DIALOGUE SNAPSHOT

The Efficacy of Economic Sanctions

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the Hollings Center
for international dialogue

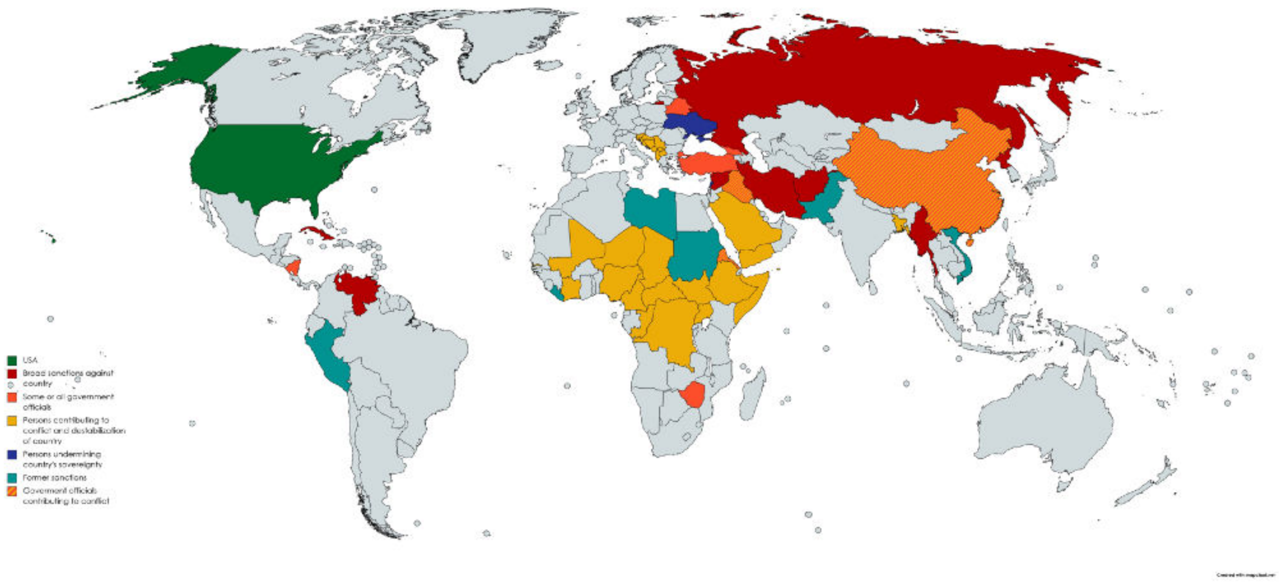
The Efficacy of Economic Sanctions

Economic sanctions have become a relatively routine foreign policy tool of the international community (encompassing state actors and international bodies) over the past 50 years. The United States alone has imposed economic sanctions on 20 countries since the beginning of the millennium, while the United Nations Security Council has 15 ongoing sanctions regimes.[1] Participants of economic sanctions state that they are effective enforcement tools, without the human and financial cost of the use of armed force. Others, however, argue that they have failed to bring about desired change in many instances. As most of the Western world relies increasingly on sanctions, many sanctioned states have begun to harden their economies against such measures, reducing exposure through both top-down and bottom-up mitigation strategies.

In this backdrop, increasing evidence suggests that sanctions are losing efficacy or are entirely ineffective. Sanctions regimes have become increasingly targeted, being directed at specific businesses, individuals, and their associates. This resulted in shifting perception of sanctions in recent, both outside and within sanctioned nations. Even targeted sanctions now have an inverse and outsize impact on the general population. Too often, applied sanctions remain in effect long after their initial application, sometimes creating unintended economic and political consequences.

Within the United States, growing debate has arisen about the efficacy of sanctions as a foreign policy tool, suggesting the need for new approaches should be considered and careful use reevaluated. This sentiment is echoed on the international stage, with the UN stipulating that "Sanctions do not operate, succeed, or fail in a vacuum. The measures are most effective at maintaining or restoring international peace and security when applied as part of a comprehensive strategy encompassing peacekeeping, peacebuilding, and peacemaking."[2] With recent high-profile sanctions against being levied against individuals, businesses and regimes, this reevaluation of sanctions as a foreign policy tool is timely.

To generate ideas on where current economic sanctions fall short, and to better understand how comprehensive peacebuilding strategies can be employed to optimize results desired with sanctions, the Hollings Center organized an interactive dialogue among participants of diverse backgrounds. The dialogue took place in September 2023 in



Map showing countries undergoing at least one type of unilateral sanctions from the United States. U.S. sanctions include both sanctions towards individuals or companies, as well as broad-based sanctions (noted in red). The map also notes countries that have had sanctions removed (blue). Source: Wikimedia, JojotoRudess, 2015.

Istanbul, Türkiye. During the dialogue, participants reached numerous collective conclusions.

Sanctions are not working and few alternatives exist: Throughout the dialogue, participants present highlighted numerous examples of negative effects from sanctions regimes, ranging from unintended consequences to general inefficacy. Coupled with a lack of clarity of the intent of specific sanctions, a consensus developed that current sanctions regimes are at best not working well or at worst not at all. Examples cited included recent sanctions imposed on Russia following the start of the Ukraine war. While sanctions created a sharp initial economic downturn, Russia has mostly recovered and not changed course. The long-running sanctions on Iran and their failure to create regime change or arrest Iran's nuclear program arose multiple times during the dialogue. There remains no good alternative, meaning sanctions as a foreign policy tool are likely to continue. Even poorly designed sanctions still carry fewer political, economic, and human costs when compared to conventional war.

Sanctions have increased in complexity, but remain poorly designed: Part of the increased complexity of sanctions results from trends in globalization and finance. But another reason is an attempt by some to minimize the collateral damage to those not being directly targeted by sanctions. There are multiple factors participants discussed that contribute to the poor design of sanctions.

- A lack of clarity about the intent of specific sanctions exists. Is the purpose political signaling (domestic agenda), coercion (a change of behavior), or deterrence? Participants noted without clear intent before sanctions are levied, it can become difficult to measure their impact and success. Furthermore, the lack of clear intent creates significant ambiguity about when or how sanctions could be lifted. Ambiguity creates the possibility of shifting purpose and sanctions permanence.
- Furthermore, no international rule-making exists when it comes to sanctions. There is no "Geneva Convention-style" international agreement on the rules. There is little agreement as to which sanctions are justified or which constitute "economic warfare."
- Lack of formal international standards or an international mechanism for levying sanctions usually results in more unilaterally applied sanctions. Participants noted that these sanctions are typically less effective than multilateral sanctions.
- In several presented cases, those that apply sanctions do not even understand the rules and parameters of the very sanctions they levy. Therefore, determining their effectiveness is virtually impossible.

Poor sanctions design and planning creates second and third-tier side effects: Second and third-tier effects of sanctions are side effects of the initial poor design of sanctions. Consequences of sanctions often go far beyond intentions after they are put into effect. With globalization, the side effects typically do not stay with certain individuals or within one country. While banks do strive to identify sanctions targets, high "false positive" identifications by banks subject too many innocent people to sanctions. Targeted individuals are often missed. And the concern of missing a target has forced companies and banks to be risk averse. Sanctions are creating breaking points and bottle necks in commerce chains that are resulting in product and profit loss for legitimate, non-sanctioned companies.

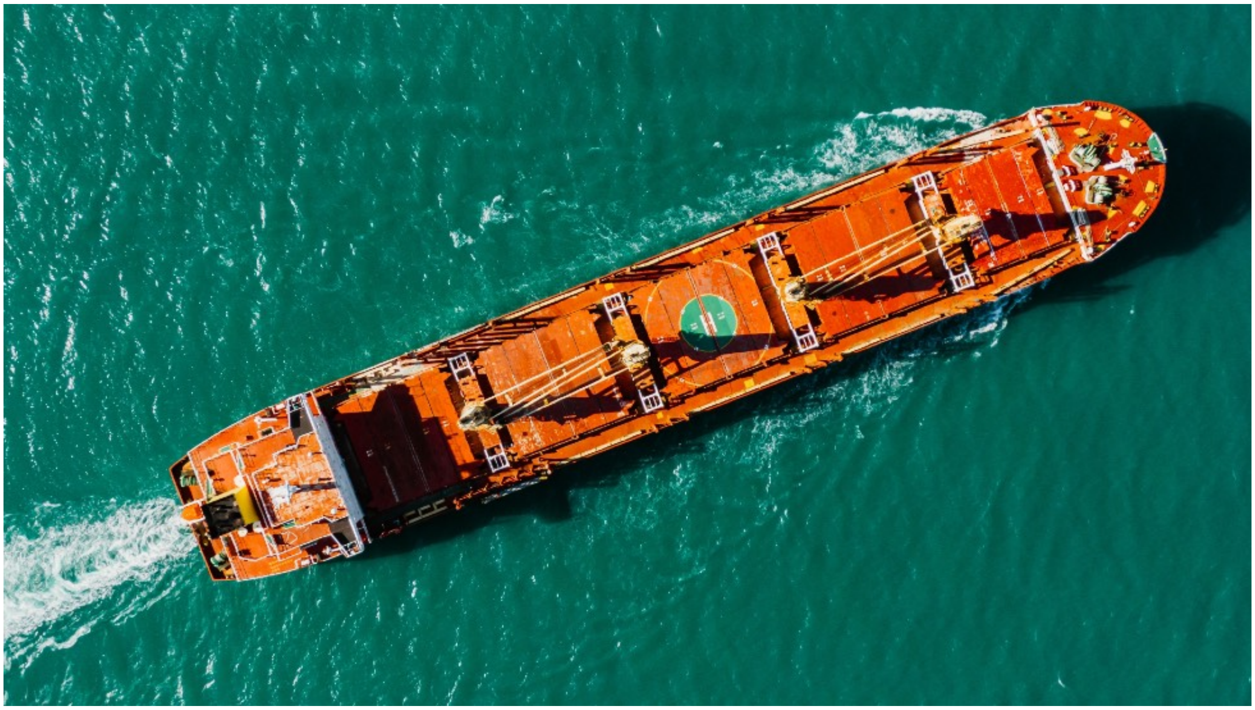
The second and third-tier effects of sanctions require further study and greater visibility. Throughout the dialogue, the participants noted the following:

- The costs of sanctions on businesses are ultimately passed to consumers. Elites and large enterprises under sanctions will take measures to protect profit margins, passing on costs and further hardships to ordinary people.
- Typically, Western international divestment follows the application of sanctions. Downturns are typically temporary, as third-party countries will often "scoop up" divested assets and interests at a significant discount. Consumers again pay the price. But, this also carries the additional side effect of making the country less vulnerable to sanctions in the long term.
- Greater burden will be placed on NGOs and civil society organizations to fill the socio-economic gaps, but their efforts will be hampered due to sanctions compliance. Even basic banking and funds transfers for legitimate humanitarian purposes will be scrutinized and slowed.
- Risk-averse international banks will depart, leading to a de-banking effect that harms ordinary individuals. Transferring money into the country will become difficult, and lack of access to the international banking system will adversely affect trade and commerce for small and medium enterprises. Elites and governments will find banking workarounds.

The use (or overuse) of sanctions is resulting in attempts by some countries to create alternative economic systems. Participants highlighted several of these systems during the discussion. Most notably, participants discussed the Cross-border Interbank Payment System (CIPS), developed by China to increase the use of RMB in trade over the US dollar, as well as bypass the Western SWIFT banking system for international transfers. This system remains underutilized currently, as global trade remains pegged to the US dollar and Western financial institutions. To address this, some sanctioned countries are pushing for foreign direct investment (FDI) over traditional dollar investment. Other countries have used bilateral trade agreements to bypass sanctions. Multilateral agreements such as those between Brazil, Russia, India, and China (BRICs) have also been used to buttress sanctions efforts. Overall, the debate resulted in a consensus among participants that a true alternative system is unlikely in the near term. The US financial system and foreign exchange liquidity tied to the dollar remains dominant.

Regardless, the increased use of sanctions has resulted in more workarounds, such as:

- <u>Lengthened banking circles</u>: Those avoiding sanctions will continue to use more intermediary banks (especially in third-party countries) to conceal the source of funds.



Shipping vessel carrying grain. In some circumstances economic sanctions can prevent the flow of necessary, humanitarian aid. Source: Shutterstock, PERO Studio.

- Increased money laundering: Sanctions evaders will continue to hide illegitimate holdings through legitimate trade and purchases. Typically, the humanitarian sector is exploited to do this.
- Use of cash and cash alternatives like cryptocurrency: In many countries sanctioned, "cash remains king." And unlike the global electronic banking system, cash remains difficult to track and verify. The development of encrypted financial holdings and cryptocurrencies further complicates the ability to track and trace sanctioned assets.
- Weaponizing misinformation: The increased ease of being able to create and disseminate misinformation via social media is making it easier to hide intent.
- Stashing of funds in other types of assets: Particularly, some elites evading sanctions will "park" their holdings into property and other FDI third-party countries.

Determining sanctions efficacy is very difficult. The dialogue featured researchers who are looking into this important issue. As researchers in the group mentioned:

- Intelligence to support the need for sanctions is poorly collected. Governments will typically be influenced by geopolitics, and bureaucrats who determine who or what to sanction are rarely given sufficient information to make those decisions.

- Banks also do not share intelligence with each other, creating possible sanctions loopholes and workarounds. There is no unified clearinghouse for this information outside of OFAC lists, which are not detailed. That results in loopholes and misidentification of legitimate clients.
- Those attempting to research these questions are still devising criteria and data sets to track the effects of sanctions. And, how to interpret such data needs to be devised. While participants considered this a step forward and encouraged its continuation, much work remains. Creating a counter-factualization to denote the effect of sanctions is essentially impossible. Therefore, creating a baseline will be very difficult.

Constructively, the discussion of sanctions efficacy in foreign policy circles is gaining momentum, resulting in some changes. These discussions have led to some legislative changes, particularly when it comes to humanitarian support. General licensing and waivers now exist for some NGOs and humanitarian organizations to support effected local populations. Participants noted these actions are a stopgap, requiring further work.

Sanctions enforcement has largely fallen upon banks. Participants representing the banking sector at the dialogue detailed how banks strive to remain compliant with sanctions regimes. This results in the banks acting as the de facto enforcers of sanctions. Banking representatives confirmed the high costs of such monitoring and enforcement. But due to the lack of effective intelligence sharing, one participant noted that false positive identification rates can be as high as 98%, affecting legitimate customers and needs. Yet, multiple participants noted that banks have successfully identified sanction-evasion cases. With the penalties to banks being high for failure, participants noted that this has led to significant de-risking, with some banks completely ceasing any work with problematic countries.

NGOs, Civil Society Organizations, and Humanitarian Organizations operating in sanctioned countries have borne the brunt of sanctions effects and bank de-risking. Participants representing NGOs/CSOs/Humanitarian groups lamented how bank efforts at de-risking are increasing risks to humanitarian efforts and dampening the effect of their work. These organizations typically operate on shoestring budgets and the delay or freezing of funds can dampen the distribution of much needed aid or close operations. Advocacy efforts to governments about these issues are now getting attention, but CSO representatives called for banks to be in the loop about reform as well. Representatives from the banking sector welcomed this call.

Third-party countries find themselves in a difficult position. Third-party countries, those unsanctioned but still able to conduct business with those unilaterally sanctioned, are being forced to choose between compliance with outside sanctions or conducting a delicate and dangerous balancing act. Go too far and third-party countries risk being sanctioned themselves. Often, especially in the imposition of unilateral sanctions, there may be legal conflicts between complying with international sanctions and national laws. Participants representing third-party countries at the dialogue noted that many third-party countries dislike the position of being forced to choose.

At the conclusion of the dialogue, participants discussed several calls for initial reform of sanctions. With unilateral and multilateral sanctions likely to remain as a foreign policy tool for the foreseeable future, participants recognized the need for reform in the immediate term. During the final session of the dialogue, the participants called for the following:

- Participants called for better definitions of purpose and intent of sanctions before they are imposed. What does effectiveness mean? How can risk tolerance be adjusted towards good actors?
- Participants called for better sanctions design. Outcomes are poorly understood, often have the opposite effects as intended, punish the wrong people, and create breaking points in commerce that impact innocent and compliant orgs and individuals.
- Participants called for continued study (impact study) of sanctions to better influence their design and better understand their impacts.
- Participants noted the cost to apply sanctions are low and the imposition of sanctions is functionally and politically easy. However, the cost to remove sanctions remains extremely high and difficult. There is little understanding about how to apply sanctions relief. Regardless of the current state of sanctions on an individual or a government, the stigma of sanctions will linger long after their removal. More research and work needs to be done on post-sanction effects.
- Participants called for continued cross-sectoral dialogue between NGOs, the private sector, bankers, regulators, academics, and ordinary people. The organizers received many comments expressing appreciation for the opportunity to engage with representatives from different sectors.

[1] Gordon, Joy (March 4, 1999). "Sanctions as Siege Warfare". The Nation.
[2] United Nations. “Sanctions | United Nations Security Council.” Un.org, United Nations, 2015, www.un.org/securitycouncil/sanctions/information.

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