

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

February 7, 2019

## Memorandum

**To:** Members, Committee on Financial Services

**From:** FSC Majority Staff

**Subject:** February 12, 2019, “The Use of Sanctions and Economic Statecraft in Addressing U.S. National Security and Foreign Policy Challenges”

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The Committee on Financial Services will hold a hearing entitled, “The Use of Sanctions and Economic Statecraft in Addressing U.S. National Security and Foreign Policy Challenges” on Tuesday, February 12, 2019, at 10:00 a.m. in room 2128 of the Rayburn House Office Building. This will be a one-panel hearing with the following witnesses:

- **Elizabeth Rosenberg**, Senior Fellow and Director of the Energy, Economics, and Security Program at the Center for a New American Security
- **Dr. Evelyn N. Farkas**, Resident Senior Fellow, German Marshall Fund
- **Daleep Singh**, Senior Fellow, Center for New American Security
- **David Mortlock**, Nonresident Senior Fellow, Atlantic Council’s Global Energy Center, and partner at the law firm Willkie Farr & Gallagher

### Purpose

This hearing will examine the efficacy of major U.S. economic sanctions programs, including those targeting North Korea, Iran, and Venezuela, with a particular focus on Russia, Treasury’s recent action 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. The hearing will also address the use of sanctions as a tool of statecraft to achieve broader strategic objectives and effectuate behavioral change in their targets, while minimizing unintended consequences for other economic actors, the global economy, and civilian populations.

### Sanctions Overview<sup>1</sup>

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

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<sup>1</sup> “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](https://www.treasury.gov/resource-center/faqs/Sanctions/Pages/faq_general.aspx#basic)

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 Executive Order of the President, or through international mandates (e.g., United Nations sanctions), later adopted into U.S. sanctions regimes.<sup>2</sup> 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.

Sanctions have been Washington’s foreign policy tool of choice throughout the post–Cold War period, as policymakers came to see them as an efficient means of advancing U.S. interests without resorting to military force. At the same time, growing international interest in shifting the pain of sanctions from whole civilian populations to identified bad actors, inspired a new approach. Dubbed “smart sanctions,” and promoted by U.S. Secretary of State Colin Powell, they aimed to move beyond countrywide embargoes by targeting leaders and influencers directly.<sup>3</sup> This refined model has been adopted across OFAC and the U.S. national security apparatus, but sanctions’ precise impact remains difficult to forecast: sanctions can end up being stronger or weaker than intended, as the private sector has grown accustomed to complying right up to the boundary of legality and illicit actors find workarounds.

The U.S. has two principal assets to handle the inevitable uncertainty. The first is the size and reach of its economy—and the global dominance of the U.S. dollar—which gives it a wide margin for error. The second is the flexibility of U.S. legal authorities, which permit Treasury to issue licenses, update sanctions lists, and pursue other course corrections with relative ease.

## 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.<sup>4</sup>

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 Administration’s lack of a unified vision

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

<sup>3</sup> “Moving Targets: The Evolution and Future of Smart Sanctions” Harvard International Review, Laura Kanji, January 4, 2017, available at: <http://hir.harvard.edu/article/?a=14138>

<sup>4</sup> “U.S. Sanctions against Russia: What You Need to Know,” Cyrus Newlin, Jeffrey Mankoff, CSIS, October 31, 2018

about the nature of the Russia challenge 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.<sup>5,6</sup> Russia has also begun to wean itself from dependence on the west; its companies have found ways to live with restricted access to finance, and Russia is forging increasingly inter-reliant commercial and political ties with allies, such as China, India, and Saudi Arabia.<sup>7</sup>

### Rusal Delisting

Last month, 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 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.<sup>8</sup>

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.<sup>9</sup> 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.

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.<sup>10</sup> Thus, in December, after months of discussion and extension of licenses 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.

Nonetheless, a Congressional effort to overturn the delisting decision was not successful.<sup>11</sup> Deripaska not only states that he does not separate himself from the Russian state,<sup>12</sup> but he is

<sup>5</sup> “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>

<sup>6</sup> “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>

<sup>7</sup> “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>

<sup>8</sup> “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](https://www.treasury.gov/resource-center/faqs/Sanctions/Pages/faq_general.aspx#50_percent)

<sup>9</sup> “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>

<sup>10</sup> “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>

<sup>11</sup> 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.

accused of multiple criminal acts<sup>13</sup> and is a former business associate of Paul Manafort, President Trump’s now-convicted former campaign manager.<sup>14</sup> The delistings were viewed by many as offering Deripaska and Putin a sweetheart deal given that Deripaska retains 45% ownership of their shares.<sup>15</sup> 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, which will allow him to satisfy debts that Deripaska owes VTB; while Treasury has said that the agreement gives no “cash” to Deripaska, this debt forgiveness is worth millions of dollars to Deripaska.

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%. The removal also sends a clouded message to the world about the U.S. commitment to isolate Russia’s economy. 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 the Russia’s ongoing military expansion and are indirectly are “working against American interests and helping Russia violate international law.”<sup>16</sup>

### Venezuela Sanctions<sup>17</sup>

Although Venezuela is one of the world’s largest oil producers and has the largest proven oil reserves, because of decisions by Venezuelan leadership, its people and economy have increasingly suffered over the last two decades. Sanctions programs, designed to isolate the Venezuelan leadership and force changed behavior, were implemented during the rule of former president Hugo Chavez, when he transformed the once-prosperous country into a “narco-state” engaged in drug trafficking, terrorism, and human rights abuses.<sup>18</sup> These programs targeted corrupt and criminal individuals in the Venezuelan government, business community, and military, as well as businesses and others working to provide financial support to terrorist groups like Hizballah.

As the humanitarian crisis has continued under Nicolas Maduro, Chavez’ authoritarian successor, the U.S. has put greater pressure for change on Venezuela and its economy. In 2017, the U.S. announced sanctions to restrict the ability of the Venezuelan government to borrow from U.S. investors or access the U.S. financial system. Most recently, and in support of the democratically elected Venezuelan opposition, the U.S. designated Venezuelan state oil company, Petr leos de Venezuela, S.A. (PdVSA), blocking its assets and restricting trade with this primary source of Maduro-government funds. The sanctions were issued in conjunction with U.S.-led international

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<sup>12</sup> “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>

<sup>13</sup> Ibid.

<sup>14</sup> “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>

<sup>15</sup> “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>

<sup>16</sup> “The Case for Russia Sanctions” Luke Coffey, The Hill, January 18, 2019

<sup>17</sup> “Venezuela: Overview of U.S. Sanctions,” Mark P. Sullivan, CRS, February 1, 2019, available at: <http://www.crs.gov/reports/pdf/IF10715>

<sup>18</sup> “Drug Trafficking Within the Venezuelan Regime: The ‘Cartel of the Suns’ InSightCrime, The Venezuela Investigative Unit, May 17, 2018, available at: <https://www.insightcrime.org/investigations/drug-trafficking-venezuelan-regime-cartel-of-the-sun/>

action to recognize a new, legitimate government, while supporting civilian-led movements. As the situation is fluid, decisionmakers are trying to balance pressure to end the Maduro government's bad acts with sanctions exceptions to allow for relief for the Venezuelan people.

### 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. As a result, Congress passed comprehensive sanctions legislation directed at the country, the North Korea Sanctions Enforcement Act, intended to address North Korea's nuclear, ballistic missile, and other weapons of mass destruction (WMD) threats; its counterfeiting of U.S. currency and other illicit activities; its financial system misuse through money laundering; its severe human rights abuses; its cyber activities; and violations of applicable U.N. Security Council resolutions, including arms trafficking and WMD proliferation. North Korea sanctions have more than doubled since the Act came into effect on February 18, 2016.

It was in this environment that President Kim and President Trump met on their 2018 summits.<sup>19</sup> The conversations between or the pledges made by the two heads of state is unknown, but intelligence reports suggest that North Korea has made no significant effort to destroy its nuclear stockpile or delivery systems.<sup>20</sup> It does not appear that North Korea's largest trading partner, China, has changed its behavior either, despite protestations from the U.S. president and hundreds of billions of dollars in trade-war tariffs.<sup>21</sup>

### Iran Sanctions<sup>22</sup>

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 does not appear to have affected Iran's activities in the Middle East.<sup>23</sup> The Iran nuclear deal, formally known as the Joint Comprehensive Plan of Action (JCPOA), was concluded on July 14, 2015, after more than a decade of negotiations between Tehran and the international community. It was the product of a difficult and protracted dialogue that began with the Europeans and eventually involved the U.S., Russia, China, and the European Union. While the nuclear deal imposed strict limitations on Iran's nuclear program in exchange for broad nuclear-related sanctions relief, the agreement was the subject of heavy partisan criticism.<sup>24</sup>

European leaders and many U.S. critics of the deal urged Trump to not withdraw from the JCPOA.<sup>25</sup> Despite this, the President announced the end of the deal in May 2018 when he did not extend waivers of American sanctions on Iran's economy that were required under the previous accord. 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.

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<sup>19</sup> A new summit has been announced for February 27-28, 2019 in Vietnam.

<sup>20</sup> "A Possible Second U.S.-North Korea Summit: What Diplomacy Has and Hasn't Achieved" Mark Manyin and Emma Chanlett-Avery, CRS, January 23, 2019, available at: <http://www.crs.gov/Reports/IN11023>

<sup>21</sup> Ibid.

<sup>22</sup> "Iran Sanctions" Kenneth Katzman, CRS, February 4, 2019, available at: <http://www.crs.gov/Reports/RS20871>

<sup>23</sup> Ibid.

<sup>24</sup> "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>

<sup>25</sup> "Key Republicans voice caution before Trump kills the Iran deal" MSNBC, Steve Benen, May 08, 2018 available at: <http://www.msnbc.com/rachel-maddow-show/key-republicans-voice-caution-trump-kills-the-iran-deal>