

Policy Paper

The weaponisation of the US financial system:

How can Europe respond?

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#Sanctions
#Sovereignty
#Weaponized
Interdependence



US secondary sanctions present a unique challenge for Europe. These measures limit where European firms can operate, hinder the EU's ability to maintain its foreign commitments, and limit Europe's ambitions of achieving strategic sovereignty. The US's re-imposition of secondary sanctions on Iran in May 2018 has highlighted this issue. With geopolitical tensions rising, it is possible that the US could impose secondary sanctions on larger EU trading partners. In light of this possibility, this paper explores why secondary sanctions are so effective and offers concrete proposals to counter them.

Executive summary

US secondary sanctions – which use America’s centrality in the world’s financial and technological architecture to restrict commerce between the target country and third parties – present a unique challenge for Europe. By controlling where European firms can operate and hindering the EU’s ability to maintain its foreign commitments, extraterritorial sanctions have limited Europe’s ambitions of achieving strategic sovereignty.

The US’s re-imposition of secondary sanctions on Iran in May 2018 has highlighted this issue. Although Europe attempted to block the sanctions or find a workaround to trade with Iran, EU-Iran trade has ground to a halt and the 2015 Iran nuclear deal is likely defunct. In the context of COVID-19, US sanctions have halted the flow of vital medical supplies to Iran, exacerbating the deadly outbreak there.

Using the Iran example as a case study, this paper identifies several reasons why the European Union is so vulnerable to US secondary sanctions, including:

- **The centrality of the US dollar and the reach of the American financial system.** The ubiquity of the dollar and the interconnectedness of American banks make it difficult for firms to avoid some contact with the US financial system, leaving them vulnerable to sanctions.
- **The large US market.** When forced to choose between selling products and services in the world’s largest economy or a smaller country like Iran, European firms choose the US.
- **The weakness of EU countermeasures.** The special purpose vehicle (SPV) INSTEX designed to facilitate trade with Iran has been underfunded and European firms have avoided complying with an EU statute blocking them from adhering to US sanctions.

In the current conditions of unpredictable American foreign policy and rising tensions between Washington and both Beijing and Moscow, there is an alarming possibility that the US could impose secondary sanctions on either China or Russia in the future. Given that secondary sanctions on either of those countries would be disastrous for Europe, this paper suggests the following policies to counter the weaponisation of the US financial system:

- Increase funding and high-level political **support for INSTEX**
- **Defend the international payments system SWIFT** from US interference or create an alternative
- Use the **Blocking Statute** to restrict EU firms' compliance with US secondary sanctions
- Strengthen the **international role of the euro**
- Establish a **“European Office of Foreign Assets Control”** to counter US sanctions.

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Introduction

Sanctions¹ have long been a favourite tool in Washington's foreign policy arsenal. Under the Trump administration, however, both the scope and scale of the United States' sanctions have grown to an unprecedented level. Trump has also been uniquely willing to employ such measures unilaterally, often in the face of allies' objections. Of particular concern to Europe is the US's use of so-called 'secondary sanctions.' This particularly potent form of economic coercion uses American control over the global financial system to restrict transactions between third parties and the target country, effectively extending US jurisdiction well beyond its borders. Secondary sanctions curtail European firms' ability to operate in certain countries and have hampered the EU's capacity to maintain its international commitments. In recent years, US secondary sanctions have aggravated Europe and called into question its ability to conduct a truly autonomous foreign policy.²

Such encroachment on European autonomy comes at precisely the time when Ursula von der Leyen has pledged to lead a "geopolitical" European Commission aiming for strategic sovereignty. While such talk has raised the hopes of those who wish to see the EU wield greater power internationally, the gaps between European ambitions and capabilities remain substantial. The EU's tepid response to the United States' imposition of secondary sanctions on Iran following its withdrawal from the 2015 Joint Comprehensive Plan of Action (JCPOA) has exposed the limitations of Europe's sovereignty. US sanctions have had the alarming effect of both jeopardising the deal and preventing the flow of vital supplies into Iran. The latter problem has become particularly critical in recent months, as Iran's inability to import sufficient quantities of medical goods has weakened its capacity to combat the COVID-19 crisis.³ Human rights organisations have attributed some of the severity of the crisis in Iran to US sanctions, highlighting the humanitarian consequences of Europe's inability to successfully counter secondary sanctions.⁴

In order to fulfil its ambition to become a credible geopolitical player and to defend its interests and values abroad, it is critical for the EU to be able to withstand extraterritorial sanctions. This can be accomplished both through defensive measures – such as creating more effective Blocking Regulations⁵ – as well as deterrent offensive measures, such as an automatically triggered sanctions response mechanism. Addressing this gap in Europe's financial and foreign policy autonomy would enable the EU to negotiate more effectively, protect its firms' financial interests, and face an increasingly aggressive United States with a more balanced bargaining position. It is also crucial to protect against the possibility of US secondary sanctions on Russia or China, both of which share deep economic ties with the EU.

“The EU’s tepid response to the United States’ imposition of secondary sanctions on Iran following its withdrawal from the 2015 Joint Comprehensive Plan of Action (JCPOA) has exposed the limitations of Europe’s sovereignty.”

¹ Defined as tools that attempt to prompt political change within a target country by limiting its access to the world economy, in line with: Robert A. Pape, *“Why Economic Sanctions Do Not Work”*, *International Security* 22, no. 2 (1997): pp. 90–136.

² Jean De Ruyt, *“American Sanctions and European Sovereignty”*, *European Policy Brief*, no. 54 (February 2019), Egmont Institute.

³ Farnaz Fassihi, *“Iran Says U.S. Sanctions Are Taking Lives. U.S. Officials Disagree”*, *The New York Times*, April 1, 2020.

⁴ *“Human Rights Dimensions of COVID-19 Response”*, Human Rights Watch, March 31, 2020

⁵ *“Iran Sanctions and the EU Blocking Regulation: Navigating Legal Conflict”*, Allen & Overy, October 2018.

With the goal of developing measures for Europe to prepare for such a possibility, this paper examines the lessons of Europe's past experiences navigating US sanctions, analyses the sources of European vulnerability, and discusses measures the EU could implement to deter and defend against future US secondary sanctions. Although the Iran case has alarmed Europe, its economic impact has been relatively limited. Given that US secondary sanctions on either Russia or China would pose a dire economic risk to the EU, Europe's approach to countering foreign economic coercion should be centred around protecting itself from this possibility.

1 US Sanctions and Transatlantic Relations: History and background

1.1 The evolution of US extraterritorial sanctions

Why are secondary sanctions so significant? Unlike primary sanctions, which forbid companies and individuals from the sanctioning country from engaging in economic activity with the target country, secondary sanctions also prohibit foreign entities from trading with any sanctioned party. This is true even if a transaction does not directly involve the sanctioning country and has no nexus within it. In the context of the United States, this means that third parties are banned from transacting with any institution or individual that is placed on the Treasury Department's Specially Designated Nationals and Blocked Persons List (SDN list). The massive American market and the extraordinary reach of its financial system make US secondary sanctions particularly potent. If a foreign entity trades with a party on the SDN's secondary sanctions list, it can be cut off entirely from the US-centred global payments system and prevented from accessing the large US domestic market. Since they extend US law well beyond its borders, secondary sanctions are often referred to as "extraterritorial sanctions" and are often seen by third parties as an infringement on their sovereignty.

The main actor in both the maintenance of the SDN list and the enforcement of sanctions is the US Treasury Department's Office of Foreign Assets Control (OFAC), which was first established in 1950.⁶ From its inception, OFAC used the threat of sanctions to both punish American adversaries and keep allies in line. Confronting rivals is often done in close coordination with American partners. In recent decades, the US and the EU (which has expanded its sanctions use considerably) have worked together on sanctions, closely aligning their policies.⁷ Examples of such cooperation include North Korea, Russia after its invasion of Crimea in 2014, and Iran in the build-up to the JCPOA.

However, Europe has occasionally found itself on the receiving end of American sanctions. An early example was in 1955, when, following France, the UK, and Israel's military intervention around the Suez Canal, the threat of economic sanctions against these close American allies prompted their withdrawal from the Sinai Pen-

⁶ Richard Nephew, "Implementation of Sanctions: United States", in *Economic Sanctions in International Law and Practice*, 1st ed., New York: Routledge, 2020

⁷ Inken von Borzyskowski and Clara Portela, "Piling on: The Rise of Sanctions Cooperation between Regional Organizations, the United States, and the EU", KFG Working Paper Series, No. 70, Kolleg-Forschergruppe, January 2016.

insula.⁸ Although the US often got its way by threatening or imposing sanctions, there have also been several instances of European powers successfully defying Washington.

In 1982, President Reagan imposed sanctions on European countries that participated in the construction of a Soviet pipeline. In language that echoes current EU leaders, France argued that “sanctions imposed by Mr. Reagan last June against European affiliates of American companies and on independent European companies using American technology were illegal and had to be ended”.⁹ During this dispute, the UK employed the Protection of Trading Interests Act (similar to the modern EU Blocking Regulation) as a way to force UK firms to comply with its, rather than the US’s, demands.¹⁰ Thatcher’s willingness to defy the US – as well as the fact that other European nations had already signalled their intention to defy American sanctions – were both critical in the UK’s success.¹¹

In 1998, Europe convinced the US to back away from increased extraterritorial sanctions on Iran and Cuba after raising a case at the World Trade Organisation (WTO).¹² The 1996 Blocking Statute,¹³ which forbade European firms from complying with US sanctions, was instrumental in this success. The Statute was first enacted as a response to the US Helms-Burton Act, which imposed strict sanctions on Cuba. Europe refused to accept such measures, protesting that they violated international law. The two parties eventually reached a truce, signing a 1998 memorandum in which Europe dropped its WTO case in exchange for waivers from US sanctions on Cuba, Iran and Libya.¹⁴

1.2 21st century US sanctions use

Following the attacks of 11 September 2001, US sanctions use expanded dramatically.¹⁵ Generally, the EU followed the United States’ lead by implementing its own array of sanctions against suspected terrorists. Both the political alignment of the EU and US against terrorist activity and the increasing sophistication of American sanctions ensured that Europe was hesitant to defy US economic coercion.¹⁶

For example, when the *New York Times* reported that the US Treasury Department and Central Intelligence Agency had been working with the Belgium-based bank messaging service Society for Worldwide Inter-bank Financial Telecommunications (SWIFT) to collect transaction data in secret, the official European response

⁸ Secretary of State’s Special Assistant (Russell), “Document 62: U.S. Policies toward Nasser”, In Suez Crisis, July 26–December 31, 1956, (Washington: United States Government Printing Office, 1956).

⁹ Bernard Gwertzman, “Reagan Lifts Sanctions on Sales for Soviet Pipeline; Reports Accord with Allies”, *The New York Times*, November 14, 1982.

¹⁰ James Feron, “Mrs. Thatcher Faults U.S. On Siberia Pipeline”, *The New York Times*, July 2, 1982.

¹¹ Jon Nordheimer, “Britain, Angry at U.S., Again Defies Sanctions”, *The New York Times*, September 11, 1982.

¹² James Bennet, “To Clear Air with Europe, U.S. Waives Some Sanctions”, *The New York Times*, May 19, 1998.

¹³ “Council Regulation (EC) No 2271/96” Document 31996R2271, EUR-Lex Law, November 29, 1996.

¹⁴ Joaquín Roy, “The ‘Understanding’ Between the European Union and the United States Over Investments in Cuba”, ASCE, November 30, 2000.

¹⁵ Exec. Order No.13224, 66 Fed. Reg., September 25, 2001.

¹⁶ Nephew, “Implementation of Sanctions”.

was muted.¹⁷ Despite a public outcry, the EU worked quickly to ensure it also had access to the data.¹⁸ In a prescient statement about the risk of setting such a precedent, then Member of the European Parliament Alexander Alvaro warned that “if we always bow to the US, we will never be able to negotiate with them as equals.”¹⁹

Having pledged to keep the US out of Middle Eastern conflicts, sanctions were a key element of Democratic President Barack Obama’s foreign policy maxim of “don’t do stupid shit”. As a way to avoid military intervention, but also remain active in foreign policy, OFAC pioneered the modern version of secondary sanctions, which employed greater oversight and control of the global financial system. These, in conjunction with European sanctions, were used to effectively drive Iran to the negotiating table. Secondary sanctions increasingly became a favourite tool of the administration, rising in prominence throughout Obama’s second term.

Although Obama’s presidency was generally far more amenable to Europe than George W. Bush’s, the US continued to pressure Europe to follow its lead on sanctions policy. For example, the EU fell in line after the US Congress restricted Iranian banks’ access to SWIFT in 2012.²⁰ In retrospect, some EU officials expressed their regret at bending too easily to American wishes, saying it set a dangerous precedent for the future.²¹

1.3 US secondary sanctions under Trump

Under Trump, sanctions have been a useful way to balance the President’s competing foreign policy instincts. They offer a way for him to square the circle between pursuing both maximalist and non-interventionist policies. Along with other means of using the United States’ economic centrality for geopolitical ends (such as trade wars and blocking appellate judges to the WTO), sanctions have enabled him to exert “maximum pressure” campaigns against adversaries without committing troops to politically unpopular ground wars. The first two years of his presidency set records for the number of new OFAC additions per year, with the 2018 count (1478) reaching more than twice the previous record, from 2004 (719). Following record sanctions additions in 2018, OFAC’s total sanctions actions (82) and civil enforcement penalties (\$1.3 billion) both peaked in 2019.²²

“Under Trump, sanctions have been a useful way to balance the President’s competing foreign policy instincts. They offer a way for him to square the circle between pursuing both maximalist and non-interventionist policies.”

¹⁷ Eric Lichtblau and James Risen, “Bank Data Is Sifted by U.S. In Secret to Block Terror”, The New York Times, June 23, 2006.

¹⁸ Nicholas Ridley and Nick Ridley, “Terrorist Financing: The Failure of Counter Measures”, Massachusetts, USA: Edward Elgar Publishing, 2012.

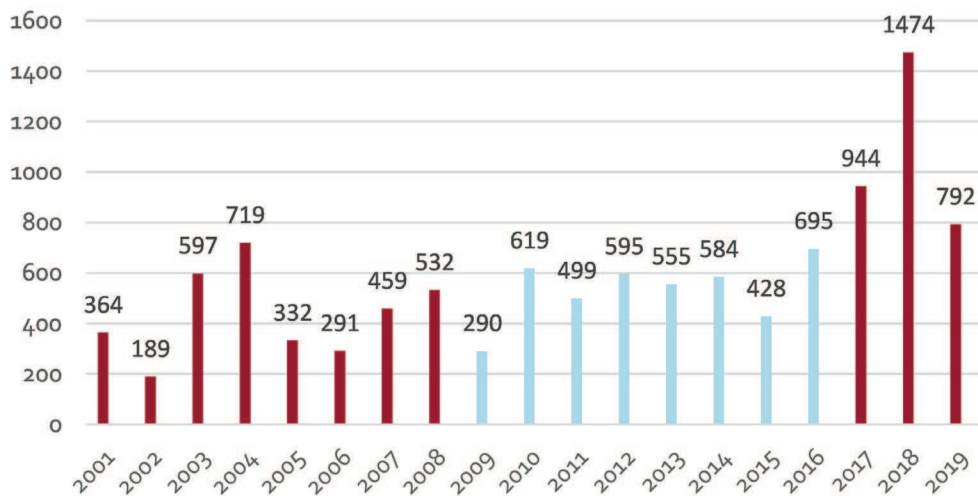
¹⁹ Von Laura Poitras, Marcel Rosenbach, and Holger Stark, “NSA Monitors Financial World”, SPIEGEL International, September 16, 2013.

²⁰ Simon Bale, “Swift Instructed to Disconnect Sanctioned Iranian Banks Following EU Council Decision”, SWIFT, March 15, 2012.

²¹ Ellie Geranmayeh and Manuel Lafont Rapnouil, “Meeting the Challenge of Secondary Sanctions”, European Council on Foreign Relations, June 25, 2019.

²² “2019 Year-End Sanctions Update”, Gibson Dunn, January 23, 2020.

Figure 1: New additions to OFAC Sanctions List by year



Source: Gibson, Dunn & Crutcher LLP

(red represents a Republican administration; blue represents a Democratic administration)

The qualitative shifts in the way sanctions have been used are just as important as the quantitative changes under the Trump administration. In contrast to Trump's broad approach – targeting Russia, Iran, North Korea and others simultaneously – Obama tended to focus on one or two main targets at a time and to only implement sanctions after diplomatic measures failed.²³ The Treasury's measures were also often coordinated with allies, such as a close cooperation with the EU on Russia following the annexation of Crimea and Iran in the build-up to the JCPOA.²⁴

In many ways, the fears of European officials who warned about the consequences of conforming to American sanctions policy have materialised during the Trump administration. Boosted by both the legal precedent and technical sophistication that his predecessors developed, Trump has deployed sanctions largely at will and without consultation with allies or a clear plan for how they will achieve his desired foreign policy objectives. Still, it is important not to draw too stark a contrast between Trump's sanctions use and that of his predecessors. Trump has used them more cavalierly than his predecessors, but trends suggest that enthusiastic sanctions use would also have been likely under Hillary Clinton.

1.4 A case study: the JCPOA and US re-imposition of sanctions on Iran

The Trump administration's willingness to pursue a sanctions policy independently of its allies became manifestly clear after the decision to re-impose sanctions on Iran in May 2018. Ignoring pleas from his European counterparts – who viewed the 2015 pact as their signature foreign policy achievement in the Middle East – Trump announced the US's withdrawal from the JCPOA. In its justification, the US cited Iran's ballistic missile programme and its support of proxy wars in the region. Many European firms began withdrawing from Iran almost immediately. French energy company Total waited only eight days after secondary sanctions were re-imposed to cancel a major oil project, citing the risk of losing dollar funding

²³ Peter E. Harrell, "Shadow Government: Trump's Use of Sanctions Is Nothing Like Obama's", Foreign Policy, October 5, 2019.

²⁴ "EU Restrictive Measures in Response to the Crisis in Ukraine", Council of the European Union, last reviewed December 19, 2019.

from international financial institutions.²⁵ Although the administration initially granted waivers for oil trades, these were rescinded in 2019 after the White House pledged to completely eliminate Iranian oil exports.²⁶

Europe has attempted to facilitate trade and maintain its commitments under the JCPOA by establishing a barter tool and encouraging the European Investment Bank (EIB) to continue financing projects in Iran, but its efforts so far have been insufficient to counteract the effects of US sanctions. Despite instructions from the European Commission and European Parliament to continue operations in Iran, the EIB has refused, citing the risk of losing access to US capital markets.²⁷

The special purpose vehicle designed to facilitate trade with Iran has also been ineffective. The Instrument in Support of Trade Exchanges, INSTEX, operates by trading with a mirrored Iranian vehicle known as the Special Trade and Finance Instrument (STFI). It thus avoids the transfer of money across the Iranian border, bypassing the SWIFT system and US sanctions. INSTEX was initially established in January 2019 by the three European signatories to the JCPOA: France, the UK, and Germany. It has since been opened up to all EU Members, with Belgium, Denmark, the Netherlands, Finland and Sweden agreeing to join in late 2019.

Despite these recent additions, most analysts agree that INSTEX is dramatically underfunded and reports suggest that, by mid-January 2020, no transactions had yet been facilitated by the deal.²⁸ These shortcomings have done little to deter the effect of US sanctions, with EU-Iran trade plummeting 75% between 2018 and 2019.²⁹ Europe has also said that INSTEX will only be used to facilitate trade in humanitarian goods. Although such supplies are not explicitly banned by US sanctions, they are still difficult to import due to firms' reluctance to do anything that could trigger secondary sanctions.

In recent months, the humanitarian consequences of INSTEX's inability to operate at any meaningful scale have become clear. US sanctions prevented Coronavirus testing kits from reaching Iran in time, allowing the disease to spread as Iran lacked early-case capabilities.³⁰ As the COVID-19 crisis escalated, Iran was also deprived of critical goods to combat the virus outbreak, a problem that was compounded by the Trump administration's recent tightening of sanctions.³¹ For example, personal protective equipment (PPE) is not covered under the medical exemptions, making it extremely difficult for Iran to import PPE during the crisis.³² These measures left Iran in dire need of medical supplies as it faced one of the worst Coronavirus outbreaks in the world.

²⁵ "US Withdrawal from the JCPOA: Total's Position Related to the South Pars 11 Project in Iran", Total.com, Total, May 16, 2018.

²⁶ "President Donald J. Trump Is Working to Bring Iran's Oil Exports to Zero", White House, April 22, 2019.

²⁷ Beatriz Rios, "EIB Cannot Do Business with Iran, Bank Chief Warns", EURACTIV.com, July 18, 2018.

²⁸ Alexandra Brzozowski, "Instex Fails to Support Eu-Iran Trade as Nuclear Accord Falts", EURACTIV, January 14, 2020.

²⁹ "Bilateral Trade between EU and Iran Reaches 4.3 Billion Euros", AHK Iran, December 23, 2019.

³⁰ Vira Ameli, "Sanctions and Sickness", New Left Review 122 (2020): pp. 49–50.

³¹ Arshad Mohammed, "U.S. to Iran: Coronavirus Won't Save You from Sanctions", Reuters, Thomson Reuters, March 20, 2020.

³² Ameli, "Sanctions and Sickness", pp. 52.

Largely due to the tepidness of the EU's efforts to save the JCPOA, Iran chose to stockpile and enrich uranium beyond JCPOA limits after the US ended waivers on sanctions of oil exports in July 2019. This was followed by Iran fully abandoning limits in the wake of General Soleimani's assassination, after which the "E3" (the three European signatories to the deal—France, the UK, and Germany) triggered the deal's dispute mechanism, potentially signalling an end of the agreement. Recent reports have indicated further efforts to save the deal, but the prospects remain dim.³³

2 Analysis of US sanctions and their impact on Europe

2.1 The 2020 election and US sanctions use

Despite the numerous differences in how they were used, the basic similarity of both Obama and Trump's fondness for sanctions shows that the appeal of sanctions in US foreign policy thinking is bipartisan. An important reason for sanctions' popularity is the so-called "action bias" in Washington. Although opinions differ with regard to what type of action should be taken in any given foreign policy crisis, a general disposition toward action pervades American foreign policy circles. This bias towards intervention is the result of both political polarisation and the impressive coercive economic and military tools the US possesses. Politically, it can be damaging for the party in power to seem it is not doing enough to counter foreign threats,³⁴ increasing the case for using sanctions. Additionally, recalling the maxim that "when all you have is a hammer, everything looks like a nail," the sheer might of the US can convince policymakers that the US has the means to fix any problem. This can often be true even if the issue at hand is not one that is easily solved through coercive means.³⁵

While the appeal of sanctions in US foreign policy thinking is bipartisan, there are some distinctions in how sanctions are viewed, both between and within the two major parties. Clearly, Trump's re-election in 2020 would portend a continuation, or even escalation, of the "maximum pressure" strategies abroad. Members of his party in both houses of Congress have proposed a draconian set of sanctions to directly target Iran's financial system.³⁶ Republicans have also led the way in advocating for increased US sanctions use on other rivals, such as Venezuela, Russia, Cuba and China.³⁷

Even if Trump is defeated in November, a return to the status quo ante is far from guaranteed. Presumptive Democratic nominee and former Vice President Joe Biden has said that it is necessary to re-join the Iran deal, but also to go farther in

³³ "Iran Ready to Co-Operate with EU to Resolve Nuclear Deal Issues – Iran President", Reuters, February 3, 2020.

³⁴ For example, Obama was criticized extensively for failing to enforce his "red line" in Syria, while Trump was widely praised for his 2017 missile strikes.

³⁵ Paul R. Pillar, "The Bias for Action in U.S. Foreign Policy", *The National Interest*, June 26, 2014.

³⁶ US Senator for Texas, Ted Cruz, "Sen. Cruz, Rep. Gallagher Introduce the Blocking Iranian Illicit Finance Act", Press release no. 4223, December 14, 2018.

³⁷ Another important, but less-discussed, move by the Trump administration was ending European waivers from the Helms-Burton Act in 2018. These waivers had been in place for 20 years.

countering Iranian influence in the Middle East.³⁸ Additionally, he has argued for tightening sanctions against other American adversaries.³⁹ Of all the candidates who entered the 2020 presidential race, only Senator Bernie Sanders expressed more reticence regarding the use of sanctions (he was one of only two senators to oppose the re-imposition of sanctions on Iran in 2017) and has unequivocally expressed his desire to re-engage with Iran.⁴⁰ Although Biden would almost surely use sanctions less haphazardly and aggressively than Trump has, the former Vice President's ascent to the Democratic nomination would mean that the US's use of sanctions would surely remain robust, regardless of who wins the election.⁴¹

2.2 An important “wake-up call” for Europe

Given the likelihood that the US will continue its muscular sanctions use in the future, the best-case scenario for Europe is that the re-imposition of sanctions on Iran – and Europe's inability to counter them effectively – will serve as the catalyst for Europe to strengthen its position against US sanctions. A European Commission document argued that “recent extraterritorial unilateral actions by third country jurisdictions like in the case of re-imposed sanctions on Iran...are a wake-up call regarding Europe's economic and monetary sovereignty.”⁴² If Europe manages to heed this warning, it could prepare itself better to withstand coercive economic measures in the future.

In this sense, Europe is fortunate to feel the full brunt of US secondary sanctions when applied to a country like Iran. Due to Iran's moderate economic size and low level of integration with Europe (total trade amounted to only 24 billion EUR in 2017), the economic impact of US sanctions was relatively limited. Several European companies – such as Siemens and Airbus – were forced to abandon contracts worth billions of dollars, but the lack of complex supply chains and longstanding economic ties between Europe and Iran contained the fallout.

There are no guarantees, however, that the US will confine its secondary sanctions to relatively minor and isolated economies. The worst-case scenarios for the EU lie in the escalating confrontation between the US and its chief rivals, China and Russia. In contrast to the Iranian case, in which European firms were able to decide easily that US market access is preferable to operating in Iran, deep economic integration with Russia and China would present a critical risk for Europe's economic health. This is especially true given the impending economic downturn as a result of COVID-19. With regard to Russia, the EU has a much greater trade exposure than the US, meaning the costs of secondary sanctions on Russia would fall disproportionately on Europe. Given the emerging bipartisan consensus that Russia presents a substantial threat to the US, this could make it an especially appealing target for US sanctions.

“There are no guarantees that the US will confine its secondary sanctions to relatively minor and isolated economies.”

³⁸ Ron Kampeas, “Democratic Candidates' Positions on Iran”, Intermountain Jewish News, January 23, 2020.

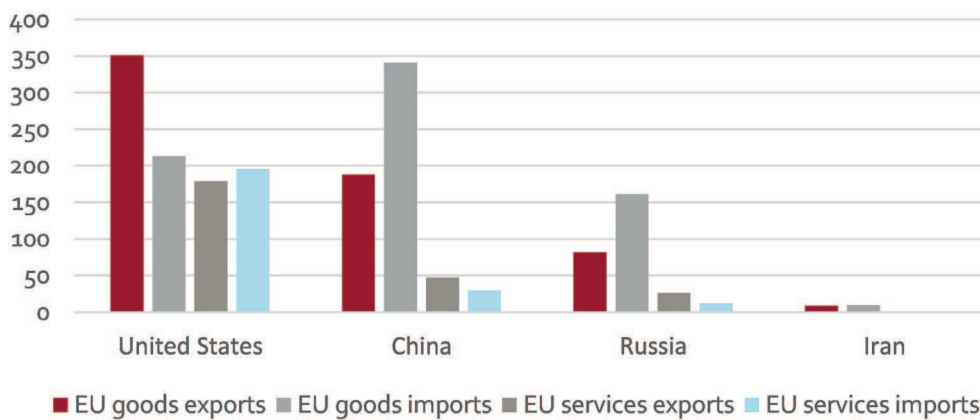
³⁹ “Joe Biden – Foreign Policy”, The New York Times, February 7, 2020.

⁴⁰ The other was Rand Paul (R-KY); Aída Chávez, “Bernie Sanders's Lonely 2017 Battle to Stop Iran Sanctions and Save the Nuclear Deal”, The Intercept, January 14, 2020.

⁴¹ Trump-style sanctions could return to American foreign policy even if he loses in November. Prominent Republicans such as Josh Hawley and Tom Cotton favor an ever more aggressive approach, and are considered top 2024 Republican contenders.

⁴² Communication from the Commission: *Towards a Stronger International Role of the Euro*, Brussels, Belgium: European Commission, December 5, 2018.

Figure 2: EU trade in goods and services (2018 €bn)



Source: European Commission

Precedent already exists for US economic coercion against Russia and China. In late 2019, the Trump administration announced sanctions on companies building the controversial Nord Stream 2 pipeline. Despite intense European opposition, sanctions were imposed regardless, forcing the Swiss company assigned to the project to abandon it. Due to the fact that the project was already near completion at the time sanctions were imposed, it will be finished, but a Russian company will be forced to take over the project, causing substantial delays. The US has also placed tight restrictions on global Chinese tech giants ZTE and Huawei, both of which are enmeshed in European markets.⁴³ These examples should serve as dramatic reminders of America's willingness to confront allies and adversaries alike – and Europe's relative inability to do much about it.

Further escalation is also possible. The most recent US National Security Strategy labelled Russia and China "revisionist powers" and argued that the focus of US military posture should be great power rivalry.⁴⁴ Bipartisan majorities have emerged in support of a hawkish stance against both countries. In late 2019, the Defending American Security from Kremlin Aggression Act, or DASKA, (referred to affectionately by its co-sponsor, South Carolina Republican Senator Lindsay Graham, as the "sanctions bill from hell") was approved by the US Senate's Foreign Relations Committee.⁴⁵ While it is unclear if the bill will come to a vote in the full Senate, the fact that it has even got out of committee should alarm Europe. Its expansive reach – prohibiting any person or financial institution allegedly involved in corruption or state-backed energy projects – would likely create de facto secondary sanctions, amplifying uncertainty and risk for European business.⁴⁶ The US's increasingly aggressive stance against China, particularly its technology firms, could create a similarly dangerous situation surrounding the world's second-largest economy. The looming prospect of sanctions that could

⁴³ Europe has also expressed some scepticism toward Huawei, but has resisted US calls for an outright ban: Matina Stevis-Gridneff, "E.U. Recommends Limiting, but Not Banning, Huawei in 5G Rollout", The New York Times, January 29, 2020.

⁴⁴ *National Security Strategy of the United States of America*, Washington, DC: The White House, December 2017.

⁴⁵ Patricia Zengerle and Timothy Gardner, "Senate Panel Advances Russia Sanctions Bill 'from Hell'", Reuters, December 18, 2019.

⁴⁶ Richard Nephew, "Understanding and Assessing the New U.S. Sanctions Legislation against Russia", Columbia SIPA: Center on Global Energy Policy, February 15, 2019.

affect larger parts of Europe's economy strengthens the case for developing a credible counterweight to US economic coercion.⁴⁷

2.3 The sources of US leverage

Given the risk of secondary sanctions against one of the EU's key economic partners, it is crucial to investigate why Europe is so vulnerable to such sanctions. The answer involves both the systemic importance of the United States and the specifics of policy decisions in Washington, Brussels, and the European capitals. On a systemic level, as financial and technological systems have expanded, the US has been at the core of these global systems, granting it enormous leverage. This is what Henry Farrell and Abraham Newman refer to as “weaponized interdependence” – a dynamic in which certain nations use asymmetric linkages in the financial and technological architecture of the world to extract gains.⁴⁸ Given the US's centrality in both finance, trade in goods, and technological networks, it is particularly well situated to exploit such imbalances.

The scale of the US financial system and international dominance of the dollar grants it unparalleled leverage in global networks. As both a reserve currency and invoicing currency in international transactions, the US dollar remains unsurpassed. Roughly 60% of global reserves are in dollars and 40% of cross-border financial transactions are invoiced in the US currency.⁴⁹ In both measures, the euro comes in a distant second.

American power is further amplified by US leverage over SWIFT. Although the financial messaging service is based in the EU, the US exercises extensive control over it, even threatening to cut Russia out of the system in response to its incursions in Ukraine. The centrality of the US dollar is closely linked to US banks' systemic global importance, since any foreign banks running afoul of US sanctions risk losing their access to American financial institutions.

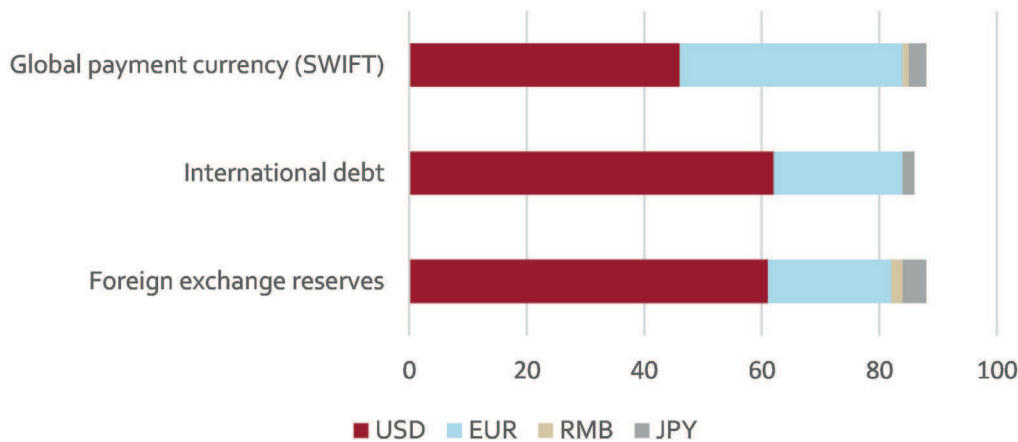
“The scale of the US financial system and international dominance of the dollar grants it unparalleled leverage in global networks.”

⁴⁷ Jonathan Hackenbroich and Mark Leonard, “Verteidigen wir Europa! Die EU braucht eine eigene Agentur, um die hiesige Industrie gegen Sanktionen zu wappnen”, ZEIT Online, August 7, 2019.

⁴⁸ Henry Farrell and Abraham L. Newman, “Weaponized Interdependence: How Global Economic Networks Shape State Coercion”, *International Security* 44, no. 1 (2019): 45.

⁴⁹ Peter E. Harrell, Elizabeth Rosenberg, David S. Cohen, Gary M. Shiffman, Daleep Singh, and Adam Szubin, *Economic Dominance, Financial Technology, and the Future of U.S. Economic Coercion*, Washington, DC: Center for New American Security, 2019.

Figure 3: The international use of global currencies



Source: European Central Bank
(in percentages, as of 2018Q4)

While the sheer volume of international transactions invoiced in its currency grants the US enormous control, its reach extends beyond mere dollar-denominated trade. As a US sanctions expert points out, America can claim jurisdiction if a transaction has any American “nexus”, even if it is not denominated in dollars. This even includes cases in which one party uses a back-end payment, email system, or accounting service that is based on American servers.⁵⁰ Given the US’s centrality in technological networks as well, there is a high chance that at least one of those services will be based in the US. For example, a Swiss IT company that handled the lost baggage management system for two Iranian airlines was recently fined \$7.8 million by OFAC because its servers were based in Atlanta.⁵¹

America’s massive market size grants it further leverage in applying secondary sanctions. With a GDP of nearly 20 trillion EUR, America remains the world’s largest economy. The European Union is deeply linked to the US in trade, with combined imports and exports exceeding 1 trillion EUR in 2019.⁵² When American sanctions force European firms to choose between Iran’s much smaller market (GDP of 390 billion EUR in 2019) and the US’s, the choice for these businesses is simple.

Yet another economic factor in the effectiveness of US sanctions is the centrality of US firms in global supply chains. Aside from the pure volume of trade the US is involved in, it is also a key intermediate step in global production. Often this takes the form of American high-skilled labour and technical expertise that global businesses rely on to develop and produce products, regardless of where they are manufactured and sold as finished products. Being cut off from US-based high-technology inputs would be crippling for many firms, increasing the potency of sanctions that threaten to do so.

“When American sanctions force European firms to choose between Iran’s much smaller market (GDP of 390 billion EUR in 2019) and the US’s, the choice for these businesses is simple.”

⁵⁰ “America’s Aggressive Use of Sanctions Endangers the Dollar’s Reign”, *The Economist*, January 8, 2020.

⁵¹ “Insight: OFAC \$7.8M Settlement With Swiss Company Expands Tech Enforcement”, *Bloomberg BNA News* (Bloomberg Law, April 16, 2020).

⁵² “European Union”, Office of the US Trade Representative, accessed March 13, 2020.

Critically, America also possesses the political will to pursue a “maximum pressure” strategy, regardless of the economic and political consequences. European firms were not the only ones hit by US sanctions; American firms lost out as well. Airbus lost 19 billion in sales to Iran Air, but its American rival Boeing lost just as much due to its own government’s decision.⁵³ Washington knew that breaking the terms of the Iran deal would harm its political relations with Europe, but did so anyway. This willingness to contradict what is seen as economic and political rationality gives the US a credibility that Europe has been unable to match.

2.4 The sources of European vulnerability

The EU-US imbalance is not solely due to American strengths. The EU is also hampered by its own inability or unwillingness to impose credible countermeasures. One potential remedy for US secondary sanctions – the EU’s Blocking Regulations – have proven to be ineffective. The regulations, which are designed to prohibit European companies from complying with extraterritorial sanctions, have worked in the past (see section 2.1). However, the 2018 amendment to the EU Blocking Regulation, a direct response to the US withdrawal from the JCPOA, was unsuccessful.

As the law firm Allen and Overy finds, the US Treasury has typically not seen foreign Blocking Regulations as a meaningful defence against its sanctions.⁵⁴ One problem is the lack of enforcement, as the EU has done little to ensure firms actually comply with the Blocking Regulation. There is also scant EU-level jurisprudence for Blocking Regulations and violations are rarely reported to the Commission. Importantly, OFAC grants foreign firms the ability to “pre-emptively comply” with US sanctions, enabling them to circumvent the Blocking Regulation.

Perhaps most damaging to Europe is its recent history of acquiescence to US sanctions. In stark contrast with the late 20th century instances of European powers successfully opposing sanctions that would have harmed European interests, in the post-9/11 era Europe has been far more compliant (see section 2.1–2.2). The fact that Europe has shown itself to be able to resist and deter Washington from imposing sanctions – such as with the Soviet pipeline in 1982 and the proposed sanctions in Cuba in 1998 – demonstrates that Europe need not be helpless in the face of extraterritorial sanctions. The basic template from those cases shows that the most critical element in resisting sanctions is sufficient political will, backed by a credible deterrent.

⁵³ Julie Johnsson and Ben Katz, “Trump Exit from Iran Pact Halts \$40 Billion Boeing, Airbus Deals”, The Bloomberg, May 8, 2018.

⁵⁴ Allen & Overy, “Iran Sanctions and the EU Blocking Regulation”.

3 Policy Recommendations

3.1 Short- to medium-term EU responses

What can Europe do to resist the United States' formidable secondary sanctions capability? In the medium term, there are at least five possible responses. First, the EU should try to salvage the JCPOA. It must do this by demonstrating that INSTEX can be a viable economic instrument, rather than merely a political gesture. The addition of six new countries in late 2019 was a good start, but the system is still in dire need of more funding. Although INSTEX has been relatively ineffective to date, initial trades have been made, and its success remains a key in resolving the Iran crisis.⁵⁵ EU High Representative for Foreign Affairs and Security Policy Josep Borrell has emphasized the importance of strengthening INSTEX, including meeting with senior Iranian officials in February. The instrument's operational capacity and funding has been steadily increased over recent months. Pursuing this progress, especially in light of the supply shortages Iran has suffered during the COVID-19 crisis, is particularly vital.⁵⁶

A key hurdle in strengthening INSTEX is providing European firms with the confidence that using it will not endanger their access to the US market. If the private economic incentives of EU firms conflict with the priorities of European foreign policy, then more high-level political support is needed to reassure businesses. Since INSTEX is not operated at EU level – and instead consists of Western European nations that are less reliant on the US security guarantee than countries like Poland – national-level support can be strengthened without the typical foreign policy sclerosis at EU level. The addition of a non-European nation – such as Russia, which offered to use INSTEX to aid Iran with the Coronavirus crisis – could also help strengthen INSTEX.⁵⁷

Second, central banks of European Member States could also be employed in the service of EU economic sovereignty. To date, European central banks – including major players like the Bundesbank and Banque de France – have been largely compliant with US demands, backing down from efforts to establish independent payments channels with Iran. Establishing commercial accounts at central banks would offer a way to circumvent the US-centred financial system. The risk to any one bank of taking the initiative alone is likely to discourage them from doing so, so the policy would have to be coordinated at EU level.

Third, given American threats of directly targeting SWIFT, Europe needs to either defend it or set up an alternative. One way to do this would be to summon support from international organisations in order to codify prohibitions on interference in the messaging service. These measures have received some attention from policy-makers, with German Foreign Minister Heiko Maas suggesting that Europe develop greater economic sovereignty by establishing a payments system independent of SWIFT.⁵⁸ In the near term, it is possible for Europe to use ad hoc financial messaging services, or to use SWIFT's same messaging standards, but without SWIFT

⁵⁵ Esfandiyar Batmanghelidj and Sahil Shah, "Europe Still Needs INSTEX to Help Solve the Iran Crisis", European Leadership Network, February 25, 2020.

⁵⁶ "Europe Steps Up JCPOA Salvage Efforts", Financial Tribune, February 21, 2020.

⁵⁷ "Russia to Continue Helping Iran to Contain Coronavirus: Ryabkov", Tehran Times, March 17, 2020.

⁵⁸ Heiko Maas, "Making Plans for a New World Order", Handelsblatt Today, August 22, 2018.

infrastructure.⁵⁹ Both solutions would surely be slower than existing methods, but could provide the first steps to circumventing the US-dominated system. Eventually, as Maas suggests, a parallel architecture could be created. In order to avoid being isolated by the US, the best course of action would be to set up a SWIFT equivalent with the help of other large economic powers, such as China and Russia.⁶⁰

Fourth, the Blocking Statute should be used more effectively to counter US secondary sanctions. Because the 2018 update to the Statute has done little to affect European firms' behaviour in Iran, a new method may be necessary. Specifically, the 1968 Brussels Convention⁶¹ – which concerns the jurisdiction and enforcement of judgments in civil and commercial matters – could be used in conjunction with Article 6 of the Statute. The EU could target US actors that initiate secondary actions against European operators, threatening to seize their assets. While it would be difficult to apply this to US government property, it would still act as a deterrent, since US companies with interests in the EU would be vulnerable.

Finally, as a deterrent, Europe could also develop a legal process to enact countermeasures automatically. The EU could develop its own equivalent to OFAC in order to do this, which would have the added benefit of showing that Europe is serious about fusing its economic might with its foreign policy objectives. As a group of researchers led by Pascal Lamy has argued, the EU could set up a “European Office of Foreign Assets Control” (“EFAC”, modelled on OFAC) to impose extraterritorial sanctions.⁶² This could be led by a “coalition of the willing,” but would ideally contain all 27 Member States. While similar in structure to America's sanctions capabilities, they stress that this organisation would not take as broad a definition of “national security” as the US does, and that it would be for the promotion of specific “European values”, such as climate and human rights protection.

3.2 Long-term strategies

Although the consequences for Europe are substantial, the long-term viability of secondary sanctions is fragile precisely because their effectiveness depends on America's systemic importance. The US's disproportionate control of global financial and technological architecture grants it enormous power, but by abusing such power, it incentivises other nations to eventually develop alternative systems. In this sense, there is an element of “use it and lose it” in US secondary sanctions. To be sure, developing alternative financial structures is not feasible in the short- to medium-run due to the substantial networks of the current dollar-based system. As one French official aptly remarked, “it's a ten-to-twenty-year thing, and hopefully not only covering Iran. You can't undo decades of policy in a year.”⁶³

“The US's disproportionate control of global financial and technological architecture grants it enormous power, but by abusing such power, it incentivises other nations to eventually develop alternative systems.”

While the practical challenge of establishing separate systems is daunting, the mere threat of depriving the United States of its central role can serve as an effective political counterweight against Washington. American officials deeply value

⁵⁹ Cathrin Schaer, “Heiko's Dream: Making Europe Financially Independent, One Transaction at a Time”, *Handelsblatt Today*, November 28, 2018.

⁶⁰ Stratfor Worldview, “In Europe, a Growing Push To Escape the Shadow of the U.S.”, Stratfor, August 22, 2018.

⁶¹ “1968 Brussels Convention on Jurisdiction and the Enforcement of Judgments in Civil and Commercial Matters”, Document 41968A0927(01), EUR-Lex Law, December 31, 1972.

⁶² Pascal Lamy, et. al, “EU and US Sanctions: Which Sovereignty?”, Berlin, Germany: Jacques Delors Institute, October 23, 2018.

⁶³ The Economist, “America's Aggressive Use of Sanctions”.

the asymmetric power granted to them and are alarmed by the prospect of losing it.⁶⁴ For example, a recent paper from the Center for a New American Security cautioned that callous sanctions use, combined with determined efforts of foreign countries to resist them, could weaken sanctions' effectiveness in the future.⁶⁵

This demonstrates that rumblings of concrete steps toward decreasing American centrality can be used as leverage against US unilateralism. This is well recognised by some in the US. Even prior to Trump's election, former Treasury Secretary Jack Lew warned that if US sanctions make international transactions too costly and complicated, "financial transactions may begin to move outside of the United States entirely – which could threaten the central role of the US financial system globally, not to mention the effectiveness of our sanctions in the future."⁶⁶ Europe would be wise to take steps to make American policymakers increasingly cognisant of this possibility.

The internationalisation of the euro is one key way to dislodge US dominance in the financial system and forms the bedrock of several of the measures discussed in the previous section.⁶⁷ This will be no easy task, however. As Kris Best has written, despite the EU's massive market size, the efforts to internationalise the euro have been hampered by both political and technical hurdles.⁶⁸ Although the challenges are substantial, the recent Franco-German proposal to issue €500 billion in joint European debt (the proposal would include the entire EU, not just the Eurozone) could aid such efforts by creating a safe European asset. The EU could also chip away at global dollar usage in international transactions by demanding that energy imports be invoiced in euros. As the world's largest fossil fuel importer, the EU could set a standard that would be hard for producers to refuse.⁶⁹ Any improvement would be crucial for resisting American sanctions.

Summoning the political will to confront the US is of course vital for enacting many of these policies. In order to do this, it is important to develop "synergies" between the quest for economic sovereignty and broader efforts to develop greater independence internationally. By becoming more economically or militarily self-sufficient, the EU has less to fear from worsening transatlantic relations and can wield greater power in other areas. This will surely be no easy task, especially given the impending economic downturn as a result of the Coronavirus. However, as the geopolitical and geoeconomic climate becomes increasingly uncertain, Europe should double down on attempts to preserve economic, defence and foreign policy sovereignty in the coming years. With Iran potentially serving as a harbinger for US sanctions on more significant economies, these efforts have never been more critical.

⁶⁴ Harrell, "Shadow Government: Trump's Use of Sanctions Is Nothing Like Obama's".

⁶⁵ Harrell, Rosenberg, Cohen, Shiffman, Singh, and Szubin, "Economic Dominance, Financial Technology, and the Future of U.S. Economic Coercion".

⁶⁶ Jackie Calmes, "Lew Defends Sanctions, but Cautions on Overuse", The New York Times, March 29, 2016.

⁶⁷ Alastair Macdonald, "EU's Juncker Wants Bigger Global Role for Euro", Reuters, September 12, 2018.

⁶⁸ Kris Best, "Economic Sovereignty and the International Role of the Euro", Jacques Delors Institute, August 22, 2019.

⁶⁹ Suggestion based on discussion with a Christian Leffler.

Conclusion

As the Iran case has shown, when a unilateralist US foreign policy is combined with a determination to weaponise its economic leverage, Europe is largely helpless to resist. The EU's failure to uphold the Iran deal is also far from the worst-case scenario. As tensions escalate between Washington and Beijing and Moscow, the prospects of secondary sanctions being placed on either Russia or China – both of which are deeply economically intertwined with the EU – is far from inconceivable. To preserve its sovereignty, protect its economic interests, and insulate itself from an increasingly capricious United States, it is critical for Europe to defend against and deter American secondary sanctions. Moreover, with US sanctions limiting Iran's ability to combat COVID-19, the moral case for the EU developing greater economic sovereignty has never been stronger. Iran's supply shortages have made it clear that much more than abstract questions of European autonomy are at stake – actual human lives are.⁷⁰

While this goal should be near the top of European geopolitical priorities, its execution will not be easy. It will require time, innovation, and political will. Dislodging the centrality of the US in financial and technological systems will take years or even decades, but the chipping away should begin sooner rather than later. Developing the tools to establish payment systems independent of SWIFT and to forge a credible sanctions deterrent will require extensive technical expertise and trial and error. It will also require Member States to sacrifice some national sovereignty in order to enable the EU to act boldly and with common purpose.

Most importantly, the EU needs to establish itself as a credible international player in American eyes. Europeans are prone to mocking Americans for their monolingualism, but in this case, it may be Europe that has some catching up to do. If the new normal in Washington will be to simply understand the language of strength, then Europe would be advised to learn how to speak it.

“With US sanctions limiting Iran’s ability to combat COVID-19, the moral case for the EU developing greater economic sovereignty has never been stronger.”

“The EU needs to establish itself as a credible international player in American eyes.”

⁷⁰ Esfandiyar Batmanghelidj and Abbas Kebriaeezadeh, “As Coronavirus Spreads, Iranian Doctors Fear the Worst”, *Foreign Policy*, March 3, 2020.

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