

United States House of Representatives
Committee on Financial Services
2129 Rayburn House Office Building
Washington, D.C. 20515

May 10, 2019

Memorandum

To: Members, Committee on Financial Services

From: FSC Majority Staff

Subject: May 15, 2019 “Assessing the Use of Sanctions in Addressing National Security and Foreign Policy Challenges”

The Subcommittee on National Security, International Development and Monetary Policy will hold a hearing entitled, “Assessing the Use of Sanctions in Addressing National Security and Foreign Policy Challenges” on Wednesday, May 15th at 2:00 p.m. in room 2128 of the Rayburn House Office Building. This will be a one-panel hearing with the following witnesses:

- **David Mortlock**, Nonresident Senior Fellow, Global Energy Center, Atlantic Council
- **Dr. Michael Carpenter**, Senior Director, Penn Biden Center for Diplomacy and Global Engagement, University of Pennsylvania
- **Elizabeth Rosenberg**, Senior Fellow and Director of the Energy, Economics, and Security Program, Center for a New American Security
- **Daleep Singh**, Senior Fellow, Center for New American Security
- **Matthew Zweig**, Senior Fellow, Foundation for Defense of Democracies

Purpose

This hearing will examine the efficacy of major U.S. economic sanctions programs, with a particular focus on Russia and Treasury’s actions to remove from the U.S. sanctions list the Russian companies that had been owned and controlled by Oleg Deripaska, a designated Russian oligarch, and specific areas and opportunities to increase economic pressure on Russia with respect to Russia’s interference in the U.S. 2016 presidential elections as well as deter future attacks on U.S. elections.

Sanctions Overview¹

Sanctions are economic and trade actions to block assets – e.g., through transactions, accounts, and property – and restrict trade and travel as a response to a “person’s” (defined as an individual or entity) bad acts. Typically directed at groups such as drug traffickers and terrorists, these foreign policy and national security tools are employed by decision makers to encourage behavioral changes by those targeted. Sanctions can be focused on whole nations or narrowly defined to individual persons or targeted sectors. Required compliance with these programs is broad, applying to all U.S. persons worldwide, foreign persons in the U.S., and depending on the program, entities abroad with a nexus to the U.S. This wide, extraterritorial reach makes sanctions an exceptionally powerful tool.

In the U.S., sanctions are largely administered and enforced by the Office of Foreign Assets Control (OFAC) within the U.S. Department of the Treasury. The sanctions programs may originate with Congress, via

¹ “Basic Information on OFAC and Sanctions,” Office of Foreign Assets Control, Frequently Asked Questions, available at: https://www.treasury.gov/resource-center/faqs/Sanctions/Pages/faq_general.aspx#basic

Executive Order of the President, or through international mandates (e.g., United Nations sanctions), later adopted into U.S. sanctions regimes.² Once a person is determined to be an appropriate target for OFAC sanctions, that individual or entity is “designated” and added to the Specially Designated Nationals (SDN) List or other sanctions lists maintained by Treasury. Entities that are owned or controlled by persons on the SDN List – 50% or more, directly or indirectly – are also blocked. OFAC can issue licenses allowing exceptions to the prohibitions on engagement with the targets. (e.g., issuing a license to provide humanitarian goods and services). OFAC also investigates sanctions-program breaches and pursues enforcement actions. The office can suspend or lift sanctions on a temporary or permanent basis.

There are several principles that have garnered broad consensus with respect to the effective use of sanctions, which have become since the end of the Cold War the foreign policy tool of choice to advance U.S. interests without resorting to military force. First, a multilateral approach—that is, sanctions implemented by United Nations Security Council resolutions or in solidarity with groups of like-minded nations—has proven to be most effective at changing behavior.³ Second, sanctions alone are not a substitute for policy, but rather a tool that should be embedded within a broader strategic framework to achieve clear foreign policy objectives.⁴ Third, sanctions can change behavior but seldom compel surrender.⁵ Fourth, the messaging around sanctions affects market expectations about the commitment of the sanctioning nation’s staying power and willingness and capacity to do more.⁶ Finally, many experts believe there is a risk that the overuse of sanctions, especially unilateral actions by the U.S., could undermine in the long-term the effectiveness of sanctions as a foreign policy tool.⁷

Major State Sanctions Targets

Russia Sanctions

The U.S. has imposed sanctions on Russian individuals, companies, and government agencies in response to Russia’s interference in U.S. elections, its aggression in Ukraine and Crimea, its UK chemical weapons attack, its activity in Syria, its violation of North Korea sanctions, and its human rights abuses. Some argue that the harsh sanctions imposed after Russia’s invasion of Ukraine tempered the scope of Russia’s land-grab, though it is difficult to prove causation.⁸ Still, sanctions have broadly failed to deter Russia’s attacks on U.S. interests and its assault on global values. Many experts argue that the current Administration’s lack of a unified vision about the challenges posed by Russia and what U.S. policy on Russia should be, and the absence of a coherent strategy and message from the White House, have undermined the effectiveness of sanctions.^{9,10} Russia has also begun to wean itself from dependence on the west; its companies have found ways to live with

² “OFAC Mission” Office of Foreign Assets Control, available at: <https://www.treasury.gov/about/organizational-structure/offices/pages/office-of-foreign-assets-control.aspx>

³ “The Evolution of Sanctions and Lessons for the Future,” by Jacob Lew, March 30, 2016. Carnegie Endowment for International Peace.

⁴ “U.S. Sanctions: Using a Coercive Economic and Financial Tool Effectively,” by David Mortlock and Brian O’Toole, November 2018. Atlantic Council Economic Sanctions Initiative.

⁵ Ambassador Daniel Fried: The Use (and Abuse) of Sanctions as a Foreign Policy Tool, Ambassador Donald and Vera Blinken Lecture Series on Global Governance at SIPA’s Center on Global Economic Governance, April 20, 2018

⁶ Testimony of Daleep Singh before the Senate Banking Committee hearing entitled, “Countering Russia: Assessing New Tools,” September 12, 2018

⁷ Foreign Affairs, “The Use and Misuse of Economic Statecraft: How Washington Is Abusing Its Financial Might,” by Jacob J. Lew and Richard Nephew, November/December 2018

⁸ “U.S. Sanctions against Russia: What You Need to Know,” Cyrus Newlin, Jeffrey Mankoff, CSIS, October 31, 2018

⁹ “The U.S. Needs a Russia Strategy Now More Than Ever, The Real Lesson from the Helsinki Summit,” Michael McFaul, Foreign Affairs, July 18, 2018, available at: <https://www.foreignaffairs.com/print/1122638>

¹⁰ “US Sanctions: Using a Coercive and Economic Tool Effectively,” David Mortlock and Brian O’Toole, Atlantic Council, available at: <https://www.atlanticcouncil.org/publications/issue-briefs/us-sanctions-using-a-coercive-and-economic-tool-effectively>

restricted access to finance, and Russia is forging increasingly inter-reliant commercial and political ties with allies, such as China, India, and Saudi Arabia.¹¹

Rusal Delisting

Last January, the Treasury Department removed three sanctioned Russian companies – EN+, Rusal, and JSC EuroSibEnergO (“ESE”) – from U.S. sanctions lists. Treasury originally sanctioned the companies in April 2018 because they were majority owned by Russian oligarch Oleg Deripaska, who was simultaneously sanctioned for bad acts including his support of Putin’s malign agenda. Under U.S. law, companies that are 50% or more owned by a sanctioned person are effectively subject to sanctions themselves (“the 50 Percent Rule”), but Treasury chose to take the extra step of specifically designating these entities.¹²

Treasury has stated that the purpose of sanctioning Rusal, EN+, and ESE was not because of the companies’ conduct, but because of their relationship with Deripaska, a noted bad actor with close ties to Putin.¹³ It argues that per the individual sanctions, dividends on his remaining holdings will be paid into frozen accounts that Deripaska cannot use unless he is personally removed from sanctions lists. It notes that Deripaska has personally suffered costs as a result of the sanctions: according to *Forbes* magazine estimates, Deripaska has lost roughly \$3 billion, half of his net worth, since the sanctions were imposed. Also, under the terms of the agreement, he is losing some of his shares and operational control of his most important business interests.

In April 2018 when the companies were sanctioned, there was immediate uproar from companies and countries engaged in the worldwide aluminum market due to the negative impact of these designations, an unintended consequence of the action.¹⁴ In December 2018, after having renewed licenses several times to delay the implementation of the April sanctions, Treasury, the companies, and Deripaska reached a deal in which Deripaska agreed to reduce his ownership shares in the companies to 45%, five percentage points below the threshold to trigger the 50 Percent Rule.

Congress attempted to overturn the delisting decision but was not successful.¹⁵ The delistings were viewed by many as offering Deripaska and Putin a sweetheart deal given that Deripaska retains 45% ownership of their shares.¹⁶ He may also retain control as portions of Deripaska’s shares were transferred to a foundation that he founded, as well as to relatives and related entities. Further, under the terms of the deal, some of Deripaska’s reduced shares in EN+ are being transferred to VTB, itself a sanctioned Russian bank, enabling Deripaska to satisfy debts he owes VTB; while Treasury has said that the agreement gives no “cash” to Deripaska, this debt forgiveness is worth millions of dollars to Deripaska. Moreover, Deripaska not only states

¹¹ “As OPEC watches nervously, Russia and Saudi Arabia create a new axis – of oil” Christian Science Monitor, Fred Weir, June 21, 2018, available at: <https://www.csmonitor.com/World/Europe/2018/0621/As-OPEC-watches-nervously-Russia-and-Saudi-Arabia-create-a-new-axis-of-oil>

¹² “Entities Owned by Persons Whose Property and Interest in Property are Blocked (50% Rule)” Office of Foreign Assets Control Frequently Asked Questions, available at: https://www.treasury.gov/resource-center/faqs/Sanctions/Pages/faq_general.aspx#50_percent

¹³ “OFAC Notifies Congress of Intent to Delist En+, Rusal, and EuroSibEnergO” Treasury Press Release, December 19, 2018, available at: <https://home.treasury.gov/news/press-releases/sm576>

¹⁴ “Aluminum soars 13% this week as Russian producer gets hit with sanctions” Market Watch, Victor Reklaitis, April 12, 2018 available at: <https://www.marketwatch.com/story/aluminum-soars-13-this-week-as-russian-producer-gets-hit-with-sanctions-2018-04-12>

¹⁵ H.J. Res. 30 passed the House of Representatives by a vote of 362-53 on January 17, 2019; in the Senate a motion to invoke cloture on S.J. Res 2 was not adopted by a vote 57-42 on January 16, 2019.

¹⁶ “Trump lifts sanctions on Russia oligarch Oleg Deripaska in ‘huge gift to Putin’” Tom Embury-Dennis, The Independent, January 28, 2019, available at: <https://www.independent.co.uk/news/world/americas/us-politics/trump-russia-sanctions-putin-oleg-deripaska-treasury-department-rusal-en-a8749781.html>

that he does not separate himself from the Russian state,¹⁷ but he is also accused of multiple criminal acts¹⁸ and is a former business associate of Paul Manafort, President Trump's now-convicted former campaign manager.¹⁹

Although Treasury has previously removed companies from U.S. sanctions lists in response to ownership changes, it's unusual for OFAC to let the sanctioned owner retain a stake as large as 45%. Treasury's decision to delist these companies could effectively "white list" them, enabling them to attract foreign capital and commercial engagement without fear of consequences from the U.S. At the same time, Rusal and EN+ continue to contribute to Russia's ongoing military expansion and are indirectly "working against American interests and helping Russia violate international law."²⁰

Venezuela Sanctions²¹

With regard to Venezuela sanctions, the administration has taken a different tack, following a more multilateral approach, as well as a diplomatic one, such as recognizing Juan Guaido, Venezuela's opposition leader, and with a clear foreign policy objective to seek to recognize another government in the country. While the Trump Administration is taking a hawkish line toward Venezuela, Russia has been bolstering its support for Venezuelan President Nicolas Maduro. According to Reuters, Russia has sent private military contractors to Venezuela to reinforce the security forces around Nicolas Maduro.²² In December, Russia announced expanded investments in Venezuela, including \$5 billion in new investments in Venezuela's oil sector and \$1 billion in gold mining.²³ Russia is also directly profiting off the situation by significantly boosting its own oil sales to the U.S. to compensate for the loss of U.S. imports of Venezuelan crude.²⁴

North Korea Sanctions

The alarming, rapid acceleration in the scale and range of North Korea's nuclear and long-range missile programs has put it at the center of worldwide attention. The Clinton, Bush, and Obama administrations all tried different negotiating tactics with the North Koreans to address the growing threat of its strategic nuclear program, in good faith, under difficult circumstances, and all failed. The North Korean pattern has historically been to precipitate a crisis, extract concessions through promises of stepping back, and then renege on its commitments. In fact, it's this same pattern that Kim Jong-un followed in order to get a summit with President Trump in June 2018. Kim began testing nuclear weapons while ignoring all international arms control principles and continued to evade U.S. and international sanctions. The summit ended with a joint statement by the two leaders that was short and vaguely worded, and weaker than previous statements negotiated with the DPRK over the last two decades.²⁵ President Trump followed up with a tweet declaring "There is no longer a Nuclear Threat from North Korea," despite the absence of any timetable for denuclearization.²⁶

¹⁷ "Treasury Designates Russian Oligarchs, Officials, and Entities in Response to Worldwide Malign Activity" Press Release U.S. Department of the Treasury, April 6, 2018, available at: <https://home.treasury.gov/news/press-releases/sm0338>

¹⁸ *Ibid.*

¹⁹ "Manafort: Is Oleg Deripaska the missing link in the Trump-Russia investigation?" Peter Stone, The Guardian, January 29, 2019, available at: <https://www.theguardian.com/world/2019/jan/29/oleg-deripaska-paul-manafort-trump-russia-investigation>

²⁰ "The Case for Russia Sanctions" Luke Coffey, The Hill, January 18, 2019

²¹ CRS In Focus. "Venezuela: Overview of U.S. Sanctions," by Mark P. Sullivan, May 8, 2019, available at: <https://www.crs.gov/Reports/IF10715?source=FeatureTopic>

²² Reuters, *Kremlin-linked contractors help guard Venezuela's Maduro*, by Maria Tsvetkova and Anton, January 25, 2019

²³ Reuters, *Venezuela signs oil, gold investment deals with Russia: Maduro*, by Corina Pons and Luc Cohen, December 6, 2018

²⁴ Miami Herald, *Russian oil imports surge in US as Venezuela's slow to a trickle*, By Franco Ordonez, March 4, 2019

²⁵ BBC, *Trump Kim summit: What did it actually achieve?* by Jonathan Marcus, June 14, 2018

²⁶ President Trump tweet, dated June 13, 2018, available at:

<https://twitter.com/realdonaldtrump/status/1006837823469735936?lang=en>

A second Trump-Kim summit on February 28, 2019 in Hanoi, Vietnam ended abruptly when Trump rejected Kim's demand that the U.S. lift all economic sanctions on North Korea in exchange for the closure of only some of North Korea's nuclear facilities.²⁷

Iran Sanctions²⁸

U.S. Administrations have also used sanctions to try to change Iran's behavior, which have negatively affected Iran's economy and some strategic decision-making but with questionable impact on Iran's activities in the Middle East.²⁹ The Iran nuclear deal, formally known as the Joint Comprehensive Plan of Action (JCPOA), was concluded on July 14, 2015, and involved the U.S., Russia, China, and the European Union. Although the Iran nuclear deal effectively blocked Iran from having a credible path to a nuclear bomb for at least 15 years and established an intrusive inspections regimen to ensure that Iran's program remains heavily monitored and exclusively peaceful, opponents of the deal criticized it for not addressing all of Iran's malign activity.³⁰ Despite international efforts to urge the President not to withdraw from the JCPOA, the President announced the end of the deal in May 2018. With the re-imposition of secondary sanctions (i.e., sanctions against third parties who transact with a targeted person) in November 2018, the U.S. is currently taking its own path on forcing change and leadership in Iran. Recent reports indicate that on the one-year anniversary of the US withdrawal from the JCPOA, Iran may be restarting its nuclear activities.³¹

Legislative Proposal

A discussion draft would mandate the imposition of increased economic pressure on Russia in response to the Kremlin's interference in the 2016 U.S. presidential election and 2018 mid-term elections, including a prohibition on U.S. persons, including financial institutions, dealing in new sovereign debt of the Russian Federation. The draft bill would also establish a list of mandatory contingency sanctions in the event of future Russian attacks on U.S. elections, with the aim of deterring Russian interference in the 2020 presidential, or any other future U.S. elections. The discussion draft would also require Treasury to update the report required under section 241 of CAATSA ("Oligarch Report") annually and prohibit the delisting of certain designated Russian companies unless the companies' aggregate ownership by a sanctioned individual and immediate family members is less than 25%.

²⁷ New York Times *How the Trump-Kim Summit Failed: Big Threats, Big Egos, Bad Bets*, by David E. Sanger and Edward Wong, March 2, 2019

²⁸ "Iran Sanctions" Kenneth Katzman, CRS, February 4, 2019, available at: <http://www.crs.gov/Reports/RS20871>

²⁹ *Ibid.*

³⁰ "Iran nuclear deal: Obama says US partisanship gone too far" BBC News, April 12, 2015, available at: <https://www.bbc.com/news/world-us-canada-32273754>

³¹ New York Times, "U.S. Issues New Sanctions as Iran Warns It Will Step Back from Nuclear Deal," by David E. Sanger, Edward Wong, Steven Erlanger and Eric Schmitt, May 8, 2019