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# International Economics

## XIII. The Economics of International Sanctions

Leipzig University | July 1, 2024

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# XIV. The Economics of International Sanctions

1. A Classification of Sanctions
2. Economic Analysis
3. Smart Sanctions
4. Some Historical Cases
5. Conclusion

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# 1. A Classification of Sanctions

**Purpose**

- To force political change in another country – it's a kind of violence short of war

**Key Actors**

- The UN and the US
- UN Article 41: economic sanctions should be first act against rogue nations, belligerents
- US the main actor in post-war era

**Definition**

- One country's discriminatory restriction of either trade or credit flows to another country
- In an attempt to affect or reverse current policy in the sanctioned nation

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# Definitions

## Actors

- Sender: the nation / government imposing the sanction
- Target: the nation on which the sanction is imposed
- Sanction busters / "black knights": smugglers, those who trade sanctioned goods with the target or facilitate financial flows to the target

## Interventionism

- Sanctions are policies to transmit coercive economic effects from senders to targets
- Their effectiveness depends on the ability of the sender to do this

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# Categories of Sanctions

- Sanctions are analogous to trade barriers – they are similar to quotas and quantity restrictions on international flow of goods
- Key difference: intention is not protectionism but political change in the target

**Seven Dimensions of Sanctions (Galtung 1967)**

1. They either reward or punish
2. They are aimed at individuals or collectives
3. They are imposed due to internal or external actions of the target
4. They can be unilateral, multilateral or universal
5. They are general or selective
6. They are total or partial
7. Sanctions restrict a mix of the target's trade, finance and diplomatic relations

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# Import Sanctions

**Definition**

- The sender restricts the import of goods from the target
- All or only some specific imports can be restricted
- Travel sanctions are a kind of import sanction: they aim at hotels, gambling establishments and similar in the target

**Consequences**

- The sender's import market and the target's export market are affected
- Goal: cause harm to producers in target

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# Export Sanctions

## Definition

- The sender restricts the export of goods to the target
- Capital goods can also be sanctioned, in order to hurt economic growth in the target
- Especially strategic goods are subject to export sanctions: arms, high tech goods

## Consequences

- The sender export market and the target import market are affected
- Goal: cause harm to consumers in target (or to importing industries)

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# Financial Sanctions

**Definition**

- Financial sanctions target financial flows, financial entitlements to income
- The asset freeze: the sender freezes the target's financial assets in the sender country, preventing flow of income from them
  - This only works if the target has net assets in the sender country
  - If the target is on net a debtor of the sender, it can retaliate by freezing sender assets

**Consequences**

- Trade and finance are inextricably linked through the balance of payment
- Trade sanctions indirectly affect financial markets
- Financial sanctions indirectly affect goods markets

# 2. Economic Analysis

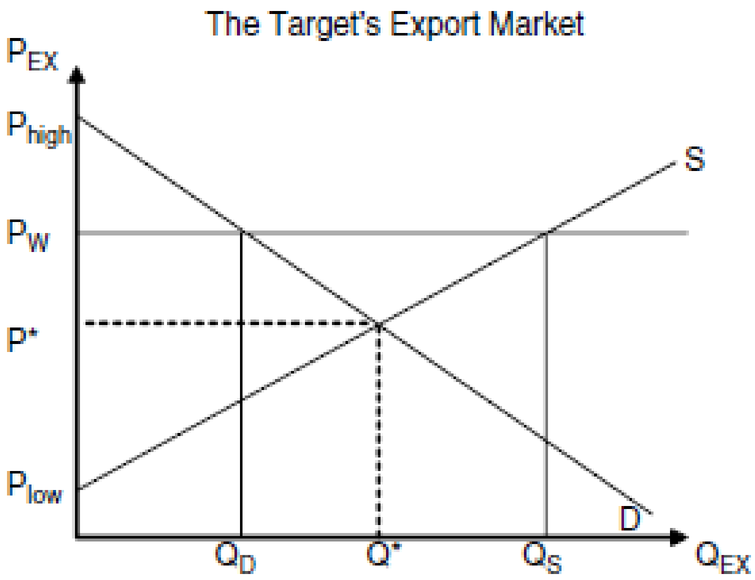
**Tools of Analysis**

- The standard tools of welfare analysis in the international market
- Balance of payments analysis

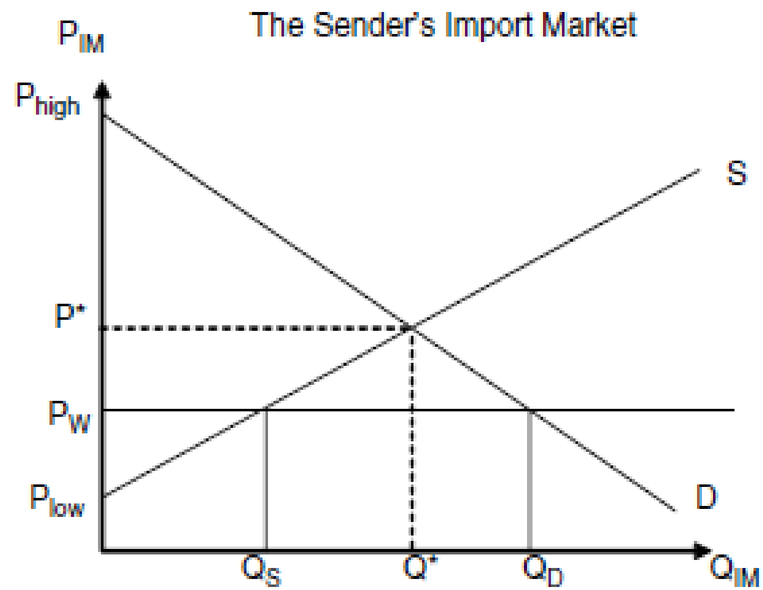
**Similarity to Protectionism**

- In general, the effect is the same: sanctions are obstacles to trade
  - They reduce international trade, leading to lower productivity, less wealth and a loss of welfare
- Import sanctions are like import quotas – except they do not generate revenues from sale of import licenses
- Export sanctions are like a voluntary export restraint (VER): a self-imposed export quota

# Before Imposing an Import Sanction




$CS = ½(P_{high} - P_w) \times Q_D$; $PS = ½(P_W - P_{low}) \times Q_S$

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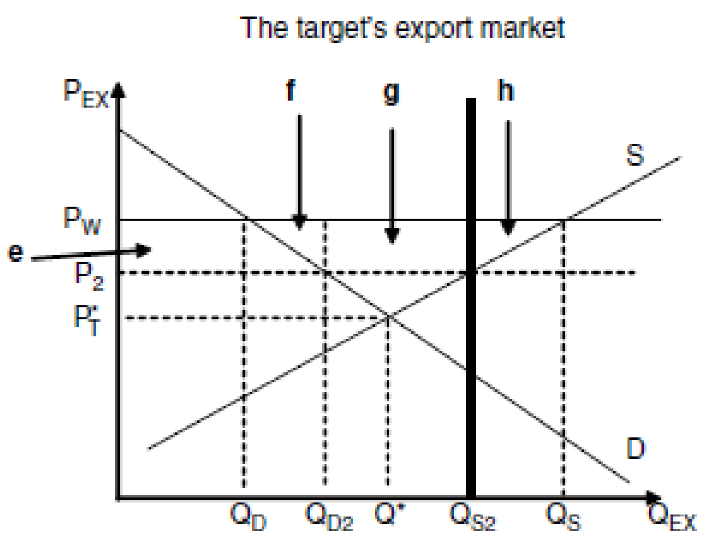
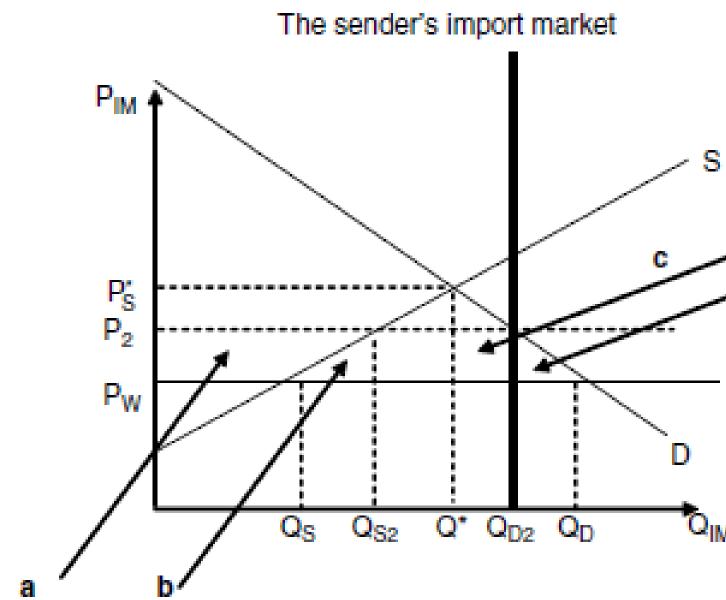
# Imposing an Import Sanction



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# The Effects of Import Sanctions

**Trade Changes**

- Price and quantity traded changes for both target and sender
- Target exports fall and the price received falls
- Sender import price rises and import quantity falls

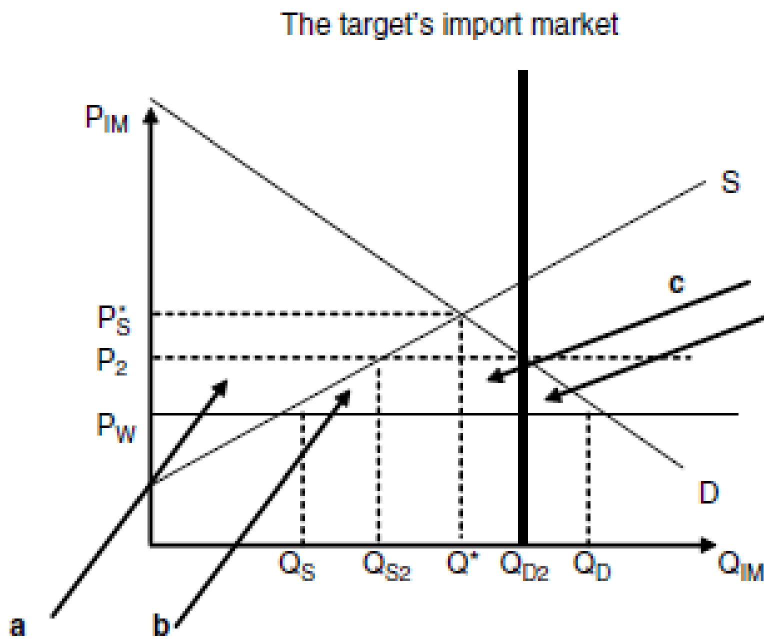
**Net Losses**

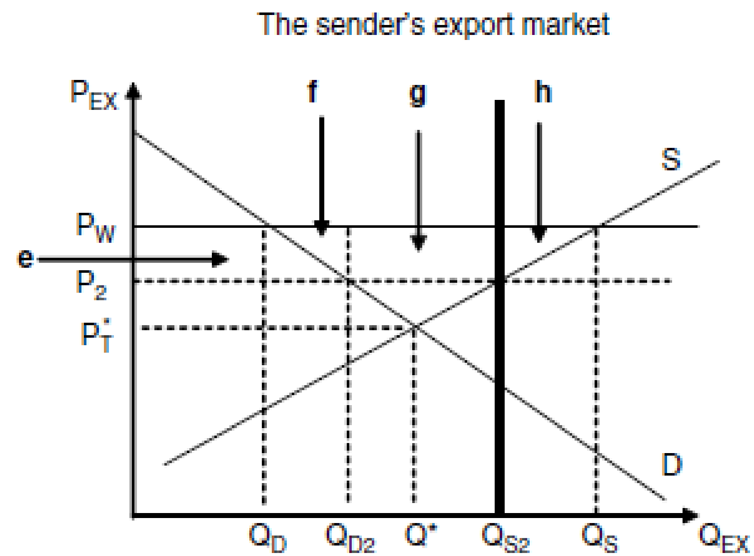
- Net welfare loss in sender economy: consumer loss of areas **b c d**
- Net welfare loss in target economy: producer loss of areas **f g h**
- The magnitude of losses to each are determined by elasticities of demand and supply

**Alternative Markets Important**

- If it is easy to find alternative export markets for the target, the effect of the import sanction may be insignificant

# Imposing an Export Sanction



# The Effects of Export Sanctions

**Trade Changes**

- The target's import price rises and quantity imported falls
- For the sender export price falls and quantity exported falls

**Net Losses**

- Target producers gain, consumers lose
- Sender consumers gain, producers lose
- Net welfare loss in target economy: consumer loss of areas **b c d**
- Net welfare loss in sender economy: producer loss of areas **f g h**
- Again, elasticities determine exact size of losses

**Alternative Markets Important**

- Of it is possible to source imports from elsewhere, sanctions might impose only small losses

# Sanctioning Capital Goods Exports

**A More Complicated Case**

- If capital goods exports to the target are sanctioned, it becomes more costly to acquire the necessary inputs for domestic production in the target
- Productivity will therefore be lower and with it real earnings
- Again, alternative markets will be sought out – only if the capital good is specific to the sender is this not possible

**Reduction In Trade, Growth of Domestic Industries**

- If there are no other sources of supply, either substitutes will be used – or a domestic industry producing the factor springs into being
- Assuming the necessary inputs are available
- With very specific capital goods, technical knowledge of their construction may also be costly to acquire
- Sanctions have the same effect as a protective tariff – it fosters the growth of an "infant industry"

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# Financial Sanctions and the Balance of Payments

**General Nature of Financial Sanctions**

- The basic analysis suggests that the consequence of financial sanctions is a rise in the cost of capital
- Or a fall in income, depending on the target being a capital importer or exporter
- Fails to see the big picture: there is a financial component to every trade
- Sanctioning financial flows therefore effectively limits trade, even in non-sanctioned goods

**Shutting off Trade**

- Effective financial sanctions can shut off trade completely
- A dominant country or effective cartel controlling settlement mechanisms needed for effective financial sanctions
  - New York Fed
  - SWIFT

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# BoP and Financial Sanctions

**Balance of Payments and Trade**

- Recall basic principles
- Import of goods are debited on the current account
- Payment of imports are credited on the financial account
  - Can be a debt or a transfer of money
- The exporter receives a claim or money from the importer

**Financial Sanctions**

- If financial sanctions are imposed, the payment is blocked
- Trade is shut off, since importers are blocked from paying
- Exporters to the target will have to wait indefinitely for their money
- *Any* sanction that reduces the foreign exchange earnings of the target leads to a reduction of its foreign trade

# Sanction Effectiveness

**Effectiveness is Unclear**

- In the case of import sanctions, widely traded, strategic goods means that the target has many alternatives
- Unless export sanctions target goods highly specific to the sender, here too the target has many alternatives

**Sanctions Cartels?**

- But cartels are always unstable: due to profits from breaking it
- Political motives and philosophical agreement can support the cartel
  - But experience suggests only in the short run
- Black knights always emerge – there are huge profits to be made busting sanctions
- Large, well-connected countries producing strategic commodities pretty immune to sanctions – they can always find a market

**Financial Sanctions an Effective Policy?**

- Especially the US can impose these, given its central position in the global financial system
- Even when sanctions cause economic damage, this does not always produce the desired political change – there is no clear transmission mechanism, so to speak

# Financial Sanctions Effective?

**Financial Sanctions an Effective Policy?**

- Especially the US can impose financial sanctions
  - Given its central position in the global financial system
- Such sanctions can cause massive economic harm to the target

**Really Effective?**

- The goal of sanctions is not economic damage – it is political change
- It is not clear how economic damage should cause political change
  - Or that it has done so historically
- There is no clear transmission mechanism
- The economy doesn't determine politics

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# 3. Smart Sanctions

**Definition**

- Sanctions focused on the regime, powerful interest groups supporting it

**Advantages**

- Collateral damage limited
- Direct pressure on regime should lead to faster policy changes
- However, practical possibility and effectiveness of smart sanctions severely limited
- It is virtually impossible to design a sanction that only affects the regime
    - Perhaps sanctions targeting individuals and their property

# Limited Effect Of Smart Sanctions

**Target Indifferent**

- In general, elites favoured by targeted regimes are indifferent to the cost
- It is already priced in as a cost they pay in exchange for regime favours
- In reality, costs from sanctions can be passed on to the general public
  - Through higher taxes, fewer government services
  - Lower wages in nationalized industries/lower transfer payments

**"Smart" Sanctions?**

- If the sanction can be focused on core constituencies, it may be effective
- In order for the regime to feel the impact, the economic damage must be pretty severe
  - Which means the sanction must cause society-wide damage

# The Rally-Around-The-Flag Effect

**Sanctions Perception**

- Sanctions generally cause patriotic/nationalistic solidarity
  - Even with an otherwise disliked government
- The regime can then use the sanctions in propaganda for their own cause
  - Including blaming all economic problems on hostile foreigners

**Sanctions Strengthen the Target Regime**

- Sanctions can also directly strengthen the regime
- If they cause shortages of goods
- The government can seize control of distribution of the commodities in question, becoming more important in the economy and to people's well-being

# Arms Embargoes

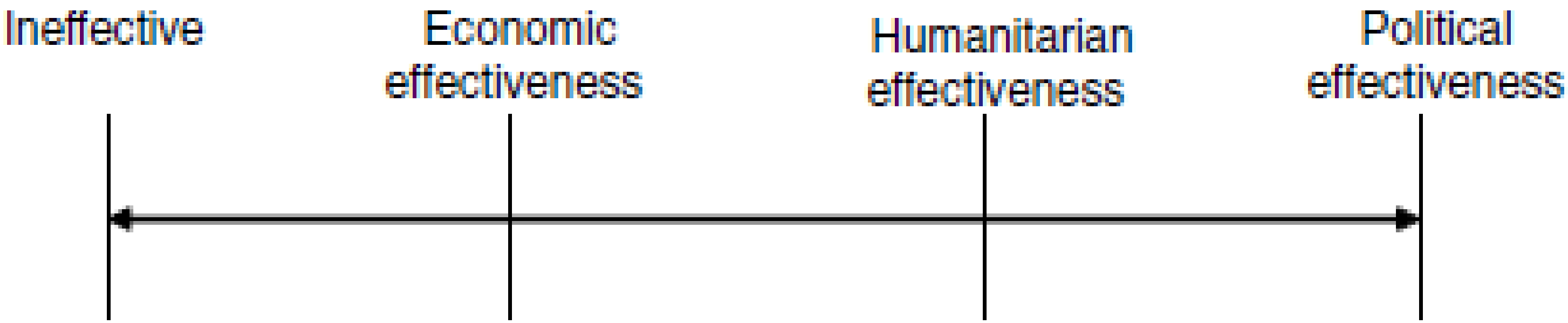
**A Key Smart Sanction**

- Arms embargoes – the limitation of export of arms to targets
- They are considered to directly reduce "bad" regimes' violent potential

**Problems**

- Only sanctions on large weapons systems and large weapons effective
  - Only these kinds are produced in relatively few countries
- Small arms trade basically unregulated, there are many players here eager for monetary profits – plenty of black knights
  - Even governments play this role: e.g., the French government giving the green light to weapons sales to Libya and Iran in the 90s – when the US had imposed arms embargoes on these countries
- While embargoes may reduce offensive capabilities, the kinds of weapons needed for domestic control are still readily available

# Sanctions Effectiveness Continuum




- In general, sanction effectiveness is dubious
- There are many ways to get around the economic effects of the sanctions
- Any comprehensive system of sanctions is going to have high humanitarian costs
- Political effectiveness is not guaranteed – the regime may suffer but still refuse demands
- Such demands are probably seen as too costly, even when the cost is non-economic
  - Loss of national honour and prestige
  - Political changes contrary to the ruling ideology
  - The loss of status of the ruler/ruling group

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# 4. Some Historical Cases

- Sanctions have been around for most of history
- Megarian Decrees of 435 BC – Athens imposing sanctions on the city of Megara, evicting Megarian merchants from many cities
- Napoleon's Continental Blockade, Union Blockade of the Confederacy, WWI (and after) blockade of Germany
- In the post-war period, the classic cases are Rhodesia and South Africa – these also notable for setting off the economic analysis of sanctions

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# Rhodesia and South Africa

**Rhodesia (modern Zimbabwe)**

- The last of the African colonies controlled by white settlers (apart from SA)
- Sanctions imposed from 1966. Goal: force political change, majority, i.e., black, rule
- Only succeeded in 1980 with accession of Robert Mugabe
- While the UK and its allies attempted to target sanctions at white settlers, this was unsuccessful
  - Black workers felt much of the burden, in the form of reduced wages

**South Africa**

- Subject to sanctions on-again off-again from the 60s to the 90s
- Goal: end of apartheid rule
- Plenty of sanctions-busting going on
- Again, the wider public suffered many of the costs: lower wages from lower productivity and lower export earnings
- In both cases, it is dubious to what extent sanctions caused the political change

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# Cuba and Iraq

**Cuba**

- Since Fidel Castro came to power in 1959 and the failed Pig of Bays invasion in 1962, the US imposed a total embargo on Cuba
- Goal: get rid of Castro, force the Cubans to rise up against him
- An abysmal failure: Castro died peacefully in 2016 – after more than 50 years of embargo

**Iraq**

- Sanctions were imposed through the UN during the 90s and early 2000s
- Goal: keep Saddam Hussein weak
- Iraqi isolation caused a huge humanitarian crisis, as the country was cut off from many imports
- Again, the sanctions must be deemed a failure – they did not weaken Hussein's control of Iraq

# 5. Conclusion

1. Sanctions are a form of interventionism very similar to protectionist policies. The purpose is different: sanctions are aimed at forcing other countries to change their policies

2. We can use the analysis of protectionism to estimate the economic consequences of sanctions. However, these are often muted, given the many possibilities for avoiding sanctions

3. When sanctions have economic effects, these are felt by the wider public – not by the political leaders, or groups close to them

4. Sanctions can lead to severe suffering in some cases, and trigger support for the target government

5. Smart sanctions are sanctions aimed at specific groups in control of policy. Their effectiveness is debated, it is probably not high

6. For sanctions to induce political change, they will have to cause severe collateral damage – and even then will likely not succeed