

House Foreign Affairs Committee
“Sanctions and Financial Pressure: Major National Security Tools”
Testimony of Adam J. Szubin
Distinguished Practitioner-in-Residence
Johns Hopkins University, School of Advanced International Studies (SAIS)
January 10, 2018

Chairman Royce, Ranking Member Engel, and distinguished members of this committee, thank you for convening this important hearing and for inviting me to testify. More substantively, thank you for your longstanding bipartisan support to U.S. sanctions programs and to my former office, Treasury’s Office of Terrorism and Financial Intelligence (TFI). This Committee has been a strong advocate for the smart use of economic statecraft and I hope that it will continue to use its leadership and influence to protect and preserve these tools for many years to come.

As someone who has worked in and studied the field of sanctions for the last 15 years, the developments are striking. One does not have to go back many years to remember a near consensus in the foreign affairs community that sanctions were ineffective and – worse – turned populations against us. I am hopeful that the binary question from that period – “Do sanctions work?” – is being replaced by more productive inquiries, such as “What threats/groups/nations are most susceptible to sanctions?”, “What are the essential elements of an effective sanctions program?”, and “How can we maximize our sanctions leverage and protect against countermeasures?”.

In 2005, as the George W. Bush administration embarked on what was to be a years-long intensive sanctions campaign to address Iran’s nuclear threat, we heard from some critics on the right that sanctions had been tried and failed, and that the only way to address Iran’s nuclear program was through military force. Some on the left argued that sanctions would only drive the people of Iran into the arms of the ayatollahs. To your credit, Congress and the executive branch, under both Republican and Democratic leaders, saw things differently. Even those who were doubtful whether sanctions would ultimately yield results believed that we owed it to ourselves to put everything we had behind the effort given the urgency of the threat and the lack of good alternatives. And the U.S. Government did put everything it had behind the effort. President Bush and Secretary of State Rice directed Stuart Levey to draw up a multi-stage strategy and the Administration marshaled the intelligence, economic, and

diplomatic resources necessary to drive it forward. In 2009, the Bush team handed it off to President Obama who sustained and built upon the effort. Congress, and this committee in particular, worked together in a bipartisan fashion, and passed tough and smart sanctions laws to intensify the impact of sanctions around the world. As the noose tightened, we saw the election of President Rouhani, and Iran finally came to the negotiating table to address the world's concerns about its then-burgeoning nuclear program. I remember the harrowing estimates in 2013 that Iran was 2-3 months from having enough enriched uranium for a nuclear bomb. It is now five years later, and Iran has not only not crossed that nuclear threshold, it has been pushed far away from it and has accepted an unprecedented nuclear inspection program.

The fact that the United States today confronts only one rogue nuclear state and not two is a testament to the steady work of Congress and two Administrations, and a credit to this Committee's support for tough and smart sanctions.

These days, sanctions have become the instrument of choice to confront vexing national security and foreign policy threats from human rights abuses to corruption, from terrorism to cybercrime. Both the executive and legislative branches have increasingly drawn on the tool and we have even witnessed dozens of U.S. state legislatures enacting their own sanctions laws. Indeed, if the policymaking community was too dismissive of sanctions fifteen years ago, I fear that the pendulum has swung too far in the other direction. I am concerned, honestly, that the tool is being used too readily and in ways that risk undercutting its effectiveness.

Nation states do not have many tools to influence hostile foreign countries and groups. We can turn to diplomacy, intelligence, military, or economic instruments when our interests and people are threatened from abroad. The largest and most daunting threats will not typically yield to diplomacy and intelligence. If we don't want to find ourselves deploying military force, we must preserve the strength of our economic and financial instruments. Unfortunately, while there are volumes written on the application of military force, we do not yet have a doctrine for the proper use of economic statecraft. This is not the place to set out such a doctrine. But I would respectfully offer seven practical and present-day recommendations that I believe are key if we want to preserve the power and influence of U.S. economic sanctions into the decades to come.

1. Fund the Effort

Sanctions have the odd distinction of being both the most popular and the least well-resourced tool of statecraft in our government. Even after some growth, the Treasury team that works on sanctions has fewer than 500 people. This includes the intelligence, regulatory, licensing, targeting, compliance, enforcement, legal, and policy teams, and they administer every sanctions program from al Qaida to Zimbabwe. Their responsibilities are growing far faster than their staffs. Moreover, many of these jobs require specialized skill sets and experience that take years to develop. The teams at Treasury are among the most dedicated I have seen in government, but if we want them to continue to deliver highly professional and impactful results, Congress must equip them to succeed.

2. Strengthen our Relationships

Sanctions are not an alternative to diplomacy, they are an exercise of diplomacy. In today's globalized economy, it is axiomatic that sanctions must be enforced multilaterally to succeed. That does not necessarily mean that a U.N. Security Council resolution is needed. Combined European and U.S. sanctions pressure after Russia invaded Ukraine imposed significant costs on Putin by depriving Russia of financing and technology that it could not obtain elsewhere. It does mean, however, that the U.S. cannot go it alone.

In every sanctions campaign in which I was involved, our success depended on support from foreign capitals, companies, and banks. We sought cooperation from financial centers, like London, Frankfurt, Tokyo, and Dubai; from multilateral institutions like the G-7; and from relevant regional institutions, like the Organization of American States, the Arab League, the Association of Southeast Asian Nations, or the African Union. Building that support requires concerted and serious diplomacy. In the realm of sanctions, the equation is fairly straightforward – if our foreign relationships deteriorate, we lose leverage. We need strong political leadership across the State Department, experienced career diplomats, and staffed embassies.

3. Control Sanctions Policy

Alongside the expansion in federal sanctions, there has been a proliferation of sanctions activity at the state level. More than thirty states have passed Iran-related sanctions laws that differ from federal law,

and a rash of states have passed laws implicating Burma, Syria, and Sudan. These laws regulate state contracting, procurement, and investment and can have a meaningful impact on international commerce. Indeed, California's two largest pension funds together hold more assets than most of the world's central banks or sovereign wealth funds.

State sanctions laws have one purpose – to alter the behavior of foreign governments. And, because federal sanctions typically already restrict primary trade or investment with sanctioned countries, state legislatures typically impose pressure indirectly, by employing “secondary” or “extraterritorial” sanctions. These laws penalize not Iranian or Sudanese companies, but companies in the jurisdictions of our allies and partners that are, in turn, trading with or investing in sanctioned countries. Such secondary sanctions are highly controversial and diplomatically fraught; the companies targeted are behaving in ways that are legal in their countries and fully comply with U.S. sanctions laws. Should Massachusetts be allowed to substitute its judgment on foreign policy for that of Congress and the President? Do state legislators have the expertise and intelligence reporting at their disposal to do so wisely? How well do states monitor developments in foreign affairs and adapt their sanctions in response?

I believe that these sanctions, while politically popular, undermine the federal foreign policy prerogative. Congress should explicitly preempt the states in this field, and make clear that directing economic sanctions at foreign governments is an exclusively federal prerogative.

To the extent Congress is not willing to preempt the states actively, it should at the very least withdraw or withhold its endorsement of state divestment and sanctions laws. Foreign policy is an area where we must speak with one voice. As President Madison wrote in *Federalist Paper* No. 42, “[i]f we are to be one nation in any respect, it clearly ought to be in respect to other nations.”

4. Enforce Coherently

If private actors do not fear consequences for evading sanctions, the measures are doomed to fail. The successes of U.S. sanctions, whether with respect to terrorist groups, narcotics cartels, or rogue regimes, have derived in no small part from the perception that the U.S. takes sanctions enforcement seriously. And we must absolutely continue to do so.

But we undermine our objectives when a constellation of local, state, and federal agencies simultaneously assert jurisdiction over sanctions enforcement and do not coordinate their activities. A financial institution can face sanctions enforcement from its federal banking supervisor, Treasury's Office of Foreign Assets Control, the Department of Justice, and – given the concentration of banking activity in New York – the New York State Department of Financial Services and the District Attorney of the County of New York. In the best of circumstances, all of the relevant agencies coordinate in advance and present a united enforcement approach. But this coordination is often lacking, which can result in inconsistent messages and outcomes in sanctions enforcement.

A few specific notes of concern. First, state and local enforcement authorities should not be interpreting sanctions requirements independent of federal authorities. There is no excuse for sanctions enforcement to be occurring at any level without the knowledge and input of OFAC, the agency charged with writing and interpreting the sanctions rules. In my past capacity as OFAC Director, I had to intervene to convince a state regulatory agency not to penalize transactions that OFAC had expressly authorized. If OFAC cannot authoritatively tell a private company what sanctions-related transactions are prohibited or allowed because a state or local enforcement agency may have different views, the strength of our national sanctions is at risk. And state and local agencies are not subject to congressional oversight. As the Supreme Court has noted, “[s]anctions are drawn not only to bar what they prohibit but to allow what they permit, and the inconsistency of sanctions here undermines the congressional calibration of force.” Crosby v. National Foreign Trade Council, 530 U.S. 363, at 380 (2000).

Unfortunately, we have experienced drift in this area in recent years.

Second, criminal authorities should prosecute companies and individuals who engage in willful misconduct. Negligence and compliance program weaknesses that are inevitable in large human enterprises should be handled by regulatory agencies.

Third, it is generally wasteful and detrimental for criminal prosecutors to require the hiring of private monitors in industries that are already highly regulated. A monitor may make eminent sense in a sector that is largely unsupervised, but the existing banking supervisory framework is more than adequate to the task of monitoring sanctions compliance, and I have yet to hear a convincing argument for a fourth or fifth “set of eyes” that would report to criminal prosecutors.

Fourth and finally, there is no sanctions advantage to piling on. Large sanctions violations warrant commensurately large penalties and willful violations may warrant prosecution. But having regulatory

and enforcement agencies fine the identical conduct multiple times simply because they can does not advance sanctions objectives and undermines the perception of integrity. In my years at Treasury, our guiding principle was that a violating institution should pay a penalty that was serious and proportionate in the aggregate, not that it should pay such an amount multiple times because it had the misfortune to fall under the jurisdiction of multiple agencies.

5. Honor our Word

At best, it is extremely difficult to persuade a government to change a core policy by applying external economic pressure. In the case of Iran, it took eight years of pressure involving dozens of countries, four U.N. Security Council resolutions, multiple acts of Congress, and countless executive actions and designations to change Iran's calculus. Even those of us on the inside were never certain that it would work.

We now face odds that are arguably even more difficult with North Korea. But we will have made a difficult challenge impossible if we are seen as a country that does not honors its sanctions promises. Specifically, if we are perceived to be disregarding or playing games with our sanctions commitments while Iran is adhering to its nuclear commitments, it would be foolish to expect a North Korean government to make nuclear concessions in exchange for a promise of U.S. sanctions relief.

Conversely, we made no promises in the Iranian nuclear deal to withhold pressure against Iran's non-nuclear activities. It is appropriate and justified to target Iranian officials and networks responsible for human rights violations, cyberattacks, missile procurement, and terrorism.

6. Ensure Flexibility

Congress has a key role in the sanctions arena, as I saw firsthand. From Iran to Sudan to Russia, Congress enacted powerful authorities to protect our financial system and to pressure foreign threats. That said, statutory sanctions work differently from executive branch sanctions – they tend to be broader, more blunt, and almost impossible to repeal. If we want foreign governments to sit down with our Secretary of State and negotiate an end to hostile behavior, we must give the executive branch the discretion to lighten or remove the pressure. If the sanctions target perceives sanctions to be written in stone, those

sanctions have ceased to act as a motivator for change and exist solely as a penalty, whose costs will be factored in.

Historically, where Congress has codified sanctions into law, it has preserved the necessary flexibility. Like guardrails on a highway, codification laws ensured that the executive branch would continue driving in the right direction but allowed it to adjust its speed and lane in response to diplomatic developments. The Jackson-Vanik Amendment provides a good case study. Congress passed the law in 1974 to pressure the Soviet Union and its allies to ease restrictions on “refuseniks,” including Soviet Jews who had been barred from practicing their religion or emigrating. When the Supreme Soviet passed a law codifying the end of emigration restrictions in 1991, President George H. W. Bush invoked the waiver provisions in the Jackson-Vanik Amendment and ended those sanctions on the Soviet Union. The waiver provisions in Jackson-Vanik were meaningful but workable, allowing the President to waive sanctions if the waiver would substantially promote the objectives of the law. If Congress disagreed, it could overrule the president’s use of the waiver through a joint resolution. (Notably, Congress did not repeal the Jackson-Vanik Amendment until late 2012, a decade after the Soviet Union fell.)

In my view, the Jackson-Vanik Amendment took the right approach to codification. It imposed guardrails on the executive branch, but not a straitjacket. Sanctions that cannot be eased without an affirmative joint resolution of Congress are not likely to incentivize behavioral change from their target. Likewise, it is counter-productive to codify sanctions in a way that only allows for easing once the ultimate objectives of the sanctions have been obtained. Those that conduct our nation’s foreign affairs must retain discretion to recognize and reward substantial progress or we may not see that progress arrive.

7. Preserve our Financial Leverage

Finally, we have to preserve the primacy of our financial system, which gives our sanctions such formidable strength. Russia and China are by now both aware of and resentful of their reliance on the West’s financial system for financing, international payments, and investment. Russia is especially set on addressing this strategic vulnerability, and we see Putin mandating Russian alternatives to U.S. financial institutions and the U.S. dollar wherever he can. When it comes to business with third countries, though, Russia has not found a widespread willingness to abandon the dollar and the West. Our institutions are seen as more accountable, our infrastructure as more resilient, and our currency as the safest and most attractive in the world.

We can be assured, however, that Russia and our other adversaries will continually be pressing other countries to move away from the West's financial infrastructure, and away from the dollar and the euro. We cannot make their work easier for them. New payment methods and virtual currencies should be subjected to the same transparency and reporting requirements as traditional methodologies. And, as discussed above, we need to be smart, coherent, and coordinated in imposing and enforcing sanctions, so foreign businesses know that our markets and regulatory system are predictable and fair. As tempting as it may be to impose secondary sanctions and tell the world that it can choose to do business in the U.S. dollar or with X country, we should do so exceedingly rarely. If foreign actors come to perceive that the cost of doing business in the U.S. and in the dollar is wholesale adoption of U.S. foreign policy, we will have eroded our sanctions leverage and done our adversaries' work for them.

Conclusion

The United States enjoys many advantages in the field of economic sanctions. We have tremendous leverage stemming from our economic strength, our close partnerships with other economic leaders, and the primacy of the U.S. dollar and U.S. financial institutions. We have also grown more experienced and smarter in our use of economic tools. If we preserve these assets, I believe that economic sanctions can protect and advance American and global security into the years and decades to come.