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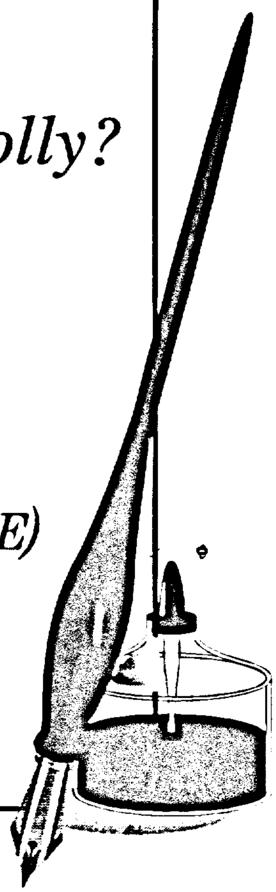
ICY STAFF COMMENTARY No. 4

Economic Sanctions: Foreign Policy Foil or Folly?

Robert T. Stranks
Policy Analyst

Economic and Trade Policy (CPE)
Policy Staff



(May 1994)

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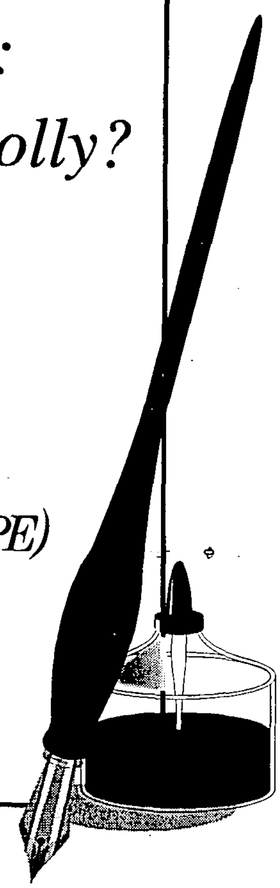

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Economic Sanctions: Foreign Policy Foil or Folly?

A key policy question is whether economic sanctions are effective foreign policy instruments. The short answer is that there is no general policy guideline appropriate for all situations. A policy based on the assumption that sanctions are or are not effective is misguided. The recent historical record of economic sanctions suggests that their effectiveness as policy instruments is very much case specific. This Commentary will, therefore, explore the factors and conditions that influence the effectiveness of economic sanctions in order to garner a greater understanding of their potential use and limitations.

Economic sanctions are punitive measures that usually have a political objective. Economic sanctions may be defined as nonviolent economic measures aimed at changing or modifying the political behaviour or conduct of another country. They are the deliberate government-inspired withdrawal, or threat of withdrawal, of trade or financial relations. Sanctions may or may not accompany the use of military force. For the purposes of this paper, trade remedy measures (such as countervailing or anti-dumping duties) are not considered economic sanctions. Nor are positive economic incentives, such as additional or new aid flows linked to modifying government behaviour, considered sanctions. Nonetheless, the removal of aid, with the objective of changing state behaviour, would be considered a sanction.

A wide array of trade and financial measures may be used. These include:

- Reducing, suspending or cancelling Official Development Aid.
- Freezing or confiscating bank assets or other assets belonging to the target country.
- Controlling or freezing interest or other transfer payments, and capital movements.
- Voting against loans, and other forms of assistance in international organizations.
- Import and export restrictions, including withdrawal of GSP, or total or a product/service specific embargo.
- Cancelling joint projects or economic agreements.

- Banning or restricting the export of technology or intellectual property.

The range of foreign policy objectives pursued through sanctions has been broad. These include encouraging a country to desist from military operations (the U.S. grain embargo of the USSR in 1980 in response to Soviet aggression in Afghanistan), destabilizing foreign governments (USSR measures against Yugoslavia in 1948), and to alter domestic policies (U.S. sanctions on China in 1989 after China's repression of political dissent, most visible in the Tiananmen Square incident). Sanctions have also, of course, accompanied military actions directed toward the unconditional capitulation of military adversaries (e.g., the two World Wars).

While foreign policy objectives are expected to be fulfilled, or at least meaningfully contributed to, by economic sanctions, the employment of sanctions may also be linked to domestic public opinion. A country's use of sanctions could well have major domestic political goals. As David Lloyd George remarked in respect to sanctions against Italy in 1935, "sanctions came too late to save Abyssinia, but they are just in the nick of time to save the British government."[1] Sanctions may be an effective means of demonstrating to the domestic constituency, as well as the international community, that "something is being done." Yet this may pose the political danger that the imposition of sanctions may raise public expectations that cannot be met. The public may perceive sanctions as being a more powerful foreign policy instrument than a given situation may warrant. Consequently, any use of economic sanctions may require a domestic awareness campaign to clarify the goals <u>and</u> inherent limitations of their employment.

Sanctioner and Target Characteristics

The two key points to consider when analyzing sanctions or considering their imposition are the characteristics of the sanctioner or sanctioner group, and the characteristics, i.e., vulnerability, of the target country or countries. The fundamental question is: are there some characteristics, economic but also political and social conditions, that improve the prospects for the successful use of sanctions? In considering the characteristics of the sanctioner group, besides the "economic size" of the group, the comprehensiveness and political will to enforce sanctions must be considered. Sanctions are unlikely to be effective in achieving their objectives when applied against a developed or a large developing country in a non-rigorous manner or

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[1] Gary Clyde Hufbauer, Jeffrey J. Schott, and Kimberly Ann Elliott, <u>Economic Sanctions Reconsidered, Institute for International Economics, 1990, p. 3.</u>

by a small number of sanctioners. In instances where third country "sanction busters" exist, it would likely be more difficult for sanctioner countries to achieve their policy objectives.

An example of comprehensive, near mandatory sanctions, but with a "sanction buster," are those that were imposed on Rhodesia. From 1965 to 1979, with only South Africa as a trade outlet, the Rhodesian economy grew in real terms. Part of the reason for Rhodesia's success was that the structure and technological level of the economy allowed the country to function while subject to sanctions. The economy possessed considerable scope for import substitution. There is little question that sanctions reduced Rhodesia's economic growth, but unemployment resulting from reduced exports was largely absorbed by directing labour toward the import substitution sector made possible by imported inputs from South Africa. Without South Africa, Rhodesia would have faced more difficult economic conditions. Arguably, this would have contributed to the forces of political change.

In addition, vulnerability to economic, especially trade, sanctions tends to be greatest for those countries in which foreign trade plays a major role in the economy. Moreover, if trade is concentrated in a few export commodities, or the exports are concentrated in terms of markets, a country could be even more vulnerable to sanctions. The type of imports and their role in the domestic production process is also a factor with respect to a country's vulnerability. If a country is dependent upon suppliers that impose sanctions, and there are no suitable substitute suppliers, a country would be more vulnerable to sanctions than would otherwise be the case. In this respect, Japan, a highly technological and sophisticated economy, would be vulnerable to sanctions imposed by a group of oil exporters. Similarly, a country highly dependent on oil exports would be vulnerable to sanctions imposed by a group of developed countries, its major export markets. From this perspective, a diversified economy, with a range of exports to a large number of countries, would reduce a country's vulnerability to sanctions.

Effects of Sanctions on the Target Country

Sanctions clearly impose an economic cost on the target country. A target country's exports and imports are often subject to restrictions. As well, aid and investment and other assets may be disrupted. A reduction in exports reduces foreign exchange, while restrictions on imports can deny critical inputs or cause higher prices to be paid for substitute imports. The disruption of commercial relations may influence credit worthiness, and this would usually cause a target country to pay a higher interest rate to alternative creditors, if alternative creditors are forthcoming.

The loss of official finance, including grants, may be irreplaceable. All these factors will have an impact on the economy. Economic conditions, at least for the public, will deteriorate to some degree. In the case of broadly based, nearly complete embargoes, as seen in the two World Wars, sanctions brought about major economic disruptions. There is not, however, any easily constructed scale of sanction responses that are proportionate to the seriousness of the target country's behaviour.

Less visible, however, and potentially more important is the impact of sanctions on human capital. These effects are not easily captured through economic statistics. The effect on human capital may be particularly severe in cases of comprehensive sanctions accompanying military action. Some observers have concluded that in 1993 conditions remained precarious for most Iraqis, when the vast majority of the population experienced extreme hardship, with education, health care, nutrition and other basic services being provided at a minimal level. Social indicators, such as the percentage of babies born with low-birth-weight, also pointed to significant human suffering. Economic hardships in vulnerable groups of society arise from the difficulty of focussing the impact of sanctions on the political elite of the target country; and from the fact that political elites may be willing to allow the general population to make considerable sacrifices. The long-run cost of the malnutrition of children, and the disruption of education is likely to be high for any target country, developed or developing. Moreover, hardships experienced as children may also spill over into retaliatory behaviour in the future. Thus, while sanctions may contribute to meeting a current foreign policy goal, they may well help to generate new policy problems in the future.

While sanctions impose economic costs, the target country's political masters may derive some benefits from the sanctions. With the right domestic political conditions, sanctions may actually serve to <u>increase</u> support for a government. Arguably, this has occurred in Cuba, which has been subject to a variety of U.S. sanctions since 1960. It is likely that U.S. measures contributed to anti-American nationalism in Cuba, and also served as a scapegoat for Castro to which he could attribute economic setbacks. Similarly, the USSR's sanctions against Yugoslavia in 1948 probably enabled Marshall Tito to consolidate his control of the country, and increase his public popularity. Much the same dynamic may be occurring in present-day Serbia. Conversely, U.S. sanctions against the Dominican Republic in 1960, may have contributed to opposition to the Trujillo regime and President Trujillo's assassination in 1961.[2]

The lesson here is that noneconomic factors have an impact on the overall effectiveness of economic sanctions, and that a given set of hypothetical measures that impose the same economic costs on two different countries would be unlikely to have the same impact. Nationalism, religion, and race or ethnic pride or some sense of historic grievance may all come into play. If sanctions contribute to strengthening a "them" versus "us" mentality in a target country, they can be strongly counterproductive, although perhaps still necessary as a demonstration to other potential rogue states that the international community is prepared to take a stand. Nonetheless, when faced with an immediate, specific case, policy makers will want to weigh carefully the important non-economic as well as the economic factors that will all have a critical impact on the effectiveness of sanctions. The calculus involved is invariably complex and prone to error.

Effects of Sanctions on the Sanctioner Country

A country's use of sanctions has an impact on that same country's domestic economy. On the import side, firms in sanctioner countries may be denied vital inputs or be required to seek alternative suppliers at some additional expense. On the export side, firms in the country applying sanctions may experience significant losses when their normal commercial operations are interrupted. Of equal importance to the immediate loss of sales, unless the sanctions are imposed pursuant to a broadly supported international consensus, is the damage to a firm's reputation as a reliable supplier. The economic cost of sanctions could linger long after the sanctions are removed. In Canada, the Special Economic Measures Act allows for applications for compensation by affected parties in Canada to be considered, but there is no legal obligation for the government to grant compensation.[3]

The withdrawal or reduction of aid flows by a sanctioner would likely impose the smallest domestic cost. Reductions in flows to a target country could be distributed to other aid recipients or the aggregate level of aid could be reduced. This said, the longer term effect, a relatively slower growth in the target country, may not be in the sanctioner's best political and economic interest. Moreover, if aid is linked, officially or unofficially, to domestic suppliers in the sanctioning country and this aid

[2]See Jean Prévost,, "For Effective and Appropriate Sanctions", Policy Staff Paper No. 93/04, Department of Foreign Affairs and International Trade, March 1993. pp. 13-5.

[3]Jean Prévost, "For Effective and Appropriate Sanctions", p.6 and Appendix II.

is disrupted, foreign sales could suffer.

Threats and Lessons

Two further aspects need to be addressed briefly. First, does the very threat of sanctions induce the identified target country to modify its behaviour? And secondly, do sanctions or the threat of sanctions directed at one country teach other countries a lesson, and discourage them from undertaking certain policies or practices? By their nature, these questions are difficult to answer with any confidence. However, it is likely that the factors influencing the effectiveness of sanctions as a whole could lend some insight into the questions. As an example, an economically powerful developed country probably would not be induced by the threat of sanctions into modifying its political goals based on the effects sanctions had on a small, trade dependent developing country. The issue must also be set in broader policy terms, and the general interests of one country vis-à-vis another. In this context, sanctions could be taken against one country, but in view of a second country's particular characteristics, such as a large, more self-sufficient market or its strategic political and security importance, sanctions may not be considered an appropriate or effective policy response in the latter circumstances.

Policy Implications

So where does all of this take us? Clearly, the consideration of economic sanctions as a Canadian policy response must take account of a few stylized "facts."

First, regardless of political requirements and domestic interests, unilateral action by Canada is not likely to be successful in any but the rarest of cases. The Canadian economy is not large enough to apply enough leverage to alter the political behaviour of a target country. An important element of Canadian policy would be actively to encourage multiple state participation in sanctions if we judge that another country's behaviour is internationally unacceptable. Apart from the political considerations of Canada acting alone, Canada requires allies if economic sanctions are to have any real prospect of being effective. Moreover, a large number of countries participating in the application of sanctions may tend to discourage third parties from engaging in "sanction busting." With most industrial inputs and manufactured products available from many sources, a basic rule-of-thumb surely is that unilateral export sanctions are not likely to be an effective foreign policy instrument for any country, and most certainly not for Canada alone.

Secondly, any policy decision must consider the possible costs or injury to

Canadian firms and their labour force. This raises some fundamental questions, such as: how are Canadian economic interests to be incorporated into the foreign policy agenda; is there a bias in foreign-policy making that downplays the economic perspective in the final phase of decision-making; and how do we determine that the economic price paid is commensurate with the political result? Both the short and long term economic costs would need to be taken into account, with the realization that estimates of the costs would be "ball park" figures. It must also be recognized that the impact of sanctions does not end when they are removed. In particular, with comprehensive sanctions that have the potential to damage severely another country's economy and contribute to widespread hardship in the population, appropriate account would need to be made for longer term impacts on political and economic relations. If the expected outcome were a significant deterioration in future relations, this could be weighted against the possibility of imposing less comprehensive sanctions. In sum, the use of economic sanctions should not be taken lightly.

Thirdly, the history of sanctions does not inspire confidence about their effectiveness. There are few "happy" endings, i.e., instances where economic sanctions clearly have made a major contribution to modifying the behaviour of a rogue state that has engaged in a practice that the international community holds condemnable. This said, the most "golden" rule for economic sanctions may be that the economically powerful may be able to undertake effective sanctions against a more economically weak and trade dependent country if they do so collectively. This in itself speaks volumes. If sanctions must be taken, and there are occasions when this is inevitable and justifiable, we should nonetheless do so in good company, with realistic expectations, and with the knowledge that we are wielding a blunt instrument in a World Order where power will continue to make some participants more equal and others more susceptible to coercion.