Background Research
Gates Forum III

Sanctions and the Symphony of Power: Revitalizing American Economic Statecraft

Conference Reference Materials

November 2024

W&M GLOBAL RESEARCH INSTITUTE

November 6, 2024

First and foremost, on behalf of Secretary Gates, we want to thank you for attending the Third Gates Forum (GF3) at William & Mary (W&M) on Economic Statecraft/Sanctions. The intent of GF3 is to answer a single overarching question: In an era of intensifying great power competition, what concrete actions can the United States take to reimagine its approach to sanctions and other tools of economic statecraft in ways that best advance its national interests, deliver effective results, and respond to changing international circumstances?

Working together, GF conferees will address this challenge that is so vital to our national interest. The intent of GF3 is to discuss and prepare the GGPC to develop recommendations for action that will find broad support to the Administration and bipartisan support in Congress.

In partnership with W&M's Global Research Institute (GRI), the attached research package consists of a Synthesis Report: "Sanctions and the Symphony of Power: Revitalizing American Economic Statecraft" that details insights from the following seven research papers provided:

1. "**The Sources of American Financial Power and its Challengers**," by Dr. Daniel McDowell, Maxwell Advisory Board Professor of International Affairs, Maxwell School of Citizenship and Public Affairs, Syracuse University

2. "**Sanctions and the American Symphony of Power**," by Dr. Daniel Drezner, Distinguished Professor of International Politics, Fletcher School of Diplomacy, Tufts University

3. "**A New World Re-Order: Geopolitical Shifts Arising from Tomorrow's Financial Systems**," by Yaya Fanusie, Director of Policy for AML & Cyber Risk, Crypto Council; Adjunct Fellow, Center for a New American Security

4. "**U.S. Sanctions and the Global South: Navigating Networked Resistance, Competing Narratives, and Unintended Consequences**," by Samantha Custer, Director of Policy Analysis, AidData

5. "**China's Economic Statecraft and Implications for the Open Economic Order**," by Dr. Audrye Wong, Assistant Professor of Political Science and International Relations, University of Southern California; Jeane Kirkpatrick Fellow, American Enterprise Institute

6. "**Toward a New Sanctions Multilateralism: How the United States Can Work Better with Allies on Economic Statecraft**," by Edward Fishman, Senior Research Scholar, Center on Global Energy Policy, Columbia University

7. "**Harnessing the Private Sector to Empower U.S. Economic Statecraft**," by Dr. Will Norris, Associate Professor of International Affairs, The Bush School of Government and Public Service, Texas A&M

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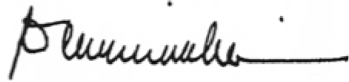
Based on the foundation of this high-quality research, at a minimum the Synthesis Report will assist conferee discussion to help the GGP develop recommendations for a final report which will be published in early February 2025. Our hope is at a minimum, you will find time to read the Synthesis Report. We are proud of the quality research that underpins this report, we have provided all the original research papers for those who want to read more.

Secretary Gates, who will lead forum discussions, looks forward to the expertise and contributions of each conferee as you participate, discuss, and help the GGPC develop recommendations for the Final Report.

Very respectfully,



Peter W. Chiarelli
General, USA (Retired)
President, GGPC

Gates Forum 3 Research Papers

1. Synthesis Report: Sanctions and the Symphony of Power: Revitalizing American Economic Statecraft

2. The Sources of American Financial Power and its Challengers
   Dr. Daniel McDowell

3. Sanctions and the American Symphony of Power
   Dr. Daniel Drezner

4. A New World Re-Order: Geopolitical Shifts Arising from Tomorrow's Financial Systems
   Yaya Fanusie

5. U.S. Sanctions and the Global South: Navigating Networked Resistance, Competing Narratives, and Unintended Consequences
   Samantha Custer

6. China's Economic Statecraft and Implications for the Open Economic Order
   Dr. Audrye Wong

7. Toward a New Sanctions Multilateralism: How the United States Can Work Better with Allies on Economic Statecraft
   Edward Fishman

8. Harnessing the Private Sector to Empower U.S. Economic Statecraft
   Dr. Will Norris

Background Research - Research Synthesis
Gates Forum III

Sanctions and the Symphony of Power: Revitalizing American Economic Statecraft

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Introduction

The United States has come to rely heavily on economic sanctions as a means of punishing and altering the behavior of foreign states and non-state entities, as well as individuals. The modern use of sanctions as a tool of coercion "short of war" dates to the early twentieth century, but the U.S. increasingly turned to financial sanctions after 9/11 to asphyxiate terrorist networks and to confront hostile states. The U.S.'s track record in using economic coercion has been mixed. Sanctions can be powerful tools in advancing U.S. foreign goals—from unraveling South Africa's apartheid regime in the early 1990s to imposing costs on adversaries. But U.S. sanctions have also fallen conspicuously short of their declared aims, such as those placed on Cuba, North Korea, Venezuela, as well as Russia after its takeover of Crimea in 2014.

The United States has been described as "the only sanctions superpower," but it has consistently employed these powers in a strategy-free fashion. Despite the intelligence-driven modernization of our sanctions instruments, U.S. sanctions are criticized as convoluted, too expensive to monitor and implement, inflexible, and rarely grounded in realistically attainable policy objectives. In government, coercive economic actions have been poorly coordinated across the interagency and thus with the U.S.'s other instruments of power—economic, diplomatic, and military. Sanctions and other crucial tools of American economic statecraft are also poorly coordinated with the U.S. business sector and with our foreign allies and partners.

Meanwhile, the targets and potential targets of U.S. sanctions have been developing sophisticated workarounds aimed at blunting the effects of economic coercion. These circumvention strategies have, among other things, contributed to the development of alternative and de-dollarized financial networks. These trends risk undermining the efficacy of sanctions. They also present novel challenges to the open and accountable rules-based international economic order which the U.S. has sponsored since 1945 as a means of promoting peaceful cooperation and prosperity among nations.

The United States today faces the most perilous international situation since the Second World War. Economics—and America's stewardship, in cooperation with allies and partners, of

the open international order—will be determinative in any Great Power competition to come. The dangerous situation facing the U.S. requires us to take a hard look and to reinvest in the full range of national power—particularly tools of economic statecraft.

This research volume was curated for Gates Forum 3, which is addressed to sanctions and American economic statecraft. The authors in this volume have prepared topline summaries of their essays which are included in this integrative report. Our contributors explore the sources of American financial power, U.S. sanctions track records, the novel challenges facing U.S. economic statecraft, and the need for improved integration of sanctions with the U.S.'s other national security instruments. The papers also raise many foundational questions for policymakers to consider: What is the purpose of sanctions—what is it that we are trying to achieve? How can the U.S. enhance the efficacy of sanctions— while limiting their overuse and unintended consequences? How can the U.S. improve the coordination of economic statecraft across the interagency, between government and the American private sector, as well as with our allies and partners? In today's dangerous and troubled world, the U.S. will need to reinvest in its economic statecraft toolkit—that is, its capacity to be good defenders of, contributors to and stewards of the open, innovative, and accountable international economic order. This integrative summary concludes with some questions and areas for action which Gates Forum conferees may wish to consider.

The Sources of American Financial Power

In the first paper of this research volume, Daniel McDowell explores the sources of American financial power and some of the international challenges it now faces. The U.S. dollar became the world economy's dominant reserve currency through the creation of the post-war Bretton Woods monetary system and the international spread of the free trading system. The international economy has only become more dollar-centric in the decades since. Global commerce, investment, debt and other transactions all depend on access to the dollar; and access to the dollar depends on the implicit consent of the U.S. government.

By cutting foreign targets off from their dollar assets or blocking them from participating in cross-border dollar payments, Washington can impose economic costs on adversaries and other actors. Financial sanctions were deployed during World War Two and in the early Cold War period, but they remained a blunt and limited instrument. Several key events and laws subsequently transformed the tool: sanctions against Iran in 1979; the development of U.S. anti-money laundering law in the 1980s; the Iran-Libya Sanctions Act of 1996; the U.S. Patriot Act of 2001.

These events contributed to the further development of targeted as well as secondary sanctions. The sanctions instrument has thus evolved to become a versatile, non-lethal, coercive tool—exceedingly precise yet also scalable. After 9/11, financial sanctions became Washington's coercive foreign policy tool of choice, and the imposition of sanctions on foreign targets— including states, non-state actors, as well as individuals—soared.

Sanctions appeal to policymakers because they can be a powerful and flexible means of responding to hostile states, terror and criminal groups, human rights abusers, and the like. Yet there has also been growing criticism at home and abroad that the U.S. has become over-reliant on sanctions. Further, targets and would-be targets have been adapting with workarounds and sophisticated circumvention strategies. The more the U.S. has used its currency as a weapon, the more the free world's adversaries—as well some of the U.S.'s treaty allies, partners, and would-be partners—have looked for ways to curtail their reliance on the U.S. dollar.

In McDowell's assessment, these developments do not, at present, threaten to topple the dollar's status as the world's dominant reserve currency. However, they have diminished the deterrent and coercive potential of American sanctions while incentivizing alternatives to the dollar-centric system. No case better illustrates this than the Russian one. The United States first imposed financial sanctions on Russia in 2014 and this was followed by additional rounds of sanctions in the years since. Vladmir Putin's regime responded to the slow, steady, and repeated tightening of the economic noose by reducing the Russian economy's exposure to the dollar and, in turn, to American financial pressure.

Thus, in the lead-up to Putin's decision to invade Ukraine, the deterrent effect of threatened U.S. sanctions was critically weakened. The initial shock of the post-invasion 2022 sanctions further declined as a result of Russia's preemptive de-dollarization. The Russian war economy is now well-insulated from existing external pressure. In the meantime, China, like Russia, has also been reducing its dependence on the dollar as a cross-border payment currency by promoting the use of its own currency and its own banks. These developments may very well adversely affect the impact of U.S. sanctions against China in a future crisis scenario.

After three years of intense economic war with Russia, what, really, have we learned? In this volume's second paper, Daniel Drezner explores how the U.S. can best preserve and bolster the efficacy of sanctions. Economic sanctions have and can be used to advance our foreign objectives. But, crucially, sanctions are just one tool in a larger suite of instruments which the U.S. can use to achieve desired outcomes. Unfortunately, as Drezner argues, U.S. policymakers are often unaware of the complex relationship between sanctions and favorable foreign policy outcomes.

Drezner's examination of a number of high-profile cases of U.S. sanctions reveals significant flaws in the American way of sanctioning. First, he describes a "ratchet effect" with sanctions—they are easy to impose and difficult to lift. This is particularly true with sanctions authorized by Congress. Therefore, even in instances when U.S. policymakers are skeptical about the utility of sanctions, they continue to accumulate.

Second, officials tend to learn (or "overlearn") the wrong lessons from high-profile success cases—in no small part because they fail to comprehend the ways that successful sanctions programs are often closely coordinated with other policy instruments. As a result, U.S.

sanctions tools tend to be massively overused or they are poorly integrated with strategy. Meanwhile, high-profile failures have become an argument for underutilizing sanctions.

In the final analysis, Drezner notes America's formidable financial strengths combined with intensifying competition and the weaponization of global interdependence have made it virtually impossible for U.S. policymakers to credibly commit to limiting the use of sanctions. Even officials genuinely interested in reducing the use of sanctions are likely to find it difficult to resist new sanctions when foreign circumstances demand some kind of U.S. response.

There is an urgent need, then, for a smarter doctrine and approach to the use of sanctions. Sanctions are more likely to work when guided by skillful diplomacy and high-grade intelligence. Crucially, they must also be supported by complementary policies and measures. What matters, even when dealing with adversaries, is getting the incentives right, and combining U.S. sanctions with other policy options—from economic inducements as well as the force of arms—can enhance their effectiveness. Drezner stresses policymakers must appreciate that sanctions are merely one instrument in the U.S.'s foreign policy toolkit. One danger we face in years ahead, given the U.S.'s reluctance to employ other instruments of power, is that we've become ever-more reliant on sanctions. This contributes to complacency which, Drezner warns, can be detrimental to the deliberate cultivation of our other instruments of national power and to our foreign policy writ large.

Fostering an Open, Mutually Beneficial, and Secure Economic Order

The American dollar's dominance in the international financial market infrastructure (FMI) is a cornerstone of U.S. economic statecraft, enabling powerful financial sanctions. However, technological advancements, particularly central bank digital currencies (CBDCs), are driving the development of alternative FMIs. In the third paper of this volume, Yaya Fanusie examines how Project mBridge, a China-led CBDC project, is at the forefront of this major shift—one that could potentially challenge U.S. dominance and leadership in the global financial system.

Around the world, the push for FMI alternatives is motivated by both the hunger for development, by the need for technological innovation in cross-border payments, as well as by geopolitical competition. Countries like China, Russia, and Iran have faced U.S. sanctions, and they are actively seeking ways to circumvent U.S. economic coercion. CBDCs offer a promising avenue for achieving this goal.

Project mBridge, which is facilitated by the Bank for International Settlements Innovation Hub, is the most advanced cross-border wholesale CBDC project to date. It enables central banks and large financial institutions to transact using CBDCs. This offers a more efficient and potentially less U.S.-centric alternative to traditional FMI. Fanusie observes that if mBridge were to be dramatically scaled up, it could lead to a deeper bifurcation of the global financial system. This would dramatically diminish the potency of U.S. sanctions and adversely impact the U.S. as a leader and standard setter in global banking.

Beyond emerging financial technologies, America's central position and stewardship of the international economic order also faces challenges in the Global South. Samantha Custer, the author of this volume's fourth paper, analyzes how U.S. sanctions are perceived and received in low-and middle-income countries versus advanced economies. Custer delves deep into articles on sanctions written by scholars from 71 sanctioned, sanctioning, and third countries in the Global South. Her paper reveals challenges and opportunities for action as U.S. policymakers employ sanctions in a time of heightened rivalry and competition.

Custer finds that there is a push in the Global South to develop "resistive economies" which are better insulated from both U.S. sanctions and geopolitical contestation. This strategy can take the form of reducing dependence on the dollar and advances in financial technologies, national payment systems, and more. Furthermore, low-and-middle-income countries have been innovative—entrepreneurial—in developing ways of evading externally imposed trade restrictions, which span old-fashioned smuggling to more sophisticated efforts to launder money.

Overall, Custer identifies three important trends in the Global South. First, countries which have been targeted by U.S. sanctions have evolved from "isolated defiance" to "networked resistance." Second, U.S. sanctions are frequently poorly coordinated with U.S. diplomatic efforts—and thus are vulnerable to damaging counternarratives. Lastly, the complete isolation of target countries and companies in the Global South fans the flames of defiance and propels them into the arms of third-country enablers.

In all these areas, the largest U.S. competitor is China, which has utilized its economic clout quite effectively to advance its diplomatic and strategic agenda. Audrye Wong's paper, the fifth in this volume, explores China's approach to both economic coercion and economic inducement and assesses how effective China has been in using economic means to advance its foreign interests.

Wong describes how China's use of economic coercion has often been characterized by informality and plausible deniability. The rise of Chinese nationalistic consumer boycotts presents a case study of China's seeming advantages as a coercive economic actor as well as its limits: by and large, Chinese coercion has not altered the existing policies of foreign states, but it has facilitated preemptive self-censorship in other nations and affected the decision-making of policymakers and especially of private companies. Beijing is furthermore expanding the legalization of its economic security toolkit—particularly as retaliatory countermeasures to Western sanctions. While there is significant potential for the Chinese government to leverage commercial chokepoints and expand its export controls, China has thus far remained relatively cautious in the use of such measures due to the likely impacts on its internal economy.

Simultaneously, Wong explores how China—which is now the top trading partner to 120 countries—has also used economic inducements to promote its external interests. Subversive "carrot" tactics have allowed China to make inroads in countries where leaders can act with relative impunity, but these tactics have also backfired in countries where leaders face greater transparency and accountability. Meanwhile, in some instances, China's efforts to cultivate and capture pro-China constituencies in foreign countries through legitimate economic inducements and interdependence have succeeded, and this has led to intensifying debates in many countries about how to manage economic and security issues with Beijing.

All in all, Beijing has been most effective at achieving short-term transactional goals. China has been skillful at using economic tools to drive wedges within countries as well as between different countries, thus inhibiting the formation of effective multilateral and regional China-skeptic coalitions. Wong acknowledges this is a particularly useful tactic for a rising power that wants both to reduce opposition to China's interests as well as inhibit geopolitical alignment with the U.S. How can American economic statecraft best respond to this challenge?

Enhancing American Economic Statecraft

Several contributors to this volume stress that U.S. sanctions and other economic programs are most effective when they are implemented in close coordination with our foreign allies and partners. As Edward Fishman argues in the sixth paper of this research volume, multilateralism, in general, bolsters the legitimacy and effectiveness of sanctions—all while helping to preserve the core sources of American economic power. But there are also drawbacks to multilateral sanctions—especially when speed and potency are imperative. These drawbacks have grown more pronounced in recent years as intensifying Great Power rivalries have made the UN Security Council an obsolete venue for coordinating sanctions. Meanwhile, the power of unilateral American sanctions has increased as the global economy has further integrated and the reach of the U.S. regulatory state has expanded.

Fishman contends we are living in a new "Age of Economic Warfare"—one in which great powers increasingly deploy sanctions and other punitive economic measures against one another. To harness the benefits of multilateralism and mitigate the drawbacks, the United States and its allies must revamp their governing structures, invest in the people who run international economic programs, and develop new doctrine for conducting economic statecraft.

This overhaul, notes Fishman, should aim to create new allies-based mechanisms which are nimble yet capable. They should possess the capacity to implement both coercive and positive economic programs, and they should enable advanced, collaborative planning among allies and partners. Critically, in Fishman's view, such mechanisms should be relatively easy to launch because they require institutional innovation rather than the wholesale creation of new multilateral arrangements.

Picking up on these themes, this volume's concluding paper by Will Norris stresses the crucial importance of improving the U.S. government's coordination with the private sector in all aspects of American economic statecraft. Any effort to use U.S. economic tools of power fundamentally depends on it. Norris underscores that economic coercion, including sanctions,

is just one component of the larger U.S. economic toolkit—and coercion is not necessarily the facet of economic statecraft at which the U.S. has excelled historically.

Instead, as Norris reminds us, the U.S.'s rise to prominence in international affairs owes principally to the dynamism of American enterprise—and the U.S. government's ability to harness this to advance our foreign interests. In the current age of geopolitical conflict and competition, economics will be determinative, and Norris argues that America's key comparative advantage still lies in our dynamic and innovative private sector. We need, therefore, to design national economic policies, institutions, and processes that strengthen and enhance that capability, building off that source of strength without hampering it.

Despite this, Norris notes that the United States has rarely been strategic and systematic about how it has developed and wielded its economic power in pursuit of international objectives. This history partly explains the ad hoc and short-term nature of U.S. policy in dealing with the complex, multi-faceted foreign challenges that it now faces.

The U.S. government has many economic tools in addition to sanctions—for example, tariffs, export controls, development assistance, diplomacy—which can help incentivize private sector actors and advance our economic and strategic interests. However, Norris notes few coordinating structures exist in government to bring all these tools together to pursue long-term strategic outcomes. Furthermore, there is a lack of common economic statecraft literacy and information-sharing across both the executive and the legislative branches, and most especially between the government and the private sector. Norris argues government capacity building ought to focus on personnel, better data and data-sharing systems, and on new institutional arrangements which can empower effective economic statecraft. As the U.S. seeks to enhance and leverage its economic dynamism and power in the world at-large, the U.S. must do so in a way that is politically and economically durable, which benefits Americans, and redounds to its formidable natural strengths.

Policy Questions to Consider

Taken together, the contributors to this research volume on U.S. sanctions and economic statecraft raise a number of foundational questions that policymakers should consider. While not an exhaustive list, some of the most salient questions include:

1. What are the different purposes of sanctions—and how effective are they, really?

2. What are the most important and illustrative recent sanctions case studies for us to understand and what lessons should we draw?

3. What does the U.S.'s use, overuse, and (possibly) abuse of financial sanctions mean for the future utilization of the tool itself, the strength of the U.S. dollar, and for American economic competitiveness?

4. How can U.S. sanctions be better integrated with other instruments of power?

5. How will the emergence of alternative financial market infrastructures impact the effectiveness of U.S. sanctions? What can the U.S. do to address these challenges—and to bolster the security and attractiveness of the open international economic order?

6. How might the U.S. best engage geo-economic “straddlers” or “fence-sitting” countries to support rather than undercut U.S. sanctions, given their outsized influence as third-country enablers or in supporting networked resistance? What are the most important countries in the “hedging middle” to prioritize—and why?

7. How should the U.S. respond to China’s effective use of both economic coercion and economic inducements?

8. What immediate steps should the U.S. government take to improve economic statecraft coordination with allies and create more agile and capable multilateral sanctions mechanisms?

9. How can the U.S. best harness the power and dynamism of the American private sector to advance its foreign commercial and security interests?

10. What are the alternatives to sanctions? The U.S. has other coercive economic tools—for example, tariffs. To what extent can U.S. and multilateral tariffs complement sanctions—or replace them—in advancing national and allied interests?

11. Overall, what should be recommended to a new administration and/or Congress for a new approach to sanctions and economic statecraft as a whole?

12. What new systems, coordinating structures, and processes are needed in government to enhance the U.S.'s capacity to conduct effective economic statecraft?

Policy Options to Consider

This research volume highlights a number of structural and policy pain points in how the United States wields its sanctions powers, coordinates sanctions policies with other instruments of economic and national power, and coordinates efforts with allies and the private sector. It further raises the need to consider alternative models and approaches for refurbishing the U.S. economic statecraft toolkit and strengthening the open international trading and financial system.

As decision-makers consider the best paths forward, some policy options to consider from the research volume include:

- A financial sanctions "Powell Doctrine" to preserve and improve the tool's effectiveness (McDowell). General Colin Powell advocated that military interventions are justifiable only when vital U.S. interests are threatened, when there is a clear and attainable objective, and when decision makers are committed to using overwhelming force to attain that objective. All too often, financial sanctions have been deployed without satisfying all (or sometimes any) of these standards. Given that the stakes of economic statecraft are much lower than the stakes of warmaking, that may be acceptable. But moving in the direction of a financial statecraft Powell Doctrine as the gold standard for sanctions-use would be a positive step toward protecting both the dollar's reputation and preserving the efficacy of sanctions.

- Requiring annual Sanctions Impact Assessments by the Intelligence Community (Drezner). These assessments—which would be reported to Congress—would analyze the economic and political effects of ongoing sanctions programs—and the implications of removing those sanctions.

- Organize a digital economic warfare red cell (Fanusie). Officials in the U.S. Departments of Treasury and Commerce should be proactive in preventing worse-case scenarios for the future financial system by creating a team of analysts focused on digital innovation. This unit should construct CBDC wargames to identify likely

developments in cross-border payments and develop comprehensive U.S. strategies to address these challenges.

- A White House mandated advisory committee or panel on sanctions efficacy (Custer). This panel would consist of respected scholars, practitioners, and policymakers familiar with the tactics employed by Russia, China, and other actors to evade U.S. sanctions, engage in retaliatory measures, and employ explicit or unofficial sanctions with third countries. The advisory committee could investigate, deliberate, and propose new strategies and approaches that U.S. agencies like State, Treasury, and Commerce can use to make it more difficult for target countries to evade sanctions and help allies as well as partners in the Global South build resilience to economic coercion by adversaries.

- Reform and streamline multilateral lending processes (Wong). The United States should actively promote the availability of alternatives for infrastructure financing and investment projects, including encouraging private commercial actors to play a bigger role, which would prevent China from being the default or dominant choice. Further, the U.S. should move away from excessively rigid "gold standards" that can detract from the goals of broadening access to investment and development financing.

- Establish a permanent Sanctions Coordination Committee within the G7 (Fishman). The G7 should create a permanent Sanctions Coordination Committee, with each government designating a representative empowered to negotiate multilateral sanctions. Currently, sanctions are just one of many topics for negotiation among the G7 Sherpas, officials that hold the equivalent role of national security advisor or deputy national security advisor. It is rare for these officials to be sufficiently versed in the intricacies of sanctions policy to conduct substantive negotiations. As a result, each government should appoint a Sanctions Sous Sherpa, who would be responsible for meeting regularly with his or her counterparts and coordinating sanctions policies.

- Integrate economic policy more effectively into our diplomacy (Norris). The U.S. needs to be more creative and innovative with how it orchestrates its economic-diplomatic tools toward a desired strategic effect. For example, joint U.S.-EU, "5 Eyes," AUKUS, or U.S.-Japan-ROK innovation funds could be established to support collaborative basic

research in key emerging technologies. Such government underwriting can serve to incentivize and crowd-in private capital while also reinforcing the U.S.'s critical diplomatic alliances. These kinds of mechanisms create sustainable partnerships with nations who share American values. They also enhance our collective ability to conduct cutting edge research and develop technologies while facilitating the comparative advantages of our free and open economic system.

- Focus on reconstituting our "positive" economic tools to compete in the Global South (Norris/Eric Brown). The U.S. needs greater capacity in government to foster new and secure trading partners within developing countries. Getting the incentives right through bilateral trade policy and other arrangements is the critical first step. How, beyond this, can U.S. institutions like the Development Finance Corporation, the Export-Import Bank, and the Millenium Challenge Corporation better facilitate expanded commerce with developing countries that benefits Americans while enlarging the open and accountable economic order?

Background Research - Chapter 1

Gates Forum III

The Sources of American Financial Power and its Challengers

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Introduction

The list of foreign policy challenges that the United States has faced down in the first quarter of the 21st century is long and varied. From Russian attempts to redraw land borders in Europe to widespread democratic backsliding around the world; from human rights atrocities amid intractable conflicts in the Middle East to state-sponsored cyberattacks on American businesses; from the ever-present threat of international terrorism to strategic competition with a rising China; pursuing and protecting American interests in the post-Cold War era has been full of complexity. By contrast, the toolkit U.S. policymakers use to respond to these challenges has grown simplistic. Economic sanctions—chiefly financial sanctions—have become Washington's favored instrument through which it seeks to influence and shape world events.

The appeal of financial sanctions among policymakers is easy to understand. The United States today arguably possesses more influence over the international financial system than any country at any point in modern history. With little effort and often at little immediate cost to itself, the United States can swiftly and decisively impose immense economic pain on foreign targets. The tool's popularity also reflects its high degree of flexibility, as financial sanctions can be purposely fit to an assortment of situations: narrowly tailored to carve a single bad actor out of the dollar system or scaled to financially isolate an entire economy.

The wellspring of the United States' immense financial capabilities is the U.S. dollar's dominance in the hierarchy of international currencies—a position that it achieved eight decades ago and has yet to relinquish. As this essay explains, the dollar's ascension in the 20th century reflected America's combined post-war global leadership and post-war economic dominance. Over subsequent decades, global dollar supremacy became further entrenched, reflecting U.S. policy moves and the self-reinforcing nature of financial networks. Foreign dependence on the dollar system meant Washington had a powerful coercive instrument at its disposal.

Recognition of these capabilities, and the subsequent development of the legal and institutional structure that further enhanced the tool, paved the way for the explosion in the

U.S. government's application of coercive financial statecraft over the last twenty-five years. Disillusionment with older methods of economic warfare, the growing complexities of international threats facing the United States, and America's declining appetite for foreign wars helped provide the justification.

Both within and without government, there are growing concerns about the costs of overreliance on financial sanctions as a cure-all for America's long list of foreign policy challenges. As Washington repeatedly demonstrates these capabilities and does so against higher profile foreign targets, U.S. adversaries are taking notes. They recognize that dollar dependence leaves them vulnerable to U.S. coercion, and they are working to get ahead of the curve. While widespread de dollarization remains out of reach for most, even modest reductions in reliance on the currency can weaken the deterrent and coercive impact of U.S. sanctions.

The United States should not abandon the use of financial sanctions as a foreign policy tool, but it needs a new, more careful approach if it wishes to preserve the potency of its coercive financial capabilities well into this century.

The Rise and Dominance of the Dollar

Most national currencies play no role outside their country of issuance. Yet, because the transaction costs of international exchange and investment are reduced when market actors use the same monetary unit to set prices, complete payments, and function as the reserve currency, the world economy has tended to elevate a small number of national currencies to international status—with one typically assuming a dominant role.

International dominance, once achieved, tends to be self-reinforcing, as individual market actors have little incentive to switch their activities into other less attractive monies which are comparatively more costly to use and less widely accepted in the global marketplace. International currency hierarchies, thus, tend to be quite stable over the long run. The dollar's reign has been uninterrupted for more than 80 years.

As international currencies go, the dollar was something of a late bloomer. Even as the United States surpassed Great Britain in the late-19th century as the world's largest and most productive economy, it took another 50 years for the currency to conclusively supplant the British pound as the international economy's preeminent unit of account, store of value, and medium of exchange. Indeed, prior to the creation of the Federal Reserve System in 1913, the dollar was but a bit player in an international economy dominated by European currencies.[1]

Things began to change during the interwar years, as U.S. financial markets deepened, matured, and became less crisis prone. By the 1920s the dollar temporarily emerged as a legitimate rival to the pound as an international reserve and trade finance currency. International use of the dollar retreated during the Great Depression as the United States turned inward, eschewing international economic leadership.[2] With neither the United States nor Great Britain willing to hold the line for economic liberalism, the first era of economic globalization buckled under the weight of economic crisis, rising protectionism, and beggar-thy-neighbor currency devaluations.[3]

Out of the ashes of the Second World War, the dollar finally and decisively ascended to its perch atop the international currency hierarchy. Now, a United States full of confidence and

ambition was ready to lead the world economy forward, which included a central role for the dollar.[4] Keen to avoid a repeat of competitive currency devaluations that wrecked world trade during the interwar years, the American architects of the Bretton Woods monetary system devised a solution: a fixed exchange rate regime with the dollar, backed by gold, and all other major currencies fixed to the dollar.

By design, Bretton Woods officially elevated the dollar above all other monies as the lynchpin currency, requiring central banks to hold the dollars in their foreign exchange reserves and formally establishing it as the world's premier store of value. Concurrently, the Marshall Plan sent billions of dollars in aid across the Atlantic. Many of those dollars were promptly used to pay for imports of materials and goods from the United States, Canada, and other European countries.[5] Meanwhile, U.S. corporations, which dominated post-war commerce, priced their wares, and accepted payment in their own national currency. This incentivized foreign competitors to do the same.[6] These forces firmly ensconced the dollar as the premier unit of account and medium of exchange for the fast growing, rapidly integrating world economy.

In the 1950s, the United States began running persistent balance of payments deficits due to U.S. outbound private investment, continued foreign aid, and overseas military spending. Foreign central banks financed these deficits by purchasing dollar assets, further entrenching the U.S. dollar as the reserve currency.[7] As dollars held in central bank portfolios ballooned, foreign monetary authorities began to convert some of those balances into gold, straining the credibility of the gold-dollar link. At the same time, swelling private dollar deposits in European banks (known as the Euromarket) further increased the risk of a speculative attack on the dollar.[8] These external pressures culminated in the 1971 decision by President Nixon to declare a temporary closure of the gold window.

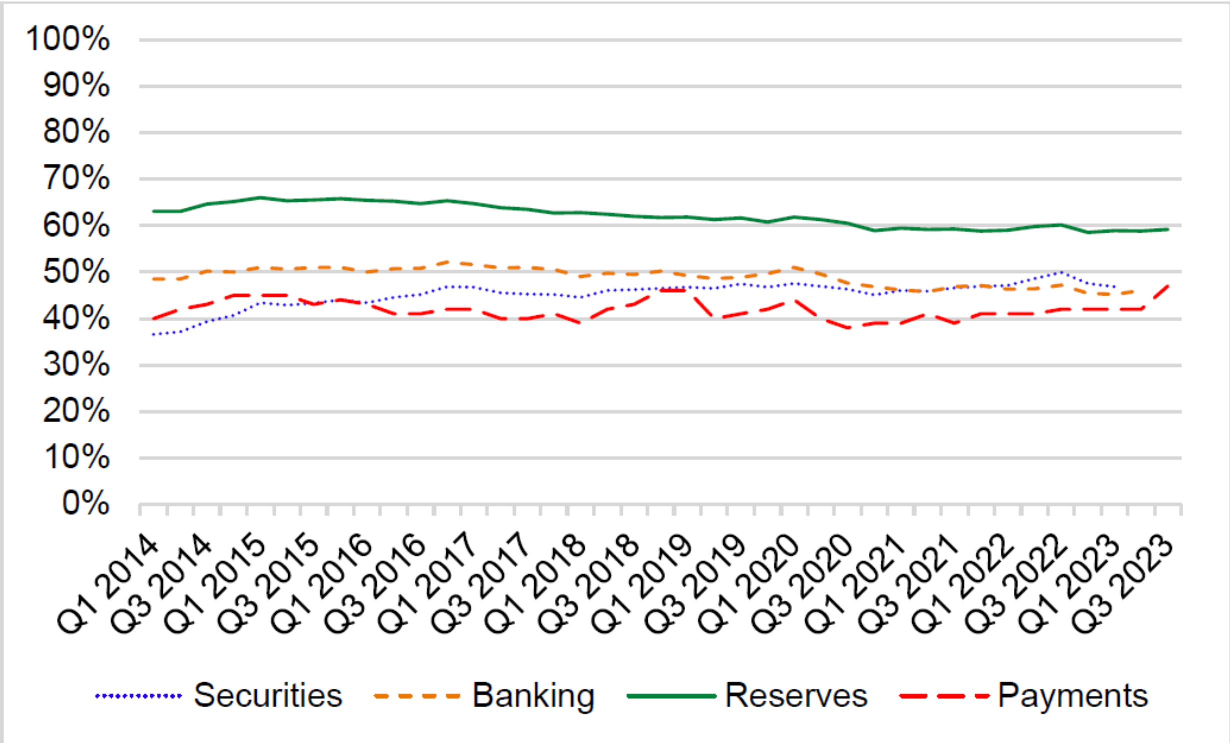
In the end, the dollar-gold link was never restored, and yet America's unilateral move to the fiat, free-floating exchange rate system of today only further entrenched dollar dominance. In the early-1980s, the Reagan administration adopted a set of economic and defense policies that produced historically large U.S. budget and trade deficits. These external imbalances were financed by a flood of foreign private capital inflows into dollar-denominated assets, as advanced economies deregulated and liberalized their financial markets over the course of the decade.[9] As the world economy entered the hyper-globalized, hyper-financialized era of

the 1990s and 2000s, world trade, international payments, debt markets, and cross-border investment had firmly coalesced around the dollar.

In today's world economy, countries that run trade surpluses typically take the dollars earned through trade and invest them in dollar-denominated assets, especially U.S. Treasury bonds. When major companies, including foreign multinationals, raise funds in securities markets, they tend to borrow in U.S. dollars. Individuals and firms around the world generally prefer to hold their savings in dollars over alternative currencies. When two actors make a cross-border exchange of goods or services, the dollar is most often the currency used to complete payment, even when neither entity is based in the United States. Figure 1 reports the dollar's global dominance visually by plotting its market share across four categories over the last decade. The U.S. currency retains between 40 to 60 percent of the worldwide market as an official reserve currency, in banking liabilities, in private securities markets, and as a cross-border payment currency. As of 2023, it is the most widely used currency in each category, and by a wide margin.

Global debt, investment, and trade all depend on access to the dollar, and access to the dollar depends on the implicit consent of the U.S. government. The ability of the United States to deny foreign actors access to its financial system, and by extension its currency, is a tremendous power resource. Over the course of the dollar's eighty-year reign, Washington has honed, refined, and expanded the way it uses this resource in the form of financial sanctions. The evolution of the tool over this time reflects policymakers' evolving understanding of the capability at their disposal and development of the institutional and legal structure that maximized its potential.

Figure 1: U.S. Dollar Global Market Share by Role, 2014-2023



First Generation Financial Sanctions

For most of the 20th century, trade policy was the channel through which the U.S. government sought to exercise economic statecraft in the world.[10] To the extent that financial sanctions were used, they were cast in a supporting, rather than lead, role. Moreover, until late in the century, U.S. efforts employing financial sanctions were used as a wartime, not peacetime, instrument—an example of what policymakers then called "economic warfare". Finally, with the exception of an ambitious targeted sanctions program used during World War II, early financial statecraft efforts were largely limited to the blunt technique of freezing adversarial states' U.S.-based dollar assets.

The day after the Nazis invaded and seized control of Norway and Denmark in April 1940, Franklin Roosevelt issued an executive order blocking the German fascist regime from accessing Norwegian and Danish assets in the United States.[11] Additional Nazi asset freezes followed as more European countries fell to the Third Reich, the aim being to protect the assets of conquered peoples and to deprive Hitler of using foreign wealth to finance his violent expansionism. Similarly, to complement a trade embargo on Japan, Roosevelt ordered the seizing of the Empire's dollar assets during the summer of 1941—but not before Japanese agents had absconded by sea with millions of dollars in paper Treasury bills.[12]

World War II also saw the introduction of the "Proclaimed List of Certain Blocked Nationals", an impressively large financial blacklist managed by the State Department and U.S. Treasury.[13] U.S. firms and persons were not permitted to transact with entities on The Proclaimed List. The aim was to economically isolate Nazi interests operating in South America.[14] The list—which swelled to include more than 10,000 entities—eventually reached into Europe as well. Though an ambitious effort for its time, the investigative procedures used to populate the list were, in the words of one historian: "so inadequate, its impact was sometimes felt by those least likely to contribute to the German war effort".[15]

After the war, the United States occasionally used financial sanctions as part of its broader Cold War strategy of containment. In 1950, amid the Korean War, the Office of Foreign Assets Control (OFAC) was formally established at the Treasury. President Truman used the new

office to block Chinese assets when Beijing intervened in the war on North Korea's behalf.[16] The financial freeze was paired with export restrictions in the hopes of compelling China to remove forces from the peninsula.[17] Twenty-five years later, following the falls of Phnom Penh and Saigon to Communist forces, President Ford ordered the blocking of Cambodian and South Vietnamese assets.[18]

A pivotal moment in the development of U.S. financial sanctions policy occurred on November 14, 1979. Following the taking of 52 American hostages from the U.S. embassy in Tehran, President Carter issued an executive order No. 12170, immediately freezing $14 billion in Iranian assets.[19] Iran was especially vulnerable to this move because of the dollar's central role in the energy trade. As Tehran earned dollars for oil exports, the earnings were stashed in domestic and overseas branches of U.S. banks. Carter's order exploited this vulnerability.

The move was historically consequential for several reasons. First, the total assets blocked were orders of magnitude larger than previous freezes.[20] Second, the asset freeze was implemented during peacetime rather than during or in the immediate aftermath of a major conflict. Finally, the order also applied to dollars held in foreign branches and subsidiaries of U.S. banks. Carter's move marked the first time that U.S. financial sanctions had been applied extraterritorially. Unblocking of the assets in 1981 proved instrumental as part of a deal to free the hostages.[21]

The Reagan administration followed its predecessor's lead, deploying financial sanctions as a peacetime instrument of coercion by blocking Libyan assets in 1986 and Panamanian assets in 1988, aiming to isolate, weaken, and perhaps even invite the overthrow of Muammar Gaddafi and Manuel Noriega—goals that did not materialize.[22] President George HW Bush froze Iraqi and Kuwaiti assets following the former's invasion of the latter in 1990, but ultimately military force was needed to compel Saddam Hussein to give up his irredentist aims.

For fifty years from 1940 to 1990, American authorities had used financial sanctions to block foreign adversaries from accessing their dollar-based wealth in a number of high leverage foreign policy crises. The results of those actions were, at best, mixed. With the exception of the ambitious but crude Proclaimed List used during the Second World War, the instrument had remained largely the same instrument over this span: blocking access to official state

assets. New developments would soon dramatically change how policymakers employed the tool.

A Precision Instrument of Coercion

In 1986 the United States became the first country to make money laundering a criminal act, as part of the ongoing War on Drugs.[23] European countries soon followed and in 1989 the Financial Action Task Force (FATF) standardized international anti-money laundering (AML) best practices.[24] Then, with the passage of the U.S. Patriot Act following the 9/11 attacks, AML regulations were again expanded, as customer identification standards, reporting, and recordkeeping requirements all intensified.

These new regulatory standards required financial institutions to adopt principles of financial transparency, information sharing, due diligence making it far more difficult for criminal actors to participate in the international financial system without being noticed.[25] Such steps signaled to commercial banks that their reputation and their ability to continue to participate in the global dollar-based financial system depended on their cooperation with U.S. authorities on matters of illicit finance. Substantial financial penalties could also be levied against financial institutions that flouted Washington's edicts. Thus, private sector actors were effectively mobilized to enforce U.S. law in a public-private partnership.[26]

With access to a trove of cross-border financial data alongside the cooperation of private sector financial institutions, Treasury now had an entirely new playbook from which it could draw. Crude, state-level asset freezes were no longer the primary lever OFAC had at its disposal. Now, at the direction of the president, the office could add the names of any individual, firm, or state institution to the financial blacklist known as the Specially Designated Nationals (SDN) list, instantly carving them out of the dollar system. The ambitious but flawed Proclaimed List had its modern descendant which fast became Washington's premier non-lethal, peacetime means of wielding coercive influence in the world.

An SDN facing full blocking sanctions is not only denied access to its dollar-based wealth but is also prevented from making or receiving payment in dollars. Given the dependence of the world economy on the U.S. currency, the effect of such a blacklisting is near immediate and total financial isolation for the target. Moreover, by targeting individuals and entities with

political influence and power, this tool strikes closer to the decision-making structures of target states compared to older sanctioning methods.[27]

Washington wasted little time employing its new precision instrument against state targets. In 1993, the Clinton administration announced the blacklisting of more than 80 Haitian elites and 35 other sub-national entities, as part of ongoing efforts to restore Jean-Bertrand Aristide to power in that country.[28] During the Balkans war, the United States froze Serbian president Slobodan Milošević's personal financial assets to bring him to heel.[29] In neither case were the measures successful at achieving their stated goals, but the use case for smart sanctions against state targets had been established.

Though the United States still occasionally imposes national-level asset freezes (as it did against Russia in 2022), the SDN list is now the primary means through which U.S. coercive financial statecraft is flexed. Today over 15,000 foreign individuals, firms, institutions, and other entities are financially blacklisted by Treasury; the department's official document listing these entities is itself over 2500 pages long.[30]

The Extraterritorial Turn

Even as the Treasury developed new levels of precision in the execution of economic statecraft, yet another 1990s law laid the groundwork for broadening the application of U.S. financial sanctions to an unprecedented scale. The Iran-Libya Sanctions Act of 1996, which continued the U.S. economic pressure campaign against the two problematic regimes, marked another watershed moment in the development of American sanctions capabilities. Until passage of the act, U.S. financial sanctions—including the 1979 Iran measures—had only applied to American banks or foreign banks operating in the United States.

The 1996 law changed this by requiring that the president impose economic and financial sanctions on any foreign company that invested in the development of Iran or Libya's energy sector.[31] This included foreign banks without any direct ties to the United States. The threat of facing U.S. penalties was designed to compel otherwise unwilling foreign firms to align with U.S. sanctions law. Business and political leaders in Europe strongly objected, and ultimately no such penalties were levied.[32] However, the idea that Washington could extend its coercive reach through the application of "secondary sanctions" had been broached.

Nine years later, the George W. Bush administration revived the idea. Relying on section 311 of the U.S. Patriot Act, it designated Banco Delta Asia (BDA), a Chinese bank based in Macau, for providing international financial services to North Korea—a major target of U.S. economic sanctions. The move barred U.S. financial institutions from maintaining correspondent accounts with BDA, cutting the Chinese lender off from the dollar system, forcing BDA into receivership.[33] Foreign banks were now on notice: cut ties with North Korea, or else.

In 2010, amid growing concerns about its nuclear weapons program, Iran again became the focus of U.S. financial pressure. The Comprehensive Iran Sanctions, Accountability and Divestment Act (CISADA) picked up where the Iran-Libya Sanctions Act left off, barring not just U.S. financial institutions but also foreign banks and firms from doing business with Iranian entities on the SDN list. Foreign institutions that flouted U.S. demands would be added to the SDN list themselves—a near financial death sentence.[34] Some credit these measures with

bringing Tehran to the negotiating table, leading to the Joint Comprehensive Plan of Action (JCPOA) and the lifting of those measures.

In the years that followed, secondary sanctions were selectively enforced against a small number of European and Chinese firms for doing business with designated Iranian and North Korean entities. Though their potency is unquestioned, they remain controversial.[35] Most notably, the Trump administration's unilateral withdrawal from the JCPOA in 2018 reinstated sweeping secondary sanctions on Iran. The decision drew the ire of America's European allies, who felt betrayed by the decision and bullied by the extraterritorial enforcement of U.S. sanctions.[36]

Financial Sanctions Overuse

For eighty years, the dollar has reigned supreme as the world's dominant international currency, forming the foundation of the United States coercive financial capabilities. Early on, policymakers used the tool sparingly, typically in support of ongoing military action against an enemy. Washington's financial sanctions capabilities, then, were largely limited to blocking official assets of fellow sovereigns. The selective use of the tool may have reflected the view that confiscating official reserves was too provocative an act to justify frequent use. Or it may have reflected the view that other economic tools, like trade embargoes, were more effective tools of coercion.

With the advent of targeted and secondary sanctions, Washington's thinking changed. Financial sanctions had evolved to become a versatile, non-lethal, coercive instrument—exceedingly precise yet infinitely scalable. As the complexity of the threats facing the United States intensified in the years after the Cold War, financial sanctions had an understandable appeal. They were adaptable to any number of situations and could be deployed swiftly against state and non-state targets alike.

In addition, innovations in targeted sanctions arrived as policymakers were losing faith in trade embargoes as mounting evidence suggested they hurt civilian populations while leaving the target's leaders unscathed[37] Nor were trade sanctions easily applied against the increasing number of non-state actors that threatened U.S. interests. To address the growing diversity of challenges facing the United States, new tools were needed.

Further, sanctions occupied a comfortable middle ground between diplomacy, on one hand, and military action, on the other. Washington now had a tool that could be deployed in situations where American "boots on the ground" had been ruled out yet a diplomatic response seemed insufficient. This was especially well suited for the post-Iraq war era where the American public grew skeptical of foreign wars. Indeed, it was during the Obama

years—an era often described as one of foreign policy restraint—that the United States use of financial sanctions began to soar.[38]

This is apparent in the accumulation of executive orders directing the Treasury to initiate a new tranche of financial sanctions against a foreign target. At the turn of the last century, there were a total of twenty-two such orders in place. In 2023, the number reached 110—a five-fold increase (see Figure 2). In 2000, there were four countries directly targeted by a U.S. financial sanctions program: Cuba, Iran, Iraq, and Sudan. In 2023, a total of twenty-two foreign countries were in this group, amounting to roughly one out of every ten sovereign states in the world today (see Figure 3).[39]

Some in Washington have warned that the tool is being overused. In a 2016 speech, then Treasury Secretary Jack Lew warned that conditioning the use of the dollar and the American financial system on "adherence to U.S. foreign policy" risked causing a "migration to other currencies and other financial systems".[40] Lew's successor at Treasury, Steven Mnuchin, used the same line of argument to lobby for a more restrained use of the instrument. To continue using sanctions to address every foreign policy challenge, he argued, would weaken the effectiveness of the tool as U.S. adversaries move their investments and payments away from the dollar.[41]

Adding fuel to these concerns was the Trump administration's 2018 decision to withdraw from the JCPOA and reinstate secondary sanctions on Tehran. This move was met with condemnation from America's allies in Europe, whose banks and firms were compelled to cut ties with Iran. It also generated calls from high-ranking policymaking elites around the continent for a more muscular euro policy and strategic autonomy from the U.S. dollar and its financial system. Indeed, the topic was so top of mind at the time that it was a focal point of Jean-Claude Junker's 2018 State of the Union speech.[42]

Figure 2: Active Executive Orders Pertaining to Sanctions Programs, 2000-2023

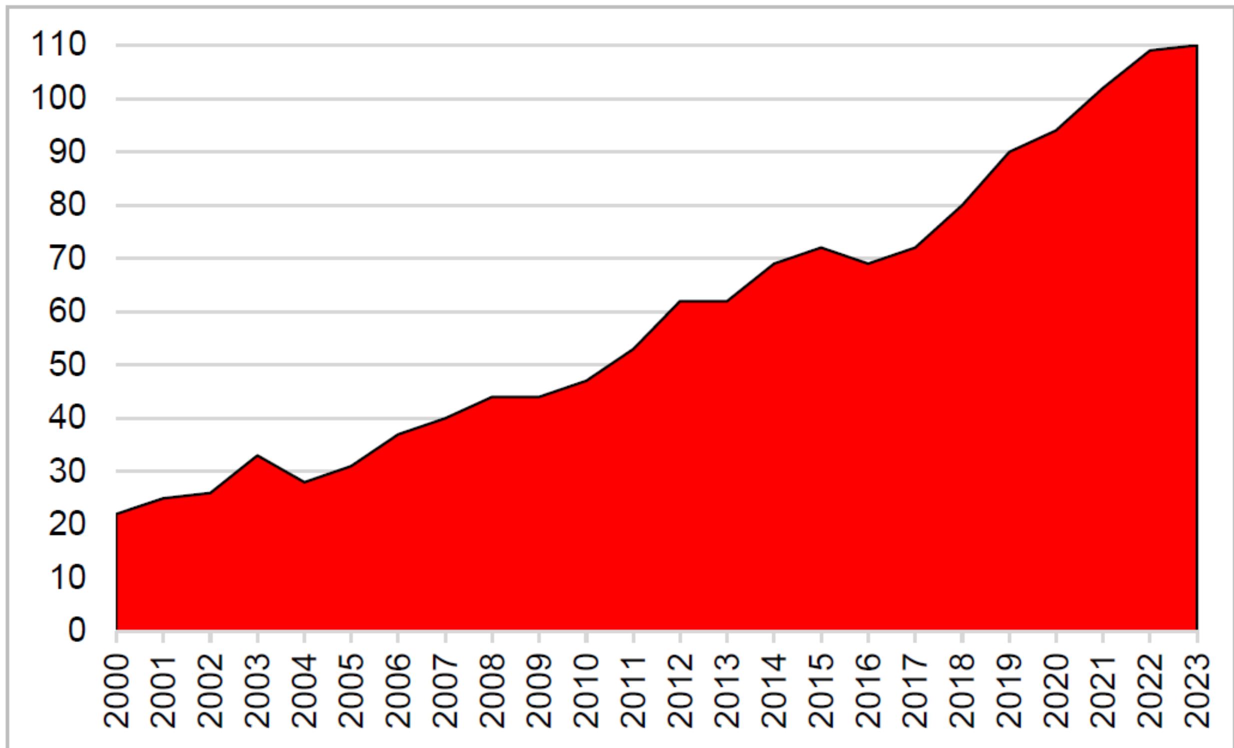
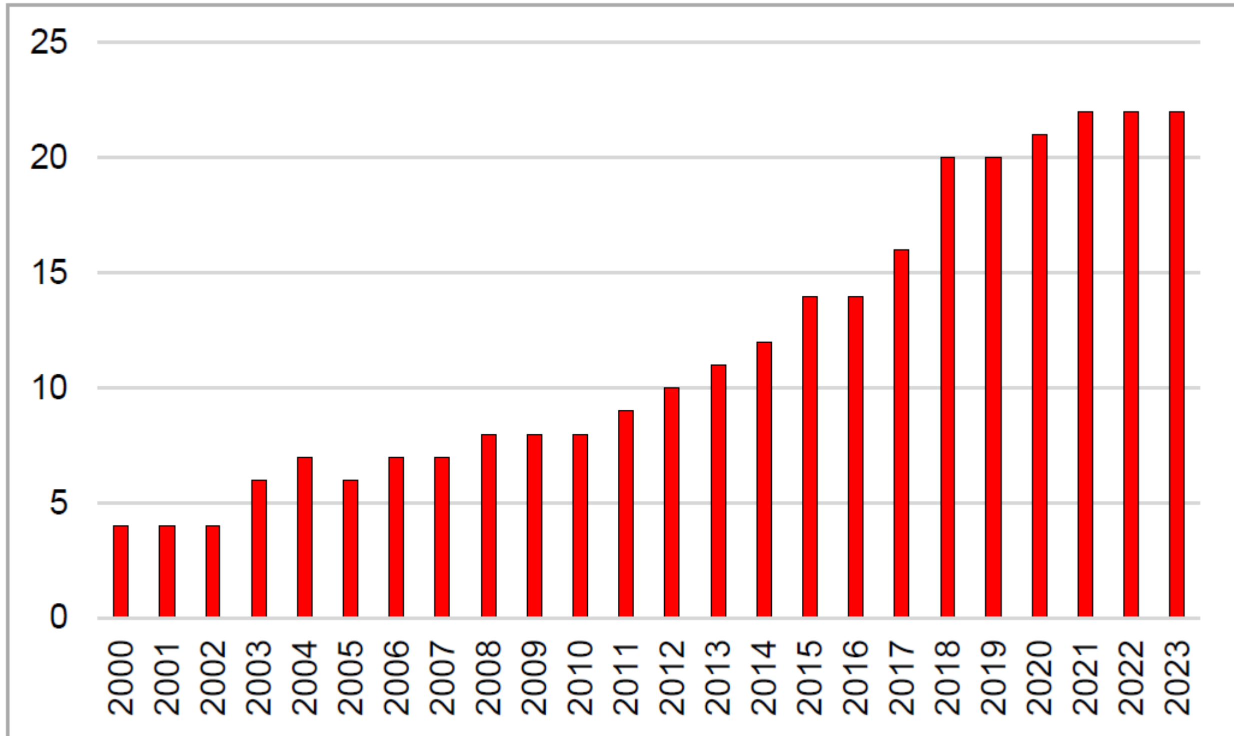


Figure 3: Foreign Countries Targeted by Financial Sanctions, 2000-2023



More recently, Brazil's president Lula de Silva received global attention when he expressed frustration with dollar dependence while visiting China on an official state visit. Elsewhere, renowned financial journalists and high-ranking IMF officials have also suggested U.S. sanctions could lead to a more fractured international monetary system as more states turn to dollar alternatives.[43]

The more the United States has used its currency as a weapon, the more America's adversaries (and occasionally its allies) have looked for ways to curtail their reliance on the dollar. No case better illustrates this than what has transpired in Russia over the last decade.

Russian De-dollarization

In the first weeks of 2022, the Biden administration warned Vladimir Putin if he moved on Ukraine, swift and severe economic sanctions would follow.[44] Undeterred, Putin ordered his military to initiate the invasion of Russia's neighbor on February 24. As promised, the United States and its allies immediately retaliated with a well-coordinated suite of economic sanctions. Oligarch's yachts were seized, Putin and his close political operatives were financially blacklisted, as were some of the largest Russian banks which were cut off from dollar funding markets and the dollar-based cross-border payment system. In a rare move following the initial salvo, full blocking sanctions on the Central Bank of Russia (CBR) were announced, preventing Moscow from accessing roughly $300 billion in U.S. dollar and euro reserves.

The initial impact of the sanctions seemed promising. The ruble lost half its value within the first month of the conflict, prompting President Biden to publicly declare the currency "rubble." However, hopes of a sanctions-induced economic crisis were short-lived. Deft policy moves by the CBR coupled with Russia's continued energy sales quickly stabilized the ruble.[45] Meanwhile, Russia reoriented its commercial and financial relationships away from the West and toward China.

The final verdict on the impact of the economic pressure campaign against Russia will not be fully written for some time. And yet at this early stage, two facts seem indisputable. First, deterrence failed. Second, Russian adaptation was lightning fast. There is no single cause that can fully explain these developments, yet both are potentially linked to sanctions overuse.

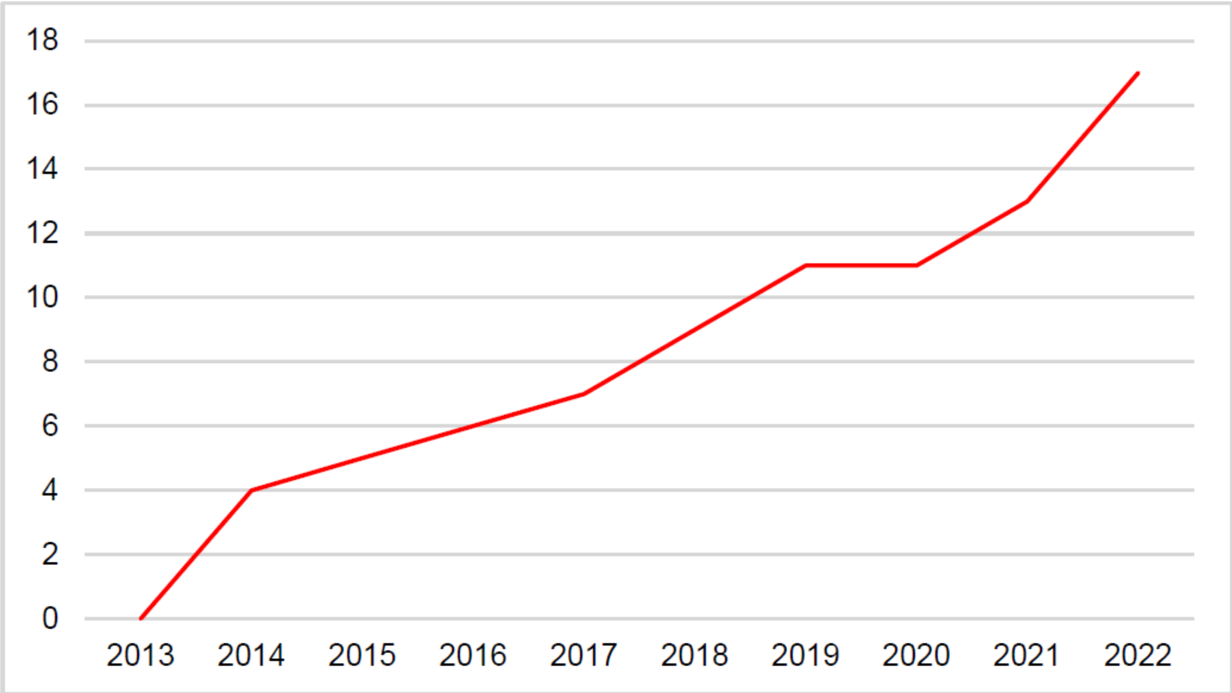
The United States first imposed financial sanctions on Russia in 2014, designating a group of defense firms, state officials, and limiting some banks from accessing dollar funding markets. Additional rounds of financial sanctions followed in 2014, 2015, 2016, 2017, 2018, 2019, and 2021 (see Figure 4). The penalties were applied for a variety of offenses, including continued

Russian military interventions in Eastern Ukraine, human rights violations within Russia, meddling in the 2016 U.S. presidential election, and cyber-attacks targeting American interests.

During this period preceding the war, Putin's regime responded with a two-pronged anti-dollar strategy aimed at reducing Russia's exposure to U.S. financial sanctions.

The first prong focused on minimizing the risk that Russian reserves would be blocked by a future round of penalties. U.S. Treasury bonds are the world's premier reserve asset, given their perceived safety and the size and liquidity of the Treasury market. Yet, most Treasuries are custodied in the United States (often at the Federal Reserve Bank of New York). Russian officials observed the United States block Libya and Iran from accessing their dollar reserves in the 2010s. Officials at CBR took note and acted preemptively.[46]

Figure 4: Executive Orders Related to Russia Sanctions, 2013-2022



Russia dramatically increased the pace of its gold purchases, adding more than 1200 metric tons to its reserves between 2014 and 2020 giving it one of the largest stockpiles of monetary gold in the world (see Figure 5). In 2018, following an especially harsh round of U.S. financial sanctions in April of that year, CBR initiated a full rebalancing of its foreign exchange reserves, slashing its dollar holdings from 45 to just 16 percent of its total portfolio (see Figure 6).[47] It moved the balance into euros and China's renminbi (RMB).

The second prong of Russia's anti-dollar strategy focused on cross-border payment, specifically trade settlement. Russia worked with a range of economic partners—China, the European Union, India, and others—to de-dollarize bilateral trade by relying on RMB, euros, and rubles. Dozens of Russian banks joined China's fledgling, RMB-based cross-border payment system. Putin called on more of Russia's trade partners to move trade settlement into local currencies.[48] By February of 2022, only 55 percent of Russian exports and 36 percent of Russian imports were settled in dollars, down from 80 and 41 percent, respectively, in 2013 (see Figure 7).

On the eve of the war, the Russian economy's relationship with the dollar was drastically different than it was eight years prior. It is not unreasonable to conclude that Putin's concerns about U.S. sanctions threats were diminished as a result, weakening deterrence. Similarly, Russia's rapid adaptation to the post-invasion sanctions reflects Moscow's earlier anti-dollar efforts following eight years of escalating financial pressure. The 2022 sanctions did inflict costs on the Russian economy; however, the shock of those measures was reduced due to preemptive de-dollarization following the slow, steady, and repeated tightening of the economic noose after 2014.

Figure 5: Russian Gold Reserves (in metric tons), 2000-2021

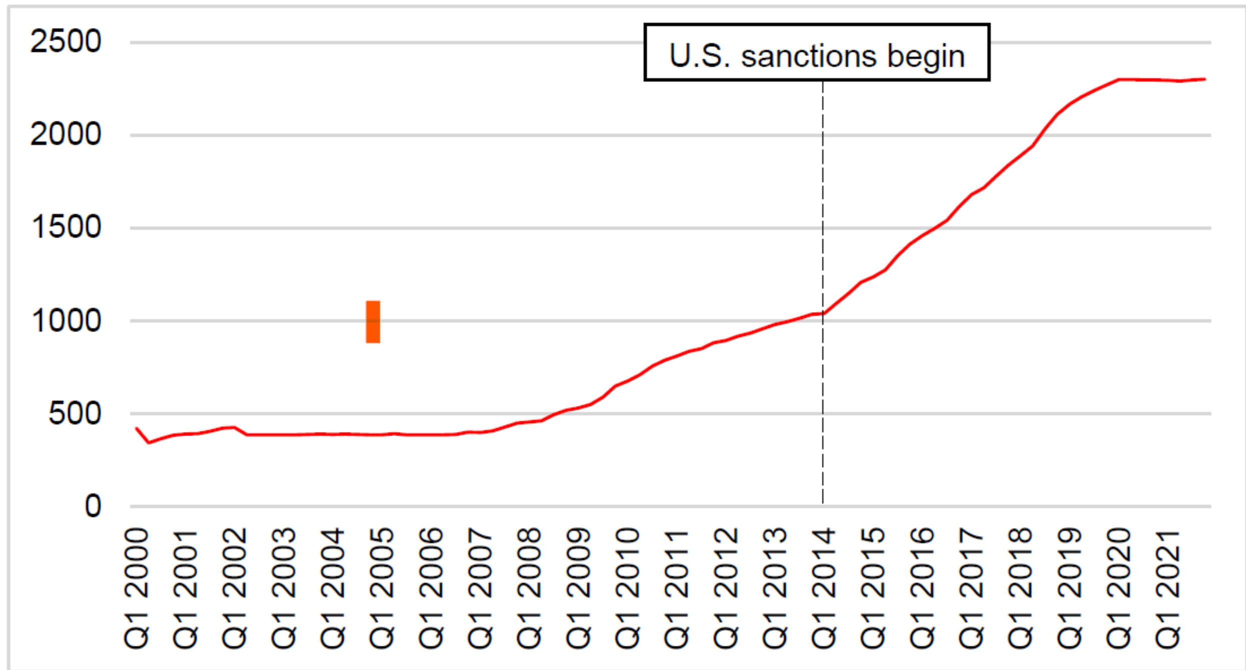


Figure 6: Currency Composition of Russian Foreign Exchange Reserves, 2017-2021

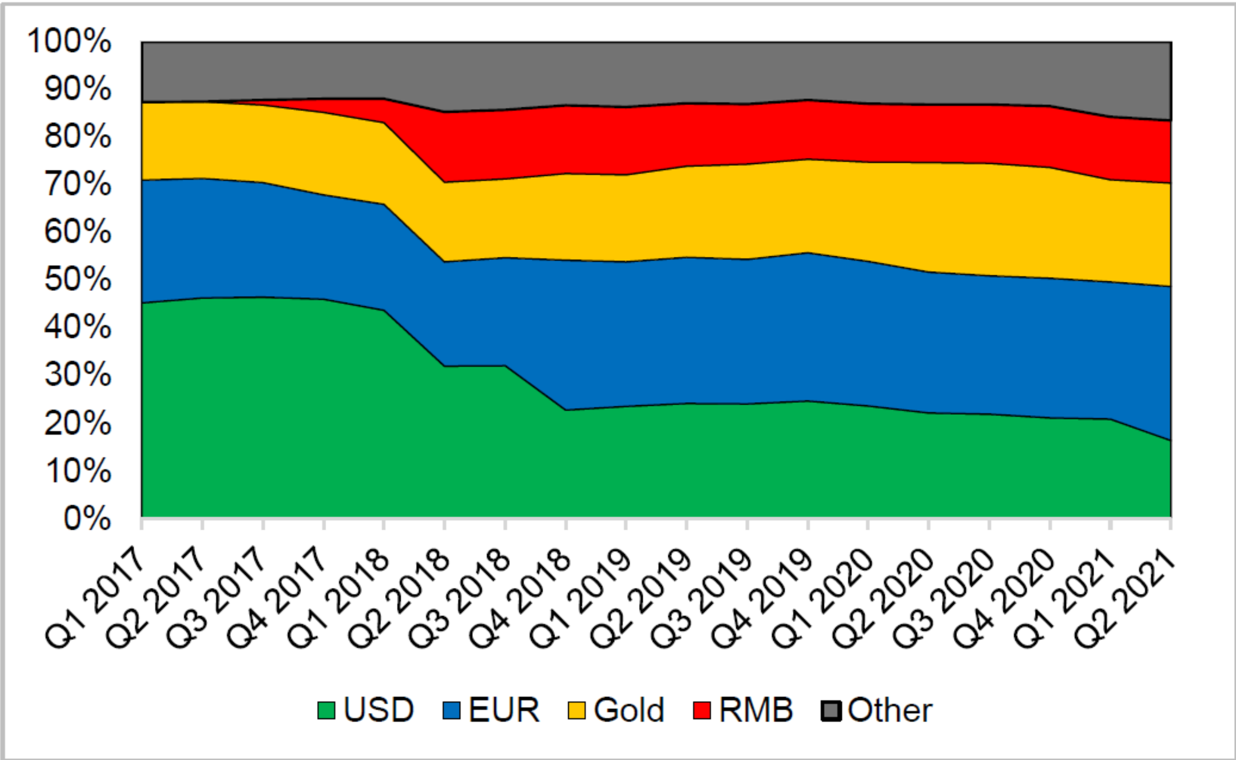
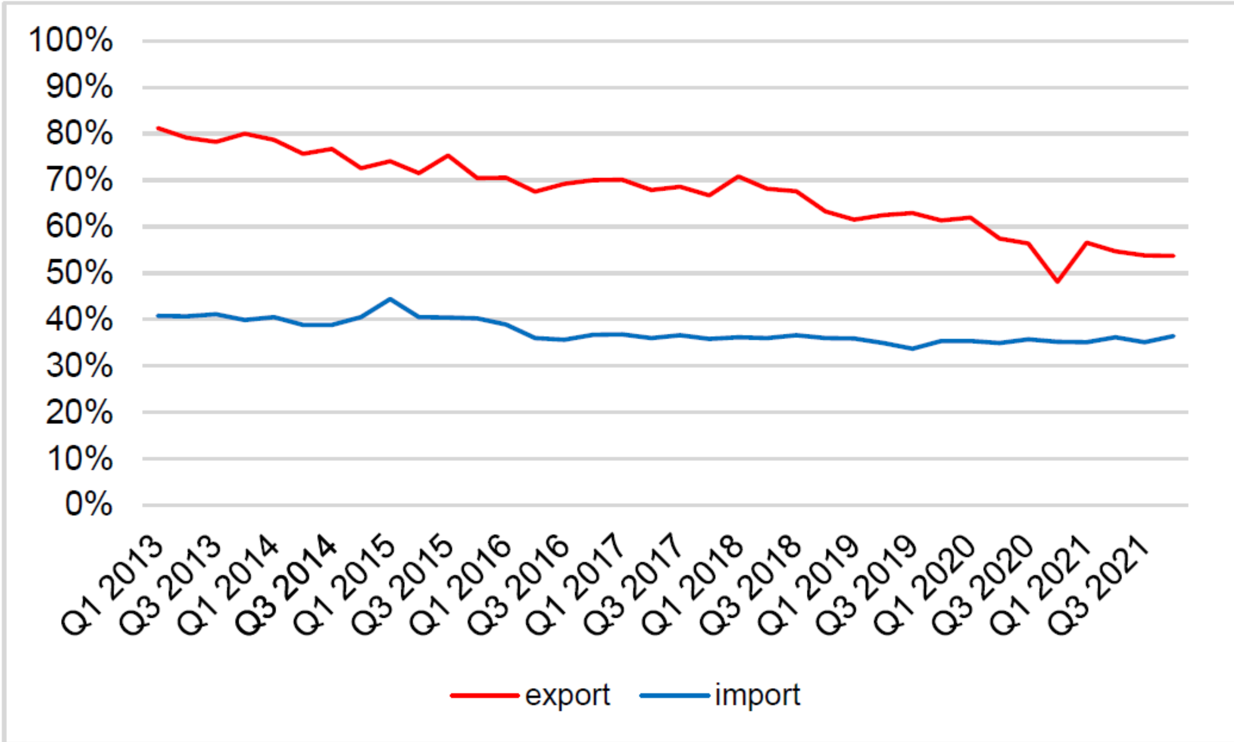


Figure 7: Currency Composition of Russian Trade Settlement, 2013-2021



Adaptation in China

Financial sanctions are not applied in secret.[49] America's adversaries observe each act and update their expectations accordingly. The more the United States uses financial sanctions, the more information it has provided to adversaries about (1) the likelihood that they too will one day be sanctioned and (2) if sanctioned, what areas of their economy are most vulnerable.

Amid rising concerns of a potential standoff over Taiwan, officials in Beijing are paying close attention to America's coercive use of its financial capabilities, and learning. China's State Council is considering sanctions risk scenarios; its central bank has held meetings with banking executives to consider how the country's official assets could be protected.[50] Given the vast size of China's foreign exchange reserve portfolio Beijing's options are constrained. Few financial markets are capable of absorbing even a fraction of China's $3.2 trillion in assets. In recent years, China has emerged as the largest official buyer of gold, scooping up nearly 300 metric tons between 2022 and 2023.[51] The country's dollar holdings remain largely unchanged since 2015, however, Beijing has moved a growing share of its dollar assets out of the United States and into a Belgium-based financial custodian—a decision that could potentially complicate unilateral U.S. sanctions targeting those assets.

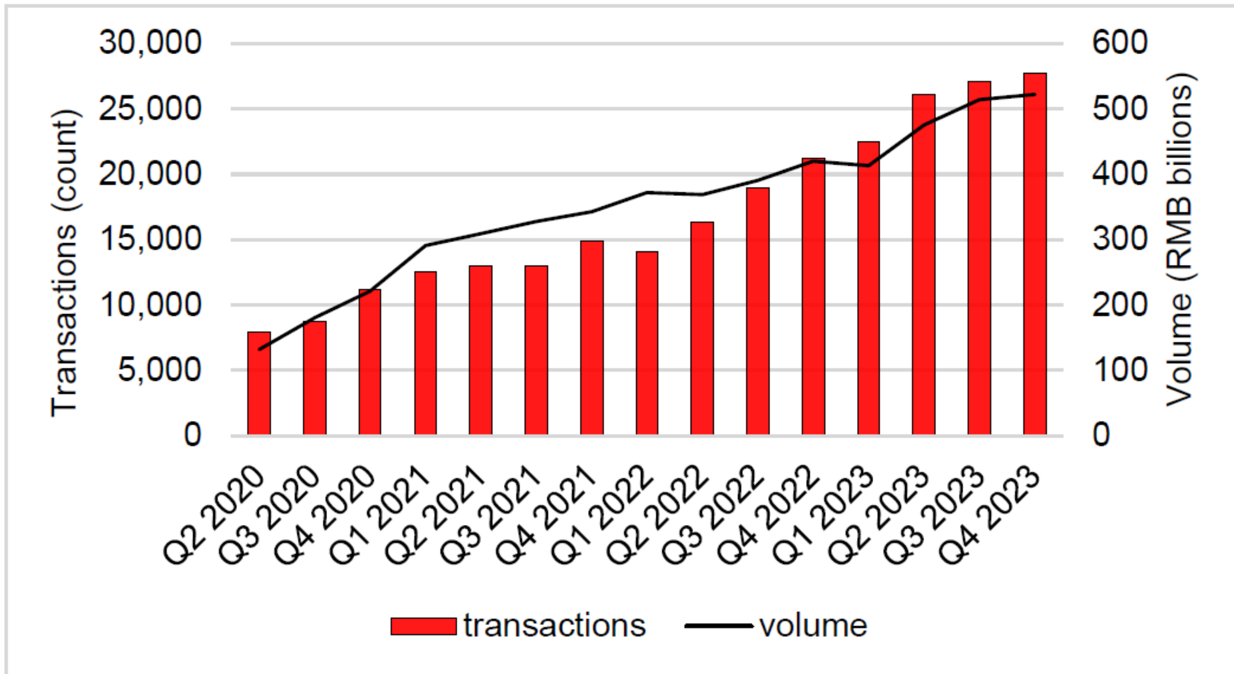
Yet, as one former Treasury official has noted, China's best means to insulate itself from U.S. financial sanctions is not to protect its dollar assets, but rather take other steps that render those dollar assets "less central to its ability to conduct international transactions".[52] To this end, China has made reducing its reliance on the U.S. dollar in cross-border trade settlement a strategic priority. Officials recognize that internationalization of the RMB is the most effective way that China can protect itself from coercive financial statecraft.[53]

Key to these efforts is China's Cross-Border Interbank Payment System (CIPS), an international network of banks, centered on Chinese financial institutions and its currency. The system can clear cross-border payments without touching the dollar or the U.S. financial system, making it a potentially valuable tool for sanctions evasion. Since its introduction in 2015, CIPS has grown steadily, attracting over 1500 participant banks to the network spanning more than 100

countries. The volume of RMB that the system clears each day, displayed in Figure 8, has more than tripled since 2020, reaching over 500 billion RMB ($70 billion) by the end of 2023.[54]

The growing use of CIPS is impacting the currency composition of China's trade settlement. In 2017, only 11 percent of China's cross-border trade was settled in RMB; by the end of 2023, this had increased to 30 percent, and could rise as high as 50 percent in the coming years. And while a portion of this increase reflects Russia's growing reliance on the RMB since the start of the war in Ukraine, most of the growth reflects use in trade settlement between China and other countries in Asia.[55]

Figure 8: CIPS transactions/volume (quarterly daily averages), Q2 2020- Q4 2023



China remains dependent on the dollar as its primary investment and trade settlement currency, however, as it has observed Washington deploy the dollar as a weapon of coercion with greater frequency and intensity, it has adopted an anti-dollar strategy reminiscent of Russia's past preparatory efforts. This has implications for the future exercise of American financial power-- complicating the United States ability to use financial sanctions against Beijing in the future.

Lessons on U.S. Financial Sanctions Policy

The use of financial sanctions as America's go-to coercive instrument is reaching an inflection point and raising important questions for policymakers to consider. What are the risks of sanctions overuse to the future of the dollar and the effectiveness of the tool? What situations constitute good use-cases for financial sanctions today? And, when deployed, what can be done to increase the effectiveness of sanctions? This essay closes with some reflections on these questions.

Despite selective de-dollarization, the dollar's global dominance remains steadfast, but risks remain.

There is little evidence to suggest that the dollar's preeminence is in danger at present. Since the start of the Russo-Ukraine war, the dollar's role in cross-border payments and trade-settlement has gone up, not down. And while its share of global reserves has fallen slightly over the last decade, it retains a large lead over its nearest competitor, the euro, with China's yuan a distant fifth in the rankings.

Even as a growing number of countries are dissatisfied with the dollar and U.S. sanctions policy, they have little choice but to continue investing in and using the currency. The dollar's greatest strength may be the lack of any viable alternative. And yet, "there is no alternative" is not a winning strategy for maintaining dollar dominance deep into the 21st century.

If the United States' use of financial sanctions over the next quarter century grows as much as it has in the last twenty-five years, the strategic environment may change. By their very nature, financial sanctions push actors outside of the dollar system. Thus, the accumulation of blacklisted individuals, firms, institutions, and countries creates an ever enlarging, captive market for an alternative currency provider. China is a potential contender here (though it would require additional financial reforms). European policymakers may again advance a strategy to further internationalize the euro if a future presidential administration carelessly undermines U.S. European economic relations. It is in the interest of the United States to

prevent serious damage to the dollar's appeal to prevent the emergence of an alternative monetary leader, however remote a possibility this is.

The larger threat, in the near term, is not the dollar's global standing, but rather the effectiveness of U.S. financial coercion. Preserving the potency of the tool matters not only for the future exercise of financial power vis-à-vis state threats, but also for the future potency of financial sanctions against non-state actors, including terrorist organizations and criminal groups. There is little that Washington can do to address the adaptation that is already underway. A more circumspect approach to sanctions use could, however, stem growing international perceptions of risk associated with dollar dependence and preserve as much of the tool's potency for a moment when it counts most. Policymakers ought to consider such long-term risks when crafting economic responses to international threats.

Raising the bar for financial sanctions use

During the Second World War and into the Cold War era, the United States used financial sanctions sparingly, often in conjunction with military action or in the aftermath of a major war, as in the case of Vietnam. The Iranian sanctions, introduced in 1979, were a watershed moment due to the amount of assets blocked and the extraterritorial nature of the freeze. However, it was the development of smart sanctions, disillusionment with trade embargoes, the growing complexity of the post-Cold War environment, and a more restrained approach to the use of force that generated such enthusiasm for financial coercion. Over the last quarter century, financial sanctions have become, in U.S. Treasury's own words, a "tool of first resort".[56]

As the risks of sanctions overuse come into relief, policymakers would be wise to develop sanctions use rule book, outlining the offenses that justify the tool's use and those that do not. For instance, rather than politicizing the dollar system by responding to cyberattacks with financial sanctions, policymakers might consider a proportional cyber response instead. Reducing, if not eliminating, the use of financial sanctions for symbolic signaling would be another positive step. In other words, if the primary motive for imposing sanctions is to send a message to the world that the United States condemns a foreign state's actions, other ways of

signaling may be more appropriate. This is especially true if there is little expectation that sanctions will change the target's behavior.

Policymakers should exercise more caution about the use of financial sanctions as the economic size of the target increases. Given the propensity for imposed sanctions to elevate concerns about dollar dependence within targets, deploying the instrument against larger economies provides considerably more momentum to the global anti-dollar movement than the use of the tool against smaller, more isolated economies. In short, the bar that needs to be cleared for financial sanctions to be deemed an appropriate policy tool should rise as the potential target's economic size increases.

Finally, the use of secondary sanctions to cajole America's friends and allies into enforcing Washington's preferred foreign policy should be avoided. Building sanctions coalitions of the willing is not easy work but is far better in the long run than adopting measures that coerce friendly states to comply with U.S. demands. It is critical that U.S. allies in Europe and Asia maintain their trust in both Washington and the dollar.

Policymakers would be wise to consider adopting a financial sanctions "Powell Doctrine" to preserve and improve the tool's effectiveness.

General Colin Powell advocated that military interventions are justifiable only when vital U.S. interests are threatened, when there is a clear and attainable objective, and when decision makers are committed to using overwhelming force to attain that objective. All too often, financial sanctions have been deployed without satisfying all (or sometimes any) of these standards. Given that the stakes of economic statecraft are much lower than the stakes of warmaking, that may be acceptable. But moving in the direction of a financial statecraft, Powell Doctrine as the gold standard for sanctions use would be a positive step toward protecting both the dollar's reputation and preserving the influence of the instrument itself.

In particular, the final criterion of overwhelming force ought to get careful consideration. The Russia case best illustrates the downsides of a slow and steady move up the escalatory ladder. At each stage, new rounds of sanctions imposed new costs on the Russian economy and provided information to Russian officials that required and enabled adaptation. As a result, the 2022 sanctions did not bite as harshly as they would have in the absence of previous

rounds. Even since February 2022, the United States and its allies have further tightened the sanctions regime on Russia as initial measures did not prove costly enough, or loopholes emerged.

Washington might be wise to keep its financial powder dry for smaller infractions but be prepared to adopt a "shock-and-awe" approach when deciding sanctions are necessary. This could even include immediately escalating to the application of secondary measures in a narrow circumstance where core U.S. interests are seriously threatened, and Washington and its allies are united in their resolve. Such an approach would be most likely to catch the target off guard, induce a financial crisis, threaten political stability, and increase the chances of compelling the target to change its behavior in short order.

Coda

Dollar dominance did not happen by accident. Its emergence reflects not only the United States economic size, but also American leadership in the world and its commitment to an orderly, rules-based, liberal world economy. Today, the dollar is the lifeblood of the world economy. The U.S. financial system is its heart. This is a tremendous power resource for the United States, but policymakers must resist the urge to see financial sanctions as the solution to every foreign policy problem. Growth in the use of the tool ought to be curtailed, not for the sake of restraint, but to ensure that the instrument can impose maximum costs in the highest leverage crises.

Questions for GF3

1. What does the overuse of financial sanctions mean for the future of the U.S. dollar?

2. How should we evaluate the effectiveness of financial sanctions as a tool for influencing Russian foreign policy behavior?

3. Can financial sanctions be effectively deployed against China?

4. What foreign policy tools, economic or otherwise, could the United States use as a substitute for financial sanctions?

5. What are the upsides and downsides of a more circumspect approach to the use of financial sanctions?

6. How much should policymakers weigh long-term costs of sanctions against the short term benefits of their use?

7. What standards, or rules of thumb, should policymakers use to determine whether the use of financial sanctions in a particular case is advisable or irresponsible?

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[3] Kindleberger, C. P. (1973). The World in Depression, 1929-1939. University of California Press.

[4] Bergsten (1996), p. 108.

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[7] Bergsten (1996), pp. 103-09.

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[12] Miller, E. S. (2007). *Bankrupting the Enemy: The U.S. Financial Siege of Japan before Pearl Harbor*. Naval Institute Press, 178-79; The legal authority for Roosevelt's actions were derived from 1917's Trading with the Enemy Act, a law giving the president the authority to prohibit trade between the United States and its enemies during wartime. In 1933, the act was amended with the Emergency Banking Act of 1933. This extended the

president's authority to enact economic prohibitions within the United States and in peacetime situations. That year, Roosevelt used the act to declare an eight-day national bank holiday, effectively freezing domestic assets in the banking system. This was used against foreign dollar assets held within the United States in 1940-1941 against Nazi Germany and the Empire of Japan (see Miller 2007, p. 171).

[13] The Proclaimed List was declared by President Franklin Roosevelt via executive order; the ban's legality was based in the Trading with the Enemy Act of 1917.

[14] Stewart (1942), p. 288.

[15] Friedman, Max Paul. (2003). "There Goes the Neighborhood: Blacklisting Germans in Latin America and the Evanescence of the Good Neighbor Policy." *Diplomatic History*, 27(4), pp. 569-597; South American companies with no clear ties to the Nazis were included, provoking anti-American sentiments. In at least one case, a Jewish refugee was wrongly blacklisted. See Friedman (2002), pp. 589-90.

[16] A negligible amount of North Korean assets was also blocked in the 1950 order.

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[20] By way of comparison, estimates suggest that the United States froze roughly $60 million in Japanese assets in 1941, $100 million in Chinese assets in 1950, and $79 million in Vietnamese assets in 1975. Even when adjusted for inflation, these totals are but a tiny fraction of the Iran total (Devane 1978, 1268; Hung 1991; Miller 2007, p. 179).

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[24] Helleiner, Eric. "State Power and the Regulation of Illicit Activity in Global Finance." *The Illicit Global Economy and State Power* (1999): 53-90; Morse, Julia C. *The Bankers' Blacklist: Unofficial Market Enforcement and the Global Fight Against Illicit Financing*. Cornell University Press, 2022, pp. 25, 55.

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[28] Haass, R. (Ed.). (1998). *Economic Sanctions and American Diplomacy*. Council on Foreign Relations, pp. 65, 80.

[29] Zarate (2014), p. 6.

[30] Office of Foreign Assets Control, "Basic Information on OFAC and Sanctions", 2018, available at https://ofac.treasury.gov/faqs/10#; Office of Foreign Assets Control, "Specially Designated Nationals and Blocked Persons List", 2024, available at: https://www.treasury.gov/ofac/downloads/sdnlist.pdf

[31] Haass, R. (Ed.). (1998). *Economic Sanctions and American Diplomacy*. Council on Foreign Relations, pp. 142-44; Wertz, D. (2013). The Evolution of Financial Sanctions on North Korea. *North Korean Review*, 69-82, see p. 81.

[32] Though the law gave the United States the authority to impose sanctions on third-country firms, no such penalties were imposed until 2010, reflecting push back from the Europeans (Wertz 2013, 81).

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[35] Meyer, Jeffrey A. 2009. "Second Thoughts on Secondary Sanctions." *University of Pennsylvania Journal of International Law* 30(3): 905-968.

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[45] Russian energy sales reflected the emergence of new buyers who were not party to the sanctions. It also reflected carve outs in the sanctions that allowed European countries to continue purchasing Russian energy while remaining in technical compliance with the sanctions.

[46] McDowell (2023), p. 48.

[47] The Central Bank of Russia stopped reporting its reserve positions in 2022.

[48] McDowell (2023), pp. 84-90.

[49] Indeed, every executive order issuing a new round of sanctions is publicly available on the internet, as is the full SDN list.

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Background Research - Chapter 2

Gates Forum III

Sanctions and the American Symphony of Power

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Introduction

The history of U.S. economic sanctions is a tale of two contradictory trends. On the one hand, beginning in the early days of the Republic, U.S. officials embraced economic statecraft as a distinctly American source of power in world politics. Over the past thirty years in particular the use of economic sanctions has increased dramatically, to the point where even official documents acknowledge that sanctions have been a "policy option of first resort."[1] According to the U.S. Office of Foreign Assets Control,[2] the United States has imposed economic sanctions on 25 countries, but that is just the tip of the iceberg. The U.S. has also implemented a wide array of issue-specific sanctions programs – ranging from narcotics trafficking to cyber-activities to nuclear nonproliferation to human rights – as well as sanctions targeting more than 12,000 specially designated nationals.

On the other hand, U.S. policymaker attitudes about economic sanctions have also varied wildly over the years. Woodrow Wilson famously extolled the virtues of sanctions. By the end of World War II, however, U.S. officials were dubious about the utility of coercive economic statecraft. That changed as the Cold War heated up. The Carter administration was a big fan of using economic sanctions to pressure countries on a variety of issues; the Reagan administration felt differently. During the 1990s, many policymakers were skeptical about sanctions. Fifteen years later, policymaker enthusiasm reached an all-time high.

How can these trends be explained? One has to view economic sanctions as one instrument in a symphony of power.[3] On occasion, sanctions alone can achieve desired foreign policy ends. On other occasions, sanctions are one part of a larger suite of policy instruments that achieved a favorable policy outcome. Unfortunately, U.S. policymakers are often unaware of this complex relationship between sanctions and foreign policy outcomes.

A look at high-profile sanctions cases – and the ways that U.S. officials reacted to those cases – reveal three significant flaws in the American way of sanctioning. First, there is a ratchet effect with sanctions; they are easy to impose and difficult to lift. This is particularly true with sanctions authorized by Congress. Therefore, even in periods when U.S. officials are skeptical about the utility of sanctions, they will continue to accumulate. Second, officials tend to

overlearn the lessons from high-profile cases – in no small part because they fail to comprehend the ways that sanctions often involve multiple instruments of power. Successful instances of economic coercion cause the tool to be massively overused; high-profile failures cause an underutilization of sanctions. Finally, the growth of U.S. financial power and weaponized interdependence has made it impossible for policymakers to credibly commit to limiting the American use of sanctions. Even well-meaning officials genuinely interested in reducing the use of sanctions will find it impossible to resist sanctions when circumstances demand some kind of U.S. response.

These arguments are illuminated by looking at the legacy that high-profile sanctions cases have had on U.S. economic statecraft. The longstanding U.S. sanctions against Cuba, for example, demonstrate the ratchet effect at work. Simply put, it is easy for the United States to impose sanctions and very difficult to lift them. The Iraq sanctions in the 1990s triggered a shift in the way that sanctions are employed, from comprehensive measures to "smart sanctions." This shift partially addressed one sanctions problem while creating others. The successful sanctioning of Iran reveals how successful outcomes often trigger more enthusiasm for sanctioning activity – which will usually lead to less productive sanctions and an atrophying of other policy instruments. Finally, the recent sanctions imposed against the Russian Federation highlight an ongoing 21st century sanctioning problem facing the United States: the near-impossibility of resisting their use.

Economic Sanctions in the Symphony of American Power

The United States has been an active user of economic statecraft since its founding, in no small part because as a fledgling republic the United States lacked other instruments of power. For most of the first 160 years of its history, the U.S. military was extremely weak in comparison to even minor European powers. While the United States was capable of military buildups, as during the U.S. Civil War and First World War, they were quickly followed by equally large demobilizations. As late as 1939, the size of the U.S. Army was smaller than Portugal. Similarly, the U.S. diplomatic corps was understrength during most of this period as well. U.S. consuls were not even paid an official salary until 1856. Not until the creation of the U.S. Foreign Service in 1924 was there much professionalization within the diplomatic corps. U.S. intelligence services barely existed prior to the Second World War. While non-state actors in the United States did provide some degree of active American diplomacy during these years, the absence of other instruments of statecraft meant that a lot of U.S. foreign policy for the 19th century relied on the single note of economic diplomacy. Outside of the Western hemisphere, the U.S. largely tried to advance its interests through the manipulation of tariffs and commercial treaties.[4]

This often meant that said statecraft was ineffectual. For example, in response to both the United Kingdom and Napoleonic France impressing U.S. sailors on the high seas, the Jefferson administration urged the passage of the Embargo Act of 1807, which barred trade with both countries. The legislation did not work as intended: economic historian Douglas Irwin characterized it as “a failure: it imposed large costs on the economy but failed to achieve any of its objectives.”[5] At the end of the 19th century, Secretary of State John Hay’s Open Door notes proved to be equally aspirational and ineffectual. Hay proposed that the great powers trade with China on a free, open and equal basis akin to most-favored nation status. Since the notes were non-binding, however, countries like Russia and Japan displayed little compunction in attempting land grabs. Even the U.S. State Department’s Office of the Historian acknowledged their relative ineffectiveness.[6] While it is possible for economic

statecraft to succeed without the support of other instruments, other mechanisms of influence can enhance their effectiveness.

As the American economy expanded, U.S. economic statecraft cast a wider shadow. U.S. trade protectionism played a significant role in deepening the Great Depression – but the 1934 Reciprocal Trade and Agreements Act helped pave the way for greater economic integration. U.S. enthusiasm for economic sanctions spiked during the negotiations for the Treaty of Versailles, and during the interwar period the U.S. became more willing to threaten and use economic sanctions. The threat of an oil cutoff helped deter Spain's entry into the Second World War on the side of the fascists. The oil embargo imposed on Japan helped to precipitate Pearl Harbor.[7]

With the end of isolationism, the advent of the Cold War and the creation of the modern administrative state, the United States could rely on an array of different instruments ranging from military aid to cultural diplomacy.[8] This was also the beginning of the frequent U.S. use of economic sanctions. According to one estimate, the United States was responsible for close to two-thirds of all sanctions attempts during this era.[9] U.S. sanctioning activity increased even further with the end of the Cold War, as U.S. hegemony created vast power differentials and U.S. centrality in a variety of economic networks enabled new forms of economic statecraft.[10]

A common argument in the sanctions literature has been that sanctions only yield results when they function as a stalking horse for other methods of coercion. [11] It would be natural to argue that as the United States has expanded its repertoire of influence mechanisms, economic sanctions have become more effective because of these other tools. Most scholarly research, however, has found little evidence that U.S. military preponderance has affected sanctions outcomes. There is no clear evidence of an appreciable increase in the success rate of U.S. sanctions as U.S. military capabilities have grown.[12]

How can these findings be reconciled with the argument that sanctions are part of a symphony of power? There are two explanations. First, one can point to cases, such as Libya in the early 2000s, in which the combination of policy tools proved to be effective at achieving a desirable outcome.[13] For economic coercion to work, it must usually be accompanied by skilled diplomacy, economic intelligence, and in some instances, the specter of military force.

Second, the expansion of other U.S. influence instruments theoretically allows for other instruments to be used in lieu of economic statecraft. If U.S. officials do not use economic statecraft to address policy conundrums better suited to other tools, sanctions would be measured as more effective even without the presence of military force. In other words, the growth of other instruments of power could, theoretically, allow policy practitioners to focus sanctions on the instances in which success is most likely.

Unfortunately, as the rest of this essay will illustrate, a variety of institutional and political biases have hampered the effectiveness of economic statecraft in recent years.

The Ratchet Effect

When Fidel Castro took power in Cuba, the United States imposed an escalating series of aggressive measures aimed at overthrowing the communist regime. Multilateral economic sanctions were imposed with the support of the Organization of American States. The Kennedy administration also relied on other instruments of statecraft, however – including, most notoriously, covert military support for the 1961 Bay of Pigs fiasco. As multilateral cooperation flagged, covert actions failed, and invasion was ruled out, the United States increasingly relied on unilateral sanctions as its primary pressure instrument. Buoyed by Soviet support, the Castro regime persisted.

Since the end of the Cold War and the cutoff of Russian largesse, U.S. hawks have argued that the communist regime was on the brink of collapse and merely needed tighter, better-enforced sanctions to topple the government. This led to multiple efforts to bolster the sanctions regime. In the 1990s, this took the form of the Cuban Democracy Act and the Cuban Liberty and Democratic Solidarity Act of 1996, colloquially known as Helms-Burton, which employed secondary sanctions against countries planning to invest in Cuba. The Castro regime did not buckle, and eventually began receiving financial support from Hugo Chavez's Venezuela. In the last two years of the Obama administration, an attempt was made to lift some of the sanctions. Those steps were reversed in 2017 under President Trump, who layered on additional targeted sanctions. Despite all of these measures, Cuba's communist regime remained unbowed.

The Cuba case highlights a persistent political and institutional bias that hampers the utility of American economic sanctions: the ratchet effect. Simply put, the politics of American foreign policy makes it much easier for U.S. policymakers to impose economic sanctions than to lift them. This means that the threat of U.S. economic coercion is credible – but it also undermines U.S. coercive bargaining once sanctions are imposed.

The politics of initiating sanctions is easy to explain. In most instances, the United States imposes economic sanctions in response to a negative policy shock emanating from the targeted actor's behavior. Even if sanctions are not the only influence tool in the policy kit, it is often the policy option of first resort. Offering inducements in response to a negative shock

looks too much like appeasement. Whenever military statecraft is a possibility, the United States will almost always impose sanctions first, as a means of demonstrating that all peaceful measures had been pursued prior to the use of force.

The advantage of sanctions is that they can be implemented quickly by the executive branch, allowing for an immediate real-time response. If the negative policy shock generates bipartisan outrage, then Congress can also be counted on to pass legislation mandating or enhancing sanctions – even if the executive is reluctant to take action.[14] Sanctions are easy to explain to the media and the wider public as an appropriate and proportionate response. They are the goldilocks option: not as risky or as escalatory as military action, but more impactful than diplomatic démarches or sense of the Congress resolutions. Furthermore, once imposed, most members of Congress stop paying attention to the issue.

The ratchet effect comes if and when the initial round of sanctions do not generate the desired policy outcome. At that juncture, the U.S. policymakers face a choice: ratchet up the economic pressure or pursue a different means of influencing the target. While the latter might include military coercion, it could also include offers of negotiations and/or inducements.

The problem for both presidents and members of Congress is that political incentives push policymakers towards the more hawkish option of ratcheting up pressure. Advocating for negotiations or for the lifting of sanctions will inevitably be labeled as doves. If the target regime is viewed as intrinsically odious by either foreign policy elites or the mass public, the optics of endorsing a more dovish position opens politicians up to accusations of weakness or impotence. Ratcheting up pressure, on the other hand, can be framed as demonstrating toughness. Furthermore, tightening sanctions can justify their extended use. The political narrative would be that sanctions were the right policy option but imperfectly implemented. This narrative is easier to cognitively reconcile with the initial support for sanctions and can extend the half-life of public support for a hawkish policy.

The Partial Mirage of Targeted Sanctions

A common criticism of economic sanctions is the humanitarian costs that they have wreaked on civilian populations. The Iraq case of the 1990s is the most high-profile example of this criticism. The post-Gulf War comprehensive trade embargo imposed by the United Nations Security Council was designed to maximize the economic pain inflicted on Iraq's government unless they acquiesced to a variety of demands, including the return of looted Kuwaiti assets and a full accounting of Iraq's chemical, biological, and nuclear weapons programs. Only five years after the imposition of the postwar sanctions, when the suffering of Iraq's population became impossible to ignore, did the United Nations create the Oil for Food program to help alleviate the humanitarian crisis.

While the Iraq sanctions were in place, there was a widespread consensus that they were responsible for a humanitarian disaster in Iraq.[15] Meghan O'Sullivan estimated that Iraq lost between $175 billion and $250 billion in possible oil revenues from the sanctions.[16] The price for a family's food supply for a month increased more than 250 times over the first five years of the sanctions regime.[17] John and Karl Mueller blasted the sanctions in 1999, concluding, "economic sanctions may well have been a necessary cause of the deaths of more people in Iraq than have been slain by all so-called weapons of mass destruction throughout history."[18]

The above assessments were based in no small part on United Nations data that Saddam Hussein's government consciously manipulated to exaggerate child mortality. Subsequent survey data suggests that while the sanctions obviously had severe impacts on the Iraqi economy, the infant mortality rate was not significantly affected.[19] Nonetheless, the policy takeaway from the Iraq case was that comprehensive embargoes were a blunt, unethical policy instrument, and a shift in tactics was needed. The response was the development of "smart sanctions," a rare example of synergy between policymakers and scholars.[20] In theory, smart sanctions were tailored to disproportionately affect the target's elites rather than the mass public. This way they could be imposed while mitigating the humanitarian effects of sanctions. Such measures included arms embargoes, travel bans, restrictions on the importation of luxury goods, and financial statecraft.

The last category proved to be the most potent, for several reasons. First, in contrast to trade sanctions, financial restrictions are amplified rather than undercut by the private sector. The incentive to bust sanctions through black market activity makes sense for local traders with minimal interest in accessing U.S. markets. The same cannot be said for banks that must be concerned about their global reputations. Private sector de-risking therefore acts as a force multiplier for sanctions. Second, financial sanctions like asset freezes are designed to harm elites. At the turn of the century, in many targeted economies, most of the mass public was unlikely to have bank accounts. Financial measures hurt holders of capital – i.e., the elites. Third, financial sanctions could be imposed on specially designated individuals and entities without affecting broader financial flows. For the American policymakers in particular, using the financial channel to impose smart sanctions played to U.S. strengths, including the dollar's role as a global reserve currency and the centrality of U.S. capital markets.[21] Financial sanctions had the same political appeal as precision-guided munitions: they could be talked about as surgical forms of coercion.

In reality, however, these financial measures have been of mixed utility. While there have been some notable successes, such as pressuring Iran into the JCPOA, in most instances they have not led to a greater degree of target acquiescence. The reasons for this will be discussed in the next section, but the important thing is that the predicted lessening of humanitarian suffering has not exactly been borne out. Even targeted financial sanctions wreak considerable havoc on target jurisdictions. Targeted sanctions increase the probability of currency crises by 40%, a crisis that affects the mass public far more than the target's elite.[22] Similarly, sanctions imposition nearly doubles the likelihood of a banking crisis in the target economy.[23] The effects of financial sanctions extend well beyond the financial sector. Dodd-Frank sanctions, for example, generated a 140% increase in infant mortality in affected villages in the Democratic Republic of the Congo.[24] One recent study examined the effect of sanctions on poverty and found that U.S. sanctions trigger an increase of more than three percent in the poverty gap between sanctioned countries and peer economies.[25] A follow-on study revealed that U.S. sanctions decreased life expectancy by up to half a calendar year.[26] Furthermore, the effects were not gender-neutral – women suffered a greater decline in life expectancy than men. This accords with other research suggesting that even smart sanctions have gendered effects on target societies.[27] As it turns out, targeted sanctions are not a magic bullet for economic statecraft.

What lessons does the emergence of smart sanctions have for the symphony of power? Paradoxically, the ease of imposing unilateral financial sanctions has made it easier for the United States to rely exclusively on sanctions in a variety of policy disputes. Because they are relatively quick and easy to impose, policymakers can implement sanctions without considering the need or desirability of other policy instruments that could complement economic pressure. This helps to explain why the U.S. has imposed sanctions with much greater frequency in the 21st century.

The Danger of Generalizing from Sanctions Success

The 2010 round of U.S.-led economic sanctions placed on Iran for its nuclear activities proved to be quite successful. Within three years, Iran's oil export revenue had been cut in half and overall oil production was at its lowest levels in 25 years. Compared to its peer group of oil exporters, Iran's economy deteriorated badly after 2010, with relatively anemic growth, higher inflation, a rapidly depreciating currency, and less than $20 billion in liquid hard currency reserves.[28] By 2013 Iran's president Hassan Rouhani had publicly acknowledged that the effect of sanctions on the Iranian economy was severe and required quick negotiations to settle the nuclear question.[29] One of the chief architects of U.S. sanctions characterized the Iran case as reaching a "'goldilocks' inflection point of effective sanctions pressure and resolve."[30]

It was in the wake of this case that U.S. policymaker enthusiasm for economic sanctions really began to take root.[31] It is therefore noteworthy that although U.S. sanctioning activity has increased in the decade since the JCPOA, the relative success rate of more recent sanctions does not appear to have improved. Why have there not been more successes if the Iran case revealed a successful formula?

This is the danger of inductive generalization – distilling lessons from high-profile sanctions cases and developing rules of thumb strictly from those cases. Skeptics of sanctions committed this error a generation ago when they denigrated the utility of economic statecraft in the wake of the Iraq case. The success of the Iran case led to the reverse effect: sanctions proponents began to vastly exaggerate their utility at the expense of other instruments in the symphony of power. If sanctions could impose limits on Iran's nuclear program, the logic runs, then they could be used to achieve even more ambitious policy ends.

The Iran success also came during a time when the popularity of alternative instruments was on the decline. American support for the use of force was enervated from two costly and unproductive generation-long conflicts in Afghanistan and Iraq. The popularity for foreign aid

and trade deals also plummeted as populist nationalism became a more potent force in American politics.

Ironically, while the success of the JCPOA negotiations stimulated greater enthusiasm for economic sanctions, that enthusiasm was bolstered even further by one of the deal's biggest critics. Donald Trump came to power with an explicit belief that the U.S. should use its economic bargaining power more robustly. Trump claimed the United States possessed enormous leverage that had not been fully realized. In March 2018, he tweeted: "When a country (USA) is losing many billions of dollars on trade with virtually every country it does business with, trade wars are good, and easy to win."[32] A year later, he characterized tariffs as "the greatest negotiating tool in the history of our country."[33] Consistent with his background as a real estate developer, Trump believed that he could cajole and harangue other countries into making concessions to the United States.[34] During his term of office, the United States either imposed sanctions or escalated economic pressure against Canada, Mexico, El Salvador, Honduras, Guatemala, Nicaragua, Cuba, Japan, North Korea, South Korea, Russia, Saudi Arabia, Türkiye, Venezuela, Pakistan, India, China, and the European Union.[35] When the U.S. withdrew from the JCPOA and reimposed sanctions on Iran, Secretary of State Mike Pompeo declared, "Thanks to our colleagues at the Department of Treasury, sanctions are going back in full effect and new ones are coming…. These will indeed end up being the strongest sanctions in history when we are complete."[36]

In retrospect, the withdrawal from the JCPOA and the re-imposition of economic sanctions on Iran highlight the limits of economic coercion. There is no doubt that the Trump-era sanctions inflicted serious economic harm on Iran. Following the sanctions re-imposition, Iran's oil exports fell by more than 50 percent, its GDP contracted, and the value of its currency fell by more than 60 percent.[37] Basic goods nearly doubled in price in 2019.[38] More than eighty percent of Iran's oil exports were cut due to the reimposed sanctions. The IMF reported that Iran's gross official reserves plummeted from $122.5 billion in 2018 to only $4 billion in 2020.

However, the administration sabotaged the sanctions with poor diplomatic tactics. The Trump administration escalated its demands along with the economic pressure. In his speech, Pompeo articulated twelve demands on Iran's regime before sanctions would be lifted, eight of which were unrelated to the nuclear issue.[39] The conditions were so onerous that observers inferred the unstated goal was regime change. Even Pompeo acknowledged that

the list of demands was "pretty long."[40] With demands so outsized, even the most punishing economic sanctions will not yield concessions.

If anything, Iran's behavior since the 2018 reimposition has worsened. The most obvious evidence of failure was Iran's accelerated nuclear program. After the sanctions reimposition, Iran eventually announced that it would no longer be bound by any operational limitations of the JCPOA. Estimates for how long it would take for Iran to build a nuclear bomb fell from a year under the 2015 deal to a few weeks.[41] Furthermore, Iran's revisionist activity in the region did not lessen despite its economic difficulties – Iran's proxies in Lebanon, Syria, Iraq, Yemen, and Gaza all became more active in the years after 2018. Israeli officials who had pushed for sanctions reimposition admitted their error. Former Israeli defense minister Moshe Ya'alon acknowledged on the record that "looking at the policy on Iran in the last decade, the main mistake was the withdrawal from the agreement."[42] U.S. proponents of JCPOA withdrawal retrospectively acknowledged, as one of them put it, that, "Trump's gamble did not pay off."[43]

The Iran sanctions proved to be a catastrophic success: because U.S. policymakers had renewed faith in sanctions as an instrument of statecraft, they applied the tool far more frequently and far more ambitiously than ever before. Unsurprisingly, this did not translate into greater success.

The Impossibility of Not Sanctioning

By 2021 U.S. officials had become aware that they were addicted to sanctions. A Treasury Department review completed in that year acknowledged that sanctions had become the U.S. foreign policy option of first resort. The memo concluded that, "sanctions should be deployed alongside other measures as part of a larger strategy in support of specific policy objectives" and that "sanctions should incorporate rigorous economic analysis, technical expertise, and intelligence to ensure that they are the right tool in our national security arsenal to pursue the identified objective."[44] After two decades of escalating sanctions usage, it seemed as though U.S. policymakers recognized their excessive reliance on the tool and the need for policy reform. In the review, concerns were voiced about whether U.S. sanctioning activity would drive other international actors to reduce their reliance on the dollar.

Russia's February 2022 invasion of Ukraine crowded out all of these concerns. After threatening "high impact economic measures" and sanctions "with massive consequences" prior to Russia's invasion, the U.S. followed through after the invasion.[45] The United States and its allies implemented an escalating series of economic sanctions designed to punish the Russian economy. These measures included kicking major Russian financial institutions off of SWIFT, freezing Russian assets held in sanctioning countries, and an array of import and export restrictions. Russian officials publicly acknowledged that they were surprised by the scope and depth of the sanctions that were imposed after the February invasion.[46] Over the subsequent two years, U.S. officials continued to ramp up the sanctions imposed on the Russian Federation. The United States exercised other instruments of power as well, including the adroit use of intelligence, diplomacy, and military aid.

As of 2024, there is widespread recognition that economic sanctions failed to deter or coerce Russia with respect to its actions in Ukraine. Furthermore, while the sanctions have hampered Russia's ability to prosecute the war, the effect has been far smaller than was expected in February 2022.[47] Increased government spending over the past two years severely mitigated the macroeconomic impact of the sanctions. Russia's oil exports – including to European countries – has enabled the country to continue earning significant export revenue. It is not difficult to find media reports suggesting that sanctions have had minimal effects on

the Russian economy.[48] Public opinion polling at the beginning of 2023 showed that a supermajority of Russians were unconcerned about the sanctions.[49]

Does the Russia case mean that the United States should rely less on economic sanctions? It might be more accurate to say that expectations need to be tempered and purposes need to be better understood. With respect to expectations, policymakers should remember sanctions are highly unlikely to cause great powers to relinquish territory won with the expenditure of blood and treasure. Territorial concessions are the biggest ask in international relations. In the history of economic statecraft, the number of instances in which a state – much less a great power – agreed to concede territory in response to economic sanctions is vanishingly small.[50] It is therefore unsurprising that sanctions failed as a tool of deterrence and compellence in the Russo-Ukrainian War.

Policymakers also must understand that using sanctions as a form of containment requires a different approach than financial measures as a form of coercion. Most U.S. financial sanctions impose immediate and significant economic costs – but over time, those costs will fade. Longstanding goods embargoes create different sanctioning dynamics. For a containment strategy to work, multilateral cooperation is essential to ensure that the target cannot find alternatives for sanctioned goods. That, in turn, requires an institutional machinery in order to facilitate monitoring and enforcement over the long run. The private sector needs to have the necessary compliance mechanisms to enforce the sanctions. All of these necessary conditions require other instruments of statecraft, including skillful diplomacy and economic intelligence.

Finally, while the sanctions imposed against Russia might not have fulfilled their direct goals, lifting them can undermine secondary goals. Even if sanctions have not deterred Russia, it remains possible that they succeeded as a more general form of deterrence. If other actors contemplated similar irredentist violations of territorial sovereignty but were persuaded by the punitive nature of the Russia sanctions, that would be a significant policy accomplishment. For the United States and its allies, sanctions are also an important tool of norm enforcement, and the Russo-Ukrainian War challenges one of the most important norms in international relations. For key U.S. allies, the sanctions are a tool of geoeconomics enabling a reorientation of their foreign economic policies. It is possible for economic sanctions to fail in their primary goal while accomplishing multiple secondary goals.

Conclusions and Policy Recommendations

Forty years ago, David Baldwin issued an important caution about accurately assessing the utility of economic sanctions: "Information about the utility of a single technique or category of techniques has *no significance whatever* for decision-making until it is set in the context of explicit or implicit assumptions about the comparative utility of alternative techniques. To the statesman only the relative utility of policy instruments matters."[51] This point is often acknowledged and equally often forgotten.

Baldwin's point is also incomplete, however. His premise is that the myriad instruments of statecraft are substitutes for each other. This is true – to a point. At its best, however, American foreign policy relies on a combination of instruments that complement each other. Most forms of economic pressure require a diplomatic component. Sanctions are more likely to work when guided by high-grade intelligence. Contrasting sanctions with other policy options – like inducements or the force of arms – can enhance their utility. Overreliance on economic sanctions can erode the structural foundations of economic power that have enabled U.S. hegemony for decades.

Finally, policymakers need to appreciate that economic sanctions are merely one instrument in a symphony of statecraft. This makes it easy to misinterpret their relative utility over time. Lessons have been overlearned from high-profile cases. The easy temptation to use sanctions in the moment has undercut strategic efforts to show restraint with this tool. As a result, like a knife that has been overused, the tool of sanctions has been dulled over time. The danger going forward is that U.S. reluctance to employ other instruments of statecraft has risen, the reliance on sanctions will persist – to the detriment of that instrument of statecraft as well as American foreign policy writ large.

This chapter does suggest a few policy recommendations that are worth considering. Possibilities include:

- Instituting sunset clauses in congressionally-mandated sanctions laws, in order to make it easier for the United States to credibly commit to lifting economic sanctions;
- Requiring annual Sanctions Impact Assessments by the intelligence community to assess the economic and political effects of ongoing sanctions programs – and the implications of removing those sanctions;
- Mandating OFAC – the chief administrator of U.S. sanctions programs – to detail which complementary policies would enhance the utility of economic sanctions;
- Prioritizing the sustainability of economic networks in which the United States enjoys network centrality over short-term sanctioning;
- Creating an NSC Directorate focused on economic statecraft;
- Tasking U.S. strategic planning groups at State, NSC, and Treasury to sketch out the future of economic statecraft.

Discussion Questions

1. Why are economic sanctions a uniquely American form of economic statecraft?

2. To what extent are economic sanctions a substitute for other policy options? To what extent are sanctions a policy complement?

3. Has the potency of weaponized interdependence been exaggerated? Why or why not?

4. To what extent is the policymaking consensus on the utility of economic sanctions a function of the last high-profile case?

5. To what extent are targeted economic sanctions a more humanitarian policy option?

6. How can Congress be better informed about the aftermath of passing laws mandating economic sanctions? Would a better-informed Congress act any differently?

7. Are there institutional mechanisms that would constrain U.S. politicians from excessive sanctioning behavior?

8. Should sanctions laws require a sunset clause?

Endnotes

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Background Research - Chapter 3

Gates Forum III

A New World Re-Order: Geopolitical Shifts Arising from Tomorrow's Financial Systems

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Introduction

A viable alternative to US-dominated financial market infrastructure[1] (FMI) that is less vulnerable to U.S. economic statecraft will likely emerge in the next ten years. Current international experimentation around new FMI technology and governance foreshadows a possibility that has not existed since the modern international banking system developed under U.S. leadership 80 years ago: The potential for businesses and governments to conduct large-scale cross-border financial transactions outside technical and institutional structures that operate under heavy U.S. influence (Federal Reserve History 2013).[2]

Characterizing a yet-to-be determined financial system with the words “alternative” and “viable” is not to assert that today’s US-influenced cross-border payment systems will be *replaced* nor does it presume a displacement of the dollar as the top global reserve currency. The legacy system is likely to persist even if an additional functional system emerges. But depending on how a more digitally native financial system of tomorrow is built and which international players govern its policies and operations, the U.S. could lose the far-reaching financial insights and political leverage that have helped it bolster America’s security interests for over half a century.

U.S. geopolitical adversaries such as China, Russia, and Iran have been seeking alternative systems for cross-border financial transactions for well over a decade. Those aspirations were mostly rhetorical at first, but are now becoming tangible as new software technology is allowing large-scale real-world transactions between international banks, but outside conventional FMI.

Intensifying interest in central bank digital currencies (CBDCs) by a variety of countries (both friendly and hostile to the US) is the biggest driver to the creation of alternative financial market infrastructure. And within the expanding realm of international CBDC research and development, one China-influenced project called mBridge, appears to be the leading candidate for a new system that could challenge U.S. equities in the global financial system.

This article explains the factors and motivations behind the international push to upgrade global financial architecture and unpacks the geopolitical dynamics unfolding as these explorations mesh with nation state actors who also want to undermine the ability for the United States to conduct financial coercion against them. It includes a somewhat speculative

forecast section that posits potential geopolitical scenarios that could play out if a project like mBridge expands as a fully functional cross-border payment mechanism available to all countries. The paper ends with recommendations of strategies and actions for the US–including public sector and private sector stakeholders–to prevent worst case scenarios and to build a future digitally-based financial system that upholds U.S. values of openness, liberty, integrity, and accountability.

U.S. Centrality to Global Payments Infrastructure Enables Sanctions Power

U.S. economic sanctions get their potency from the importance of U.S. financial institutions to international banking and trade. The U.S. dollar is the most liquid currency internationally and non-U.S. banks often prefer to settle international transactions in dollars even when neither party is in the United States.[3] To acquire dollars, non-U.S. financial institutions must have access to the U.S. financial system (CRS 2022).[4]

To facilitate transactions across jurisdictions, the global banking system relies on a network of indirect relationships. In general, banks do not have direct connectivity with every other bank in the world and in many cases banks do not hold enough reserves in foreign currencies to facilitate all the international transactions demanded by their customers. To transact with the array of banks around the globe and to also access highly-demanded U.S. dollars as needed, banks open accounts directly with "correspondent banks" where the correspondent institution provides a transactional channel with a third bank as well as access to a currency needed by the initial bank (BIS 2016).[5] Furthermore, many non-U.S. banks need direct relationships with U.S. banks or with correspondent banks that have relationships with U.S. banks and greater access to U.S. dollars. In order to have those relationships and keep that access, the U.S. requires foreign financial institutions to adhere to U.S. financial laws and regulations, including U.S. sanctions. Violating these rules can bring penalties, fines, and criminal prosecution in U.S. courts.

The current FMI for cross-border payments is this global interdependence of banks that enables financial weaponization (Farrell and Newman 2019).[6] If a non-U.S. bank is cut off from U.S. financial institutions and from correspondent relationships that connect to U.S. financial institutions, that bank's ability to facilitate cross-border payments on behalf of its customers is hampered significantly. The primacy of U.S. financial institutions to international trade causes banks to follow U.S. sanctions law and refrain from servicing individuals and entities the U.S. Treasury places on its list of specially designated nationals and blocked persons (OFAC 2024).[7] Thus, traditional FMI supports the potency of U.S. sanctions as part of U.S. economic statecraft.

Multiple Factors Motivating Disruption of Traditional FMI

The current global push to pursue FMI alternatives is not driven wholly by geopolitical factors. Much exploration is built by a widely acknowledged need for technological innovation in global payment infrastructure. The current FMI for cross-border transactions is clunky and inefficient. In fact, the Federal Reserve has underscored the importance of technological innovation in improving cross-border transactions (Flemming and Judson 2024).[8] In an early 2024 speech in South Africa, U.S. Fed Board Governor Michelle Bowman emphasized that unlike domestic payment systems, global payments face the complexity of multiple currencies and legal and policy frameworks, numerous time zone differences, and a variety of commercial and government actors that cause higher transaction costs and delayed processing times (Bowman 2024).[9] She further highlighted that such friction undermines financial inclusion by constraining many peoples' access to credit and other basic financial services and credit (Ibid.). Similarly, the Financial Stability Board (FSB) pointed out in its *Enhancing Cross-border Payments* report in 2020 that global financial market infrastructure is hampered by "fragmented data standards or lack of interoperability; complexities in meeting compliance requirements, including for anti-money laundering and countering the financing of terrorism (AML/CFT), and data protection purposes; different operating hours across different time zones; and outdated legacy technology platforms (FSB 2020)."[10] And the International Monetary Fund (IMF) has criticized the opacity of global payment structures, where multiple banks are involved in one payment and where exact pricing is not always known upon starting a transaction (Dong 2017).[11]

International financial institutions are prioritizing initiatives to upgrade global payment structures. The FSB has launched an effort with the G20 Roadmap for Enhancing Cross Border Effectiveness, setting ambitious global targets to be achieved by 2027, including improving payment system interoperability, updating legal and regulatory frameworks, and enhancing cross-border data exchange and messaging standards (FSB 2023).[12] For its part, the Bank for International Settlements (BIS) has initiated a number of projects, including Project Nexus, that aim to address the challenges presented by existing payment rails, such as their cost, slow speed, and limited transparency for both end-users and smaller banks (BISIH July 2024) (PYMNTS 2023).[13]

Although the need to upgrade cross-border payment systems is universally understood in the financial sector, geopolitical anti-U.S. undercurrents motivating some countries' pursuits of new FMI are also apparent. The immense strength of U.S. financial coercion within global financial market infrastructure has made life difficult for many U.S. adversaries (Hurowitz 2022).[14] The dollar's "weaponization" via sanctions and export controls has caused the targets of U.S. economic statecraft to lash out against the US.

A key example of this backlash is when Iranian banks were removed from the SWIFT[15] system in 2012 as part of broader efforts by the U.S. and European Union to compel Iran to halt its uranium enrichment activities, in order to hinder development of Iran's nuclear weapons capability (Gladstone and Castle 2012).[16] The decision to "de-SWIFT" Iran followed an order by the European Union Council, which instructed SWIFT to discontinue its communications services to Iranian financial institutions subject to European sanctions (Bale 2012) (The Guardian 2012).[17] SWIFT's then-CEO, Lázaro Campos, described the move as an "extraordinary and unprecedented step" for the organization (Ibid). The action severely impacted Iran's ability to engage in international transactions, effectively cutting off a vital channel for Iran to electronically transfer billions of dollars in revenue from oil sales and other exports (Gladstone and Castle 2012). As it has done in the past, Iran responded to its removal from the financial system by criticizing the decision as illegal and a form of bullying by Western powers (Ibid).

More recently, the U.S. imposed sanctions on Hong Kong and Chinese officials in August 2020 under President Trump's Executive Order on Hong Kong normalization, which implemented the Hong Kong Autonomy Act (Soliman et al 2020).[18] The sanctions were a direct response to China's imposition of a restrictive national security law on Hong Kong and its crackdowns on pro-democracy protests in Hong Kong (Ibid). According to the Treasury Department, the sanctioned individuals, including Hong Kong Chief Executive Carrie Lam, were "directly responsible for implementing Beijing's policies of suppression of freedom and democratic processes."[19] The U.S. actions were met with strong condemnation by the Chinese government. For example, Chinese Foreign Ministry spokesperson Zhao Lijian accused the U.S. of openly meddling in Hong Kong affairs and blatantly interfering in China's internal affairs (Xinhua Net 2020).[20] Zhao Lijian further accused the U.S. of violating international law and other norms governing international relations (Ibid). China even went so far as to issue retaliatory sanctions against 11 U.S. citizens, including prominent politicians and heads of non-profit organizations (Kini 2020) (Bloomberg News 2020).[21]

Russia has also felt the brunt of Western economic warfare, especially after select Russian banks were removed from the SWIFT system following the county's invasion of Ukraine in early

2022. In response to the sanctions, Russia accelerated the use of its own financial messaging system, System for Transfer of Financial Messages (SPFS), which it had been developing as an alternative to SWIFT since 2014, the same year that it annexed Crimea (Perez n.d.).[22] Russia had also been preparing for its potential exclusion from SWIFT by building up foreign reserves and decreasing its national debt (Ibid). Russia also looked to expand its use of China's Cross-Border Interbank Payment System (CIPS) as another alternative to SWIFT (McKee 2022).[23] Following the partial removal from the SWIFT system, Russia became increasingly dependent on China and Chinese currency in lieu of other global reserve currencies. However, CIPS access fell under pressure as a number of China's state-owned banks put restrictions on Russia's access to funding soon after U.S. Treasury announced it would place secondary sanctions on foreign financial institutions doing business with Russia's defense sector (van Brugen 2024).[24]

Technology Now Enabling Alternatives that U.S. Friends and Adversaries Have Sought

Many countries–both those that are politically friendly and those that are hostile to the United States–are experimenting with software technologies and developing new processes that could allow cross-border payments outside the conventional mechanisms of today's correspondent banking system. The shift is enabled by technological innovation emerging within the past decade, especially through blockchain technology. All of these software-based infrastructure projects are nascent with only a few implemented beyond a pilot stage. However, these projects' significance lies not in how much volume of trade they are currently facilitating, but in what they signal: the capacity for other countries and foreign financial institutions to transact on alternative financial market infrastructure whose operations are out of reach of U.S. economic statecraft. Such a possibility was quite elusive until central banks started reacting to the rise of Bitcoin and cryptocurrencies and began considering how to create their own versions of digital currencies.

Foreign nations' aspiration for new financial market infrastructure became pronounced in the wake of the 2008 financial crisis, but it did not move much beyond rhetoric–at first. China's central bank, the People's Bank of China (PBOC) in 2009 called for the international community to create a new system managed by the IMF where IMF special drawing rights (SDRs) would serve as the global reserve currency instead of the U.S. dollar (Barboza 2009).[25] Russia proposed a similar new reserve system at G20 meetings that same year (Reuters 2009).[26] Both countries were seeking to reduce–if not eliminate–the global reliance on U.S. assets in the financial system. Neither country's proposals gained any traction, however.

Practical attempts beyond rhetoric for alternative financial infrastructure would only materialize as governments became more familiar with software that introduced a new method for conducting digital financial transactions. In late 2008, the pseudonymous computer scientist Satoshi Nakamoto published the white paper Bitcoin: A Peer-to-Peer Electronic Cash System (Satoshi Nakamoto 2008).[27] The paper lays out the blueprint for a method of confirming and recording digital transactions through an online ledger maintained by a decentralized network of computer nodes. The system, known as a blockchain, was designed as permissionless, meaning anyone with Internet access could help maintain the blockchain system and also acquire, hold, and transfer its native asset known as bitcoin. This

digital token is held in digital wallets composed of destinations known as addresses. Bitcoin became known as the first cryptocurrency. Although the Bitcoin blockchain went live in early 2009, it was a niche innovation at the time mostly used by a small segment of computer science developers and was unlikely to be on the radar of most central bankers seeking a new financial system less dependent on the dollar (Sergeenkov 2022).[28] But by 2014, some central banks had taken notice of cryptocurrencies. That year, the Bank of England published a report on payment innovation from "privately-developed, Internet-based digital currencies, such as Bitcoin (Ali et al. 2022)."[29] The report focused on evaluating cryptocurrencies' potential risks to monetary stability, but it also explained how a blockchain–which it refers to as a "distributed ledger"–operates, and discussed the technology's benefits for payment efficiency. The authors concluded that "the distributed ledger is a genuine technological innovation which demonstrates that digital records can be held securely without any central authority (Ibid)." Although this assessment did not indicate any UK interest in exploring a central bank digital currency (this would come a few years later), it acknowledged that the tech stack undergirding Bitcoin was worthy of study and consideration.

Separately, in 2014, the People's Bank of China created its own unit to research the technologies that could enable a national digital currency (PBOC E-CNY Working Group 2021).[30] The research unit began to look extensively at blockchain technology (Fanusie and Jin 2021).[31] It should be noted that, for the most part, central banks were against adopting the permissionless feature of cryptocurrency systems. As stewards of their nations' monetary policies, central bankers were not interested in introducing digital financial infrastructure independent of government control. Rather, they began considering how to adapt elements of distributed ledger technology for a possible state-controlled digital payment instrument. Such a concept became known as a central bank digital currency (CBDC).

Some of the world's most influential monetary policymakers would soon tout the theoretical merits of CBDCs. In 2019, Mark Carney, then-governor of the Bank of England, told a multinational meeting of central bankers that they should consider adopting a "synthetic hegemonic currency" potentially derived from a "network of central bank digital currencies" (Carney 2019).[32] Although the UK is America's closest ally, Carney saw perpetual dollarization[33] as an economic problem for the rest of the world, making every other country vulnerable to economic shocks in the United States. He suggested that such a CBDC-based system could "dampen the domineering influence of the U.S. dollar on global trade" (Ibid). But like Russia and China's calls for an alternative monetary reserve system after the 2008 financial crisis, the Bank of England governor's proposal did not manifest in wide scale multilateral coordination, at least not immediately.

CBDCs - A Brief Primer

Central Bank Digital Currencies (CBDCs) are the direct digital issuance of a nation's fiat currency. According to the Atlantic Council, 134 countries and currency unions, representing 98 percent of global GDP, are exploring a CBDC on some level (CBDC Tracker 2024).[34] Three countries–the Bahamas, Jamaica, and Nigeria–have fully launched a CBDC, and nineteen of the G20 countries are now in advanced stages of CBDC development. CBDC pilots tend to have two functions: Either wholesale or retail. Each type serves distinct purposes and targets different user groups within the economy.

Retail CBDCs are designed for use by the general public, similar to physical cash, but in digital form (Di Lorio 2021) (World Bank Group 2021).[35] These digital currencies are intended to be accessible to individuals and businesses for everyday transactions. The primary objective of retail CBDCs is to provide a secure, efficient payment system that enhances the convenience and speed of transactions while reducing the costs associated with cash handling and payment processing. Through the provision of a state-backed digital currency, many central banks proclaim the aim to strengthen financial inclusion, especially for those who are unbanked or underbanked, by providing them with a reliable means of participating in the digital economy. Advocates argue that retail CBDCs also have the potential to increase the resilience of the payment system by providing an alternative to private sector payment solutions, thereby reducing systemic risk.

Wholesale CBDCs, on the other hand, are intended for use by financial institutions and intermediaries for large-scale transactions and interbank settlements. These digital currencies are designed to improve the efficiency, security, and transparency of wholesale payment systems and financial market infrastructures (Di Lorio 2021) (BIS Report 2021).[36] Advocates claim that wholesale CBDCs will facilitate faster and more cost-effective cross-border transactions, reduce counterparty risk, and enhance liquidity management for financial institutions. By leveraging distributed ledger technology (DLT) or other advanced digital payment infrastructures, wholesale CBDC projects aim to streamline settlement processes, reduce the need for intermediaries, lower operational costs and make banking more resilient to shocks.

While both retail and wholesale CBDCs may aim to harness the benefits of decentralized ledger technologies, their applications and target audiences differ significantly. Retail

CBDCs focus on providing a digital alternative to cash for the general public, while wholesale CBDCs are geared towards improving the efficiency and security of high-value transactions and interbank settlements, with a particular emphasis on enhancing the underlying financial market infrastructure. Both types of CBDCs have the potential to transform financial market infrastructure.

For instance, a country like Singapore with a highly efficient existing retail payments system and a high proportion of citizens with bank accounts may not see a pressing need for a retail CBDC (Menon 2021).[37] In contrast, a developing country with a large unbanked population and a less sophisticated payments infrastructure may prioritize the implementation of a retail CBDC to improve financial access. Others may further view retail CBDCs as a means of providing greater consumer choice and reducing the dependence on private digital money created by banks and financial technology (fintech) firms.

Privacy Concerns

One of the biggest policy concerns with CBDCs is how to maintain personal privacy, especially from government surveillance. Unlike conventional FMI, where only private banks have direct access to the real-time transaction data of their customers, CBDCs *could* be designed in a way in which the central bank or some other government agency has total access to the user's personal transaction data. Many have raised these concerns around China's CBDC (Fanusie 2021).[38] This potential has triggered popular and political pushback to varying degrees, especially in democratic countries. Multiple U.S. politicians have pledged to ban a Fed-issued "digital dollar" (Manoylov and Wynn 2024).[39] In Europe, the EU is taking concrete steps toward a digital euro, although the European Central Bank claims that its level of privacy should be as close to cash as possible (Daman 2024).[40]

By the time Carney gave his "synthetic hegemonic currency" speech, nations who were reeling under America's economic statecraft had already begun testing the waters of digital financial innovation. Just a few years after the Bank of England's 2014 report on digital currencies, governments hampered by U.S. sanctions started developing blockchain-based architecture they hoped would help them circumvent U.S. economic statecraft and conduct international financial transactions. The first such effort that was announced unabashedly as a sanctions evasion strategy was the petro national digital currency of Venezuela's Maduro Regime, launched in early 2018 (Krygier 2018).[41] The petro was a cryptocurrency token

reportedly backed by Venezuelan oil reserves and one of the rare examples of a cryptocurrency–though designed by the Maduro regime–to be floated as a nation's digital currency. The effort was rudimentary and poorly-executed. The regime did not establish much business, technical, or policy infrastructure within Venezuela to support the distribution or practical use of the petro (Fanusie and Logan 2019).[42] And the token's creation by itself did not alter the poor economic and corrupt political conditions of Venezuela that made its economy anemic and its currency unattractive to foreign counterparts. Soon after the petro's launch, the U.S. Trump administration signed an Executive Order sanctioning any digital currency created by the Maduro regime, effectively dissuading international financial institutions and businesses from dealing with it (White House 2018).[43] Soon, it became clear that blockchain-based sanctions resistance via the petro was futile (Fanusie and Logan 2019).

The failure of the petro, however, likely provided lessons for other governments contemplating sanctions resistance through digital currency tech. In the midst of the public attention of the petro, other nations were developing more deliberate, long-range national blockchain and digital currency projects. The Russian government initially considered banning cryptocurrency in 2014 (Kostarev 2014).[44] Yet, by 2018, Russian President Putin openly called for the country to explore blockchain technology to "avoid various limitations in global finance trade" (Baydakova 2018).[45] By 2019, Russia had implemented multiple blockchain pilots for its state-owned banks that were under U.S. and EU sanctions (Fanusie and Logan 2019). However, unlike the Maduro regime, Russia did not quickly launch a digital currency but, rather, was slowly doing research and development, testing out blockchain infrastructure within its institutions, and seeming to pave a way for a functional technical environment that could support an eventual digital ruble. In late 2020, Russia's central bank released a consultation paper[46] (Bank of Russia 2020) on its plan for a digital ruble and began testing a digital ruble pilot in 2023 (Bank of Russia 2023).[47]

Iran–under heavy sanctions pressure–has approached sanctions evasion by digital finance similarly to Russia. It has been investigating and building blockchain infrastructure without unveiling a national digital currency and, instead, eyeing multilateral coordination as essential to developing a viable way to counter U.S. sanctions. The Central Bank of Iran (CBI) launched a blockchain institute at a local prestigious technology university in 2017 and began supporting academic research into the tech (Fanusie and Logan 2019). SWIFT did grant Iranian banks access again to its messaging system in 2016, but it was short-lived. The Trump administration reimposed sanctions on the banks in 2018. Vulnerable to U.S. financial weaponization, Iran was even more motivated to seek an alternative system to facilitate global trade. Iran's immediate blockchain focus, however, was to build the domestic private sector

technical architecture, something the Maduro regime never did. In 2019, the CBI announced that it had launched a national blockchain platform called Borna for banks and fintech startups to build digital financial applications (Avan-Nomayo 2019).[48] In 2019, Ali Divandari, the head of the central bank's Monetary and Banking Research Institute publicly acknowledged blockchain as relevant technology for Iran (Pozzi 2019).[49] But he dismissed the notion that shifting to blockchain tech within Iranian banks would enable sanctions resistance (EghtesadOnline 2019).[50] Instead, Divandari posited that the technology could only facilitate needed international trade if Iran's trading partners also had similar financial infrastructure operating outside the conventional banking payment system (EghtesadOnline 2019).

Another key catalyst in global CBDC exploration in this period was the launch of the Libra stablecoin project, initiated by Facebook (now Meta) in mid-2019.[51] Libra was renamed Diem in late 2020 (Bursztynsky 2020).[52] The Libra team designed the Libra stablecoin to be backed by a basket of bank deposits from "high quality central banks" (Amsden 2020).[53] Many nations were concerned that the stablecoin–whose adoption they expected would be bolstered by Facebook's unquestionable social media reach–would overtake global payment systems and hurt domestic currency circulation. Even the Bank of Canada described Libra as a potential threat to Canada's financial system and proposed that creating a Canadian CBDC would help stave off threats from private digital currencies (Diez de los Rios and Zhu 2020).[54] Although the Libra project was only in the planning and development stage, it gained major media attention worldwide. Libra never got off the ground due to strong push back by monetary policymakers and politicians, but in its wake, most central banks were much more familiar with digital currencies and began considering how CBDC innovation could upgrade domestic payments and help bolster domestic currency usage.

The blockchain exploration occurring from 2018 to 2019 likely also showed countries that blockchain technology was not the singular option for new FMI. Central banks would soon understand that they could choose to integrate different software architectures, from distributed ledgers to a centralized ledger, depending on the type of transactions supported, whether wholesale or retail, domestic or cross-border. China's retail CBDC, the e-CNY, is a good example. The PBOC moved away from the blockchain-focused approach of its early research to a centralized ledger design, driven by the aim to support high transaction volume with domestic retail payments (Fanusie and Jin 2021). At the same time, the Chinese government continues to push blockchain technology innovation within its financial sector for wholesale payments (Wan 2020).[55]

Iranian central bank official Divandari's acknowledgment in 2019 that Iran needed more than just its own national digital currency to overcome U.S. sanctions was a signal of a more

sophisticated strategy to emerge among U.S. adversaries. It indicated the missing piece for individual nations to find a viable alternative to today's US-led financial market infrastructure: an international collaborative effort. Such collaboration is now emerging.

Joint Efforts in New Financial Market Infrastructure Point to Viability

As a slew of central banks are exploring the possibility of creating their own national CBDC, some are also forming joint pilot projects to test how countries could conduct cross-border wholesale financial transactions through CBDCs. This requires setting up formal systems where banks can transact across borders. Central banks conducting wholesale CBDC research have explored bilateral cross border transactions over the past several years, but these efforts, though informative, have been mostly proofs of concept resulting mainly in research papers (Kumar and Chhangani 2024) (Green 2023).[56]

Project Jura, a collaborative experiment involving the Banque de France, the BIS Innovation Hub, and the Swiss National Bank represents one such project. The study explored the settlement of tokenized[57] euro commercial paper and foreign exchange transactions using wholesale CBDCs (BIS 2021).[58] Relatedly, Project Ubin represented a multi-year collaborative initiative by the Monetary Authority of Singapore (MAS) to explore the use of blockchain for clearing and settling payments and securities (MAS 2024).[59] The project explored tokenizing the Singaporean dollar, optimizing inter-bank payment settlements, enabling cross-border transactions, and digitizing payments. Importantly, Project Ubin demonstrated that inter-bank transactions, cross-border remittances, and tokenized securities could be settled using DLT with full settlement finality and transaction privacy.

International financial institutions have also proposed models for facilitating cross-border interoperability of CBDCs, including the BIS Unified Ledger and SWIFT's New Cross-Border Project (Kumar and Chhangani 2024). The BIS model aims to address financial system inefficiencies by enabling secure transactions and instant settlements within a transparent framework. Specifically, the project uses APIs for a centralized system, with transactions validated by authorized entities. South Korea has launched a pilot project using the BIS Unified Ledger that involves commercial banks issuing tokenized deposits within a CBDC network managed by the Bank of Korea and other financial institutions. The project aims to integrate jurisdiction-specific regulations into a universal protocol for international transactions.

SWIFT's own cross-border CBDC model, on the other hand, leverages its existing financial messaging infrastructure to enhance cross-border payments, theoretically making them faster, more transparent, and cost-effective. In beta testing, the model connects disparate CBDC networks, allowing them to communicate and transact using SWIFT's infrastructure. The project began in March 2023 with over eighteen participants and expanded to over thirty entities, processing more than 5,000 transactions in twelve weeks. SWIFT's model functions as a hub-and-spoke arrangement with SWIFT at the center. This structure would reportedly offer countries flexibility to maintain their domestic CBDC infrastructure while ensuring global connectivity.

However, one project has evolved beyond a proof-of-concept and attained a minimum viable product. And it is highly influenced by the People's Republic of China.

The mBridge to Somewhere

Project mBridge, organized by the BIS Innovation Hub, is the most advanced cross-border wholesale CBDC project to date (Fanusie 2021).[60] Its founding members, in addition to the BIS, are the People's Bank of China, the Hong Kong Monetary Authority, the Bank of Thailand, and the Central Bank of the United Arab Emirates, and the project has over 26 observing institutions (BIS 2024).[61] The project enables central banks and large financial institutions to transact between themselves using CBDCs issued by the central bank members of the platform. In late 2022, the pilot program facilitated $22 million worth of real value transactions in CBDCs between banks using the system and in mid-2024, BIS declared that mBridge had reached a minimum viable product stage (BISIH 2022).[62]

The mBridge platform is a blockchain software program created specifically for the project and runs on a permissioned blockchain network, so that access is restricted to the program's participants. Each central bank participant operates a computer node on the mBridge blockchain so that each central bank can confirm the platform's transactions through a decentralized consensus mechanism (BISIH 2023). The central banks then onboard commercial banks who can use mBridge on behalf of clients who want to conduct trades with counterparts in any of the jurisdictions represented by the central banks in the network (Ibid). The network utilizes smart contracts to govern and execute regulated activities such as CBDC issuance, redemption, and transfers, and can be programmed to set risk-adjusted and customized controls and specific products tailored to the private banks' customers. By enabling real-time, bilateral connectivity between banks, the network reduces the number of intermediaries needed for cross-border transactions. This capability is precisely what the 2014 Bank of England research paper on digital currencies alluded to when it lauded the potential benefits of distributed ledger technology for payment efficiency (Ali et al. 2022).

Project mBridge is likely to serve as the best model for countries looking to enhance their cross-border payment systems, especially those underserved by conventional FMI. It also represents a significant step towards the broader adoption of CBDCs in the global financial system. It is important to note that mBridge is not occurring outside the radar of Western financial institutions. The *observing* members of the mBridge pilot include the Federal Reserve Bank of New York, the European Central Bank, and the World Bank. The commercial banks onboarded to conduct trades on the program include western financial institutions such as Goldman Sachs, Standard Chartered, HSBC, UBS, and Societe Generale (BISIH June

2024).[63] However, Chinese financial institutions have had the biggest share of banks involved with the pilot and only central banks operating a node get full access to inspect and work with the project's software (Ibid). China's outsized influence in mBridge is discussed further below.

With New Financial Market Infrastructure, Countries May Not Need to Displace Dollar Directly

Platforms such as mBridge offer an alternative strategy to dollar displacement in global trade by utilizing new procedures and platforms that eliminate the need for dollars in cross-border transactions. But the dollar is not an ostensible target of elimination. Rather, mBridge is sidestepping *the process* that favors dollars in foreign exchange (FX) markets. By making domestic-to-foreign currency exchange easier, parties in countries with less attractive currencies can conduct trade without having to resort to a more globally liquid third party currency like the dollar or euro. This system, if expanded widely, would alter banks' incentives for holding certain foreign currencies over others.

How Global Cross Border Payments Work in Traditional FMI

In traditional financial market infrastructure, to purchase goods from overseas, the buyer must pay the seller in the currency of the seller. For example, if a clothing outlet in the UAE wants to buy clothing inventory from Thailand, the UAE merchant has to access the Thai baht currency. It theoretically would be possible for the UAE merchant to go to a UAE bank that is holding Thai baht and then convert UAE dinar to the requisite amount of baht to send the Thai seller. But for practical purposes, the banking transaction would likely involve dollar conversion. Most global banks hold high amounts of dollars, making it the most liquid global currency. When dealing with cross-border transactions, valued in the equivalent of millions of dollars, converting to dollars provides greater payment flexibility since it is a more attractive currency to hold (compared to the UAE dinar or Thai baht, for example). So instead of converting directly from dinar to baht, it may be easier and quicker for the UAE merchant's bank to convert from dinar to dollars and then convert into baht. Also, the UAE bank may need to transact through a correspondent bank that serves Thai customers. The correspondent bank may not typically prioritize dinars in its reserves to fulfill dinar-baht conversion, but it would want reserves to enable dollar-baht conversions. Given the wide

expanse of the U.S. economy, many customers of non-U.S. banks, especially large businesses, likely have some expenses in dollars to support their transactions with globally active U.S. firms.

The biggest attraction of mBridge for countries is in its more streamlined process for FX transactions, and thus reducing FX settlement risk. Under mBridge, parties from two different countries do not need to use a network of correspondent bank intermediaries to process cross-border transactions and settle liabilities between commercial banks to cover the trade payments. Instead, mBridge enables direct FX payment versus payments (PvP)[64] in central bank money, which is safer than private commercial bank money.[65] The mBridge program refers to PvP as an atomic payment because it occurs as one solid operation, as opposed to most cross-border payment processes involving multiple steps that can occur independent of each other. In an atomic FX transaction, the seller does not receive her local currency from the platform unless the buyer has provided his local currency to the platform. This eliminates counterparty risk and obviates the multi-step payment process that causes time lags, higher fees, and gross inefficiency. There are some PvP settlement systems available in global banking, but they are restricted to the countries with the top currencies (BISIH 2019).[66] BIS points out that this atomic FX capability is particularly advantageous for emerging markets and developing economies, who face higher costs in correspondent banking and do not have as much access to PvP systems as more advanced economies (BISIH 2022) (BIS 2019).

One aspect of mBridge that is likely to be very attractive to many countries, but less-understood outside of central banking circles is the question of "monetary sovereignty"(BISIH 2022). The platform allows central banks to supervise foreign access to their domestic currency and restrict usage as the domestic government sees fit. This is important for broad monetary policy aims like capital controls and financial stability and is especially relevant for central banks of less powerful economies concerned with the encroachment of foreign entities (state or private) interfering with a nation's ability to manage its money supply. The priority of monetary sovereignty is what motivates central banks when they evaluate threats from private digital currency innovation as seen in Canada's stance on Libra and when they fulfill the key objective of any central bank to control the issuance of a currency (Diez de los Rios and Zhu 2020) (Gianviti 2005).[67]

One thing the mBridge project does not do is address the privacy concerns which are being raised in Western countries. The official BIS mBridge brochure from 2023 explains that central

banks who issue the CBDC involved in a payment will be able to identify each party and decrypt all transaction data (BISIH 2023). Without saying it outright, this means that a central bank would be able to not just monitor and track the CBDC across borders, but also the entities involved in the transaction, something not possible with traditional banking infrastructure. Although it would seem that transaction details would only list financial institutions and not individuals, the mBridge project has not clarified whether the platform might enable some level of drilling down where the central bank could view the individual companies or people whose trades are being settled by the wholesale transactions.

…a central bank would be able to not just monitor and track the CBDC across borders, but also the entities involved in the transaction, something not possible with traditional banking infrastructure.

Although mBridge is a BIS-facilitated effort and no one country officially controls it, China is the de facto leader of the project. The mBridge 2022 report explained that China's e-CNY performed the best of all the currencies on the platform due to the PBOC's previously established technical infrastructure through its domestic CBDC pilot (BISIH 2022). Also, the cloud servers hosting all mBridge data are located in Hong Kong, where national security laws have been imposed by Beijing and defer to mainland China (Ng 2024).[68] Furthermore, the head of the PBOC digital currency research institute describes mBridge as an important complement to China's domestic, retail e-CNY research (Mu 2023).[69] That same official acknowledged that China is the country that proposed mBridge's design framework, built in a modular fashion like "lego bricks." (Changchun 2023). mBridge might not fully be Chinese infrastructure, but it is the infrastructure of Beijing's choosing.

For China, the end-game of mBridge looks to be a strategic positioning, to fill a gap that U.S. financial institutions are not filling, not to try to outcompete the dollar by replacing it with the Chinese yuan or any other currency that transacts on the platform's digital rails. The technical features of mBridge do not impact the fundamentals of the U.S. economy and can not be expected to counter the overwhelming demand of the U.S. dollar. The mBridge project is

enabling an alternative process for cross-border transactions that is technologically viable, offers efficiencies not accessible in conventional FMI, and that gives central banks greater supervision over their currency controls and empowers them with governance over the platform. All indications point to mBridge as the prime CBDC cross-border platform for countries seeking better FMI and to its steady expansion in the next few years. Saudi Arabia's central bank joined as a member in mid-2024 and the project is inviting private sector firms around the world to propose new solutions and use cases to further develop the project (BISIH 2024) (Jones 2024).[70] BIS declaring mBridge as achieving minimal viable product status in June 2024 is a milestone that should prompt keen U.S. policymaker attention.

The key question is: What would change for U.S. economic statecraft if mBridge scales up to a full global launch, where any financial institution from any country could potentially transact on it? To address this concern, what follows is a forecast scenario, identifying what a world with a fully functioning and adopted mBridge would look like and some challenges that are likely to arise for U.S. interests.

A New World Re-Order: Forecasting mBridge's Geopolitical Impact as Viable Financial Market Infrastructure for Wholesale Cross-Border Payments

- Forecast Baseline Assumptions:
    - As a prerequisite, all countries who join mBridge must have issued their own wholesale CBDC.
    - No sooner than 2030, the mBridge system will become available for all central banks with a CBDC. An MVP phase of at least 5.5 years would eventually include 20 member central banks.
    - Every member central bank will be required to operate an mBridge node.
    - A subset of members will become part of the mBridge governance board (MGB), who direct the broad policy and operations of mBridge.
    - By 2030, the mBridge system will have left its Bank for International Settlements (BIS) sponsorship and re-form as an independent body run by its members. This move will be largely due to key members' dissatisfaction with the BIS decision in 2022 to not support Russian transactions due to U.S. and EU sanctions (Reuters 2022).[71] China would argue that bans from mBridge should only come from UN sanctions and the governance board adopts China's policy stance.
    - There will be no inherent limits to how much value can transact in the mBridge system. Individual central banks set their own policy specifications and controls via the platform's smart contract programming. All transactions undergo compliance and legal checks, but the system works faster and more smoothly than traditional cross-border payments. The platform operates 24/7.
    - While open to any CBDC-issuing country, mBridge will be mostly marketed to middle income countries and nations experiencing difficulties with conventional FMI (World Bank

2024).[72] Russia and Iran will join mBridge by the time the system fully launches. North Korea is barred as long as it is under UN sanctions.

  - The United States and European Union do not issue CBDCs by 2030 and do not join mBridge. They also voice concerns about the system's data security, but are not able to convince the vast majority of other nations to stay away from the platform.

- *Impact Scenario 1: The Problem of the Payment Multiverse*
  - China unveils a "Two Flowing Rivers Strategy" where it conducts cross-border transactions through either traditional FMI or mBridge, depending on the counterparty. If a trading partner is an mBridge member, Chinese law only allows wholesale payment flows through the mBridge system.
  - Impact:
    - Chinese entities on the OFAC SDN list shift all their financial transactions to mBridge infrastructure. The U.S. considers putting secondary sanctions on third country commercial banks that transact with sanctioned entities on mBridge, but mBridge transaction data is not publicly available. The U.S. cannot determine which transactions are taking place, by whom, or for what.
    - Other mBridge members consider adopting the Two Flowing Rivers Strategy, causing the U.S. to lose significant visibility into global transactions, especially with middle income countries.

- *Impact Scenario 2: CBDC Geo-Politicization*
  - The mBridge governance board (MGB) discovers that access to its platform is highly prized by countries that want fast, convenient transactions with emerging markets. Innovation in retail digital payments starts to hinge on developments in wholesale CBDC as companies want to align their domestic payment infrastructure with international systems in order to save costs. As wholesale CBDCs evolve from exploratory research to practical instruments for global payments, the MGB becomes a strategically important global financial body, as significant to middle income countries as the IMF, the Financial Stability Board, and the Financial Action Task Force.
  - The MGB starts using its growing relevance to push for political outcomes on the global stage. For example, when the U.S. gets involved in a military conflict in the Middle East,

the MGB urges member countries to not allow U.S. airspace over their territories. After heated discussion among members, the MGB drafts a rule to make mBridge access contingent upon agreeing to a so-called Non-Destabilization Pact, which states that mBridge member countries cannot support "imperial aggression against weaker nations." In some cases, the MGB will ban a central bank outright but in other cases, it will just prevent the member from operating a node. The MGB gives itself discretion to determine which conflicts fall under "imperial aggression." The pact narrowly passes an MGB vote.

- Impact:
  - The United States now has to consider how other countries whose support it seeks in tense geopolitical situations will be economically impacted by MGB counter-moves. Washington is used to anti-U.S. political blocs, but never before did such coalitions have much impact on international finance.
  - CBDC issuance itself becomes a globally divisive political issue, separating the world into pro-CBDC nations that tend to be more deferential to the most influential members of the MGB, like China. Much of the innovation around finance starts to skew toward CBDC infrastructure, which is seen as having more room for growth and expansion.
  - Domestically, in the US, the political dynamics around CBDCs shift compared to the 2020s. By the mid-2030s, many U.S. populist and labor groups see CBDCs as key to better national economic opportunity, which they believe is being stifled by U.S. elites who benefit from the legacy financial system. Leaders in China, Iran, Russia, Syria, Venezuela, and New Palestine stoke these tensions and gain sway over many U.S. political dissidents who spread propaganda at their bidding in favor of CBDC systems and the goals of the MGB.

- *Impact Scenario 3: Shrinkage of U.S. Global Banking*
  - The amount of cross-border transactions going through the US-led FMI by commercial banks in middle income countries declines greatly. Correspondent banking had already become costlier for smaller economies and by the 2030s, it becomes almost prohibitively expensive for the poorest countries, causing more central banks to develop CBDCs and join the mBridge system.

- The conventional cross-border FMI system is still important and the dollar remains the leading global reserve currency, but the relevance of both is much higher for wealthier nations. The global financial system is now bifurcated, with conventional US-led banking infrastructure used mostly by a minority of high-income, highly industrialized countries and mBridge being the system of choice for the rest of the world.
- Impact:
  - U.S. global banks will focus less on serving emerging markets and developing countries. Foreign banks in those nations will still need U.S. dollars when having to facilitate transactions to U.S. firms, but the dollar will be less necessary for transactions that do not involve a U.S. or G7 counterparty.
  - U.S. sanctions will be less potent than in the 2020s. The U.S. can still influence banks who are highly dependent upon US-led FMI, but sanctions will be less disruptive for banks who mostly depend on the mBridge system. For mBridge members, the OFAC SDN list will be seen more like a set of suggestions rather than a list of prohibitions.

To Maintain Economic Statecraft, U.S. Should Prevent Global FMI Bifurcation

The number one strategic objective for U.S. policymakers who want to prevent anything similar to the above scenarios is to ensure that tomorrow's financial system does not split into a multiplicity of separate, non-interoperable infrastructure systems. Financial infrastructure has been critical to supporting U.S. national security and geopolitical influence for decades (Zarate 2013).[73] Any new system emerging will naturally be influenced by the chief parties that plan, manage, and engineer it. The U.S. should seek to influence the financial system from within it rather than from without. If a system develops separately from the US, it will be harder for the U.S. to promote its national security interests.

This does not mean that a better, more efficient cross-border payment system should not be created. It should. But the U.S. needs to be way more active in developing the vision of such a system and helping bring it to fruition. Right now, the leading architect and planner of the financial market infrastructure of tomorrow is the People's Republic of China. With its proficiency in its own CBDC pilots and its leadership in multilateral CBDC collaboration, China's central bank is becoming the go-to resource for wholesale digital finance innovation.

Right now, the leading architect and planner of the financial market infrastructure of tomorrow is the People's Republic of China.

Recommendations

The U.S. must pioneer the development of a global financial system that works for more countries. The need for the U.S. to take the lead does not necessarily mean that the U.S. should jump on the CBDC bandwagon, launch a digital dollar, and develop a central bank-run cross-border CBDC platform like mBridge. U.S. finance officials have remarked that they are evaluating the possibility of a U.S. CBDC, including what benefit it might have, and that the Fed could not launch one without a mandate from Congress. But, the evaluation that is occurring seems myopically technical. The NY Fed's involvement in Project Cedar and in the BIS Project Agora are good steps to educate U.S. central bankers about digital finance technology available to upgrade payments (BISIH September 2024).[74] Nevertheless, the U.S. needs to also articulate a clear vision for the digital financial future and assert what values are to be embedded in the system that the U.S. wants to support. This cannot be done by central bankers alone, who may tend to be technocratically focused.

The following are recommendations for the US, with the government, private sector, and civil society working in tandem:

- Organize a Digital Economic Warfare Red Cell. Officials in the U.S. Departments of Treasury and Commerce should be proactive in preventing worse-case scenarios for the future financial system by creating a team of analysts focused on digital innovation. This unit should construct CBDC wargames to identify likely developments in cross-border payments and figure out U.S. strategies to address challenges.

- Draft a values-based U.S. vision for the global digital financial future. U.S. stakeholders must define how values of openness, liberty, and public accountability should be supported in a growing internet environment where financial and personal data are more trackable and programmable. This should not be just the purview of the Fed and Treasury. The Commerce Department, which has previously stressed the need for more U.S. digital financial innovation should be part of developing this vision, as should private sector trade associations, and privacy advocacy groups (U.S. Department of Commerce 2022).[75]

- Incorporate the U.S. values-based vision into all explorations of international payment innovation. The U.S. should not shy away from CBDC exploration, but

before undertaking any new pilots, the U.S. should map out design alternatives that go beyond central bank-run platforms. It is quite likely that a U.S. values-based approach will encourage less reliance on government infrastructure and will enable market-based competition to take on a role in pilot projects. The U.S. should push for digital financial innovation pilots, without the assumption that these undertakings must require a CBDC and wholly government-run architecture like with mBridge. In particular, the U.S. should pass legislation to fully regulate U.S. dollar stablecoins, as both a priority for U.S. macroeconomic and national security interests (Massad 2024).[76]

- Increase the computer science expertise within the Fed and other U.S. financial agencies. Competing in digital financial innovation will mean creating breakthroughs in software development and advanced cryptography. Relevant research will call for economists and computer scientists to mesh their skills and their approaches to financial solutions. The Fed, Treasury, and financial regulators like the Office of the Comptroller of the Currency, the Consumer Financial Protection Bureau, and even the Securities and Exchange Commision and the Commodities Futures Trading Commission will need computer science developers to not only review smart contracts, but to program them.

- Call out the authoritarian proclivities and financial integrity risks of some CBDC efforts. The U.S. does not need to malign CBDCs categorically as a concept. CBDCs may be practical and suitable for some nations. But U.S. officials need to publicly sound the alarm around the potential for certain CBDC designs to be used to undermine human rights, stifle political freedom, and threaten personal privacy. The U.S. should argue that stewardship of the global financial system should not rest with authoritarian governments and should dissuade countries from joining technology coalitions led by such nations.

The United States can maintain strength in economic statecraft if it adapts to the technological shifts on the horizon, clarifies its own strategy, and intensifies its effort to lead in digital financial innovation. The effectiveness of U.S. economic statecraft will depend upon how well the U.S. develops its role in research and development of emerging cross-border payment innovation, sets the moral and technical standards for employing new technologies and infrastructures, and demonstrates to the world that the U.S. has the most compelling vision as well as the economic and political soundness to engineer tomorrow's financial system.

Discussion Questions

1. How might the rise of alternative financial market infrastructures impact the effectiveness of U.S. sanctions regimes, and what strategies can be employed to address these challenges?

2. How can the U.S. foster a values-based vision for the global digital financial future that aligns with its economic statecraft objectives?

3. In light of the potential challenges posed by new CBDC-to-CBDC cross border payment channels to U.S. economic statecraft, how should the U.S. adapt its sanctions and other economic coercion tools to remain effective in the evolving digital financial landscape?

4. What are the potential implications of a bifurcated global financial system, with one system led by the U.S. and another by China, for global trade, economic growth, and geopolitical stability? What worst-case scenarios are possible?

5. What role, if any, should the U.S. seek in the emerging alternative financial market infrastructures like mBridge? Should the U.S. influence these experiments from within, from without, or just let them be?

6. How might the U.S. collaborate with allies to shape the development of CBDCs and prevent the bifurcation of the global financial system?

7. mBridge appears to be more attractive to middle and low-income countries that are poorly served by the correspondent banking system. Is it inevitable that such nations are going to increasingly align with financial institutions created or favored by China or Russia.

8. Given the complexities and potential challenges associated with CBDCs, what steps should be taken to ensure data privacy and security in the evolving digital financial landscape?

9. What role should the private sector play in supporting the U.S. government's efforts to lead in digital financial innovation and maintain its economic statecraft?

10. How can the concept of "monetary sovereignty" be balanced with the need for international cooperation and interoperability in the development of CBDCs and new financial market infrastructures?

11. How should the U.S. approach the regulation of stablecoins and other private sector digital currencies to ensure financial stability and protect consumers while fostering innovation? Are these private-sector efforts a sufficient answer to concerns about alternative FMI based on CBDCs?

12. What role can international organizations like the IMF and World Bank (in which the U.S. has much influence) play in fostering collaboration and preventing fragmentation in the development of new financial market infrastructures?

13. How equipped or aware is the incoming Presidential administration around the issues raised in this paper?

Endnotes

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[1] An FMI is defined as a multilateral system for clearing, settling, or recording financial transactions, according to the Bank for International Settlements (BIS) and the International Organization of Securities Commissions (IOSCO) Committee on Payment and Settlement Systems and Technical Committee of the International Organization of Securities Commissions. 2012. "Principles for Financial Market Infrastructures." Report. https://www.iosco.org/library/pubdocs/pdf/IOSCOPD377-PFMI.pdf. Although FMI transactions can be for payments, securities, or derivatives, this paper exclusively discusses FMI for payments. In particular, the focus is on cross-border (between counterparties of different nations) payment infrastructure that supports large value payment systems, such as transactions with values worth millions of dollars involving large firms and institutions as opposed to retail payments with small-value transactions by the general public.

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payments-transformation/. Additionally, the Federal Reserve Bank of New York's New York Innovation Center (NYIC) is actively participating in international research projects to explore technological solutions. Projects like "Project Cedar" and "Project Agorá" are investigating the use of distributed ledger technology and the tokenization of central bank and commercial bank money to streamline and improve wholesale cross-border payments. These initiatives aim to reduce unnecessary frictions and enhance the overall efficiency of cross-border transactions (FRBNY 2024). Federal Reserve Bank of New York (FRBNY). 2024. "New York Fed to Participate in Joint International Research Effort on Tokenization and Cross-Border Payments." Press Release. https://www.newyorkfed.org/newsevents/news/financial-services-and-infrastructure/2024/20240403.

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Background Research - Chapter 4
Gates Forum III

U.S. Sanctions and the Global South: Navigating Networked Resistance, Competing Narratives, and Unintended Consequences

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Introduction

Economic sanctions are long-standing instruments of national power employed by the United States (U.S.) and advanced economies to coerce rogue actors to comply with international norms, deny them access to resources used to finance malign behavior, and deter would-be copycats in the future.[2] When the U.S. imposes sanctions, particularly unilateral ones, political leaders assume that America has sufficient clout to isolate a country (or entity) politically and impose economic costs to incentivize the target to change their behavior. However, the logic of this assumption is increasingly tenuous. In the unipolar moment following the Soviet Union's demise, America was an undisputed economic and political heavyweight. At that time, the U.S. could exert outsized influence over target countries that were typically much smaller economically and less connected politically. However, the geoeconomic landscape has fundamentally changed over the last two decades.

America remains an economically vibrant and politically powerful nation, but it no longer enjoys unrivaled hegemony in either of these domains. The People's Republic of China (PRC) is now the single largest trading partner to more than 70 percent of the world's countries,[3] and its Belt and Road Initiative facilitates economic, cultural, and political connectivity among roughly 150 members to date.[4] Russia has aggressively pursued economic integration with post-Soviet countries via its Eurasian Economic Union and aid to much smaller economies that have been targeted by Western sanctions, such as Syria, North Korea, and Iran, among others.[5] Moreover, the expanded BRICS+ club of 10 emerging markets, which represents "half of the world's population and two-fifths of its trade" volumes, increasingly has the means and will to resist U.S. sanctions and help others do the same.[6] Meanwhile, senior U.S. and UK political leaders have invoked the term "hedging middle" to spotlight the geostrategic importance of middle powers who guard their strategic autonomy and navigate great power competition by playing both sides in pursuit of better deals.[7] In his contribution to this research volume, William Norris argues that these "fence sitters" are an important group for the U.S. to cultivate as strategic partners to ensure the future vitality of America's economic statecraft and, by extension, the efficacy of its use of sanctions.

U.S. economic sanctions, pursued unilaterally or with a small coalition of the willing, must increasingly navigate a more contested marketplace. American policymakers often frame their use of sanctions in normative terms (i.e., advancing human rights, democratic norms, international peace, and the liberal order). Nevertheless, America's frequent use of unilateral sanctions, sometimes in coordination with a coalition of willing allies, and the propensity for sanctions to create collateral damage for target countries opens it up to criticism.[8] In an era of intensified competition, Global South elites are skeptical of the motives of Western-led sanctions or censures of authoritarian rivals. When U.S. sanctions are not carried out in conjunction with the United Nations Security Council, it is easier politically and economically for third countries to express their disapproval by doubling down on non-alignment or targets to actively counter these efforts. Third countries may also attract benefits or incur costs from a sanctions regime in ways that impact U.S. economic, security, and geopolitical interests.

Herein lies what the political scientist Joseph Nye has referred to as the paradox of American power: U.S. economic and military might is insufficient to get the outcomes it wants in the absence of cooperation with other countries.[9] Sanctions are typically thought of as an instrument of "hard power," incentivizing others to change their behavior in response to economic sticks (applying a sanction) or carrots (removing a sanction).[10] Nevertheless, sanctions are constrained or enabled by the extent of America's "soft power," its ability to attract others to willingly accept and participate in a regime even without tangible incentives.[11] An underappreciated challenge for U.S. economic sanctions is that their success relies upon a reservoir of goodwill towards America that their application has the potential to undercut.

Foreign publics and leaders' views of the U.S. sour in the face of policies seen as narrowly self-interested and "hypocritical, arrogant, [and] indifferent" towards others.[12] American policymakers are not well-positioned to combat powerful counternarratives that question the legitimacy of U.S. sanctions and portray its motives as malign. America underinvests in its strategic communications capabilities abroad,[13] overly relies on unilateral sanctions and struggles to mobilize the political will to remove previously imposed sanctions.[14] As the companion piece by Daniel Drezner in this research volume describes, ample research on the unintended consequences of sanctions over three decades has raised the alarm over negative humanitarian spillovers. U.S. policymakers' embrace of targeted "smart" sanctions (i.e., penalizing key officials or institutions rather than whole societies) has not convinced their

many detractors that American sanctions do not harm foreign civilian populations irreparably.[15] Taken together, these conditions create vulnerabilities for the U.S. in building a credible, compelling case with foreign leaders and publics for when, how, and why it uses sanctions.

This paper aims to be complementary, not duplicative, to the robust literature that already exists on the use and effectiveness of sanctions. Specifically, it focuses on understanding how international sanctions (applied by the U.S. and others) are perceived and received in low- and middle-income countries that have traditionally been sanction targets or third-country observers versus the advanced economies that have most often deployed these tools. Aside from ad hoc anecdotal observations or retrospective case studies, little systematic attention has been paid to whether, how, and in what ways attitudes differ between these groups.

In this analysis, we use the term "Global South" as an imperfect shorthand to describe an incredibly diverse set of roughly 130 low- and middle-income countries with varying political clout, economic prospects, and relationships with the U.S.[16] Some countries project more individual power than others but it is also instructive to consider the Global South as a group that has growing political and economic importance and a history of "banding together" to pressure advanced economies to change international rules, norms, and institutions that they view as being unfair to their collective interests.[17]

Capturing the universe of insights from all foreign publics and leaders across the Global South on this topic is infeasible. Instead, this paper offers an imperfect bellwether: a sample of 366 articles written by scholars from 71 low, middle, and high-income countries on sanctions from Scopus, a multidisciplinary abstract and citation database containing 94 million records of research articles. An initial search of the database yielded 2,014 relevant articles. The final sample includes 100% of the articles with authors from low- and middle-income countries (204), along with a random selection of 20% of the articles from authors to represent two other groups: the U.S. and Russia (93) and other high-income countries (69). Box 1 provides more information about how this sample of articles was selected and its composition.

There are limitations to the views captured in the Scopus database and as those represented here. In many parts of the world, low levels of media and academic freedom likely skew what local scholars feel comfortable putting into the public domain. The reliance on English

language articles likely also colors the sample. Despite these limitations, this paper provides a useful first step forward in helping U.S. policymakers understand how attitudes towards sanctions among sanctioned, sanctioning, and third countries may enable or constrict their efforts. Scholars may not directly control the levers of power in their countries, but their universities can be influential in training the next generation of policy elites and advising incumbent leaders. Scholars are also influenced by the broader policy discourse in their countries when it comes to choosing what questions to answer, interpreting evidence, and formulating preferences. In this respect, understanding how scholars converge or diverge on sanctions is a window into the attitudes of the societies of which they are a part.

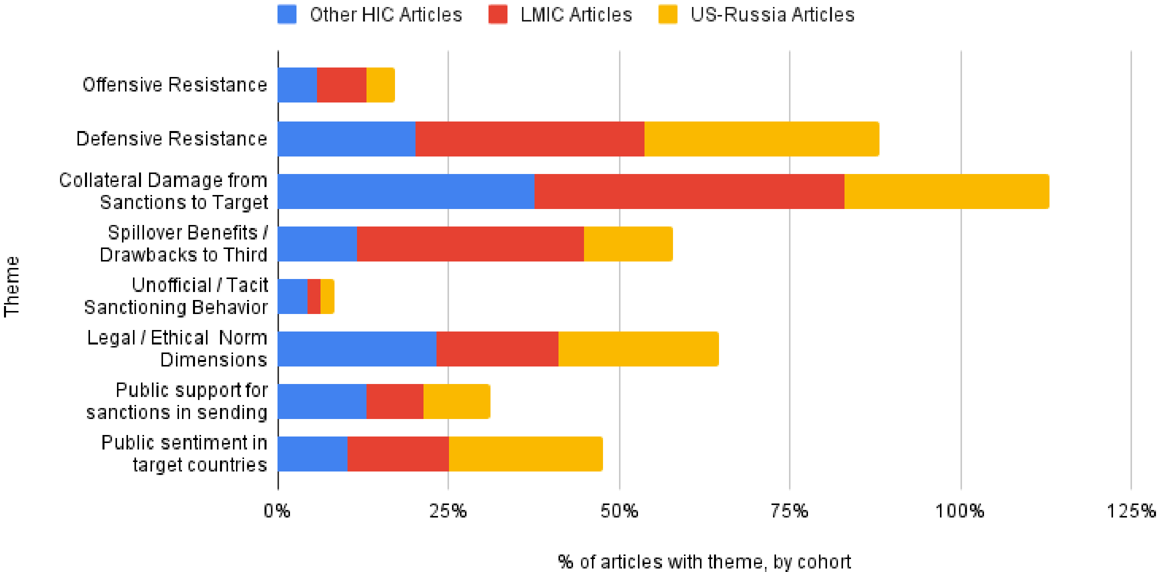
The remainder of the paper draws upon this evidence base to speak to three forward-looking challenges that U.S. policymakers must navigate to employ sanctions effectively in an era of heightened competition. Section 2 explores the phenomenon of networked resistance—target countries embracing offensive and defensive strategies as a means of defying pressure from U.S. sanctions. Section 3 examines the power and proliferation of damaging counternarratives visible across target countries, third countries, and high-income countries that risk fraying fragile coalitions of senders. Section 4 looks at how scholars speak to the unintended consequences of sanctions that persist despite the growing pivot to targeted rather than comprehensive sanctions, including the effects on targets and third countries. Section 5 concludes with implications and options for U.S. policymakers to consider as they look to strengthen how they deploy sanctions as part of a robust foreign policy toolkit in an era of heightened competition.

Box 1. Brief Methodology Note
The research team ran queries of the Scopus database in order to identify three lists of relevant articles related to “sanctions AND economic” based on the geographic location of the author’s host institution. Group 1 included authors based at host institutions in the U.S. and Russia (1933 articles). These were treated separately given the volume of articles written that included authors from host institutions in those two countries. Group 2 included articles from other high-income countries (2513 articles). Group 3 included articles from low- and middle-income countries (892 articles). In instances where an article was a collaborative effort across authors from across these three groups (e.g., an article written by scholars from host institutions in France, Morocco, and the U.S.), they appeared in all the relevant lists.

A manual review of the titles and abstracts was conducted to determine the likely relevance of the articles to the topic of this paper, which reduced the list of articles to 2,014: (i) group 1 (467 articles); (ii) group 2 (343 articles); and group 3 (204 articles). A final sample of articles for a more in-depth review was constructed as follows. Given the unique interest of this paper in surfacing Global South perspectives, we overweighted articles from this group by taking 100% of the low- and middle-income country articles (204). We randomly selected 20% of the relevant articles for each of the remaining two groups: 93 U.S. or Russia articles and 69 other high-income country articles. No time period filters were applied, and the final sample includes articles from as early as 1964 through as recent as 2024.

Basic information about each article was documented to summarize the authors' key findings about the sanctions (e.g., impact, compliance, effectiveness, secondary effects), methods, policy recommendations, perceptions, and scope (e.g., sanction senders, targets, dates, reasons, types). The research team systematically tagged articles as to whether they corresponded to one or more of eight emerging themes: (i) offensive resistance—imposing hurt on the sender; (ii) defensive resistance—curbing damage to the target; (iii) collateral damage for target countries; (iv) spillover benefits or drawbacks to third countries; (v) unofficial or tacit sanctioning behavior by competitors; (vi) legal/ethical norms; (vii) public support for sanctions in sending countries; and (viii) and public sentiment in target countries regarding sanctions, their senders, and policy change.

Authors were categorized into one of three country cohorts on the basis of their listed organizational affiliation and location. For example, if an author listed their affiliation as the School of Governance and Economics of Rabat in Morocco, the article would be included within the list of authors and articles from low- and middle-income countries. Figure 1 summarizes the frequency of articles mentioning a given theme across the three cohort groups: U.S. or Russian scholars; other high-income country (HIC) scholars; and low- and middle-income country (LMIC) scholars.



Source: Scopus Database, as categorized by the author and supporting AidData staff. Notes: HIC refers to high-income countries other than the U.S. and Russia (whose income status as defined by the World has fluctuated between high and middle-income).

Challenge #1. Target Countries Have Evolved From Isolated Defiance to Networked Resistance

Large and small target countries have become emboldened in defying U.S. sanctions using offensive and defensive resistance strategies. With offensive countermeasures, target countries seek to retaliate and impose economic or political harm on the sender to reduce its resolve. Comparatively, defensive countermeasures aim to curb the sender's ability to exact damage on the target's economy and position sanctions as futile in a bid to deter future actions. Some strategies are familiar, long-standing practices, such as the use of retaliatory tariffs or import substitution tactics. Others are relatively newer forms of resistance such as Russia's co-optation of a fleet of "gray" or "shadow" vessels after the Ukraine invasion to "obscure [their] origins and ownership" to facilitate sanctions busting[18] and rumors of a new BRICS currency that may or may not bear fruit.[19]

Who uses these offensive and defensive resistance strategies? Daniel McDowell, a contributor to this research volume, examines efforts by China and Russia to adopt alternative currencies to the U.S. dollar for cross-border payments to mitigate their risks in the event of sanctions, while simultaneously exacting hurt against an adversary. Although larger economies may more easily employ these tactics, they are not necessarily limited to Russia and China. In her book, Autocracy Inc., the American journalist and historian Anne Applebaum, argues that the leaders of autocratic nations have strong incentives to "imitate one another" and forge links with other like-minded players within larger networks to boost their individual and collective bargaining power.[20] In this paper, we analyzed the extent to which and how scholars across 71 low, middle, and high-income countries talk about these passive and active resistance strategies as applied across a wider cross-section of actors.

Offensive Resistance: Imposing Hurt on the Sender

Large economies like the PRC and Russia have ample means to use offensive countermeasures to impose economic costs on the U.S. and other senders in response to

direct unilateral or secondary sanctions. The PRC has enacted a series of eight main "anti-sanction" laws, the tempo and scope of which have grown since 2020; the most ambitious may be the Anti-Sanctions Law of 2021 seen as a "blocking statute, retaliatory regime, and proactive sanctions legislation rolled into one.[21] Chinese scholars have argued that the PRC should exploit contradictions in sending countries' policies and actions to their advantage.[22] Russia has employed retaliatory measures from travel and import bans to curbing arms shipments and energy supplies against countries who sanctioned it over the annexation of Crimea, meddling in elections, poisoning of diplomats, and the invasion of Ukraine.[23] The Kremlin has also been opportunistic in using sanctions as an animating issue for the Russian public as to why they should reject European values and instead embrace a unique and distinct Russian identity.[24]

Chinese scholars frame U.S. financial sanctions against Huawei and other state-owned enterprises as a trade war between the nations. America uses economic coercion to slow the pace of the PRC's growing dominance, blurring the lines between "run-of-the-mill primary sanctions with protectionist tariffs, export controls, and secondary sanctions."[25] The net result, they say, is a vicious cycle of escalating economic costs for both countries: consumers and businesses pay more to import goods and services from alternative suppliers, while tariffs and restrictions on technology transfers, reduce trading revenues.[26] Nevertheless, Chinese scholars advocate for peer countries to emulate the PRC's proactive use of anti-sanction measures to stand up for themselves in a world of "chaotic competition."[27] This strategy of hardening oneself as a target may have a deterrence effect on future sanctions, for one experimental study found that public support waned to support sanctioning the PRC when people were primed to think about the potential economic consequences to their own country of doing so.[28]

Russian scholars tend to view the Kremlin's use of retaliatory sanctions as justifiable to reduce Western pressure, help companies adapt, and mitigate economic hardship for its population. Some credit Russia's food embargo against countries that introduced or supported sanctions related to its annexation of Crimea, as "effective in curbing the impact of Western sanctions and prompting economic recovery,"[29] and helpful in producing a reorientation in Russia's domestic economy, accelerating modernization in the agro-business sector in ways to increase profits and promote resilience."[30] Scholars in China argue that "retaliation is Russia's optimal choice" as the Kremlin's use of travel bans and import bans on food, used cars,

clothes, and consumer products would impose a higher cost on its adversaries than on Russia.[31]

The Kremlin's perceived success in employing retaliatory countermeasures likely fed into its decision to double down on this strategy, imposing a farther-reaching import ban against countries it deemed "unfriendly" in 2021 and enlarging this list in 2022 to include all who had joined a new wave of sanctions against Russia in the face of its invasion of Ukraine.[32] However, since Russia's trade with Europe was already strained by this point, European scholars found limited economic impact from the additional countersanctions on their economies, aside from specific sectors like the dairy industry.[33]

Although larger economies may be more likely to employ offensive countermeasures at scale, smaller players have also contemplated their ability to employ coercive leverage in other ways to impose costs and reduce resolve in sending countries as to the continued merits of sanctions. Iranian scholars have argued in the past that Iran could consider threatening to cut off oil exports or disrupt the transit of goods through the Strait of Hormuz.[34] South African peers have argued for African nations to reevaluate their economic relations with the U.S. and EU, reduce reliance on the U.S. dollar, and consider a petrodollar system in solidarity with oil-rich nations on the receiving end of Western sanctions.[35]

In a global study of 150 countries in the United Nations over two decades, scholars found evidence to support the idea that target countries use General Assembly sessions to exact political retaliation on sending countries, shifting blame for sanctions on the sending countries and voting in direct opposition to the preferred positions of sanctioners on a number of issues.[36] However, there are also misgivings about the drawbacks of aggressively employing countersanctions to impose hurt on sender countries. For example, Indian scholars saw clear reputational downsides from Russia's policy of ignoring international intellectual property protections to privilege its own domestic firms.[37]

Defensive Resistance: Curbing the Sender's Ability to Exact Damage

One of the immediate priorities for target countries is dealing with macroeconomic volatility in the face of international sanctions: combatting runaway inflation, stabilizing exchange rates, protecting financial reserves, guarding speculative attacks (i.e., short-selling currencies and stocks), and ensuring continued access to capital for the public and private sector. Scholars

studying Russia's response to the recent wave of post-Ukraine invasion sanctions credit the Central Bank of Russia's (CBR) rapid introduction of a series of defensive measures—suspending trading on Moscow's stock exchange, increasing the key interest rate, imposing strict capital controls to reduce flight risk—as consequential in reducing the impact of Western sanctions and hastening the economy's recovery.[38] In fact, scholars studying CBR's actions over the last decade posit that the Kremlin likely anticipated that Western nations would sanction Russia over its aggressions towards Ukraine and was able to preemptively harden itself as a target.[39]

In the long term, Global South scholars have written about numerous possibilities for developing "resistive economies" that are more immune to sanctions pressure.[40] One strategy is reducing dependence on the U.S. dollar for financial transactions and exchange reserves through diversifying reserves in gold or alternative currencies, adopting advances in financial technologies (fintech), creating a national payment system, or adopting a competitor's payment system like China's digital renminbi (RMB) or the Russian rouble.[41] Another approach is to invest in domestic intellectual capital to curb dependence on international expertise.[42] Target countries employ import substitution—ramping up domestic production of previously imported goods—with some explicitly citing the PRC's "Made in China 2025" initiative as an inspiration[43] and doubling down on centrally planned economies.[44] Numerous studies examine how such efforts to boost domestic production and demand have increased target country resilience by accelerating underperforming sectors' modernization, liberalizing economies to incentivize innovation in new areas, and positioning domestic firms to displace foreign competitors.[45]

Low- and middle-income countries have been entrepreneurial in exploring and implementing myriad sanctions-busting tactics to great effect in evading trade restrictions—from old-fashioned smuggling and transshipment of goods via third countries to more sophisticated efforts to set money laundering fronts, special purpose vehicles, and indirect firm ownership.[46] The fact that Iran was able to utilize the Iranian diaspora in the EU and a network of Iranian grocery stores in the Eurozone as an enabler for its sanction-busting activities is a case in point for how the openness of Western economies to immigration and trade can ironically become a vulnerability that is willingly exploited by entrepreneurial target countries.[47] Although sector-specific sanctions can be desirable in curbing the negative economic fallout for target countries, examples from Iran, Russia, and (much earlier) Rhodesia

indicate that they are willing to adapt by pursuing secondary industrialization in alternative sectors that do not face similar export bans.[48]

For many Global South scholars, target countries should prioritize survival over gamesmanship, putting proactive policies in place to curb negative spillover effects for the poorest and most vulnerable. Studies argued for stronger social safety nets, food assistance, and other anti-poverty schemes to address common sanction repercussions of unemployment, rising prices, and household economic insecurity.[49] Health system strengthening was a common cry, particularly with regard to the negative impact of sanctions on COVID-19 response and access to essential medicines with studies advocating for exempting pharmaceutical companies and other medical suppliers from customs and tax exemption protections and loan forgiveness or deferment.[50] Others urged target country governments to enact stronger regulations to curb rising carbon emissions, reinvestment strategies to promote production in low-polluting industries, and support the development of renewables and clean energy alternatives.[51]

Challenge #2. U.S. Sanctions are Vulnerable to Damaging Counternarratives

China and Russia, America's competitors in a fierce fight for global supremacy, frame U.S. unilateral sanctions as desperation and jealousy on the part of a weakened global who wants to curb their rise. For low- and middle-income countries, U.S. unilateral sanctions are thinly veiled neocolonialism or neoimperialism in a bid to keep less powerful nations under its thumb. Nor is America immune to criticism from its allies in Europe and Asia, where scholars from other high-income countries express growing unease with the ethics and legality of U.S. unilateral sanctions and perceived economic costs to their own societies risk fraying fragile coalitions of senders.

To what degree should U.S. policymakers care about these damaging counternarratives? An isolated leader's propaganda or disinformation campaign to promote alternative narratives about U.S. sanctions may not warrant much attention from American policymakers at all. Citizens within these regimes and foreign publics abroad are likely to discount these narratives, particularly if they see the autocrats as part or wholly to blame for the sanctions in the first place. There are other circumstances, however, when competing narratives are more than an annoyance and can metastasize into something that can achieve far greater damage to America's reputation. When foreign publics view the U.S. as inconsistent in what it says and does, this dissonance provokes doubt about America's intentions that add fuel to grievances in ways that transform one man's conspiracy theory into a much pervasive counternarrative. For example, one recent controversy across the Global South has been contrasting U.S. justifications to sanction Russia over its invasion of Ukraine versus the criticized non-response to Israel's aggressions in Gaza.

Competitive Counternarratives: The U.S. Seeks to Curb Other's Rise

Are U.S. sanctions merely reinforcing hegemonic narratives or disrupting the rise of competitors? This question was raised with regard to America's closest competitors for global dominance and commonly characterized the U.S. as weaponizing sanctions to inflict unfair damage against its rivals.[52] For example, in an in-depth study of U.S. secondary sanctions

against Huawei and other Chinese state-owned enterprises, Chinese scholars argued that Western media coverage was biased and served to reinforce a racist narrative that promoted the idea that China is a threat to U.S.and Western interests.[53]

Similarly, Malaysian scholars conducting a discourse analysis of Chinese netizen posts on Zhihu (a social question-and-answer website), found that U.S. sanctions against Chinese companies were associated with a sharp uptick in nationalist sentiment. The study found that the majority of Chinese netizen posts believed the U.S. sanctions to be motivated by the desire to disrupt China's rise (53 percent), was tantamount to outright war (56 percent), and demonstrated anti-U.S. sentiment (62 percent).[54] Relatedly, Russian scholars posited that "anti-Russian sanctions" employed by the West were motivated primarily by competition and jealousy of Russia's economic success. Moreover, Western nations were the real instigators of the Ukrainian crisis and armed conflict through their ill-advised Eastern Partnership Policy.[55]

Imperialist Counternarratives: The U.S. is an Neo-colonial Power

Are sanctions a form of neo-colonialism? This is a question that is a recurring theme across scholars that feeds into a broader discourse in the Global South that is skeptical about normative framing of sanctions to justify great powers imposing costs on weaker ones to their own benefit. African scholars have argued that Western sanctions have harmed the lives and livelihoods of households in poorer countries in an "attempt to validate the…quest for perpetual domination of the 'Third World.'[56] For example, Western sanctions against the ZANU PF-led government in Zimbabwe were portrayed as base retaliation for land reform that disenfranchised the white population in the country, rather than concern for human rights.

This line of thinking is not limited to small economies and extends to emerging powers like the BRICS. Indian scholars saw nuclear non-proliferation sanctions against their country as the failure of the West to practice strategic empathy in acknowledging India's reasonable desire to have a nuclear deterrent to hedge against aggressive neighbors.[57] Russian scholars questioned the use of unilateral sanctions as Western countries seek to undermine their nation's sovereignty[58] and national security.[59] Even U.S. scholars acknowledge the power of a perceived national security threat in deterring a target country's willingness to change its behavior in the face of sanctions[60] and increasing support for the government's continued defiance.[61] Moving from security to economics, South African scholars have made the case

that African countries should reevaluate their relationships and dependence upon the West, which makes them more vulnerable to such pressures.[62]

America’s defenses against these imperialist counternarratives are weakened by a strong perception in low- and middle-income countries that Western countries are capricious in seeking their own gain at the expense of others. Scholars from Nigeria, Turkey, Serbia, and the U.S. have found evidence that sanctions affect public opinion in target countries in ways that run counter to the sender's intent.[63] Sanctions have been associated with increased public opposition to the U.S., driven by the belief that these economic sticks disproportionately affect those out of power: punishing the middle class and hurting everyday citizens.[64] There have also been instances of declining trust reported between financial and business counterparts in the sender and target countries over follow-through on contractual obligations and respect for intellectual property.[65] Collateral damage from sanctions on the civilian population has the effect of exacerbating grievances towards the sending country for economic hardship,[66] even to the point that local populations may exhibit a greater willingness to support or condone international terrorism.[67]

Lack of certainty or clarity on the sender’s true intent for the application of sanctions was associated with lower public support for policy change in the target country,[68] particularly in the presence of a strong counternarrative that it is the sender that benefits at their expense.[69] The fact that sending countries can choose to escalate or de-escalate pressure as they wish, feeds into a narrative that sanctioners are capricious—continuously ‘redefining’ the rules of the game regarding the goals and required behavior change required for sanctions relief.[70] In this view, the U.S. withdrawal from the Joint Comprehensive Plan of Action for Iran (JCPOA, also known as the Iran nuclear deal) was particularly damming in revealing ‘true intentions.’ This episode reinforced the perspective that the sanctions regime was always about America’s self-interest in winning concessions rather than a serious commitment to helping Iran rebuild its economy and rejoin the international community. Both the target country and America’s allies viewed the U.S. withdrawal as a betrayal that exacerbated economic instability in Iran and negatively impacted firms in other countries affected by secondary sanctions.[71]

Regardless of a sender’s stated intentions to target those in power, all too often local populations in target countries are the real losers in the face of international sanctions. One of the strongest points of convergence in the discourse of scholars in the Global North and

Global South is the recognition that sanctions created substantial and far-reaching collateral damage on households across every facet of society: health outcomes (e.g., access to medicine, life expectancy, food insecurity, pandemic control);[72] clean energy and the environment (e.g., carbon emissions, climate vulnerability, energy insecurity, green innovation);[73] economic wellbeing (e.g., education mobility, standard of living, livelihoods, economic security, poverty, inflation);[74] industrial productivity (e.g., firm performance, tax revenues, sustainability, innovation, modernization, privatization);[75] and governance (e.g., ethnic violence and discrimination, the militarization of interstate conflicts, corruption prevalence, terrorist group survival, elections, human rights, rule of law).[76]

Law and Order Counternarratives: U.S. unilateralism is illegal and unethical

Given the strong body of evidence on the negative humanitarian spillovers of comprehensive sanctions, there has been a movement to advocate for the use of more targeted "smart" sanctions that have a sharper focus on penalizing key officials or institutions and minimizing harm to civilian populations.[77] This is insufficient for a minority that feels the use of sanctions—whether comprehensive or targeted—should be outlawed on the basis of humanitarian and ethical grounds, with countries instead embracing economic carrots (e.g., trade, aid, investment) rather than sticks to promote peace and development.[78]

More commonly, scholars across countries of all income levels acknowledged that sanctions were valid when they complied with international law.[79] However, they argued for better regulation of sanctions by international organizations such as the United Nations or the World Trade Organization, along with strengthening capacity and frameworks for these institutions to effectively monitor sanction compliance with international laws, enforce internationally imposed limits, and safeguard global progress towards the Sustainable Development Goals.[80] Some scholars advocate for better procedures for how to remove sanctions and the introduction of default sunset clauses which remove the powerful inertia factor in sanction regimes that make them easier to apply than take away.[81]

A number of scholars from the Global North and Global South highlighted the importance of additional measures to mitigate unintended negative consequences of sanctions for target countries.[82] For example, some studies argued for the mainstreaming of intentional human

rights impact assessments to be conducted within the process of designing sanctions and for social workers to be more active in monitoring the enforcement of sanctions regimes to mitigate negative outcomes.[83]

Some types of sanctions were viewed as more problematic than others. Unilateral and secondary (extra-territorial) sanctions, such as those frequently employed by the U.S., provoked the most negative reactions with Global North and Global South scholars questioning their legality under the UN Charter and contravention of sovereignty and non-intervention norms.[84] Aid suspensions are another form of sanction that provokes ample debate on ethical and humanitarian grounds. While the presence of development assistance may indeed "shield targeted countries" from economic pressures, the removal of this aid may exacerbate the negative spillover effects for the most vulnerable in society.[85]

Unintended Consequences: Third Country Enablers, Unofficial Sanctions, Target Country Isolation

Targets of sanctions often view third countries as critical enablers of their ability to decouple from reliance on the West and reroute trade and foreign direct investment flows from sanctioning countries to more sympathetic old allies or new friends.[86] Even when sanctions succeed in isolating a target regime from the prospect of sanction-busting help, there numerous examples in the sample articles of scholars citing evidence that isolation can backfire, making countries more defiant and pushing them into greater dependence on competitors that do not require unpopular behavior change.

Although the U.S. and the EU have traditionally been among the most prolific senders, sanctions are not limited to use by democracies. Over the last two decades, America's closest competitors in the race for global supremacy, Russia and the PRC, have demonstrated a growing willingness to experiment with the use of economic coercion, albeit with some uniquely authoritarian characteristics. For example, Audrye Wong, in a companion piece in this research volume, focuses on how Beijing has weaponized the buying power of its large population and growing middle class via nationalistic consumer boycotts to deter countries and companies from engaging in policies it views as counter to its interests. Leveraging the sample of articles from Scopus we can assess how scholars across 71 low, middle, and high-income countries talk about these dynamics as applied across a wider cross-section of actors.

Third Countries: Sanction Spillover Benefits and Drawbacks

Western sanctions have triggered a redistribution in trade and investment to sympathetic destination markets including China, India, Russia, Turkey, United Arab Emirates, Central Asia, and transition economies.[87] Additionally, governments such as Myanmar, Venezuela, Syria, Iran, Zimbabwe, and North Korea rallied sympathetic allies such as Russia or the PRC to

provide economic assistance (aid or debt) to withstand sanction pressure or counteract the costs of aid suspensions.[88]

These shifting relationships allow targets to withstand sanction pressures at the moment and undercut future restrictive measures by diluting the economic costs.[89] Third countries can benefit from lucrative trade and investment deals at the expense of the U.S. and its allies. Studies of the relationship between trade flows, sanctions, and third countries indicate that this is not an empty threat but an empirical reality, with gains accruing to China, Russia, UAE, India, and Turkey as they capture economic activity redirected from sending countries such as the U.S. and EU, for example.[90] This support can create new challenges. Zimbabwe is a case in point, where scholars lament the country's Look East Policy (LEP) for opening the door to Chinese investment that hurts the economy and promotes indebtedness.[91]

Of course, third countries must also navigate less rosy side effects from sanction-induced distortions in the global economy. Scholars have cited a number of pitfalls experienced by third countries as a result of sanctions that they did not sign on to including rising prices from shortages in global commodities (e.g., fuel, food, metals);[92] increased uncertainty that affects financial markets (e.g, stock and bond prices; exchange rate volatility); [93] disruptions in international supply chains and transportation networks;[94] and depressed cross-border economic activity (e.g., tourism, labor migration, economic integration).[95] The extra-territoriality of U.S. secondary sanctions, which penalize firms for engaging in normal financial or trade transactions with sanctioned countries or companies is a source of discontent for third countries over financial losses, inability to diversify trading partners and suppliers, along with slowed growth.[96] Third countries are also wary of non-economic byproducts from sanctions such as the potential for cross-border spillovers of conflict, terrorism, and human insecurity;[97] along with rising geopolitical tensions and threats to regional stability.[98]

Great Power Competition: Quid Pro Quo Compliance and the Proliferation of Informal Sanctions

There is an emerging pro-sanction discourse among BRICS+ powers as they become more influential in world politics and see the utility of this tool in their own foreign policy arsenal.[99] According to the Global Sanctions Database, Russia and the PRC stand out as the two

non-democracies among the list of top 10 senders of unilateral economic sanctions (e.g., trade, travel, and financial) by frequency between 2013 and 2022.[100] The Kremlin's increased use of retaliatory sanctions to impose hurt on the U.S., EU, and other countries who sanctioned Russia over the last decade was profiled in section 2. The PRC's use of economic coercion is even more prolific. Although its stated policy rhetoric is to oppose official sanctions, a new dataset (the Threat and Imposition of Economic Sanctions, TIES) identifies 135 cases where the PRC was the sender of unilateral economic sanctions between 1949 and 2020.[101]

The majority of cases involving the PRC were examples of tacit or unofficial sanctions (e.g., nationalist boycotts, arbitrary technical requirements, watchlist of unfavorable countries or firms) that allow for plausible deniability regarding the state's involvement. However, some were more explicit bans on certain types of symbolic goods.[102] Examples of PRC target countries include South Korea, Japan, Taiwan, Mongolia, and Norway.[103] Most often these sanctions sought to penalize countries or firms for positions counter to Beijing's objectives or preferred narratives related to Taiwan, Tibet, and Xinjiang or which are seen as undercutting the PRC's aspirations to be the sole security provider in Asia (e.g., retaliation for South Korea's hosting of Terminal High Altitude Area Defense, THAAD, system).

Target Countries: Perverse Incentives of Isolation to Stoke Defiance

Scholars in the Global North and Global South argue that cultural proximity, historical relationships, and trading relationships between the sender and the target country are associated with the effectiveness of sanctions in bringing about desired policy change.[104] Target countries and companies are more likely to comply when the sender is a major trading partner (or aligned with the intent of the target's major training partners), has a comparative edge in that trading relationship, and there are few alternatives.[105] In fact, this is one of the main rationales for pursuing multilateral sanctions under the UN framework, as scholars attribute successes in reducing state support for terrorism in Libya and Sudan to the participation of a large number of UN countries that had sufficient economic clout and political legitimacy to break through to local leaders more convincingly than the U.S. could achieve on its own.[106]

Conversely, perceived isolation in the target country from the sanctioning country and the international community reduces their malleability to economic pressure and limits the sending country's knowledge and visibility of the local political economy, inhibiting the design of effective sanctions.[107] There may be long-term consequences that endure after a sanction regime ends in terms of differing policy positions in fora such as the United Nations and a distrust that impedes future cooperation.[108]

Beyond trade, development assistance ('aid') offers another channel to minimize isolation and sustain limited relationships with a target country in ways that can create the right conditions for sanctions to succeed. For example, several studies have found compelling evidence that investing in a robust political opposition, independent civil society, and media freedoms play critical roles in the formation of domestic pressure groups to hold local governments to account for policy change to reduce the costs of sanctions.

Such investments, facilitated by continued aid to non-government actors, may also have the power of off-setting damaging counternarratives about sanctions, increasing support for the sender, curbing the government's ability to shift blame on foreign actors, and stoking public support for policy change.[109] In the absence of such aid, dictators exploit the lack of domestic pressure groups to deflect blame for the sanctions, ignore the costs borne by households, and even trigger a surge in support for the leader.[110]

The prospect of resuming full economic and political relations with the international community can be a powerful incentive for target countries and companies to change their behavior, but only if they see a realistic path to the phased reduction or removal of sanctions. Unfortunately, the power of damaging counternarratives and the poor track record of senders in removing sanctions create perverse incentives for foreign leaders and publics who do not see a credible 'exit ramp' for sanctions relief as a reward for good behavior, which reduces their incentives to change.[111] In fact, scholars have pointed to the negative repercussions of skepticism regarding whether sanctions can be lifted—from heightened risks of kinetic conflict to greater public pessimism about the possibility of easing international tensions.[112]

Conclusion

This paper surfaces three forward-looking challenges that U.S. policymakers must navigate to employ sanctions as part of a robust foreign policy toolkit in an era of heightened competition: networked resistance, damaging counternarratives, and unintended consequences. The insights in this paper lend themselves to three areas for policy action by U.S. policymakers in the future with seven specific opportunities for Gates Forum conferees to consider as they propose a broader menu of reform options.

First, U.S. policymakers must update their strategic calculus to navigate a new reality: target countries are no longer passively defiant in isolation but increasingly networked with other willing partners in their resistance to sanctions. By extension, the U.S. toolkit needs a refresh and expansion to undercut the efficacy of retaliatory anti-sanctions, that seek to impose hurt on the sender, and defensive countermeasures, that aim to curb the impact of sanctions on the target economy. The U.S. could also play a more proactive role in monitoring and disclosing information about the motives, means, and influence of opaque economic coercion tactics used by Russia, the PRC, and other authoritarian regimes, as well as helping target countries build resilience to these overtures.

Second, to rise to the challenge of combating harmful counternarratives, U.S. policymakers must reinvest in America's strategic communications capabilities and clearly articulate its goals and criteria for applying or removing sanctions. The U.S. should reevaluate its actions to root out inconsistencies between its rhetoric and actions that can unintentionally foster distrust. Moreover, U.S. leaders should put in place mechanisms that make it easier to remove or reduce sanctions (e.g., sunset clauses) for a credible exit ramp, shift from unilateral to multilateral efforts when possible, and mitigate collateral damage to target countries (e.g., humanitarian impact assessments).

Third, U.S. policymakers should use the entire suite of tools in their economic statecraft arsenal to apply pressure but avoid complete isolation of target countries and companies, as this merely propels them into the arms of third-country enablers or fans the flames of defiance. Patient aid in investing in the capacity of local pressure groups (e.g., civil society,

political opposition, independent media), ideally before but also after, employing economic sticks could be consequential. Maintaining a minimum viable level of trade linkages and people-to-people relations are important life-lines that serve as tangible reminders of the benefits to their country of resuming normal economic relations.

Seven Specific Opportunities for Action

- Opportunity #1: The White House could convene an advisory committee or panel of respected scholars, practitioners, and policymakers familiar with the tactics employed by Russia, China, and other actors to evade U.S. sanctions, engage in retaliatory measures, and employ explicit or unofficial sanctions with third countries. The advisory committee could investigate, deliberate, and propose new strategies and approaches that U.S. agencies like State, Treasury, and Commerce can use to make it more difficult for target countries to evade sanctions and help allies build resilience to economic coercion by authoritarian actors.

- Opportunity #2: The U.S. China Economic and Security Review Commission could commission and publish an in-depth report examining the motives, tactics, and outcomes of the PRC's increasing use of offensive and defensive countermeasures in response to U.S. sanctions pressure, along with unofficial sanctions on third countries. The report could include an assessment of U.S. and allied vulnerabilities to these measures and recommendations for how the U.S. should respond. The report could be accompanied by a public hearing to raise awareness among U.S. policymakers and the public about these issues and briefings for Congressional leaders on relevant committees to discuss and overcome vulnerabilities. A parallel effort could be pursued looking at similar issues related to Russia's use of these same tools.

- Opportunity #3: Congress could utilize future authorizations and appropriations related to renewals of the "Countering the PRC Malign Influence Fund" and "Countering Russian Malign Influence Fund" to include an explicit emphasis on programming that produces trustworthy data and evidence to monitor and publish information opaque economic coercion tactics including the use of unofficial and explicit sanctions used by Russia, the PRC, and other authoritarian regimes, as well as builds the capacity of foreign publics to use this information to mitigate their vulnerabilities and cultivate resilience to these overtures.

- Opportunity #4: The White House could mandate the three agencies with dedicated units for implementing sanctions—Treasury's Office of Foreign Assets Control (OFAC), State Department's Office of Economic Sanctions Policy and Implementation (TFS/SPI), and Commerce's Bureau of Industry and Security (BIS)—to institute annual reviews to assess the status, cost, progress, and likelihood of success in achieving their stated objectives for active U.S. sanctions.[113] If reviewing each sanction regime on a yearly basis is untenable given current staffing levels, agencies could propose a rotating review where each sanction is reviewed on at least an every three-year basis. Reviews could be documented and reported to the President, the National Security Council, the National Economic Council, respective agency leaders, and Congress. They could include clear recommendations for the termination of sanctions where sufficient progress has been made and changes to a sanctions regime where the likelihood of success is unlikely.

- Opportunity #5: The White House could convene a Task Force comprised of agency, congressional, private sector, and civil society representatives to propose recommendations for how the U.S. will institute transparent, credible, and rigorous monitoring and assessments of the humanitarian impacts of its unilateral sanctions.[114] The Task Force could deliberate whether and how the U.S. should voluntarily adapt or adopt the humanitarian impact monitoring and assessment methodology proposed in September 2024 by the UN Special Rapporteur on the Negative Impact of Unilateral Coercive Measures on the Enjoyment of Human Rights.[115] The Task Force could also recommend guidance for the best way for U.S. agencies to incorporate trusted civil society voices into the process of assessing, documenting, and mitigating the negative humanitarian impacts of U.S. unilateral sanctions (e.g., joint monitoring efforts, independent third-party evaluations, input in the design of new sanctions to mitigate humanitarian impacts).

- Opportunity #6: The State Department's Bureau of Public Affairs, through its Office of International Media Engagement (which oversees six regional hubs that engage international audiences through traditional media and social media), Foreign Press Centers, among other assets could develop media outreach and educational programming to increase the familiarity of foreign journalists and experts about how U.S. sanctions policies operate. Ideally, these proactive strategic communications

efforts could emphasize steps that the U.S. is taking to improve effectiveness, increase accountability and transparency, and curb the negative impacts of its unilateral sanctions.

- Opportunity #7: The 2022 passage of UN Security Council Resolution 2664, with support from the Biden Administration, provided legally binding "carve-outs" or exceptions that aim to reduce the impediments to the conduct of humanitarian operations with populations in sanctioned countries, while including protections against "aid diversion" by terrorist groups or sanctioned individuals.[116] However, the effectiveness of this resolution ultimately hinges upon how well the U.S. implements and communicates changes to its sanctions policies and procedures to incorporate this greater flexibility, across the interagency, Congress, and non-government actors. The White House could commission an interagency review to provide an inventory of steps the U.S. government has taken to implement Resolution 2664 within its sanctions policy to date, whether and how these steps have produced improvements in the ability of U.S. humanitarian agencies are able to deliver life-saving assistance in sanctioned contexts and propose specific recommendations for additional changes needed to improve usage of these carveouts in future.

Discussion Questions

- How might the U.S. best engage “hedging middle” or “fence-sitting” countries to support rather than undercut U.S. sanctions, given their outsized influence as third-country enablers or in supporting networked resistance? Who are the most important players to prioritize—and why?

- In what areas is the U.S. most vulnerable to retaliatory sanctions, unofficial sanctions, or other tactics of economic coercion commonly employed by the PRC, Russia, and other authoritarian regimes? How could the U.S. best mitigate its risks in these areas?

- How can the U.S. best provide practical support to other countries to build their own resilience in the face of retaliatory sanctions, unofficial sanctions, or other tactics of economic coercion?

- What are the most persistent and problematic counternarratives about U.S. sanctions that have taken root within low- and middle-income countries? Why and how are they spread?

- What areas of low-hanging fruit might exist for the U.S. to cooperate with like-minded allies to improve how low- and middle-income countries perceive and experience its unilateral sanctions?

- Under what conditions should the U.S. reduce or remove sanctions? What prevents the U.S. from doing so when appropriate? How could the U.S. overcome these blockers to credibly signal that there is an ‘exit ramp’ for sanctioned countries in reward for good behavior?

- How could the U.S. better maintain minimum viable trade, assistance, and people-to-people ties with sanctioned country populations to avoid the unintended consequences of isolation?

Endnotes

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Background Research - Chapter 5

Gates Forum III

China's Economic Statecraft and Implications for the Open Economic Order

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Introduction

Economic interdependence has facilitated China's use of economic statecraft – the manipulation of trade or investment ties for political purposes. Beijing has become more active at using both coercion and inducements in attempts to shape the actions of governments as well as companies. Scholars have documented the Chinese government's efforts to leverage its geoeconomic strength globally, as well as its domestic drivers and constraints.[2] Globalization and China's integration in the world economy certainly brought about many material benefits and enabled more rapid growth for many countries, China included; at the same time, increasing strategic concerns and great power competition have sharpened the policy dilemmas of managing China's geoeconomic heft alongside continued economic openness. This paper focuses on assessing the actual and potential consequences of Beijing's use of economic statecraft.

While China's economic statecraft has altered the strategic calculations for many countries and could have far-reaching implications for the trajectory of great power competition, Chinese influence is not a foregone conclusion. Beijing has encountered considerable pushback and often shot itself in the foot, suggesting that U.S. policymakers need not be overly concerned about undue influence. At the same time, the diffuse benefits of economic interdependence – that often arises quite naturally – remain a powerful draw and one that is hard for Washington to tackle head-on without offering alternative or complementary economic opportunities.

China’s Approach to Economic Coercion: Informality and Visibility

We might normally think of sanctions as formal policies based on legal and institutional frameworks, including through multilateral institutions such as the UN or EU, and as reflected in common U.S. sanctions policies. But Chinese economic coercion tends to be **informal**, where political disruption of trade is not based on official laws or publicly acknowledged as economic statecraft.[3] In fact, Beijing often denies political motivations and uses informal measures such as internal government guidelines or other technocratic regulations, such as selective food safety inspections. For example, during a 2012 standoff with the Philippines over the disputed Scarborough Shoal, Philippine bananas were left to rot at Chinese customs because the government claimed pesticide contamination.

This “just do it” approach to economic sanctions provides the Chinese government with **plausible deniability**, which helps in evading institutional constraints such as WTO rules. Additionally, the vague and unannounced nature of these sanctions means that immediately executing these sanctions -- as opposed to merely threatening to do so – sends a more credible and observable signal to deter the target as well as other potential challengers.[4]

China also likes to target **symbolic products with ready substitutes** – think Norwegian salmon, Philippine bananas, or South Korean cosmetics – so as to minimize damage to its own economy. This suggests that **visibility** matters for Beijing. Even if the economic costs may not be that large for the targeted country, sanctioning products that hold strong resonance among politicians, business leaders, and the public would be seen as sending a strong message of deterrence.

Mobilizing Nationalistic Consumer Boycotts

Capitalizing on its market power and established propaganda apparatus, Beijing is increasingly mobilizing patriotic consumer boycotts as a more manipulable, more visible, and less costly tool of coercion, especially to target third parties and companies over sensitive issues such as Taiwan and Hong Kong.[5] The use of such boycotts are on the rise – a recent study found 90 incidents between 2008 and 2021, with the majority occurring since 2016.[6] When South Korea announced the deployment of a U.S.-led missile defense system (THAAD) in 2016, China responded by rallying its citizens to boycott Lotte, a South Korean department store chain involved in a land swap deal for deploying the missile batteries, and to avoid traveling to South Korea, a popular destination for Chinese tourists. In 2021, Chinese internet users called for boycotts of Swedish clothing brand H&M and other companies that pledged not to use cotton produced with forced labor in Xinjiang.[7]

Patriotic consumer mobilization entails a state-led effort to politically redirect consumer behavior in order to punish foreign countries or companies. While consumer-led boycotts have been a feature of anti-Japan protests in China,[8] today nationalistic boycotts constitute a means of coercion against a broader range of governments and companies. It kills two birds with one stone – managing domestic public opinion for regime legitimacy while harnessing such sentiment to signal resolve and deterrence to international audiences. In rallying Chinese citizens, state media propaganda emphasizes themes of foreign humiliation and exploitation; frames consumer boycotts as grassroots patriotism; rebuts domestic criticisms as traitorous; and explicitly links boycotts to foreign policy goals of signaling and deterrence.[9]

China often uses nationalistic boycotts as part of a diverse toolkit of coercive economic responses. When rallying boycotts against South Korea, Beijing simultaneously employed regulatory coercive actions such as constraining group tours and closing South Korean department stores for fire safety violations. These complementary tools can reinforce coerciveness. Patriotic consumer mobilization helps to justify regulatory actions that may impose costs on the economy and individual consumer – such as not being able to buy a

prominent product or travel to a desired destination. Whipping up nationalistic sentiment can mitigate domestic criticism and generate greater public support for government actions, thus providing political cover and lending teeth to other coercive tools.

Coercive Advantages: Three Features of Nationalistic Boycotts

In previous work, I outlined three fundamental traits of patriotic consumer mobilization that lends coercive advantages: manipulability; uncertainty; and plausible deniability.[10] First, boycotts rely on citizens as the unit of action, making it more manipulable and less costly for China's economy compared to using firms or government regulation. Consumer goods and services are relatively substitutable, and public attitudes are relatively susceptible to nationalistic mobilization. The CCP has often effectively managed public opinion and used it instrumentally to maintain domestic stability or promote foreign policy goals.[11]

Second, uncertainty over precision and controllability facilitates costly signaling and coercive brinkmanship. Once set in motion, consumer action could take on a life of its own beyond initial boycott targets. That the authoritarian Chinese regime is willing to bear domestic political risks of mobilizing collective action serves as a costly signal of resolve to other countries that it is less likely to retract its policies.[12] Uncontrollability also increases coercive power by playing to the brink and magnifying target countries' fears. Compared to legal sanctions, empty stores and consumer protests (such as the burning of targeted goods) generate more visceral media images. Data on boycott incidents suggest that a considerable number of recorded boycotts are actually grassroots-led, with no public state involvement. This underscores the tool's longer-term mobilization potential, whereby nationalistic consumers and firms are already primed to instigate boycotts in new situations (and even more likely in the ideological Xi era, where public displays of patriotism are beneficial). In 2023, responding to government propaganda about Japan releasing radioactive water from the Fukushima nuclear plant, Chinese netizens compiled a list of Japanese companies ostensibly producing contaminated products. During the backlash over Xinjiang cotton in 2021, while the CCP particularly singled out H&M, Chinese consumers also broadened calls for boycotts to a range of companies, from Burberry to Nike.

Third, there is a strong element of plausible deniability, attributing boycotts to grassroots sentiment and "offending the Chinese people." It is not always clear what is

government-directed versus bottom-up mobilization, and the Chinese government often denies its role. Similar to China's use of gray zone coercion in territorial disputes,[13] this makes it harder for targets to respond without undesirable escalation, while providing added maneuvering room for Beijing to taper off coercion without any explicit announcement or overt admission of failure.

Conditions for Using Nationalistic Boycotts

Nationalistic boycotts come in handy when targeting third parties over sensitive issues. Patriotic sentiment is channeled not against sensitive targets, which may get too politically risky, but rather to punish third-party offenders. This provides a valve to release public nationalism and sends a broader signal to foreign observers and international audiences, while reducing potential escalation and reputational costs. For example, we have seen numerous Chinese citizen boycotts against foreign companies for undermining China's territorial integrity (including support for Taiwan, Hong Kong, and Tibet), rather than directly channeling public sentiment against Taiwanese companies. A report cataloging Chinese consumer boycotts of foreign companies from 2008-2021 identified only 16 out of 90 incidents that were about a political dispute with the company's home country.[14] The vast majority of incidents were in response to third-party company actions and statements perceived to be undermining China's territorial sovereignty over Taiwan, Hong Kong, and Tibet; supporting Hong Kong pro-democracy protests; criticizing Xinjiang policies; or discriminating against Chinese people.

Beijing is also more likely to use consumer boycotts when it has greater economic leverage over targets, such as smaller economies where certain companies are more economically dominant or symbolically prominent in the consumer realm, or companies producing domestically substitutable products. While multiple countries had imposed sanctions on Chinese actors involved in human rights abuses in Xinjiang, and several foreign companies had decided not to use Xinjiang cotton over forced labor concerns, the Chinese government particularly singled out H&M, a Swedish company, in state-led boycotts. This is likely because H&M's products – mass-market clothing – are readily substitutable in the Chinese market; coupled with already tense Sino-Swedish relations, this made it a low-cost target. Additionally, when coercing South Korea, China was able to easily identify and target major conglomerates and auto companies, such as Lotte and Hyundai. Although China punished Seoul for deploying a U.S.-led missile defense system, Beijing has not targeted U.S. companies such as

Apple or Walmart. The United States represents a harder target than South Korea because of its larger economy and its role in producing a broad array of consumer products – boycotting many different companies would likely impose major costs on consumer welfare while generating limited impact on U.S. policy. The Chinese government would appear ineffectual in its response, and provoking a major economy could lead to harmful retaliatory sanctions. Finally, boycotts may be used to simultaneously achieve domestic economic goals, such as allowing Chinese companies to capture market share and move up the value chain.

Economic Consequences and Political Outcomes

Economic costs for targeted companies do not necessarily equate to policy changes in line with Beijing's wishes. Looking at the case of South Korea's deployment of THAAD, although Lotte suffered major losses and eventually withdrew from the Chinese market, Seoul did not substantially alter its decision to host missile defense batteries. Additionally, high-profile Chinese boycotts significantly worsened South Korean public opinion toward China, which has in turn shaped Seoul's geopolitical outlook in tightening the U.S. alliance.

Companies may be more sensitive to actual or potential coercion. In many instances, foreign businesses have adjusted their policies on issues such as Taiwan and Xinjiang, or apologized for offending Chinese consumers. Such apologies have occurred in over half of boycott incidents in the last several years, although at times they incurred further criticisms of insincerity.[15] While business actions may not be immediately as consequential as government policy shifts, cumulatively they can create a political environment of preemptive censorship or acquiescence to Beijing's interests. But there are also many other examples where companies have not conceded. Companies appear more likely to apologize on Hong Kong and Taiwan-related issues, but less so on Xinjiang. While the former set of issues could be seen as more about territorial sovereignty and hence a political matter, the subject of Uyghurs in Xinjiang touches more clearly on human rights issues and has received considerable attention from foreign audiences, which may make it more reputationally costly for foreign brands to be seen as being on the wrong side of such norms.

The 2021 Chinese boycotts over the use (or lack thereof) of Xinjiang cotton suggest a few takeaways. First, the economic costs are most concerning when Beijing enacts complementary sanctions – H&M was also erased from mobile maps and e-commerce sites. Second, companies have different levels of resilience to boycotts, depending on how substitutable

their goods are. While H&M as a mass market fast fashion brand suffered the most financially and eventually closed many of its stores in China, Burberry as a luxury retailer did not suffer any substantial adverse revenue declines. Ultimately, for most targets, nationalistic boycotts may be more bark than bite, but they produce a powerful psychological deterrent effect that feeds into perceptions and fear of China's economic clout.

Legalization of Economic Sanctions Amidst Economic Security Concerns

Beijing is also taking some concrete steps toward increased legalization and institutionalization of economic sanctions, although thus far this has largely focused on retaliatory measures and counter-sanctions, serving as a preventive measure to deter "anti-China" actions.[16] These moves are occurring in the context of Chinese leaders' present-day perceptions that China is facing an increasingly complex array of external threats to its economic security, a rapid shift from considerable optimism in the 1990s and even into the early 2010s.A 2021 People's Daily article highlights how global industrial and supply chains are facing challenges due to "non-economic factors" — read, the U.S. trade war and geopolitically-driven economic pressures such as export controls and investment restrictions.[17] Xi's move to "integrate" development and security – officially adopted during the Fifth Plenum of the 19th Central Committee in October 2020, overcoming internal resistance[18] – represents a significant shift away from the CCP's 'development-first' approach, as declared by Jiang Zemin in 2002. Implicit in this new approach is that there may be tradeoffs between development and security, but safeguarding security is an elevated priority, and economic development should serve to enhance China's national security.

Chinese writings have emphasized leveraging the global economy to enhance China's economic security. "Deep coupling"[19] helps to ensure that China maintains access to needed resources, inputs, and technologies, and also presumably to position China as a crucial node in trading and investment networks, making it harder for other countries to cut China out of critical supply chains. This can in turn facilitate rapid industrial upgrading and becoming more self-sufficient in critical and core technologies.[20] As Xi wrote in 2020, "…we should strive to reshape new industrial chains and comprehensively increase technological innovation and import substitution…We must build on our advantages, solidify and increase the leading international positions of strong industries, and forge some "assassin's mace" [杀手锏 shashou jian] technologies [a wide array of technologies that might afford an inferior military an advantage in a conflict with a superior military power]. We must sustain and enhance our superiority across the entire production chain in sectors such as high-speed rail, electric power

equipment, new energy, and communications equipment, and improve industrial quality; and we must tighten international production chains' dependence on China, forming powerful countermeasures and deterrents against those foreigners who would artificially cut off supply to China."[21] Beijing thus seeks to reduce dependence on other countries but without necessarily exiting global supply chains, in a way that leaves other countries still dependent on China as a critical node.

This points to both an **increasing awareness of economic weaponization and reliance on economic coercion, but also a relative emphasis on defensive rather than offensive measures.** China is prepared to leverage its economic ties to deter (and respond to) other countries from cutting it out of supply chains, though so far Chinese leaders have not given clear indications that it would proactively disrupt these supply chains to decouple from the United States or other major economies. Of course, China has made moves to exclude foreign technology in strategic sectors, such as boosting domestically-produced chips and software, and certifying only Chinese suppliers for EV batteries at the expense of Korean and Japanese companies. But maintaining strategic forms of economic integration – which serves national goals as well as individual firms' self-interest – can often also be an effective divide and conquer tactic, for example attracting European businesses in order to reduce economic security coordination between Washington and European capitals.[22]

Beijing is also expanding the **legalization of its economic security toolkit.**[23] Xi previously called on China to use "legal weapons" in "the struggle against foreign countries."[24] In just the last few years, Beijing has adopted a spate of legal and regulatory measures, as outlined in the table below.[25]

China's Expanding Legalization of its Economic Security Toolkit: Examples of Recent Laws and Regulations	
Foreign Trade Law	Revised in 2016 to allow China to adopt countermeasures against discriminatory, prohibitive, or restrictive measures taken by another country on trade. This was one of the first legal steps Beijing took to institutionalize its sanctions retaliatory toolkit.

Foreign Investment Law	In effect since January 2020, the FIL is supposed to improve the regulatory environment for foreign investment, but also allows reciprocal measures against restrictions on or otherwise perceived discrimination against Chinese investors abroad, and contains ambiguous language that gives Chinese regulators broad discretionary powers in granting or blocking market access.
Unreliable Entity List	MOFCOM released this list in September 2020, soon after the Trump administration issued executive orders against WeChat and TikTok. The UEL is a mechanism to take punitive measures against identified foreign entities, as a way of imposing costs on these companies that comply with foreign sanctions and blacklists in restricting market transactions with Chinese companies, organizations, or individuals.
Export Control Law	A new law in force since December 2020 that created a unified China's export control regime with the explicit goal of safeguarding "national security and interests"; applies to a broader range of goods, technologies, and services beyond military and dual-use items. It also allows for reciprocal measures in response to foreign governments' export controls.
Rules of Counteracting Unjustified Extra-Territorial Application of Foreign Legislation and Other Measures	Released January 2021 and is similar to the EU's Blocking Statute; MOFCOM leads a working mechanism that would investigate such extraterritorial measures. Through this, Beijing hopes to deter the use of and compliance with secondary sanctions.
Anti-Foreign Sanctions Law	Officially a legal framework for countersanctions and other measures against foreign countries that impose sanctions on China. MERICS describes it as a much more expansive "blocking statute, retaliatory regime and proactive sanctions legislation rolled into one." It is characterized by typically vague language that make red lines hard to know in advance.

Many of these legal frameworks can be seen as countermeasures and retaliatory responses to U.S. and EU policies, such as export controls, restrictions against Chinese companies and investments, and economic sanctions. For example, the Unreliable Entity List punishes foreign companies that comply with foreign sanctions, the Rules on Counteracting Unjustified Extra-territorial Application of Foreign Legislation is meant to counter secondary sanctions, while the Export Control Law limits the export of dual use or national security-related technologies as well as reciprocal measures against foreign export controls. At the same time, analysts have pointed out that some of the legislation, such as the Anti-Foreign Sanctions Law, is potentially more sweeping in its range of targets – beyond governments to include organizations and individuals – and scope, including allowing for proactive coercion or broad regulatory discretion.

Such legalization could be seen as representing a shift in how Beijing approaches economic statecraft. While China has sometimes used regulatory cover for economic coercion, such as food safety inspections of Philippine bananas, it rarely admits a political motive, and by and large it has tended to use informal approaches in its economic statecraft, including attributing punitive actions to nationalistic consumers and patriotic companies. Expanded legalization could reflect a few factors: it may be part of a broader process of institutionalizing and formalizing tools of economic statecraft over time, including as China observes how other countries deploy such tools; it facilitates better coordination and enforcement, given the multiple actors and entities involved; or simply that these are situations where the CCP wants to claim credit in front of their domestic audience for a tough response to foreign coercion by adopting reciprocal policies, and legal frameworks facilitate that. Finally, Chinese analysts have pointed to the valuable signaling and deterrence role of legal anti-sanctions measures amidst great power competition.[26]

Beijing has started to draw more explicitly on legal tools in its economic policies. In July 2023, the Ministry of Commerce announced export controls on gallium and germanium, two critical minerals for semiconductor production, citing the Foreign Trade Law.[27] In October 2023, after U.S. imposed additional restrictions on AI chips, Beijing announced restrictions on graphite products whereby Chinese exporters would have to apply for permits.[28] In other instances, the Cybersecurity Administration of China announced in May 2023 that American chip manufacturer Micron had failed its cybersecurity review. Citing the Cybersecurity Law of China, it barred Chinese telecommunications companies from purchasing Micron's

products.[29] And in February 2023, MOFCOM also announced its first ever use of the Unreliable Entity List, designating Lockheed Martin and Raytheon over arms sales to Taiwan.[30] The two companies had already been previous targets of sanctions, including through the AFSL and bans on the companies' CEOs in 2022. At the same time, neither of these companies have a meaningful business presence in China, not least because of U.S. restrictions on defense contractors.

This suggests that announced sanctions may be more of a symbolic move, and that Beijing remains relatively cautious about executing these legal frameworks. Such caution could be attributed to a reluctance to impose costs on its own economy and companies, for example if there are risks of disrupting supply chains of import-dependent raw materials or undermining Chinese firms supplying strategic sectors.[31] For example, exports of the 3Gs (graphite, gallium, germanium) have faced restrictions but not complete bans; analyses suggest that markets have adjusted and price impacts have cooled, especially amidst sluggish demand.[32] Additionally, legal sanctions provide reduced maneuvering room compared to informal measures that have allowed Beijing to quietly ease off coercion without looking like it is backing down.

For the Chinese government, legal frameworks could be most useful as a preventive measure to discourage and deter "anti-China" actions. Currently, Beijing's toolkit (e.g. the unreliable entities list) remains miniscule relative to Washington's suite of tools. Too aggressively imposing legal sanctions could also further play into U.S. interpretations of Chinese intentions and the present political eagerness to ramp up punitive measures. While American and other companies inevitably seek to sidestep government restrictions (as with semiconductor exports), they are unlikely to overtly rebel against tightening legal requirements; escalatory retaliatory responses by Beijing may then counterproductively promote retreat from the Chinese market. On the other hand, as China's economy becomes more advanced and innovative, particularly in critical sectors, it could have more potential chokepoints to pressure countries in the future.

Economic Inducements: Subversion Alongside Seduction

While economic coercion is often a focus of policy debates, Beijing's use of inducements remains a core component of its economic statecraft. From the Belt and Road Initiative to the Global Development Initiative, the lure of the Chinese market as well as the financing and growth opportunities offered by Chinese investments – all enabled by the impressive growth of the Chinese economy over the last few decades – have entrenched widespread perceptions of China as an indispensable economic partner. Many assume that Beijing has easily leveraged its economic clout to buy influence and acquiescence to its political interests. But the track record is much more mixed. China has met with some successes but also many failures in its attempts at influencing the policy choices of other countries. The strong gravitational pull of the Chinese economy does not necessarily mean that others are altering their political orbits.

Subversive Carrots

My research shows how the effectiveness of inducements depends on both China's approach – subversive versus legitimate – as well as the strength of domestic political institutions in recipient countries.[33] China often provides economic inducements in illicit and opaque ways that circumvent political processes and institutions – what I call "subversive carrots." Chinese companies have offered bribes and kickbacks, sometimes with the tacit approval of Chinese officials, to elites in countries receiving investment or aid projects in order to grease the wheels of bureaucracy. At other times, Chinese companies have bypassed the process of competitive bidding and regulatory approval to secure a contract, often at inflated costs, generating extra profits for both Chinese actors and local elites. In many ways, this approach reflects China's domestic political economy, where businesses depend on political connections, corruption is widespread, and few regulations govern foreign investment and foreign aid.

Subversive carrot tactics have allowed China to make inroads in places where leaders can act with relative impunity, but have backfired in countries where leaders face accountability mechanisms. Cambodia is a classic case of subversive carrot success in a low accountability system, where Chinese largess through murky aid and investment projects has bought Cambodian advocacy for Beijing's expansionist positions on the South China Sea disputes. At a 2012 ASEAN summit, Cambodia wielded its position as chair to block discussions of South China Sea disputes, leading to an unprecedented failure to issue a joint statement. At one point, the Cambodian foreign minister cut off delegates who tried to raise the issue, and at another, he stormed out of the room when they proposed even a watered-down statement. A Filipino delegate at the meeting recounted to me how the PRC vice foreign minister was "given a platform to lecture us on Scarborough Shoal" while the Filipinos were denied the chance to voice their concerns. Government officials I interviewed in the region described Cambodia's behavior at the summit as the result of a "straight-up monetary deal" in which Beijing paid off the Cambodian government in exchange for its support. In the months before the meeting, senior Chinese leaders visited Phnom Penh, offering additional grants and loans for infrastructure and development projects worth hundreds of millions of dollars. Since this incident, ASEAN has become increasingly divided and incapable of dealing with contentious issues such as the South China Sea disputes.

While seemingly an easy and cheap approach, subversive carrots also spark public dissatisfaction and elite contestation, with Beijing and Chinese-financed projects often getting entangled in political scandals and campaign rhetoric. In the Philippines, corrupt telecommunications and rail projects in the 2000s led to public backlash and a Senate investigation. In Malaysia, a major corruption scandal implicating Chinese-financed investments and involving the incumbent prime minister led to a resounding electoral defeat, marking the first opposition victory in the country's history. The succeeding administration quickly suspended a number of Chinese projects and renegotiated plans for a major railway. On a strategic level, the negative spillover effects on Beijing's global image (along with heightened use of coercion) has undermined China's attempts to position itself as a great power that ostensibly promotes ``win-win'' cooperation and preaches non-interference in internal affairs.

Legitimate Seduction

In other cases, building up pro-China constituencies through legitimate inducements has successfully created contestation over how to manage economic and security issues with Beijing. This approach is rooted in a broader logic of economic interdependence: China seeks to cultivate foreign stakeholders that have an interest in good relations. Beijing promotes trade and investment across multiple sectors in the hope that the groups that benefit from economic exchange with China can be counted on to lobby their own governments to seek cooperative relations with the country. Convinced by these private-sector elites of the importance of the Chinese economy, the logic goes, political leaders will work to minimize any disagreements with Beijing.

In present-day Germany, we see the political influence of business groups invested in continued economic ties with China – such as Volkswagen, BMW, and BASF – alongside internal divisions among politicians and key ministries on national strategy toward China. Berlin has traditionally been cautious of wading into political tensions with Beijing, choosing instead an approach that prioritized economics and the principle of 'Wandel durch Handel,' or 'change through trade.' In 2019, Germany exported almost US$118 billion of goods to China, which represented over half the value of all EU exports to the country. Additionally, access to the Chinese market has been a big draw for major German companies. Germany's blue-chip industrial behemoths, such as Volkswagen, Siemens, and chemical manufacturer BASF, were among the first Western firms to invest in China in the 1980s. Automakers, including BMW, Daimler, and Volkswagen, have major production facilities located in China, with a third or more of their profits generated there.

By many accounts, German industry has been very influential in Berlin's policymaking toward China. As chancellor from 2005-2021, Angela Merkel made a dozen trips to China, often consulting with major German firms beforehand and bringing high-level business delegations with her to Beijing. In 2013, after German automakers lobbied to avoid confronting China over trade practices, Berlin successfully stopped the EU from imposing duties on Chinese solar panel imports. In 2020, Merkel led the push to conclude the EU's investment deal with China, despite the incoming Biden administration's requests to hold off and coordinate on policy.

The current German chancellor, Olaf Scholz, was the first G7 leader since the pandemic to visit China in November 2022, accompanied by a sizable business delegation. Before his trip, Scholz went against the advice of his ministers and the EU to agree to Chinese investment in Hamburg, the country's largest seaport. During his second trip to Beijing in April 2024, the German leader remained reluctant to speak out publicly about Taiwan or human rights issues such as Tibet or Xinjiang. Reports suggest that German businesses urged his team to downplay concerns over Chinese overcapacity and focus on maintaining German access to the Chinese market. Additionally, Scholz requested to delay impending arrests of German citizens over spying for China as well as for the European Commission to delay announcing a case on discriminatory Chinese procurement practices in medical devices. Berlin also previously denied a request by Taiwan's then vice president-elect to travel as a private citizen through Germany (she was allowed into other European countries such as Belgium and Poland).

The gap between Germany and the rest of Europe has been evident over the EU's recent anti-subsidy investigation into Chinese electric vehicles. Berlin's position is driven by a strong fear of Beijing imposing retaliatory tariffs against German automakers, as admitted frankly by the German economy minister. The German chancellor described the EU move as "protectionist," while the CEO of Mercedes-Benz urged Brussels to do the opposite -- to lower rather than raise tariffs on Chinese EVs in order to ensure a ``level playing field'' and build "economic win-win situations" -- language that not only parroted Beijing's win-win narrative but was also ironic given analyses of Chinese government subsidies leading to overcapacity and artificially cheap EVs.

Evaluating the Lure of Inducements

Beijing's economic statecraft has been most effective at achieving short-term transactional goals, such as vetoing a multilateral statement, as with Cambodia in ASEAN. In the EU context, Hungary, Serbia, and Greece have on various occasions vetoed EU statements

In general, China's economic statecraft has operated more by preference multiplication – empowering groups with overlapping preferences (whether out of self-interest or national interest) to advocate for more cooperative ties with China. Persuading actors to change their policy preferences has been more difficult for Beijing. Legitimate inducements that operate by

the law, bring economic benefits to the public, and engage a broader range of stakeholders, are more likely to be able to shift attitudes. Much of the time, this has worked diffusely over long periods of time, and often as an outgrowth of broader economic interdependence rather than a deliberate long game. As underscored by my elite interviews in Malaysia, despite previous pushback against corruption-tainted Chinese projects, an established record of other economically-beneficial Chinese investments has entrenched national and local politicians' views of China's economic importance along with their desire to minimize confrontation over issues such as the South China Sea disputes and the Uyghurs in Xinjiang.

In this respect, Beijing appears best able to achieve influence through the diffuse latency of economic interdependence. China as a crucial economic partner remains a compelling narrative and a powerful draw for many countries, and often conditions the attitudes and decisions of many political leaders. Perhaps the deepest economic influence comes paradoxically when Beijing may not have set out to achieve an explicit or immediate political goal, but can subsequently leverage such influence during moments of critical decision-making.

On the flip side, the Chinese government's refusal to restructure bad debts, often leaving borrower countries mired post-Covid and adding to broader macroeconomic uncertainty, could negatively affect China's image in the Global South and certainly its claims to be a benevolent provider of development where it is needed most. Moreover, countries such as Brazil and Indonesia are also imposing tariffs on Chinese products in an effort to get Chinese companies to localize production, which many developing countries see as more beneficial for their own economic development. How Beijing responds to these issues will shape its reputation and how enticing its economy will remain.

Driving Wedges: Inducements as a Disruptor

Economic inducements can help a rising power such as China gain strategic influence without inciting immediate counterbalancing or censure, unlike the overt use of military force. While subversive carrots can peel off targeted elites, legitimate seduction done right promises broader benefits to recipient countries as well, making it harder to turn down the lure of China's economic statecraft (rooted also in its large market size, cost advantages, and innovative technologies). By altering the perceived costs and benefits for individual countries,

inducements can create divisions and undermine multilateral coordination on responding to Beijing's actions.

While a fundamental political realignment toward Beijing remains unlikely, economic statecraft has been able to drive wedges within countries as well as between different countries, thus inhibiting effective China-skeptic coalitions – particularly useful for a rising power seeking to reduce opposition to its interests as well as inhibit alignment with U.S. interests. While Washington by and large sees Beijing as a geopolitical rival threatening U.S. dominance and leadership, many countries in the Global South prefer to view China through the lens of trade, investment, and development. By making even starker the tradeoffs of concrete economic benefits versus relatively abstract shifts in the security order, economic inducements further accentuate these differing priorities. In Asia, while mostly seeking continued U.S. presence in the region, many countries view China as the inevitable economic center of gravity and have publicly articulated that they do not want to have to choose between the two great powers. One major lesson that Beijing has drawn from Russia's 2022 invasion of Ukraine is the challenge that the United States faces in creating and sustaining a global coalition to counterbalance Chinese influence. If most governments outside of a small group of like-minded allies and partners have preferred not to publicly criticize and isolate Moscow – a relative pariah in the international system – for its unprovoked use of military force, things will likely be even harder when it comes to censuring a country that is a much more central and integrated player in the global economy.

Even traditional U.S. allies and partners such as Germany, South Korea, and Australia remain eager for closer economic ties with China, which has in turn shaped their foreign policy orientation and their willingness to openly criticize China or be seen as siding with Washington. During a 2023 visit to Beijing, French president Emmanuel Macron emphasized the importance of ``strategic autonomy,'' and that Europe should not be ``America's followers'' or get ``caught up in crises that are not ours'' such as Taiwan. His visit included a sizable business delegation, as did the 2022 visit by German Chancellor Olaf Scholz, the first European leader to visit China since the pandemic. In a vivid illustration of China's wedge strategy, Macron was received with much diplomatic fanfare and feted by President Xi, while the European Union president Ursula von der Leyen, who had traveled together with Macron, was given the relative cold shoulder -- a sign of Beijing's dissatisfaction with the EU's more critical stance toward China.

Ultimately, Beijing’s economic statecraft will make it harder for Washington to marshal a cohesive, united, and sustainable coalition against China. Even if Beijing has a spotty record of effectively using inducements, as it currently does, it has been sufficient to sow divisions and create roadblocks to multilateral coordination. While it may not be easy for China to stake out its own geopolitical claims, at the very least it is able to undermine U.S. efforts to counter Beijing's presence and influence.

Policy Implications

As countries craft policy responses toward China's economic statecraft, they will have to struggle with the dilemma between access to Chinese markets, capital, and technology with potentially greater vulnerability to Chinese pressure. Washington needs to ensure that it plays an active, constructive role to avoid alienating other countries especially in the Global South, inhibit Beijing's ability to drive wedges, and continue having a hand in shaping the norms of a global open economic order. Fundamentally, the domestic political environment in the United States that limits policymakers from negotiating transformative multilateral trade and investment agreements has fed the continuing perception that Washington is all guns and no butter.

As a first point of context, the trajectory of China's economy will have implications for its use and effectiveness of economic statecraft. Slowing growth, sluggish consumption, declining investment, and political tightening (particularly with Xi's crackdown on the private sector and foreign companies) lowers the attractiveness of the Chinese market and weakens pro-China constituencies abroad. A desire to attract foreign investment would reduce the government's inclination of mobilizing nationalistic boycotts or imposing broad sanctions that could disrupt its own supply chains. At the same time, China could use trade and investment controls to also bolster domestic companies and facilitate their market dominance over foreign competitors. Furthermore, slower growth or crowded markets back home would likely push Chinese companies to export their technologies and goods and entrench China further in global value chains, such as in the electric vehicle and renewable energy sectors.

One important takeaway is that recipient countries have agency in determining and responding to China's economic influence attempts. Building resilience against China's coercion and inducements needs to start with engaging with their interests and capacities. Especially on the inducement side, zero-sum geopolitical rhetoric has not won over leaders in the Global South eager for economic development and financing access. Promoting the availability of alternatives for infrastructure financing and investment projects, including encouraging private commercial actors to play a bigger role, would prevent China from being the default or dominant choice. Cooperation with other major investors and donors, including

Japan, South Korea, Australia, and the Asian Development Bank, will help to establish important standards and ensure multiple sources of financing. The Partnership for Global Infrastructure and Investment involving G7 countries represents an admirable effort, although peer competition in infrastructure financing will remain difficult given the Chinese state's ability to mobilize resources at scale.

Investor countries should also more effectively engage with and promote the use of multilateral institutions, such as the World Bank and the Asian Development Bank. My fieldwork in countries such as the Philippines shows that Chinese financing is often attractive because it moves much more quickly (although sometimes undermining local standards). Working for the reform and streamlining of multilateral lending processes could make these alternatives more appealing and effective. Having excessively rigid 'gold standards' can sometimes detract from the goals of broadening access to investment and development financing.

The bilateral or multilateral sharing of know-how would limit Beijing's ability to circumvent accountability processes and institutional standards. Investor countries could work with developing countries and provide technical expertise, resources, and guidance to negotiate or renegotiate better deals with China. Often, developing countries may lack the relevant experience and knowledge, and this approach would be a relatively low-cost and efficient way to promote improved transparency and accountability standards while pushing Beijing to meet these standards. Focusing on project quality would improve overall outcomes for the surrounding populations, and avoid framing investment choices for recipient countries—many of whom need infrastructure and development financing—in terms of U.S.-China strategic rivalry. In the longer run, strengthening accountability institutions and promoting informational transparency of investment and aid projects—regardless of the source country—would enable bottom-up oversight in recipient countries. One challenge is that when U.S. agencies such as State and Treasury provide such advice, they are often not seen by recipient countries as impartial, particularly when Chinese involvement is in play.

Walking the talk is helpful. The U.S. State Department recently started operating what it calls 'The Firm', an internal consultancy-like structure that provides advice and resources on identifying supply chain vulnerabilities and countering the impacts of Beijing's economic coercion, such as finding alternative markets for targeted goods. This model started with

Lithuania, which faced Beijing's ire in 2022 over the opening of a Taiwanese representative office, and has since been sought after (mostly behind closed doors) by a number of other governments. Expanding these efforts to the inducement front would also be valuable, and may provide even more economic opportunities for U.S. and partner country companies.

Coordinating evidence-based knowledge-sharing on sources of economic vulnerabilities and resilience would also go a long way in countering exaggerated perceptions of China's economic power. This should occur not just within allies and partners but more broadly with other countries as well as companies. As discussed above, economic coercion has not really succeeded at getting governments to reverse course once policies are implemented, and Beijing has been relatively circumscribed in the scope of its sanctions for fear of hurting its own economy. But visible forms of coercion have created powerful psychological deterrent effects – perceptions of greater Chinese coercive clout than there actually exists has led to preemptive self-censorship and policy adjustments. Additionally, in an increasing synergy of economic and informational tools, Beijing is actively trying to shape public narratives about China's economic clout and its indispensability, as well as promote the legitimacy of political actors seen as favorable toward China. Especially in political contexts where there is a relative lack of expertise or attention on China, Beijing's narrative dominance would fill the information gap and entrench perceptions of China's economic clout. It is not infrequent that political elites hold beliefs that Chinese investment and trade is more important than any other economic partner, even though the data differ.

Finally, there are likely to be tensions between different economic statecraft tools. Sharpening economic security measures that encourage friendshoring and limit Chinese involvement in strategic supply chains will serve the U.S. industrial base and long-term economic resilience well. However, these policies are seen by many other countries – rightly or wrongly – as evidence of U.S. protectionism and zero-sum competition with China. This will in turn undermine U.S. inducement efforts to promote itself as a fair and objective partner for economic development or as a vital pillar of an open economic order.

Questions

● Under what conditions does Beijing use legal versus informal economic coercion? What kinds of sectors are most vulnerable to export control measures and what are the economic or political factors shaping these choices?

● If it is easier for China to use economic statecraft to drive wedges and disrupt cooperation rather than win permanent friends, will these outcomes be sufficient for China to gain the level of global influence that it seeks? Is undermining U.S. influence sufficient?

● What is the interplay between China's use of economic coercion and economic inducements? Is it possible to employ both categories of tools simultaneously without undermining their effects?

● How might the long-term health and trajectory of the Chinese economy affect Beijing's ability to use different tools of economic statecraft, and the effectiveness of such tools?

● How can governments most effectively shape companies' decisions in line with outlined national security and longer-term economic interests when China continues to be perceived as an inevitable market destination? For e.g. German automakers remain invested in the Chinese market and continue to advocate for Beijing's preferences even as they face fierce competition and are likely to be pushed out in the medium term.

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Background Research - Chapter 6

Gates Forum III

Toward a New Sanctions Multilateralism: How the United States Can Work Better with Allies on Economic Statecraft

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Introduction

Virtually all scholars and practitioners of economic statecraft agree: multilateral sanctions are more effective than unilateral ones.[2] The intuition behind this consensus is clear—unilateral sanctions can cause temporary supply disruptions, but in a globalized economy, trade routes and financial flows are easily reconfigured. If Russia can't sell oil to Europe, it reroutes tankers to India; if Iran loses U.S. investment in its energy sector, it secures funds from Asia; if China faces restrictions on selling electric vehicles in the United States, it finds markets in Europe. When the United States acts alone, the target of sanctions may suffer only fleeting pain, while American companies forfeit lucrative opportunities to foreign competitors. In the long run, the United States risks being the only loser.

By and large, this conventional wisdom is correct. But it obscures a fundamental—and historically novel—feature of contemporary economic statecraft. Over the past two decades, the advent of more sophisticated forms of U.S. financial sanctions, coupled with Washington's increased appetite to use secondary sanctions, has given the United States the ability to apply substantial economic pressure on adversaries even when it acts unilaterally.[3] These potent financial sanctions derive their power from a confluence of sources, including the essential role of the U.S. dollar and American financial institutions in cross-border transactions, the increasingly global reach of the U.S. regulatory state, and the accelerated globalization and financialization of the world economy that followed the end of the Cold War.[4]In the current environment, it is thus not always the case that multilateral sanctions are more economically impactful than unilateral measures—especially if multilateralism comes at the expense of the speed or scope of the penalties.

Yet economic impact is seldom the purpose of sanctions; it is a means to an end. And the benefits of multilateralism go beyond the fact that it often, if not always, enhances impact. Securing support from allies can strengthen the overarching policy that sanctions aim to advance. It can also set up sanctions for long-term success and protect the sources of American economic and financial power. The challenge for policymakers today is to cultivate

structures, personnel, and doctrine that enable the United States to wield sanctions multilaterally without sacrificing speed or scope.

The Benefits of Multilateralism

The United States benefits in three main ways when it imposes sanctions in concert with other countries:

(1) Reducing opportunities for backfill. The U.S. government's ability to deny foreign firms access to the American financial system and market gives it substantial leverage over such firms. But strictly speaking, Washington cannot tell foreign companies what they can and can't do. For instance, the U.S. government can warn a Chinese bank that it risks losing access to the U.S. financial system if it transacts with Russian counterparties. But that Chinese bank is free to ignore the threat, accept any costs, and continue transacting with Russian firms. More often than not, foreign firms take the threat of U.S. secondary sanctions and enforcement action seriously, yet there are always exceptions. In 2012, the United States sanctioned China-based Bank of Kunlun for its dealings with Iran—and to this day, Chinese refineries pay Iran for oil through Bank of Kunlun.[5] The only government with ironclad authority to tell Chinese firms what they can and can't do is based in Beijing.

The U.S. government learned this lesson in the 1990s. When President Bill Clinton banned American firms from investing in Iran's energy sector, Houston-based Conoco pulled out of a project in the country. Shortly thereafter, France-based Total swooped in to replace Conoco in the Iranian project. Congress threatened Total with secondary sanctions via legislation, but the Clinton administration decided it was not worth a transatlantic rift and waived the penalties. The George W. Bush administration agreed and sustained the waiver. Total proceeded with the project.

The lesson of both the Bank of Kunlun and Conoco-Total episodes is that there is only one surefire way to prevent sanctions backfill: securing support from the governments with ultimate regulatory authority over the relevant banks and companies. Simply put, a larger coalition gives the target fewer lifelines.

(2) Bolstering perceived legitimacy. Every sanctions program exists within a broader policy narrative. When that narrative is perceived as legitimate by a large portion of the international community, the sanctions are likelier to exert economic pressure, maintain long-term political support, and ultimately realize their intended policy objectives.

In 2010, when the Barack Obama administration—after extensive negotiations with Congress—began actively enforcing secondary sanctions against Iran, it did so unilaterally.[6] Yet it timed the inauguration of this new policy with the passage of a fresh UN Security Council resolution that beefed up multilateral sanctions on Iran, exhorted banks to "exercise vigilance" when dealing with Iranian counterparties, and drew explicit connections between Iran's nuclear program and its energy sector.[7] The UN mandate helped U.S. diplomats and Treasury officials persuade much of the world to comply with American secondary sanctions, even though they were not legally obliged to do so.[8]It may have also helped convince the Iranian government that the only path to attaining economic relief was to earnestly pursue nuclear negotiations.

Another benefit of legitimacy is that it can help sustain sanctions over the long term. In 2014, when Russia annexed Crimea and invaded the Donbas, the United States acted in concert with the European Union and other G7 allies to impose sanctions on Russia. While multiple large U.S. companies surrendered major business ventures in Russia—perhaps most notably, ExxonMobil—the fact that the U.S. government acted alongside other advanced industrial democracies put the sanctions on a stable political foundation. Despite rumblings that the Donald Trump administration might unilaterally lift sanctions, or that Hungary or another Russia-friendly EU state might veto them, the 2014 sanctions persist to this day.[9]

The surge in great power competition over the last decade has rendered the UN Security Council an obsolete venue for sanctions legitimation. The next best alternative is to build coalitions of the willing, starting with U.S. allies then moving outward.

(3) Preserving the sources of American economic power. In 2016, then Secretary of the Treasury Jack Lew warned that "overuse of sanctions could undermine our leadership

position within the global economy, and the effectiveness of our sanctions themselves."[10] His concern was that excessive use of U.S. sanctions could make reliance on the dollar and U.S.-centric financial infrastructure seem risky, potentially driving the world to adopt alternative currencies and financial channels.

Two years later, Lew's warning seemed prophetic. In April 2018, the Trump administration imposed sanctions on Rusal, a Russian company responsible for 7 percent of global aluminum production. Unlike the Obama-era Russia sanctions, these measures were unilateral—U.S. officials didn't even give colleagues in Europe a heads-up. The result was widespread chaos in aluminum markets, threatening to shut down Europe's largest alumina refinery and spiking aluminum prices by 30 percent.[11] The Trump administration quickly suspended the sanctions without getting any concessions from Moscow. Meanwhile, in the wake of this shambolic episode, the Central Bank of Russia drastically reduced its dollar reserves and took steps to decrease the role of the dollar in Russia's cross-border payments.[12] Notably, the Russian central bank shifted the lion's share of its reserve holdings into euros. By acting unilaterally, the Trump administration made the euro seem like a safer alternative than the dollar.

By contrast, when the Biden administration imposed sanctions on the Central Bank of Russia in February 2022, it acted in concert with the rest of the G7. The multilateral nature of this action made it significantly more impactful, immobilizing not just Russia's dollar reserves, but also the country's holdings of euros, sterling, and yen—amounting to some $300 billion in total.[13] Crucially, it did not diminish the dollar's global role.[14] Moving away from the dollar requires a viable alternative, and the coordinated sanctions made the euro, sterling, and yen appear just as geopolitically risky as the dollar.

Had the United States acted unilaterally in 2022, the result would almost certainly have been an expanded flight from the dollar toward the euro. The best way to ensure Lew's fear never materializes is to impose sanctions in collaboration with the issuers of the world's other major reserve currencies, all of which are close U.S. allies.

The Drawbacks of Multilateralism

There are also drawbacks of multilateral sanctions that policymakers must take into account:

(1) Slowing down action. Coordinating sanctions with allies is a time-consuming and politically sensitive process. Each country has its own domestic constituencies that might be adversely affected by the measures, and few governments possess the personnel or analytical capabilities to confidently project the economic impact of sanctions before they are imposed. As a result, it is a common problem for the United States and its allies to roll out sanctions too slowly to influence a fast-moving crisis.

When Russia launched an operation to seize Crimea in February 2014, the United States and its European allies were taken by surprise. They had no sanctions options ready to go, nor had they ever seriously discussed the possibility of imposing sanctions on Russia. While Washington and Brussels managed to build consensus on a raft of symbolic sanctions within weeks of the outbreak of the crisis, it took them five months to align behind sectoral sanctions on Russian banks and energy companies. By then, the Russian government had already formally annexed Crimea, and its proxies had occupied key cities in the Donbas. The penalties came too late to have any chance at deterring Russia from carving up Ukraine's territory.

Because sanctions are often first deployed as a crisis response tool, speed is of the essence. Recent history shows that multilateralism can come at the expense of speed.

(2) Watering down potency. For the same reasons multilateralism can slow down the speed at which sanctions are imposed, it can also weaken the potency of the sanctions themselves. Because each country has its own economic interests, the more countries that are in the room, the smaller the area of consensus there will be for sanctions. Multilateral sanctions often devolve into an exercise in finding the lowest common denominator.

The Iran sanctions of the 2000s were a case in point. In 2004, President George W. Bush bemoaned that the United States had "sanctioned ourselves out of influence with Iran."[15] His frustration stemmed from the fact that the United States had long maintained a domestic trade embargo on Iran, and on the multilateral front, the UN Security Council could not agree to impose any meaningful economic pressure on Iran. In the years to come, the UN Security Council managed to pass several Iran-related resolutions, but none of them included significant economic sanctions.

Eventually, the U.S. government broke free from this impasse by reframing UN Security Council Resolutions as a tool for *legitimating* unilateral sanctions on Iran, not as a vehicle for *imposing* multilateral sanctions. The penalties that created a severe economic downturn in Iran in 2012–13 and paved the way for the Joint Comprehensive Plan of Action (JCPOA) were largely unilateral American measures, especially secondary sanctions. Had the United States refrained from secondary sanctions and allowed the UN Security Council to set the bar for penalties, Iran's economy almost certainly would have kept on growing just as it did in the two decades leading up to the nuclear deal.

(3) Ineffective enforcement. The United States is the only country with a well-established sanctions implementation apparatus and a track record of aggressive enforcement. The most notable sanctions enforcement actions in recent history have involved U.S. law enforcement agencies penalizing *foreign* firms and individuals that were operating in the United States—for instance, the $9 billion fine against France-based BNP Paribas in 2014 and the $4 billion fine against Binance, a cryptocurrency exchanged originally founded in China, and its chief executive in 2023.[16] In effect, the U.S. government serves as the world's sanctions police.

However, when the United States imposes sanctions in concert with allies, it often defers to those allies to enforce sanctions violations that occur in their respective jurisdictions. A good example is the 2022 Russia sanctions and export controls, which are supported by a coalition of more than 30 countries. While building such a coalition was an important diplomatic feat, it quickly became clear that very few American allies are equipped to enforce sanctions against their own companies. One major problem is

that in the EU, each individual member state is responsible for enforcement within its own borders, even though policy is set in Brussels. The result has been a leaky sanctions regime, in which Russia successfully finds ways to procure the technologies it needs from Europe.[17]

In recent months, the United States has ramped up enforcement of secondary sanctions, including against European companies. But this only came after years of ineffective domestic enforcement by EU countries, and even now, the U.S. government is often reluctant to come down hard on European firms. If the objective of sanctions is to prevent Russia from obtaining the foreign technologies it needs for its war machine, the United States would likely have been better off imposing aggressive secondary sanctions from the start as opposed to relying on allies.

Principles and Objectives for Multilateral Sanctions Moving Forward

To make multilateral sanctions more effective, U.S. officials should be guided by the following principles and objectives:

(1) Nimble yet capable. For multilateral sanctions to be worth it, the United States and its allies must have the capability to impose them quickly without sacrificing their potency. This will require streamlining the U.S. sanctions policymaking process and designating clear lines of authority for sanctions diplomacy. It will also require building close relationships and connective tissue with sanctions officials in allied governments, spanning both senior and working levels.

(2) Negative *and* positive tools. A key weakness of Western economic statecraft today is that it is heavily focused on negative tools such as sanctions and export controls. There are many good reasons for the United States and its allies to develop more flexible authorities for deploying positive tools—for instance, providing foreign assistance, delivering trade benefits, and channeling capital abroad. Among these reasons is that it could also make negative tools like sanctions more impactful. Allied countries that suffer disproportionately because of a sanctions program should be offered benefits to help make them whole. It would be much easier to win support for multilateral sanctions if the United States and its allies could provide economic assistance to coalition members that agree to make outsize sacrifices.

(3) Plan in advance. Within days of the start of Russia's 2022 full-scale invasion of Ukraine, the G7 jointly imposed robust sanctions, far exceeding analysts' expectations by freezing Russia's sovereign reserves and slapping full-blocking sanctions on the country's largest banks. Even the Russian government was surprised by the intensity of the Western response.[18] The only reason this was possible was because the United States and its allies had been preparing and coordinating sanctions options for five

months before the invasion began. The early warning achieved by U.S. intelligence agencies gave American and European diplomats the time and space to get ready for the crisis.

Such advance planning is exceptionally rare when it comes to sanctions. Unlike the Department of Defense, which prepares and rehearses off-the-shelf plans for a variety of global contingencies, the U.S. agencies charged with economic statecraft do virtually no advance planning. Instead, everyone scrambles to the Situation Room when a crisis breaks out and cobbles together sanctions options under intense time pressure, typically resulting in excessive caution. This problem is amplified when the United States aims to impose multilateral sanctions. For multilateral sanctions to be effective, the United States and its allies must create standard processes for advance planning.

(4) Easy to launch. Consistently deploying effective multilateral sanctions will require institutional innovation. The primary forum for sanctions diplomacy during much of the post–Cold War era, the UN Security Council, no longer functions amid today's intensifying great power competition. A replacement is needed. But institution-building is hard, and it will be much easier for the United States to build on top of an existing platform instead of trying to create a new one. Thankfully, the G7 has emerged in recent years as a capable forum for allied crisis management and sanctions coordination. Yet its success has largely been thanks to contingent factors: chief among them, a U.S. president—Joe Biden—who is deeply committed to the transatlantic bond and strong personal relationships among the G7 Sherpas. There is still no ready-made process for sanctions coordination at the G7 level.

Recommendations for Improving Multilateral Sanctions

We are living in a new Age of Economic Warfare, in which great powers increasingly deploy sanctions and other coercive economic measures against one another. To compete effectively, the United States and its allies must revamp their structures, personnel, and doctrine for conducting economic statecraft.

Structures

(1) Establish a permanent Sanctions Coordination Committee within the G7. The G7 should create a permanent Sanctions Coordination Committee, with each government designating a representative empowered to negotiate multilateral sanctions. Currently, sanctions are just one of many topics for negotiation among the G7 Sherpas, officials that hold the equivalent role of national security advisor or deputy national security advisor. It is rare for these officials to be sufficiently versed in the intricacies of sanctions policy to conduct substantive negotiations. As a result, each government should appoint a Sanctions Sous Sherpa, who would be responsible for meeting regularly with his or her counterparts and coordinating sanctions policies.

The Eurocentric composition of the G7 means that it won't be the optimal forum for coordinating all sanctions policies, especially those pertaining to China. The G7 Sanctions Coordination Committee can function as a core group that then creates issue specific subcommittees that pull in other countries. A model for such a structure was the G7+ Russia Sanctions Contact Group, established in 2014 to coordinate sanctions on Russia. It included all the members of the G7 plus Poland, Norway, and Australia. A similar China-focused subcommittee could pull in Australia, South Korea, India, New Zealand, and the Netherlands.

The G7 Sanctions Coordination Committee would be charged with the following

core responsibilities:

- Preparing and vetting sanctions options. The Sanctions Coordination Committee would develop and analyze sanctions options for current crises and future contingencies. It would also organize tabletop exercises to simulate how governments would respond with sanctions to potential crises and identify probable sticking points. The goal would be to have fully vetted options ready for leaders to discuss and decide on tailored to a variety of high-risk contingency scenarios.

- Sharing intelligence. The Sanctions Coordination Committee should serve as a clearinghouse for sharing sanctions-related intelligence. Such intelligence sharing could help build alignment for potential sanctions actions and aid countries in domestic enforcement.

- Joint diplomatic outreach. The Sanctions Coordination Committee should conduct joint diplomatic outreach to neutral countries. A good model is the tripartite U.S.-EU-UK diplomatic outreach to countries such as the United Arab Emirates to try to tighten enforcement of Russia sanctions.[19] Joint outreach will make it likelier that neutral countries refrain from taking active steps to undermine G7 sanctions.

- Joint declarative policies. For sanctions to play a role in deterrence, the United States and its allies must clearly signal the steps it is willing to take in response to certain hostile actions. President Biden and other G7 leaders attempted such signaling in the leadup to Russia's 2022 full-scale invasion of Ukraine.[20] The Sanctions Coordination Committee could develop additional declarative policies and issue them with the imprimatur of the G7 and any other countries that wish to sign on. The G7 has already declared its intention to launch a Coordination Platform on Economic Coercion, which could aid countries suffering from foreign sanctions and embargoes.[21] Over time, it is even possible that the G7 could issue an economic equivalent of NATO's Article 5, in which signatories pledge to come to one another's aid and respond in kind in the

event of foreign economic aggression.[22]

(2) **Create a permanent Economic Statecraft Planning Cell within the U.S. Executive Branch.** As the G7 reforms to meet the challenges of the Age of Economic Warfare, the U.S. government must do the same to streamline and bolster its own capacity to conduct economic statecraft. American authorities for economic statecraft are dispersed across the interagency, and there is no single official empowered to conduct sanctions diplomacy on behalf of the whole U.S. government. To some extent, the status quo of American economic statecraft resembles the U.S. military before the creation of unified combatant commands. As a result, coordinating multilateral sanctions is often impeded by tensions within the interagency, as State, Treasury, and Commerce jealously guard their turf.

A good way to fix this problem is to create a permanent Economic Statecraft Planning Cell (ESPC) in the Executive Branch, ideally enshrined in statute like the National Counterterrorism Center (NCTC) and supported by a dedicated budget. The ESPC would be chaired by the White House's Deputy National Security Advisor for International Economics, the official who serves as the U.S. Sherpa to the G7. It would possess a staff of perhaps 20 policy and intelligence officials detailed from State, Treasury, Commerce, the CIA, and other agencies. The primary charge of the ESPC would be to create interagency-approved sanctions options for consideration by the NSC and the G7 Sanctions Coordination Committee. It would also take the lead on planning ahead for future contingencies that will require the deployment of economic statecraft tools—for instance, a potential Chinese blockade or invasion of Taiwan.

(3) **Elevate the Head of the State Department's Office of Sanctions Coordination as the principal U.S. official in charge of sanctions diplomacy.** In late 2020, Congress passed a law creating the State Department's Office of Sanctions Coordination, reviving an office originally created in 2013 by the Obama State Department and enshrining it in statute.23 In the years since, the office has made important contributions but is still searching for a well-defined role. To optimally position the United States for sanctions diplomacy, the U.S. government should give the head of this office primary responsibility for negotiating multilateral sanctions on behalf of the interagency. The

official would serve as the U.S. Sanctions Sous Sherpa and lead representative to the G7 Sanctions Coordination Committee. He or she would also serve as a permanent member of the interagency Economic Statecraft Planning Cell.

The Head of the State Department's Office of Sanctions Coordination should be given the rank of Under Secretary of State, making him or her a peer of Treasury's Under Secretary for Terrorism and Financial Intelligence and Commerce's Under Secretary for Industry and Security. When conducting sanctions diplomacy, the official would travel with an interagency delegation to ensure Treasury and Commerce equities are fully represented.

Giving the State Department the lead role in sanctions diplomacy would align America's structure with those of other governments, in which foreign ministries typically manage sanctions coordination. It would also help ensure that U.S. negotiating positions on sanctions are attuned to America's broader foreign policy priorities.

Personnel

(1) **Develop cadres of U.S. government officials trained in economic statecraft.** Successful economic statecraft requires an interdisciplinary skillset, drawing on diplomacy, strategy, finance, technology, business, and regulation. Currently, most of the officials charged with U.S. economic statecraft are either lawyers and regulatory experts (at Treasury and Commerce) or diplomats (at State). Only recently have experts in finance and technology entered the policymaking equation through offices such as Treasury's International Affairs Division and the NSC's new Directorate for Technology and National Security.

It is difficult for any individual to master these various disciplines, but it's possible to develop sufficient fluency in all of them to effectively craft economic statecraft policies. The U.S. government should aim to develop cadres of such professionals by providing funding for educational programs (both at government-run institutions such as the Foreign Service Institute and at university-based public policy schools) and creating

more opportunities for interagency rotations in economic statecraft. Just as years of war in Afghanistan and Iraq created cadres of U.S. military service members, diplomats, and intelligence officers fluent in one another's domains, the U.S. government should seek to create similar cadres with expertise in economic statecraft.

(2) Build pathways to service in economic statecraft for individuals from the private sector. Now more than ever, private companies are both the objects and instruments of U.S. foreign policy.[24] Sanctions are a case in point: While the U.S. government sets the policies, it is ultimately individual firms that carry them out. Understanding how the private sector operates is thus critical to effective economic statecraft. The U.S. government should create pathways for individuals from the private sector to serve high impact tours of duty in economic statecraft. For instance, multiple billets on the new ESPC could be set aside for individuals from the private sector, as could billets in the offices at State, Treasury, and Commerce responsible for different aspects of economic statecraft. A lot of top talent from the private sector would be interested in serving for one or two years in the U.S. government, even if few would want to become full-time civil servants. There is a good precedent for this practice during World War II, when business executives flocked to the U.S. government to run bodies such as the War Production Board, the Lend-Lease Program, and the Office of Economic Warfare.[25]

Doctrine

The rise of sanctions in U.S. foreign policy over the last two decades has upended the logic of globalization that predominated American economic thinking after the end of the Cold War. No longer is the world economy seen as a neutral space, free from political oversight, and no longer is interdependence seen as an unmitigated positive condition that can check great power conflict. At the same time, most U.S. officials aren't ready to shun globalization and interdependence entirely. National Security Advisor Jake Sullivan, for one, has called to protect critical U.S. technologies with a "small yard and high fence."[26]

To prevent economic warfare from spiraling out of control, the U.S. government would be well served by articulating a doctrine for the use of sanctions and other tools of economic

statecraft.

(1) Principles for the responsible use of sanctions. In concert with allies in the G7 and beyond, the U.S. government should seek to build consensus on principles for the responsible use of sanctions. Such principles would include humanitarian exemptions for food, medicine, and medical devices, as well as constraints on deploying the most aggressive tools such as freezing foreign reserves. These principles can help guide policymakers in making decisions and bolster the perceived legitimacy of U.S. and allied sanctions.

(2) Clarity in objectives. The U.S. government rarely lays out clear objectives for its sanctions programs. This is a mistake, causing significant policy inertia.[27] On an annual basis, the U.S. government should evaluate and, if necessary, update objectives for each of its sanctions programs, publishing short public reports. While U.S. officials may bristle at such a requirement, over time it will likely have a disciplining effect on U.S. sanctions policy, as programs that are obviously failing will be subjected to public scrutiny.

(3) Carrots and sticks. While the recommendations in this paper pertain primarily to negative tools, that is only for the sake of practicality. The U.S. government does not currently possess authorities for positive economic statecraft that are as flexible as sanctions—a domain in which the president has very broad powers thanks to the International Emergency Economic Powers Act (IEEPA).[28] Over time, however, each of the structures outlined in this paper should evolve to play a coordination function for positive economic statecraft, too. To that end, Congress should consider further broadening the U.S. International Development Finance Corporation's mandate and bolstering its resources, as well as affording the executive increased flexibility to negotiate sector-specific economic agreements that can facilitate "friendshoring."[29] Until the United States and its allies can effectively deploy sticks *and* carrots, their economic statecraft policies will not fulfill their potential.[30]

Discussion Questions

(1) What immediate steps should the U.S. government take to create more agile and capable multilateral sanctions mechanisms, particularly through the G7?

(2) How can the U.S. government reorganize its own policymaking processes and structures for economic statecraft to ensure preparedness for future crises, including a potential conflict over Taiwan?

(3) How can the U.S. government better enforce multilateral sanctions to prevent backfill, particularly in cases involving major economic actors such as China and large neutral countries like India?

(4) What proactive measures should the U.S. government take to protect the underlying sources of American economic power, including the role of the U.S. dollar and financial infrastructure, as the use of sanctions continues to grow?

(5) Should the United States pursue the creation of a formal economic equivalent of NATO's Article 5, committing G7 and allied countries to respond jointly to economic coercion?

(6) How can the United States build bipartisan support for expanding the toolkit of economic statecraft, particularly for developing positive economic tools like trade benefits and foreign assistance?

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Background Research - Chapter 7

Gates Forum III

Harnessing the Private Sector to Empower U.S. Economic Statecraft

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Introduction

American economic statecraft fundamentally depends on the dynamism and innovation of our private commercial sector. Our private firms—not the government—conduct the vast majority of international economic activity, including cross-border trade and investment. These private sector interactions have important implications for U.S. strategic and foreign interests—what political scientists call "security externalities."[2] The government can structure the incentives facing private firms in order to encourage or discourage particular effects or patterns of economic behavior that generate security externalities which are conducive to our foreign interests. In the past, the U.S. government has harnessed the private sector to successfully advance our economic and other aims abroad.

Over the past 100 years, the United States has periodically re-assessed and restructured our economic statecraft institutions and instruments. For example, the Banking Act of 1933 that laid out the parameters for regulating the U.S. banking and finance sector was passed in the aftermath of the 1929 stock market crash.[3] The Bretton Woods institutions which govern the global economy were created in 1944.[4] The General Agreement on Tariffs & Trade (GATT) was established in 1947 to bolster partners and allies through preferential trade relations.[5] The 1948 Economic Recovery Act—i.e., the Marshall Plan—was designed to rebuild war-torn Europe.[6] The strategic effect of this economic bolstering effort was profound, leading to both the revitalization of West Germany and the Japanese miracle in the 1960s and 1970s. The GATT free trade regime would later become the basis for the World Trade Organization and the eventual post-Cold War era of unprecedented global economic growth.

Several key observations from this history must be stressed. First, coercive measures like sanctions are just one component of American economic statecraft—and they are not necessarily the dimension of economic statecraft at which we have historically excelled.[7] Much of the empirical literature on coercive economic power certainly highlights its limitations.[8] Fortunately, coercion is only one part of the larger symphony of U.S. national power.[9] Any effort to use economics to advance our foreign goals fundamentally relies on government's coordination with the private sector.

Across history, however, the United States has rarely been strategic and systematic about how we develop and wield our tools of national economic power. Our moments of deliberate economic statecraft innovation and capacity-building were in response to major shifts in the international environment and/or at home. Instead, the U.S. (and Delaware case law) has generally preferred to leave commerce in the hands of private corporations—purpose-built institutions whose explicit goal is to maximize share-holder value through profit-seeking, market expansion, returns on investment, etc. The role of government vis-à-vis the U.S. economy has been principally at the macroeconomic level—for example, by ensuring a stable monetary supply, regulating in the public interest, addressing market failures, and taxation/fiscal policy, etc.

In the twenty-first century, the United States faces a host of new international economic challenges. Our competitors and adversaries use state-owned and directed firms to manipulate international markets and tilt competitive landscapes in favor of their interests. They have further studied our economic, educational, and political systems and now seek to exploit some of the very qualities of openness, transparency, and collaboration that have made America so successful. It has been difficult for the U.S. Government (USG) to respond effectively and strategically to this given that the institutional underpinnings of today's international economic order were largely built in the aftermath of WWII.[10] The open and inclusive international economic order was not designed to accommodate the inclusion of adversarial nations intent on taking advantage of the system.

We need to innovate in government, but our economic statecraft (for example, our efforts to "derisk" in the aftermath of the post-COVID supply chain shocks, and the intensifying economic competition with China) has thus far remained principally reactive to international dynamics. The USG has been leveraging authorities, institutions, legislation, and capacities which were often built in a different era and for a different purpose (e.g., the 1950 Defense Production Act, the International Emergency Economic Powers Act of 1977, Trading with the Enemy Act of 1917). The U.S.'s export control regime is another good example of this. Export controls were initially designed during the Cold War to prevent the transfer of military technology to adversary nations.[11] The expanded application of export controls in the semiconductor realm as part of a larger effort to hamstring China's technological prowess and maintain U.S. leadership over key "dual use" technologies of the future has resulted in an over-extension of institutions like the Export Control Review Committee.

Economics will be determinative in the Great Power competition to come. The U.S. now faces a formidable competitive global environment that requires innovation in government doctrine, tools, and capacity. Critical national objectives—from securing supply chains, to coordinating with allies to foster innovation and grow new markets, from facilitating trading capacity in new partners, to maintaining a competitive innovation engine at home that produces the world's industry-leading companies—all demand that we take a hard look and undertake to reinvent our economic statecraft tools. In all this, the American private sector will almost *always* be three steps ahead of government, and private enterprise remains our comparative advantage in any long-term competition. To harness this potential, we need to design governing arrangements that shape the incentives such that private firms (when they optimize for their own self-interests) will end up behaving in a way that redounds to the national interest.

Today's State Capacity

The U.S. Government's ability to upgrade our economic statecraft toolkit faces some daunting obstacles. The various authorities used to conduct economic statecraft are scattered across more than 1,400 different offices in 10 agencies and 13 departments with no single integrating lead organization other than the National Security Council. Policymakers further lack the information and ability to do economic statecraft campaign planning, contingency modeling, strategic forecasting, or meaningful economic statecraft analysis. Most critically, the government has very little by way of organizational mechanisms for working collaboratively and constructively with private enterprise—despite the fact that the private sector is *the* way that the United States "does" economics internationally. As a consequence, vital issues of economic statecraft have tended to be framed politically in coercive, oppositional terms that puts U.S. commercial interests at odds with the American national interest.

There is moreover very little institutional capacity in the USG to deliberately design and sustain strategically coherent, coordinated economic statecraft. No single federal department or agency is tasked as the USG's lead for exercising the economic tools of national power, despite clear agency leads for the other elements of power. The Department of State handles diplomacy and the Department of Defense is in charge of our armed forces. But there is no definitive lead agency or department to exercise America's economic tools of national power. The Department of Commerce has a largely domestically focused, commercial mission and Treasury's center of gravity is squarely focused on macroeconomic and regulatory tasks. The State Department has an Economic Bureau and USAID leads our overseas development efforts. This is supported by the Development Finance Corporation and the Millenium Challenge Corporation, and the Export-Import Bank also does great work to support commercial investments overseas. But few of these government (or quasi-government) agencies are regularly coordinated for a comprehensive, strategic effect that advances U.S. foreign and security goals.

The United States simply has no Department of Economic Statecraft. Instead, we rely on *ad hoc* authorities and interagency implementation that is frequently poorly coordinated by an

overstretched White House team which is often—appropriately—focused on the crisis of the day.

> *The United States simply has no Department of Economic Statecraft.*

Most of the interagency offices responsible for some aspect of U.S. economic statecraft will wait for clear direction from above before exercising their authorities. Although this is somewhat understandable, the aggregate result is a tendency toward inertia and siloed economic statecraft in the face of myriad and complex challenges. Even recent efforts like the 2022 CHIPS and Science Act and the 2022 Inflation Reduction Act are more short-term fixes to urgent challenges rather than comprehensive efforts to build national economic statecraft policy and capacity for future use.

There is, moreover, a lack of common economic statecraft doctrine and literacy across the executive and legislative branches of government. Despite its rising importance, there is no single doctrine of economic statecraft—or debate about what it should be. Instead, international economic policy is understood to be different things to different people. For example, some might consider economic statecraft and sanctions to be the same thing. Others might think of economic statecraft as being inherently coercive. Still others would include sanctions, export controls, development aid, and commercial diplomacy as all being specific instantiations of economic statecraft. Often, these conceptions are deeply shaped by where one finds oneself in the bureaucracy. Where you sit (and what authorities your office controls) determines how you think about economic statecraft. If your authorities are all hammers, then everything looks like a nail.

We need greater clarity across government, but a critical further area in need of improvement is the USG's ability to speak more clearly and effectively with the private sector about what is at stake and what we are trying to achieve. Few avenues currently exist to facilitate clear, transparent, effective collaboration between the private sector actors that conduct international economic activity and the parts of the USG that are responsible for designing

and leveraging economic policy tools to pursue strategic interests. This lack of capacity leads to enormous inefficiencies at home and suboptimal performance abroad. A good example of such shortcomings can be found in the sanctions arena.

Firms often resist sanctions. Coercive economic statecraft tends to create at least five areas of friction for private sector actors. First, when/how do sanctions end? Firms frequently complain that while it may be easy to impose new sanctions, there are rarely deliberate off-ramps or ways to sunset or gracefully end them. As a result, once enacted, sanctions will often remain in place well after their period of maximum impact. More rigorous evaluation mechanisms—which report back to Congress—would help to alleviate some of these inefficiencies even as they improve effectiveness.

Second, in the private sector's perspective, it is not always clear when sanctions are required to be obeyed (and by whom) as opposed to merely signaling displeasure. U.S. firms often grumble about losing market share to foreign firms whose home government might have looser sanctions requirements against a target regime or poor detection and enforcement capacity.

Third, sanctions can blindside firms. When they do not comply, firms cite a lack of information and clarity about sanctions. Regulations can be difficult for firms to navigate. There can be a lot of gray areas and uncertainty in legislative language. Clear, two-way communication between the USG and private sector industries can help address some of these problems. Commercial actors value predictability in their business environments. Sanctions can come with little notice, making compliance difficult and/or costly.[12] How much lead time should firms get to comply with a new sanctions regime? There is something of a conundrum between not providing too much notice to sanctions targets while also ensuring good communications with private sector firms. Does telegraphing sanctions against foreign targets deter undesired behavior? Or does this merely provide advanced notice enabling the target to prophylactically take actions to blunt or circumvent the impact of sanctions when they are imposed? Do sanctions even work?[13]

A fourth pain point that has gained momentum in the past few years is the blowback from secondary sanctions. This comes in the form of disquieted allies who chafe at what is often seen as an extraterritorial abuse of the privileged American position in networks like SWIFT

and the global financial regime more broadly.[14] Allies tend to not like getting strong-armed by the U.S. to go further than perhaps they would otherwise prefer. When faced with the prospect of secondary sanctions, even geopolitically aligned partners often feel their sovereign agency to determine their nation's support for a given action is curtailed by secondary sanctions.[15] Non-aligned countries as well as adversaries, meanwhile, have been constructing alternative clearing systems and payment arrangements that are not as reliant on the dollar. Financial and monetary levers of power are indeed quite impactful.[16] But going to the well too frequently has incentivized BRICS nations and others to begin moving toward alternative systems, currencies, swaps, and financial regimes. Over time, these efforts can and will undermine the dollar's unique position in the global economy.

Finally, sanctions and other measures are often poorly integrated into a larger U.S. strategy. Private sector actors usually view sanctions as new regulations with which they will be forced to comply. Sanctions are seen as little more than an additional cost burden rather than as lynchpins in some broader national security strategy. Outside of the U.S., one of the most problematic phenomena are foreign entities which simply disagree with U.S. objectives. These players were frequently not on board with the imposition of sanctions in the first place. When firms in those spoiler countries control enough of the supply of a particular good, sanctions are unlikely to be effective against the target. Chinese support for North Korea or Indian and Chinese purchases of Russian oil illustrate this point nicely.

We need to broaden our aperture of economic statecraft and more creatively consider policies and actions other than sanctions. For example, "positive" forms of economic statecraft can help align strategic interests between the U.S. and allies by creating winners in particular economies or markets that can reinforce preferences for stability. These firms can help lock-in common strategic ground among partners and allies. New efforts to promote an allied defense industrial base are a prime example of this. In this way, economic activities (like trade, investment, institutions) can serve as a type of "mortar" between geostrategic bricks that align on a particular set of issues across nations. This economic concrete can help our strategic alliances to weather ups and downs brought about in the normal course of events.

A Need for Strategy, Human Capital, Information, & (possibly) Institutions

While it is clear the world has changed from the post-1991 moment, it is less clear how this changed world requires us to think about designing new structures to best position the United States for the coming decades. How can government improve its ability to harness the private sector's full potential and better advance our national interests in this new global situation? How can we improve our coordination with allies and partners to secure our collective ability to conduct cutting-edge research in science and technologies and grow new industries and markets? What structures do we need within the USG to build secure trading and investment capacity in other nations—i.e. supply chain security? In short, what do we need to do to upgrade the U.S. economic statecraft toolkit for the twenty-first century?

Without a common conceptual foundation, there is no real way to begin to create a common policy across the interagency, between the executive and legislative branches, or between government and the private sector. Without conceptual clarity, it becomes difficult for us to think through what we need to do and how best to respond to the challenges facing the United States that transcend traditional boundaries between economics and security.

We need, first of all, a common, bottom-up understanding of what economic statecraft means, one that recognizes the vital role of the private sector. As noted, commercial actors—not the government—conduct most of our foreign economic activity. These transactions generate security consequences for the United States. These "security externalities" constitute the second conceptual part of the definition.[17] The government can manipulate the incentives of commercial actors so as to encourage or discourage patterns of behavior that generate security externalities conducive to our foreign interests. This is the final part of a bottom-up approach to defining precisely what economic statecraft is.

American economic statecraft is thus defined as the intentional attempt of government to deliberately incentivize commercial actors to act in a manner that generates security externalities favorable to the U.S.'s strategic interests. Framing the relationship between

economic interaction and national security as one of "security externalities" is meant to highlight the importance of commercial actors and call attention to the strategic ramifications of their activities.

> *American economic statecraft is thus defined as the intentional attempt of government to deliberately incentivize commercial actors to act in a manner that generates security externalities favorable to the U.S.'s strategic interests.*

Under this paradigm, the necessity of working through commercial actors to do anything in the domain of economic statecraft becomes clear. Framing economic statecraft through the lens of security externalities is meant to underscore how economic statecraft is, in fact, practiced. It appropriately locates agency with the private sector actors that conduct the actual economic activities. This incentives-based approach provides an empirically accurate understanding of the role of the USG vis a vis the private sector when it comes to the exercise of economic power. It should also infuse some humility into our sense of the proper role of the state in matters of economic statecraft. Focusing on security effects is also a prudent way of preventing the sprawl of industrial policy and warding off protectionism. Economic statecraft necessarily involves altering or distorting markets. Therefore, keeping justification limited to the realm of security helps to ensure some level of discipline. When exercising economic tools of national power, it is vital to minimize distortionary burdens on the commercial actors that underpin our continued economic prosperity.

To do economic statecraft effectively, there is, today, a critical need for thoughtful capacity-building in government. We need to invest in government coordinating structures, in the people who design and lead economic statecraft programs, and in better information systems to help government and the corporate sector navigate the new international dynamics we face.

To do economic statecraft effectively, there is, today, a critical need for thoughtful capacity-building in government.

Capacity-building in government ought to focus on two critical areas in particular. One top priority is people. How can the USG best recruit and maintain highly effective people in this space? How can we train-up and equip the next generation of economic statecraft strategists? One of our strengths as a nation is our ability to adapt and gracefully retool to handle complexity. This capability rests on high quality human capital. There is a significant demand signal from both government and the private sector for skilled individuals who are able to successfully navigate the emerging geoeconomic dynamics. In the short run, we need to empower current USG personnel to be more effective at working with the private sector. This will require building up our intellectual capital in this space as well as designing efficient mechanisms for information sharing across government, and between it and the private sector.

We should further consider how best to reform our USG institutions for designing and implementing economic statecraft policy. The government shapes the incentive structures facing private sector firms consciously or unconsciously through policy tools that construct the business-government operating environment for a given sector of the economy. Government actions in areas like tax policy, subsidies, investment programs, sanctions, export controls, offset credits, matching funds, even laws, regulations, export credits, the federal funds rate, and loan programs can all shape the incentives under which private sector actors will seek to maximize their own best interests.[18]

We must therefore ask: where are there gaps in our current architecture? How can we best leverage existing capabilities and what might we need to create de novo? What structures do we need in and outside of the government to more effectively design and execute economic statecraft strategy and policy? How can we foster the ability to engage in economic campaign planning to achieve long-term objectives? What sort of abilities can we cultivate to anticipate and plan for important economic contingencies? What models of public-private partnerships

are best-suited to facilitating the various elements of economic statecraft? How should we better facilitate the coordination of private sector actors in the economic statecraft space?

There are many national interests which can drive this sort of capacity building. How, for example, can we best expand global markets in ways that drive job-growth at home and advance our other national interests? Countries in the Global South may very well become the engines of the next wave of global economic growth. How will the United States engage with those partners to develop new markets while still ensuring the integrity of its supply chains? While the needs facing the nation in the domain of economic statecraft may be clear, the specific next steps and prioritization of efforts are less so.

Principles to Guide American Economic Statecraft

All strategies rest on principles or assumptions that guide them. Below are several principles derived from our unique strengths and assets as a nation. These have been suggested as helpful jumping off points for crafting U.S. economic statecraft doctrine and tools. They are based on discussions over the past five years between the private sector, academia, and former and current U.S. government officials.

1) As general rule, we ought to design economic statecraft in light of the commercial incentives that drive the private sector. Use government policy to work with and harness these interests by incentivizing them—rather than trying to fight against this grain or trying to wish them away. Successful economic statecraft must operate through incentives to shape and leverage the scale, ingenuity, and vibrancy of American enterprise. Work with the American private sector, not against it.

2) Our national power ultimately derives from U.S. economic growth and innovation. Increasing long-run productivity gains is key to succeeding in any international competition. Real gains in productivity come from innovation. The sustained capacity for radical innovation is the key competitive advantage for the U.S. Such innovation can completely change the "rules of the game" with a new way of doing things, novel technologies, or sometimes entire industries that result. This kind of creative destruction is a hallmark of our adaptable, entrepreneurial, free market system. The pillars of our innovation system—including world-class higher education, our research ecosystem, legal infrastructure, markets, data, human capital—ought to be deliberately fostered, preserved, sustained, and shielded from deliberate efforts to undermine them.

3) When it comes to designing industrial policy, we must be constantly on guard against "capture." Our political system (especially when it interacts with business) is prone to what social scientists call "capture" which means that groups with fairly narrow agendas and preferences will tend to dedicate resources and efforts to lobby Congress to advance their particular interests whether or not that is actually in the nation's best interest.[19] We need, therefore, to be very careful about industrial policy, protectionism, or other sorts of market-distorting measures as these can easily lead to inefficiencies and a failure to innovate.

4) The U.S. should have a preference to rely on market-oriented solutions since those tend to be most efficient and sustainable over the long term. Government initiatives are most effective when they are focused on addressing market failures.

5) U.S. economic statecraft should maximize scale and legitimacy by coordinating and leveraging the power of allies and partners. Such aggregation would provide scale for markets that would help drive innovation and offset the draw of China's large internal market. But such economic statecraft coordination provides an additional benefit. It would also include legitimacy that comes from coalitions and multilateral support for U.S. actions. This strategic aggregation of leading nations is an unmatched, and sustainable comparative advantage for the United States—especially vis a vis China.

6) The U.S. enjoys a big "incumbency advantage" in any long-term competition. The United States wrote the rules of today's voluntary, open, transparent, and improvable global economic order. We are as a consequence the dominant nation in global affairs. Although we face rising challengers, we should force those challengers to make the case for why things would be better when they get to write new rules for international commerce. Fear of the unknown can help tip nations that might be sitting on the fence toward that to which they are already accustomed. This inertial tendency to go along with what is already widely known and accepted can work to the U.S. advantage. We should preserve and take advantage of our dominant influence. By deliberately forcing challengers to justify any changes, we also call attention to the inherent benefits of the current order and its improvability.

7) As we move forward in the economic statecraft domain, it is crucial to focus on the various ways that government and diplomacy can support different kinds of business, investment, and trade to help create jobs for fellow Americans and new opportunities for American businesses. We need to grow the U.S. economy in ways that are not just reflected in the stock market, but also in terms of jobs and wages. America has always stood for the advance of equality and liberty, but it will be impossible to realize these noble aims at home or internationally if the underpinning economic success is not in place to support them.

Some Recommendations for U.S. Economic Statecraft

Much work needs to be done to enhance the way in which the United States wields its economic tools of national power. One of our key challenges is to maximize private sector opportunities that exist at a time when the economic landscape is more contested and markets are less stable. It is critical for policymakers to ask how best we can maintain the world-class strength of the U.S. business community while also advancing our other security and foreign interests. Such efforts should include and aim to optimize the full panoply of capabilities rather than relying on coercive measures like sanctions alone. Our power and high standing in the world has come about though building a freer and more just international order.

Economic statecraft fundamentally depends on the private sector. It will be important to keep American business sharp—in a way that it remains globally competitive for decades to come. It will be critical to conscientiously incorporate the important role of the private sector in American economic statecraft. The vast majority of trade, investment, and human capital flows are the result of microeconomic decisions made by firms. The government's unique economic statecraft capacity is to shape the incentive structures facing those firms. This is how economic statecraft is actually done in practice. Our current governmental institutions are poorly suited to coherently conducting twenty-first century economic statecraft. The nation needs specific solutions to these problems.

1. <u>Improve information flows in the domain of economic statecraft.</u>

A first step for improving coordination between the USG and private sector around issues of economic statecraft is to get both sides to better appreciate the depth, heterogeneity and complexity of the other. The private sector tends to view the government through its narrow, particular lens largely driven by how that sector of the business world interacts with or conceptualizes "the government." For example, some industries view government as a regulator, or "the tax man," or a slow-moving bureaucratic obstacle to be avoided, or as a

compliance issue or a legal responsibility. Often it is a novel idea to think about the USG pursuing the national interest on behalf of Americans—let alone the idea that the private sector might play an integral role in advancing national security interests! On the other side, the USG all too frequently compresses the wide range of commercial actors into a thin, monochromatic abstraction called "THE Private Sector." This glosses over important heterogeneity and eschews the wide range of differences between mom-and-pop small businesses and the oil and gas industry majors or how either of those contrast with Silicon Valley tech giants or Wall Street banking as opposed to biotech start-ups and Instagram influencers.

Improving the flows of information across the USG and between the USG and the variety of private sector actors would go a long way toward improving our economic statecraft. There may be a need for a less balkanized information sharing system across the interagency. Shared information could facilitate more accurate forecasting, economic statecraft campaign design and execution, as well as better understanding of tradeoffs involved in taking one course over another.

We also need better information sharing between government and private sector industries. Policymakers need to appreciate how their decisions affect the private sector so as to avoid unintended harmful consequences. The White House and Congress need to make decisions, but in many cases, they have no reliable way of knowing how those decisions will influence the private sector. What might be some better ways to facilitate the exchange of information and how can the USG best harness the latent capacity of the U.S. private sector?

One practical idea would be to design "private sector testbeds" that could create a venue for possible economic statecraft modeling and experimentation/gaming. Such public-private partnerships could provide ways to check whether specific USG economic statecraft actions and possible activities would actually be likely to result in the sort of behaviors and responses that they are designed to induce from the private sector. Such test beds could be organized on a sectoral basis and would provide yet another way to improve the flow of information between the commercial actors and economic statecraft policy makers. Such improved situational awareness would also help both sides to more proactively identify positive instances to advance U.S. foreign interests including business opportunities.

2. Invest in building up our economic statecraft professionals.

Far too few career civil servants have direct professional experience in the private sector. At the same time, rising talent from the private sector rarely gets an opportunity to serve in government and to see how foreign economic policy is made from the inside. There is a need to devise employment and hiring procedures that allow greater movement between the private sector and government. We also need creative public-private partnership mechanisms that facilitate the flow of people and information between the private sector and the USG. This will help drive innovation and ensure that government expertise stays current and maintains American leadership in the key industries of the future.

One tactical idea for consideration is whether the creation of a "Fellows of Excellence" program at places like the Department of Commerce's field offices might help the USG to tap into human capital excellence resident locally in the private sector. This kind of a program can provide a sabbatical experience to help augment the Department of Commerce's ability to stay abreast of a broad range of fast-moving, strategically consequential industries like artificial intelligence and biotechnology. Such an experience ought to be flexible (in terms of duration, frequency, compensation, etc.) to maximize the USG's ability to access the best people from the private sector.

3. Bring procedural rigor—doctrine, planning, and analysis—to the economic statecraft domain.

In addition to these efforts to improve the flows of information and human capital, we should consider formally adopting a doctrine of economic statecraft—one that focuses on "security externalities." We lack a coherent, scalable, consistent approach to economic statecraft across both government agencies and between government and the private sector. Common definitions, language and understanding are a prerequisite to any meaningful effort to design strategy and doctrine around economic statecraft. Momentum is growing across the aisle both on the Hill and in the executive branch. There is growing recognition of a need to more strategically employ our economic tools of national power. This effort needs to begin by officially establishing a common foundation of terms and definitions. These would be fairly easily adopted and are important prerequisites for establishing a common operating picture.

There is also a need to complementarily develop sophisticated modeling and campaign planning tools in the economic statecraft domain. Just as the use of our military or diplomatic tools of power depends on deliberate planning and exercises, we should generate operational plans for likely economic statecraft contingencies and concerted economic statecraft campaigns. Again, as is the case with their military or diplomatic equivalents, such plans might be made public and available to Congress so leaders can be informed. Such mechanisms can help educate both public officials and private sector leaders as they plan for the future.

Perhaps it would also be worthwhile to write a classified and a public economic statecraft strategy. This could draw on a dynamically evolving empirical understanding of what does and does not "work" in economic statecraft. Today, American economic statecraft is organized primarily around the multitude of authorities and specific policy tools that exist. This colors how we see the phenomenon and how economic statecraft is understood—where you stand depends on where you sit. But this is not good for designing coherent strategy. Instead, we may wish to consider focusing less on the specific economic statecraft tools being used and more on the ends being sought. An outcomes or effects-based approach would facilitate coordination and bring several different kinds of economic and other statecraft tools to bear on achieving the common, desired outcome. In this way, the symphony of economic power (the multitude of positive and negative measures, trade, monetary, and financial tools, etc.) could be made a bit more harmonious and strategically coherent.

As part of this strategic shift toward a deliberate and coherent economic statecraft policy process, there are several follow-up activities that might be worth considering. For one, it would be helpful to establish a Task Force to conduct an explicit review (modeled on Treasury's 2021 formal review effort) of all the tools of economic statecraft currently available to the USG. Then, based on this snapshot of USG capabilities, it may be productive to conduct a systematic gaps analysis to determine what new instruments might be desirable in the USG economic statecraft toolkit.

4. <u>Leverage the talents and capacity of academia in the nation's service.</u>

All of this work will require the concerted help of the considerable talent and resources in America's universities. Such an effort will naturally be focused on providing the intellectual

capital necessary for enhancing the U.S. economic toolkit. This research effort should be galvanized by public and philanthropic support around important questions and lines of inquiry driven by real-world challenges. Supporting basic research in the national interest has long been an effective use of federal dollars. But in this effort, the academy should also remain true to its teaching and service obligations as well. We will need to design programs to educate future generations of public servants to ensure that they have the necessary skills to operate effectively across business and government in the dynamic geopolitical context. At the undergraduate and graduate levels, the U.S. Academy has a large role to play in designing a thoughtful curriculum that imparts valuable skills bridging economics, security studies, business, international relations, and other fields to properly equip graduates for the future. Initially, we can rapidly achieve scale by leveraging technology to coordinate class offerings to a select group of economic statecraft students across various pockets of expertise that are currently scattered across a number of scholarly institutions. Such a curriculum would need to be coordinated nationally and could be supported by a professional academic membership consortium. This would be a cost-effective way to stand-up a talent pipeline and quickly scale up our national capacity to conduct effective economic statecraft.

5. <u>Get supply chains right.</u>

Another important area that still requires additional work is in the supply chain security arena. How can we better coordinate economic statecraft with allies and partners? What can the USG do to encourage friendshoring?

One relatively easy recommendation for government would be to identify supply chain vulnerabilities and find ways to match those vulnerabilities with market opportunities. For example, the United States might not consider fertilizer as something that is all that strategic or directly critical for American national security. But in 2022 Japan identified fertilizer as one of 11 critical materials.[20] By identifying elements that trusted partners and allies worry about from an economic security standpoint, we might uncover some items that American businesses can easily provide. Facilitating reliable, secure supplier relations between American companies and Japanese customers not only creates an economic opportunity for American firms, but also serves to strengthen U.S.-Japan alliance relations even as it helps assuage an ally's supply chain vulnerability. There are likely a host of other products that we might not consider as all that strategically significant (e.g. agricultural exports, energy,

industrial equipment, electronics, bio-medical products) but would help partners and allies feel more secure knowing that they could rely on American sources for these goods that they categorize as a matter of economic security. Across another broad range of goods, the United States *and* our partners and allies might both share supply chain concerns. While we might not be able to meet each others' needs, improved economic diplomacy and allied coordination might still allow us to achieve common economies of scale. Such pooling and coordinating of demand can make stockpiling, redundancy, and resiliency commercially viable. This joint approach is already being piloted in areas like critical minerals and semiconductors. Similar efforts might yield beneficial economic statecraft results across other industries as well. Oil, AI, renewable energy, and a number of emerging technology frontiers could benefit from smart governmental initiatives to catalyze commercial actions and enhance American competitiveness for decades to come.

What kinds of public-private partnerships have been shown to unleash private sector dynamism? What would be required to advance our national security interests through the actions of the private sector? For example, should the USG subsidize the creation of a strategic stockpile for specific critical minerals?

6. <u>Integrate economic statecraft more effectively into our diplomacy.</u>

We need to be more creative and innovative with how we orchestrate our diplomatic tools toward a desired strategic and economic effect. For example, joint US-EU, "5 Eyes," AUKUS, or US-Japan-ROK innovation funds could be established to support collaborative basic research in key emerging technologies. Such government underwriting can serve to incentivize and crowd-in private capital while also reinforcing our critical diplomatic alliances. These kinds of mechanisms create sustainable partnerships with nations who share our values. They also enhance our collective ability to conduct cutting edge research and develop technologies even as it facilitates the comparative advantages of our free and open system.

We also need greater capacity in government to foster new and secure trading partners within developing countries. Getting the incentives right through trade policy and other means is the critical first step. How, beyond this, can USG institutions like the Development Finance Corporation, the Export-Import Bank, and the Millenium Challenge Corporation better

facilitate expanded commerce that benefits American business and workers while also advancing U.S. interests globally?

Critical minerals, energy, or other key materials may not always be located in nations that have the institutional capacity that OECD countries have. What can the USG do to better support American competitiveness in areas of the globe where we might not have trusted relationships? How can the USG better catalyze U.S. private sector engagement in the developing world in ways that benefit American workers even while improving lives in those partner nations? What tools can the USG use to promote U.S. business interests internationally while strengthening U.S. industries at home?

The State Department's "Deal Teams" are country team-led efforts to coordinate across the USG to identify, source, and help land commercial opportunities for U.S. businesses in key markets worldwide. It would be useful to conduct a systematic review of what has been working (or what did not work & why) from this tactical effort at the host-nation level. This knowledge can then be used to expand the best elements and improve the integration of Deal Teams with our overseas development agencies as well as other regional multilateral bodies and international partner institutions.

Commercial diplomacy and the strategic use of American business interests are an underutilized element of national power. There is important work to be done on educating corporate leaders on how their business endeavors can impact national security even as we seek to build an appreciation for how geopolitical dynamics can shape their commercial decisions.

All of this diplomatic work ought to take place under a broader strategic communications refrain that forces would-be challengers to make the case for why things would be better if they were to re-write the rules of international relations. Many nations have benefitted (and are likely to continue to reap self-interested rewards) from the stability, openness, transparency, fairness, and adaptive nature of the global system that has been built and cooperatively led by the United States. One of our big advantages is that what is in U.S. best interests is often also in the best interests of many of our partners and allies best interests. We should deliberately harness and leverage this significant "incumbency advantage" as we improve our diplomatic outreach.

7. Innovate our USG institutional design to facilitate more effective economic statecraft.

A larger set of issues for policymakers to consider is whether we have the right institutional design, funding, and human capital to "do" economic statecraft effectively. The authorities for conducting economic statecraft are scattered throughout more than 1,400 offices spread across 10 federal departments and 13 agencies. This makes the coordination of our economic statecraft difficult. Secretary Raimondo has made the point that the Department of Commerce's relatively small Bureau of Industry & Security (BIS) is under-resourced at $200 million per year.[21] Given how much economic statecraft we have been trying to do via export controls, she has argued that Commerce is needed more than ever.

We also need to improve interagency coordination and leadership on matters of economic statecraft. This will likely require imaginative thinking and a willingness to experiment with innovative institutional designs and processes. The system currently looks to the National Security Council as the ultimate interagency coordinating body. While the NSC policy processes and mechanisms can be made to work for economic statecraft, the reality of the necessity of prioritizing "the urgent" at the White House level of our system often means "the important" must take a back seat. The result is a largely *ad hoc* set of efforts that lurches American economic statecraft in a reactive fashion from one crisis to the next. The whiplash is felt by private sector firms as they struggle to keep up and maintain compliance.

A dedicated institutional body that is properly resourced and with the appropriate authorities could design and implement a more sustainable and enduring U.S. economic statecraft strategy and toolkit. Such a body would also serve as a repository of institutional memory for exercising economic tools of national power. Eventually, the USG could even cultivate a professional corps with the appropriate skillset for pursuing our strategic objectives via economic tools of power.

8. First, do no harm: Innovation and how not to kill the private sector geese that lay the golden eggs.

Perhaps the most important challenge for U.S. economic statecraft is the preservation and sustainment of the decades-long track record of American innovation. The United States has demonstrated a remarkable capacity for innovation that reshapes entire industries. The

innovation ecosystem that the United States has built is the envy of the world. Our world-class research universities attract the brightest minds from across the globe even as our dynamic venture capital community nurtures creative new companies. How can the USG best strengthen the U.S. innovation ecosystem? This is our key comparative advantage: the ability to radically innovate and the entrepreneurship to commercialize and scale that innovation. Ensuring its continued global leadership will be a central economic statecraft challenge in years to come.

Policymakers should also consider the talent dimension of economic statecraft. How will the U.S. win the longer-term competition for the world's best and brightest? We need to improve the American human capital base, both by cultivating our own skills domestically as well as remaining the preferred destination for so many smart, ambitious risk-takers who choose to emigrate to the U.S. The incoming leadership team should seek to build the structure to re-invest and renew our human capital on an ongoing basis. The future global economic landscape will bring significant changes to productivity, and it would be wise to plan for ways to re-cultivate America's human capital base on an ongoing basis.

Our competitive advantage lies in the American private sector and any economic statecraft reforms ought to build off that base without hampering it. As we seek to enhance our ability to leverage American economic power, we should strive to do so in a way that is politically and economically durable and redounds to our considerable natural strengths. For all U.S. economic statecraft, our principles of equality and liberty should continue to serve as our bedrock. These principles are a key source of strength for the U.S. at home and internationally. Historically, they have been a source of our international legitimacy and leadership, and they can continue to serve as a common ground for allies and partners to gravitate toward and coalesce around shared security and economic priorities.

Endnotes

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