Wielding the Tools of Economic Statecraft

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Introduction

These days, when the United States undertakes to coerce a foreign actor to halt an undesirable activity, the tool of first resort is rarely kinetic action or an overt show of force. Nor is the most likely option a censorious UN resolution. Often, the primary U.S. tool is some form of economic coercion, the most prominent of which is imposition of economic sanctions. In the post-9/11 security environment, the United States has deployed sanctions and other tools of economic statecraft against a wide range of adversaries, from Putin cronies to the Iranian Revolutionary Guard Corps, from government officials in Xinjiang to Venezuelan kleptocrats. In a world interconnected by massive financial flows and international trade, in which the U.S. dollar is the world's reserve currency and the unit of account in which much cross-border trade is invoiced, the power available to the United States to conduct coercive economic statecraft is unparalleled. Yet deploying the tools of economic statecraft effectively and responsibly, and safeguarding their efficacy for future generations, requires care and prudence.

Although sanctions are the best-known tools of U.S. economic statecraft, there are many others. The measures the United States has championed to track and thwart money laundering and terrorist financing (widely known as "AML/CFT"), now adopted in many countries the world over, are vital to deterring and punishing misuse of the financial system. The U.S. foreign investment screening regime, the Committee on Foreign Investment in the United States, or CFIUS, preempts foreign investment that would undermine U.S. national security. Export controls and entity listings prevent adversarial foreign actors from acquiring goods, technologies, and other U.S. support. Even tariffs, quotas, and other trade-related sanctions can be used to adjust trade flows to the detriment of competitor

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countries. And there are many others.[1] These measures form the constituent parts of the United States' "toolkit" for economic statecraft.

Extensive use of economic statecraft has afforded the United States copious experience with both success and failure. There are lessons to be learned from surveying the past two decades of economic statecraft, just as there are from examining the current situation and from making an educated prediction as to what the future holds. The past shows us that leveraging U.S. economic power is often a more tailored and less escalatory alternative to other forms of statecraft, an alternative that can be precise, effective, and staggeringly asymmetric—if deployed in a well-crafted manner, which is not always the case. A clear-eyed review of the present U.S. posture suggests actions that the United States should take, and others it should avoid, to preserve the effectiveness of its current toolkit. And trends that will shape the future—simultaneous evolution in both adversary tactics and U.S. vulnerabilities—counsel in favor of regular, rigorous gap analysis to identify where the current toolkit is lacking and to design and deploy new tools to plug those holes.

I. YESTERDAY: ASSEMBLING THE TOOLKIT

The increased prominence of economic statecraft as a tool of national security is an enduring legacy of the national security reforms undertaken after the 9/11 attacks. Within the first week after 9/11, the U.S. Treasury Department was working on policies to freeze terrorists' funds and trace the financial flows that bankrolled them.[2] These two goals manifested in dramatic expansions of two of the most powerful tools of U.S. economic statecraft: sanctions and AML/CFT measures. In the twenty years since, the United States has refined those tools for more precise and effective targeting, persuaded many like-minded countries to employ such tools in service of common goals, and developed and deployed a variety of other tools of economic statecraft. As the United States utilized these tools with increasing frequency and to greater effect, success was predicated on one widely recognized fact:

The centrality of the United States in international economics and finance makes U.S. economic statecraft uniquely powerful. A variety of economic realities combine to empower U.S. economic statecraft: the size and prominence of the U.S. economy, the influential role of the United States and U.S. financial institutions in the global financial system, and the primacy of the U.S. dollar in

1. For fuller discussions of many of these measures, see generally ROBERT D. BLACKWILL & JENNIFER M. HARRIS, WAR BY OTHER MEANS: GEOECONOMICS AND STATECRAFT (2016) and BENN STEIL & ROBERT E. LITAN, FINANCIAL STATECRAFT: THE ROLE OF FINANCIAL MARKETS IN AMERICAN FOREIGN POLICY (2006). As a result of the increased prominence of economic tools in executing U.S. foreign policy, Congress in 2017 made the Secretary of the Treasury a statutory member of the National Security Council. *See* Countering America's Adversaries Through Sanctions Act § 274(a), 50 U.S.C. § 3021(c)(1).

2. JOHN B. TAYLOR, GLOBAL FINANCIAL WARRIORS: THE UNTOLD STORY OF INTERNATIONAL FINANCE IN THE POST-9/11 WORLD 6-7 (2007); JUAN C. ZARATE, TREASURY'S WAR: THE UNLEASHING OF A NEW ERA OF FINANCIAL WARFARE 19, 29-30 (2013).

international economic relations. The dollar serves not just as a widely adopted reserve currency, but also as the currency in which a vast swath of cross-border transactions are invoiced—including many involving no other U.S. nexus—and as one side of a large portion of foreign exchange transactions. Together, these and other factors align to make U.S. economic statecraft more effective in coercing behavior than analogous tools in the hands of other nations. As former Treasury Secretary Jack Lew observed, "foreign banks and companies will often comply with U.S. sanctions not because their own governments require it but because they wish to retain access to the U.S. market, dollar, and financial system."[3]

As such, when rhetoric and diplomacy fail, the tools of economic statecraft are now often the first concrete actions the United States takes to coerce foreign actors to cease undesirable behaviors. Rarely can foreign actors respond in kind with anywhere near the effect U.S. actions have. They might consider a military response, but the nature of U.S. economic statecraft makes such a response highly escalatory and therefore generally unappealing for targeted actors.

II. TODAY: MAINTAINING THE TOOLKIT

Though the current toolkit for U.S. economic statecraft is astonishingly powerful, its use is not without vulnerabilities and discontents, as world-news headlines of the past few years reveal. U.S. actions sometimes have unintended consequences, harming entities the United States did not intend to target. Enforcement is sometimes lacking. Targets of U.S. measures develop workarounds. Even like-minded countries complain of what they view as U.S. "extraterritoriality."[4] These and other concerns suggest strategies the United States should adopt to maintain its toolkit's singular effectiveness.

Safeguard the tools of economic statecraft for future use. In any decision to deploy sanctions or another tool of economic statecraft, policymakers must consider whether deployment today will undermine the tool's future effectiveness. For example, stretching to deploy a tool at or beyond the limits of its legal bounds can create litigation risk. So too can rushing to deploy a tool without completing the necessary legal predicates. And an adverse litigation ruling not only can block the instant action, but if it results in a bad precedent, it also can compromise the future availability of the tool deployed.[5] Similarly, while the United States should not shrink from acting alone where principle requires, building partner support

3. Jacob J. Lew & Richard Nephew, *The Use and Misuse of Economic Statecraft: How Washington Is Abusing Its Financial Might*, 97 FOREIGN AFFAIRS, Nov.-Dec. 2018, at 139.

4. *Id*. at 142.

5. *See, e.g.*, Amanda Macias, *Judge Halts Trump Administration Order Banning WeChat From Apple and Google App Stores*, CNBC (Sept. 20, 2020, 9:28 AM), https://perma.cc/WPL5-W86Y; Dan Strumpf, *Pentagon Backs Off Xiaomi Blacklisting After Legal Challenge*, WALL ST. J. (May 12, 2021, 1:05 PM), https://perma.cc/7Q5P-NXLQ.

not only generally makes our actions more effective; it also reduces the likelihood that our allies will oppose, or worse, actively work to circumvent, our efforts.[6]

Work to minimize unintended consequences through precise deployment. Economic statecraft often leads to unintended consequences. One reason for this is the deep and nonobvious interconnections throughout the global economy. Another is that responsible actors are wary of coming anywhere close to crossing the United States, and therefore they often "comply" with U.S. measures more broadly than the measures themselves require. For both of these reasons, over-compliance can result in harms to third parties—for example, entities with names similar to sanctioned parties, or untargeted entities related to sanctioned parties.[7] It can also lead to "derisking," the practice of avoiding doing business in places where commercial actors deem the risk of noncompliance (even accidental) to outweigh the benefits of doing business there.[8] These effects can directly harm U.S. businesses—for example, when derisking leads to their surrendering an overseas market to foreign competitors or when opaque policies cause companies to incur unnecessary compliance costs. These unintended consequences cannot be wholly eliminated, but they can be reduced by precise targeting and clear communication about what does and does not run afoul of U.S. sanctions and other measures. At times, concrete commitments regarding where the boundaries lie will sacrifice some amount of enforcement discretion, but that loss should be weighed carefully against the nontrivial economic benefits of providing certainty to well-intentioned commercial actors.[9]

Deploy tools of economic statecraft only if the United States has the ability, resources, and intention to enforce them. The effectiveness of U.S. economic statecraft depends in large measure on American credibility: the widespread perception that when the United States imposes a measure, it intends to and will enforce it. Take sanctions: Consistent, vigorous enforcement of U.S. sanctions fosters a culture of compliance in international actors. Failing to enforce sanctions in the face of evident violations, on the other hand, erodes the perception that violating U.S. sanctions is a very bad idea and thereby encourages actors to ignore them. As such, it is unwise to impose measures that the United States lacks the ability, resources, or intent to enforce.[10] Effective use of economic statecraft is self-reinforcing; ineffective use is self-defeating.

Calibrate economic pressure in a way that leaves room to punish additional bad behavior and reward improved behavior, and have public and private messaging reflect these possibilities. There is often political pressure to set coercive

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6. *See, e.g.*, Laurence Norman, *EU Ramps Up Trade System with Iran Despite U.S. Threats*, WALL ST. J. (Mar. 31, 2020, 6:15 PM), https://perma.cc/96UT-BPR9.

7. *See, e.g.*, Byron McKinney, *COSCO Shipping & OFAC Sanctions—The Nightmare in the Haystack*, IHS MARKIT (Oct. 8, 2019), https://perma.cc/48U8-YT73.

8. *See* Edward Fishman, *Even Smarter Sanctions*, 96 FOREIGN AFFAIRS, Nov.-Dec. 2017, at 102, 104.

9. For a thoughtful discussion of the conundrum imposed by failure to demarcate clearly what is impermissible, see Stuart Levey, *Kerry's Peculiar Message About Iran for European Banks*, WALL ST. J. (May 12, 2016, 6:49 PM), https://perma.cc/M9W9-AV9N.

10. *See* Fishman, *supra* note 8, at 106-08.

measures to a "maximum" level, and then there is further political pressure against ever turning down the heat. Both impulses stand in the way of appropriate calibration of coercive economic pressure. Leaving at least some room to dial up the pressure puts bad actors in a situation in which they feel economic pain but also understand that it could get worse, the prospect of which discourages further bad behavior.

On the flip side, the effectiveness of economic pressure often depends on bad actors' believing that rectifying their behavior will benefit them—otherwise, why change? Yet there often exists domestic political pressure not to lift any economic pressure even in response to salutary developments. To alleviate this counterproductive pressure, it can sometimes make sense to articulate, at the time sanctions or other measures are imposed, what sort of improved behavior will result in their reduction or removal, and to follow through when that improvement occurs.[11] Such explicit goals and conditionality can mitigate—though probably not eliminate—political pressure to maintain coercive economic measures indefinitely. Projecting to bad actors a willingness and ability both to get even tougher in response to further bad acts and to reward good behavior has consequences not only in individual cases. It is central to conveying to bad actors everywhere the risk/reward calculus they face once U.S. attention fixes on them.

III. TOMORROW: ADAPTING THE TOOLKIT

The story of economic statecraft is an interplay of threats and tools, with tools evolving to meet current threats and threats evolving to elude current tools. This seesawing has been evident in the years since 9/11. The U.S. toolkit has been increasingly effective in combating terrorist financing, all the while novel threats such as cyber breaches and data theft have challenged existing tools. To continue effective economic statecraft, the United States must be vigilant in identifying new threats and adapting its toolkit to meet them. The experiences of the past two decades provide a roadmap for future adaptation.

Recognize the diversity of economic levers available. The powerful reach of U.S. sanctions makes them front-of-mind for policymakers, "the near-reflexive instrument of choice."[12] But their use at times has drawbacks, including those described above, especially when like-minded countries object, and they are not the ideal tool for every situation. Observers recognize that there is a danger of growing "addicted to the use of sanctions, at the expense of other—possibly more effective—policy options."[13] Confronted with a threat, prudent policymakers will survey the full economic toolkit and think carefully about which tool or tools to

11. *See* CENTER FOR A NEW AMERICAN SECURITY TASK FORCE ON THE FUTURE OF U.S. COERCIVE ECONOMIC STATECRAFT, AMERICA'S USE OF COERCIVE ECONOMIC STATECRAFT 4 (Ctr. for a New Am. Sec. eds., 2020) [hereinafter *CNAS Report*].

12. BLACKWILL & HARRIS, *supra* note 1, at 152.

13. MICHAEL B. GREENWALD, THE FUTURE OF THE UNITED STATES DOLLAR: WEAPONIZING THE U.S. FINANCIAL SYSTEM 8 (Atl. Council GeoEconomics Ctr. eds., 2020).

employ, taking into account the respective tools' availability, effectiveness, resource burdens, and potential collateral consequences.

Regularly reassess the current toolkit's effectiveness. An evolving threat environment can degrade the effectiveness of current tools. Indeed, the more effective current tools are at thwarting our adversaries' goals, the more incentive adversaries have to achieve their goals through novel methods that fall beyond the reach of current tools. Similarly, the more effective are our existing tools, the more comfortable policymakers become with their use, and the greater their tendency to stretch existing tools to address novel threats, even those threats for which current tools are not well-suited. As such, policymakers must make a conscious effort to periodically reassess the fit between toolkit and threat environment. Staff whose job it is to deploy current tools will often be (appropriately) preoccupied with execution of their missions, and they may lack a wide-angle view of the threat environment. While those staff will have useful, on-the-ground insights for such a reassessment, policymakers should charge other disinterested and objective personnel with assessing current tools' effectiveness and conducting "red-teaming" and gap analysis of current capabilities. Moreover, that analytic work should assess not only a tool's absolute effectiveness, but also its *cost*-effectiveness: It makes little sense to impose measures for which the burden on the U.S. government and on the American economy outweighs the attendant benefit to U.S. foreign policy.

Where the threat environment requires, refine existing tools and develop new ones. When a new threat emerges that is not well-addressed by current tools, policymakers should work creatively to modify current tools or develop new tools that fit. As discussed above, this sort of creative thinking characterized policymaking in the years immediately after 9/11. Similarly, during the Trump administration, the United States did "expand its use of sanctions"—but it also "renewed and expanded other parts of America's coercive economic toolkit."[14] This was especially true of the various measures that the administration adopted to address Chinese activities it identified as market-distorting, offensive to human rights, or otherwise problematic: Among other measures, the United States adopted prohibitions on investing in Chinese military companies, barred the use of certain Chinese-produced technologies in U.S. telecommunications systems, and pushed like-minded countries to ensure that their own telecommunications networks were free of such technologies.[15] Even securities listing standards had a role to

14. *CNAS Report*, *supra* note 11, at 1.

15. Exec. Order No. 13,959, 85 Fed. Reg. 73,185 (Nov. 17, 2020) (prohibiting securities investments in Chinese military companies); Exec. Order No. 13,873, 84 Fed. Reg. 22,689 (May 17, 2019) (addressing the security of information and communications technology and services supply chains); Alexandra Alper, *U.S. Finalizing Rules to Limit Sensitive Tech Exports to China, Others,* REUTERS (Dec. 17, 2019, 7:04 AM), https://perma.cc/NQJ3-2LSD; *The Clean Network*, U.S. DEP'T OF STATE, https://perma.cc/GWX4-HHKV (archived content summarizing Trump administration "Clean Network" initiative). The Biden administration has largely continued these efforts. *See, e.g.*, Demetri Sevastopulo,

play in this renewed great power competition.[16]

CONCLUSION

Despite these innovations, it is clear that there are growing gaps in the U.S. toolkit. Most critically, the United States is currently grappling with difficult questions about how to protect both the sensitive personal data of U.S. persons and hard-won U.S. technological know-how from expropriation and exploitation by foreign actors. The Trump Administration worked to deploy various tools of economic statecraft to address these threats, but their complexity counsels in favor of developing new methods and new tools—likely including enforceable international agreements—to combat these sorts of harms to Americans and American companies.[17]

Fortunately, with regard to policy innovation, the legal landscape for developing new tools of economic statecraft is generally quite flexible: Existing statutory grants of authority give the Executive Branch substantial leeway in responding to evolving threats, and Congress has shown itself willing to legislate new or expanded authorities where necessary.[18] Policymakers would be wise to recognize the need for continual adaptation. Protecting the national security is an ongoing, dynamic challenge, and the geoeconomic toolkit of today is not necessarily the one that will be needed tomorrow.

U.S. Adds Chinese Supercomputing Companies to Export Blacklist, FIN. TIMES (Apr. 8, 2021), https://perma.cc/8WS8-7FQR.

16. PRESIDENT'S WORKING GRP. ON FIN. MKTS., REPORT ON PROTECTING UNITED STATES INVESTORS FROM SIGNIFICANT RISKS FROM CHINESE COMPANIES (2020).

17. *See* Matthew J. Slaughter & David H. McCormick, *Data Is Power: Washington Needs To Craft New Rules for Digital Age*, 100 FOREIGN AFFAIRS, May-June 2021, at 60–61; Lauren Feiner & Amanda Macias, *Mnuchin Confirms TikTok Is Under CFIUS Review Following National Security Concerns*, CNBC (July 29, 2020, 11:17 AM), https://perma.cc/9FKV-MXJX.

18. For example, the president's authorities under the International Emergency Economic Powers Act, IEEPA, are expansively phrased, see 50 U.S.C. § 1702(a). Congress in 2018 extensively reformed the CFIUS process to adapt to adversary tactics that circumvented its existing statutory jurisdiction, see Foreign Investment Risk Review Modernization Act of 2018, Pub. L. No. 115-232, Title XVII, Subtitle A (2018).

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