

STUDY

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Extraterritorial sanctions on trade and investments and European responses



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ABSTRACT

Recent US measures directed against Iran, Cuba and Russia (North Stream 2) have become indirectly a critical challenge for the European Union as well. As they purport to deter economic actors under EU jurisdiction from engaging with target countries, they have an important extraterritorial dimension, which affects EU business and individuals and ultimately the sovereignty of the EU and its Member States. A review of the existing sanction regimes and of the geopolitical context reveals that other international players and the PR China in particular may follow suit in using such measures. The study shows that extraterritorial sanctions have important economic implications, particularly for the EU and its vulnerabilities. Extraterritorial sanctions also raise critical questions as to their legality under general international law, WTO law and other specific international rules. The EU is especially affected by these measures and has taken some measures already in response. These could be improved and additional measures could be taken, as the policy recommendations set out.

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List of abbreviations

AML	Anti-money laundering
BIT	Bilateral investment agreement
BRI	Belt and Road initiative
BYIL	The British Yearbook of International Law
CAATSA	Countering America's Adversaries Through Sanctions Act
CFO	Chief financial officer
CFSP	Common Foreign and Security Policy
CGE model	Computable general equilibrium (CGE) model
CIA	Central Intelligence Agency
CIPS (China)	Cross-border interbank payment system
CIRI	Cingranelli and Richards Human Rights Data Project
CJEU	Court of Justice of the European Union
CLOUD	Clarifying Lawful Overseas Use of Data Act
CMEA	Council for Mutual Economic Assistance (= "COMECON")
DARIO	Draft Articles on the Responsibility of International Organizations
DCCEMG	Dynamic common correlated effects mean group
EBA	European Banking Authority
EEA	European Economic Area
EEAS	European External Action Service
EFTA	European Free Trade Association
ENP	European Neighborhood Policy
EPPO	European Public Prosecutor's Office
EU	European Union
FATF	Financial Action Task Force
FCN	Friendship, Commerce and Navigation treaty
FDI	Foreign direct investment
FIUs	Financial intelligence units
FPI	Foreign Policy Instruments
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
GDP	Gross Domestic Product
GDPR	General Data Protection Regulation
GNP	Gross national product
GSP	Generalized scheme of preferences
HRC	Human Rights Committee
IAEA	International Atomic Energy Agency
ICCPR	International Covenant on Civil and Political Rights
ICJ	International Court of Justice
ILC	International Law Commission
ILM	International Legal Materials, by the American Society of International Law
ILSA	Iran and Libya Sanctions Act

IMF	International Monetary Fund
INSTEX	Instrument in Support of Trade Exchanges
ISDS	Investor-State Dispute Settlement
JCPOA	Joint Comprehensive Plan of Action
MENA	Middle East and North Africa
MOFCOM	Ministry of Commerce (China)
NSL	National Security Law for Hong Kong (2020)
OAS	Organization of American States
OECD	Organization for Economic Co-operation and Development
OFAC	Office of Foreign Assets Control
PEESA	Protecting Europe's Energy Security Act
PP	Percent Point (the unit for the arithmetic difference of two percentages)
PPF	Production possibility frontier
RMB	Renminbi; official currency of the PRC
SCA	Stored Communications Act
SOE	State-owned enterprise
SPS	Sanitary and phyto-sanitary
SWIFT	Society for Worldwide Interbank Financial Telecommunication
TEU	Treaty on European Union
TFEU	Treaty on the Functioning of the European Union
TWEA	Trading with the Enemy Act
UK	United Kingdom
UN	United Nations
UNCITRAL	United Nations Commission On International Trade Law
UNSC	United Nations Security Council
US	United States of America
USMCA	United States-Mexico-Canada Agreement
USSR	Union of Soviet Socialist Republics
WTO	World Trade Organization

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Executive summary

Background

The European Union's exposure to US extraterritorial sanctions is a major challenge. Recently, the current US administration activated harsh economic sanctions against Russia, Iran, and Cuba in a unilateralist and confrontational turn away from earlier policies of peaceful change and multilateral containment. To augment unilateral economic pressure, these sanctions also undertake to discourage companies and individuals of third parties to do business with the targeted countries. This conduct has been rightly framed as „extraterritorial“.EU businesses are seriously and possibly even specifically affected by those measures. In addition, this bold attempt to prescribe the conduct of EU companies and nationals without even asking for consent challenges the EU and its Member States as well as the functioning and development of transatlantic relations. The extraterritorial reach of sanctions does not only affect EU businesses but also puts into question the political independence and ultimately the sovereignty of the EU and its Member States.

Both, the EU and Member States have reacted quickly and adopted diverse measures. These include not least the activation of the EU's „blocking statute“ (Council Regulation (EC) No 2271/96 of 22 November 1996) and the establishment of INSTEX.

Aims and Findings

This study aims to see, whether more could be done to effectively cope with these challenges. This could include an enhanced capability of the EU and its Member States to counteract, to hedge its businesses and the EU economy against such pressures and - ultimately, to reduce the risky dependence on any one political and economic power.

In order to consider what could be done, the study provides an in-depth assessment for understanding the geopolitical context of sanctions and the role for the EU and its Member States. It analyses the economic effects in detail to see their magnitude and to find out, how the EU's businesses and economy are affected. Furthermore, the study proposes a comprehensive assessment with regard to the legality of extraterritorial measures for taking a sound position in international discourse as well as for discussing potential legal remedies.

Drawing from these insights, the study presents a series of informed and sound policy recommendations. We therefore also draw at the exposure, approaches and positions of a number of OECD countries in comparison. In this regard, the different strategic objectives, the options and hand and a number of proposals have been taken into account, including the institutionalization of EU agency, which could coordinate EU sanctions and counteractions.

The study is divided into three interrelated sections. Section 1 introduces the definitional and evolutionary backdrop to the economic impact (Section 2) and legal analysis (section 3) of extraterritorial sanctions. Section 1 offers a comprehensive insight into the use of economic sanctions for political purposes. It addresses the rationales behind the use of extraterritorial sanctions as a tool of geo-economics, and questions their effectiveness. Section 1 therefore also provides for a description of economic sanctions by the EU and give examples of their use. The section then explores the differences between the US sanctions against Cuba, Libya or Iran and European sanctions. Here, we focus on those restrictive measures which the US applies to legal and natural persons in third countries with the ulterior objective of putting pressure on the political target of those restrictive measures. In addition, the section presents an overview of China's explorations in applying its own legislation extraterritorially, whether through the Belt and Road Initiative or the National Security Law for Hong Kong.

Section 2 focuses on the economic analysis of extraterritorial sanctions and the assessment of the EU vulnerability to the extraterritorial measures. The central point of the economic analysis is the assessment of the EU vulnerability to the extraterritorial measures which is based on the retrospective analysis of previous sanctions imposed by the US which were not joined by the EU. The subsequent part covers the experience of other countries to extraterritorial measures: China and Russia. Our analysis shows that effects of a sanction on third parties are highly dependent upon the status of the country being sanctioned and the trade relationship between the sanctioned country and the third country. It provides micro-evidence of large firm-level impacts of the sanctions on Iran and scattered evidence of the impact of sanctions of Cuba. We provide evidence to show that there were only minor disruptions from US sanctions against Cuba for Russia and China, while the re-imposition of sanctions on Iran – as a much more important player in global energy markets – had a more noticeable effect on the two countries.

Drawing on insights from the game-theoretic literature as well as those given by the standard neoclassical trade model, and building on the existing literature, we perform an original empirical analysis devoted to, inter alia, the effects of sanctions on macroeconomic indicators (GDP growth rate, productivity, poverty) and international trade. In particular, the empirical analysis looks at the effectiveness of sanctions, the impact of sanctions on main macroeconomic variables and the impact on international trade.

Our analysis on sanctions and their objectives shows that the success rates differ substantially with sanctions aimed at restoring democracy having a generally higher rate of success (over 80 % episodes with at least partial success) and the sanctions targeted at terrorism and territorial conflicts having the lowest success rate in. Sanctions against terrorism still stand out as those least effective with only 33 % success of the completed sanctions episodes, while sanctions aimed at ending war and protection of human rights have a corresponding success rate of over 66 %. Sanctions related to the destabilization of the regime, have been successful in 42 % of episodes.

Regarding the impact of sanctions on macroeconomic variables, our results point to a large and negative effect of sanctions. Sanctions lead to a large decrease in economic activity: growth rates of GDP, GDP per capita or GDP per worker which drop by 1.5 percent point on average. When considering different sanction types, the most detrimental to economic activity are trade sanctions: On average they lead to a drop between 3.0 and 4.3 percent point in GDP growth rates. Overall, while this section shows that sanctions are in general detrimental to the economic conditions of the target country and have a negative impact on international trade, we do not find the extraterritorial features of US sanctions to significantly add to the overall macroeconomic effect of economic sanctions, in contrast to the micro-evidence provided earlier.

Section 3 of the study then provides for a legal analysis of extraterritorial economic sanctions. Since the conformity of such sanctions with international law is often touched upon only implicitly, we first to the general implications of the term “extraterritorial” in view of general public international law. In order to get a full picture, international conventions and regulations that govern international economic processes in particular are taken into account. We then assess the legality of the diverse US measures, especially in view of the EU’s own and fairly different scheme of economic sanctions. Furthermore, we offer an assessment of the legality of US measures in view of potential responses. Remedies, including to challenge US measures in international courts and tribunals or even in US courts are an important, but not the only type of response for raising diplomatic pressure or reducing the vulnerability of EU businesses in economic terms.

In developing arguments for suitable responses, the study addresses the ways in which the EU has already reacted, including diplomatic means, counter-legislation (the blocking statute) and the creation of INSTEX. In addition, we look at possible further responses the EU and its Member States can give themselves. The responses examined fall into three main categories:

- responses addressing the illegality of US extraterritorial action: We look at responses addressing the illegality of US sanctions through international and domestic dispute settlement, supporting dispute settlement commenced by affected EU citizens and businesses and countermeasures under general international law. We look at WTO, FTA and investment dispute settlement, additional options regarding the International Court of Justice, and options for the EU to take retaliatory financial sanctions.
- responses countering the legal effect of US measures: We analyze the so-called blocking statute (Council Regulation (EC) No 2271/96), and the Commission's Delegated Regulation (EU) 2018/1100. On this basis, we explore, whether there is potential for improvement.
- responses reducing the economic vulnerability of EU businesses: We explore, whether in legal terms, the effectiveness of INSTEX can be improved and secured.

In the final section, the study proposes a series of recommendations for political action by the EU and its Member States in general, and by the European Parliament:

- Intensify the coherent and joint voicing of the lack of legality of extraterritorial sanctions with third countries and institutions

Consistent statements may have an impact on the political discourse in the US, send a strong signal to the international community and contribute to the urgently needed clarification of international law on the issue. Parliament should call on the High Representative and the Commission to monitor continuously and with priority measures with possible extraterritorial effects, to seek to join with other States and to make or orchestrate EU and EU+X (third states or organizations) joint statements in a consistent manner.

- Encourage and assist EU businesses in bringing claims in international investor-state arbitration and in US courts

European companies may have recourse to international investment arbitration and national courts against sanctions imposed by the US or other States. In this respect, the support of the EU and its Member States by way of diplomatic protection is key. In addition, coordination and cost coverage should be considered, as is already envisaged in a similar form in the blocking regulation. Parliament could systematically call on the Commission and the Member States, to support such legal action, and invite the Commission, to explore means of coordination and reimbursement of costs together with Member States. Regarding Member States' bilateral Friendship, Commerce and Navigation treaties (FCN), Parliament could consider calling on Member States to take possible steps under existing FCN treaties to address a possible breach of corresponding treaty obligations by the US as part of a response of the EU.

- Complaints against extraterritorial measures in the WTO

WTO dispute settlement is key and one of the more critical and relevant responses. Reports by a WTO panel can be influential in dispute settlement under bilateral agreements and can contribute to clarify the legal limits of the use of extraterritorial sanctions. Bringing a complaint in the WTO could strengthen the EU's reputation vis-à-vis the US and in the wider international community and highlight its credibility as a strong defender of the rule-based world economic system. Parliament might

therefore invite the Commission to consider in a timely manner to bring a complaint against the application of Part III of the Helms Burton Act. In this respect, Parliament might intensify its interparliamentary network towards organizing an interparliamentary coalition by referring to the existing fabric of its delegations, interparliamentary committees and assemblies. More specifically, Parliament's Committee on International Trade might consider to develop a specific, trade-related, joint committee structure, by taking into account its networks build within the Parliamentary Conference on the WTO.

- Consider taking unfriendly acts or eventually countermeasures against illicit sanctions

The EU may respond to US sanction measures by way of retorsion and thus act in a way, which is unfavorable but lawful. This includes measures in areas of relations and cooperation such as diplomatic and consular relations and cultural exchanges to name but a few. Such action often has quite some political effect, but also considerably burden on the transatlantic relations. Parliament might consider to urge the High Representative and the Commission to clearly state, that the EU "will consider all available options" to remedy an illicit sanctioning measure. In addition, Parliament could ask the Commission to estimate the potential consequences of such measures in the form of impact assessment. Further, Parliament might consider to propose such bold statement to be accompanied by some unfavorable act.

- Consider using SWIFT to block transactions as a sanction or countermeasure

A specific countermeasure could be the blocking of financial transactions by the SWIFT system, which is constituted under Belgian law and subjected to European legislation and has in the past been used in connection with the implementation of UN sanctions. However, imposing restrictions on financial transaction undertaken by SWIFT would also entail economic effects that could also affect European businesses. Such measures should therefore be considered only in case of a grave violation of international law with important repercussion on the European Union, its Member states and EU businesses and after the application of all other options have failed.

- Countering effects of foreign sanctions by robust EU blocking legislation and enforcement by Member States

The EU has legislation in place to protection against and counteract the effects of the extraterritorial application of the laws. Currently, the question arises, whether the blocking statute should be extended to cover the recent US sanctioning measures sought to halt the North Stream 2 project. Parliament should consider inviting the Commission to take steps in this direction.

- Promote the EURO to take a larger role in the international financial system

Given the centrality of the US to the global economic system – and, more importantly, the role of the US dollar as the global reserve currency – states have been loath challenge US sanctions directly, with most of the circumvention coming at the firm level. The EU could cautiously explore ways to dilute the power of the US dollar by strengthening the international role of the EUR. There are several reasons (*inter alia*, insufficient depth of EU financial markets, currency stability) why acceptance of the euro as an international currency has stalled since its inception in 1999. The feasible way in which the euro area can continue to increase the influence of the euro is to continue to increase the size of its own economies and foster their own linkages in international trade and finance. Much of the decision to use the dollar comes from convenience in what is essentially a network problem: private sector firms prefer the dollar because it is highly utilized, so it becomes even more utilized. In order to overcome this network problem, the euro needs to become more indispensable, i.e. the EU needs to grow and trade even more than it does now, so that firms will find themselves dealing in euro and with countries that

themselves use the euro. Increasing the share of global trade will allow the EU to at least target the (large) segment of the world that uses the dollar as a denomination but does not actually deal with the United States; such a shift would also, by extension, make it more difficult for the US to enforce unilateral sanctions globally.

- Establishing an EU agency of Foreign Assets Control (EU-AFAC)

Strengthening the EU's ability to take effective economic sanctions as a matter of its own interest might also promote its credibility as a partner in geo-strategic perspective. To date, there is no EU agency to coordinate sanctions and counteractions at hand. Possibly, such agency could importantly promote the effectivity of EU sanctions and might even help to respond to extraterritorial sanctions employed by third countries. An EU-AFAC could develop common standards, tools and certification mechanisms for due diligence to boost the confidence of European businesses that they are engaged in legal trade and investment. It could assist European companies seeking waivers and exemptions from sanction senders. An EU-AFAC could also strengthen EU legal protections for entities engaged in trade and investment with high-risk markets by developing guidelines related to a reinforced blocking regulation and by creating linkages to laws that underpin the Single European Payments Area. Parliament should take a careful position, in view of the tasks and the feasibility of such EU institutional structure, in view of the relationship between the EU and its Member States and the allocation of competences, and with regard to the democratic legitimacy, accountability and parliamentary control mechanisms. An EU-AFAC could in theory play a broad role in coordinating EU sanctions policy and defending the bloc's economic sovereignty. But creating such an agency would be a challenge, not least because it would probably require Treaty change, for which no unity exists among member states, some of which are wary of undermining their significant trade and investment flows with the US, or China for that matter. There is, frankly, more mileage in improving INSTEX, the blocking regulatory system and coordination of implementation by member states.

1 Introduction¹

Recently, the US administration activated harsh economic sanctions against Russia, Iran, and Cuba in a unilateralist and confrontational turn away from earlier policies of peaceful change and multilateral containment. To augment unilateral economic pressure, these sanctions also undertake to discourage companies and individuals of third parties to do business with the targeted countries. This conduct has been rightly framed as „extraterritorial“. EU businesses are seriously and possibly even specifically affected by those measures. Also, this bold attempt to prescribe the conduct of EU companies and nationals without even asking for consent challenges the EU and its Member States.

Both, the EU and Member States have reacted quickly and adopted diverse measures. These include not least the activation of the EU's „blocking statute“ (Council Regulation (EC) No 2271/96 of 22 November 1996) and the establishment of INSTEX.

Now, there is time to see, whether more could be done to effectively cope with these challenges. This would include an enhanced capability of the EU and its Member States to counteract, to hedge its businesses and the EU economy against such pressures and - ultimately, to reduce the risky dependence on any one political and economic power.

In order to consider what could be done, a proper assessment is warranted to understand the geopolitical context of sanctions and the role for the EU and its Member States. Also, the economic effects need to be assessed in greater detail to see their magnitude and to find out, whether the EU's businesses and economy are particularly affected.

Furthermore, the legality of the extraterritorial measures has to be explored both in order to take a sound position in international discourse as well as to find out about potential remedies.

Drawing from these insights and in view of developing informed and sound policy recommendations, a political assessment has to be conducted. It shall look at the exposure, approaches and positions of a number of OECD countries in comparison. Moreover, it should take into account the political will within the EU, as witnessed by statements and proposals from the EU and Member States. Finally, our assessment will be drawn in view of the vulnerabilities of the EU and its priorities including the stability of the transatlantic relationship.

1.1 Overview of existing extraterritorial sanctions and implementing measures and their impacts especially on the EU and its Member States

On this basis, policy recommendations will be developed. The different strategic objectives, the options at hand and a number of proposals will be taken into account, including the institutionalization of EU agency along the lines of the US OFAC, which could coordinate EU sanctions and counteractions.

In this part of the study, we will first take a step back and explain the rationale behind the use of sanctions as a tool of geo-economics, and question their effectiveness. We will include a description of economic sanctions for political purposes by the EU and give examples of their use. While the EU and third countries like the UK use comprehensive trade embargoes more cautiously, the exercise of economic sanctions continues to be applied by the predominant power of the 20th century: the USA. It

¹ The authors acknowledge outstanding research assistance of: Paweł Galiński (CASE), Weinian Hu (CEPS), Thomas Walli (Innsbruck University), Abdoul Karim Zanhouo (CASE).

is this American practice that underpins the object of this study: the effect of extraterritorial sanctions adopted by the US government, mainly by the Treasury Department, and the ways and means at the EU's disposal to block them and counteract. The second part of this section is aimed at providing an overview of the differences between the US sanctions against Cuba, Libya or Iran and European sanctions. Here, the focus will be on so-called 'secondary' sanctions, i.e. those restrictive measures which the US applies to legal and natural persons in third countries with the ulterior objective of putting pressure on the political target of those restrictive measures. This section will also present an overview of China's inroads in applying its own legislation extraterritorially. As such, section 1 introduces the definitional and evolutionary backdrop to the economic impact (section 2) and legal analysis (section 3) of extraterritorial sanctions.

1.2 Sanctions as a tool of geo-economics

1.2.1 Aims of sanctions

Sanctions constitute one of the most frequently used foreign policy tools in international relations. The term 'sanctions' does not have any commonly agreed definition. The term can simultaneously carry a positive connotation, as when one speaks of the 'legal sanction' in the sense of conferring on a title or a normative proposition the legitimacy of law. Most of the time, however, the notion carries the negative connotation of a penalty or a punishment of deviant behaviour. It is in the latter sense that we approach the issue.

Jean Combacau defines sanctions as "measures taken by a state acting alone or jointly with others in reply to the behaviour of another state, which, it maintains, is contrary to the international law" (Combacau, 1992, p.313). Thus, the idea of imposing sanctions presupposes a breach of an international norm. Georges Abi-Saab and other scholars have confirmed this, by defining a sanction as a coercive response to an internationally wrongful act authorized by a competent social organ (Abi-Saab, 2001, p. 39). It may be inferred from that definition that a "competent social organ" is not an individual state acting in its own right (i.e. no 'private justice'), but rather a body authorized to act on behalf of a collective interest, such as, for example, the UN Security Council or the Council of the European Union (Crawford, 2001).

In more recent practice, though, sanctions have been widely understood to be imposed in reaction to behaviour that the sender, individual states or international organizations, considers objectionable, even if this has not been codified as illegal. Panos Koutrakos describes sanctions as measures that "connote the exercise of pressure by one state or coalition of states to produce a change in the political behaviour of another state or group of states" (Koutrakos, 2001, p. 49). This comes closer to the "effects doctrine" that the US has subscribed to in international law.

It is widely recognised by scholarship that compliance is often not the only, or not even the primary, aim of sanctions but that they fulfil other functions. These include the desire to demonstrate the sender's willingness and capacity to act, to anticipate or deflect criticism, to maintain certain patterns of behaviour in international affairs, to deter further engagement in the objectionable actions by the target and third parties, to support international institutions, to promote subversion in the target or to assuage domestic audiences (Barber, 1979; Lindsay, 1986). While each situation may see a combination of two or more of these objectives, the central aim of restrictions imposed in reaction to undesirable acts is mostly geared toward exercising pressure to alter the political behaviour of the targeted parties (Portela, 2014).

1.2.2 Effectiveness of economic sanctions

In international relations, sanctions are not limited to the interruption of economic relations but encompass measures devoid of economic significance, such as diplomatic sanctions. Moreover, beyond their traditional use by states, sanctions have been adopted by international organisations to assist them in fulfilling their mandates.

During the second half of the 20th century, however, trade embargoes and other restrictive measures of an economic nature were the preferred means of putting pressure on rogue states. Such 'economic sanctions', fourteen cases of which were imposed by the UN and more than fifty by the US and the EU combined (Cortright and Lopez, 2002, p. 1), have been defined as the "deliberate, government inspired withdrawal, or threat of withdrawal, of customary trade or financial relations" (Hufbauer et al., 2007, p. 3).

While academics have attempted to chart how sanctions are expected to work, decision-makers have never validated or disconfirmed their suggestions (Baldwin and Pape, 1998). The standard mechanism for the transmission of sanctions was formulated by peace scholar Johan Galtung in a seminal study on the UN Security Council (UNSC) sanctions against Southern Rhodesia in the 1960s. Galtung (1967) delineated the expected chain reaction of sanctions, which implies that the economic harm produced by sanctions generates popular discontent, which is then channelled to the ruling elite, which in turn is pressured to conform to the sender's demands in order to revert to the previous level of well-being. Thus, the leadership is faced with the choice of either giving in to the sender or being unseated. According to Galtung's formulation, sanctions tools operate analogously to military force since both aim at the "political disintegration of the enemy so that he gives up the pursuit of his goals" (Galtung, 1967, p. 386). The theory foresees that the more intense the value deprivation, the more thorough the political disintegration (Portela, 2014).

Economic sanctions like comprehensive trade embargoes often produce indiscriminate and perverse effects in target countries. The humanitarian catastrophe caused by the comprehensive UN embargo on Iraq in the early 1990s is a case in point (Mueller and Mueller, 1999). Economic decline in the targeted state impoverishes the lower classes and weakens the middle classes, while the regime shields and rewards the elites that support it. Faced with the prospect of living in an increasingly beleaguered country, the intellectual elite often chooses to migrate. The business community finds it ever more difficult to operate under the legal framework, which results in the criminalisation of commercial activity (Schlichte, 2001). Because sanctions lend themselves to manipulation by leaders, the leadership routinely uses them as a pretext to increase repression and tighten its control over the population and the media, which allows it to monopolise the discourse on sanctions and present them as unjust measures responsible for all the hardships people are confronting (Portela, 2014). Finally, sanctions perpetuate isolation from the rest of the world, which frustrates those segments of society that would benefit from enhanced international exposure: business elites, civil society groups, the political opposition and even reform-oriented elements within the government (Will, 2003). There are plenty of examples from the practice that took place in the aftermath of the Cold War, when the UN dramatically increased its activity in peace and security. The 1990s were dubbed the 'sanctions decade' in view of the dramatic rise in the number of sanctions regimes imposed by the UN Security Council (Cortright and Lopez, 2000).

That practice has also taught governments that economic sanctions might hurt the domestic economy of a sanctioning state as well, depending on market size and trade flows. Lessons have been learned from Russia's counter-sanctions against restrictive measures adopted by the EU, prohibiting, inter alia, European businesses to invest in the modernization of Russia's energy sector. The Russian counter-sanctions included pressure on France not to halt its plans to deliver €1.2bn worth of warships to Russia;

and on food and plant exports from Italy, the Netherlands and other EU countries (Blockmans, 2014). Energy specialists at the time pointed out that only half of Russian gas exports went to the EU and that this made up a mere €17 to 25 bn, depending on seasonal fluctuations (Institute for Energy Economics, 2014). By contrast, Russia netted almost €200 bn in oil. However, as this is a global market a boycott would have simply meant that export streams would be deviated with EU member states ending up paying a premium. Whereas Russia would lose €4-4.5 bn of revenues each month of an EU gas embargo (ca. 3.5 % of Gazprom's annual revenue), President Putin might have calculated that his regime could very well outlive individual EU member states' temporary resolve to forego Russian gas. Finland would already experience gas shortages after one month. Other EU member states would last three-to-nine months without it (Institute for Energy Economics, 2014). With alternatives to imports of Russian gas materializing slowly, the EU's reliance on Russian gas is expected to last for another five to ten years.

Whatever there may be of this, the European Commission and the European External Action Service (EEAS) now routinely conduct an 'impact assessment' of a sanctions campaign on EU economies before adopting restrictive measures. This gives member states' experts time to haggle over the details of the restrictive measures.

Targeted (or 'smart') sanctions were designed precisely to correct the above-mentioned effects. Because they do not presume to affect the economy as a whole, they are not expected to bear significant humanitarian consequences, impoverishing the population and criminalising society. By putting the punitive spotlight on members of the leadership and the elites they hold responsible for wrongdoings, the senders attempt to signal to the citizenry that they do not seek to cause general harm (Portela, 2010). Nevertheless, the types of measures considered 'targeted' actually feature different degrees of 'targetedness': Oil embargoes hit the economy far harder than arms embargoes and lead to a much wider proliferation of circumvention tactics (Blockmans, 2013; Blockmans and Waizer, 2013). Thus, arranged as a continuum, visa bans would constitute the most discriminatory measure, while sanctions affecting transportation or the financial sector would have the widest consequences (Biersteker, Eckert and Tourinho, 2012). The EU's sanctions practice seems designed to follow a gradual approach: from assets freezes and visa bans on natural and legal persons to more comprehensive sanctions prohibiting European traders and investors to engage with blacklisted counterparts.

1.2.3 The EU's approach to (economic) sanctions

The EU has traditionally referred to sanctions as 'restrictive measures' (French: *mesures négatives*). EU sanctions practice features three distinct strands.

Firstly, the EU decides and implements its own autonomous sanctions, i.e. in the absence of a UNSC mandate. Secondly, it implements sanctions regimes decided on by the UNSC, which are mandatory. Thirdly, the EU often supplements UNSC regimes with sanctions that go beyond the letter of the UNSC resolutions, a phenomenon labelled 'gold-plating'.

Officially the EU only uses 'sanctions' in connection to the measures agreed to in the framework of the Common Foreign and Security Policy (CFSP), routinely adopted by unanimity in the Council in the form of a 'common position' or 'decision' on the basis of a provision under Title V of the Treaty on European Union (TEU), which is then implemented through a regulation based on Art. 215 TFEU. Pursuant to Art. 275 TFEU, the legality of these decisions can be tested by the Court of Justice and even courts and tribunals of the member states.²

² Grand Chamber Judgment of the CJEU, case C-72/15, Rosneft, 28 March 2017, ECLI:EU:C:2017:236

Nowadays, the EU prefers to employ the concept of ‘targeted’ sanctions, which departs from the full economic embargoes that dominated the international landscape up until the mid-1990s. Yet the negative conditionality tied to its restrictive measures imply that economic pain is inflicted upon the target.

Reductions in aid or suspension of trade preferences adopted under Art. 96 of the Partnership Agreement between the members of the African, Caribbean and Pacific Group of States, of the one part, and the European Community and its Member States, of the other part (Cotonou Agreement) are referred to as ‘appropriate measures’. In the context of the European Neighbourhood Policy (ENP), the phrase ‘less for less’ is preferred to tie a drop in financial support by the EU to backsliding of reforms by the authorities of a neighbouring country.

The withdrawal of the application of the Generalised System of Preferences (GSP) from beneficiaries is not referred to as a sanction either, even if, like most of the restrictive measures mentioned above, they are intended to produce effects on the trade with targeted countries (Portela and Orbie, 2014).

1.3 Extraterritoriality

Since the outbreak of the global financial crisis in 2008, the security environment has been marked by a shifting balance of power, an increasing use of hybrid threats, space and cyber warfare, disinformation, and a growing role of non-state actors.³ While these developments have pushed the EU toward a proliferation of targeted sanctions mechanisms, including the creation of sanctions lists for ‘horizontal’ (as opposed to ‘vertical’, i.e. country-specific) purposes, like the fight against cyber and chemical warfare, and against violators of human rights (incl. genocide, extra-judicial killings, torture), the US and China are increasingly seeking to extend the reach of their domestic law overseas, compelling foreign companies and people to do the bidding of Washington or Beijing. The impact of such extraterritorial sanctions driven by political considerations poses new, if indirect, challenges to the EU.

As Gideon Rachman noted in a recent OpEd in the Financial Times: “The rise of extraterritoriality is the latest sign of the decline of the rules-based international order, under which big powers at least pretended to play by the same rules as everybody else”. Now, the US and increasingly also China seem to think that they can play by different rules from those that apply to everybody else. This looks less like the 21st century, as imagined by international lawyers and more like the 19th century, in which imperial powers imposed their will on others (Rachman, 2020).

Indeed, when sanctions are imposed or authorized by an institution like the UNSC or the EU Council to coerce targeted entities to abort their internationally wrongful acts, then questions of extraterritorial jurisdiction generally do not arise. But claims have increasingly emerged in the context of economic issues whereby some states, particularly the US, seek to apply their laws outside their territory in a manner which may precipitate conflicts with other states or international organizations. These measures are referred to as “secondary sanctions”, as opposed to “primary sanctions” which are aimed at targets within the sending state’s jurisdiction.

The US, and perhaps China, have the power to enforce their laws around the world. For midsize powers that is not an option. For the EU, whose normative power *does* of course extend beyond its territory (Bradford, 2020), for instance through its application of anti-trust legislation (Torremans, 1996) and GDPR, imposing secondary sanctions to meet political ends is not a preferred option. Like smaller players, the Union, which is bound by Art. 21 TEU to respect and promote international law, prefers to

³ COM(2020)605 final, The EU Security Union Strategy.

support international rules-making bodies such as the World Trade Organization (WTO), which has ruled against both China and the US on occasion.

In this segment, we will first present an overview of the American and Chinese practice with extraterritorial sanctions. We will pay particular attention to the US sanctions targeting – directly and indirectly – Iran and the reaction thereto of the EU and its member states. This will serve to contrast the US practice with the EU’s sanction policy against Iran.

1.3.1 United States of America

The US has gone furthest in the use of extraterritorial law. Its most important weapon is one available to no other state — the dollar’s status as the global reserve currency. The rationale rests on the premise that foreigners often use the American financial system and so become vulnerable to prosecution under US law. Concomitantly the US can threaten foreign companies and individuals with financial sanctions, wherever they are.

The application of American economic sanctions to subsidiaries of US-based corporations established in Europe can be traced back to a case of 1961-1965 involving an effort by the administration of Lyndon Johnson to impose its embargo on trade with China on the French subsidiary of the Fruehauf-Seymour Group.⁴ Several states made diplomatic protests at these extraterritorial jurisdiction claims.⁵ The issue flared up again in the early 1980s when the US tried to punish the Soviet Union for the imposition of martial law in Poland by requiring European companies like Alsthom-Atlantique to cease work on construction of the Siberia-Western Europe natural gas pipeline, and thus prevent the export of Western technologies to the communist bloc.⁶ Though no court has directly held the then US’ pipeline regulations unlawful, they were withdrawn under pressure from the then European Community and its member states, which issued several joint démarches.⁷

The adoption of legislation in the US imposing sanctions on Cuba, Iran and Libya has stimulated opposition in view of the extraterritorial reach of these measures. The extension of sanctions against Cuba in the Cuban Democracy Act of 1992, for example, prohibited the granting of licences under the US Cuban Assets Control Regulations for certain transactions between US-owned or controlled firms in the UK and Cuba. This led to the adoption of an order under the 1980 Protection of Trading Interests Act by the UK government.⁸

Amending the 1992 legislation, the adoption of the Helms-Burton Act in March 1996 tightened sanctions by providing, inter alia, for the institution of legal proceedings before US courts against foreign persons or companies deemed to be ‘trafficking’ in property expropriated by Cuba from US nationals.⁹ In addition, the Act enabled the US to deny entry into the country of senior executives (and their spouses and minors) of companies alleged by the State Department to be ‘trafficking’. Together with the 1996 D’Amato Act,¹⁰ intended to impose sanctions on persons or entities participating in the development of the petroleum resources of Iran or Libya, this legislation was challenged by many states (Lowe, 1997), not just for its purported violation of international law,¹¹ but also for the threat of litigation and heavy damages. The European Union, in particular, took a strong stance on the US

⁴ ILM (1966), Vol. 5, p. 476. The text is available at <https://casetext.com/case/united-states-v-fruehauf-2>.

⁵ See, e.g., Report of the 51st Session of the International Law Association (1964), p. 565.

⁶ See “Current Legal Developments”, ICLQ, Vol. 37 (1987), p. 398.

⁷ Aides Mémoires of 14 March and 28 April 1983, on file with the authors.

⁸ BYIL (1993), Vol. 64, p. 643.

⁹ ILM (1996), Vol. 35, p. 357. This part of the legislation was suspended by President Clinton for the second half of 1996.

¹⁰ ILM (1996), Vol. 35, p. 1273.

¹¹ OAS Doc. OEA/SER.P AG/doc. 3375/96, 4 June 1996.

approach,¹² with the adoption of a so-called ‘Blocking Regulation’¹³ and the threat of bringing the Helms-Burton Act before a WTO dispute settlement panel. This attempt was deflected by an undertaking by President Clinton, who had been reluctant to sign the Act in the first place, to continue to issue waivers deferring effectiveness of its provisions.¹⁴

Less trigger-happy as some of his predecessors, President Obama preferred to use the power of America’s extraterritorial jurisdiction. The Treasury Secretary was Obama’s “favorite combatant commander” (Lowrey, 2014). Among the ones finding themselves in the Treasury’s crosshairs were 14 football executives, including nine current or former FIFA officials, arrested in Switzerland in 2015 and extradited to stand trial in the US.¹⁵ Their mistake was to process allegedly corrupt transactions through US banks. Of more geopolitical importance was the sanctions war that the US waged to force Iran to the negotiating table and reverse its alleged quest for a nuclear weapon (see below for more details).

Russia is also a target for US sanctions, which is where the German port of Sassnitz came into the picture. Russian ships completing the controversial Nord Stream 2 gas pipeline to Germany have been docking there. This has attracted the attention of US senators Tom Cotton, Ted Cruz and Ron Johnson, who in August 2020 sent a letter to the town and a German company involved in the project, threatening them with sanctions.¹⁶ Mike Pompeo, US Secretary of State, has warned companies involved in Nord Stream: “Get out now, or risk the consequences.”¹⁷ German politicians are outraged by this pressure — but they are also worried. US law is sufficiently vague to make any German bank or law firm involved in Nord Stream potentially vulnerable to US prosecution (Lohmann and Westphal, 2019).

The Trump administration has taken up the sanctions instrument with much enthusiasm as well. Following the crackdown on the pro-democracy movement in Hong Kong, the US has targeted Carrie Lam, Hong Kong’s chief executive and some of her colleagues. Lam admitted that she faced difficulties using credit cards.¹⁸ But perhaps the most spectacular extraterritorial application of US sanctions law by the Trump administration was the arrest of Meng Wanzhou, CFO of Huawei Technologies, who was detained upon arrival in Vancouver, Canada on 1 December 2018 on an American extradition request for fraud and conspiracy to commit fraud in order to circumvent US sanctions against Iran.¹⁹ Huawei has also been targeted by US laws that prevent the sale of American computer chips to the Chinese tech giant.²⁰ That will make it much more difficult for Huawei to roll out its 5G technology around the world.

The 2018 ‘U.S. Clarifying Lawful Overseas Use of Data Act’, a.k.a. CLOUD Act, amended the 1986 ‘Stored Communications Act’ (SCA) and gives American law enforcement authorities the power to request data

¹² See the letter to the Congressional Committee considering changes in the US export control legislation, reproduced in ILM (1996), Vol. 35, p. 1329; Decision 95/145/EC, ECSC of the Council and the Commission of 10 April 1995 concerning the conclusion of the Agreement between the European Communities and the Government of the United States of America regarding the application of their competition laws, OJ (1995) L 95/45; a démarche of the European Community, reproduced in BYIL (1992), Vol. 63, p. 725; European Commission Press Release WE 27/96 of 18 July 1996.

¹³ Council Regulation (EC) No 2271/96 of 22 November 1996 protecting against the effects of the extraterritorial application of legislation adopted by a third country, and actions based thereon or resulting therefrom, OJ (1996) L 309/1.

¹⁴ ILM (1997), Vol. 36, p. 529. On 18 May 1998, the Understanding with respect to the Disciplines for the Strengthening of Investment Protection was reached, whereby the EU agreed to suspend action in the WTO in exchange for an EU-wide exemption by the US from the extraterritorial elements of the Helms Burton Act. See BYIL (2006), Vol. 76, p. 850.

¹⁵ M. Collett, B. Homewood and N. Raymond, ‘World soccer rocked by U.S., Swiss arrests of officials for graft’, Reuters, 27 May 2015.

¹⁶ https://www.cruz.senate.gov/?p=press_release&id=5294.

¹⁷ M. Lee, ‘US warns firms about sanctions for work on Russian pipelines’, The Washington Post, 15 July 2020.

¹⁸ I. Marlow and N. Lung, ‘Hong Kong Leader Carrie Lam Has Credit Card Trouble After U.S. Sanctions’ Bloomberg, 18 August 2020.

¹⁹ R. Fife and S. Chase, ‘Canada arrests Huawei’s global chief financial officer in Vancouver’, Globe and Mail, 5 December 2018.

²⁰ D. Shepardson, K. Freifeld and A. Alper, ‘U.S. moves to cut Huawei off from global chip suppliers as China eyes retaliation’, Reuters, 15 May 2020.

stored by most major cloud providers, even if it is electronically-stored communications data located outside the United States.²¹ This extraterritorial jurisdiction has raised concerns about the safety of (personal) data stored in the cloud and potential conflicts with the EU's General Data Protection Regulation (see section 3).

1.3.2 China²²

When confronted with extraterritorial jurisdiction, the tactic of non-compliance with evidence collection and the recognition and enforcement of judgments has been used on the grounds of violations of China's sovereignty and public order. But Chinese state agencies may consider participating in litigation in individual anti-trust or human rights cases. Even though their arguments may not be admitted in foreign courts' deliberations, courts will still listen and become acquainted with Chinese laws, procedures and business contexts.²³ China does not use the argument that its state-owned enterprises (SOEs) would benefit from immunity to America's extraterritorial jurisdiction, in anti-dumping investigations and civil litigation. But China's claim that its SOEs are not public bodies has been dismissed by US courts, some of which have voluntarily granted immunity from prosecution in civil litigation to companies directly controlled by the Chinese central and local governments that are not operating in the United States (Li, 2019). Chinese companies are generally advised to actively participate in litigation and use US legislation to protect their rights. TikTok/ByteDance, for instance, has counter-sued the US Commerce Department to confront the implementation of Executive Order 13942, prohibiting transactions with the Chinese company for "any provision of services (...) to distribute or maintain the TikTok mobile application, constituent code, or application updates through an online mobile application store."²⁴

The very notion of extraterritoriality is sensitive in China because of its echoes from the 19th century, when many foreigners lived under their own laws in Chinese cities such as Shanghai. Traditionally, when diplomatic tensions become high China will employ a variety of 'economic instruments' trying to punish its opponent (in addition to official protests issued by the Ministry of Foreign Affairs). Such measures include launching anti-dumping investigations and subsequently imposing high tariffs on products of high demand in China (e.g. Australian barley and wines), using sanitary and phytosanitary (SPS) restrictions to halt agri-food imports (e.g. Philippines bananas, Australian beef and Norwegian salmon), suspending treaty negotiations (e.g. China-Korea Free Trade Agreement against THAAD missile deployment in Korea), and issuing travel warnings (e.g. Australia). In 2020, amidst increasing tensions with Australia, China warned its students to reconsider study in Australia, citing racial incidents. China is Australia's largest source of foreign students.

²¹ H.R.4943 - CLOUD Act 115th Congress (2017-2018). The CLOUD Act is balanced by a number of safeguards intended to prevent abuse. For example, an SCA order seeking the stored contents of communications must be for specific data and will only be granted where the government can establish "probable cause" that a particular criminal offence has been committed and that there is "reasonable belief" or justification that the information sought is "relevant and material" to that ongoing criminal investigation. It thus does not allow mass and indiscriminate collection of communications data. In addition, service providers have the right to challenge these SCA orders where they conflict with domestic law.

²² Weinian Hu, Research Fellow in the Regulatory Policy unit of CEPS, contributed to this section of the study.

²³ For example, China's Ministry of Commerce has appeared in court in the "Vitamin C Anti-Monopoly Case" (Animal Science Products, Inc. v. Hebei Welcome Pharmaceutical Co. Ltd.), referring to the Chinese law on the price fixing of imports and exports by enterprises. Although the Ministry's oral arguments and written opinions were not admitted by the Supreme Court, US federal courts took note of the Chinese government's positions. In many previous cases involving the Chinese government and officials, the Chinese Ministry of Foreign Affairs has submitted written opinions to allude U.S. federal courts to the Chinese government's position.

²⁴ See Commerce Department Statement on U.S. District Court Ruling on TikTok Preliminary Injunction: <https://www.commerce.gov/news/press-releases/2020/09/commerce-department-statement-us-district-court-ruling-tiktok> (last accessed 28 September 2020).

To date, China has not established a coherent legal framework for extraterritorial application or improved the settlement system of the RMB cross-border interbank payment system (CIPS) to support countermeasures.²⁵ Discussions among legal scholars and practitioners have so far focussed on understanding how America's extraterritorial jurisdiction system works and on formulating strategies to circumvent US sanctions. Before the extraterritorial applicability of Chinese law becomes a reality, domestic laws will have to be scrutinized in the light of anti-monopoly, national security and other legislation and standards. Going forward, the Chinese judiciary has been urged to examine domestic legal provisions, laws and administrative practices in order to identify which of them might be applied extraterritorially with sufficient judicial certainty.²⁶

The language of its new National Security Law for Hong Kong (NSL), announced in June 2020 provides a good example of China's drive towards the extraterritorial application of domestic law. Art. 38 of the NSL is so vague and sweeping that it makes even foreigners speaking overseas vulnerable to prosecution for "subversion" (Art. 1) in China: "This Law shall apply to offences under this Law committed against the Hong Kong Special Administrative Region from outside the Region by a person who is not a permanent resident of the Region."²⁷ Remarkably, this provision gives the NSL an even broader reach than mainland criminal law, according to which a foreigner is not liable for an act that is a crime under the law unless either the act or the effect occurs in China. The National Security Law has no such limitation. But in the end it is not the substantive definition of the crimes that count; it's the institutions that will investigate, prosecute, and judge them that matter. In law enforcement, 'counterterrorism' has served as a cover for repressing or monitoring minorities and dissidents. With the creation of new law enforcement institutions for Hong Kong dependent on appointment and appeals procedures that lead back to the People's Republic's central authorities, the NSL that China has imposed on Hong Kong gives Beijing the means to destroy the freedom and autonomy the territory has enjoyed since the 1997 handover from the UK. Media reports suggest that many of the city's business leaders are eager to believe that the NSL will be narrowly applied. But there is little reason to believe that Beijing will apply it with restraint. The government of Xi Jinping has already demonstrated, on multiple fronts, its contempt for liberal freedoms.

Western universities are taking the threat seriously. Patricia Thornton, who teaches Chinese politics at Oxford university, recently tweeted: "My students will be submitting and presenting work anonymously", as protection against the law.²⁸ Professors at US universities have announced similar moves. The main fear is that Chinese students could be reported on and pursued for straying from Beijing's official line — perhaps over Taiwan, Hong Kong or Xinjiang. This risk has only increased as

²⁵ Improving legislation also means strengthening the review mechanism before banking information, data, and state secrets may be exported overseas, since they may serve as evidence in court.

²⁶ For instance, Art. 2 of the Law against Unfair Competition, which refers to the term "operators" as natural persons, legal persons and unincorporated organisations engaged in the production, operation or provision of services. Since the provision does not specify if overseas operators fall within the same remit, it should de facto be applied to them. Another example pertains to Art. 4, paragraph 3 of China's International Criminal Judicial Assistance Law stipulates that: "Without the consent of the competent authority of the People's Republic of China, foreign institutions, organizations and individuals shall not conduct criminal proceedings in the territory of China. Institutions, organizations, and individuals within the People's Republic of China shall not provide evidence materials and assistance provided by this Law to foreign countries." However, this clause does not stipulate the competent authority, approval process, time limit, materials to be provided, etc., and neither the rules of operability. Also, with regard to national security, Art. 8 of the Anti-Secession Law foresees the use of "non-peaceful means" and other necessary measures to defend national sovereignty and territorial integrity should "separative forces" declare Taiwan independence. This provision, in fact a policy statement in nature, won't be qualified to become extraterritorially applicable. To become extraterritorial applicable, within the scope of the Anti-Secession Law "separative forces" should be defined to include, for example, individuals and enterprises that support "Taiwan independence" forces through funding and with other means.

²⁷ <https://hongkongfp.com/2020/07/01/in-full-english-translation-of-the-hong-kong-national-security-law>

²⁸ PM_Thornton, 22 September 2020.

seminars move online, where they can be recorded. Some western academics and think tankers are also concerned about their own safety, and are refusing to travel to China.

Beijing's ventures into extraterritoriality have begun with free speech are unlikely to end there.²⁹ When, for instance, disputes occur along the Belt and Road initiative (BRI), two designated "international" commercial courts in China may very well conduct arbitration.³⁰ Going by the canons on conflict of laws and the territoriality-based choice of law rules, courts normally respect the freedom of contractual parties to choose the law of the forum when determining the applicable law at times of dispute. Chinese law prescribes that, where parties to an international contract fail to select the applicable law, the contract will be governed by the law of the state that has the closest link to it.³¹ In case of disputes regarding BRI-funded projects, Beijing expects that to be Chinese law.³² Under the present blueprint of the BRI's legal architecture, a lending or any other kind of commercial agreement concluded between China and another country will opt for Chinese jurisdiction as the law of the forum in the event of dispute.³³ If, as its leadership proclaims, China is committed to uphold and modernise the multilateral trade system,³⁴ then it should mobilise the broad international buy-in for its connectivity and growth strategy to fit the BRI with a legal architecture and dispute settlement mechanism that spurs international solutions rather than imposes Chinese legal constructs (Blockmans and Hu, 2019).³⁵

The promulgation of the entity list is China's latest move in order to counter the increasing use by the US of extraterritorial jurisdiction in its trade war with China. Emulating the US, China's Ministry of Commerce (MOFCOM) has published on 20 September 2020 the "Provisions of Unreliable Entity List"³⁶ that targets foreign companies accused of endangering Chinese national security.³⁷ The provisions are based on the Foreign Trade Law and the National Security Law. According to Art. 2 restrictions and prohibitions can be imposed with immediate effect on "foreign entities" (i.e. foreign enterprises, organisations, and individuals) that are (1) "endangering the national sovereignty, security, or development interests of China;" or (2) "suspending normal transactions with Chinese enterprises, organisations, or individuals, in violation of market-based principles, thereby seriously harming the legitimate rights and interests of Chinese enterprises, organisations, or individuals". By virtue of Art. 10, unreliable foreign entities may be restricted or prohibited from 1) engaging in China-related import or export activities; 2) investing in China; 3) entering into China. Their work permit, or residence permit may be restricted or revoked; fines may be imposed, etc.

²⁹ China has vowed to invoke Art. 5 of the Cybersecurity Law to take measures to monitor, defend, and deal with cybersecurity risks and threats originating within and outside the country.

³⁰ Between the two courts, one is in Xi'an to arbitrate commercial disputes from projects on the Silk Road Economic Belt, one is in Shenzhen for disputes arising from the 21st Century Maritime Silk Road.

³¹ See Arts 4 and 6 of the Law on the Laws Applicable to Foreign-related Civil Relations, as well as Art. 126 of the Chinese Contract Law and Art. 145 of the General Principle of Civil Law.

³² For a special series of BRI-relevant judgments rendered by Chinese courts, see the website of the 'Guiding Chinese Cases' project of Stanford Law School, available at <https://cgclaw.stanford.edu/>

³³ Recognising and enforcing foreign judgment in China is a difficult undertaking, treacherous and cost-consuming (Zhang, 2014).

³⁴ See, e.g., Z. Ming, "China supports and upholds multilateral trading system", *EU Observer*, 26 July 2018.

³⁵ In order to achieve a swift, less costly, dispute settlement solution, one may not be inclined to seek investor-to-state dispute settlement (ISDS) as a solution. In recent years, UNCITRAL has identified a few concerns with the mechanism, such as consistency, coherence, predictability, correctness of arbitral decisions, cost and duration, which require improvement. Other concerns pertain to arbitrators and decision-makers, cost and duration of ISDS cases. For details, see "Possible Reform of Investor-State Dispute Settlement (ISDS)", note by the Secretariat, United Nations Commission on International Trade Law Working Group III, Thirty-sixth session, Vienna, 29 October – 2 November 2018, A/CN.9/WG.III/WP.149.

³⁶ Available at: <http://english.mofcom.gov.cn/article/policyrelease/questions/202009/20200903002580.shtml>

³⁷ A Working Mechanism is expected to be in place soon for the implementation of the Provisions, which will be led by MOFCOM.

That said, a general understanding in discussions that are currently taking place in China is that prudence must be exercised, whether in terms of legislation or tactics to counter the US application of extraterritorial jurisdiction. It is conceded that the country is a superpower in many aspects, including technology, and that countering America often does not yield the intended results.

1.3.3 US sanctions against Iran in perspective

To better explain the rationale behind the use of extraterritorial sanctions, we offer a closer look at the US imposed sanctions against Iran in 2017. These measures were aimed at forcing Iran to accept wider and stricter restrictions than those laid down in the 2015 JCPOA. The arguments used by the Trump administration to withdraw from the nuclear deal and reimpose secondary sanctions on all those doing business with Iran referred to the JCPOA's 'sunset' clauses, expiry dates after which Iran could resume enrichment; the alleged flaws found with the inspection regime under which the International Atomic Energy Agency (IAEA) verifies Iran's compliance with its commitments; and the fact that Tehran ramped up its ballistic missile testing and increased its meddling in Syria, Yemen, Iraq and Lebanon (Blockmans, 2018).

Apart from the legal argumentation (see section 3 of this Study), circumstantial dynamics in both the international and domestic arenas combined into the decision-making process. Trump's hard line was not entirely shared in the wider US administration, including the top brass of the National Security Council and the Department of Defence. There was nevertheless widely held agreement that the president had to be placated, if not appeased, and that something significant had to be delivered. Given that the 2017 mid-term elections could see the Republicans losing their majority in both chambers, this would upset the legislative agenda in the second half of the presidency. The window for Trump to deliver on one of his campaign promises was thus closing. All in all, Trump was motivated by domestic political considerations and his close relationship with the Israeli government and Saudi Arabian Crown Prince, and driving him to withdraw the US from the Iran nuclear deal when the statutory deadline for re-certification expired on 12 May 2018.

Since taking the US out of the Iran nuclear deal — claiming the accord had failed to prevent Iran's destabilising regional activities or halt its weapons programmes — the Trump administration has attempted to exert maximum pressure on Tehran in pursuit of a new, tougher deal. President Trump has repeatedly claimed he could strike a new bargain with Iran but Iran has vowed not to negotiate with him so long as sanctions are strictly enforced. Trump's Democratic presidential opponent, Joe Biden, has said he would re-enter the nuclear deal, which was negotiated during the Obama administration, if Iran returns to compliance with the agreement. Iran's leaders have hinted they might authorise such negotiations if Biden were elected.

Whatever there may be of the politics, the Trump administration has re-activated nuclear-related sanctions against Iran. Once more European companies faced a binary choice between doing business with Iran or continuing operations with a US dimension (Modrall, 2016). For European banks, this harked back to bad memories of the pre-JCPOA age, when severe penalties were imposed by US financial authorities for their dealings with Iran. BNP Paribas, for instance, received a USD 9 billion fine in 2014 for violating US sanctions. Without the protection of their investments against the long arm of US sanctions policy, many European companies stopped trading with Iran.

This bold attempt to prescribe the conduct of EU companies and nationals, without even asking for consent, puts into question not just the transatlantic alliance on how to deal with an autocratic Iran, but also the political independence and ultimately the sovereignty of the EU and its members. The EU was quick to react and adopted diverse measures. These include not least the activation of the EU's

'blocking statute'³⁸ and the establishment of INSTEX (for more details, see section 3 of this Study). Unfortunately, these counter-measures have not proved to be very effective in changing the risk calculation of European businesses (see section 2 of this Study).

The Trump administration added insult to injury in September 2020 by asserting that all UN sanctions eased or lifted by the JCPOA are reimposed and must be enforced by UN member states. The US did so in a unilateralist and confrontational turn away from earlier policies of peaceful change and multilateral containment. To increase economic pressure, the US Secretary of the Treasury announced that "any financial institutions that knowingly facilitate a significant transaction for these individuals or entities could be subject to US sanctions."³⁹

Even before the announcement, however, France, Germany and the UK (E3) issued a joint statement arguing that the US effort to reimpose UN sanctions "was incapable of having legal effect".⁴⁰ The E3 argued that Washington cannot take such measures because it had already withdrawn from the JCPOA in 2018. For his part, UN Secretary-General Antonio Guterres said the United Nations would not take any action pending clarification by the Security Council on whether sanctions that have been lifted should be reimposed. Iran's president Hassan Rouhani welcomed the fact the rest of the UN Security Council ignored the US's demands and claimed victory, saying Washington's actions highlighted how it had become diplomatically isolated: "We can say that the US's 'maximum pressure' policy against Iran has caused a failure and isolation for the US itself."⁴¹

The majority of the international community wants to preserve the Iran nuclear deal and sees the Trump administration's efforts to destroy the agreement as counterproductive, destabilising and vindictive. The limited impact of the latest round of US sanctions may be an indication that a degree of exhaustion has been reached by US sanctions policy.

2 Economic assessment of the possible effects of extraterritorial measures on EU industries and EU imports and exports

The central point of the economic analysis is the assessment of the EU vulnerability to the extraterritorial measures which we will base on the retrospective analysis of previous sanctions imposed by the US which were not joined by the EU. The subsequent part covers the experience of other countries to extraterritorial measures: China and Russia. This chapter also includes a theoretical note on the economics of sanctions, in particular the insights from the game-theoretic literature as well as those given by the standard neoclassical trade model. We also present a review of empirical works. Building on the existing literature, we perform our own empirical analysis devoted to, *inter alia*, the effects of sanctions on macroeconomic indicators (GDP growth rate, productivity, poverty) and international trade.

While the economic literature is to a large extent silent on the effects of sanctions on third countries, including the EU, we have attempted to bridge this gap by analysing case studies of US extraterritorial sanctions. It turns out, that effects of a sanction on third parties are highly dependent upon the status of the country being sanctioned and the trade relationship between the sanctioned country and the third country. While the macroeconomic effects of US sanctions on the EU are difficult to identify, we

³⁸ Council Regulation (EC) No 2271/96 of 22 November 1996.

³⁹ N. Ching, "US Imposes Sweeping New Sanctions on Iran", VOA, 21 September 2020.

⁴⁰ <https://uk.ambafrance.org/US-bid-to-reimpose-Iran-sanctions-legally-void-say-E3>.

⁴¹ N. Ching, "US Imposes Sweeping New Sanctions on Iran", VOA, 21 September 2020.

show micro-evidence of large firm-level impacts of the sanctions on Iran and scattered evidence of the impact of sanctions of Cuba. As far as the effects on other countries are concerned, in the case of Cuba, there were only minor disruptions from US sanctions for Russia and China, while the re-imposition of sanction on Iran – as a much more important player in global energy markets – had a more noticeable effect on the two countries.

Our literature review and our own empirical study cover a broader topic of economic sanctions. They show that sanctions are in general detrimental to the economic conditions of the target country and have a negative impact on international trade. However, both the theoretical and empirical literature deliver mixed results on sanction effectiveness and this is also true when we consider pro-democratic effects of sanctions in our own empirical analysis. We also do not find the extraterritorial features of US sanctions to significantly add to the overall effect of economic sanctions.

2.1 European vulnerability to extraterritorial sanctions

The existing literature is mainly devoted to the effects and effectiveness of economic sanctions on their targets. However, there can never be a complete isolation of the effects of sanctions only to their targets, in particular if the sanctions have an extraterritorial component. Indeed, the disruptions that come with sanctions, especially if they are targeted on countries which are well-integrated into global value chains, are likely to spill over to third parties and create knock-on effects both regionally and (again depending on the pre-sanction level of integration) internationally. Recognizing this reality, we will focus on the vulnerability of a specific set of countries - the European Union - to sanctions imposed by the US. Within this framework, we concentrate on sanctions where the EU has not joined in (as sanctions where the EU was a participant do not necessarily show “vulnerability” but instead the trade-off willingly incurred to achieve a desired effect). The centrepiece of this analysis will be an in-depth look at a series of sanctions imposed by the United States over the past 30 years against countries perceived to be a threat, but where the same perception was not shared in the EU.

Our analysis is aided by the long history of the use of sanctions by the US as an economic tool, short of military conflict, to attempt to change the behaviour of international actors. In many aspects of foreign policy, the US and the EU have shown common resolve, when commercial interests are threatened or the end result of sanctions is not necessarily clear. But the transatlantic relationship is also coined by sharp divergence in the imposition of such sanctions. Therefore, this section will examine three such situations, namely the Torricelli Act of 1992, the Iran and Libya Sanctions Act of 1996 (ILSA), and the Helms-Burton Act of 1996. While these sanctions regimes are all clustered in a specific decade when the EU was a much different institution (i.e. the euro area did not yet exist) and when the global economy was on a much different path (towards greater rather than less integration), these cases will provide some evidence for understanding what effects could be expected for European firms in the event of future Nord Stream 2 sanctions.

2.1.1 The Toricelli Act of 1992

The Torricelli Act (formally, the “Cuban Democracy Act”) of 1992 was enacted when the US stood astride the world as the undisputed hegemon following the collapse of communism in Central and Eastern Europe, but its genesis goes back much further and is indeed rooted in conflict at the beginning of the 20th century and the lens of the Cold War. The ongoing US embargo of Cuba was established on the basis of the “Trading with the Enemy” Act (TWEA) of 1917, created upon the US entry into World War I, authorizing the President to enact economic sanctions on “hostile nations;” in 1961, following the toppling of the Batista regime in Cuba and the seizure of power by Fidel Castro, US President John F. Kennedy broke off diplomatic relations and invoked TWEA in 1962 to set an expansive embargo (officially the “Cuban Assets Control” Regulations of 1963, see Michalec, 1991).

The Torricelli Act was an expansion of the 1963 regulations and, in many ways, was meant to hasten the demise of Cuba's communist regime after the withdrawal of aid from its patron, the Soviet Union. The Act was simultaneously an overt stretch of extraterritoriality as is commonly defined (i.e. meant to restrict the economic activity of third countries) and a more circumspect, veiled attempt to influence behaviour. From the overt (and rather blunt) side, "the Act authorizes the President to apply sanctions against any country that does not cooperate and continues to trade with Cuba" (Donner, 1993:263). In practicality, this meant the power to sanction foreign subsidiaries of American multinational corporations which continued to trade with Cuba, although the Act also permitted cessation of foreign aid to countries which also provided aid to or trade with the island nation (Jefferies, 1993).

The impact of this tightening of the embargo on both US and European firms was immediate, as specific examples abound of abandoned ventures, some of which occurred as a result of the intricate nature of global supply chains: for example, German pharmaceutical firm Bayer AG had moved production of the active ingredient of its pesticide Sencor to Kansas City which, after the Torricelli Act, meant that it was no longer able to sell the product to Cuba even after permission was requested (Hidalgo and Martinez, 2000). In a similar vein, Swedish company Pharmacia had been active in Cuba since 1970, but once it completed a merger with US manufacturer Upjohn in 1994, it found itself prohibited from supplying Cuba with medicine (Gordon, 2016). The exact same issue occurred in 1995 with a Swedish subsidiary of German firm Siemens after it merged with a US firm (Hidalgo and Martinez 2000). On the other hand, European firms which had no connections with the US were slightly *advantaged*, as they were able to pick up opportunities in Cuba that US and US-connected firms had abandoned. This was particularly evident in the tourism, tobacco, and machinery sectors, where economic relations were more specialized and/or able to be geographically circumscribed (USITC, 2001).

An additional source of economic effects was much more indirect, originating from Section 1706 in the Act, which prevented ships from docking in the United States for 180 days after they had entered a Cuban port (Cain, 1994). This approach, cloaked as a domestic regulation rather than an attempt to reach out and influence behaviour in other countries, was likely to be more disruptive than the overt sanctioning of foreign subsidiaries, as it single-handedly removed a source of efficiency in shipping lanes: many European ships had stopped in the Caribbean and especially Cuba before continuing on to the US (Gordon, 2016), and this prohibition now meant either extra shipments or forsaking some opportunities in order to not run afoul of the law.

There is far less data available on the effects of this clause on either European companies or Cuba, although Hidalgo and Martinez (2000) note that a New Zealand firm cancelled shipments of 1500 metric tons of powdered milk to Cuba because their shipping company could not afford the 180-day prohibition on further transit to the United States. As with the previous restrictions, European firms with no connections to the US were likely to benefit from both the removal of US competition in Cuba, as well as the higher prices which could be commanded due to the lack of competition: a report from the American Association for World Health (1997) noted that Cuba spent an extra USD 8.7 million on health equipment imported from the EU (as well as other areas) from 1993 to 1996. The Torricelli Act's 180-day window could thus have acted as an entry barrier to many firms, allowing some EU companies the opportunity for higher revenue. At the same time, however, given the reliance on exporters on shipping companies – many of which do have business in the US, even if the specific exporter does not – it was not a guarantee that EU exporters would be able to take advantage of the market (as shown in the New Zealand example).

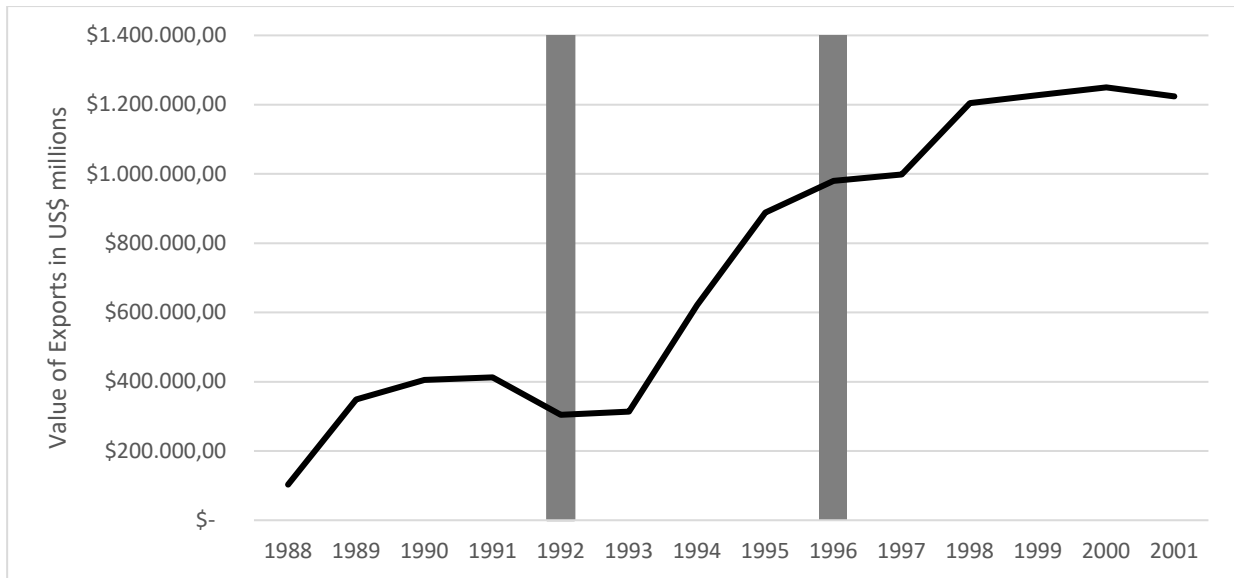
2.1.2 The Helms-Burton Act of 1996

In a similar vein as the Torricelli Act, and continuing the long history of US use of extraterritoriality with regard to Cuba, the Helms-Burton Act of 1996 (officially the “Cuban Liberty and Democratic Solidarity ((LIBERTAD) Act”) was a multifaceted legal instrument. The Act was “a mixture of codification of existing economic sanctions previously imposed pursuant to executive orders; inducements and promises related to restoration of democracy in Cuba; threats against persons from third countries that do business with Cuba; a new, unprecedented remedy for expropriation; and restrictions on entry into the United States by persons who ‘traffic in confiscated property’ or who are affiliated with such persons by ownership, employment or family” (Lowenfeld, 1996:419).

In a novel turn, the Act opened up another avenue of legal recourse against businesses which were present or trading in Cuba, allowing lawsuits by US nationals against companies which utilized property which had been expropriated during the revolution. This clause was highly contested by both EU and Canadian businesses, and the governments of these respective entities filed complaints with both the World Trade Organization (WTO) and North American Free Trade Act (NAFTA). However, Smis and van der Borght (1999) note that the US agreed to suspend Title III of the Act relating to “trafficking” in 1997, a decision upheld by each subsequent President until April 2019, when US President Trump announced that it would be enforced (along with Title IV, which prohibits entry for any person found to have trafficked in expropriated property). The enforcement of this Title has severe economic ramifications for the EU: according to the U.S.-Cuba Trade and Economic Council (a private organization), as of 2018, there were 5,913 verified claims against companies operating in Cuba worth a total of USD 8.5 billion, and companies such as KLM, Lufthansa, and Unilever (“Title III Lawsuits,” 2019).

While Title III threatens firms with a combined market capitalization (as of end 2018) of USD 860 billion, any attempts to actually enforce its provisions are likely to be fraught with massive legal complications (Solis 1997, among others) and it is likely that the ability of the US to prevail in a court with these lawsuits would be doubtful. On this basis, it was Title I of the Act which may have had greater consequences for European business. Title I was a strengthening of the economic embargo provisions in place since the 1960s, requiring reporting (and thus assuming greater enforcement) of the prohibition on third-party countries (including the EU) from selling goods in the United States that contained any components which could trace their provenance to Cuba. Such a prohibition, already existing, was given additional backbone by Helms-Burton in its removal of discretion from the hands of the US President, meaning that the economic embargo against Cuban goods could *only* be removed by a certification that communism in Havana had fallen (Dodge, 1997).

As with the Torricelli Act of 1992, the Helms-Burton Act set restrictions on both utilizations of property or labour in Cuba, meaning once again that any existing supply chains would have been disrupted (and, in practicality, would have forced firms to relocate – or at a minimum divest themselves of any expropriated material they may have been using - in order to maintain both production and access to the US market). Thus, the effects of the Helms-Burton Act were similar to the Torricelli Act in terms of lost investment. With an eye on cumulative effects, a 1997 report by the European-American Business Council surveyed 42 multinational companies and found that 61 % of the companies had been adversely affected by the Cuban embargo in general (and 64 % by the provisions of Helms-Burton), with the worst-hit sectors the automotive industry and high-tech manufacturing (EABC, 1997).

Figure 1 EU Member States Exports with Cuba

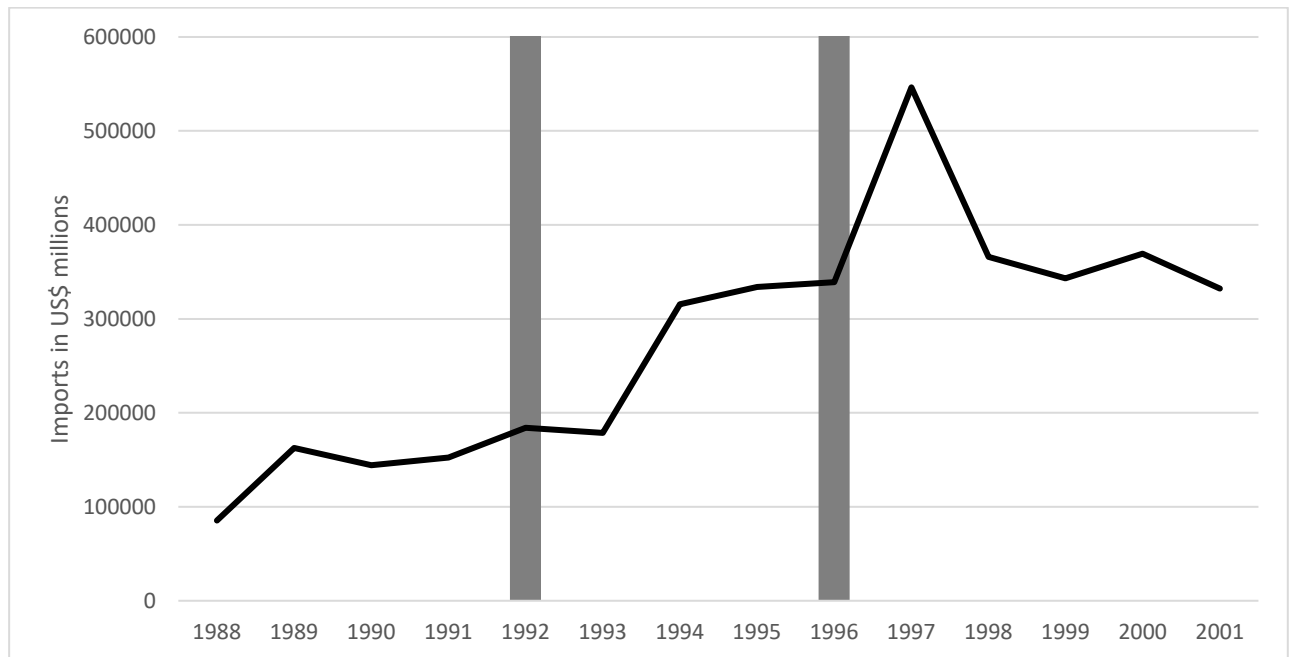
Source: Author's calculations based on COMTRADE data. Solid lines correspond to the Torricelli Act and the Helms-Burton Act.

Direct costs also accrued to European firms in terms of fines levied by the US Government due to perceived or actual contravention of the Act. Given the difficulty of proving violations of sanctions, many of these cases took years to resolve (incurring additional legal costs) and still resulted in substantial fines: for example, the Treasury Department fined Credit Suisse Bank nearly USD 500 million for financial transactions involving Cuba (as well as other countries on the US sanctions list), while Dutch bank ING paid a record USD 619 million in fines for violating the embargo in 2012 (Gordon, 2016). Treasury's Office of Foreign Assets Control (OFAC) was extremely busy after Helms-Burton, investigating 10,823 cases of violations from 2000 to 2006, collecting USD 8.1 million from violators and "imposing more penalties for violations of the Cuba embargo than for all of the other 20-plus sanctions programs the agency implements" (GAO, 2007:62). It is hardly surprising, given the increase in enforcement accompanying Helms-Burton, that several European firms chose to leave Cuba entirely, including Barclays, BAWAG PSK, Credit Suisse, and Deutsche Bank (*ibid.*, p. 54).

Despite this reality, overall exports to Cuba showed increases from EU Member States over the decade of the 1990s (Figure 1) alongside increases in imports (Figure 2). However, there were steep declines in exports surrounding the two pieces of legislation leading to a plateau in exports and a consolidation before value started growing again. The aggregated nature of the data makes it difficult to say if volumes actually increased, if it was a shift towards fewer-but-higher-value goods which were traded after the tightening of the embargo, or if there were exchange rate moves which almost totally account for the higher value of exports (likely, as Cuba's peso underwent a massive devaluation from 1990 to 1993, leading to both dollarization and a highly volatile rate against the US dollar for the rest of the decade). At the same time, this aggregation of data might be capturing domestic reforms which were happening within Cuba from 1994 to 1997 to stave off economic collapse, as some limited liberal reforms – such as the creation of export processing zones – may have contributed to the increase in exports with the EU. For imports, on the other hand, there was a large spike after Helms-Burton which fell in the very next year, perhaps suggesting that backlogs were being cleared before the Act really began to be felt; despite this, from 1998 onward, imports remained at approximately the same level as prior to the Act (as with exports, there is no indication of this meant a shift towards higher value goods at the expense of volume). In sum, however, the two Acts appear to have increased the volatility of

trade volumes, even if they did not have impressive dampening effects in the longer-term on aggregate trade flows and may have been dominated by Cuban domestic policies.

Figure 2 EU Member States Imports from Cuba



Source: Author’s calculations based on COMTRADE data. Solid lines correspond to the Torricelli Act and the Helms-Burton Act.

2.1.3 Iran and Libya Sanctions Act of 1996

The last of the three major sanctions-related legislation from the US in the 1990s is perhaps the most sweeping and, since its inception, has been modified, repealed, and then put back into place. It also remains one of the key examples of the frictions caused by extraterritoriality. The Iran and Libya Sanctions Act (ILSA) of 1996 was a response to the “acts in support of international terrorism” by both countries which were perceived to “endanger the national security and foreign policy interests of the United States” (Alexander, 1997:1602). But the roots of the Act went back much further. In the case of Iran, the Iranian revolution (and the occupation and seizure of hostages at the US Embassy in Tehran) in 1979 had set the US firmly against the theocratic regime, while in Libya’s case, years of support of anti-Western and anti-Israeli terror groups and direct involvement in terror attacks (including the Rome and Vienna airport attacks of 1985, the bombing of a disco in West Berlin in 1986, and the Lockerbie bombing in 1988) had resulted in military strikes (1986) and a desire to ratchet up economic pressure on Libya’s chief earner, hydrocarbons (Zoubir, 2002).

Indeed, ILSA was targeted at the oil and gas fields of both countries, adding a new source of pressure on both regimes and attempting to close off the flow of investment coming from Europe (which had not joined in previous embargoes and in fact had eschewed any talk of reducing dependence on oil from these countries, see Dunning [1998] and Zoubir [2002]). Section 5(a) of the Act forced the US President to take measures against companies – domestic or foreign - which invested more than USD 40 million in any 12-month period in the Iranian oil and gas sector before the first report to Congress in 1997, dropping this threshold amount to USD 20 million as a trigger for sanctions thereafter. At the same time, the Act mandated similar sanctions against investment in the petroleum sector in Libya (Gordon, 2016).

Unlike the Cuban sanctions of 1992 and especially 1996, the ILSA afforded the executive branch more flexibility, including the ability to offer waivers and a sunset clause (which would have required re-authorization every five years). Such flexibility was utilized in practice, as the Libyan sanctions were withdrawn in 2006 (turning the act merely into the Iran Sanction Act, which was consolidated and renewed in 2010). However, the continued stalemate between the Iranian and US governments has meant that the Iranian sanctions have been in place nearly continuously since 1996, with only a short break under the Joint Comprehensive Plan of Action (JCPOA) from 2015 to 2018.

During this time, the EU has remained staunchly against the extraterritoriality encapsulated in the ILSA, especially given the ambiguity over the meaning of “investment” and how its definition had come to be applied against European firms such as Total, S.A. (Zedalis, 1998). As with the Helms-Burton Act, the US executive branch has worked to neutralize some of the stringency of ILSA, primarily through liberal use of the waiver, while EU policy has gradually drifted towards the US with regard to Iran, given the Iranian regime’s continued support for terrorism which has directly affected Europe and the continued development of a nuclear capability (Pinto, 2001). From 2006 onward, concurrent with UN resolutions against the Iranian nuclear program, the EU moved towards a similar policy of divestment from the oil and gas sector in Iran, culminating in the decision in 2012 to ban purchases of crude oil and halt trading from European companies operating in these sectors (Van de Graaf, 2013). With the JCPOA, the EU also joined together with the US and in fact appeared to have moderated the US stance successfully (Cronberg, 2017), albeit with major assistance from a President who was eager to unwind any US power projection abroad. However, the US withdrawal from JCPOA in 2018 had led once again to a stark divergence between the two powers on an Iran policy and continued uncertainty for EU firms.

The reality of the JCPOA was to allow for space for European firms to improve their position within Iran, a position which had been gradually built up in the 1990s and 2000s as the EU pushed back substantially against US sanctions (including using the threat of WTO action). However, the re-imposition of US sanctions, much like their mere presence in the late 1990s and early 2000s, was likely to influence firms at the margins, and the uncertainty of such sanctions being withdrawn and then re-imposed was also due to have substantial effects. As an additional twist, firms were confronted with a catch-22 situation, where it may be illegal under EU law for firms to *comply* with US sanctions (so-called “blocking regulations”). The sum total of this ambiguity was to create powerful disincentives for working with or in Iran, creating problems for firms which have already invested and threatening companies which are trying to walk the line between US and EU laws (Love, 2020).

The impact of the re-imposition of sanctions on Iran for EU companies is, as with the other effects explored in this section, difficult to ascertain directly, and there is no extant literature which attempts to calculate the losses from the point of view of the EU exclusively. To perform this task, we examine a litany of cancelled orders and disruption due to the sanctions can be compiled from media reports and various European companies due to US sanctions on Iran. As Table 8 in the appendix shows, using just a small but representative sample of larger Western European firms, cancelled orders and lost business could easily run well over a hundred billion euro. Moreover, this analysis does not begin to factor in opportunity costs of switching revenue streams or any disruptions to supply chains suffered by these firms in the course of both local and global production (although, to be fair, the small scale of Iranian operations would mean that most costs would be localized in Iran and less so to global operations, especially for the largest European firms).

This microeconomic effect is reflected in the macroeconomic figures, as trade data with Iran plummeted after the US withdrew from the JCPOA and re-imposed sanctions in 2018. After a jump in trade value and volumes in 2016 (imports increasing by 347 % in value!) and 2017 (a further increase of 85 %), imports from Iran to the EU dropped 92.8 % in 2019, while exports to Iran dropped nearly 50 %.

Mineral products took the largest hit, with imports falling off 99.7 %, while overall industrial goods showed a decline in imports of 95.5 %. If instead we focus on exports, European firms saw an aggregate loss of EUR 6.165 billion from the high of 2017 to the nadir of 2019, an amount which (as noted) is likely higher in terms of lost future revenue. In any event, the effects of sanctions have been pronounced and, despite EU attempts to counter the sanctions, appear set to continue.

2.1.4 Likely implications for the Nord Stream 2 case

As noted in the introduction to this section, the Torricelli Act and the Helms-Burton Act occurred in a different era, but, unlike the ILSA, they were more stringently applied and thus can offer some clues as to what stringent sanctions on firms dealing with Nord Stream 2 can be expected. On the other hand, the revamped Iran Sanctions Act is a much more recent creature and its re-imposition has created immense uncertainty, so it can also provide clues as to what effects any sanctions resulting from Nord Stream 2 would look like.

In the first instance, the proposed sanctions related to Nord Stream 2 appear to be more in line with the stringency of Iranian sanctions in the post-JCPOA world than with the waiver-led exceptions of both Helms-Burton and the original ILSA legislation. Much of this is due to the fact that, unlike the Cuban embargo and the ILSA/ISA sanctions, the goal of Nord Stream 2 sanctions is discrete, time-sensitive, and tangible. The Cuban embargo had a broad, possibly quixotic, goal (ousting the communist regime and restoring democracy) and the Iranian sanctions had a myriad of goals related to US foreign policy (stopping nuclear proliferation, punishment for the hostage-taking, ending Iranian support for terrorism). The Nord Stream 2 sanctions are meant to prevent the completion of the last 160 km of pipeline needed to finish the project. If this is to be accomplished, there needs to be a much more stringent net extended akin to the Helms-Burton Act's removal of discretion regarding the entire embargo from the President, meaning that maximum pressure is brought to bear on a short period of time. This will raise costs to European companies and, as seen with Iranian and Cuban sanctions, force firms at the margin to retire from the project.

As seen above in our discussion of the effects of these previous sanctions, there were both potential winners and losers among European firms from US sanctions. In particular, losers were those who had any work or traded with the US in any form, while potential winners were firms who were exporters but were operating exclusively in local or regional markets. Multinational firms such as Allseas, cognizant of the business which could be lost as a result of Nord Stream 2 sanctions, have already withdrawn from the project, perhaps leaving an opening for smaller firms to step in (in reality, this could also lead to compensating Russian firms benefiting the most). However, the integration of global supply chains means that the classification of a European firm as "doing business with the United States" has been spread wider, ensnaring firms which have merged, utilized intermediate goods from the US, or interacted in any way with US firms.

The proposed Nord Stream 2 sanctions, captured in the proposed "Protecting Europe's Energy Security Clarification Act of 2020," have encouraged this expansion of extraterritoriality, as the wording of the proposed legislation changes existing wording to purposely be much more ambiguous: First, the clauses dealing with pipe-laying equipment have been changed from "sold, leased, or provided" to "facilitated selling, leasing, or providing," meaning a much more liberal interpretation of "facilitating" can be used. Secondly, similar with the unclear definition of "investment" in the Helms-Burton Act, the uncertainty engendered by this wording may scare off many European firms which technically are clear from reprisal.

Additionally, unlike the original sanctions, new clauses have been added focused on financial services (including insurance, reinsurance, and underwriting) related to companies laying pipeline, as well as

any technology upgrades or inspection services related to equipment used for pipe-laying activities. These new prohibitions expand the orbit of potentially affected industries much further: For example, a firm which conducts an inspection of a ship which is then used to transfer equipment to another ship which is then related in laying pipe for Nord Stream 2 could potentially be liable for US sanctions. As in the Cuban examples noted above, it is highly unlikely that smaller firms would be willing to undertake such a risk of sanctioning and would likely wash their hands of any involvement (no matter how peripheral) with Nord Stream 2.

This situation places European companies in a difficult bind, for, as noted in the discussion on Iranian sanctions, the EU response to US sanctions may also foster uncertainty for European companies, in particular if blocking legislation is put into place. The cumulative effect of firms attempting to avoid fines from the US side while simultaneously not being seen as complying with the sanctions may create massive costs (and headaches) for European firms worried about both their overseas and domestic markets. In this sense, the US sanctions will have achieved a desired effect, as they will make it very difficult for any firm to willingly take on political risk from two directions.

2.2 Effects of US sanctions on Iran on third countries

As noted in the previous section, the spillover effects of sanctions can go beyond (in some cases, far beyond) the targets, with the potential to disrupt supply chains, trade, and investment in other countries other than the target and/or those who trade directly with the targeted country. Section 1 examined how discrete sanctions pursued by the US, centred on Cuba and Iran, may have impacted European firms; this section, on the other hand, expands the net to study how other big actors in the global economy (including but not limited to Russia and China), have been affected by extraterritorial measures taken by the United States over the past 25 years.

As in the previous section, we are handicapped by the reality that there are very few studies which explore the economic effects of sanctions, even on the target country. As noted above, papers such as Neuenkirk and Neumeier (2015) take an admirable shot at quantifying the effects of sanctions on target countries, finding that US sanctions amount to approximately 1 % of GDP growth over a 7-year period and an aggregate decline in GDP of 13.4 %. However, for countries which are not even party to or the target of sanctions, there is a decided lack of interest from the economics profession, due to two obstacles, one theoretical and one practical.

Coming from a theoretical vantage point, there is little guidance in economic theory on what sanctions (seen as a disruption to trade between two partners) would have on third parties. In the first instance, international trade is rife with distortions throughout the global trading system and it is difficult to imagine counterfactuals even using modelling tools such as the synthetic control method (SCM). More importantly, however, the theory is not clear on how a sanction between trading partner X on country Y would affect country Z *ceteris paribus*. Indeed, the theoretical influence could run in several directions:

1. If country Z traded extensively with countries X and Y, then it would have to choose which of the two countries it preferred. If it preferred country Y, it would lose business with country X, and if it preferred country X, it would be prevented from business with country Y. In either case, there would be a welfare loss for the country as its trade is re-routed.
2. Alternately, if country Z trades extensively with country Y but not at all (or only slightly) with country X, it could benefit from the new opportunities available from the withdrawal of country X firms from country Y.
3. Finally, if country Z trades extensively with country X but not at all (or only slightly) with country Y, it would continue to trade with country X even in the presence of sanctions on country Y.

Indeed, it might also benefit from the sanctions as in scenario 2, as its firms could possibly pick up opportunities from the withdrawal of country Y firms under threat.

In two of these three scenarios, the third party would actually benefit from sanctions, while in only one – where they are a trading partner of both countries – would there be a loss. However, this aggregate look is not nuanced enough to understand what is happening at the firm level: while overall trade volumes might increase/decrease, in individual firms, there might be disruptions in supply chains which involve country Y, even if there is no direct trade between the two countries. An additional scenario is necessary here.

Imagine that firm A in country Z purchases automotive parts from firm B in country X which have inputs from country Y; with the advent of sanctions, crucial components of these parts are now unavailable to firm B, which must go elsewhere, changing the time to deliver and likely the cost. The effect is then reflected in the price of goods which eventually make their way to firm A in country Z, despite any formal trading arrangement or flows between country Z and country Y.

From a practical standpoint one can see how these difficulties of disentangling the effects of sanctions on third parties from the myriad of domestic, international, and network effects which drive trade flows are almost insurmountable. Indeed, to be able to project out such complex changes would require a massive CGE model that takes into account not just consumption patterns but global supply chains across a broad cross-section of industries – a time-consuming and capital-intensive undertaking. As such, we can realistically only discern short-term disruptions that occur around the imposition of a sanction, perhaps supplemented with longer term trade trends between the third party and the target country, in order to understand which scenario shown above occurred in the aggregate. This is the approach we attempt in this section.

2.2.1 The USA vs. Cuba

The long history of US sanctions against Cuba, for the most part, had little effect on third parties mainly because Cuba was integrated into another trading bloc entirely, the Council for Mutual Economic Assistance (CMEA or COMECON). As a socialist country, it traded mainly with other socialist countries, with trade being a more managed affair than one which followed economic and market tenets. Consequently (especially during the 1970s), Cuba had increasing dependency on Soviet trade linkages but countries such as the Soviet Union or East Germany saw little impact from the US trade embargo (Theriot and Matheson 1985). In this sense, the US sanctions on Cuba fell into our second scenario above, where CMEA countries traded with Cuba but not with the US, and so “benefitted” from exclusive trade with the island nation.

It was not until the collapse of the CMEA alongside the Soviet Union – meaning that Cuba could no longer rely on managed trade – that the broader effects of US sanctions would be seen, especially given that Cuba’s former allies were now trying to integrate themselves into global supply chains (and especially increase trade with the United States). Thus, any existing incentive to try and renew trade ties with Cuba was suddenly closed by the threat of US sanctions, and many countries did not have the energy or resources to eschew trade with the US in favour of a small, still-socialist nation.

Figure 3 Value of Russian Imports from and Exports to Cuba, 1996-2018

Source: World Bank WITS Database

Russia, as the successor state of the USSR and the former patron of Cuba, was precisely one of these countries, exhausted financially in the 1990s and attempting to forge trade links outside of the former CMEA area. With the collapsing of the Soviet Union in the late 1980s, trade with Cuba fell precipitously, with exports falling by approximately 70 % from 1989 to 1991 and the overall value of trade decreasing by 92 %. While the Torricelli Act came into force immediately after this time (1992), it was precisely a response to the withdrawal of Russian trade rather than a cause of it. As noted in Section 3, the Act was seen as a way to finally push the communist regime in Cuba over the edge and deliver the same freedom spreading around the globe (famously, Russia abstained from condemning it at the United Nations, see Mesa-Largo, 1993). Thus, Russian domestic politics were to blame for the decline in Cuban trade and were also to some extent the reason behind the Torricelli Act, meaning little effect of the Act on Russian firms.⁴²

In a similar vein, the Helms-Burton Act also came about at a time where Russia was struggling financially, but it appears to have had a more demonstrable effect on Russian exports to Cuba (Figure 3); from a high of USD 465 million in 1996, exports to Cuba declined precipitously to a low of USD 70 million in 1998, even prior to the Russian Ruble crisis of that year. While Russian firms continued to import from Cuba, only seeing the value of trade fall off in the early 2000s (likely after the US-Russian comity on fighting international terrorism after the events of September 11th, 2001), it was exports which took the largest hit in the late 1990s and early 2000s. Using our scenarios noted above, it appears that US sanctions on Cuba put Russia precisely in a bind akin to Scenario 1 and, sensing the rewards of US-Russian trade as more important than trade with Cuba, prioritized the US trade and foreign policy relationship (Bain 2010).

However, this state of affairs was not to last, as the deterioration of the US-Russia relationship, occasioned by Russia's invasion of Georgia in 2008, the annexation of Crimea, the invasion of eastern Ukraine in 2014 and Russia's growing rivalry with the United States, meant that Russian President Vladimir Putin was eager to challenge US power globally (Ambrosetti et al., 2020). This manifested itself

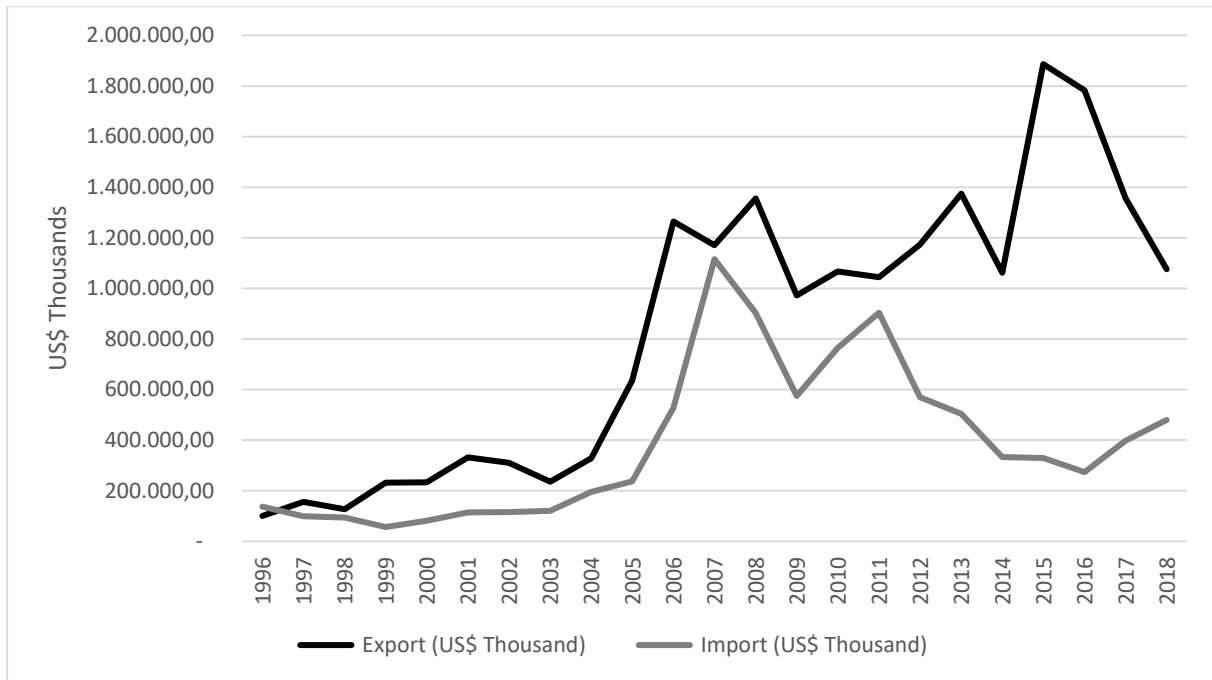
⁴² Note that Russian President Vladimir Putin did note that there was a loss of business for Russian firms during this period, as in 2000 he mentioned during a talk with Fidel Castro that Russian companies had been replaced by Western competitors.

in Cuban relations as a concerted effort by Russian firms to resume trading with Cuba, ignoring any threats from the US. Therefore, where Russia had been in Scenario 1 in the 1990s, it has shifted towards Scenario 2 and was prioritizing Cuban trade over the US. In terms of exports, this can be clearly seen in Figure 8, where exports rose 337 % over 2015 to 2018, and, according to the *Financial Times* (Frank 2020), was anticipated to rise an additional 29 % in 2019. While the US sanctions regime was tightened against Cuba in 2016 – after a thaw under President Barack Obama – Russia appeared to be going its own way.

In sum, the effect on Russia of US sanctions on Cuba appeared to be negligible in either 1992 or 2016, mainly due to domestic pressures in the country (one away from trading with Cuba and one towards it). The only effect which appears to have occurred was in response to the Helms-Burton Act, and this too was driven by domestic politics, namely an attempt to get closer to the United States on foreign policy more generally. Given the small size of Cuba economically, and its lack of integration in global supply chains more generally, any effects of the US sanctions on Russia were infinitesimally small.

Such an effect can also be seen in the economic relations between China and Cuba, which have been driven – as during the days of the Cold War – by ideological affinity, coupled with China's play for a greater role in international commerce (Xianglin *et al.* 2015). Seeing the withdrawal of Russia in the early 1990s as an opportunity, China has attempted to cultivate trade and economic ties with Cuba, becoming the island nation's number one trade partner by 2018 and keeping this position in 2019. Cuba enthusiastically signed up for China's Belt and Road Initiative (BRI) in 2017, and the two countries have become much closer diplomatically and economically (Figure 4). All of this has occurred as China and the US have also become much closer in terms of trade, meaning that China has to some extent been able to have its cake (Cuba) and eat it too (the United States, see Shixue [2015]). Moreover, given the festering trade war with China that has occurred under the Presidency of Donald Trump, the Chinese government is unlikely to listen to American instructions regarding their trade with Cuba, especially given the rivalry which emerged between American and Chinese firms during the thaw in the mid-2010s (Lee and Schwartz 2016). As with Russia, the effects of American trade sanctions appear to have had little effect on Chinese firms, with any shift in the trade relationship – including the rapid increase in trade volumes from 2015 onward - being driven by domestic factors rather than worries about sanctions.

Figure 4 Value of Chinese Imports from and Exports to Cuba, 1996-2018



Source: World Bank WITS Database

2.2.2 The USA vs. Iran

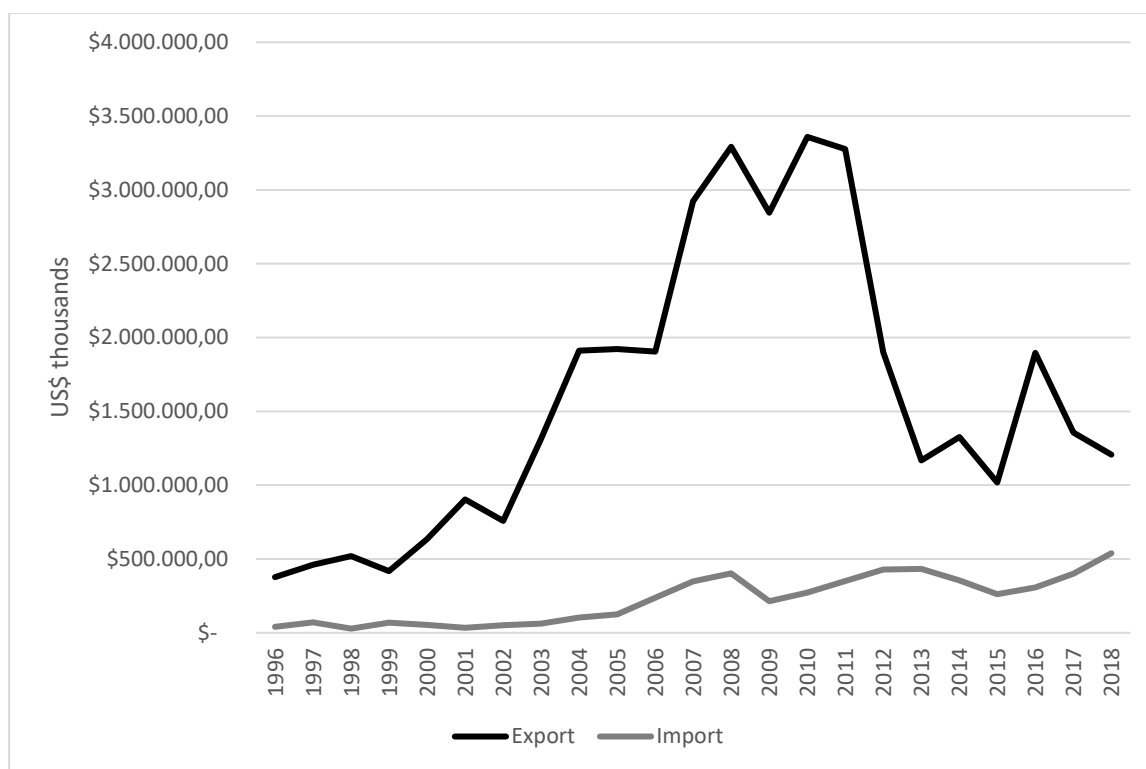
A similar tale, namely one of thawing and re-freezing, can be told about Iran and the waxing and waning (and waxing again) of sanctions. However, Iran is a much more relevant case for understanding the effect of US sanctions on global supply chains as it is simply a much more important player in the global economy. Compared to Cuba, which, in terms of size of its GDP, is no higher than 77th in the world (according to the CIA and, in reality, is likely much lower), Iran is ranked by the IMF as having the 19th largest economy in the world in 2019, ahead of Australia and tied with Taiwan. More importantly, Iran also is major producer of oil and gas, a bargaining chip which both gives it substantial leverage in global energy supply chains and makes it much more highly sought-after as a trade partner. This intrinsic characteristic of the Iranian economy means that it is evident that it should play a larger role in global trade; at the same time, any moves to disrupt its trade patterns, i.e. sanctions, will thus have a larger and more disruptive effect for other nations other than Iran.

These effects can be clearly seen if we start, as we did in the last section, with Russia. Russia and Iran have had a tangled relationship throughout history, with Iran figuring into Russian foreign and economic policy as both a counterweight to the West and as an interest in its own right (Perteghella and Talbot 2020). In terms of absolute economic relations, however, Russia and Iran have not been substantially important to each other since the fall of the Soviet Union, with Russia only 0.83 % of Iran’s exports in 2018 and Iran only 0.28 % of Russian exports in the same year.

With regard to the effect of sanctions, as Figure 5 shows, there was an uptick of trade between the two parties (favouring Russia almost exclusively) during the global financial crisis, coming down as Russia’s export markets in Europe recovered in 2012 and 2013; the jump in exports to Iran in 2015 was also likely due to sanctions, but not from the US, instead the ones imposed by the EU on Russia for Crimea. The only econometric evidence available on the effect of US sanctions comes from Felbermayr *et al.* (2019) and only for the pre-JCPOA era (1980 to 2015), but it does find that, over the entire life of Russian-

Iranian trade, there was a significant statistical effect on both imports and exports, with both being depressed over time due to US sanctions (their estimates show an almost 300 % cumulative reduction in Iranian imports of Russian goods between 2006 and 2015). Rasoulinezhad (2016), writing in a Russian journal, estimates that the channel that carried this depression of trade was financial sanctions, and in particular the denial of Iran from using the SWIFT system. Such a finding is entirely plausible, as the inability to pay for imports would be a major stumbling block to international trade and appears to have been a significant drag on Russian-Iranian trade; it also would explain the sudden decline in Russian exports to Iran in 2012, in addition to the recovery in the EU, as the disconnection occurred in January of that year.

Figure 5 Value of Russian Exports to and Imports from Iran, 1996-2018



Source: World Bank WITS Database

Eyeballing the data from Figure 5, it appears that neither the JCPOA nor the re-imposition of sanctions in 2018 appear to have an effect on overall Russian trade volumes (data for 2019 available from Russian sources shows that trade in 2019 was flat, in line with previous trends). Pelzman (2020) notes that the commodity concentration of Russian exports does in fact put it in line to substitute for US trade, meaning that there is a possibility of increased trade with Iran in the future, even if such trade has not yet materialized. Unfortunately, the re-imposition of sanctions in 2018 also came with a disconnection again from the SWIFT system, meaning that the same obstacles to increasing Russian trade remain. If Russia is able to circumvent these financial issues, including the issue of payment *and* the Russian interest in non-proliferation (Pieper 2019), then there is the possibility that trade will increase. Without a resolution of this stumbling block, however, it is likely that trade will remain at the same low plateau.

In a similar vein, and also unlike Cuba, China has had a long history of economic relations with Iran. From the Iranian side, courting China as well as Russia has been a beneficial move to sidestep the

economic impact of Western sanctions; from the Chinese side, over the past decade, China has become the largest consumer of Iranian oil globally, utilizing Iran exports of petroleum to feed its sizeable energy needs (Hong 2014). Indeed, in a move to cement this evolving relationship, there has been an official move in Tehran to create a 25-year strategic partnership with China (Bozorgmehr 2020). While the official strategy as of this writing (September 2020) had not been proposed to Beijing, it was indicative of a growing closeness between the two countries, especially in the face of US intransigence towards both.

The reliance of China on Iranian energy exports has been the key economic relationship and the one where US sanctions have been most problematic; in our taxonomy of scenarios shown above, the US application of sanctions on Iran has forced China into Scenario 1, where it needs to decide between the US and Iran. The decision is not as clear-cut as Cuba, however, as the US is China's largest trading partner and Iran has but 2 % of the total value of US-China trade, but, as noted, Iran's exports to China are almost entirely predicated on energy goods (while Iran imports mainly cars from China – and has China as its largest trade partner in both imports and exports, at least in 2018).⁴³

As US sanctions on Iran are not new, there is some economic evidence on how China has been affected in earlier years; Felbermayr et al. (2019) note that many other third countries experienced a significant drop in trade due to sanctions on Iran prior to the JCPOA (from 1980 to 2015), but China was relatively immune in this period, even if trade remained at a lower level – for the years where data is available, imports from China for Iran were consistently about 5 % of all trade, beginning to rise only around 2010 and continuing on an upward trend since. By 2013, however, 20 % of Iran's imports came from China, and this number continued to climb during the thaw related to the JCPOA, reaching a height of 27.8 % in 2018.

However, it is evident that the collapse of the JCPOA has changed the equation, especially since the thaw in relations between the US and Iran from 2015 to 2018 increased economic activity in Iran in general and with China in particular. From the beginning of the re-imposition of the sanctions in 2018, the US attempted to play "good cop" and use carrots to induce behavioural change in China. Specifically, China (along with seven other countries) received an exemption from the sanctions due to their efforts to reduce trade with Iran (not coincidentally perhaps, six of the eight exemptions went to Iran's largest importers of oil in 2017, see Pant and Answer, 2018). However, an increase in sanctions in 2019 showed a shift back towards a "stick" mentality, and the tightening of sanctions have begun to dramatically shape Chinese trade: the country officially cut most of its declared oil imports in 2020 from Iran, and customs data provided by Argus shows that oil exports from Iran to China in March 2020 decreased by 88.9 % in comparison with the amount a year before.⁴⁴ While this is a substantial effect, there have been pockets of resistance, and there is both evidence of sanction evasion – with Chinese ships turning off their transponders so as to not be tracked - and compensation via non-official deliveries (Chazan 2020). But unlike previous rounds of sanctions, the US has continued to ratchet up pressure on Chinese companies, including targeting specific companies by name with sanctions for their circumvention of the Iranian restrictions (Tan 2019); this pressure has closed off some areas for sanction-busting, as there is no apparent evidence of rerouting Iranian exports.⁴⁵

While it is very difficult to scratch the surface and see the effect of these sanctions on Chinese firms in particular, the massive decline in trade in late 2019 and 2020, coupled with the effects of the coronavirus pandemic, have undoubtedly affected Chinese business in its orientation, if not in an outright disruption. In particular, the Chinese thirst for energy has been made up by a shift towards

⁴³ Data from Observatory of Economic Complexity (OEC) at MIT.

⁴⁴ <https://www.argusmedia.com/en/news/2099942-chinas-russia-saudi-crude-imports-stay-high-in-march>

⁴⁵ <https://www.ft.com/content/6b944786-9809-11e9-8cfb-30c211dcd229>

imports from Saudi Arabia rather than Iran, with an additional 500,000 barrels a day imported from the Saudis in 2019 than in 2018 (according to Bloomberg data). Indeed, imports of oil increased from nearly all other suppliers over this time frame, including Russia, Iraq, and Brazil, meaning an ability to make up the shortfall of Iranian energy. At the sectoral level, however, there has been some difficulties, particularly in the automotive industry: car giant SAIC saw a substantial fall in its number of cars sold from 2018 to 2019, falling from 6.162 million to 5.378 million passenger cars (according to data from the Chinese Association of Automobile Manufacturers), while across the entire sector the sales of automobiles went down 12.7 % in 2019 since 2018 (data from the same source). Given the loss of Iran as an export destination, it appears that this effect is indeed showing up in the data.

2.3 Effects of sanctions as viewed by the empirical and theoretical literature

In this section we broadly review the literature devoted to economic sanctions. We focus on the strand devoted to the interplay between countries that leads to the imposition of sanctions (mainly game theoretic literature), the effects of sanctions on international trade and capital flows as viewed by simple economic models and the empirical works devoted to the effectiveness of sanctions, their impact on the main macroeconomic variables as well as on the changes of the political situation in the target country.

The so-called sanction game (see appendix), i.e. the interaction between the sender deciding whether to sanction and target deciding whether to comply does not have a simple prediction, i.e., the outcome of the game is subject to uncertainty. Moreover, there is no clear connection between the severity of sanctions and the probability of compliance of the target (Tsebelis, 1990). The more severe is the penalty, the lower is the probability of its successful enforcement by the target as shown by the Shidiqi and Pradipto (2011).

This leads to a question why sanctions are imposed in the first place. The literature provides several answers to that. One is incomplete information. For example, the reason for imposition of sanctions could be wrongful information about the target's actual cost of compliance or the sender's determination, i.e., the ability to enforce the sanction over the longer term (see, for example, Eaton and Engers, 1992). On the other hand, the public choice literature suggests that the sanctions themselves may be an outcome of an interplay of different interest groups in the sender country with a government that is maximizing the probability of re-election. In that sense, the sanctions may be imposed in order to satisfy these interests groups (or find a balance between them), rather than to make the target comply (Kaempfer and Lowenberg 1992, 2007, Beladi and Oladi, 2006). Moreover, Drezner (2003) argues that anticipation of frequent conflicts increases the likelihood of sanctions imposition by the sender, despite the costs of coercion.

The threat of sanctions may be more important than the sanctions themselves. For example, Eaton and Engers (1992) show that under perfect information (about the cost of compliance and the costs of sanctions to the sender), the target's behaviour improves in anticipation of a threat. The importance of the threat stage is also elaborated by Lacy and Niou (2004), who argue that in the actual cases of the imposed sanctions, the threat stage had a significant contribution to the outcome of the effective sanctions.

A more comprehensive approach to sanctions is proposed by Kirshner (1997, "microfoundations approach") as well as Beladi and Oladi (2015) who emphasized the importance of the impact of different sanction types on different players in the sender and the target countries. Thus, for example, freezing of assets creates the most immediate and significant impact for elites and government members which hold substantial assets abroad, while have limited to no effect on the broad society.

Aid sanctions, in turn, have the most direct effect of the central government, even more so, if the latter relies on external aid to gain political support from core groups. Further, prohibition of exports to the target will directly harm final consumers and producers that depend on imported intermediate goods. Import sanctions, in turn, will primarily affect exporting sectors and port cities. The effectiveness of trade sanctions in both cases would depend on the relative importance of international trade and affected sectors for the target's economy. This approach underlined the importance of tailored and targeted sanctions to specific groups and their interests to maximize the effectiveness of coercion (i.e., smart sanctions).

2.3.1 Effects of sanctions on international trade and investment

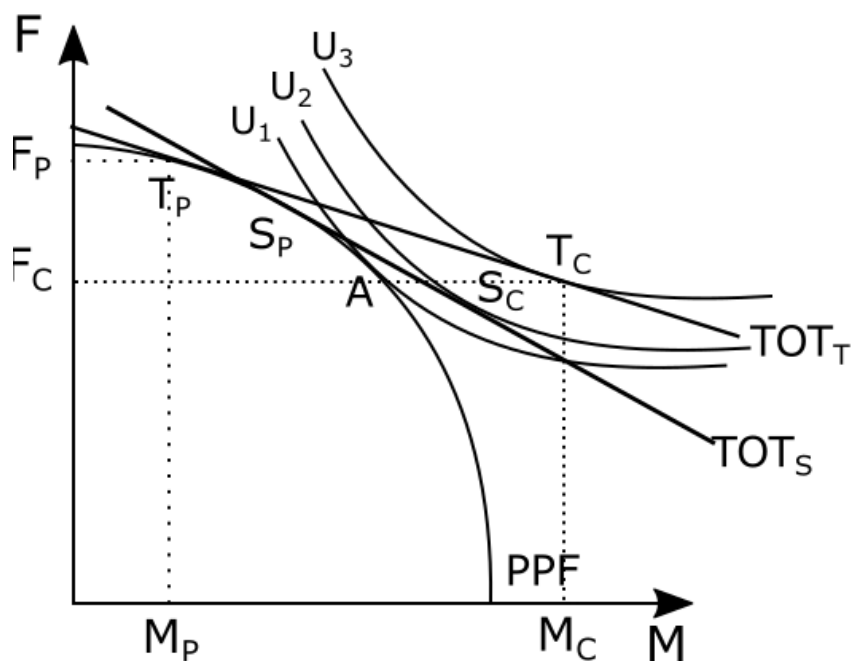
We look at the effect of trade sanctions on the target and the sender through the lens of a Heckscher-Ohlin neoclassical trade models as formalized by Jones (1956). Our analysis includes a target with relatively large endowment of labour relative to capital (a developing country) as compared to the rest of the world and the sender (a relatively capital-abundant, advanced country). In other words, target's capital-labour ratio is lower than that of the sender. There are two goods produced and consumed – food (F) and manufactures (M). Output of F is more labour-intensive (uses relatively more labour), output of M is capital-intensive.

The prediction of the Heckscher-Ohlin model is that (1) the output of F relative to the output of M in the target country is higher than elsewhere in the world, and (2) the target exports F and imports M because the costs of production of F relative to M are lower than elsewhere in the world (the target has *comparative advantage* in production of F). These stylized facts are reflected in Figure 6. The target country's production possibility frontier (PPF) shows the range of choices of possible output mixes given the resources of factors of production. The slope of TOT_T line reflects the world price ratio (terms-of-trade) under free trade. Economic efficiency requires that the TOT_T line is tangent to the PPF⁴⁶ and thus corresponds to point T_p showing the outputs of both goods (F_p and M_p) of the target country under free trade. The consumers choose the best possible consumption bundle given the TOT_T line which shows all consumption bundles affordable to the economy given the value of its output at world prices.⁴⁷ Therefore the TOT_T line is a budget constraint for the consumers who choose the best bundle available in their budget to reach the highest available indifference curve (U_3) and thus maximize their welfare. Imports of M are equal to $M_C - M_p$ while exports of F – to $F_p - F_C$.

⁴⁶ So that the rate at which we can “turn” good F into M by shifting resources from production of F to M is exactly equal to the ratio of world prices, i.e., the ratio at which we can exchange F to M at world markets.

⁴⁷ The country can sell all and some of its output at these prices and consumers can purchase any combination of the two goods provided that the total consumption expenditure is not greater than the value of output at world prices, therefore the value of consumption equals the value of output.

Figure 6 Effect of sanctions in a neoclassical model of trade



Source: own elaboration

Let's consider the first case of complete sanctions (moving towards complete autarky). These make trade impossible, therefore world prices no longer apply to the target economy and its consumption bundle must equal to the production bundle. This corresponds to point A, where exports and imports are zero, while the welfare level (U_1) and output of F are lower than in a free trade equilibrium and output of M is respectively higher. The loss of welfare is due to the fact that the target can no longer take advantage of its cost-driven comparative-advantage in production of F and has to produce more M. Therefore, the prices of F go down relative to the prices of M (deterioration of terms of trade). This price change leads to a result known as the Stolper-Samuelson theorem, which in our case means that the wages drop, and the rental rate of capital goes up. The so-called Jones (1956) magnification effect implies that the real wages of the workers go down, and the real return to capital goes up, which drives a potentially serious impact on distribution of income in the target economy. In the case of oligarchic economies, this may in fact benefit the capital-owning oligarchs and harm the working population.

The effect of sanctions applied by selected partners (or partial trade sanctions) are milder. They can be interpreted as a fall in the world demand for good F produced in the target economy, which would lead to a fall of the world price of F relative to M. This is reflected by the shift of terms-of-trade towards the line TOT_S . The resulting production mix is at S_P and the consumption mix is at S_C , both being between the free trade and autarky equilibrium. This means that there are still exports and imports but they are considerably smaller than in a free trade equilibrium, and there is still a welfare loss relative to free trade but it is milder than in full autarky.

It is also worth mentioning that if we consider the effects on the target country, they are mirrored by the effects on the sender. There will also be a welfare loss, lower imports of F and lower exports of M, and the sender economy will reduce its specialization in M (which in turn will harm the capital owners and benefit the workers in import-competing industries). These effects will depend on whether the target is the only sender's trade partner – if it is the case, this would also mean complete autarky for the sender, so the welfare effect is the highest; if not, then it corresponds to a partial effect with a milder negative welfare effect.

What determines the relative size of these effects? In particular, it is the relative size/importance of the target relative to the sender: the smaller the sender, the larger the negative welfare effect (in the same vein: the more important the sender as a trade partner, the larger is the negative effect). The second important factor is the elasticity of the world prices: the larger is the effect of sanctions on the world prices, the larger is the welfare loss. This price elasticity, in turn, depends on the size of the target relative to markets for its exported goods.

The Heckscher-Ohlin (H-O) model explains the so-called North-South, or inter-industry, trade – trade in goods of one sector in exchange for those from the other sector (in our example: M and F). It therefore mainly applies to trade between countries at different levels of development. Helpman (1981) and Helpman and Krugman (1985) develop a version of the model that has two goods – let's call them again M and F with M being capital intensive and F – labour intensive. Additionally, M is also differentiated, and each variety of M is produced in a different firm located in either one of the trading partners. Consumers derive welfare not only from quantity of goods, but also from the number of available varieties of good M.

In this model, if countries have the same factor abundance, only trade in good M occurs, where some varieties are traded for the others (as in, e.g., brands of cars). If countries differ in factor abundance, the country with low level of capital exports mainly the homogenous good F and some varieties of good M and imports only other varieties of good M. Gains from trade in both cases stem from the greater access to varieties of M in both countries and the fact that F is exported from a labour abundant country. Therefore, in such a model, sanctions would harm both a developing (target) and a developed (sender) country as in both cases the number of varieties available to the consumer would decrease as a result of trade restrictions, because the developing country would start producing more varieties of M and would reduce output of F, while the reverse happens in the developed country. In a symmetric situation (both either developed or developing countries), sanctions would lead to a drop of consumed product varieties and a reduction of welfare.

While the H-O framework does not cover capital flows as the current account of the analysed countries is always balanced, Kaemper and Lowenberg (2007) consider a simple framework to analyse the effect of financial sanctions on capital flows (in a single-good economy this time). If we consider the balance of payment identity in the simplest terms, other things equal, a trade surplus and deficit are matched with an outflow (domestic investment abroad or foreign disinvestment at home) and inflow of capital, respectively. If we consider financial sanctions, foreign investors will disinvest causing an outflow of funds. We have to remember that the outflow of funds does not mean that the physical foreign capital disappears, it is instead sold to the domestic investors and, since potentially all investors are forced to do so because of sanctions, the price of physical capital goes down (fire sale). Given that the stock of capital is unchanged or largely unchanged, its productivity is not altered while its purchase price goes down. This leads to a higher real rate of return on capital to the domestic owners (who may be related to the current government, i.e., oligarchs). As the balance of payments identity is binding, the target has to finance the purchase of the assets either through sales of the domestic assets abroad or through an increase of exports. In the case of concurrent trade sanctions and/or the nonexistence of domestic assets abroad, the prices of domestic assets are likely to fall even more. As stated by Kampfer and Lowenberg (2007): *"The increase in the rate of return due to the acquisition of productive assets at fire-sale prices translates into a windfall gain to domestic capital owners, which increases the tax base available to the government to finance its policies, including those that attracted the sanctions in the first place."*

Over the longer term, financial sanctions lead to a reduction of the stock of capital in the target country, in particular if foreign direct investment used to be an important source of capital. This increases the marginal productivity of capital and, at the same time, decreases the price of capital – hence the real

return to capital is uncertain. While the fall of capital stock will lead to a deterioration of economic situation over a longer term, if the rate of return on capital falls, firm profits are likely to fall and thus generate less tax income for the government of the target and its policies. Therefore, while financial sanctions may, over the short term, benefit the government (and/or the wealthy) of the target country, over the longer term, sanctions may discourage that government from financing its questionable policies. This, however, will come at a cost of lower economic activity at the target economy and thus will harm its population.

2.3.2 Effects of sanctions: survey of empirical literature

A comprehensive empirical analysis of sanctions has been provided by Hufbauer et al. (2008 and earlier editions). They show, in particular, that the economic damage of sanction episodes increased significantly since 1985 with the average cost to target growing from 1.4 % of GNP per case prior to 1985 to about 5 % of GNP per case for the episodes after 1985. These numbers are likely to reflect a growing share of sanctions imposed by major powers on smaller economies with the median sender-to-target GNP ratio inflating from 45 to 453 after 1985. They further used a gravity model to explain the impact of US-inspired sanctions on target-country trade with the US and other trading partners. Their results show that the US sanction episodes had sizable negative effects on bilateral trade between the US and target countries yet only limited reduction in trade with all partners. At the same time, more intensive and comprehensive sanctions have been found to be highly effective in restricting target countries' trade flows. Further, Hufbauer et al. (2008 and earlier editions) estimated the general success rate of previous sanction episodes at about 34 %, which, however, depends significantly on the type of pursued policy change. Thus, the sanctions are likely to succeed if they are imposed rapidly and decisively, the objective is modest, the target country is small relative to the sender country, and both previously benefited from substantial bilateral trade.

The effects of sanctions on target countries' trade flows has been further analysed by, inter alia, Caruso (2003), Hufbauer and Oegg (2003), Yang et al. (2004), Frank (2017), Hinz (2017), Bali (2018), Dizaji et al. (2018), Kohl and Reesink (2019), Felbermayr et al. (2020). Similarly, to Hufbauer et al. (2008), Caruso (2003) found that severe US sanctions resulted in sizable reduction of bilateral trade (-89 %), while more moderate sanction episodes had limited effects. The latter, in addition, have been found to induce marginal positive effect on bilateral trade between target country and other major economies. Similarly, the results of the gravity model estimation presented by Yang et al. (2004) shows that sanctions had limited impact on trade flows between the US and target countries where selective sanction have been imposed. More comprehensive sanctions, however, were estimated to reduce bilateral trade flows between the US and the target significantly (by 78 %), while increasing trade between the EU or Japan and the target. Hinz (2017) further estimated the trade loss of about USD 50 billion or 0.4 % of the world trade following three most recent sanction episodes, including Iran, Russia, and Myanmar.

Focusing on the case of Iran solely, Dizaji et al. (2018) confirm Caruso (2003) and Yang et al. (2004) conclusions on positive effects of sanctions on trade with other partners. Specifically, their analysis of the effects of sanctions on the bilateral trade in agriculture products between Iran and the EU and Middle East and North Africa (MENA) region suggested presence of sizable positive impact of sanctions on agricultural export from Iran to the EU countries, albeit the imports from the latter slightly decreased.

Similarly, to other studies, Kohl and Reesink (2019) found that economic sanctions induce detrimental effects on international trade. However, the magnitude of estimated effects is only a fraction of what has been discussed in the existent literature - 14 % for moderate and 27 % for extensive sanctions. Further, contrary to the game-theoretic literature on sanctions (see for e.g. Lacy and Niou, 2004), Kohl

and Reesink (2019) found that threats to implement sanctions had no meaningful impact on trade. Finally, the latest available estimates presented by Felbermayr et al. (2020) suggest an average potential bilateral trade contraction between sender and target countries at about 85 % in the complete bilateral sanction episodes and about 17 % in the case of bilateral trade sanctions only.

Focusing on the macroeconomic effects of sanctions, Neuenkirch and Neumeier (2015) presented a comprehensive analysis of growth effects of the US and UN sanction episodes between 1976 and 2012. They argue, in particular, that the UN sanctions carry significant and lasting economic growth effects by inducing on average about 2.3-3.5 percent point (pp) contraction of real per capita GDP growth in the target countries. When comprehensive and broader sanctions have been considered, the GDP reduction has been estimated to each more than 5 pp. In the case of the US sanctions, however, the effect on GDP growth have been rather limited, albeit still negative – 0.5-0.9 pp on average. On the other hand, Neuenkirch and Neumeier (2016) found that US sanctions contribute to inequalities in target countries with average 2.3-5.1 pp increase in poverty gap compared to the neighbours. The estimated effects are further increasing up to 6.1-7.4 pp on average for severe sanctions. These results are in line with the analysis presented by Pape (1997) who showed that sanctions imposed on Iran (1951), Rhodesia (1965), and Panama (1987) led to about 14.3 %, 13.0 %, and 6.0 % GNP loss by the target countries, respectively.

Further, Biglaiser and Lektzian (2011) analysis on foreign direct investment (FDI) in 171 countries between 1965 and 2000 found that the US investors tend to withdraw investments from target countries prior to the imposition of sanctions. At the same time, the results of their empirical analysis have shown that US investments tend to return to target countries once the sanctions are actually imposed. This implies that the sanctions per se do not have significant deterrent effect on investments in the long-term, yet it is the uncertainty associated with the risk of imposition of sanctions which can induce short-term fall or withdrawal of investments. A further elaboration by Lektzian and Biglaiser (2013) underlined sizable positive effect of sanctions on global FDI flows. Thus, the decrease in investment inflows from the US to target countries has been paired with significant increase in inward FDI flows from the rest of the world. This implies higher potential costs of sanctions for the US companies, while target countries benefitted from capital replacement. Similarly, results presented by Mirkina (2018) confirmed the temporality of FDI contraction in target countries for the 1990s sanction episodes, which albeit significant in the short-run tends to vanish over time. Moreover, sanction episodes from previous decades have been found to have to sizable effect on FDI inflows to target countries.

Finally, the evidence of the impact of sanctions on democracy is mixed. For example, Riley and Travis (2011), and von Soest and Wahman (2015) provided empirical evidence of positive impact of sanctions on democracy. Moreover, Riley and Travis (2011) confirms significant reduction of political repression in the cases where target country was a purely autocratic regime. Similarly, the estimation presented by von Soest and Wahman (2015), albeit did not allow to confirm that sanctions increase the level of democracy in the target country, showed a significant and positive correlation between the two.

In contrast, the results presented by Gutmann et al. (2017) argue that sanctions induce sizeable deterioration in civil liberties and political rights in the target country. The empirical findings of Wood (2008) also support a hypothesis that imposition of sanctions threatens the stability of the target state, which further the level of repression. Similarly, Peksen and Drury (2009) underline inefficiency of sanctions as a policy tool based on their analysis of both Freedom House and Cingranelli and Richards Physical Integrity Rights (CIRI) indexes. Further, Peksen and Drury (2010) in their analysis of sanction episodes in 1972-2000 conclude on the presence of immediate and lasting reduction of democratic freedoms in the target countries.

2.4 Empirical analysis of the effects of sanctions

Our empirical analysis revisits the main insights effect of sanctions from the literature. In particular, we are interested in the effectiveness of sanctions, the impact of sanctions on main macroeconomic variables and the impact on international trade. The novelty of our approach is in the use of a recently released Global Sanctions Database by Felbermayr et al. (2020) which covers the largest collection of 726 sanction episodes for the period of 1950 to 2016.

These data are particularly useful because they contain information on the sanction types⁴⁸ and the objectives of sanctions⁴⁹. Each sanction episode can have multiple types of sanctions imposed, multiple objectives, and different rates of success.

The success rates of sanction with regard to different objectives in all the episodes covered by the database is given in Table 1. It shows that the success rates differ substantially with sanctions aimed at restoring democracy having a generally higher rate of success (over 80 % episodes with at least partial success) and the sanctions targeted at terrorism and territorial conflicts having the lowest success rate in. If we consider only completed episodes, sanctions against terrorism still stand out as those least effective with only 33 % success of the completed sanctions episodes, while sanctions aimed at ending war and protection of human rights have a corresponding success rate of over 66 %. Sanctions related to the destabilization of the regime, have been successful in 42 % of episodes (roughly 46.7 % out of the completed sanction episodes with that objective)⁵⁰.

We follow with the analysis of the impact of sanctions on the macroeconomic variables, level of poverty, and the change of regime. For illustrative reasons we show the evolution of GDP growth rates together with the start of sanctions episodes in Figure 7: Iran and Cuba, cases which have been elaborated in detail in the previous sections. One can try to relate the drops in GDP growth rate to the sanction episodes, but in fact in many cases the GDP growth rate falls before the sanction episode (or it has large fluctuations that are not related to those sanctions episodes) or can increase after impositions of sanctions (due to reasons that may not be related to sanctions in a causal way). Therefore, instead of descriptive analysis, we resort to econometric methods which can take into account a large number of episodes to find out statistical regularities and take into account other factors affecting growth rate.⁵¹

⁴⁸ Trade sanctions, financial sanctions, travel restrictions, arms sales sanctions, sanctions on military assistance and other sanctions (not elsewhere classified).

⁴⁹ Policy change, destabilization of the regime, solving a territorial conflict, prevention of war, anti-terrorism, ending war, addressing human rights violations, addressing democracy and other objectives.

⁵⁰ While each sanction episode can have a number of objectives, number of sanction types and types of success it is difficult to present a comprehensive picture of all sanction episodes. As it turns out, the differences of the imposed sanctions between the failing sanctions and the successful sanctions for each objective are not large enough to statistically show differences in the effectiveness of different sanctions in reaching those objectives (and the number of sanction episodes for each objective is also too low to statistically important differences) using an econometric model. In Table 4 in the Appendix we show the percentages of applied sanction types in a number of successful episodes for each objective in the table below and it shows large differences in the types of sanctions applied. This does not say which sanctions are more effective for a particular objective but rather shows regularities in what sanction types are used in successful sanction types, i.e. financial sanctions are often used in for most sanction objectives, trade sanctions in policy change, war prevention and territorial conflict objectives, arms sanctions are primarily used in sanctions geared at ending war etc.

⁵¹ In analysing these issues we follow the recent literature and apply difference-in-difference methodology (see, e.g., Angrist and Pischke, 2009), which allows to distil the effect of an applied policy from effects of other factors by comparing the treatment group (countries subject to sanctions) with non-treatment groups (other countries) before and after imposing sanctions. Moreover, to assure that the two groups of countries are comparable, we apply the matching methods (we follow Neuenkirch and Neumeier 2016, for a significantly larger database of sanctions and for several macro variables than in the original study) that choose the so-called “statistical twins” for the group subject to sanctions with similar characteristics (level of development, state of democracy, participation in armed conflict, level of openness etc. In order to undertake the matching procedure, we use data from various sources, such as World Bank World Development Indicators, Penn World Tables, Polity database, Armed Conflict Database. This way our results can be understood in causal way, i.e., show an actual effect of sanctions rather than pure correlations.

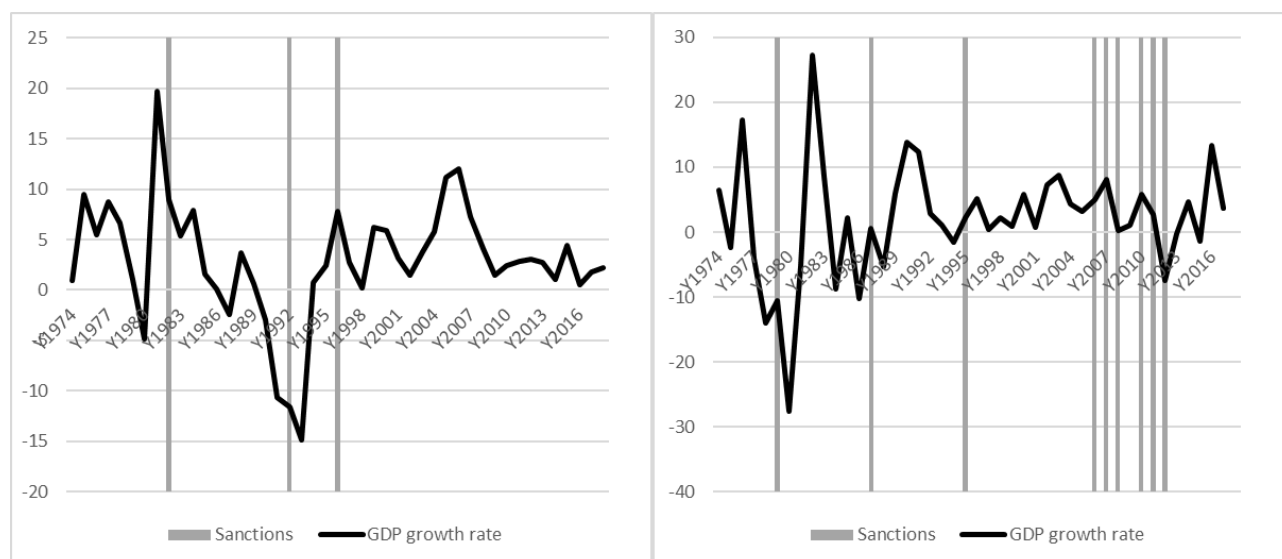
Table 1 Sanction success rate by objective (percentage of total sanction episodes of a particular type)

	Out of all sanctions		Out of completed sanctions	
	Total success	At least partial success	Total success	At least partial success
Democracy	58.1	81.2	63.1	88.1
Destabilize regime	28.0	42.0	31.1	46.7
End war	42.9	48.7	60.0	68.2
Human rights	26.6	47.8	36.7	66.0
Policy Change	41.4	50.5	49.5	60.2
Prevent War	35.7	43.9	48.6	59.7
Terrorism	6.7	17.8	12.5	33.3
Territorial conflict	30.3	36.4	34.5	41.4
Other	41.5	46.3	51.5	57.6

Source: own elaboration using data from Felbermayr et al. (2020)

Our results presented in Tables 4 and 5 in the Appendix point to a large and negative macroeconomic effect of sanctions. The general conclusion is that sanctions lead to a large decrease in economic activity: growth rates of GDP, GDP per capita or GDP per worker (a proxy for productivity) which drop by 1.5 pp. on average. When considering different sanction types, the most detrimental to economic activity are trade sanctions – on average they lead to a drop between 3.0 pp and 4.3 pp in GDP growth rates. On the other hand, the effect of remaining sanction types is around -1 pp.

Figure 7 Real in GDP growth rate and sanctions (%): Cuba (left), Iran (right)

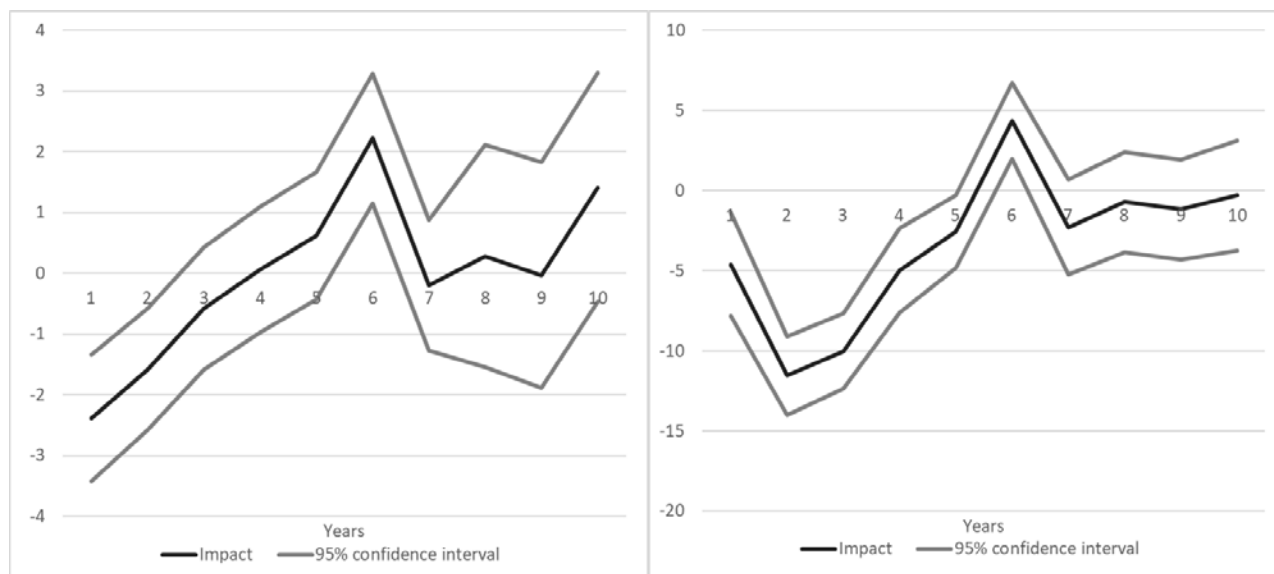


Source: own deliberation on the basis of data from Felbermayr et al. (2020) and World Development Indicators (World Bank)

We also look at the changes in GDP growth rate over time. In case of all sanctions, the initial drop in GDP growth rate is around 2.5 pp which quickly fades to become zero already in the third year

following the imposition of sanctions. Trade sanctions have a larger and more long-lasting effect with the drop in GDP growth rate peaking at on average at minus 12 pp in the second year after sanctions introduction and fading away towards the fifth year. In both cases, there is a slight recovery of GDP around the sixth year following the imposition of the sanctions but it is a fraction of the GDP lost over the sanction years (see Figure 8).

Figure 8 Changes in GDP growth rate associated with sanctions (% left) and trade sanctions (% right)



Source: results of a gravity model estimation. Black lines show the changes in trade associated with introduction of sanctions (%), the grey lines show 95 % confidence intervals. Years following the imposition of sanctions in year 1

Considering the effects on poverty, the average effect of imposition of the sanctions is around 0.9 pp in terms of poverty gap, which means that the percentage of people below the international poverty line increases by 0.9 pp after introduction of sanctions. These results are in line with the previous literature, in particular Neuenkirch and Neumeier (2016). The observed increase in the poverty gap can be due to trade sanctions (-1 pp) and to a larger extent – financial sanctions (-2.2 pp).

We also look at the effect of access to technology, i.e., the effect of sanctions on technical progress.⁵² While sanctions on average do not have a sizeable effect on the level of technology gap, trade sanctions seem to negatively affect technological progress as the gap widens by roughly 1 pp once trade sanctions are imposed.

Next, we check⁵³ if sanctions improve the probability of regime change towards democracy⁵⁴. The results show that, on average, sanctions lower that probability of shifting towards democracy, albeit to a limited extent (-2 pp). Taking sanction types into account, trade sanction can have a pro-democratic or democratizing effect – introduction of such sanctions can lead to a roughly 7 pp increase in the probability of shifting towards democracy and 1 point increase in Polity score.⁵⁵ However, the introduction of financial and extraterritorial sanctions is strongly connected to the deterioration of democratic standards, and, while trade and financial sanctions are often applied together, the overall

⁵² We measure this by a technology gap, as expressed by the total factor productivity (an index of combined productivity of all factors of production) relative to the level in the US (taken as benchmark of the technological frontier)

⁵³ We use similar methodology to macroeconomic analysis, but instead of macro variables we use either a dummy variable equal to 1 for democracy and zero otherwise.

⁵⁴ It has to be noted that we consider all sanctions here, not only those that are aimed at destabilizing regimes.

⁵⁵ it takes at least 10 points to increase from autocracy to democracy

effect of sanctions on democracy tends to be negative. The unclear overall effect of sanction is therefore in line with the mixed results found in the literature.

We use a gravity model of trade⁵⁶ to look at the effect of sanctions on international trade, which is negatively affected mainly in the case of trade sanctions (see Figure 9).

The effect of complete export and import sanctions on target exports imports, respectively, is about minus 70 %. We can also see a similar effect of import sanctions on target exports and vice versa. In the case of partial trade sanctions, these effects are in the range between 14 % and 27 % for imports and exports, respectively. The effects of sanctions on trade are relatively long lasting (see Figure 10) – they last at least 7 years in the case of export sanctions and 8 years in the case of import sanctions.

It is important to understand that the above-mentioned results are expressed in relative terms, i.e., the percentage change in trade between the sender and the target is relative to all other trade between the sender and the target (i.e., the econometric method distinguishes the result of the sanctions from the effects of other variables that affect trade between the sender and the target). Therefore, we do not comment on the evolution of trade in absolute terms as we are not able to say what happens with overall trade once sanctions are introduced.⁵⁷

While our results show that there is no such universal empirical regularity as trade redirection,⁵⁸ previous evidence seems to suggest that there might have been cases where it occurred. This applies to, e.g., the 2014 Russian sanctions on the EU, where an increase in trade in banned food products was observed from selected EU countries through Belarus, Serbia and Macedonia (Fritz et al. 2017), as well as the 2012 sanctions on Iran, where the United Arab Emirates experienced a large increase of trade with Iran simultaneous to trade sanctions imposed on that country (Felbermayr et al. 2019).

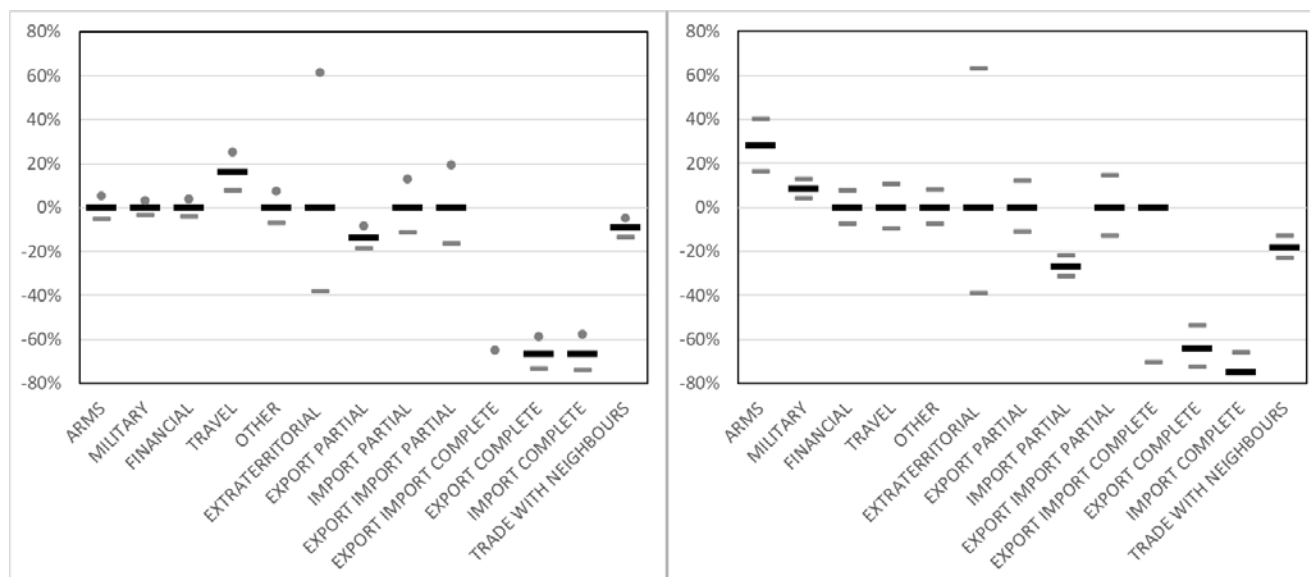
We have shown examples of the impact of the extraterritorial sanctions on trade, including some firm-level evidence in the previous sections of this report. However, it has to be noted that statistically, the extraterritoriality of sanctions does not add any visible additional negative effect to the macroeconomic impact of sanctions, nor does it appear to have any general additional impact on aggregate trade flows.

⁵⁶ The methodology follows Felbermayr et al. (2020) with an alternative trade dataset (source: CEPII).

⁵⁷ From the technical point of view, it is impossible because the current state of the art in estimation of gravity models requires introduction of both destination- and country-specific time variables, which account for variation of all country-specific time-variant observed and unobserved factors affecting overall trade of both senders and targets. This way, if we observed an increase in trade with other partners, this may not be due to trade diversion but also other factors, such as changing overall economic activity etc.

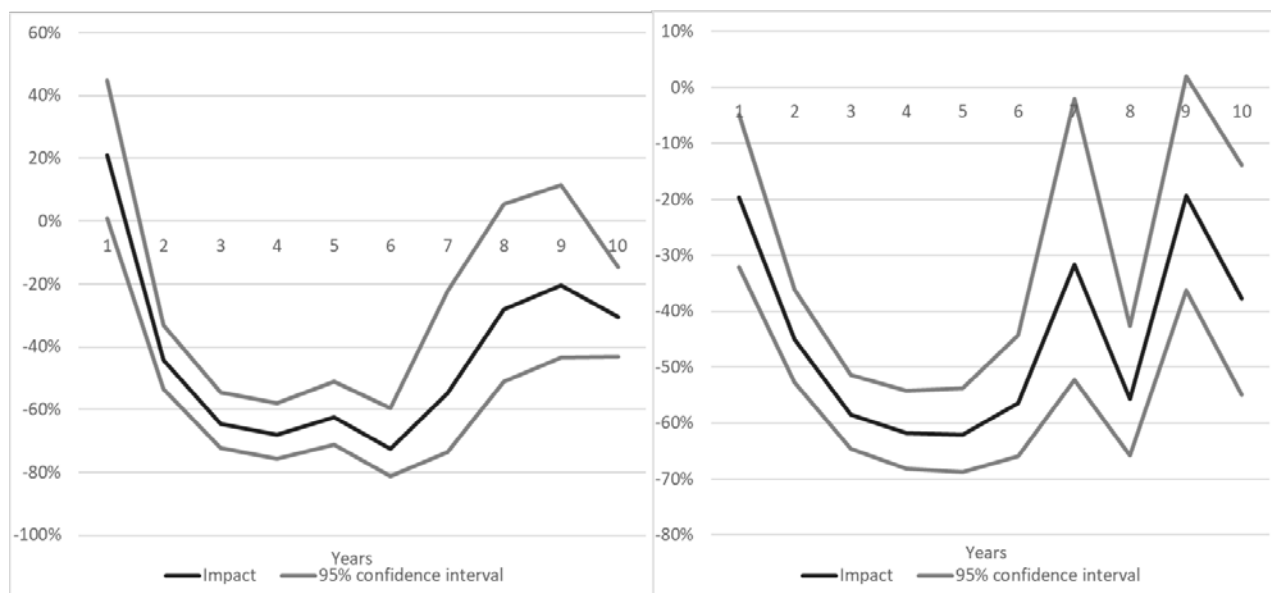
⁵⁸ In order for evidence of trade redirection, in particular the one that is aimed at avoiding sanctions, we look for changes in trade of the targets with their neighbours that are not subject to sanctions at the same time the sanctions are introduced to the target (variable “trade with neighbours”). If trade is redirected through neighbouring countries, we should observe a positive effect, i.e., some trade would be redirected towards/from the immediate neighbours. We do not see this effect. In fact, trade with not sanctioned neighbours decreases, which may be due to second round effect of suppressed economic activity or breaking of supply chains (i.e., sanctions on exports reducing demand for imports of inputs, sanctions on imports leading to breaks in value chains) and therefore it is not possible to disentangle the two opposing effects.

Figure 9 Sanctions effect on exports (left) and imports (right) by sanction type



Source: Results of our own gravity model estimation. Black lines show the changes in trade associated with introduction of sanctions (%), while the grey bars show 95 % confidence intervals. There may be multiple sanction types per sanction episode. PPML estimation with pair fixed-effects and origin and destination-specific time-effects

Figure 10 Complete trade sanction effect on exports (left) and imports (right) over time



Source: Results of our own gravity model estimation. Black lines show the changes in trade associated with introduction of sanctions (%), calculates as $\exp(\text{regression coefficient})$ in years following the imposition of the sanctions and grey lines show confidence intervals. PPML estimation with pair fixed-effects and origin and destination-specific time-effects. Years following the imposition of sanctions in year 1

3 Legal assessment and responses

Economic sanctions have been widely used without much discussion about their legality. This changed, when the US introduced measures, which affect third States and their businesses, and which have been labelled as „extraterritorial“, or „secondary“ sanctions. They met with harsh criticism by the UN and various States, which prominently questioned their conformity with international law. As will be seen, such measures can indeed hardly be justified under the international law rules on the proper exercise of sovereign powers.

Sanctioning measures may also conflict with the manifold treaty obligations, which exist in view of economic activities and human rights. As the earlier complaint of the EU against the Helms-Burton legislation in WTO dispute settlement indicates, obligations under WTO law may be at stake, particularly after recent WTO jurisprudence clarified that „national security“ exceptions can hardly be seen as a „carte blanche“, which would allow States to „self-judge“ their measures. This is particularly true, if it comes to measures directed against WTO members, which are not the target of such measures. As will be seen, this does not only apply to obligations under the WTO but is also true for various other international agreements, to which the US is a party.

The legality of sanctions can be challenged by the EU, its Member States and EU businesses in a number of international courts and tribunals and before national courts. The EU and the Member States could also encourage their businesses to do so. Also, clear statements by the EU and Member States are essential with a view to the further development of customary law, as a means to take position in international discourse and to partner up with other affected States.

Ultimately, the EU and Member States have the option to take countermeasures against foreign sanctions, which are not in conformity with international law.

Beyond challenging and remedying such sanctions, the EU has options at hand to neutralize the legal effects of foreign sanctions by way of the „blocking state“. Furthermore, Measures to reduce the economic vulnerability of the EU economy and EU businesses are at hand.

3.1 “Extraterritorial” sanctions and the general international law on jurisdiction

Particularly US economic sanctions are often characterized as „extraterritorial“ to signify their incompatibility with international law. For 28 consecutive years, the General Assembly of the UN has called for a repeal of “laws and regulations, such as that promulgated on 12 March 1996 known as ‘the Helms-Burton Act’, the *“extraterritorial effects of which affect the sovereignty of other States, the legitimate interests of entities or persons under their jurisdiction and the freedom of trade and navigation”*.⁵⁹ In 2019, an overwhelming majority of 187 states supported the respective resolution, whereas only the USA, Brazil and Israel voted against it.⁶⁰ The issue also appears on the General Assembly’s agenda for its 2020 session.⁶¹ Likewise, the EU, in recital 7 of Council Regulation (EC) No 2271/96 of 22 November 1996 protecting against the effects of the extraterritorial application of legislation adopted by a third country, and actions based thereon or resulting therefrom has maintained in this context, that “the extraterritorial application [of] such laws, regulations and other legislative instruments violate

⁵⁹ UN Doc A/RES/74/7, para 2. Emphasis added.

⁶⁰ With Colombia and Ukraine abstaining and one country being absent, <https://undocs.org/en/A/74/PV.28>, p. 18; <https://www.state.gov/wp-content/uploads/2020/05/Report-Voting-Practices-in-the-United-Nations-2019.pdf> p. 24. In 2018, while only the USA and Israel voted against the resolution, 189 countries voted in favor. See: <https://undocs.org/en/A/73/PV.30>, p. 19

⁶¹ Agenda of the seventy-fifth session of the General Assembly, adopted by the General Assembly at its 2nd plenary meeting, on 18 September 2020 (agenda item 42: “Necessity of ending the economic, commercial and financial embargo imposed by the United States of America against Cuba”) UN Doc A/75/251.

international law". This highlights the concern about such practices, which is that the US measures purport to determine how business be conducted on the single market and/or how European companies and individuals should do business with third states without asking for the consent of the EU and its Member States. Thus practices do not only touch upon the EU and Member State sovereignty but also and affect those businesses and ultimately EU economic growth.

In general terms, such questions are dealt with by general public international law in terms of sovereignty. It is commonplace that every sovereign State may govern its territory and rule about persons, activities and property within these borders. On the basis of nationality, States furthermore have jurisdiction over their nationals, wherever they may be - „active nationality principle“ (Oxman, 2007). It is the fundamental principle of world order and more specifically the sovereign equality of States under Art. 2.1 of the Charter of the United Nations that all other States enjoy these powers in the same manner.

3.1.1 US economic sanctions affect the sovereignty of the EU and its Member States

A delineation of the use of sovereign powers is rather clear if executive action in the form of law enforcement, such as police measures, licensing etc. is concerned: as a matter of its sovereignty, a State may exercise such power on its territory and has to respect other State's sovereign right to do the same on their territory. On the surface, this might suggest that such measures are legal without further ado. However, as the Permanent Court of International Justice has found already quite some time ago in its landmark 1927 Lotus case, sovereignty is not only about enforcement measures but also entails the „power to prescribe“ and „the power to adjudicate“⁶² (Kamminga 2012).

Indeed, where legislation addresses business conduct abroad or activities by foreign businesses, the sovereignty of other States may be affected as well. The same holds true in case, where courts of one State deal with matters, which relate to other States and their proper power to adjudicate. In this light, the legality of the diverse sanctioning measures can hardly be judged upon simply by looking at their enforcement and where it takes place on the ground. Refusing visas, freezing assets, barring transactions and criminal prosecution can hardly be seen in isolation. All these measures are triggered by certain specific and well-defined activities and businesses which the US wants to see avoided and which are precisely described in the sanctions legislation at hand. While executing these measures in the US represents an exercise of enforcement powers, the regulatory context specifying conduct and objectives clearly represents a prescription and consequently an exercise of prescriptive powers. (Reinisch, 1996; Berger, 2016)

All these measures target foreign businesses and individuals, relate to their activities outside US jurisdiction and aim at discouraging them from conducting certain activities abroad. There is little doubt, that these measures affect the sovereignty of foreign States.

This finding can hardly be put into question by saying that the measures simply ask firm operators to make a choice between doing business in the US or elsewhere.⁶³ This overlooks, that the issue is not one of simple business choices but fundamentally one of the sovereign rights of other States and the EU, which are affected by the US which undertake to prescribe a certain conduct outside their jurisdiction. (Rensmann 2015).

⁶² *The Case of the S.S. Lotus (France v. Turkey)*, PCIJ (1927) Series A, No. 10, pp. 18-19.

⁶³ See, for instance: Remarks of Under Secretary for Terrorism and Financial Intelligence David Cohen before the New York University School of Law on "The Law and Policy of Iran Sanctions", 9/12/2012, <https://www.treasury.gov/press-center/press-releases/pages/tg1706.aspx>, last visited on 10 October 2020.

3.1.2 No established case of legitimate uses of the power to prescribe

The allocation of sovereign powers to prescribe and to adjudicate can hardly rely on the simple logic of borders as is true for enforcement powers (Crawford, 2019). Regulation and adjudication almost inevitably produce some overlap. Also, next to territorial sovereignty, other principles are relevant here, too, as is nationality (Restatement, §§ 422, 410). The legality of the exercise of prescriptive and adjudicative powers thus is about the proper allocation of sovereign spheres of jurisdiction rather than about a simple territorial delineation. The Lotus case had given States large discretion in exercising prescriptive powers regarding foreign issues. However, today, it is understood, that the exercise of prescriptive powers in cases with some foreign elements would only be permissible, where a genuine link exists between the States exercising such legislative power and the issue at hand. Several more concrete principles and situations have been identified over time, where this is the case. Economic sanctions as discussed here would be clearly permissible, if they would be covered by those principles.

- A. Under to so-called "*effects doctrine*" in international law, legislation referring to foreign conduct is permitted, where such conduct produces substantial effects within the territory of the legislating State, as is the case will restrictive business practices, which may affect the internal market (Stoll/Holterhus 2013). However, no such effects within the territory have been claimed in regard to the sanctioning measures at hand here (Reinisch, 1996; Rathbone/Jevdel/Lentz, 2013; Rensmann 2015).
- B. Furthermore, according to the well-established *passive personality principle*, a State may exercise jurisdiction to remedy harm done to its nationals abroad. The principle has been widely applied to in criminal law to prosecute certain grave crimes committed against nationals by foreigners abroad. This includes acts of terrorism, murder, infliction of serious bodily harm, the taking of hostages etc. (see McCarthy 1989; Ryngaert 2015). The principle inevitably conflicts with jurisdictional titles of other States, including such other states' jurisdiction over acts committed on their territory and their own nationals. For this reason, it has been labelled "quite likely, the most aggressive basis for extraterritorial jurisdiction" (Ryngaert 2015) and has remained controversial both in literature and practice. At first glance, the Helms-Burton legislation might look as being covered by the principle, as it purports to enable US nationals to claim compensation from persons "trafficking in confiscated property claimed by United States nationals". However, such confiscation would hardly be in line with the gravity of the crimes, that so far have been understood to justify action under the principle. Accordingly, the principle so far has been applied for measures of criminal prosecution, while the legislation at hand is about compensation for the taking of Cuban property under Cuban law. The territorial jurisdiction by Cuba and active personality jurisdiction by the EU and its Member States, is relevant in this case, too. All in all, the legislation very likely oversteps the proper limits of USA's jurisdiction under international law.
- C. In addition, it is largely acknowledged, that States may exercise their power to prescribe to protect the security of the State against conduct by foreigners or non-residents („*protective principle*"). This has been well established for cases of counterfeiting its currency or official documents, submit false statements to its officials, or attack its diplomats and for espionage. As is often mentioned, it could also cover anti-terrorist legislation. The sanctions as discussed here, however, differ significantly from these recognized example cases (Ryngaert, 2015; Rensmann, 2013). The Helms-Burton legislation does not explicitly refer to protection. The sanctions recently imposed on businesses and government officials in Germany because of the North-Stream 2 pipeline are officially said to aim to protect the „European energy security". Even when assuming, that States enjoy discretion in defining what they regard as security, it is

difficult to see, how US sanctions aiming to protecting European energy security could be justified on these grounds.

- D. Lastly, a State may exercise its prescriptive powers - even without any substantial nexus - in the area of *universal jurisdiction*, that is, to remedy „certain offenses of universal concern, such as piracy, slavery, forced labor, trafficking in persons, recruitment of child soldiers, torture, extrajudicial killing, genocide, and certain acts of terrorism“ (Restatement, §402 (1)(f) and §413). As far as they directly aim at addressing such crimes, economic sanctions would probably be legitimate. However, beyond such grave, outstanding and well established international crimes, economic sanctions could hardly be justified in this way (Reinisch, 1996; Rensmann, 2015).

As this short overview already indicates, economic sanctions can hardly be seen in line with well-established cases, where States may legislate on conduct abroad as a matter of their prescriptive powers. Given the ambiguities and remaining uncertainties in this area of international law, other legitimate uses of prescriptive powers may be argued, but would have to stand a much stricter test in view of a genuine link. This would be especially significant with regard to the US practice of „secondary sanctions“. Such measures purport to prevent third party nationals to conduct business with a target State of sanctions. As such parties and States, or the EU respectively, are not involved in the cause of the sanctions, it is difficult to see, how a substantive link could be construed.

3.2 General international law: Non-intervention

Economic sanctions may amount to a violation of the prohibition of intervention under customary international law, which prohibits interference in the internal affairs of other states and thus protects the sovereign equality of states (Kunig 2008; Carter 2011).

A violation of the prohibition of intervention, however, requires the use of coercion with a certain intensity. Whether economic sanctions are sufficient to meet this threshold is a controversial issue and depends not least on the type and scope of the measure in question. In 1986, the International Court of Justice denied the question in the Nicaragua case.⁶⁴ By contrast, the UN General Assembly has repeatedly been more open in this regard. For example, as mentioned above, an overwhelming majority of UN member states have criticized the comprehensive U.S. sanctions against Cuba for decades.

All US sanction regimes discussed in this study aim to influence the behavior not only of the sanctioned individuals and legal entities, but also of foreign governments. For instance, in the case of the North Stream 2 sanctions, the U.S. is purposefully using considerable economic pressure for the sole purpose of counteracting a structurally relevant energy policy decision taken by other sovereign states and enforcing its own geostrategic interests. It is uncertain, however, whether the type and intensity of the sanctions will reach the intensity threshold. If indeed this threshold were to be reached, the United States would not be able to justify the breach of the prohibition not to interfere. Neither has the UN Security Council approved the sanctions, nor can they be justified under the law of state responsibility as reprisals against previous violations of international law. Even the fact that the USA invokes Russian misconduct does not change this: Russian misconduct would not justify countermeasures against European companies, but only against Russia itself.

⁶⁴ *Militarv and Paramilitary Activities in und against Nicaragua. (Nicaragua v. United States of America)* Merits, ICJ Reports 1986, para 245.

3.3 Sanctions and State responsibility

Economic sanctions may also and separately be justified to unilaterally remedy a violation of a rule of international law under the general international law rules on State responsibility. The violation of territorial integrity, self-determination and the principle of non-intervention in the case of Crimea are an example at hand. The EU sanctions against Russia are aimed to react to this breach of international law and to induce Russia to comply with its international obligations.⁶⁵

Indeed, a State which suffers an injury may take measures against a State which is responsible for an internationally wrongful act in order to induce that State to comply with its obligations. This is stated by Art. 48 of the 2001 Draft Articles on State Responsibility of the International Law Commission⁶⁶, which is understood to accurately reflect customary international law on the issue. Member States can rely on this rule, when they are affected by sanctions.

According to Draft Art. 54, also „States other than the injured State“ may take „lawful measures ... in response to breaches of obligations for the protection of the collective interest or those owed to the international community as a whole.“ As the International Law Commission (ILC) has made it clear in its commentary on the provision, „The article speaks of “lawful measures” rather than “countermeasures” so as not to prejudice any position concerning ((those)) measures.“ In all, these rules do not prevent the EU and its Member States to impose sanctions, which aim at remedying breaches of international law. According to the statement of the ILC, their legality remains to be an open question.

It is clear from these provisions, that measures are to be directed against the State responsible for the violation of international law and must be proportional.

All in all, under the emerging customary international law on State responsibility, sanctions against a State responsible for a violation of international law may be justified. Conversely, State responsibility does not justify sanctions taken for other foreign policy objectives and cannot justify “extraterritorial” sanctions, which affect third States. To the contrary, any of these measures might entail State responsibility and ultimately justify counteractions.

Besides, States can respond to actions by other States by way of taking unfriendly acts, which do not conflict with international law. This might include, for instance, to restrict cooperation in security, cultural or economic matters or the restrain diplomatic or consular activities. This right to retorsion can be exercised for a wide variety of foreign policy considerations.

3.4 A distinct right to sanctions, including extraterritorial ones

Beyond the various justifications discussed above, a more general right to take sanctions is sometimes put forward. Indeed, sanctions may be taken on the basis of a binding decision of the UN Security Council, as envisaged by the Charta of the United Nations. However, neither the Charta, nor any other international agreement spell out a right to impose sanctions unilaterally. It is equally doubtful, whether a rule of customary international law exists, which could generally justify unilateral sanctions. Although economic sanctions are applied quite frequently in State practice, it is highly doubtful, whether a consistent *opinion iuris* can be established in this regard. This is considered very much an open question (White, 2015; Pellet/Miron 2013; Pellet 2015).

⁶⁵ See Council Decision 2014/145/CFSP of 17 March 2014 concerning restrictive measures in respect of actions undermining or threatening the territorial integrity, sovereignty and independence of Ukraine.

⁶⁶ Text adopted by the International Law Commission at its fifty-third session in 2001 and submitted to the General Assembly as a part of the Commission's report covering the work of that session (A/56/10), see also Yearbook of the International Law Commission, 2001, vol. II, Part Two, as corrected.

However, even if it were to exist, such potential right to sanctions could hardly justify extraterritorial economic sanctions as discussed here. A potential right to sanctions is about using economic pressure to persuade a State to change its conduct. The extraterritorial dimension is about whether a State may interfere with the sovereignty of a third State by prescribing business conduct in an attempt to second its sanctions vis-à-vis the target State of sanctions. It affects the sovereignty of potentially quite a few States and their businesses almost accidentally and without any relation to the initial cause of the sanctions. This important legal difference is echoed in the critical reactions of the UNGA, the EU and a whole number of States on US extraterritorial sanctions as has been mentioned above and as will be further seen below. It is notably also reflected in US legal terminology and concepts as signified by the term “secondary” sanctions as opposed to “primary” ones. Consequently, a justification for such “extraterritorial sanctions” or: “secondary” sanctions would have to rely on a distinct rule of customary international law. So far, “extraterritorial” or “secondary” sanctions have been primarily imposed by the US and met with quite some critical reactions from around the world. In these circumstances, it is difficult to see a customary rule being established by general practice of States and a related *opinion iuris*. This is particularly worth noting, as with emerging standards of scrutiny applying to the national security exception, it becomes increasingly difficult to particularly justify “extraterritorial” or “secondary” sanctions.

3.5 Conformity with WTO obligations

It must not be forgotten that economic sanctions might also contravene the USA’s treaty obligations. Economic sanctions target businesses and business conduct, by refusing visa, freezing assets and blocking transactions. All these activities are covered and regulated by various international agreements to which the US and the EU and its Member States are parties, including WTO law, other economic agreements and human rights instruments. The law of the WTO, which consists of a set of interconnected treaties, is of particular importance in the case of economic sanctions, as it sets out a number of commitments concerning international trade between WTO members.

At the outset, Members of the WTO, including the USA, have committed to refrain from quantitative restrictions on imports as well as of exports by virtue of Art. XI of the General Agreement on Tariffs and Trade (GATT). The refusal of export licenses as envisaged by US sanctions legislation, such as CAATSA, conflicts with this obligation. As far as trade in services are concerned, WTO members must allow for the movement of natural persons in diverse service sectors regarding which they have assumed special commitments⁶⁷ (Art. XVI(1) GATS and its footnote 8). Furthermore, under Art. XI GATS, a Member shall not apply restrictions on international transfers and payments for current transactions relating to its specific commitments in the areas of trade in services. The freezing of assets and the blocking of financial transactions are likely to be in conflict with this obligation. As they target the trade in goods and services with specific other members of the WTO, US sanctions are also likely to additionally conflict with the obligation to grant most-favored-nation treatment as enshrined in Art. I:1 GATT and Art. II GATS.

WTO law contains exceptions, allowing WTO members to take measures that would otherwise conflict with their obligations under WTO law in order to attain certain regulatory or policy goals. The most important are so-called national security exceptions, contained in Art. XXI GATT and similarly in Art. XIVbis GATS. Under GATT Art. XXI lit. b, “[n]othing in this Agreement shall be construed ... (b) to prevent any contracting party from taking any action which it considers necessary for the protection of its essential security interests (i) relating to fissionable materials or the materials from which they are

⁶⁷ The schedule can be accessed here: https://docs.wto.org/dol2fe/Pages/FE_Search/FE_S_S009-DP.aspx?language=E&CatalogueIdList=17945,23569,20307,8373&CurrentCatalogueIndex=3&FullTextHash=&HasEnglishRecord=True&HasFrenchRecord=True&HasSpanishRecord=True

derived; (ii) relating to the traffic in arms, ammunition and implements of war and to such traffic in other goods and materials as is carried on directly or indirectly for the purpose of supplying a military establishment; (iii) taken in time of war or other emergency in international relations”.

In the past, the USA, Russia and other States have argued that this entire provision was “self-judging”, i.e. that it endowed them with unlimited discretion to decide which their essential security interests are and how to protect them best (Weiß 2019). However, recent WTO jurisprudence has clarified that this is not the case. According to the 2019 Panel report in *Russia – Transit*⁶⁸, WTO Members, while remaining free to define their own essential security interests, must do so in good faith and must observe certain limits, which remain subject to review. Similarly, a state is not entirely free to determine which measures are “necessary” to protect its essential security interests.⁶⁹ With regard to similar national security exception clauses in other treaties, this position has been confirmed by the ICJ and the CJEU.⁷⁰ In particular, it must be kept in mind, that Art. XXIV lit. b GATT contains three enumerated conditions or requirements, which an action must meet to be covered by Art. XXI lit. b. As the Panel found, these requirements can and must be subjected to an objective review as they are not covered by the term “which it considers” in the first part of Art. XXI lit. b GATT, which signifies a self-judging effect. Accordingly, a trade measure, taken in the context of extraterritorial economic sanctions must objectively meet one of the requirements of Art. XXI lit. i-iii in order to be eligible for justification.

Seen from the perspective of economic sanctions, arms embargoes and embargoes of nuclear material would well qualify for justification, as Art. XXI lit. b (i) explicitly refers to “fissionable materials or the materials from which they are derived” or related services (Art. XIVbis (ii) GATS – “fissionable and fusionable materials”) or “traffic in arms, ammunition and implements of war” (Art. XXI lit. b (ii) GATT, first part).

It is more difficult to see how other sanctions may be covered by the WTO security exemptions under the condition of objective review in WTO dispute settlement. Restrictions may be allowed, if they concern trade related directly or indirectly to the supply or the provisioning of a military establishment (Art. XXI lit. b (ii) GATT, second part and Art. XIVbis (1)(b) GATS). Arguably, this is the case with the Iran sanctions, but the Helms-Burton Act and the North Stream 2 sanctions can hardly be seen in this line. The GATT and GATS security exemptions are more generous with regard to measures “taken in time of war or other emergency in international relations” (Art. XXI lit. b (iii) GATT and Art. XIVbis (1)(b)(iii) GATS). However, as the Panel explained with a view to the wording, which includes the term “war” next to “emergency in international relations”, “political or economic differences between Members are not sufficient, of themselves, to constitute an emergency in international relations for purposes of subparagraph (iii).” (para. 7.75). “An emergency in international relations would, therefore, appear to refer generally to a situation of armed conflict, or of latent armed conflict, or of heightened tension or crisis, or of general instability engulfing or surrounding a state.” (para 7.76). It is difficult to see, how the Helms-Burton Act and even more so the North Stream 2 sanctions will meet this requirement in an objective review by a WTO panel. This is particularly worth noting, as with emerging standards of scrutiny applying to the national security exception, it becomes increasingly difficult to particularly justify “extraterritorial” or “secondary” sanctions.

⁶⁸ Panel report, *Russia – Measures concerning traffic in transit*, WTO Doc. WT/DS512/R, 5 April 2019

⁶⁹ *Russia — Measures Concerning Traffic in Transit*, Report of the Panel (5 April 2019) WTO-Doc. WT/DS512/R.

⁷⁰ *Militarv and Paramilitary Activities in und against Nicaragua (Nicaragua v. United States of America)* Merits, ICJ Reports 1986, paras. 280-282; *PJSC Rosneft Oil Company v Her Majesty's Treasury and Others*, Judgment of the Court (Grand Chamber) of 28 March 2017, C-72/15, ECLI:EU:C:2017:236, paras. 111-117.

3.6 Conformity with FCN Treaties

Besides WTO law, the USA has committed to grant similar or even more extensive rights for economic operators in Treaties of Friendship, Commerce and Navigation (FCN-Treaties) (Walker 1957; Vandefelde 2017). Up to the 1950s, the USA concluded such treaties bilaterally with many western European states, including EU member states Austria, Belgium, Denmark, Finland, Germany, Italy, Ireland, the Netherlands, Spain and Sweden (Table 12 in the appendix). These FCN-Treaties are still in force today as far as matters dealt by them are not covered by European Union agreements. They contain a broad range of obligations concerning the treatment of citizens and companies from the respective other country. Under FCN-Treaties, the US assumed a broad range of obligations to facilitate and protect the economic activity of foreign nationals and companies within US territory. As will be exemplified using the US-German FCN-Treaty, the sanctions foreseen in US legislation conflict with many of these obligations. As most FCN-Treaties contain similar language, the same applies *mutatis mutandis* to FCN-Treaties concluded between the USA and other EU member states.

Under Art. II(1) US-German-FCN, the USA is under an obligation to allow free entry and sojourn of German nationals. Visa restrictions against sanctioned persons or against principal executive officers of a sanctioned entity, as foreseen in US sanctions legislation like CAATSA and PEESA, conflict with this obligation. While the USA's obligation is "subject to the laws relating to the entry and sojourn of aliens" (Art. II(1) USA-German-FCN), that exception must in itself be consistent with the overall object and purpose of the treaty, which is to promote friendly relations and commerce. In sum, it is highly questionable whether visa restrictions as foreseen in US sanctions legislation conform to obligations under such FCN treaties.

In addition, the USA may only expropriate foreign nationals for the public benefit, upon prompt, effectively realizable and full compensation and not under worse conditions than those applying to US nationals and nationals from third countries (Art. V(4) and (5) US-German-FCN). Comprehensive asset freezes, foreseen in US sanctions legislation, may be seen as a de facto or indirect expropriation and conflict with the aforementioned restrictions on expropriations under FCN-Treaties.

FCN-Treaties discipline the USA's imposition of "exchange restrictions, which are unnecessarily detrimental to or arbitrarily discriminate against the claims, investments, transportation, trade or other interests of nationals and companies [of the respective other party] or their competitive position" (Art. XII(2) US-German-FCN). "Export restrictions" include "all restrictions, regulations, charges, taxes, fees, and other requirements (...), which burden or interfere with the assumption of undertakings for, or the making of, payments, remittances, or transfers of moneys and financial instruments" (Art. XII(5) US-German-FCN). Prohibitions of transactions in foreign exchange and prohibitions of any transfers of credit or payments between financial institutions or by, through, or to any financial institution under US jurisdiction involving any interest of the sanctioned person, as e.g. foreseen by CAATSA, conflict with this obligation.

Similarly, prohibiting "US persons" to enter into certain business relations with sanctioned persons can conflict with FCN-Treaties. This applies e.g. to the prohibition to grant loans and prohibitions to invest in sanctioned persons or to buy equity or debt instruments.

FCN-Treaties contain exception clauses that are by and large similar to those contained in Arts. XX and XXI GATT (see e.g. Art. II(5) and XXIV US-German-FCN). Therefore, what has been said above about the limits and reviewability of these clauses also applies here. Some exception clauses in FCN-Treaties are drafted even narrower than those in the GATT or only apply to certain obligations assumed under the

FCN-Treaty.⁷¹ With regard to national security exceptions, international dispute settlement bodies have emphasized that a) the claimed national security interests must be “essential” and b) that the adopted measures must be “necessary” in the specific situation at hand, which may prove difficult.⁷²

3.7 International Investment Agreements

US sanctions might also conflict with international investment agreements, comprising so-called bilateral investment agreements (BITs) as well as investment chapters in regional trade agreements (Dolzer and Schreuer 2012). The USA has concluded BITs with a range of central and eastern European countries, many of which have subsequently joined the EU.⁷³ Among them are Bulgaria, Croatia, the Czech Republic, Estonia, Latvia, Lithuania, Poland, Romania and Slovakia (Table 13 in the appendix). Like FCN Treaties, BITs protect foreign nationals in the territory of the other country. As, from a certain point in time, BITs used to be concluded in lieu of FCN-Treaties, they often contain similar obligations. The scope of BITs is usually narrower than the one of FCN Treaties, focusing entirely on the facilitation and protection of foreign investment. However, as will be exemplified using the US-Czech-BIT of 1992, the relevant BITs in force nevertheless contain a broad range of obligations to facilitate and protect the economic activity of European companies in the USA. Moreover, BITs tend to spell the USA’s obligations out in more detail than FCN Treaties.

Under BITs, foreign nationals may enter and move freely within the USA for the purpose of establishing, developing, administering or advising on the operation of an investment. Moreover, investors may engage the principal managerial personnel of their choice (Art. II(3) and (4) US-Czech-BIT). Visa restrictions and expulsions of sanctioned persons conflict with these rights.

Similar to FCN-Treaties, BITs restrict the USA’s right to comprehensively freeze assets of sanctioned persons. For instance, pursuant to Art. III US-Czech-BIT, investments shall not be expropriated or nationalized either directly or indirectly except for a public purpose, in a non-discriminatory manner, upon payment of prompt, adequate and effective compensation, and in accordance with due process of law.

Moreover, BITs ensure the transferability of investment-related funds into and out of the USA without delay and using a market exchange rate (e.g. Art. V US-Czech-BIT). The envisaged prohibitions of transactions in foreign exchange and prohibitions of any transfers of credit or payments conflict with this.

Besides BITs, investor rights may emanate from regional trade agreements. At present, there is no such agreement in place between the USA and the EU. However, the USA has ratified bilateral trade agreements with a range of other countries, most of which contain chapters on the facilitation and protection of foreign investment. These chapters may work in favor of local subsidiaries of European companies that are either sanctioned themselves or are affected by US prohibitions to engage in business relations with sanctioned persons. For instance, Mexican and Canadian subsidiaries of European companies may benefit from the United States-Mexico-Canada Agreement (USMCA), a North

⁷¹ For instance, Art. XXIV US-German-FCN lacks the term “which it considers” as contained in Art. XXI GATT, which is key to the questions, whether Art. XXI GATT is self-judging.

⁷² See the narrow construction of these clauses in *Militarv and Paramilitary Activities in und against Nicaragua (Nicaragua v. United States of America)* Merits, ICJ Reports 1986, paras. 280-282; *PJSC Rosneft Oil Company v Her Majesty’s Treasury and Others*, Judgment of the Court (Grand Chamber) of 28 March 2017, C-72/15, ECLI:EU:C:2017:236, paras. 111-117.

⁷³ Note that the so-called “grandfathering regulation” allows EU member states to amend or conclude bilateral investment agreements under certain conditions. See Regulation (EU) No 1219/2012 of the European Parliament and of the Council of 12 December 2012 establishing transitional arrangements for bilateral investment agreements between Member States and third countries, OJ L 351, 20.12.2012, p. 40–46. For the review of the regulation’s implementation, see the Report (COM(2020) 134 final) from the Commission on the application of Regulation (EU) No 1219/2012 establishing transitional arrangements for bilateral investment agreements between Member States and third countries.

American regional trade agreement. The USMCA foresees a restrained version of investor-state dispute settlement (ISDS), which could notably be used by European subsidiaries in Mexico.

International investment agreements contain exception clauses, which are mostly comparable to those in the WTO and FCN-Treaties discussed above (see e.g. Art. X US-Czech-BIT). Again, with regard to security exceptions, the USA must establish that its sanctions are “necessary” to “protect its essential security interests”.

3.8 International financial law

Furthermore, the US measures are likely to be in conflict with its obligations regarding international payments and transfers under the IMF Articles and related OECD standards.⁷⁴ Under Art. VIII sections 2 and 3, IMF members shall avoid restrictions on current payments and discriminatory currency practices. The IMF articles do not contain an explicit exemption clause in view of essential security interests. However, the executive board has decided early on in the form of a binding decision on interpretation, that such issues fall outside the scope of the agreement.⁷⁵ Again here, doubts arise as to whether the national security exemptions attached to these rules will be applicable, especially so in the case of extraterritorial sanctions (Menkes, 2019). This particularly will include the standards of good faith. In this regard, the extraterritorial dimension of the sanctions will have to be considered, as they are imposed to economic actors, who are not related the cause of the sanctions and related States.

3.9 Human Rights Treaties

While the USA has been generally reluctant to ratify human rights treaties, it is a party to the 1966 International Covenant on Civil and Political Rights (ICCPR), a binding multilateral human rights treaty.

Sanctions imposed by the USA can interfere with a number of substantive human rights guarantees and particular those enshrined in the ICCPR (de Waart 2015; Lugato, 2016). The extension of sanctions to legal entities and to its principal executive officers interferes with freedom of association as protected under Art. 22 ICCPR. Freedom of association does not only protect the formation of associations of any kind, including legal entities established for business purposes, and the free internal organization, including the choice of its management and personnel. Rather, it also protects the functioning of such entities and the pursuit of their objectives, such as the engagement in economic activity, the accumulation and enjoyment of property and making of profits (Joseph and Castan 2013; Taylor 2020). Measures limiting these activities, such as asset freezes, travel bans for key personnel or prohibitions of third parties to engage in businesses with a company interfere with these rights. Such an interference can only be justified if it is “necessary in a democratic society in the interests of national security or public safety, public order (*ordre public*), the protection of public health or morals or the protection of the rights and freedoms of others” (Art. 22(2) ICCPR). In essence, this amounts to a test of proportionality. Again, the USA would have to establish that economic coercion through sanctions are “necessary” to attain one of the enumerated goals.

Moreover, under US sanctions legislation, targeted individuals will be listed in public reports and be included in publicly available lists of designated persons. Such public listings can amount to a violation of the right to privacy and to the protection of personal honor and reputation, as protected by Art. 17(1). ICCPR (Buszewski and Gött 2015).⁷⁶

⁷⁴ Articles of Agreement of the International Monetary Fund, 27 December 1945, 2 UNTS 39.

⁷⁵ IMF Executive Board, Decision no 144-52/51 of 14 August 1952.

⁷⁶ See HRC, Sayadi and Vinck v. Belgium, para. 10.12 et seq.

Imposing sanctions directed against nationals of certain countries only can also amount to a discrimination on grounds of national origin, prohibited by Arts. 2(1) and 26 ICCPR.

3.10 EU responses

Challenging the legality of measures in international and national courts and tribunals

A first response is to bring US sanctions before national or international dispute settlement mechanisms. Some of these dispute settlement mechanisms can be activated by the EU and/or its member states, whereas others can be activated by affected EU citizens and companies themselves.

Dispute Settlement Mechanisms open to the EU and its Member States

- A. WTO Dispute Settlement: Affected WTO members, such as the EU, may seek redress for violations of WTO rules by other members by means of WTO dispute settlement. After conducting consultations, an affected member may ask for the establishment of a panel, which will give findings and recommendations on the issue. If a WTO member fails to bring its measures in conformity with the recommendations, the complaining member may ultimately call for the authorization to suspend its obligations against such Member.

The European Union had already brought a complaint to the WTO after the adoption of the Helms Burton legislation in 1996. After the parties reached a mutually agreed solution, the authority of the Panel elapsed.⁷⁷ Now, that the current US administration has lifted the presidential veto against the application of parts of the legislation, a new complaint can be brought. In substance, the crucial question of the self-judging character of the national security exemption has been explicitly ruled upon by the Panel on Russia - Transit⁷⁸ in a way, which would support a claim by the EU.

It should be noted that the current impasse of the Appellate Body of the WTO forecloses an appellate review but does not affect a panel procedure and the authorization of suspensions. It should further be noted that in case of the abuse of a right to appeal in the present situation of impasse of the Appellate Body – an “appeal into the legal void” –, the complaining Member would be free to rely on remedies under general international law. To this end, the EP, the Council and the Commission agreed on an amendment of Regulation (EU) No 654/2014 concerning the exercise of the Union's rights for the application and enforcement of international trade rules.⁷⁹

- B. Dispute Settlement under FCN-Treaties: FCN-Treaties usually foresee intergovernmental consultations. Should these consultations fail to settle the matter, the parties can commence formal dispute settlement. Under the US-German-FCN, each party can bring the case before the International Court of Justice.⁸⁰ FCN-dispute settlement clauses have repeatedly and

⁷⁷ See WTO-Doc. WT/DS38/6, 24 April 1998.

⁷⁸ See WTO Panel report on Russia - Measures concerning Traffic in Transit (WT/DS512/R and WT/DS512/R/Add.1), 29 April 2019.

⁷⁹ “EU strengthens trade enforcement arsenal with revamped regulation”, European Commission press release, 28 October 2020, <https://trade.ec.europa.eu/doclib/press/index.cfm?id=2204>, last visited 3 November 2020. EP, INTA Committee, Draft Report on the proposal for a regulation of the European Parliament and of the Council amending Regulation (EU) No 654/2014 of the European Parliament and of the Council concerning the exercise of the Union's rights for the application and enforcement of international trade rules, 2019/0273(COD); European Commission, Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) No 654/2014 of the European Parliament and of the Council concerning the exercise of the Union's rights for the application and enforcement of international trade rules, COM(2019) 623 final of 12.12.2019.

⁸⁰ Art. XXVII(2) US-German-FCN and No. 24 of the accompanying signing protocol.

successfully been used against the USA⁸¹, but also by the USA itself.⁸² With particular regard to US sanctions regimes, there is a pending case brought before the ICJ by Iran in 2016 on the basis of the 1955 US-Iranian FCN. In its application, Iran claims that US sanctions violate several central provisions of the FCN, most of which are identical or comparable to those in FCN Treaties between the USA and European States.⁸³ In a judgment on preliminary objections raised by the USA, the ICJ found in 2019 that it had jurisdiction to entertain the case, and that Iran's application was admissible.⁸⁴

In a similar vein, those EU member states which have concluded an FCN-Treaty with the USA may bring the above said violations of FCN-Treaties by US sanctions before the ICJ.

- C. Inter-State Dispute Settlement under International Investment Agreements: International investment agreements usually contain inter-state dispute settlement mechanisms. For instance, according to the US-Czech-BIT, disputes between the USA and the Czech Republic about the interpretation or application of the BIT may be submitted to inter-state arbitration pursuant to the UNCITRAL arbitration rules.⁸⁵
- D. Inter-State Complaints under the ICCPR: Compliance with the ICCPR is monitored through a system of periodical reporting to the Human Rights Committee (HRC), an independent monitoring body established under the ICCPR and affiliated with the UN. Moreover, states may choose to accept that other states may file inter-state complaints with the HRC. Both the USA and some European states, for instance Germany, have accepted the HRC's jurisdiction regarding such complaints. Accordingly, European states could bring cases of alleged non-compliance before the HRC.

Options for EU citizens and operators

- A. Investor-State Dispute Settlement under International Investment Agreements: International investment agreements feature a powerful mechanism for ISDS. In case of (alleged) violations of the substantive investor rights set forth in the agreements, investors may directly bring claims against the USA before an international investment tribunal. The independent tribunal examines the case as to the facts and the law and, in case it determines a violation, may award compensation to the investor. The tribunal's award is enforceable against US assets within the USA and abroad.
- B. Domestic remedies before European or US Courts: European citizens and companies can commence legal proceedings before domestic courts. For one part, they can claim damages from US citizens and businesses, e.g. US banks, involved in the implementation of sanctions, before EU and member state courts, e.g. on the basis of the Blocking Statute discussed below. Moreover, EU citizens and companies affected by sanctions can bring cases before US courts. The US judiciary plays a key role in clarifying and potentially limiting the extraterritorial reach of US sanctions legislation. Although there is not yet any established case law of the US Supreme Court or the district courts on the legality of sanctions under the US Constitution, there are indications that the courts will limit the power of the US administration, both as an

⁸¹ FCN-Treaties were e.g. invoked against the USA in the *Nicaragua* and *Oil Platforms* cases, see *Militarv and Paramilitary Activities in und against Nicaragua (Nicaragua v. United States of America)* Merits, ICJ Reports 1986, p. 14; *Oil Platforms (Islamic Republic of Iran v. United States of America)* Judgment, ICJ Reports 2003, p. 161.

⁸² *Elettronica Sicula S.P.A. (ELSI) (United States of America v. Italy)* Judgment, ICJ Reports 1989, p. 15.

⁸³ See *Certain Iranian Assets (Iran v. United States of America)* Application Instituting Proceedings filed in the Registry of the Court on 14 June 2016, available at <https://www.icj-cij.org/files/case-related/164/164-20160614-APP-01-00-EN.pdf>

⁸⁴ *Certain Iranian Assets (Iran v. United States of America)* Preliminary Objections, Judgment, ICJ Reports 2019, p. 7.

⁸⁵ Art. VII US-Czech-BIT. For a similar clause, see Art. X US-Poland-BIT.

issue of deference to Congress and as a matter of the USA's international legal obligations (SWP/Lohmann, 2018, p. 8). As discussed further below, the EU and its member states should support affected EU companies to pursue lawsuits through all judicial instances in order to obtain a Supreme Court ruling clarifying the power of the US government to impose extraterritorial sanctions on them.

3.11 Countermeasures

Where there is no international dispute settlement mechanism in place, the EU or one of its member states can resort to the general law on state responsibility, an area of customary international law restated in the International Law Commission's Articles on the Responsibility of States for Internationally Wrongful Acts of 2001.⁸⁶

Under general international law, the USA are obliged to cease any breach of international obligations towards the EU and EU member states and to make full reparation for any injury arising from the breach.⁸⁷ Such reparation may include restitution, compensation and satisfaction.⁸⁸

If the USA refuses to cease the violation or to make reparation, the EU and its member states may resort to countermeasures. Countermeasures are means to induce the injuring state to comply with its obligations under international law.⁸⁹ In order to induce the injuring state to comply, the state may also adopt countermeasures that would otherwise violate its own international obligations towards the injuring state. International law leaves the choice of countermeasure to the discretion of the state adopting it. Still, countermeasures must remain proportionate and must not involve the threat or use of military force.⁹⁰

Importantly, the right to take countermeasures does not relieve a state from complying with obligations assumed under dispute settlement mechanisms.⁹¹ Thus, for example, the EU and its member states may not impose retaliatory tariffs on US goods without resorting to WTO dispute settlement first.

As seen above, US sanctions and their implementation are partially incompatible with customary international law and are likely to violate treaties the USA has ratified. Unless special dispute settlement procedures apply, the EU and its member states may react to these violations by adopting commensurate countermeasures of their choice in order to induce the USA to comply with its international obligations.

Among the available countermeasures, economic countermeasures tend to be the most impactful. However, as far as retaliatory tariffs and other trade measures are concerned, the EU must observe its obligations under WTO law, notably the obligation to refrain from such measures unless and to the extent authorized by the WTO dispute settlement bodies. Therefore, directly imposing retaliatory tariffs as countermeasures would in many instances conflict with WTO law. Still, some agreements on issues of trade or investment do not fall within the purview of the WTO dispute settlement system.⁹²

⁸⁶ The ILC Articles only concern the international responsibility of states and thus do not concern invocations of state responsibility by the EU. In 2011, the ILC published a 'sister document' to the 2001 Articles on the responsibility of international organizations, the 2011 Draft Articles on the Responsibility of International Organizations (DARIO). The DARIO by and large contain comparable rules.

⁸⁷ Arts. 30 and 31 ILC.

⁸⁸ Art. 34 ILC.

⁸⁹ Art. 49(1) ILC.

⁹⁰ Art. 50(1) and 51 ILC.

⁹¹ Art. 50(2)(a) ILC.

⁹² See the list of covered agreements in Art. 1(1) DSU and its accompanying Appendix 1. One example of an agreement not subject to WTO dispute settlement is the 2017 Bilateral Agreement between the European Union and the United States of America on prudential measures regarding insurance and reinsurance, signed 22 September 2017, entered into force 4 April 2018, OJ L258, 06/10/2017, p. 4.

Suspension of concessions under these agreements may therefore be a lawful way of retaliating against US sanctions.

One other avenue is to suspend the performance of other agreements the EU or one of its member states have concluded with the USA. Many of these agreements do not foresee specific mechanisms of dispute settlement and may thus be legitimate candidates for retaliatory suspension. There are numerous agreements in place, and for each of which it should be considered in detail whether and to what extent retaliatory suspension would be an option. One could for instance think of suspending collaboration in the transmission of information and data. As a general issue, however, it needs to be borne in mind that the EU and its member states may have a genuine own interest in the continued performance of these agreements.

Finally, the EU and its member states could use leverage to retaliate against US citizens and companies. For example, the EU and Belgium could pass and implement legislation temporarily excluding US banks and other financial institutions from SWIFT, one of the leading worldwide banking communication systems. SWIFT is incorporated under Belgian law and thus subject to Belgian and EU jurisdiction and laws. In the past, SWIFT excluded Iranian banks from its system, pursuant to EU sanctions legislation. Although affected US banks would arguably be able to find workarounds, their exclusion will nevertheless increase transaction costs and, in turn, economic pressure. This pressure, combined with exposure from the Blocking Statute (see below), could induce more banks to apply for waivers from US sanctions legislation or to pass on the pressure to the US government. Negative side-effects, such as a loss in confidence in the SWIFT system and the promotion of competing communication systems, must be borne in mind.

3.12 Generally Available Responses

Besides the responses discussed to this point, state sovereignty allows certain reactions to US sanctions without the need to meet further legal requirements. These include, for instance, formal protests, expulsion of diplomatic personnel and other diplomatic reactions. Also included are responses amounting to so-called 'unfriendly behavior' (or retorsion), as long as they do not compromise compliance assumed international obligations. Furthermore, the EU may halt ongoing procedures, e.g. the ratification of recently signed agreements, in order to create leverage. Similarly, the EU may terminate the provisional application of agreements. Examples for both are the 2017 amendments to two EU-US agreements on certain issues of civil aviation.⁹³ Again, however, the EU would have to carefully consider own exposure and its own interests in these agreements.

3.12.1 Responses countering the legal effect of US measures

The EU has in the past responded by counter-legislation intended to nullify the effects of US extraterritorial sanctions. Notably, it has enacted the aforementioned so-called Blocking Statute (Council Regulation (EC) No 2271/96). The Blocking Statute was enacted in 1996 as a response to US sanctions against Cuba, Libya and Iran. The Blocking Statute enlists certain pieces of US sanctions legislation in its Annex. Against these US laws and their implementation, the Blocking Statute foresees the following measures:

⁹³ Amendment 1 to the Agreement on cooperation in the regulation of civil aviation safety between the European Community and the United States of America, signed 13 December 2017, OJ L11, 16/01/2018, p. 3; Amendment 1 to Memorandum of Cooperation NAT-I-9406 between the United States of America and the European Union, signed 13 December 2017, OJ L90, 06/04/2018, p. 3.

- European citizens and enterprises whose economic and financial interests are directly or indirectly affected by the enlisted US sanctions legislation enlisted in the blocking statute's Annex are required to inform the Commission within 30 days about these effects.⁹⁴
- Foreign court rulings based on the enlisted US laws (i.e. primarily US judgments) are not recognized or enforced in the EU.⁹⁵
- Prohibitions emanating from enlisted US sanctions laws may not be observed.
- EU individual and companies may recover damages caused by the extraterritorial application of the enlisted US sanctions laws.⁹⁶
- EU member states must foresee effective, proportional and dissuasive penalties for breaching the Blocking Statute.⁹⁷

These measures compel European citizens and enterprises to actively disobey US sanctions legislation. The implementation of the Blocking Statute has yielded some notable results. Recently, courts in several member states have begun to enforce the Blocking Statute more assertively.⁹⁸ Consistent enforcement is central to the Statute's effectiveness. Only if enterprises must expect that the Blocking Statute will be enforced as vigorously as US sanctions legislation, they will be inclined to align their conduct with the Blocking Statute and disobey US law. In 2018, after the USA's withdrawal from the JCPOA, the Commission updated the Blocking Statute by enacting Commission Delegated Regulation (EU) 2018/1100. The update adds US sanctions laws against Iran to the Blocking Statute's Annex, thus expanding the statute's application to these laws. The Annex could be expanded further to comprise other pieces of US sanctions legislation, e.g. those concerning Nord Stream 2.

In the Letter of Intent relating to the State of the Union 2020 address of 16 September 2020, European Commission President Ursula von der Leyen announced that a legislative proposal on an Instrument to deter and counteract coercive actions⁹⁹ by third countries would be adopted by the European Commission. The legislative proposal is expected in 2021. In addition to this anti-coercion instrument the European Commission is planning to issue in the 4th quarter of 2020 a 'Communication on Strengthening Europe's Economic and Financial Sovereignty', which may be followed up in 2021 by a proposal for a 'reinforced sanctions mechanism'.

3.12.2 Coalition-building

Besides the EU and its member states, other states are affected by US sanctions laws as well, as are companies from third states and even from the USA itself. The EU and its member states should therefore aim to build coalitions with affected states and entities to increase pressure on the USA.

A showcase for an international diplomatic coalition against US sanctions is the overwhelming international opposition against the US embargo against Cuba, which in the Helms-Burton-Act contains extraterritorial sanctions affecting individuals and enterprises from Europe and other countries. For almost 30 consecutive years, the UN General Assembly has condemned the embargo and the use of extraterritorial sanctions.¹⁰⁰ The relevant resolutions were adopted by an overwhelming majority of 187 states in 2019 and similarly high numbers in the previous years.

⁹⁴ Art. 2 Blocking Statute.

⁹⁵ Art. 4 Blocking Statute.

⁹⁶ Art. 6 Blocking Statute.

⁹⁷ Art. 9 Blocking Statute

⁹⁸ <https://www.kneppelhout.nl/actueel/the-eu-blocking-regulation-and-its-impact-on-european-companies>

⁹⁹ https://ec.europa.eu/info/sites/info/files/state_of_the_union_2020_letter_of_intent_en.pdf,

¹⁰⁰ Art. 5 Blocking Statute.

In addition, the EU should explore the possibility of forming inter- or transnational ‘asymmetric coalitions’. US sanctions are addressing (and in fact are primarily regulating) US citizens and companies. The EU could offer incentives to such companies, e.g. preferential treatment regarding market access, in exchange for using means to oppose US sanctions within the USA. The same could be considered for governments of US states which oppose the sanctions policy of the US federal government or whose economy is particularly affected by the sanctions or are particularly interested in strengthening economic ties with Europe.

Political coalitions – whether on the domestic, inter- or transnational level – will be easier to build in some cases than in others. As far as support within the USA is concerned, it must be noticed that sanction regimes like those erected against Nord Stream 2 enjoy wide support among both major US parties and beyond. In this case, coalition-building will be difficult. However, the case may be different regarding the sanctions against Iran following the USA’s withdrawal from the JCPOA. The JCPOA had the support of the Obama administration and the USA’s withdrawal was widely criticized inside the USA.

3.12.3 Providing Assistance to European Citizens and Businesses by way of diplomatic protection

Finally, and complementarily to the other options, the EU and its members should provide assistance to European citizens and businesses.

One element is to provide technical and financial assistance for companies that are being sued by US individuals and companies or being targeted by the US government for alleged breaches of US sanctions legislation. This could include establishing knowledge infrastructure like advice and information on US law and international law, which could include to employ lawyers qualified in US and international law, inter-governmental information networks on pending lawsuits and the relevant legal issues to be accessed by the EU and the member state governments, or – data protection law permitting – even affected European companies themselves. Financially, the EU could create insurance schemes or a fund to provide loans to cover litigation costs. The same technical and financial assistance could be offered to European companies actively commencing legal action before European courts against US companies, before international investment tribunals against the US government or before US companies or the US government before US courts.

The European Data Protection Board and the European Data Protection Supervisor considered the interaction between the CLOUD Act and concluded that only in very limited cases would a cloud provider be able to respond to an SCA order.¹⁰¹ This is because Art. 48 of the EU’s General Data Protection Regulation (GDPR) expressly states that a foreign court order or decision of an administrative authority, including an SCA order, will not be automatically recognised and enforced in the EU, unless there exists a bilateral mutual legal assistance treaty between a member state and the US.¹⁰² A cloud provider responding to an SCA order runs a real risk of breaching the GDPR. This in turn raises the prospect of fines of up to EUR 20 million or 4 % of annual worldwide turnover.

Added to this is the risk that the cloud provider will be in breach of contract when disclosing data under an SCA order. Under Art. 28(3)(a) of the GDPR, the cloud provider must have a contract with their customer that commits them to only disclose personal data in response to a legal request if that request arises under EU or Member State law.

¹⁰¹ Letter to the Chair of the European Parliament’s Committee on Civil Liberties, Justice and Home Affairs, 10 July 2019, available at https://edps.europa.eu/sites/edp/files/publication/19-07-10_edpb_edps_cloudact_coverletter_en.pdf.

¹⁰² The US has such MLATs in force with Hungary, Italy, Netherlands, Spain and 15 non-EU countries.

Given the potential for significant sanctions for breach of the GDPR and breach of contract, and the cloud provider's likely commercial desire to be seen a safe and respectful custodian of its customers' data, there are good reasons to believe that cloud providers would want to challenge an SCA order in many situations. This would be different if the US authorities were seeking non-personal data, such as financial information, which falls outside the protection of the GDPR. However, few orders will solely encompass non-personal data – in most cases non-personal data will be mixed up with personal data.

Moreover, the EU should seek to enhance the economic resilience of their citizens and businesses. This could comprise risk insurances against US sanctions, or assistance schemes supporting the restructuring of business models and supply chains in order to reduce exposure to US sanctions. The EU should also facilitate compliance with the Blocking Statute and potential other pieces of EU counter-legislation and should provide authoritative guidance and advice to affected European enterprises on how to comply with such legislation.

Lastly, pursuant to Art. 23 TFEU and Art. 46 EU Charter of Fundamental Rights, every EU citizen is entitled to protection by the diplomatic or consular authorities of any other member state if its own member state is not represented in the US.

One further avenue is to create mechanisms for circumvention. In the case of US sanctions imposed on Iran in the aftermath of the USA's withdrawal from the JCPOA, one response was the creation of the Instrument in Support of Trade Exchanges (INSTEX).

4 A comparative assessment of exposures and approaches

The previous parts have shed light on various aspects of economic sanctioning. To inform decisions on the future way to go for the EU in this matter and to arrive at sound policy recommendations, which stand the test of realities, some more context is required with a view on the geopolitical environment. It is important to understand, how other States, such as Japan and Canada are affected and what positions they take. Such comparative perspective is particularly warranted to see, whether the EU is particularly affected and to explore, whether there is a basis to partner in future action. Also, the EU's political will to act has to be taken into account given its vulnerabilities and considering, that transatlantic relations should not be significantly affected by EU action. As the European Parliament has recently recalled, "the EU should continue to work with the US as a partner with whom it has to find solutions to trade issues of common interest and also to threats and to trade frictions, including the extraterritorial application of laws adopted by the US which are contrary to international law"¹⁰³ On this basis options for action are discussed and political recommendations are explored.

4.1 Selected OECD countries

In order to complete the picture as elaborated so far, a comparative view is necessitated to see, whether the EU is specifically affected and to explore, whether there would be a basis for the EU to partner with other States to address US extraterritorial sanctions.

In political terms, US extraterritorial sanctions have met with clear criticism and a number of reactions. For 28 consecutive years, the General Assembly of the UN has called for a repeal of "laws and regulations, such as that promulgated on 12 March 1996 known as 'the Helms-Burton Act', the

¹⁰³ European Parliament resolution of 7 October 2020 on the implementation of the common commercial policy – annual report 2018 (2019/2197(INI)).

extraterritorial effects of which affect the sovereignty of other States, the legitimate interests of entities or persons under their jurisdiction and the freedom of trade and navigation".¹⁰⁴

The EU, Member States and a number of other OECD countries had voiced their concerns when the Helms-Burton Act was initially concluded and adopted blocking statutes, which are still applicable today (see Annex). When the current US Administration decided to lift the veto on part III, the EU, together with the Candidate Countries Turkey, North Macedonia, Montenegro, Serbia and Albania, the potential candidate Bosnia and Herzegovina as well as the EFTA and EEA countries Liechtenstein and Norway voiced their deep regret¹⁰⁵ as did Canada¹⁰⁶, Mexico¹⁰⁷, Japan¹⁰⁸, the Russian Federation¹⁰⁹, Switzerland¹¹⁰. Also, the EU High Representative/Vice President, the Minister of Foreign Affairs of Canada and the EU Commissioner for Trade issued a joint statement to consider the extraterritorial application of unilateral Cuba-related measures contrary to international law and further state: "We are determined to work together to protect the interests of our companies in the context of the WTO and by banning the enforcement or recognition of foreign judgements based on Title III, both in the EU and Canada."¹¹¹

While the economic asymmetry of US and EU trade relations is briefly covered in section 3 of this study, what stands out from this analysis is that most EU member states¹¹² are involved in economic relations to the US at the level slightly lower than other OECD members. In particular, outside EU, Mexico and Canada and to a smaller extent Korea and Switzerland¹¹³ are heavily dependent on trade relations with the US and it is certainly in their political interest to address the problem of US extraterritorial sanctions.

4.2 Assessing the magnitude of the political will to act

EU organs and institutions as well as Member States have issued clear statements on their concerns about extraterritorial sanctions and have taken action in various ways. In order to explore realistic recommendations, the political will within the EU and its magnitude should be kept in perspective. There would be some underexplored ways to intensify the EU's voice: For example, the EU Commission and Council Presidents could try to use bilateral summits of the EU with third states and international institutions to jointly address concerns and develop coordinated responses. In the same vein, Parliament could activate its delegations for relations with national parliaments of third countries and for the different joint parliamentary assemblies to develop joint efforts for challenging the sender(s) of economic sanctions. Similarly, Parliament could make use of the joint institutions of interparliamentary consultation such the Conference of Speakers and Presidents, COSAC, and the interparliamentary committee meetings to jointly address views, concerns and remedies (Maurer 2005, Maurer 2011).

¹⁰⁴ UN Doc A/RES/74/7, para 2. Emphasis added.

¹⁰⁵ Declaration by the High Representative on behalf of the EU on the full activation of the Helms-Burton (LIBERTAD) Act by the United States, press release of 2 May 2019, <https://www.consilium.europa.eu/en/press/press-releases/2019/05/02/declaration-by-the-high-representative-on-behalf-of-the-eu-on-the-full-activation-of-the-helms-burton-libertad-act-by-the-united-states/> last visited on 1 October 2020.

¹⁰⁶ Global Affairs Canada, „Government of Canada will defend interests of Canadians doing business in Cuba“, Statement by the Minister of Foreign Affairs, 17 April 2019, <https://www.canada.ca/en/global-affairs/news/2019/04/government-of-canada-will-defend-interests-of-canadians-doing-business-in-cuba.html>, last visited 1 October 2020. See also: Government of Canada, Foreign Extraterritorial Measures Act (FEMA), <https://www.justice.gc.ca/eng/rp-pr/csj-sjc/fema-eng.pdf>, last visited on 1 October 2020).

¹⁰⁷ Position of the Mexican Government on Ending Suspension of Title III of the Helms-Burton Act, Foreign Ministry-Economy Ministry Joint Press Release, <https://www.gob.mx/sre/prensa/position-of-the-mexican-government-on-ending-suspension-of-title-iii-of-the-helms-burton-act>, last visited on 1 October 2020.

¹⁰⁸ Japan: Ministry of Foreign Affairs, "Full application of Title III of the Helms Buton Act, Statement by Press Secretary Takeshi Osuga, press release, https://www.mofa.go.jp/press/release/press1e_000122.html, last visited on 1 October 2020;

¹⁰⁹ The Ministry of Foreign Affairs of the Russian Federation, Comment by the Information and Press Department on Title III enforcement of the Helms-Burton Act, 3 May 2019, https://www.mid.ru/en/kommentarii/-/asset_publisher/2MrVt3CzL5sw/content/id/3631655, last visited on 1 October 2020.

¹¹⁰ Switzerland, Statement of the Federal Council of 14 August 2019.

¹¹¹ <https://www.canada.ca/en/global-affairs/news/2019/04/joint-statement-by-eu-high-representativevice-president-federica-mogherini-minister-of-foreign-affairs-of-canada-chrystia-freeland-and-eu-commissio.html>, last visited on 1 October 2020

¹¹² Except Ireland where trade with the US contributes to over 13,7 % of GDP.

¹¹³ See Tables 9 and 11 in the Annex and the explanation of the indicators shown in section 3 of this part of this study.

Nothing would prevent Parliament from developing a legislators' network that could encourage the respective executives to explain, defend and refrain from their respective views with regard to the – likely – effects of economic sanctions.

4.3 EU vulnerability and Vulnerability to US sanctions

While our analysis in section 2 pointed to the direct vulnerability to the US sanctions in the sanctioned countries and have shown examples of the disrupted businesses, here we focus on the dependence of the EU economy on trade relations with the US that are likely to be “held hostage” when extraterritorial sanctions are imposed. Vulnerability to US sanctions depends on the ability of the US to influence economic decisions through fines on businesses or restrictions in international trade in case of non-compliance with the sanctions imposed on an important EU trade partners. In this part, we briefly characterize the nature of economic relations between EU and the US through an analysis of the bilateral trade structure. In order to take into account the intrinsic network of linkages within the global value chains, we use measures based on value added flows instead of gross trade flows because they allow for assessing the importance of bilateral trade in generating the partner countries GDP. Figure 11 shows the amount of value added (roughly equivalent to GDP) that is generated by producing goods and services in the EU28 that ultimately end up absorbed in the US final demand. These values can be understood as the contribution of exports to the US of a particular country to that country's GDP. It covers all sectors that directly and indirectly participate in production of those exported goods and services in that country. In 2015¹¹⁴ (latest available data) 3.5 % of EU GDP can be attributed to exports to the US. When looking at the geographical distribution of those gains, they are larger in countries that are more open and export more to the US. One can see that trade with the US is more important to the EU-15 than it is to the EU13 (New Member States). Out of the EU-15, apart from Ireland which is largely involved in trade in IT services, Germany stands out as a country where 4.2 % of GDP was generated through trade with the US.

On the other hand, the corresponding indicator for the EU importance to the US GDP is 2.2 % for the same period, which shows a considerably lower importance of the EU market to the US than vice versa and such asymmetry may play a big role in enforcing compliance with sanctions. Looking beyond EU at the other OECD economies (Tables 9 and 11 in the appendix), one can see, however, that the importance of US market is considerably larger not only in Canada and Mexico, but also Korea, Israel and Switzerland, with other countries at the similar level as in the EU.

As far as the product structure of trade is concerned, the bilateral involvement (large exports of value added in a particular sector in both directions) is large in many sectors with on average higher EU dependence on US market than vice versa. Some sectors tend to be particularly dependent on US markets: in chemicals and pharmaceutical products US demand is responsible for generation of 12.6 % of EU value added in that sector and in motor vehicles 11.5 % with a considerably smaller involvement in the opposite direction.

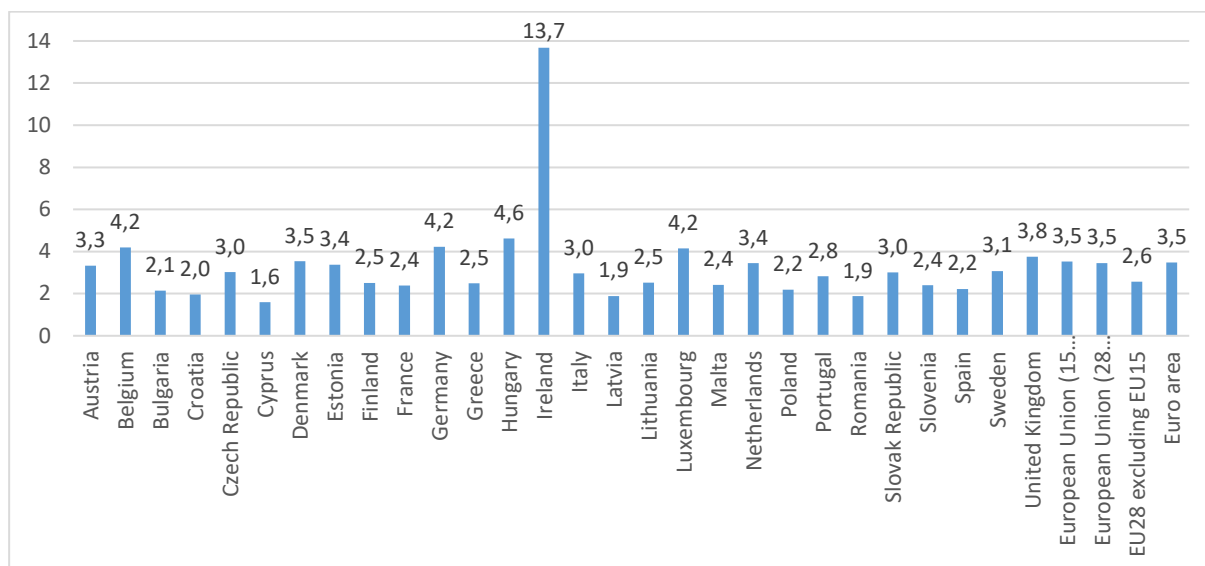
Some asymmetry is also observed in the bilateral positions in foreign direct investment. The outward EU-28 FDI stock was EUR 2.53¹¹⁵ trillion in 2018 with the inward US FDI in the EU at EUR 2.18 trillion. The bulk of US FDI is in financial services (75 % in 2017) and this is the only large category where US is a net foreign investor in the EU. In other sectors, in particular in manufacturing, EU is a net foreign investor

¹¹⁴ While these numbers may seem updated, they are calculated on the basis of international input output tables which do change over time but these structural changes tend to need a very long time to materialize. This is why we base this analysis on shares rather than absolute numbers.

¹¹⁵ All FDI data come from Eurostat

in the US with the chemical, pharmaceutical, and food industry being the largest net investors in the US.

Figure 11 EU value added exports to US as % of GDP



Source: own elaboration of OECD/TiVA. Note: the indicator is equal to: share of the VA (value added) exports from EU absorbed in the US final demand as a share in total EU VA exports multiplied by the share of VA exports in total VA generated in the EU. Data for 2015

Economic activity in the global economy also depends on the access to specialized inputs to production processes. In general, the involvement of the US in global value chains tends to be lower than on average in Europe but also the type of involvement is different. While the US uses relatively little foreign inputs in their output of goods and services, other countries use relatively large amount of intermediate goods originating in the US (low backward participation and high forward participation) while in the EU, the share of backward participation is larger – i.e., the EU is more dependent on imported inputs.¹¹⁶ However, as shown by e.g. Li et al. (2019), US and EU are distinct demand and supply hubs. In the EU hub, Germany is central to economic activity and most intermediate and final goods trade takes place with the EU-28, while the US trades mostly with other countries in the Americas and South-East Asia and with Germany, the UK and Ireland.

We use the notion of foreign value added in exports to understand the dependence of the EU on US inputs-intermediate goods. The results are presented in Table 11 in the appendix. In the EU in 2015 the value added imported from the US and used in the form of intermediate goods in production of EU exports was equal to 2.6 % and 1.6 % for the New Member States. This number may not seem very large when compared to gross exports. However, when compared to total value added sourced abroad, it certainly points to the importance of production inputs purchased in the US. For example, in the EU-15 the total value of imported intermediates is 13.4 % of the value of exports of which 2.7 pp. (one-fifth) is sourced in the US. Following Li et al. (2019), this dependence on US inputs (parts and components, intermediate services but also intellectual property) may be particularly important in the ICT sector and the services sector.

To conclude, the trade relations between EU and US are asymmetric, i.e. the EU is more dependent on the access to US final product markets (in particular in motor vehicles and pharmaceuticals) than vice versa and dependence of the EU on imported inputs is also large. EU firms also invest more in the US

¹¹⁶ See, e.g., <http://www.oecd.org/sti/ind/GVCs%20-%20UNITED%20STATES.pdf> as well as Li (2019) for comparison.

than US firms invest in the EU. While non-compliance with US extraterritorial sanctions is rather not likely to bring about a full-fledged conflict involving bilateral trade relations as, according to our analysis, the US has also a lot to lose (potentially up to over 2 % of GDP in lost exports and potentially more through limited access to imported intermediate goods plus through potential losses on US firms operating in the EU), the degree of dependence of the EU on the US through trade and FDI links certainly makes the potential disruptions of EU firms activity in the US much more costly to the EU than vice versa.

5 Conclusions and Recommendations

Drawing from the findings of sections 1 to 4 and in view of the above, a number of options can be identified and policy recommendations can be given in this regard. As already mentioned in section 3, options for action of the EU may have various directions. These include:

- Addressing the lack of legality of US sanctions
- Protection against effects of US sanctions
- Promotion of independence and resilience

Along these lines, in the following, a number of recommendations are discussed, which vary importantly in terms of effectiveness, the kind of effectiveness, time perspective and political cost. Action can largely be taken in parallel or in sequence.

a. **Voicing the lack of legality of extraterritorial sanctions coherently and – jointly**

As has been mentioned above, the European Union has voiced its position as to the lack of legality of the Helms-Burton act and its full application already together with candidate and EEA States. Also, a statement to this effect has been jointly given by the EU and Canada. Such clear statements may have an impact on the political discourse in the US but furthermore importantly send a strong signal to the international community and finally supports an urgently needed clarification of international law on the issue (Rensmann, 2015), which so far is in part unclear and in flux. It would be desirable, that the measures of the United States be countered continuously and coherently. The impact of such statements could be importantly amplified, if they would be issued jointly by the EU and other States.

We would therefore recommend that Parliament calls on the High Representative and the Commission to monitor continuously and with priority measures of the United States and other states with possible extraterritorial effects, to seek to join with other – affected - States and to make or orchestrate EU and EU+X (third states or organizations) joint statements in a consistent manner.

b. **Encourage and assist EU businesses in bringing claims in international investor-state arbitration and in US courts**

As has been pointed out, European companies may have recourse to international investment arbitration and national courts against sanctions imposed by the US or other States. In view of the impact, that foreign sanctioning measures may have for individual EU businesses, in the overall interest of enforcing international law and finally, in the interest of demonstrating the EU's determination and ability to back its businesses, such action should be welcomed and supported. In this respect, the support of the Member States by way of diplomatic protection is key. In addition, coordination and cost coverage should be considered, as is already envisaged in a similar form in the blocking regulation.

Accordingly, and referring to the criticism of the legality of foreign measures Parliament could highlight, that such remedies are at hand and may be promising. Parliament could also call on the Commission and the Member States, to support such legal action by way of diplomatic protection and

invite the Commission, to explore means of coordination and reimbursement of costs together with Member States.

c. Invite Member States to initiate inter-State dispute settlement regarding FCN treaties

As has been explained above, some of the US measures may also potentially violate FCN agreements, that the US has concluded with various member states. The question of whether possible options for dispute settlement or political intervention with the prospect of positive outcomes can be undertaken in individual cases depends on the individual case and careful examination of the relevant agreements. While these agreements had been concluded by Member States, there is an interest of the EU as a whole involved, as is reflected in Art. 351 and 352 TFEU. Undoubtedly, such measures would impact international relations and particular so also transatlantic relationship.

Parliament could consider calling on Member States to take possible steps under existing FCN treaties to address a possible breach of corresponding treaty obligations by the US as part of a response of the EU.

d. Bringing a complaint against US measures in the WTO

In view of responses which aim at challenging the legality of the US extraterritorial sanctions, WTO dispute settlement is key and one of the more critical and relevant responses. A complaint against the Helms Burton legislation could enable a WTO panel to find, that those measures cannot be justified by the national security exception in WTO law. Such findings would also be relevant for other types of extraterritorial sanctions and their consistency under WTO rules. Furthermore, and because similarly worded exemptions are common in other areas of international economic law treaties, including FCN treaties, BITs and FTAs, a report by a WTO panel can be hoped to be influential also in dispute settlement under those agreements and ultimately can more generally clarify the legal limits of the use of extraterritorial sanctions. While at the time of the 1996 EU complaint against the Helms-Burton Act in the WTO, the national security exemption was still largely considered self-judging and had never been subjected to WTO jurisprudence, there is good reason to believe, that a WTO panel will now follow the recent Panel report in Russia – Transit and engage in a review of the national security defense. Further clarification can be expected from the various Panel reports on complaints against the US tariff measures on steel and aluminum, which are due to be circulated soon.¹¹⁷ These reports will signify, to what extent the more restrictive interpretation of the national security exemption will be further manifested.

Bringing a complaint could strengthen the EU's reputation vis-à-vis the US and in the wider international community and highlight its credibility as a strong defender of the rule-based world economic system. This is particularly so, as the EU had pioneered WTO action against the Helms-Burton Act in 1996. At that time, a number of WTO members reserved their third party rights in that dispute, namely Canada; Japan; Malaysia; Mexico; Thailand.¹¹⁸ In the joint statement by the EU High Representative/Vice President, the Minister of Foreign Affairs of Canada and the EU Commissioner for Trade as mentioned above, the WTO has been explicitly mentioned.

It can be assumed that such a complaint will certainly have an impact on transatlantic relations with their current uncertainties. From today's perspective, however, it should be noted that this individual complaint only adds to a number of other WTO disputes already under way between the EU and the US, which in some case relate to equally sensitive issues.

¹¹⁷ This includes complaints by China - DS 544; India - DS 547; the EU - DS 548; Canada - DS 550; Mexico - DS 551; Norway - DS 552; Russian Federation - DS 554; Switzerland - DS 556 and Turkey - DS 564.

¹¹⁸ WT/DS38/4 of 24 February 1997.

The crisis in WTO dispute settlement, which was caused by the US refusal to elect new members of the Appellate Body, will also have to play a role in the assessment. In this respect, however, it must be pointed out that the US initiatives are directed against appellate procedure and the Appellate Body. As far as can be seen, WTO dispute settlement at panel stage is not affected by this criticism and is being used by the USA and other WTO members to the same extent as before.

The assessment would also have to take into account that an unintended negative impairment of the transatlantic relationship can be mitigated in two ways. On the one hand, the EU would be free at any time to discontinue the proceedings, as done already in 1996 after having reached a mutually agreed solution. On the other hand, the EU should seek to ensure the support of other WTO members or even arrange for them to lodge a complaint in parallel.

In light of all this, we recommend that Parliament asks the Commission to consider in a timely manner to bring a complaint against the application of Part III of the Helms Burton Act and to seek to convince other WTO members to file similar complaints or to support EU action, not least by reserving their rights as third parties in such proceedings. In doing so, Parliament could rely on its pioneering role of the EU in challenging the Helm-Burton legislation in 1996, refer to the European-Canadian joint statement and point to the recent and favorable developments in the interpretation of the national security exemption. Furthermore, Parliament might intensify its interparliamentary network towards organizing an interparliamentary coalition in this regard by referring to the existing fabric of its delegations, interparliamentary committees and assemblies. In this regard, Parliament's Committee on International Trade might consider to develop a specific, trade-related, joint committee structure, by taking into account its networks build within the Parliamentary Conference on the WTO.

e. Consider taking unfriendly acts or eventually countermeasures against illicit sanctions

The EU may respond to US sanction measures by way of retorsion and thus act in a way, which is unfavorable but lawful like for example through the planned Instrument to deter and counteract coercive actions by third countries. This includes measures in areas of relations and cooperation such as diplomatic and consular relations and cultural exchanges to name but a few. Such action often has quite some political effect, but also considerably burden transatlantic relations.

Even more, where foreign sanctioning measures clearly violate international law even countermeasures might be taken under the international law of State responsibility. Such countermeasures would considerably affect foreign relations and transatlantic relations, as the case may be. They should only be considered, where the violation of international law is clear and significant and considerably impacts the sovereignty of Member States in the EU and EU businesses and where the abovementioned other options have been tried without result. The latter will be difficult to assume in view of the fact that the other options just considered do not seem to have been exhausted. Therefore, at this stage, the application of such measures could hardly be recommended. However, it might be helpful to clearly state, that the EU is aware of this option and will consider it. Such statement may be given in context with officially taking position against undue measures as mentioned above. Thus, Parliament may consider to urge the High Representative and the Commission to clearly state, that the EU "will consider all available options" to remedy an illicit sanctioning measure. In addition, Parliament could ask the Commission to estimate the potential consequences of such measures in the form of impact assessment. Further, Parliament might consider to propose such bold statement to be accompanied by some unfavorable act.

f. Consider using SWIFT to block transactions as a sanction or countermeasure

Finally, it should be mentioned that another option - and indeed a specific countermeasure - could be the blocking of financial transactions by the SWIFT system, which is constituted under Belgian law and subjected to European legislation and has in the past been used in connection with the implementation of UN sanctions. Imposing restrictions on financial transaction undertaken by SWIFT, however, would not only place serious burdens on foreign relations and on transatlantic relations in particular. It would also entail economic effects that could also affect European businesses. Such measures should therefore be considered only in case of a grave violation of international law with important repercussion on the European Union, its Member states and EU businesses and after the application of all other options have failed. For the time being, action in this regard appears to be inappropriate. However, it might be useful to signal, that the EU is aware of this option and will take it into account in considering responses to foreign measures.

g. Countering effects of foreign sanctions by robust EU blocking legislation and enforcement by Member States

As seen, the EU has legislation in place to protection against and counteract the effects of the extraterritorial application of the laws and is planning to strengthen it through the Instrument to deter and counteract coercive actions by third countries. Regulation 2271/96 has been adapted to also cover US legislation in view of sanctions against Iran. Currently, the question arises, whether it should also be extended to cover the recent US sanctioning measures sought to halt the North Stream 2 project. Parliament should consider inviting the Commission to take steps in this direction. We will therefore look into possible straits for revision of the Commission's Implementing Regulation (EU) 2018/1101, of August 3, 2018, laying down the criteria for the application of the second paragraph of Art. 5 of Council Regulation (EC) No 2271/96 protecting against the effects of the extraterritorial application of legislation adopted by a third country, and actions based thereon or resulting therefrom. In addition, we will have a closer look at those implementing provisions of the Member States on specifying the system of sanctions established by the Regulation itself (such as, in the case of Spain, Law 27/1998, of July 13, on sanctions applicable to infringements of the rules established in Council Regulation (EC) No 2271/96 of November 22, 1996).

The full entry into force of Title III of the Helms-Burton Act on 2 May 2019 acted as a weather bell for the claims which could arise against, inter alia, Spanish citizens with interests in Cuba. The antidotal EU Regulation No. 2271/96 and its implementing legislation (cf. Commission Implementing Regulation (EU) 2018/1101) was intended to block the extraterritorial effect produced by the US. The EU legislation was supplemented by provisions of the Member States, focused, in particular, on specifying the system of sanctions established by the Regulation itself. In the case of Spain, those provisions are provided in Law 27/1998.

The Commission and, in the case of Spain, the State Secretariat for Trade (Art. 2.2 Law 27/1998) may require the person affected to provide all information which he considers relevant within a period of 30 days from the date of the request.

Art. 5 of Regulation 2271/96 forbids the persons mentioned in Art. 11 of the Regulation to comply, directly or through subsidiaries or intermediary persons, with the requirements or prohibitions provided in the Helms-Burton Act. This prohibition also includes the possible requests of foreign courts based on that Act. However, the Commission may authorise full or partial compliance with the US extraterritorial legislation when it is considered that non-compliance may seriously damage the interests of the private individual or of the EU itself (Art. 5.2). The Commission will be assisted by a

Committee formed by representatives of the Member States and chaired by the representative of the Commission.

The procedure for obtaining such authorisations is governed in detail in Implementing Regulation 2018/1101. Applications, duly reasoned, shall be sent to the European Commission and, specifically, to the Service for Foreign Policy Instruments (FPI, co-located with the EEAS). Art. 4 of Regulation 2018/1101 contains 14 non-exhaustive and non-cumulative criteria which may be taken into account when assessing applications. The above-mentioned provision grants a considerable degree of flexibility to the Commission and, in any event, the final criterion listed contains a closing clause which permits consideration of any other relevant factor to prove the existence of serious damage to the private individual or to the EU itself, if the provisions of the Helms-Burton Act are breached.

In the event of a breach of the obligations or prohibitions imposed by the Regulation, the latter provides for the imposition of sanctions, although it leaves it in the hands of each Member State to specify them. An element of the Spanish legislation (Art. 4.2) to be taken into account is that in cases in which the interests of a legal person are affected, the legal person and the directors of the company will be jointly and severally liable. The sanctions provided in Law 27/1998 (Art. 5) are ranked as: minor, serious or very serious. The amount of the sanction must be determined in view of the extent of the economic or financial interests affected and ranges from €1,502.53 to €60,101.21. However, the amount may be greater if the economic or financial interests affected exceed €6,010,121.04. In these cases, the serious infringement may be penalised by a greater fine, in proportion to the economic or financial interests involved, up to a maximum of €601,012.10. In addition, (Art. 7), provision is made for the possibility, apart from the sanctions outlined, for the imposition of penalty payments, following a warning, in cases in which the persons required to supply information to the European Commission or to the State Secretariat for Trade fail to comply with such requests. The overall maximum amount of the penalty payments will be €30,050.61.

According to Art. 4 of Regulation 2271/96, judgments of courts or tribunals and decisions of administrative authorities located outside the EU giving effect, directly or indirectly, to the Helms-Burton Act or to actions based on or resulting from it, shall not be recognised or be enforceable in any manner in the EU. By this countermeasure it is sought to safeguard from the Helms-Burton Act assets located in the EU of the persons included within the scope of Regulation 2271/96.

To this must be added the prohibition provided in Art. 5.1 of the Regulation of compliance with requests of foreign courts which are hearing proceedings arising from the application of the Helms-Burton Act. This impedes, for example, compliance with notices or requests for taking evidence which originate in such courts. Law 27/1998 considers the breach of this prohibition as a serious infringement (Art. 3.2). However, it should be remembered that it is possible to request the relevant authorisation from the Commission to avoid this prohibition.

Art. 6 of the Regulation grants to the persons included within the scope of Regulation 2271/96 a right of action to obtain compensation for any damage, including procedural costs, which is caused to them as a consequence of the application of the Helms-Burton Act. By this countermeasure it is sought to counteract the claims which may be commenced under Title III of the Helms-Burton Act, legally classifying as compensable damage any consequence which may arise from such application; by means of the counterclaim scenario.

h. Improving INSTEX

Establishing INSTEX has been an important step in protecting EU businesses and to make the EU economy more resilient in facilitating transactions by EU businesses, which fall in the ambit of US extraterritorial sanctions. In view of US dominance in the world economy at large, it could not be expected, that this instrument would change business realities and attitudes immediately. Indeed, so far, INSTEX has been used only in a fairly limited number of cases.

i. Promote the EURO to take a larger role in the international financial system

Given the centrality of the US to the global economic system – and, more importantly, the role of the US dollar as the global reserve currency – states have been loath challenge US sanctions directly, with most of the circumvention coming at the firm level (and even then, as shown in Part B very infrequently). The idea of circumventing the power that US sanctions have via other means, however, has been a persistent one in European policy circles (European Commission 2018), with an emphasis on first attempting to dilute the dollar (if not supplant it) by strengthening the international role of the EUR. In theory, if the EUR were more utilized as a basis for transactions globally, it would weaken the US ability to impose effective sanctions; simply put, given that most of the world deals in dollars, even if not directly working with US firms (Gopinath [2015] estimated that 80 percent of dollar-denominated imports never reach the US), the consequences of crossing the United States by violating sanctions are much higher.

The idea has some elegance behind it, especially when one considers that the role of the EU as a combined entity in international trade and finance is fairly similar to the US. Indeed, together the EU and the US account for nearly half of global GDP, while the US represents 11.2 percent of all global exports and 17 percent of global imports (in 2018), compared to 15.6 percent of global exports for the EU and 15.2 percent of global imports. This similar heft provides an argument that the euro should be more accepted in global transactions, providing both a counterweight to dollar dominance but, perhaps more reasonably, offering firms a variety of choices in their financing and invoicing decisions. Such a shift might be more beneficial for firms from a risk management perspective, but also would water down the ability of the US (or the EU, for that matter) to impose unilateral sanctions.

Unfortunately, as recently noted by Dabrowski (2020), there are several reasons why acceptance of the euro as an international currency has stalled since its inception in 1999. First, the depth of US financial markets dwarfs that of the EU, while the world's largest financial centers (including New York, London, and Hong Kong) remain outside of the EU and trade in dollar-denominated assets. Many firms have decided that access to these financial markets – and, as Dabrowski notes, the business-friendly and simpler legal regimes that accompany them – are more important than seeking out euro-denominated assets. Of course, as Sapir et al. (2018) argue, faster progress towards the Banking Union and (especially) the Capital Markets Union could alleviate some of these issues, as the greater availability of euro-denominated assets could encourage their use and, by extension, the use of the euro in trade arrangements. However, as Dabrowski (2020) cautions, the fact that euro area economies have had their public debt downgraded in recent memory provides a deterrent to markets rushing towards euro-denominated bonds. Thus, fiscal prudence and a shift away from the ECB's persistent reliance on monetary policy as a panacea for all that ails the euro area would be required in order to entice investors. In many ways, this requires not much more than a shift in domestic policies to achieve.

In addition to financial markets, currency stability is a key factor in its adoption globally (Lim 2006). Here too the euro suffers, as the dollar's dominant role in financial markets (coupled with the ready availability of US public debt) makes it more of a safe haven in times of distress, a reality which cannot be said about the euro over the past decade. Stabilizing the euro is a much more difficult task, as the

perception of the euro as inherently more volatile will require a shift of perception at the level of international investors; this requires the sort of calm which has been lost in the push to have euro area and domestic policies focused on perpetual stimulus. In fact, the tenuous nature of policymaking in the euro area, including the lack of euro area convergence (Franks et al. 2018), makes it incredibly difficult for the euro to achieve the tranquility needed for international acceptance and, as number two already (in the old American saying), the euro has to “try harder.” While completion of the Banking or Capital Markets Unions may assist in creating some breathing space for markets (financial depth usually assists with stability, at least at moderate levels, see Acedański and Pietrucha [2019]), the issues which have accompanied monetary policymaking (Hartwell 2020) and the challenges of what is patently becoming even less of an optimal currency area (Aizenman 2018) may make stability even more difficult to achieve.

In this reality, the only way in which the euro area can continue to increase the influence of the euro is in the manner it has already, namely to continue to increase the size of its own economies and foster their own linkages in international trade and finance. Much of the decision to use the dollar comes from convenience in what is essentially a network problem: private sector firms prefer the dollar because it is highly utilized, so it becomes even more utilized. In order to overcome this network problem, the euro needs to become more indispensable, i.e. the EU needs to grow and trade even more than it does now, so that firms will find themselves dealing in euro and with countries that themselves use the euro. Increasing the share of global trade will allow the EU to at least target the (large) segment of the world that uses the dollar as a denomination but does not actually deal with the United States; such a shift would also, by extension, make it more difficult for the US to enforce unilateral sanctions globally.

j. Establishing an EU agency of Foreign Assets Control (EU-AFAC)

The US Office of Foreign Assets Control (OFAC) is an agency within the US Treasury Department. It has been founded in 1950 but has been preceded by similar agencies before. OFAC is in charge for the implementation of the major US federal laws envisaging economic sanctions. It is authorized to collect fines, to freeze assets and to halt economic transactions as well as to grant exceptions, where they are foreseen in the laws and maintains lists of targeted individuals and entities. With its broad authorities, resources, this central agency is considered to make a huge difference in institutional terms in implementing and enforcing economic sanctions (Lohmann, 2019).

In the EU, the tasks at hand are different and even more demanding, as in addition to implementing the EU’s sanctions, responses to foreign economic sanctions are at stake. It should be noted, that strengthening the EU’s ability to take effective economic sanctions as a matter of its own interest will also promote its credibility as a partner in geo-strategic perspective.

Unlike the US OFAC as part of the US department of treasury, there is no EU agency at hand. Possibly, such agency could importantly promote the effectivity of EU sanctions and might even help to respond to extraterritorial sanctions employed by third countries. A careful consideration is warranted here, however, in view of the tasks and the feasibility of such EU institutional structure, in view of the relationship between the EU and its Member States and the allocation of competences, and with regard to the democratic legitimacy, accountability and parliamentary control mechanisms.

The US decision to withdraw from the JCPOA and pursue a ‘maximum pressure’ campaign against Iran has pushed the EU to find new ways to preserve economic relations with Iran and thus salvage the nuclear deal. At the heart of this issue is a group of banks that can serve as a gateway between the Iranian and European financial systems. So far, INSTEX has not solved this issue and at present there exists no European agency with the capacity to oversee such a financial channel. One idea, floated by, among others, the French Economy Minister Bruno Le Maire, is the establishment of a European version

of OFAC. Such a body, Le Maire said, would be “capable of following the activities of foreign companies and checking if they are respecting European decisions.”¹¹⁹ It would, in other words, be geared towards trade facilitation rather than restriction. This EU-AFAC could develop common standards, tools and certification mechanisms for due diligence to boost the confidence of European businesses that they are engaged in legal trade and investment. It could assist European companies seeking waivers and exemptions from the US, and act as an overall interlocutor between European companies and American authorities. An EU-AFAC could also strengthen EU legal protections for entities engaged in trade and investment with high-risk markets by developing guidelines related to a reinforced blocking regulation and by creating linkages to laws that underpin the Single European Payments Area. This would ensure that institutions within the wider European banking system could not arbitrarily deny services to gateway banks or European businesses, effectively quarantining them because of their sustained links to high-risk jurisdictions.

An EU-AFAC could therefore – theoretically at least – play a broad role in coordinating EU sanctions policy and defending the bloc’s economic sovereignty. But creating such an agency would be a challenge, not least because it would probably require Treaty change, for which no unity exists among member states, some of which are wary of undermining their significant trade and investment flows with the US, or China for that matter.

There is, frankly, more mileage in improving INSTEX, the blocking regulatory system and coordination of implementation by member states.¹²⁰

In a world of almost completely free capital flows (save for certain instances of exchange control), any regulation and supervision has to be international to be effective. Hence the role of the Financial Action Task Force (FATF) in establishing 40 key principles for the combat of money laundering and terrorist financing, in carrying out mutual evaluations of FATF members, in liaising with non-FATF members, FATF style organisations such as Moneyval, in blacklisting non-cooperative jurisdictions, in action against bank secrecy or anonymous accounts. While the EU embraces FATF’s principles, it can nevertheless find itself at loggerheads of a US Treasury Department intent on enforcing those rules – for its own political reasons (cf. Iran nuclear deal) – by way of extraterritorial sanctions.

Today, banks and other entities complete thousands of suspicious transaction reports every day, of which – due to lack of capability, capacity, or political direction – only a small number are followed up by financial intelligence units (FIUs). The European Commission and member states have come out in favour of the creation of an EU wide anti-money laundering (AML) agency.¹²¹ This, it is believed, might assist in reducing some of the cross-border coordination and cooperation issues in AML enforcement. However, it is an illusion to believe that a single agency could in the current circumstances be the sole solution. AML supervision requires the cooperation of a multitude of financial and non-financial supervisors, FIUs and law enforcement officials. In an EU context this means well over 100 entities. It raises the issue of EU competence, certainly in the law enforcement and judicial domain. An upcoming report on AML in the EU suggests that a step-by-step approach is more likely to yield results, building on the framework already put in place by European Banking Authority (EBA), and expanding this gradually, first by means of increasing effectiveness of data exchange, and possibly later with a distinct governance structure. But before acting at the EU level, member states should put their house in order.

¹¹⁹ ‘France urges Europe to push back against ‘unacceptable’ US sanctions on Iran’, France24, 11 May 2018.

¹²⁰ See E. Geranmayeh and M. Lafont Rapnouil, ‘Meeting the Challenge of Secondary Sanctions’, ECFR, June 2019.

¹²¹ See <https://www.rijksoverheid.nl/documenten/kamerstukken/2019/11/08/position-paper>. The European Parliament for its part, in resolution passed on 10 July 2020 on the Commission’s action plan, welcomed the proposed changes to the EU AML institutional structure, based upon ‘its deep concern regarding the EBA’s ability to carry out an independent assessment owing to its governance structure’. EP doc. [2020/2686\(RSP\)](#).

To be credible, however, AML policies need strong enforcement. Also here, there are many flaws. AML-related crimes are treated differently across the EU. For the “hard core” ML matters, cooperation among prosecutors remains slow to tackle cross-border cases. The recent creation of the European Public Prosecutor’s Office (EPPO) will facilitate this, but this will take time to become effective. For “soft” ML, such as tax avoidance approaches differ widely across the EU as to whether this is a crime or an administrative offence. Given the diversity of approaches and structures in the member states related to money laundering and law enforcement, turning the AML directive into a regulation may be a step forward. But only when combined with the other, above-mentioned measures.

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Annex

The sanction game

The fundamentals of the game-theoretic approach to sanctions have been proposed by Tsebelis (1990) who argued that the likelihood of failure and success of sanctions violation are significantly influenced by the interactions between the players (i.e. target and sender). The problem of sanctions is presented in Tsebelis (1990) as a standard 2x2 simultaneous game. The strategies for the first player – target country – include “violate” or “not to violate” international agreements/standards. The second player – sender country – has a choice between imposition or not imposition of sanctions. The table below shows the payoffs of each player depending on other player’s strategy.

Table 2 Sanction game

		Sender Country	
		Sanction	No Sanction
Target Country	Violate	$a_1 \ a_2$	$b_1 \ b_2$
	Comply	$c_1 \ c_2$	$d_1 \ d_2$

Note: $b_1 > d_1$; $d_2 > c_2$; $c_1 > a_1$; $a_2 > b_2$. Source: Tsebelis (1990).

Further, the game is based on several assumptions regarding the order of payoffs: (1) if the sender country decided not to sanction, the preferred strategy for the target would be not to comply with the agreements/standards ($b_1 > d_1$); (2) due to costs inflicted by sanctions for the sender, the latter would prefer not to sanction if its interests were not hurt ($d_2 > c_2$); (3) due to deterrent effects of sanctions on the target, the latter would prefer to comply with the standards and avoid sanctions rather than violate them and be sanctioned ($c_1 > a_1$); (4) when senders’ interest are violated it would prefer to react and impose sanctions rather than remain inactive ($a_2 > b_2$).

The analysis of the six sanctions scenarios presented in Tsebelis (1990) shows that the optimal strategy of each player depends on the payoffs of the opponent, rather than of their own. This implies that the players will always have an incentive to change their strategies in response to opponent’s choice, leading to an infinite cycle of responses (e.g., if the sender does not sanction, the sender violates, then target sanctions, then sender doesn’t sanction, then target violates, and so on). The game, therefore, has no pure strategy Nash equilibria as no player would choose a particular strategy with a probability of 1. Therefore, a sanction game of this form has no clear outcome. Expanding the game by including frequency of sanctions, Tsebelis (1990) further argued that the effects of the increase of the severity of sanctions led to increased frequency of sanctions enforcement, by the sender yet had little to no effect on the target country’s likelihood to comply.

Table 3 List of surveyed empirical studies

Trade	Macroeconomics	Democracy/regime change	Sanctions effectiveness
Caruso (2003)	Biglaiser and Lektzian (2011)	Wood (2008)	Dehejia and Wood (1992)
Hufbauer and Oegg (2003)	Riley and Travis (2011)	Peksen and Drury (2009)	van Bergeijk (1994)
Yang et al. (2004)	Lektzian and Biglaiser (2013)	Peksen and Drury (2010)	Dashti-Gibson et al. (1997)
Hufbauer et al. (2008)	Neuenkirch and Neumeier (2015b)	von Soest and Wahman (2015)	Pape (1997)
Neuenkirch and Neumeier (2015a)	Mirkina (2018)	Gutmann et al. (2017)	Bonetti (1998)
Hinz (2017)			Drury (1998)
Bali (2018)			Bolks and Al-Sowayel (2000)
Dizaji et al. (2018)			Hart (2000)
Kohl and Reesink (2019)			Nooruddin (2002)
Felbermayr et al. (2020)			Jing et al. (2003)
			Hufbauer et al. (2008)

Table 4 Successful sanctions (%)

	Democracy	Destabilize regime	End war	Human rights	Policy Change	Prevent War	Terrorism	Territorial conflict	Other
Trade	9.5	21.4	20.9	20.2	43.3	37.5	35.0	55.6	36.0
Financial	47.3	35.7	21.7	38.7	25.6	20.8	45.0	27.8	48.0
Arms	9.9	16.7	30.4	12.7	11.1	19.4	5.0	0.0	4.0
Travel	17.1	7.1	11.3	13.9	8.9	11.1	15.0	11.1	12.0
Military	16.2	19.0	15.7	14.5	11.1	11.1	0.0	5.6	0.0

Source: own elaboration using data from Felbermayr et al. (2020). The percentages in each column show the sanctions of a particular type in the total number of successful sanctions with a given objective.

Table 5 Estimation results: macroeconomic variables, all sanctions

	(1)	(2)	(3)	(4)	(5)
VARIABLES	GDP	GDP per capita	GDP per worker	TFP GAP	Poverty
Sanctions	-0.0142***	-0.0155***	-0.0148***	0.00217	-0.00937***
	(0.00271)	(0.00269)	(0.00258)	(0.00276)	(0.00158)
Observations	4,013	4,019	3,910	2,709	698
R-squared	0.176	0.191	0.197	0.140	0.859

Source: own estimations.

Note: Standard errors in parentheses, the asterisks denote statistical significance: *** p<0.01, ** p<0.05, * p<0.1, difference-in-differences model with entropy matching. All regressions include fixed effects and time effects.

Table 6 Estimation results: macroeconomic variables, sanction types

VARIABLES	(1)	(2)	(3)	(4)	(5)
	GDP	GDP per capita	GDP per worker	TFP Gap	Poverty Gap
sanctions	-0.00921**	-0.00953**	-0.0124***	0.00713	-0.00509
	(0.00400)	(0.00397)	(0.00382)	(0.00460)	(0.00321)
trade	-0.0343***	-0.0333***	-0.0174***	-0.0103**	0.0104***
	(0.00496)	(0.00492)	(0.00479)	(0.00514)	(0.00366)
arms	0.00107	-0.000349	0.00402	0.00492	-0.00246
	(0.00470)	(0.00467)	(0.00449)	(0.00550)	(0.00509)
military	4.02e-05	-0.000664	0.00171	-0.00780*	-0.00486
	(0.00385)	(0.00382)	(0.00367)	(0.00444)	(0.00395)
financial	0.00673	0.00475	-0.00187	0.00211	-0.0227***
	(0.00457)	(0.00453)	(0.00439)	(0.00525)	(0.00509)
travel	0.00863	0.0106*	0.00282	0.0103	0.000778
	(0.00604)	(0.00599)	(0.00577)	(0.00697)	(0.00315)
extra_sanct	-0.0179	-0.0204	-0.00173		
	(0.0188)	(0.0186)	(0.0177)		

VARIABLES	(1) GDP	(2) GDP per capita	(3) GDP per worker	(4) TFP Gap	(5) Poverty Gap
Observations	4,013	4,019	3,910	2,709	698
R-squared	0.187	0.201	0.200	0.145	0.865

Source: own estimations.

Note: Standard errors in parentheses, the asterisks denote statistical significance: *** p<0.01, ** p<0.05, * p<0.1, difference-in-differences model with entropy matching. All regressions include fixed effects and time effects.

Table 7 Estimation results: regime change

VARIABLES	(1) Democracy	(2) Democracy	(3) Polity score	(4) Polity score
sanctions	-0.0284** (0.0112)	0.0345** (0.0168)	-0.113 (0.115)	0.526*** (0.174)
trade		0.0391* (0.0212)		0.507** (0.220)
arms		-0.00890 (0.0201)		-0.332 (0.208)
military		-0.0153 (0.0163)		-0.157 (0.168)
financial		-0.202*** (0.0190)		-1.787*** (0.197)
travel		0.0518** (0.0262)		0.220 (0.271)
extra_sanct		-0.151** (0.0756)		-3.034*** (0.783)
Constant	0.467*** (0.0278)	0.495*** (0.0276)	0.746*** (0.286)	0.956*** (0.284)
Observations	3,897	3,897	3,754	3,754
R-squared	0.802	0.809	0.887	0.891

Note: Standard errors in parentheses, the asterisks denote statistical significance: *** p<0.01, ** p<0.05, * p<0.1, difference-in-differences model with entropy matching. All regressions include fixed effects and time effects. First two columns relate to regression with a democracy dummy variable as the dependent variable (linear probability model), the remaining two columns – regression with Polity score.

Table 8 Lost Revenue of European Companies due to post-2018 Sanctions on Iran

Company name	Lost revenue	Project/Description
Airbus (EU)	17 billion EUR	Delivering new planes within a contract with Iran Air
A.P. Moller-Maersk (Denmark)	Unknown	Maersk hastily exited the Iranian market upon resumption of sanctions; the firm had been hit with a EUR 3 million fine in 2010 for circumventing US sanctions and was determined to not have a repeat performance
AXA Group (France, Germany)	970,000 EUR	Losses stemming from cancelled insurance premia across Europe and in Iran
Daimler (Germany)	Unknown	Joint venture with Iranian vehicle manufacturer and dealer Iran Khodro Co to produce Mercedes-Benz trucks in Iran, including opening of a representative office in Tehran, called off
Gruppo Ventura (Italy)	2 million EUR	Ended a project for modernization of railroad outside of Tehran
PSA Group (France) and Renault (France)	850 million EUR	Joint deal to build 350,000 cars annually cancelled
Quercus (Great Britain)	550 million EUR	Solar power delivery cancelled as a result of sanctions
Siemens (Germany)	Potentially tens/hundreds of millions of euro	Siemens halted all business in Iran after the termination of JCPOA. In 2012, when sanctions were first in place, the company had a write-down of EUR 347 million, but upon lifting of sanctions in 2015, there was a one-time surge in revenue of EUR 212 million as back-orders were cleared. Total losses after 2018 could thus be between these two points.
Tenova (Italy)	7 million EUR	According to the annual report of parent company Ternium SA, revenue worth approximately USD 7.8 million was collected in Iran in 2019 from previous orders; it is likely that a similar performance would have been seen absent the sanctions.
Total (France)	4.25 billion EUR	Development of Iranian giant South Pars gas field.

Sources: Associated Press, AXA Group Annual Report 2018, Bloomberg, Financial Times, Iran Business Registry, Reuters, Ternium SA Annual Report 2019.

Table 9 Importance of the US final demand in GDP of trade partner countries (%)

Country	Share of US final demand in exported VA	Share of VA exports in domestic VA/GDP	Share of US final demand in GDP
Austria	9.4	35.2	3.3
Belgium	10.8	38.9	4.2
Bulgaria	5.4	39.3	2.1
Croatia	6.2	31.5	2.0
Czech Republic	6.9	43.6	3.0
Cyprus	4.2	38.0	1.6
Denmark	10.5	33.7	3.5
Estonia	7.6	44.3	3.4
Finland	9.7	26.0	2.5
France	10.9	22.0	2.4
Germany	13.9	30.4	4.2
Greece	11.5	21.7	2.5
Hungary	9.7	47.5	4.6
Ireland	21.2	64.6	13.7
Italy	13.0	22.9	3.0
Latvia	5.6	34.0	1.9
Lithuania	6.6	38.2	2.5
Luxembourg	6.3	65.7	4.2
Malta	4.4	54.7	2.4
Netherlands	9.9	34.9	3.4
Poland	6.6	33.2	2.2
Portugal	10.0	28.3	2.8
Romania	6.7	28.0	1.9
Slovak Republic	6.9	43.9	3.0
Slovenia	5.6	42.6	2.4
Spain	9.1	24.3	2.2
Sweden	10.1	30.5	3.1
United Kingdom	17.9	20.9	3.8

European Union (15 countries)	21.5	16.5	3.5
European Union (28 countries)	22.9	15.1	3.5
EU28 excluding EU15	7.8	32.7	2.6
<u>Euro area</u>	17.6	19.7	3.5
Australia	10.4	17.3	1.8
Canada	62.3	23.3	14.5
Chile	16.5	25.8	4.3
Iceland	14.8	39.0	5.8
Israel	31.6	23.4	7.4
Japan	22.2	14.4	3.2
Korea	18.3	30.8	5.7
Mexico	67.1	21.6	14.5
New Zealand	13.8	23.1	3.2
Norway	8.4	31.9	2.7
Switzerland	15.2	38.9	5.9
Turkey	8.5	20.0	1.7

Source: own elaboration on TiVA OECD data. VA – value added. Data for 2015.

Table 10 Bilateral importance of trade relations of trade partner countries (%)

Sector	US exported VA in EU final demand	EU exported VA in US final demand	EU final demand importance to US economy	US final demand importance to EU economy
DTOTAL: TOTAL	22.4	22.9	2.2	3.5
D01T03: Agriculture, forestry and fishing	9.7	14.7	1.8	2.3
D05T09: Mining and quarrying	18.7	20.4	4.2	5.3
D05T06: Mining and extraction of energy producing products	18.1	21.9	4.1	5.4
D07T08: Mining and quarrying of non-energy producing products	17.7	16.4	4.1	5.1
D09: Mining support service activities	22.8	27.4	4.7	5.4
D10T33: Manufacturing	18.3	23.5	4.0	7.6
D10T12: Food products, beverages and tobacco	13.0	19.8	1.3	3.1
D13T15: Textiles, wearing apparel, leather and related products	16.3	20.5	2.2	5.0
D16T18: Wood and paper products; printing	15.6	18.9	2.8	4.5
D16: Wood and products of wood and cork	15.1	15.1	2.2	3.4
D17T18: Paper products and printing	15.7	20.4	3.0	5.0
D19T23: Chemicals and non-metallic mineral products	20.2	26.7	4.3	9.5
D19: Coke and refined petroleum products	17.9	25.9	4.1	5.5
D20T21: Chemicals and pharmaceutical products	22.3	29.1	5.0	12.6
D22: Rubber and plastic products	15.2	20.1	2.9	6.4
D23: Other non-metallic mineral products	18.5	20.7	2.8	4.2
D24T25: Basic metals and fabricated metal products	14.9	20.6	3.7	6.9
D24: Basic metals	14.6	19.1	4.9	8.3
D25: Fabricated metal products	15.0	21.5	3.3	6.3
D26T27: Computers, electronic and electrical equipment	18.6	19.6	4.6	7.3
D26: Computer, electronic and optical products	19.0	21.7	4.7	8.0
D27: Electrical equipment	16.7	17.3	4.2	6.4
D28: Machinery and equipment, nec	14.7	17.0	4.9	7.4
D29T30: Transport equipment	21.4	30.4	5.8	11.7
D29: Motor vehicles, trailers and semi-trailers	10.3	31.6	1.6	11.5
D30: Other transport equipment	26.7	26.9	10.9	12.3
D31T33: Other manufacturing; repair and installation of machinery and equipment	19.7	23.9	2.3	5.6
D35T39: Electricity, gas, water supply, sewerage, waste and remediation services	19.2	20.9	1.0	2.5
D41T43: Construction	22.6	22.0	0.0	0.6
D45T82: Total business sector services	25.1	22.8	2.7	3.5
D45T56: Distributive trade, transport, accommodation and food services	18.6	20.6	2.5	4.0

D45T47: Wholesale and retail trade; repair of motor vehicles	18.9	21.1	2.5	4.1
D49T53: Transportation and storage	17.5	18.3	3.2	4.4
D55T56: Accommodation and food services	19.6	27.0	1.5	3.0
D58T63: Information and communication	26.5	22.9	2.6	3.5
D58T60: Publishing, audiovisual and broadcasting activities	25.5	31.8	3.1	4.4
D61: Telecommunications	28.3	16.4	2.5	2.1
D62T63: IT and other information services	26.9	22.0	2.0	3.7
D64T66: Financial and insurance activities	33.0	25.5	4.0	4.6
D68: Real estate activities	22.5	22.6	0.7	0.8
D69T82: Other business sector services	29.5	25.4	4.5	5.0
D84T98: Public admin, education and health; social and personal services	21.9	23.9	0.4	0.8
D84T88: Public admin, defence; education and health	21.4	24.4	0.3	0.8
D84: Public admin. and defence; compulsory social security	24.0	22.0	0.2	0.2
D85: Education	20.5	28.1	0.9	0.9
D86T88: Human health and social work	21.2	23.2	0.0	1.2
D90T98: Other social and personal services	24.5	22.1	0.6	1.0
D90T96: Arts, entertainment, recreation and other service activities	24.5	22.1	0.6	1.1
D97T98: Private households with employed persons	0.0	0.0	0.0	0.0
D05T39: Industry (mining, manufactures and utilities)	18.4	23.3	3.7	6.8
D45T98: Total services	24.9	22.9	2.0	2.7
D58T82: Information, finance, real estate and other business services	29.1	24.7	2.8	3.3
D41T98: Total services (incl. construction)	24.9	22.9	1.9	2.6

Source: own elaboration on OECD TiVA data. VA – value added. Data for 2015.

Table 11 US value added embedded in exports and total value added embedded in exports (% of total gross exports)

	Foreign VA in exports	US VA in exports
Austria	26.5	1.3
Belgium	34.1	3.4
Czech Republic	39.3	1.6
Denmark	29.3	1.6
Estonia	34.8	1.5
Finland	25.9	2.0
France	21.4	2.3
Germany	21.0	1.9

Greece	24.5	1.0
Hungary	43.1	2.2
Ireland	40.2	9.7
Italy	22.2	1.4
Latvia	22.4	1.0
Lithuania	31.6	0.9
Luxembourg	68.8	13.8
Netherlands	27.9	4.2
Poland	26.6	1.3
Portugal	28.4	1.0
Slovak Republic	44.8	1.4
Slovenia	32.5	1.3
Spain	22.7	1.4
Sweden	20.7	1.6
United Kingdom	15.1	2.1
European Union - 15	13.4	2.7
European Union - 28	12.2	2.6
EU 28 excluding EU 15	29.7	1.6
Euro area	16.9	2.9
Australia	11.6	1.6
Canada	21.2	10.0
Chile	15.1	3.0
Iceland	23.7	3.3
Israel	18.6	2.5
Japan	13.2	1.5
Korea	32.6	3.4
Mexico	36.1	13.9
New Zealand	13.8	1.6
Norway	13.9	1.4
Switzerland	24.6	3.0
Turkey	16.8	1.0

Source: own elaboration based on OECD TiVA Database value added. Data for 2015.

Table 12: FCN-Treaties between the US and EU Member States

Official Name	Contracting Parties	Signed; entered into force	Reference
Treaty of Friendship, Establishment and Navigation between the Kingdom of Belgium and the United States of America	Belgium	signed 21 February 1961, entered into force 3 October 1963	480 UNTS 149
Treaty of Friendship, Commerce and Navigation between the United States of America and the Kingdom of Denmark	Denmark	signed 1 October 1951, entered into force 30 July 1961	421 UNTS 105
Treaty of Friendship, Commerce, and Consular Rights	Austria	signed 19 June 1928, entered into force 27 May 1932	118 LNTS 241
Treaty of Friendship, Commerce, and Consular Rights	Finland	signed 13 February 1934, entered into force 10 August 1934	152 LNTS 45
Treaty of Friendship, Commerce, and Consular Rights	Germany	signed 8 December 1923, entered into force 14 October 1925	52 LNTS 133
Treaty of Friendship, Commerce and Navigation between the United States of America and the Federal Republic of Germany	Germany	signed 29 October 1954, entered into force 14 July 1956	273 UNTS 3
Treaty of Friendship, commerce and navigation between the United States of America and the Italian Republic	Italy	signed 2 February 1948, entered into force 26 July 1949	79 UNTS 171
Treaty of Friendship, Commerce and Navigation between the United States of America and Ireland	Ireland	signed 21 January 1950, entered into force 14 September 1950	206 UNTS 269
Treaty of Friendship, Commerce and Navigation between the Kingdom of the Netherlands and the United States of America	The Netherlands	signed 27 March 1956, entered into force	285 UNTS 231
Treaty of Friendship and General Relations	Spain	signed 3 July 1902, entered into force 14 April 1903	11 Bevans 628

Table 13: Bilateral investment agreements between the US and EU Member States

<u>Official Name</u>	<u>Contracting Parties</u>	<u>Signed; entered into force</u>	<u>Reference</u>
The Treaty between the United States of America and the Republic of Bulgaria Concerning the Encouragement and Reciprocal Protection of Investment	Bulgaria	signed 23 September 1992, entered into force 2 June 1994	TIAS 94-602
Treaty between the Government of the United States of America and the Government of the Republic of Croatia Concerning the Encouragement and Reciprocal Protection of Investment	Croatia	signed 13 July 1996, entered into force 20 June 2001	TIAS 01-620
The Treaty between the United States of America and Czech and Slovak Federal Republic Concerning the Encouragement and Reciprocal Protection of Investment	Czech Republic	signed 22 October 1991, entered into force 19 December 1992; amendment signed 10 December 2003, entered into force 10 August 2004	
Treaty between the Government of the United States of America and the Government of the Republic of Estonia Concerning the Encouragement and Reciprocal Protection of Investment	Estonia	signed 19 April 1994, entered into force 16 February 1997	1987 UNTS 131
Treaty between the Government of the United States of America and the Government of the Republic of Latvia Concerning the Encouragement and Reciprocal Protection of Investment	Latvia	signed 13 January 1995, entered into force 26 November 1996	TIAS 96-1226
Treaty between the Government of the United States of America and the Government of the Republic of Lithuania Concerning the Encouragement and Reciprocal Protection of Investment	Lithuania	signed 14 January 1998, entered into force 22 November 2001	TIAS 12918

<p>The Treaty between the United States of America and Czech and Slovak Federal Republic Concerning Business and Economic Relations</p>	<p>Poland</p>	<p>signed 21 March 1990, entered into force 6 August 1994</p>	<p>TIAS 94-806</p>
<p>Treaty between the United States of America and the Government of Romania concerning the Reciprocal Encouragement and Protection of Investment</p>	<p>Romania</p>	<p>signed 28 May 1992, entered into force 15 January 1994; amendment signed 22 September 2003, entered into force 9 February 2007</p>	<p>TIAS 94-115.1; amendment TIAS 07-209</p>
<p>The Treaty between the United States of America and Czech and Slovak Federal Republic Concerning the Encouragement and Reciprocal Protection of Investment</p>	<p>Slovakia</p>	<p>22 October 1991, entered into force 19 December 1992; amendment signed 10 December 2003, entered into force 10 August 2004</p>	

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