Economic Sanctions

KEITH MASKUS, UNIVERSITY OF COLORADO BOULDER

GOLDEN GATE COMPUTER SOCIETY, APRIL 25, 2022

1

Introduction: NEED

I am making this presentation on behalf of NEED, the National Economic Education Delegation.

Vision: One day, the public discussion of policy issues will be grounded in an accurate perception of the underlying economic principles and data.

Mission: NEED unites the skills and knowledge of a vast network of professional economists to promote understanding of the economics of policy issues in the United States.

NEED presentations are nonpartisan and intended to reflect the consensus of the economics profession. There are over 500 members, including 45 PhD economists, who make presentations to organizations and institutions all over the United States.

Disclaimer:

NEED presentations are designed to be nonpartisan.

It is, however, inevitable that the presenter will be asked for and will provide their own views.

Such views are those of the presenter and not necessarily those of the National Economic Education Delegation (NEED).

2

Economic sanctions: background

The massive sanctions against Russia since it invaded Ukraine in February have made them a subject of considerable interest and discussion.

But sanctions have been used for a very long time: at least since 432 BC when, according to the playwright Aristophanes (in *The Acharnians*), Pericles issued his "Megarian decree" stating that "…the Megarians shall not be on our land, in our market, on the sea, or on the continent." This trade embargo by Athens against Megara evidently had a major role in precipitating the Peloponnesian War.

Sanctions were used infrequently in the early 20th century, mostly in bilateral attempts to deter militarism (e.g., against Mussolini's invasion of Ethiopia in the 1930s).

They became increasingly more common after WW2 and during the Cold War. The primary user was the US, seeking democratic regime changes in Latin America or to prevent friendly relations of small countries with the Soviet Union. The Soviet Union deployed similar sanctions in Europe.

Their use grew rapidly after 1970 and incorporated new objectives: expanding human rights, seeking compensation for property expropriation, combating drug cartels, debilitating terrorist groups, slow down nuclear proliferation.

Economic sanctions have played a central role in US (and increasingly EU) foreign policy in recent decades.

3

Economic sanctions: background

Some well-known historical examples of US-led sanctions (and a few lessons learned):

- The trade and travel embargo against Cuba, 1960 – now. Multiple objectives that changed priorities over time, mostly aimed at removing the Castro regime and its successor. Not successful in regime change, largely due to Cuba's support from Soviet Union and other economies. Arguably it has restrained Cuba's economic development
- Trade and investment sanctions (many by private companies) against South Africa, 1984-91, aimed at removing the Apartheid system. This is seen widely as the major example of success, though many argue the regime was ready to fail on its own.
- Trade and travel embargo against North Korea, 1950 – now. Goals are to impair military/nuclear development and destabilize the government, which have largely failed.
- Olympics boycott and restraints on farm exports to USSR, 1980-81, seeking a Soviet troop withdrawal from Afghanistan. May have contributed to the ultimate withdrawal but was costly for US athletes and farmers.
- Trade, investment, and technology restrictions against Iran, 1984 – now. Multiple goals, including reducing support for terrorism and getting Iran to renounce nuclear ambitions. The 2015 JCPOA made progress in return for relaxing some sanctions, but it was abandoned by Trump Administration.

4

Recent data

The Global Sanctions Database (GSDB; https://www.globalsanctionsdatabase.com/) is a comprehensive source of data on all publicly traceable information on sanctions from 1950 – 2019.

Currently there are 1,101 sanctions episodes in the data, categorized according to:

- Types of sanctions;
- Political objectives of the sanctions;
- A measure of the perceived effectiveness of each sanctions episode, if possible.

Among the interesting stylized facts:

- Sanctions are increasingly used over time.
- Sanctions are becoming more varied, shifting from trade restrictions to financial, travel, and "smart" sanctions.
- The main objectives of recent sanctions have been related to human rights and democratization.
- The "success" rate of sanctions has fallen since the mid 1990s.

5

Definition and types

A reasonable definition is "Economic sanctions [are] the deliberate, government-inspired withdrawal, or threat of withdrawal, of customary trade or financial relations." (Hufbauer, *Economic Sanctions Reconsidered, 3rd Edition*, Peterson Institute for International Economics, 2007).

Sanctions are "sticks" trying to achieve certain foreign-policy objectives. They may be accompanied by the promise of "carrots" to encourage compliance.

It is useful to distinguish the sanctions "sender" (the imposing country, set of countries, and perhaps international organization) and the "target" country.

Types:

- Trade restrictions, boycotts, and embargoes that limit trade flows. These may be limits on exports to the target imposed by the sender or import restraints from the target imposed by the sender.
- Financial sanctions, including limits on use of the global financial system, reduced access to credit, and freezing or seizure of assets.
- Limits on exports of sensitive technologies, goods, and services to target countries.
- "Smart" sanctions aimed at individuals, firms, or organizations in target countries.

These may be used in conjunction with military and diplomatic sanctions.

6

Objectives

The objective(s) of a sanctions program may not always be clear. In fact, there may be value in hiding the true objective.

But these seem to be the main foreign-policy goals:

- Destabilize government regimes in the hope of regime change.
- Coerce target governments to change an objectionable policy, including abuses of human rights, environmental degradation, and unfair trade practices.
- Punish countries for military aggression.
- Deter future undesirable policies and aggressions.
- For the US and EU, to signal global leadership in condemning foreign misbehavior.

There are also important domestic objectives in the sender countries:

- Sanctions can express outrage on behalf of domestic residents/voters (e.g., after Tiananmen Square in China and sanctions against Myanmar).
- To prepare citizens for the potentiality of armed conflict if necessary.
- Sanctions can achieve a "rally around the flag" political benefit.

7

Why the increasing use of sanctions?

War fatigue after Afghanistan and Iraq: sanctions are seen as "doing something" without resort to conflict.

The increasingly globalized economic and financial system is thought by many analysts to be a strong reason why countries would not go to war. But it also raises the scope and diversity of potential sanctions.

Some argue that the approaching end of US global economic leadership and the breakdown of globalization is making it more likely that powerful countries such as Russia, China, and India will become more assertive with smaller countries. Sanctions may be the only available response going forward.

8

The (in)effectiveness of sanctions

The conventional wisdom among political scientists and economists is that economic sanctions are generally ineffective in achieving their goals. Why might sanctions fail to change foreign behavior?

1. A sanctions program may not be enough to impose significant costs on the target. Even very high economic costs may not deter an autocratic leader, who might manipulate the sanctions for personal gain.

2. The sender fails to achieve cooperation by other potential sanctioning nations. International cooperation is essential in the modern global economy but may be hard to achieve.

3. Other countries may support the target country through:
- Filling the trade shortfalls, circumventing the sanctions. Trade is simply diverted, not destroyed.
- Providing access to alternative financial systems. For example, Russia may take advantage of a newly developing Chinese payments system.

4. Sanctions may cement resolve in the leaders and population of target countries.

5. Sanctions may alienate foreign allies, especially if enforcement is extraterritorial.

6. They may harm domestic businesses and consumers. Businesses may dislike the uncertainty and reputation effects.

9

When might sanctions work?

Despite that skepticism, recent research finds more statistical evidence that large-scale sanctions impose significant costs on their targets, even if they may not achieve regime change or policy changes.

What characteristics make sanctions more likely for succeed?

1. The sender(s) is much larger in size than the target.

2. The sender places a higher priority on changing behavior in the target than does the target in sustaining it.

3. The sanctions are comprehensive and impose pain on the elites.

4. The sender has substantial control over access to financial systems and the target may be readily subject to financial crises or default.

5. There is sufficient international coordination to minimize the risk of circumvention.

6. There is a political opposition in the target that may be mobilized.

7. The pain imposed on domestic firms and households in the sender(s) is manageable for a sustained period.

All this suggests that designing and implementing an effective sanctions program is a highly technical and complex undertaking.

10

The US-China trade war as a case of economic sanctions

The US and China have a long history of trade cooperation and conflict, with bilateral agreements going back to the 1980s.

With China's entry into the WTO in 2001 its manufacturing exports grew massively, generating both consumer gains and large employment losses in the US and Europe.

The long-term problem: structural Chinese industrial policy and remaining protectionism. This is a very complex story but in brief:

- China consistently fails to meet basic WTO obligations.
- China's government has been strategic about how to admit foreign investment and acquire technology.
- Vast parts of China's industrial and technology sectors remain largely off limits to foreign investment and there are significant industrial subsidies paid.
- China pursues an aggressive and dynamic industrial policy aimed at global competitiveness in numerous high-technology sectors ("Made in China 2025" has alarmed policymakers and firms in US, EU, Japan.)

The Obama approach:

- Bilateral engagement and lawsuits at the WTO.
- Negotiation of the Trans-Pacific Partnership (TPP) in order to box in China on these technology issues

11

Emergence of the Trump-led trade war

Donald Trump talked about China as a major economic and security threat for a long time. And he rode to the White House based on anti-trade, anti-immigration promises.

Trump's approach to the structural Chinese problems was to think of it as a sanctions problem: higher US tariffs would hurt China enough to get the policies to change.

The process began in 2018 with some high antidumping tariffs, heavy steel and aluminum tariffs, and then several rounds of tariffs aimed at imports from China. China retaliated with its own rounds of higher tariffs. A series of bilateral talks generally got nowhere.

The outcomes of this tit-for-tat conflict:

- US tariffs on average against China rose from about 3% to 19.3%. China's tariffs on average against the US rose from 6.5% to 21.3%. These tariffs remain in place.
- The countries reached a "Phase One Agreement" that committed China to buying unrealistically high imports from the US and to reform their IP regime. They have not done any of that.
- Econometric evidence finds that the tariffs have destroyed more US manufacturing and construction jobs than they may have created, while raising prices and disrupting supply chains.
- This "lose-lose" outcome is an example of a failed and costly sanctions program.

12

The sanctions against Russia

The current sanctions had their foundation after Russia's takeover of Crimea and the Donbas region of Ukraine in 2014.

The Obama administration imposed extensive micro sanctions against specific Russian oligarchs and companies seen to benefit from the invasions. Similar, but smaller, micro sanctions were imposed by certain countries in the EU. These involved some trade sanctions, technology limits, and financial freezes.

These "smart" sanctions have been shown to be costly for the targeted firms and individuals, which lost market share and had to reorganize their businesses.

But the 2014 sanctions did not extend to country-wide trade restrictions or major financial limitations. Neither did they disrupt planning for the Nord Stream 2 pipeline, a favored project of Germany.

And they did not alter Russia's behavior at all.

13

The sanctions against Russia

Many observers argue that these relatively weak sanctions emboldened Putin to undertake his current invasion of Ukraine.

But the western response has been to erect the most comprehensive and systematic economic sanctions ever assembled:

- Coordinated across major OECD economies in type and scope.
- Trade embargoes (except oil and gas in Europe).
- Asset freezes and seizures of Russian government finances and those of Putin's closest advisors and oligarchs.
- Russian banks are precluded from using the SWIFT communication and clearing systems.
- The newest and biggest sanction: frozen access to Russia's foreign reserves held in the US and Europe. This immediately generated problems for Russia to meet debt obligations issued in dollars and euros, putting the country into a near default.

14

The sanctions against Russia

How likely is all this to work?

It's far too early to say with any confidence. And what is the US/EU definition of success?

If success means Russia withdraws fully from Ukraine, that seems doubtful given the commitment of Russia's government to achieve that security buffer.

But what would our theory and review of economic sanctions suggest?

- The pain in Russia is growing deeper and more widespread, which could raise an opposition. Some predict that Russia's real GDP could fall by 5% or more in 2022.
- While China may offer some support, it cannot offset the financial sanctions for a long time. China has other problems and priorities to deal with.
- So far, US and EU residents seem to support the sanctions but that may change if energy prices and inflation remain high.

As Russia becomes increasingly isolated perhaps these significant sanctions will "work" in the sense of getting Russia to withdraw, except for Crimea. That would seem to be a success but is far from guaranteed.

15