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Preserving the Power of US Economic Statecraft

Thank you, Liz, and to CNAS for hosting this event. It is a pleasure to be here, and congratulations to Peter, Liz and the advisory team on the release of a thoughtful and thorough report that makes an important contribution on a timely issue – the future of US economic coercion.

Economic statecraft is a crucial pillar of US foreign policy, and one that has grown ever more important in a globalized economy with the US at the financial center. Economic sanctions, for example, give policy makers a unique capability to exert pressure beyond diplomacy but short of military force to achieve foreign policy goals. And augmenting diplomacy this way helps accomplish vital national security objectives, while preserving force as an option of last resort.

Today, we know how to tailor sanctions precisely to pressure another nation to change its own policy, but this has not always been the case. Not long ago, sanctions were a blunt instrument, and often an embargo would harm bystanders as much as targets. And sanctions could be in place for decades, with growing economic consequence, but little ability to compel another sovereign to modify its behavior.

Over the past decade policy makers, including members of the advisory panel, finely honed these tools. We now can marshal broad international cooperation to surgically target pressure on bad actors, and to ramp up the level of economic pain and circles of impact as needed, while limiting spillover effects that could undermine cooperation of like-minded nations. The aim is to use economic pressure to achieve a clearly stated policy goal, while limiting unintended impacts on innocent parties.

In short, economic pressure is not an end in itself, but a way to open the window for diplomacy to produce desired policy outcomes.

During the Obama Administration we used sanctions forcefully and effectively. Working with allies in Europe, tough and targeted US sanctions were a key element of the international response to Russian aggression in Ukraine; and with a combination of strong multilateral and unilateral economic measures, we forced Iran to the table to negotiate an agreement to put its nuclear program under tight restrictions and intrusive monitoring. We used sanctions to combat terrorism, nuclear proliferation and human rights abuses and to respond to foreign interference in US elections and cyber-attacks. At the same time, we recognized that economic pressure could not solve every foreign policy challenge, that powerful weapons must be deployed with great care, and that, to be truly effective, we had to be able to turn sanctions off, as we did with Myanmar, Cuba, and Iran as part of negotiated arrangements.

Whether new or inherited from previous administrations, US sanctions today target malign behavior from narcotics trafficking to cyber-attacks, and from human rights violations to terrorism and nuclear proliferation. But while sanctions continue to be a powerful expression of US statecraft, the nature of their use has changed, raising new questions: Can overuse and increasingly unilateral action undermine the efficacy of sanctions over time? And in the extreme, is the singular role of the US in the global economy, the source of this power, at jeopardy of being diminished?

Against that background, today's report is important. It contributes to our understanding of foundational principles and assesses the outlook and challenges ahead. I will touch on some key points the report raises, and then offer a few comments, and some worries, about the current US approach.

As discussed in the report, US economic statecraft has long benefited from the centrality of our financial system, the strength of the dollar, and the attractiveness of our export market, which together give US sanctions significant extraterritorial reach. Foreign companies and banks comply with US sanctions because they seek continued access to our market, currency, and financial architecture.

US dominance arose from the post-World War II economy, deepened with the end of the Cold War, and after three quarters of a century the US position remains unrivaled. Vibrant growth in other economies, however, will naturally start to erode this preeminence, a process that could evolve slowly over many decades.

While there is no immediate challenge to the dollar's dominance as a global reserve currency, looking ahead it would not be prudent to assume that the status quo will endure forever. And while a transition is not on the horizon, when it comes, there may not be much warning. Sterling was the world reserve currency until the Great Depression and World War II, and then quite quickly, it was not. And there are some signs that demand for dollars may trend down, for example as a country like China transitions from current account surplus to deficit and stabilizes or draws down its foreign reserves, and other reserve holding nations diversify their exposure to a wider basket of currencies.

The US should continue to use economic power to achieve important policy objectives, while at the same time protecting this unique capability for the future. I fear from fiscal policy to specific trade and sanctions actions, we are doing the opposite, and accelerating the world's search for an alternative.

Our fiscal and trade policies work at cross purposes. While the current Administration declares that reducing trade imbalances is a top priority, it is pursuing a fiscal policy that goes in the opposite direction. Deficit-financed tax cuts are increasing our need to borrow from other countries, which will drive up trade imbalances as we continue to consume more than we produce. At the same time, we are stressing our relationships around the world with friends and foes alike by pursuing aggressive and ill-founded tariffs in the name of reducing trade imbalances. An approach is not strong, regardless of the rhetoric, if it weakens US leadership and undermines global economic and geopolitical stability. And as the report highlights, these policy decisions, and how they are enacted, threaten to dilute the force of coercive tools available to US policy makers.

In terms of sanctions, a US push to reemphasize unilateral action is strengthening our strategic competitors and driving a search for ways to do business outside of the dollar and U.S. supply chains: after the Trump Administration withdrew from the Joint Comprehensive Plan of Action, Iranian leaders made their first two foreign visits to Beijing and Moscow and we see new lines of cooperation emerging. Perhaps more unsettling, our European allies united to establish a special purpose vehicle to facilitate trade with Iran beyond the reach of the US financial system. None of this suggests that the volume of activity will offset the immediate pressure of US sanctions on Iran, or that another currency will supplant the dollar anytime soon. But it is disturbing evidence that things are moving in the wrong direction driven by unforced errors, and that mechanisms are being tested to work around the United States.

The report correctly raises the risk that our current trade policy, if sustained, could diminish US economic power. While we must demand fair trade practices, brute force and a trade war that hurts our economy and our consumers as much as it does the intended targets is unlikely to produce broad and durable progress. And it comes at significant cost in terms of international leadership. For three quarters of a century a tremendous source of US power was that the rest of the world wanted to be more like us, and sadly, our example today leaves us open to criticism that we do not even honor the rules we helped to create.

Whether trade policy or sanctions, economic statecraft is not executed in a vacuum, and policymakers should consider broad and long-term ramifications for free trade as well as the ability of nations to rely on the US as a stable source of goods and services, and as a reliable partner to address transnational policy issues from security to climate change. Today, the US is absent in areas where for so long we were leaders, and with a return to more traditional statecraft, we will again need to balance competing priorities.

Sanctions are a tool to achieve a diplomatic goal, not just to impose economic pain, and to change the behavior of another country requires clear standards. Sanctions are most effective when the goal is clear, and three conditions are present: broad international support; a reliable expectation of relief when behavior changes; and rigorous and highly principled execution.

Building international support intensifies pressure on the target and reduces the likelihood of leakage and avoidance. A multilateral approach requires compromise, which can be laborious and frustrating, but also tends to build the pressure needed to force the desired policy change.

Unless a country can rely on sanctions being lifted, it is not likely to change its policy, and sanctions become simple punishment and not a means for forcing a policy change. Credibility that promises will be kept is vital for sanctions to be effective in the future.

And one needs to implement a sanctions regime effectively, which means finding violators and holding them accountable in a process that can withstand global scrutiny. Even the most formidable domestic effort also needs international cooperation, which broadens our reach for both information gathering and enforcement.

In an increasingly multipolar world, we cannot take for granted the exclusive and dominant US economic role and treating it as infinite and permanent could easily weaken it. For example, if we overuse unilateral measures, international cooperation will be at the minimum level needed to avoid immediate economic or legal consequences, and it will accelerate the process of looking for ways to work around the United States in the future. Actions to date, like the SPV, are testing the plumbing for future use.

I want to briefly touch on several worrisome trends: ambiguous diplomatic objectives; growing unpredictability; increased unilateral action; use of enforcement actions as bargaining chips; and finally a narrowed focus on isolated policies with less regard for the broader context.

First, it is not clear in the case of Iran if the Trump Administration is using sanctions in conjunction with diplomatic engagement, or whether they are simply becoming a form of economic punishment. Sanctions are not an effective tool for regime change and imposing economic hardship without a path to clear diplomatic goals may trigger a nationalist backlash that strengthens rather than weakens a failing and malign regime at home. It certainly will produce animosity towards the US in the nations with which we previously partnered. Endless sanctions without effective diplomacy becomes a form of economic war, and as history suggests from the half century long Cuba embargo, not a very effective approach.

Second, by walking away from one international agreement after another and engaging in other erratic behavior, the Administration sends a signal for other countries to reconsider their own ability to reliably predict US policy. From JCPOA withdrawal to a confused romance with a North Korean dictator, other nations now must wonder if sanctions relief will come after they comply with a demand for policy change, or from an impulsive gesture. If our adversaries conclude they no longer have a rational basis to predict US action, it will be more difficult for sanctions to persuade another sovereign to bend to our will. This also encourages them to offer half measures that secure ephemeral public relations wins rather than serious, durable steps to address national security interests.

In the case of the JCPOA, the agreement reflected Iran's calculated decision to curtail its increasingly capable nuclear program to gain relief from sanctions, and the agreement shut down Iran's path to developing a nuclear weapon. Then as now, there is every reason to demand that Iran end its other malign practices, and we left in place sanctions against terrorism and other policies that violate broadly held values. But the nuclear deal reduced the single most dangerous existential threat that Iran posed, which is why rolling back nuclear sanctions at the time was the right thing to do, creating space that should have been used to pursue diplomatic progress to address our remaining concerns. The US decision to withdraw from the JCPOA and reimpose sanctions, without evidence that Iran broke the nuclear deal, now leaves the world pointing a finger at the US as the deal breaker, and our closest European allies looking for ways to circumvent the dollar-based financial system. This increases the risk that Iran will resume a nuclear weapons program, with little prospect of progress on the broader array of challenges Iran presents, and at the same time reduces the likelihood that Iran or other malign governments will change their policy in response to sanctions.

Third, unilateral actions come in many forms, and the recent decision to end waivers that permit several countries to continue oil imports from Iran at a reduced level is the latest example. This action will test the ability of the US to maintain a unilateral sanctions regime as it causes economic hardship in countries whose cooperation we need. The sanctions that brought Iran to the table were effective because the countries affected by the oil restrictions cooperated and substantially reduced their imports. Their cooperation required intensive ongoing diplomacy and was only sustained because our waivers mitigated the detriment to their own economies. Without alternate and affordable sources of oil, this new policy will create growing tension with close allies and heighten tension with adversaries. And, of course, it is worth noting that none of this was necessary to reduce Iran's ability to access freely its oil revenues, which were required to be secured in escrow accounts in any event.

Another troubling trend is the current Administration's willingness to use pending enforcement actions as bargaining chips. On ZTE, for example, to resolve an unrelated trade dispute the US reversed course and dropped penalties for what had been found to be a violation of a settlement agreement. And in the case of Huawei, there is now the prospect that a case for extraditing a senior executive may also be comingled with transactional demands in a trade negotiation.

When legal and quasi-judicial matters are politicized, it undermines the system and the work of the strong career staff at DOJ, OFAC, and other enforcement agencies. If the Administration transparently inserts politics into enforcement actions, especially when it has little credibility on specific matters like Russia sanctions, it raises questions about the legitimacy and fairness of our whole system.

I also worry that using enforcement actions as leverage in policy negotiations undermines future cooperation. For example, if an extradition from Canada is seen as a bilateral bargaining chip in US trade talks with China, why should other allies cooperate with future requests for cooperation that might be highly challenging for them? Conversely, will countries engaged in future trade negotiations with the US seek to bring in extradition or other criminal enforcement-related matters?

Confusing opportunistic negotiating leverage with fair enforcement based on the rule of law sets a dangerous example for the world. There is always room for prosecutorial discretion, and sometimes it can and should be used in deference to national security goals. But if you decide to prosecute, then prosecute; if the grounds are not strong or the resources not worth the likely outcome, then do not. Once a matter is in the legal system injecting political influence in a judicial or quasi-judicial proceeding sends a very troubling signal.

Finally, economic tools are never used in isolation, and always need to be balanced in a world of competing priorities. The current Administration's highly aggressive and singular focus on trade leaves little bandwidth to cooperate on other pressing concerns, like increasing pressure on North Korea to reduce its nuclear threat. In the Obama Administration we negotiated hard with China on trade and succeeded in ending unfair exchange rate policies that hurt American businesses and workers. At the same time, we worked together and made progress on the Paris Climate Agreement and sanctions to force Iran to end its pursuit of nuclear weapons. In sharp contrast, with single minded focus on trade negotiations, we hear little today about the US and China cooperating on sanctions to deter North Korea's nuclear weapons program. The challenge of juggling multiple priorities at the same time is a test of leadership.

The current trajectory of US economic statecraft is troubling, and it seems unlikely that the current Administration will deviate from its aggressive unilateralism. Ultimately, economic leverage is a function of our leadership in the world, both economic and moral. The US must protect its right to act alone, but should do so only when truly necessary and with a full understanding of the consequences.

We have not yet reached a point of no return, and no other nation is currently prepared to assume the mantle of US global economic leadership. But if we continue down this path, I worry we will hasten the shift. To ensure the power of economic statecraft for years to come, we must use it judiciously. This requires an honest accounting of the limitations as well as the scope of American power and the CNAS report today is an important contribution towards that goal. Thank you, and I look forward to your questions.