package Targeting 56 Shipping and Trading Companies and Vessels to Further Isolate Rogue Regime," Press Release, United States Department of the Treasury, February 23, 2018 (https://home.treasury.gov/news/press-releases/sm0297).
[16] "CAATSA – Russia-related Designations," United States Department of the Treasury, September 20, 2018 (https://home.treasury.gov/policy-issues/financial-sanctions/recent-actions/20180920_33).

access to the international financial system and to global markets greatly impacted the group's ability to finance its operations.[17] While such targeted sanctions may not change an adversary's desire to threaten U.S. national security, they can impact the adversary's ability to do so.

3) **Impactful list-based sanctions require constant vigilance by regulators, law enforcement, the intelligence community, and the private sector to ensure targets are unable to evade sanctions**. While sanctions can be a powerful tool for achieving U.S. foreign policy objectives, sanctions targets are continually developing and implementing strategies and tactics to blunt their impacts. These adversaries use a range of sanctions evasion techniques – many of which rely on obfuscation and opacity – to surreptitiously move funds and goods across the world, frustrating the impact of U.S. sanctions programs.[18] Effective implementation of sanctions is a constant game of cat and mouse, where the sanctions target attempts to evade detection and authorities and the private sector try to detect and root out such activity. While efforts to disrupt evasion are not always successful, forcing sanctioned persons to engage in such surreptitious activity often imposes significant costs and increases the risks they face.

4) **More expansive sanctions programs – including comprehensive jurisdictional programs – can have a greater macroeconomic impact and can also make it harder for countries to engage in activity that threatens the United States and its allies and partners.** For example, the recent U.S., EU, UK, and other jurisdictions' sanctions on Russia have reportedly limited Russia's ability to continue to produce advanced military equipment in a way that has made it more difficult for Russia on the battlefield. Indeed, this effort at using sanctions to degrade Russia's military capabilities has been an explicit focus of U.S. officials following the initial waves of sanctions on Russian companies and financial institutions.[19] Similarly, while Russia has been able to blunt the impact of sanctions due – in part – to increased energy prices helping provide additional revenue for the country, some economists have argued that the sanctions are taking a toll and will lead to a long-term decrease in Russian GDP and productivity.[20]

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[17] *See, e.g.*, Assistant Secretary for Terrorist Financing Marshall Billingslea, Testimony before House Committee on Financial Services Subcommittee on Monetary Policy and Trade, November 30, 2017. (https://www.treasury.gov/presscenter/press-releases/Pages/sm0227.aspx)

[18] Eric Lorber, "Schemes and Subversion: How Targets of Sanctions Undermine and Evade Sanctions Regimes," Testimony before House Committee on Financial Services, Subcommittee on National Security, International Development, and Monetary Policy, June 16, 2021 (https://www.fdd.org/wp-content/uploads/2021/06/2021.06.16-Lorber-Testimony.pdf)

[19] *See, e.g.*, "Remarks by Deputy Secretary Wally Adeyemo at Meeting of Countries Imposing Economic Restrictions on Russia," Press Release, United States Department of the Treasury, October 14, 2022 (https://home.treasury.gov/news/press-releases/jy1020). *See also* "The Impact of Sanctions and Export Controls on the Russian Federation," Fact Sheet, United States Department of State, October 20, 2022 (https://www.state.gov/the-impact-of-sanctions-and-export-controls-on-the-russian-federation/).

[20] "The Economic Impact of Russia Sanctions," Congressional Research Service, *In Focus*, December 13, 2022 (https://crsreports.congress.gov/product/pdf/IF/IF12092)

5) **However, more expansive programs, including comprehensive programs, often fail to achieve lofty policy objectives.** Expansive sanctions programs are often properly credited with important successes; for example, the sanctions campaign against Iran is widely thought to have helped bring Iran to the negotiating table to negotiate what ultimately became the Joint Comprehensive Plan of Action. However, even comprehensive programs are often insufficient to achieve substantial foreign policy objectives. For example, the comprehensive program on North Korea – while certainly impacting its economy – has not compelled North Korea to give up its nuclear weapons program. This does not mean such programs are ineffective; indeed U.S., EU, UN, and other sanctions on North Korea have undoubtedly made it more difficult, costly, and expensive for North Korea to fund certain activities, including the development of its nuclear weapons program, but rather that they often times are not a silver bullet for solving difficult foreign policy challenges.

6) **Sanctions, particularly secondary sanctions, are more likely to be impactful when access to U.S. markets is more important than access to the sanctions target's markets.** For example, in the case of Iran, the incentive for potential partners to forsake connections with U.S. markets in favor of Iranian markets was very low, as Iran's market (both for energy products and other items) was comparatively small and underdeveloped. Thus, when the United States put forward a choice to foreign companies that they could either do business in Iran or the United States, but not both, most companies chose to continue doing business in the United States. This dynamic may not always hold, however. Indeed, China's economy is roughly comparable in size to the U.S. economy. The United States has not waged an aggressive, expansive sanctions campaign against a country with such an economy. It is an open question whether large numbers of non-U.S. firms would decide to continue doing business with China and not the United States, and what impact that could have on a U.S. sanctions campaign.

7) **Sanctions are likely to be more impactful when the target – particularly a country's leadership – cares more about the negative economic effects caused by the sanctions than their policy objectives.** If a country's leaders think the country can weather the negative economic impacts – or value the objectives more than the cost of sanctions – the use of these tools is unlikely to succeed. Most recently for example, the U.S. Government's efforts to deter Russia from invading Ukraine with the threat of crippling sanctions did not change the Russian decision to invade Ukraine in February 2022. Because Russian leadership did not believe that the United States and its allies and partners would impose such sanctions, because they believed that Russia could weather the impacts, or because they were willing to pay the cost of sanctions in order to achieve their objectives in Ukraine, the threat of sanctions failed to cause Russian President Vladimir Putin to change course.

Conclusion

These are important lessons gleaned over the last twenty years of the aggressive use of sanctions against U.S. adversaries and relevant when considering the use of sanctions in any context. I look forward to answering your questions.

Thank you very much again for the opportunity to testify.