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Assessing U.S. Sanctions on Russia:

Next Steps

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Introduction

Chairman Crapo, Ranking Member Brown, and distinguished members of the Senate Committee on Banking, Housing & Urban Affairs, I am honored to appear before you today to discuss assessing U.S. sanctions on Russia and next steps.

I would like to focus my testimony on the effectiveness of the current U.S. sanctions programs targeting Russia, as well as what the United States can do to responsibly ramp up economic pressure on Russia to convince Moscow to cease destabilizing activities in Eastern Ukraine, reduce malicious cyber activities targeting the United States and its allies, and limit their military operations in Syria.

To date, U.S. sanctions on Russia have a mixed record of success. Many macroeconomic indicators and recent studies suggest the various forms of sanctions—in particular the sectoral sanctions imposed on key Russian economic sectors—have had an impact on overall Russian economic health. Likewise, Russian Government officials continually push for sanctions relief, either in public statements[1] or by trying to undermine EU sanctions,[2] suggesting that Russia is feeling the pinch.

Nevertheless, the United States has not achieved many of the core objectives it sought when deploying these tools; while the United States has imposed one of the most sophisticated sanctions regime ever constructed—including list-based sanctions targeting Russian individuals supporting separatist activities in eastern Ukraine, as well as individuals engaged in human rights abuses, a comprehensive embargo on Crimea, sectoral sanctions focused on key sectors of the Russian economy, sanctions targeting Russian malicious cyber activity, and secondary sanctions authority—Russia continues to engage in threatening activity in a range of areas. In Eastern Ukraine, Russian-backed forces continue to violate the ceasefire, routinely attacking Ukrainian villages and military personnel. Likewise, Moscow continues to target Russian opposition leaders, often with lethal means. Last year and again more recently, Russian opposition leader Vladimir Kara-Murza was poisoned after speaking out about Russian human rights abuses and corruption, with many believing the Russian Government was behind the attempt on his life.[3] This poisoning

[1] David Herszenhorn, "Putin Calls for End to Use of Sanctions and Criticizes U.S. in Afghanistan," *The New York Times*, July 10, 2015, https://www.nytimes.com/2015/07/11/world/europe/putin-criticizes-us-role-in-afghanistan.html; "Russia Can't Mend Times with U.S. While it Backs Sanctions: Lavrov," *Reuters*, Dec. 10, 2015, http://www.reuters.com/article/us-russia-usa-lavrov-idUSKBN0TT0YR20151210; Roland Oliphant, "'Cancel Sanctions and Scale Back NATO' Russia Tells US as Vladimir Putin Scraps Nuclear Deal," *The Telegraph*, Oct. 3, 2016, http://www.telegraph.co.uk/news/2016/10/03/putin-scraps-deal-to-dispose-of-bomb-grade-plutonium-in-swipe-at/; "Russia Demands U.S. End Sanctions, Pay Compensation if Plutonium Accord to be Resumed: Draft Law," *Reuters*, Oct. 3, 2016, http://www.reuters.com/article/us-russia-usa-nuclear-lawmaking-idUSKCN1231HA?il=0.

[2] "Putin Steps Up Drive to Kill Sanctions Amid Signs of EU Disunity," *Voice of America News*, July 29, 2016, http://www.voanews.com/a/putin-steps-up-drive-kill-sanctions-signs-eu-disunity/3440262.html.

[3] Andrew Kramer, "More of Kremlin's Opponents Are Ending Up Dead," *The New York Times*, Aug. 20, 2016, https://www.nytimes.com/2016/08/21/world/europe/moscow-kremlin-silence-critics-poison.html.

followed the shooting death of Russian opposition leader Boris Nemtsov in February 2015, a killing widely perceived as a response to Nemtsov's outspoken protests against the government.[4] In Syria, Russia continues to support President Bashar al-Assad with direct military intervention,[5] including during the Syrian Government's brutal assault on Aleppo.[6] And finally, in the cyber realm, according to the intelligence community, Russia has continued its efforts to influence and undermine U.S. allies across Europe, in recent months focusing these efforts on upcoming elections in Western Europe.[7]

This Committee should make no mistake; Russian activity in these areas poses a serious threat to U.S. interests and the United States should be prepared to use all elements of its national power—including its economic power—to blunt Moscow's ability to undermine U.S. interests at home and abroad.

Additional, responsibly crafted U.S. sanctions can be a powerful tool to impact Russia's decision making and reduce its nefarious activities in each of these areas. Specific types of sanctions that, if properly calibrated, could be particularly effective in increasing the pressure on Russia include:

- The codification of certain executive orders ("EOs"), including EOs 13660, 13661, 13662, 13685, and 13694, as well as additional statutory designations under these codified EOs;
- Establishment of a task force, potentially led by the Financial Crimes Enforcement Network ("FinCEN"), to identify and seize assets of targeted Russian persons, including those with close to ties to Russian President Vladimir Putin;
- Certain restrictions related to U.S. and European financial institutions' purchase or facilitation of Russian sovereign debt, which has been a way for Russia to prop up Russian state-owned enterprises and financial institutions in the face of sectoral sanctions; and
- Primary and secondary sanctions on elements of Russia's oil and gas industry, with possible carve-outs for certain countries particularly dependent on the Russian energy sector.

However, any new sanctions on Russia must take into account four important considerations. First, while additional sanctions are appropriate here, Congress should be wary of imposing sanctions that are *too* powerful. If the United States attempts to impose broad, Iran-like sanctions on Russia that target large swaths of the Russian economy and do not contain carve-outs for allies and

[4] Andrew Kramer, "Boris Nemtsov, Putim Foe, Is Shot Dead in Shadow of Kremlin," *The New York Times*, Feb. 27, 2015, https://www.nytimes.com/2015/02/28/world/europe/boris-nemtsov-russian-opposition-leader-is-shot-dead.html.
[5] Sam Heller, "Russia in Charge in Syria: How Moscow Took Control of the Battlefield and Negotiating Table," *War On The Rocks*, June 28, 2016, https://warontherocks.com/2016/06/russia-is-in-charge-in-syria-how-moscow-took-control-of-the-battlefield-and-negotiating-table/.
[6] Alison Meuse, "U.N. Report Says Syrian Forces and Rebel Factions Committed Aleppo 'War Crimes'," *National Public Radio*, Mar. 3, 2017, http://www.npr.org/sections/parallels/2017/03/03/518134951/u-n-report-says-syrian-forces-and-rebel-factions-committed-aleppo-war-crimes.
[7] "Background to 'Assessing Russian Activities and Intentions in Recent US Elections': The Analytic Process and Cyber Incident Attribution," *Director of National Intelligence, Intelligence Community Assessment*, Jan. 6, 2017, https://www.dni.gov/files/documents/ICA_2017_01.pdf.

partners, this could backfire, limiting critical European willingness to participate in our sanctions campaign and making it more difficult for Moscow to fulfill—at least partially—U.S. demands. Similarly, such sanctions could do serious damage to the Russian economy in ways that threaten our interests; while we want to pressure Russia to cease its malign activities, destroying the Russian financial system or cratering its economy would have worldwide blowback, threatening markets across the globe.

Second, Congress should think through how it can unwind sanctions pressure in the case that Moscow—even partially—changes its behavior. Current sanctions bills, including the Counteracting Russian Hostilities Act of 2017 ("Counteracting Russian Hostilities Act"),[8] ramp up the pressure on Russia significantly. Yet, as we have learned over the past few years, unwinding sanctions can often be a difficult and fraught process, and Congress should think about how and when it will unwind sanctions even as it builds pressure. Any such new sanctions legislation should include built-in "off-ramps"—namely elements of the sanctions regime, such as specific designations or specific Directives—that could be undone in a situation of partial Russian compliance with its various obligations, such as those under the Minsk agreements. Such partial sanctions relief could be traded for Russian fulfillment of these obligations, and this approach would increase the chances the United States could limit—though not completely eliminate—Russian challenges to U.S. interests.

Third, any such sanctions must be nested in a larger strategy of pressuring Moscow, including aggressive diplomacy and responding in kind to malign Russian activities such as offensive cyber operations. Sanctions are a means to an end, and Congress and the administration must be clear as to what that end is and how they intend to achieve it. Ramping up economic pressure on Moscow without clear objectives, the employment of other coercive tools, and buy-in from the administration—is unlikely to be effective in getting Moscow to change its behavior.

Fourth and as I discuss below, the United States must be prepared to address Russian retaliation for such sanctions, including in the form of countersanctions, increased cyber attacks, and even kinetic action in ways that threaten U.S. interests.

I will focus my comments today on four main areas. First, I discuss the various elements of the U.S. sanctions program on Russia, including sanctions on Russia related to Ukraine, cyber activities, and corruption (together, the "U.S. Russia Sanctions Program"). Second, I discuss whether the U.S. Russia Sanctions Program has been effective, both in impacting the Russian economy and in changing Russian behavior in desired ways. Third, I discuss ways to further increase the pressure on Moscow in responsible ways, drawing in part on existing legislative proposals such as the Counteracting Russian Hostilities Act. Finally, I provide legislative suggestions to ensure that we are able to ramp down sanctions pressure when appropriate as effectively as we can ramp it up, increasing the likelihood that we will at least limit many of Moscow's malign activities.

[8] S.94, "Counteracting Russian Hostilities Act of 2017," 115th Cong. (2017).

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I. Current U.S. Sanctions on Russia

Taken together, the current U.S. Russia Sanctions Program constitutes one of the most sophisticated economic sanctions programs ever devised and implemented. Because each component of the sanctions program is a targeted and justified response to a specific form of Russian aggression, many of our partners around the world—including European states as well as Canada, Australia, and Japan—have joined the United States in employing economic and financial restrictions.

The U.S. Russia Sanctions Program—which is now comprised of sectoral sanctions, list-based designations, secondary sanctions authority, and a comprehensive embargo—expanded most rapidly in 2014 following Russia's destabilizing activities in Ukraine—including the annexation of Crimea. Despite its sophistication, however, the Program is not comprehensive, and a number of avenues exist for a measured expansion. Assessing the benefits and drawbacks of those recommendations requires a baseline understanding of the current types of sanctions the United States has imposed on Russia, including the underlying rationale for their imposition. The current section provides an overview of U.S. sanctions already in place with respect to Russia's activities in Ukraine, cyber-enabled malicious activities, and human rights violations. It explains the reasoning behind each sanctions imposition—reasoning that informs when and how the United States should eventually unwind sanctions components based on changes in Russian behavior.

Destabilizing Activities in Ukraine

In late February 2014, shortly after Ukraine's ex-president Viktor Yanukovych was forced out of Kiev by mass protests, Vladimir Putin gave an order for Russian Special Forces to begin "returning Crimea to Russia."[9] Gunmen planted the Russian flag at the local parliament in early March, setting the scene for a sham March 16 referendum in which Crimea purportedly voted to join the Russian Federation.[10]

Russian aggression continued following this de facto annexation of Crimea. Russian-backed separatists began seizing cities in eastern Ukraine; when Ukrainian forces appeared able to retake separatist-held territories, Russian reinforcements pushed the Ukrainians back.[11] An initial peace deal called the Minsk Protocol (or "Minsk I") failed, but in February 2015, the Minsk II ceasefire agreement ("Minsk II") was negotiated by the leaders of France, Germany, Ukraine, and Russia. Minsk II contains 13 points including, first, a commitment to the withdrawal of heavy weapons by both sides, monitored by the Organization for Security and Co-operation in Europe ("OSCE").

[9] Mary Ellen Connel and Ryan Evans, "Russia's 'Ambiguous Warfare' and Implications for the U.S. Marine Corps," *Center for Naval Analysis*, May 2015, https://www.cna.org/CNA_files/PDF/DOP-2015-U-010447-Final.pdf.
[10] Alissa de Carbonnel, "How the Separatists Delivered Crimea to Moscow," *Reuters*, Mar. 13, 2014, http://in.reuters.com/article/ukraine-crisis-russia-aksyonov-idINL6N0M93AH20140313.
[11] "What Are The Minsk Agreements?" *The Economist*, Sept. 14, 2016, http://www.economist.com/blogs/economist-explains/2016/09/economist-explains-7.

Minsk II also calls for the restoration of Ukraine's full control over its borders and for constitutional reform in Ukraine, among other points.[12]

In response to Russian aggression, the United States has employed three general categories of sanctions. First, the United States has imposed blocking sanctions on designated individuals and entities, adding them to the Treasury Department's Specially Designated Nationals List ("SDN List"), thereby freezing their assets and prohibiting transactions with U.S. persons. The blocking sanctions have been imposed on those undermining democratic processes and institutions in Ukraine; threatening the peace, security, stability, sovereignty, and territorial integrity of Ukraine; and contributing to the misappropriation of Ukraine's assets. Shortly after their initial imposition, these sanctions were extended to cover Russian government officials and persons operating in the Russian arms or related material sector.

Second, the United States has developed "sectoral sanctions" targeting selected entities in the financial, energy, and arms sectors of the Russian economy. These entities are listed on the Sectoral Sanctions Identification List ("SSI List"). Such sectoral sanctions generally prohibit U.S. persons from engaging in certain kinds of medium- and long-term transactions but generally allow day-to-day business activity; they also prohibit U.S. person involvement in many activities related to deep-water, Arctic offshore, or shale oil projects.

Third, the United States has imposed an investment ban and prohibition on the exportation or importation of goods, technology, or services to or from the Crimea region. These prohibitions constitute, in effect, a comprehensive embargo on Crimea.

The following authorities related to sanctions on Russia in response to its invasion of Ukraine are codified in the Ukraine Related Sanctions Regulations (31 C.F.R. Part 589).

[12] The core 13 components of the Minsk II Agreement include:

1. Immediate, full bilateral ceasefire as of 15 February 2015 at 00:00;
2. Withdrawal of all heavy weapons by both sides, to be completed within 14 days;
3. Effective monitoring regime for the ceasefire and withdrawal of heavy weapons by the OSCE;
4. Launch of dialogue on modalities of local elections in accordance with Ukrainian legislation;
5. Pardon and amnesty of figures involved in the conflict;
6. Release of all hostages and other illegally detained people, based on the "all for all" principle;
7. Safe delivery of humanitarian aid to those in need, based on an international mechanism;
8. Restoration of full social and economic links with affected areas;
9. Full Ukrainian control over its border with Russia throughout the conflict zone;
10. Withdrawal of all foreign armed groups, weapons and mercenaries from Ukrainian territory;
11. Constitutional reform in Ukraine with decentralisation as a key element; a new constitution by the end of 2015;
12. Local elections in Donetsk and Luhansk regions to be held according to OSCE standards; and
13. Intensifying of the work of the Trilateral Contact Group.

See Naja Bentzen, "Ukraine and the Minsk II Agreement: In a Frozen Path to Peace?" *European Parliamentary Research Service*, PE 573.951, Jan. 2016, http://www.europarl.europa.eu/RegData/etudes/BRIE/2016/573951/EPRS_BRI(2016)573951_EN.pdf.

- **Executive Orders 13660**[13] **and 13661**[14] (Mar. 6 and 16, 2014; 99 and 107 designations, respectively). By authorizing additions to the SDN List, these Orders block the property and interests in property of individuals and entities who have been determined to be responsible for, or complicit in actions or policies that undermine democratic processes or institutions in Ukraine or that threaten the peace, security, stability, sovereignty, or territorial integrity of Ukraine. In general, these designations include former Ukrainian public officials working with the Government of Russia, as well as individuals close to Russian President Vladimir Putin and other senior Russian government officials involved in planning activities in Ukraine.

- **Executive Order 13662**[15] (Mar. 20, 2014; 258 entities listed). This Executive Order authorizes the use of U.S. sectoral sanctions, which impose transaction-specific prohibitions on designated entities. U.S. sectoral sanctions are divided into four Directives, which target the Russian financial, defense, and energy sectors.
    - Directive 1 (financial sector) prohibits U.S. persons from transacting in new debt of longer than 30 days maturity or new equity of designated financial institutions.
    - Directive 2 (energy sector) prohibits U.S. persons from transacting in new debt of longer than 90 days maturity of designated energy companies.
    - Directive 3 (defense sector) prohibits U.S. from transacting in new debt of longer than 30 days maturity of designated defense companies.
    - Directive 4 (energy/unconventional oil) prohibits U.S. persons from providing goods, services (except for financial services), or technology in support of exploration or production for deep-water, Arctic offshore, or shale projects that have the potential to produce oil in Russia.

- **Executive Order 13685**[16] (Dec. 19, 2014; 47 designations). This Executive Order establishes a comprehensive embargo on the territory of Crimea, and U.S. persons are prohibited from investing in Crimea, and importing goods from—or exporting goods to—the area.

- **Ukraine Freedom Support Act**[17] (Dec. 18, 2014). Congress passed this Act to assist Ukraine in restoring its sovereignty and territorial integrity and to deter Russia from further destabilizing activities. While the Act did not result in new sanctions designations, it does establish new secondary sanctions authority. It provides the President with the authority

[13] Exec. Order No. 13,660, 79 Fed. Reg. 13,493 (Mar. 10, 2014), *available at* https://www.treasury.gov/resource-center/sanctions/Programs/Documents/ukraine_eo.pdf.
[14] Exec. Order No. 13,661, 79 Fed. Reg. 15,535 (Mar. 19, 2014), *available at* https://www.treasury.gov/resource-center/sanctions/Programs/Documents/ukraine_eo2.pdf.
[15] Exec. Order No. 13,662, 79 Fed. Reg. 16,167 (Mar. 24, 2014), *available at* hhttps://www.treasury.gov/resource-center/sanctions/Programs/Documents/ukraine_eo3.pdf.
[16] Exec. Order No. 13685, 79 Fed. Red. 247 (Dec. 19, 2014), *available at* https://www.treasury.gov/resource-center/sanctions/Programs/Documents/ukraine_eo4.pdf.
[17] Ukraine Freedom Support Act of 2014, Pub. L. No. 113-272, 128 Stat. 2952 (2014), https://www.congress.gov/113/plaws/publ272/PLAW-113publ272.pdf.

> to impose sanctions on foreign companies that make significant investments in "special Russian crude oil projects," which include Russia's deep-water, Arctic offshore and shale projects. The Act also allows the President to prohibit or restrict the dealings of foreign financial institutions with the U.S. banking system if he determines that they have knowingly engaged in significant transactions involving sanctionable activities or sanctioned entities. To date the President has not designated entities under this authority.

Malicious Cyber-Enabled Activities

In late December, the United States acted in response to the Russian government's cyber operations aimed at the United States. According to multiple U.S. intelligence agencies, Russia's cyber activities were intended to sow doubt about the integrity of our electoral process and erode faith in liberal democracy.[18]

A pre-existing version of Executive Order 13694 of April 2015 had created a targeted authority for the U.S. Government to address cyber-enabled malicious activities that: (i) harm or significantly compromise the provision of services by entities in a critical infrastructure sector; (ii) significantly disrupt the availability of a computer or network of computers; or (iii) cause a significant misappropriation of funds or economic resources, trade secrets, personal identifiers, or financial information for commercial or competitive advantage or private financial gain.

Yet Russia's use of cyber-enabled means to undermine democratic processes at home and abroad made clear that a tool explicitly targeting attempts to interfere with elections was also warranted.[19] The Executive Order was thus amended to authorize sanctions on those who tamper with, alter, or cause a misappropriation of information with the purpose or effect of interfering with or undermining election processes or institutions.

Using this new authority, the United States added nine entities and individuals to the SDN List: two Russian intelligence services (the GRU and the FSB); four officers of the GRU; and three companies that provided material support to the GRU's cyber operations. The Treasury Department also designated two additional Russian individuals under the pre-existing Executive Order: one is responsible for the theft of over $100 million from U.S. firms, universities, and agencies; the other compromised the computer networks of major U.S.-based e-commerce companies and misappropriated personal identifiers for financial gain.[20]

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[18] "Background to 'Assessing Russian Activities and Intentions in Recent US Elections': The Analytic Process and Cyber Incident Attribution," *Director of National Intelligence, Intelligence Community Assessment*, Jan. 6, 2017, https://www.dni.gov/files/documents/ICA_2017_01.pdf.

[19] "FACT SHEET: Actions in Response to Russian Malicious Cyber Activity and Harassment," *The White House*, Dec. 29, 2016, https://obamawhitehouse.archives.gov/the-press-office/2016/12/29/fact-sheet-actions-response-russian-malicious-cyber-activity-and.

[20] *Id.*

- **Executive Order 13694**[21] (amended by E.O. 13757 of Dec. 28, 2016;[22] 11 designations). E.O. 13694 authorized the imposition of sanctions on individuals and entities determined to be responsible for malicious cyber-enabled activities that constitute a significant threat to the national security, foreign policy, or economic health or financial stability of the United States.

Human Rights Violations

Following the death of Sergei Magnitsky, a political activist who suspiciously died in prison on November 16, 2009 after uncovering fraud involving Russian tax officials,[23] Congress passed the Magnitsky Act. This act aimed to punish Russian officials involved in his death and in the corruption he uncovered as well as individuals determined to be responsible for gross violations of human rights. Most recently, on January 9, 2017, the United States designated five additional Russians, "including powerful senior law-enforcement official Aleksandr Bastrykin and lawmaker Andrei Lugovoi, who has been accused in Britain in the poisoning of Kremlin critic Aleksandr Litvinenko."[24]

- **Sergei Magnitsky Rule of Law Accountability Act of 2012**[25] (Dec. 14, 2012; 44 designations). This legislation requires that sanctions be imposed on individuals determined, based on credible information, to be responsible for the detention, abuse, or death of Sergei Magnitsky; who have participated in efforts to conceal the legal liability for, or who have financially benefited from the detention, abuse, or death of Magnitsky; or were involved in the criminal conspiracy uncovered by Magnitsky.[26] This legislation also requires that sanctions be imposed on individuals determined to be responsible for extrajudicial killings, torture, or other gross violations of internationally recognized human rights committed against individuals seeking to expose illegal activity carried out by officials of the Russian Government, or seeking to obtain, exercise, defend, or promote internationally recognized human rights and freedoms in Russia.[27]

II. Gauging the Effectiveness of U.S. Sanctions on Russia

[21] Exec. Order No. 13694, 80 Fed. Reg. 18,077 (Apr. 2, 2015), *available at* https://www.treasury.gov/resource-center/sanctions/Programs/Documents/cyber_eo.pdf.
[22] Exec. Order No. 13757, 82 Fed. Reg. 1 (Jan. 3, 2017), *available at* https://www.treasury.gov/resource-center/sanctions/Programs/Documents/cyber2_eo.pdf.
[23] "Announcement of Sanctions Under the Sergei Magnitsky Rule of Law Accountability Act," *Treasury Department Press Center*, May 20, 2014, https://www.treasury.gov/press-center/press-releases/Pages/jl2408.aspx.
[24] Carl Shreck, "U.S. Sanctions Russia's Bastrykin and Alleged Litvinenko Killers," *Radio Free Europe Radio Liberty*, Jan. 10, 2017, http://www.rferl.org/a/russia-bastyrkin-lugovoi-magnitsky-sanctions/28222295.html.
[25] Russia and Moldova Jackson-Vanik Repeal and Sergei Magnistsky Rule of Law Accountability Act of 2012, Pub. L. No. 112-208, Dec. 2014, https://www.congress.gov/112/plaws/publ208/PLAW-112publ208.pdf
[26] "Announcement of Sanctions Under the Sergei Magnitsky Rule of Law Accountability Act," *Treasury Department Press Center*, May 20, 2014, https://www.treasury.gov/press-center/press-releases/Pages/jl2408.aspx.
[27] *Id.*

The effectiveness of these various sanctions programs is mixed; economic and political indicators suggest that they have had an impact on the Russian economy and Russian decision-making, though not sufficient to coerce Russia to cease its aggressive cyber activity, relinquish control over Crimea, or cease its support for separatists in Eastern Ukraine.[28]

Imposing Economic Costs

The Russian economy has clearly struggled since the broadest sanctions were imposed in 2014,[29] but the downturn was likely driven both by the collapse in global oil prices and the imposition of sectoral sanctions. For example, the Congressional Research Service notes that most sanctions hit just as the oil price was dropping by more than 60% between the start of 2014 and the end of 2015.[30] Yet the sanctions do appear to have had an independent impact at the macroeconomic level; a 2015 IMF estimate that "U.S. and EU sanctions in response to the conflict in Ukraine and Russia's countervailing ban on agricultural imports reduced Russian output over the short term by as much as 1.5%."[31] In April 2015, speaking to the lower house of parliament in Moscow about "unprecedentedly harsh sanctions pressure," Russian Prime Minister Dmitry Medvedev said that the sanctions had cost Russia $26.7 billion in 2014 and would cost $80 billion more in 2015.[32]

The sanctions may have exerted their greatest impact through changes in foreign investment and at the firm level. As the work of one of my fellow witnesses showcases, the sanctions created an atmosphere that discouraged foreign direct investment and that this "lower investment in Russia could lead to a cumulative loss of output of up to 9 percent of GDP."[33] Likewise, her work also found that U.S. targeted sanctions, while not specific to the Russia program, cause countries to "face significantly elevated levels of political risk, depressing investment in the target's economy."[34] Data compiled by the Congressional Research Service corroborates this finding,

[28] The question of whether these sanctions have been effective touches on a wide range of other issues not addressed here, such as whether the employment of these tools in the current situation will deter future aggression by Moscow or by other states whose leaders are observing Russia's tactics with great interest. This testimony focuses directly on the economic impact of these tools and whether and how they have changed Russian decision making in the short term, related to the issues of Ukraine, cyber activities, and human rights abuses.

[29] Note that it is difficult to differentiate between the economic impacts of the various sanctions programs described above. Most of the studies focused on the economic impact of these sanctions pay particular attention to the Ukraine-related sanctions, and in particular the SSI program, as these are the broadest coercive measures the United States and the EU have employed against Russia. In reality, these sanctions programs have interactive effects, to an extent; for example, additional designations related to Russia's malicious cyber-enabled activities likely signal to foreign investors that tensions will continue between the United States and Russia, likely depressing FDI.

[30] Rebecca Nelson, "U.S. Sanctions and Russia's Economy," *Congressional Research Service*, Feb. 17, 2017, https://fas.org/sgp/crs/row/R43895.pdf.

[31] *Id*. At 6-7.

[32] Ed Adamczyk, "Medvedev: Sanctions Cost Russia $106 Billion," *UPI*, Apr. 22, 2015, http://www.upi.com/Top_News/World-News/2015/04/22/Medvedev-Sanctions-cost-Russia-106-billion/3551429721857/.

[33] Elizabeth Rosenberg, Daniel Drezner, Julia Solomon-Strauss, and Zachary Goldman, "The New Tools of Economic Warfare: Effects and Effectiveness of Contemporary U.S. Financial Sanctions," *Center for a New American Security*, Apr. 2016, https://www.cnas.org/publications/reports/the-new-tools-of-economic-warfare-effects-and-effectiveness-of-contemporary-u-s-financial-sanctions.

[34] *Id*. at 1.

showing that net inward FDI into Russia "essentially came to a halt in late 2014 and early 2015," consistent with the general finding.[35] As a former economic advisor to the Russian government stated in 2015, the sectoral sanctions in particular had "worked out as far more severe in their effect than anyone seems to have believed."[36]

Likewise, research conducted by another witness on this panel suggests that targeted firms are also feeling this impact, finding that "the average sanctioned company or associated company loses about one-third of its operating revenue, over one-half of its asset value, and about one-third of its employees relative to their non-sanctioned peers."[37] That U.S. sanctions are "hitting their intended targets" without causing too much "collateral damage," as the paper concludes, is important, as it suggests that designations can be carefully ramped up to respond to further Russian provocations. As former Deputy National Security Advisor Juan Zarate and Russia expert at the Center on Sanctions and Illicit Finance at the Foundation for Defense of Democracies Boris Zilberman argue, "Russia's corporations, particularly the titans of industry, are heavily linked to Putin and his inner circle. As such, the Kremlin is often forced to bail out companies via corporate debt assistance as they deal with fallout from sanctions and low oil prices. By maintaining and potentially increasing economic pressure on these companies, the U.S. and E.U. can force the Kremlin to spend more of its money, more often, to prop up a growing list of state-dependent corporations."[38]

Despite the macroeconomic and firm-level impact of the U.S. sanctions on Russia, both the IMF and the Bank of Russia's research and forecasting department project positive Russian GDP growth in 2017.[39] This does not necessarily mean that sanctions have ceased to cause macroeconomic pain: a survey of experts suggests that the Russian economy would receive an additional lift—of 0.2% this year and 0.5% in 2018—if U.S. sanctions were relaxed.[40] Still, Russia has weathered the sanctions program and the concurrent oil price collapse, and improvements in its economy do suggest that U.S. restrictions impose less cost now than they have in the past. The bottom line is that these sanctions have had an impact on the Russian economy, though that impact appears to be diminishing.

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[35] Rebecca Nelson, "U.S. Sanctions and Russia's Economy," *Congressional Research Service*, Feb. 17, 2017, https://fas.org/sgp/crs/row/R43895.pdf.
[36] Priyanka Boghani, "What's Been the Effect of Western Sanctions on Russia?" *PBS Frontline*, Jan. 13, 2015, http://www.pbs.org/wgbh/frontline/article/whats-been-the-effect-of-western-sanctions-on-russia/.
[37] Daniel Ahn and Rodney Ludema, "Measuring Smartness: Understanding the Economic Impact of Targeted Sanctions," Working Paper 2017-01, *U.S. Department of State, Office of the Chief Economist*, Dec. 2016, https://www.state.gov/documents/organization/267590.pdf.
[38] Juan Zarate and Boris Zilberman, "U.S. Russian Financial Warfare: Conduct-Based Approach to Countering Russian Influence and Increasing Western Leverage," Working Paper, *Center on Sanctions and Illicit Finance, Foundation for Defense of Democracies*, on file with author.
[39] "IMF Staff Concludes Visit to Russian Federation," *International Monetary Fund Press Release*, No. 16/529, Nov. 29, 2016, http://www.imf.org/en/News/Articles/2016/11/29/PR16529-Russian-Federation-IMF-Staff-Concludes-Visit. *See also* Anna Andrianova, "Russia is Running on More Than Just the Black Stuff," *Bloomberg*, Mar. 7, 2017, https://www.bloomberg.com/news/articles/2017-03-07/russia-is-running-on-more-than-just-the-black-stuff.
[40] Anna Andrianova, "Russia is Running on More Than Just the Black Stuff," *Bloomberg*, Mar. 7, 2017, https://www.bloomberg.com/news/articles/2017-03-07/russia-is-running-on-more-than-just-the-black-stuff.

Coercing Change in Behavior

It is harder to point to tangible indications that sanctions have altered Russian behavior with respect to Ukraine, malicious cyber-enabled activities, or human rights violations. Journalists, rights advocates, opposition politicians, and whistleblowers are still treated harshly and sometimes killed.[41] On the cyber front, Ukraine last month "accused Russian hackers of targeting its power grid, financial system and other infrastructure with a new type of virus that attacks industrial processes."[42] Montenegro claimed in mid-February that government and media websites came under Russian attack for several days.[43] A French presidential candidate claims that he is being targeted with "[I]nternet attacks from within Russia with the goal of helping the campaigns of his pro-Moscow rivals."[44] In short, Russia's malicious cyber efforts are continuing.

Russia shows no sign of relinquishing control of Crimea, and it continues to destabilize eastern Ukraine. Just last week, Kiev threatened sanctions against the Ukrainian subsidiary of Kremlin-owned Sberbank because the bank said it would comply with an order from Vladimir Putin to recognize identity documents issued in the separatist-held regions of Donetsk and Luhansk.[45] Fighting recently flared up in places like Sartana, a farming village near the Ukrainian-held port of Mariupol, after months of relative quiet: on the Ukrainian side alone, at least 26 people were killed and 124 wounded in the month after January 28 compared to eight dead and 46 wounded in the month prior.[46] A new ceasefire to address the flare-up seems to have failed.[47] On February 26, the State Department, recognizing Russia's unwillingness to meet its obligations under Minsk II, called on "Russia and the separatist forces it backs" to "honor the cease-fire called for under the Minsk agreements" and to "withdraw all heavy weapons, and allow full and unfettered access to the OSCE monitors."[48]

Nevertheless, some organizations and analysts believe that sanctions have had some impact on behavior because, in their absence, Russia would likely have gone further in Ukraine. Former

[41] Andrew Kramer, "More of Kremlin's Opponents Are Ending Up Dead," *The New York Times*, Aug. 20, 2016, https://www.nytimes.com/2016/08/21/world/europe/moscow-kremlin-silence-critics-poison.html.
[42] Natalia Zinets, "Ukraine Charges Russia with New Cyber Attacks on Infrastructure," *Reuters*, Feb. 15, 2017, http://www.reuters.com/article/us-ukraine-crisis-cyber-idUSKBN15U2CN.
[43] Ben Farmer, "Montenegro Asks for British Help after Cyber Attacks in Wake of 'Russian-backed coup plot'," *The Telegraph*, Feb. 28, 2017, http://www.telegraph.co.uk/news/2017/02/28/montenegro-asks-british-help-cyber-attacks-wake-russian-backed/.
[44] "France Drops Electronic Voting for Citizens Abroad over Cybersecurity Fears," *Reuters*, Mar. 6, 2017, http://www.reuters.com/article/us-france-election-cyber-idUSKBN16D233?il=0.
[45] "Ukraine Eyes Sanctions on Subsidiary of Russia's Sberbank," *Reuters*, Mar. 7, 2017, http://www.reuters.com/article/us-ukraine-crisis-sanctions-idUSKBN16E2KL.
[46] Mark Mackinnon, "As Russia-U.S. Ties Strengthen, Violence Escalates in Ukraine," *The Globe and Mail*, Feb. 26, 2017, http://www.theglobeandmail.com/news/world/as-russia-us-ties-strengthen-violence-escalates-inukraine/article34143679/.
[47] Euan McKirdy, "Ukraine Ceasefire: No Sign of Withdrawal, Official Says," *CNN*, Feb. 23, 2017, http://www.cnn.com/2017/02/22/europe/ukraine-ceasefire-violations/.
[48] Mark. C. Toner, "United States Condemns Attack on Special Monitoring Missions in Eastern Ukraine," Press Statement, *United States Department of State*, Feb. 26, 2017, https://www.state.gov/r/pa/prs/ps/2017/02/268039.htm.

Deputy Assistant Secretary of State Peter Harrell observed in September 2015 that "Russia does appear to have made tactical adjustments to its strategy at different points during the crisis to minimize the odds of [further] sanctions being imposed."[49] In his view, the demonstrated effect of sanctions and the threat of broader measures "may have helped deter Russia from moving forward and seizing the strategic city of Mariupol" in February 2015.[50] A March 2016 publication of the European Parliament argued that sanctions were deterring further violence, again pointing to the Black Sea port of Mariupol.[51]

In addition, at least in the context of Ukraine, Vladimir Putin and Foreign Minister Sergei Lavrov have explicitly called for[52] and even demanded[53] an end to sanctions. Russia has also worked to undermine EU unity on sanctions, including by "methodically lobbying southern and eastern EU member states," with Italy, Greece, Hungary, Cyprus, Slovenia, Slovakia and Bulgaria as prime targets.[54] Some analysts believe that Moscow may be aiding populist parties—including in Western European countries—because it sees these parties as "useful allies in pursuing its objectives in Europe, such as ending economic sanctions or undermining European support for Ukraine."[55] These demands and efforts suggest that, even if the sanctions have not fulfilled all of the objectives they were initially employed to achieve, they do appear to be impacting Russian decision making. In addition, these comments suggest that the sanctions provide the United States with leverage it would not otherwise have; clearly the Russian leadership would like to have the sanctions lifted, and this desire means that the United States can exchange relief for certain concessions from Moscow. To unwind them without consideration of this fact and without seeing change in Russian behavior would be a strategic mistake.

Thus, while our sanctions on Russia have not proven to be a silver bullet, there are indications that they have had an impact on the Russian economy and on Russian decision-making. Additional sanctions pressure would likely further impact Russia's decision calculus, and, if done responsibly,

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[49] Peter Harrell, "Lessons from Russia on the Future of Sanctions," *Center for a New American Security*, Sept. 2015, https://s3.amazonaws.com/files.cnas.org/documents/CNAS-Report-Economic-Statecraft-2-FINAL.pdf.
[50] *Id*. at 6.
[51] Martin Russell, "Sanctions over Ukraine: Impact on Russia," *European Parliamentary Research Service*, PE 579.084, Mar. 2016, http://www.europarl.europa.eu/EPRS/EPRS-Briefing-579084-Sanctions-over-Ukraine-impact-Russia-FINAL.pdf.
[52] "Russia Can't Mend Times with U.S. While it Backs Sanctions: Lavrov," *Reuters*, Dec. 10, 2015, http://www.reuters.com/article/us-russia-usa-lavrov-idUSKBN0TT0YR20151210; David Herszenhorn, "Putin Calls for End to Use of Sanctions and Criticizes U.S. in Afghanistan," *The New York Times*, July 10, 2015, https://www.nytimes.com/2015/07/11/world/europe/putin-criticizes-us-role-in-afghanistan.html; On statement regarding EU sanctions, see "EU Releases Details on Extended Sanctions Against Russia," *Voice of America News*, June 18, 2016, http://www.voanews.com/a/european-union-releases-details-extended-sanctions-russia/3382180.html.
[53] Roland Oliphant, "'Cancel Sanctions and Scale Back NATO' Russia Tells US as Vladimir Putin Scraps Nuclear Deal," *The Telegraph*, Oct. 3, 2016, http://www.telegraph.co.uk/news/2016/10/03/putin-scraps-deal-to-dispose-of-bomb-grade-plutonium-in-swipe-at/,
[54] "Putin Steps Up Drive to Kill Sanctions Amid Signs of EU Disunity," *Voice of America News*, July 29, 2016, http://www.voanews.com/a/putin-steps-up-drive-kill-sanctions-signs-eu-disunity/3440262.html.
[55] Arthur Beesley, "EU Leaders to Hold Talks on Russian Political Meddling," *Financial Times*, Oct. 16, 2016, https://www.ft.com/content/ff1f1cdc-9227-11e6-8df8-d3778b55a923.

could help the United States pressure Moscow to change its behavior in Ukraine, cyber, and in the realm of human rights abuses.

III. Increasing the Pressure on Russia, Responsibly

The United States and its partners can take a number of steps to increase pressure on Russia in a way that will squeeze its economy and—more importantly—impact its decision making. Recent legislative initiatives in the Senate, including the proposed Counteracting Russian Hostilities Act of 2017 ("Counteracting Russian Hostilities Act")[56] and the proposed Russia Sanctions Review Act of 2017 ("Russia Sanctions Review Act"),[57] are right steps in this direction. In particular, the Counteracting Russian Hostilities Act would impose powerful sanctions on Russia, including primary and secondary sanctions related to its petroleum industry, the Russian defense sector, and the Russian financial sector.

However, as Congress considers ramping up sanctions on Russia, it should keep in mind that while such pressure is important, the United States should try—to the extent possible—to ensure that the sanctions are carefully targeted and do not have unintended and undesirable impacts. For example and as occurred during the initial Sectoral Sanctions Identifications List program ramp up in the fall and winter of 2014, the sanctions pressure on Russia deeply shook investor confidence and threatened the stability of the Russian financial system. Indeed, in December 2014, U.S. sanctions—in conjunction with other factors—led to a near run on the Ruble, which was supposedly triggered by the Central Bank of Russia promising to effectively print money to prop up certain companies owned by Putin's confederates and hurt by Western sanctions.[58] While the U.S. sanctions on Russia were meant to impact the Russian economy in the medium- to- long-term and to put pressure on Vladimir Putin and his elite circle, they were not intended to cause a run on the currency, which could have seriously undermined the stability of the Russian financial sector.

While the United States certainly should pressure Moscow, undermining the stability of one of the world's largest economies would have serious and detrimental ripple effects. In effect, Congress should carefully balance increasing the economic pressure on Russia while making sure that any steps it takes do not risk collapsing the Russian economy or seriously impacting the economic health of our partners, particularly in the European Union and Eastern Europe.

On this point, Congress must consider the impact ramping up sanctions will have on our European partners, and in particular whether they will be willing to join our efforts. Over the past three years, the United States and the European Union have worked very closely to ramp up pressure on Russia; while there are minor differences between the U.S. and the EU sanctions programs in

[56] S.94, "Counteracting Russian Hostilities Act of 2017," 115th Cong. (2017).
[57] S.__, "Russia Sanctions Review Act of 2017," 115th Cong. (2017), http://big.assets.huffingtonpost.com/Russia_Sanctions_Review_Act.pdf.
[58] Peter Feaver and Eric Lorber, "The Sanctions Myth," *The National Review*, July-August 2015, http://nationalinterest.org/feature/the-sanctions-myth-13110?page=2. *See also* Sergey Aleksashenko, "Evaluating Western Sanctions on Russia," *Atlantic Council*, Dec. 2016 at 10, http://www.atlanticcouncil.org/images/publications/Evaluating_Western_Sanctions_on_Russia_web_1206.pdf.

response to Russian aggression in Ukraine, in general these programs—and targeted entities—are the same. In fact, the EU SSI-type program is in some ways more restrictive than the U.S. SSI program. This close partnership has significantly increased the economic impact on Moscow; Russian entities were unable to turn to attractive alternative partners in the EU to secure financing, for example, when they were cut off from U.S. debt markets.

While certain countries such as Germany have signaled a willingness to ramp up pressure on Russia, other EU countries may be less willing to join U.S. efforts. To the extent that we can secure European buy-in—and parallel European escalation of economic pressure—our sanctions will stand a greater chance of success. Likewise, when considering certain sanctions proposals put forth below, Congress should be mindful of their impact on European cooperation. For example, those proposals that impose restrictions on the activities of both U.S. and non-U.S. companies will likely raise political tensions with the Europeans. To the extent that the United States can secure EU cooperation on many of these matters without resorting to U.S. domestic legislation that conditions access to U.S. markets on compliance with our sanctions policy, the more likely our approach will be to succeed.

Recent legislative proposals contain excellent steps for imposing powerful sanctions that will likely impact Russian decision-making. By further sharpening these tools, Congress can ensure that it raises the pressure on Russia in a way that both directly targets Moscow's decision makers and limits the impact on our allies and partners. The proposals outlined below are generally ordered from least likely to impose significant additional economic pain and create possible unintended consequences to most likely to impose such pain and create such consequences. In effect, each subsequent option is likely more powerful, yet also likely riskier, than the preceding option.[59] For those more-powerful-yet-riskier tools, I have suggested adjustments that may limit some of their potential downsides.

This **sanctions escalation ladder** should provide Congress with a range of options, depending on how much pressure it wants to put on Moscow.

- **Rung #1: Codification of existing Executive Orders**, including Executive Orders 13660, 13661, 13662, 13685, and 13694. At a minimum, Congress should act to preserve the sanctions currently in place on Russia. The reason for the creation of these executive authorities—and the designations issued pursuant to them—has not changed; Russia has not fulfilled its obligations under Minsk II, has not meaningfully reduced its aggressive cyber activity towards the United States, and as the recent episode with Vladimir Kara-

[59] Note that I do not review the proposals contained in the Russia Sanctions Review Act. While there is certainly room for congressional approval and disapproval of waiving certain components of the U.S. Russia Sanctions Program, the Russia Sanctions Review Act focuses on how to limit the administration from unwinding current sanctions on Russia, not on how to increase the pressure on Moscow. Given that sanctions on Russia have been somewhat effective and that additional economic pressure may likewise have an impact, I have focused on how to responsibly ramp up pressure rather than maintain the status quo.

Murza suggests,[60] has not significantly improved its human rights record. Without improvements in these areas, Moscow should not be rewarded with the lifting of sanctions, and Congress should take steps to ensure that does not happen. Unwinding these programs and de-designating entities in exchange for Moscow's help in fighting certain extremist elements, either in Syria or elsewhere, risks seriously undermining the international principles that underpinned the U.S. and EU decisions to impose such measures. For example, if the United States unwinds its sanctions program on Russia as part of a "grand bargain" for Russian help fighting extremism—and Russia is allowed to maintain control of Crimea and continue supporting separatist movements in Eastern Ukraine—states that seek to violate the sovereignty of neighboring countries will know that the United States does not prioritize enforcement in response to territorial aggression. Such an unwinding also undermines the future effectiveness of U.S. sanctions. If sanctions targets can simply wait for a change in political circumstances, they will not be motivated to make the concessions that the United States demands. Instead, violators will take increased hope in the possibility that they can outlast economic restrictions because the United States will inevitably shift its foreign policy priorities.

In addition to simply codifying these Executive Orders, Congress could statutorily designate a range of other targets pursuant to these authorities. For example, Congress could designate additional individuals known to engage in cyber operations against the United States, military or administrative officials playing an active role in Eastern Ukraine or Crimea, or other high-level officials within the Russian government. Such additional pressure—particularly coupled with an increased focus by the proposed FinCEN-led task force discussed below—could significantly impact Putin's inner circle, bottom line, and decision-making.[61] In addition, Congress could specify that these designations only be lifted in the case of tangible and measurable progress by Russia on a range of issues, such as fulfillment of certain obligations under Minsk II.

- **Rung #2: Establishing a task force dedicated** to identifying, tracking, tracing and—as appropriate—**seizing assets of designated Russian individuals**, particularly those close to Russian President Vladimir Putin. The Counteracting Russian Hostilities Act recommends the creation of a Russia task force within the Financial Crimes Enforcement Network at the Treasury Department, which will work with the Office of Foreign Assets Control ("OFAC") and the Office of Intelligence and Analysis ("OIA") to identify certain illicit Russian assets within the United States. A creation of this type of standing entity could be particularly powerful; based on information gathered in recent years from title insurers under the FinCEN Geographic Targeting Order targeting certain high-end real estate markets, it is clear that large sums of Russian money are flowing into U.S. real estate

[60] Andrew Kramer, "More of Kremlin's Opponents Are Ending Up Dead," *The New York Times*, Aug. 20, 2016, https://www.nytimes.com/2016/08/21/world/europe/moscow-kremlin-silence-critics-poison.html.
[61] S.94, "Counteracting Russian Hostilities Act of 2017," 115th Cong. (2017) at 47-48.

markets.[62] It is very likely that designated Russian persons—including Russian oligarchs close to Russian President Vladimir Putin—are laundering their funds through a network of shell companies and depositing them within the United States. Seizing the assets of these designated persons would have an immediate impact on their pocketbooks and could put direct pressure on Putin's inner circle.

To be effective, such a task force would need to focus more broadly than high-end real estate, and would need to conduct deep dives into company formation information and beneficial ownership information of key bank accounts. In addition, it would need to be properly resourced; effectively establishing such a task force would require proper staffing, including the creation of dedicated positions (without simply shifting personnel from other important roles within Treasury). In addition, while FinCEN in some ways is a natural fit for this task force, given its access to information provided by U.S. financial institutions, Congress should consider including other, relevant agencies, such as the Department of Justice.

Congress should also consider requiring regular reporting from this task force on its findings and, based on that information, statutory PATRIOT Act 311 designations of Russian financial institutions engaged in illicit activity. Such designations would further squeeze the Russian financial sector and cut off illicit financial actors from the legitimate global banking system, though such efforts may take years to reach fruition.

- **Rung #3: Prohibiting the purchase, subscription to, or facilitation of the issuance of Russian sovereign debt**. This suggestion—contained in the Counteracting Russian Hostilities Act—is meant to address a gap in the current SSI program; that Russia may be using capital injections to prop up government-owned entities, as well as designated private companies owned or controlled by Vladimir Putin's allies in Russia. In effect, though financial institutions designated as SSIs pursuant to Directive 1 may not be able to secure debt financing, Russia itself can, and then can provide direct funds to those entities in a scheme that looks very much like sanctions evasion. By prohibiting U.S. and foreign persons from purchasing or generally dealing in such debt, this suggestion could cut off this sanctions evasion mechanism and make it significantly more difficult for Russia to prop up a number of its core financial institutions.

  According to the IMF, Russia's international reserves dropped from $509.6 billion at the beginning of 2014 to $368.4 billion at the end of 2015, but they have increased slightly and remained stable at just below $400 billion since the decline.[63] That decline during 2014-15 coincided with the sharpest oil price drop, during which time Russia was forced to sell foreign exchange to support the ruble.

[62] Josh Barbanel, Samuel Rubenfeld, and Laura Kusisto, "U.S. Expands Real-Estate Data Targeting Order," *The Wall Street Journal*, July 27, 2016, https://www.wsj.com/articles/u-s-expands-real-estate-data-targeting-order-1469647229. Note that this Order was again extended in February 2017.
[63] "Russian Federation, Staff Report for the 2016 Article IV Consultation," *International Monetary Fund*, IMF Country Report No. 16/229, July 2016, http://www.imf.org/external/pubs/ft/scr/2016/cr16229.pdf.

Russia has drained one of its sovereign wealth funds, the Reserve Fund, from $87 billion in 2014 to roughly $16 billion currently; its other sovereign wealth fund, the National Wealth Fund—designed to support pensions and social spending—contains $73 billion, but most of that amount has already been allocated.[64] Still, as noted above, international reserves have remained stable. According to Bloomberg, "by printing rubles for the Finance Ministry and crediting foreign currency to its own account, the central bank has kept international reserves—which include the government's savings—almost intact even as the [Reserve Fund] has dwindled."[65] Analysts expect that the Reserve Fund will be drained in 2017, but it is unclear what significance this will have.[66]

One of the major unknowns of this proposal is the magnitude of the economic impact it would have on Russia. While it would no doubt impact SSI designated-entities' ability to balance their sheets and remain solvent, concerns exist that it would significantly destabilize the Russian financial system and create a significant contagion effect. To mitigate such concerns, Congress could structure such a prohibition to apply only to U.S. persons or where a U.S. nexus is involved. Such a structure would permit foreign financial institutions to transact in this foreign debt without fear of secondary sanctions. However, given the expansive reach of U.S. jurisdiction over the international financial system and U.S. regulators' willingness to impose significant fines on entities violating U.S. sanctions regulations, most large and reputable financial institutions would be understandably extremely reluctant to transact in such sovereign debt. This reluctance would translate into market impact; the decrease in buyers of the debt would mean that Russia would have to offer higher interest rates to find market partners, ensuring that Moscow would have to pay more to borrow. Such a move would increase the costs on Russia but would also be unlikely to seriously undermine the Russian financial sector.

In addition, Congress could include a provision of the legislation that allows for the imposition of penalties to all persons (not simply U.S. persons) who transact in Russia sovereign debt in the case of continued Russian non-compliance on a range of items, such as fulfilling its Minsk II obligations. For example, Congress could build in a six-month assessment review of the impact of these sanctions and—if it was not satisfied that such a prohibition for U.S. persons on dealing in Russian sovereign debt was having a sufficient impact—could automatically expand the provision to apply to all persons. Such an expansion could be a powerful escalation, but undertaken only after verification that the initial sanction was not having the desired impact.

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[64] Josh Meakins, "Why Russia is Far Less Threatening Than It Seems," *Washington Post Monkey Cage*, Mar. 8, 2017, https://www.washingtonpost.com/news/monkey-cage/wp/2017/03/08/why-russia-is-far-less-threatening-than-it-seems/?utm_term=.901bc86a6fa1

[65] Olga Tanas, Ilya Arkhipov, and Evgenia Pismennaya, "Russia Said to Shield Reserves as Putin Taps Sovereign Fund," *Bloomberg*, June 28, 2016, https://www.bloomberg.com/news/articles/2016-06-28/bank-of-russia-said-to-shield-reserves-as-putin-taps-wealth-fund.

[66] Nadia Kazakova, "Russian Ruse Keeps Currency Reserves Afloat," *Saxo Group*, July 8, 2016, https://www.tradingfloor.com/posts/russian-ruse-keeps-currency-reserves-afloat-7897510.

- **Rung #4: Increasing the pressure on the Russian oil, gas, and petrochemical industries**. Another pathway to significantly pressure Russia would be to more expansively target its oil, gas and petrochemical industries. While Directives 2 and 4 of the SSI program target the health of Russia's petroleum industry in the medium-to-long terms (by targeting the development of resources that would come online during that time frame), they have not put as much pressure on Russia's economic resources in the shorter term. Similarly, proposals contained in the Counteracting Russian Hostilities Act also focus on the medium term; by penalizing U.S. and foreign persons that broadly invest in Russian energy resources, the United States would certainly impact the ability of the Russian Federation to produce such resources in a cost-effective way. Yet with the rising price of oil, such measures might not have an immediate or powerful impact in the short term, and consequently may not change Russia's activity during that time frame.

  In addition to the recommendations proposed in the Counteracting Russian Hostilities Act, particularly Section 207(a), Congress should consider additional sanctions that pressure Russian energy companies in the short term.

  First, Congress should consider imposing export restrictions on crude oil produced by three Russian major companies, namely Gazpromneft, Bashneft, and Rosneft. According to one study, these three companies account for almost 50% of Russian crude oil exports.[67] While these targets could still sell oil elsewhere, it would cost more to do so and impose limited punishment on the Russian Government.

  To be effective, such sanctions would need to be constructed as secondary in nature, *i.e.*, threatening to cut European and Asian companies off from U.S. markets if their home countries continue to import certain hydrocarbon products from these companies. Such a step would likely cause significant diplomatic tension, particularly with our partners in the European Union. To mitigate such tension, the statutory provision could be structured to give the administration six months to work with the Europeans to draw down their reliance on petroleum products produced by these entities. If, at the end of that period, an insufficient drawdown had occurred, Congress could reserve the prerogative to impose secondary sanctions on targeted companies in the EU and Asia. Congress could also write in a significant reduction or national security exception element to this provision, much like the provision included in the National Defense Authorization Act Sec. 1245 in the Iran context, to ensure that we would not unduly be punishing our allies or seriously undermining the economies of our partners, particularly those in Eastern Europe who are highly reliant on Russian energy exports. Such a provision could either be in lieu of, or in addition to, the six-month period to allow the administration to convince countries in Europe and Asia to draw down.

[67] Sergey Aleksashenko, "Evaluating Western Sanctions on Russia," *Atlantic Council*, Dec. 2016, http://www.atlanticcouncil.org/images/publications/Evaluating_Western_Sanctions_on_Russia_web_1206.pdf.

Second, Congress could consider prohibiting correspondent accounts and payable access for financial institutions providing banking services on behalf of key Russian oil-producing companies. Such a move would have an immediate and powerful impact on these companies, as the global oil trade is primarily dollar-based. In effect, if these companies were unable to do oil transactions in dollars, they would need to use alternative currencies, a time-consuming and expensive process. Note that this approach would likely cause major economic damage to the Russian energy sector and its economy as a whole.

Third and building off this approach, Congress could go further and impose secondary sanctions on any financial institutions doing business with these Russian entities. Such a step would cut these entities off not only from the U.S. financial sector but would also limit their access to other markets as well. It would also likely limit their access to Chinese and other forms of financing. While wielding such a tool might cause a change in Russian behavior, it would also likely cause significant damage to the Russian economy and cause a serious diplomatic row with our European allies, which have been working closely with the United States in ramping up the pressure on Russia.

When evaluating these various proposals, two additional considerations merit attention. The first is the likelihood—and severity—of Russian countersanctions or other responses. As a result of U.S. and EU sanctions on Russia in response to its activities in Ukraine, Moscow imposed countersanctions on the EU, limiting food shipments.[68] The United States and the European Union should expect further symmetric and asymmetric responses in the case that we ramp up sanctions pressure. Such responses could include countersanctions or increased cyber activity, and could be proportional to degree of new pressure we impose on Moscow (*i.e.*, the more powerful sanctions we impose, the more significant Moscow's retaliation may be).

The second consideration is that while Russia poses many challenges to the United States, we still want the opportunity work with Moscow on a range of difficult issues, such as international terrorism, North Korea's nuclear weapons and ballistic missile programs, stability in Afghanistan, and a number of other areas. Ramping up sanctions pressure on Russia may impact their willingness to work constructively with us on these matters. While increased pressure is justified in response to Moscow's continued defiance of international law and aggressive actions towards the United States, we should recognize that further sanctions may make cooperation with Russia in other areas more difficult.

IV. Ensuring Russian Compliance

As this Committee considers imposing additional sanctions on Russia, it should also consider how to effectively unwind this pressure in such a way that provides Russia with the incentive to change its behavior. One of the key sanctions lessons of the past few years is that unwinding sanctions is

[68] "Russia May Extend Counter-Sanctions Until End-2017," *Reuters*, May 27, 2016, http://www.reuters.com/article/us-russia-crisis-sanctions-idUSKCN0YI1GI.

often significantly more difficult than simply turning a legal switch.[69] Indeed, unwinding sanctions can often prove complicated, and in many cases ill-considered or ineffective blunt unwinding of sanctions provides unnecessary concessions to our adversaries and forgoes opportunities to continue to pressure these targets for a variety of other malign activities.[70] Likewise, ramping up powerful sanctions but failing to provide realistic pathways for countries to change their behavior and enjoy even partial sanctions relief could lead to a situation of sanctions stalemate, where the United States has imposed powerful sanctions but the target is unwilling to abide by every one of our demands (and therefore does not see any relief). Such a situation can be highly problematic, as the target suffers but the United States does not achieve its policy goals.

Aggressive sanctions ramp-up must be coupled with a thoughtful unwinding process, one that provides for meaningful relief to a target *if* that target changes its behavior and one that does not raise the bar for achieving such relief too high.

In certain respects, elements of the current legislative proposals in the Senate may raise the bar for relief too high. For example, Section II of the Counteracting Russian Hostilities Act—which imposes sanctions on Russia for its activities in Ukraine—sets a high threshold for termination of the sanctions program, namely that Russia ceases ordering, controlling, or otherwise supporting or financing separatist elements in Ukraine and also halts military operations in Syria. While the United States should seek to achieve these goals, most Russia analysts have doubts as to whether Russia will fully relinquish control of Crimea or totally cease military operations in Syria as a result of sanctions pressure. Yet in order for the sanctions to be lifted, that is what is required. Setting the bar for termination of these programs this high means that it is unlikely the United States will be able to unwind these sanctions in the foreseeable future.

Further, such a threshold actually disincentivizes Russia from even partially complying with many of its obligations under Minsk II; if the only way Russia can secure sanctions relief is with total fulfillment of its obligations under Minsk II, it has limited incentive to fulfill only some of its obligations, as it will be unlikely to see sanctions relief from doing so.

While the waiver elements of this legislation do provide for some flexibility—namely permitting the President to waive the imposition of certain sanctions if he determines it is in the national security interests of the United States and certifies that Russia is taking certain steps in Ukraine and Syria—what is needed is a statutorily constructed set of **"off-ramps"** that provide a clear roadmap for the Russians to receive limited sanctions relief in exchange for meeting certain obligations under Minsk II or verifiably reducing their malicious cyber activities against the United States and its partners.

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[69] *See, e.g.*, Peter Feaver and Eric Lorber "Penalty Box," *Foreign Affairs*, June 6, 2014, https://www.foreignaffairs.com/articles/united-states/2014-06-06/penalty-box.

[70] Eric Lorber, "Securing American Interests: A New Era of Economic Power," *Center on Sanctions and Illicit Finance, Foundation for Defense of Democracies*, Feb. 2017, http://www.defenddemocracy.org/content/uploads/documents/CSIF_Securing_American_Interests.pdf.

Such a statutory construct could work as follows: New legislation could include the codification of the Executive Orders related to Russia and Ukraine, along with additional, statutory designations of certain parties (*e.g.*, in an annex) involved in destabilizing Ukraine or currently governing Crimea. The legislation could further specify that these additional designations will be lifted if Congress reviews and agrees that Russia has fulfilled certain, delineated obligations under Minsk II. For example, if Russia withdraws all of its heavy weapons from the conflict zone, the United States will lift these designations. The level of sanctions unwinding provided could be queued to the magnitude of the obligation Russia fulfills. For example, if the new legislation includes powerful sanctions related to Russian sovereign debt, the lifting of those sanctions could be tied to the fulfillment of other, more significant obligations under Minsk II, such as Russia allowing for full Ukrainian control over its border with Russia throughout the conflict zone. In this way, the United States would not be providing significant sanctions relief to Russia in exchange for minor concessions.

Such legislation could be structured in alternative ways that achieve the same effect, as well. For example, the legislation could rely on a presidential certification that Russia had fulfilled certain of its obligations under Minsk II or that it had significantly reduced its cyber-attacks against the United States and its partners, but then provide Congress the opportunity to review and approve (or disapprove) of that certification following briefings by the administration and the intelligence community. Only upon approval would the statutorily imposed sanctions specified be unwound.

Any such provisions should include a degree of built-in flexibility, such as specifying that if Congress deems it appropriate, additional or alternate sanctions can be relaxed as a result of Russian actions. Such flexibility will ensure that while Congress demarcates a clear path in from the cold to Moscow, it can adjust to changes in the situation as necessary.

This "off ramp" approach provides a number of important benefits. First, it increases the likelihood that the United States will achieve some—albeit not all—of its objectives, particularly with regard to Ukraine. By ramping up pressure on Moscow and then providing such off-ramps, the United States will give Russia a clear path to sanctions relief and will increase the prospects that Moscow will live up to at least some of its Minsk II obligations. Otherwise and based on the current sanctions stalemate, it does not appear likely that Russia will change its activities in Ukraine and indeed may simply try to wait out U.S. sanctions until the parallel EU sanctions regime falls apart or with the hope that the Trump Administration will make a decision to relax some of the current sanctions on Russia.

Second, while providing limited sanctions relief, this approach also keeps the pressure on Russia to change its other undesirable behavior. While Russia may receive such limited relief, it will still be under significant economic pressure, particularly if some of the more powerful sanctions on the country remain in place. As a result, the United States can continue to pressure Russia even while granting it some relief. This approach overcomes one of the primary critiques of a major recent sanctions unwinding episode—the Joint Comprehensive Plan of Action ("JCPOA") between the P5+1 and Iran. In that case, the Obama Administration was arguably reluctant to enforce remaining sanctions on Iran for fear of undermining the agreement, and as critics of the deal argue,

partially as a result Iran continued to engage in destabilizing activity throughout the region, including exporting terrorism, ballistic missile development, and supporting Syrian President Bashar al-Assad and the Houthis in Yemen. Utilizing this "off ramp" mechanism may help avoid this pitfall by making it clear that a number of sanctions on Russia will remain in place even with the partial relief and that Russia should not expect to see relief related to those remaining sanctions unless and until it changes its behavior tied directly to them.

V. Moving Forward

Russia continues to threaten U.S. national interests in a number of ways, including its destabilizing activities in Ukraine and its cyber-attacks aimed at undermining democratic institutions, to say nothing of its blatant human rights abuses and brutal military campaign in Syria. The United States should be prepared to use all the tools at its disposal—diplomatic, cyber, economic, and military—to counter these Russian threats. But as Congress, which has a key role to play in these efforts, decides whether to ramp up economic pressure on Russia, it should do so in a way that is both responsible and provides Moscow with a clear pathway for drawing down tensions and gradually relieving that economic pressure as a reward for improved behavior.

Thank you for your time. I look forward to your questions.