The Impact of Economic Sanctions in the 1990s

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1. INTRODUCTION

THE end of the Cold War served as a starting point for a true proliferation in the use of economic sanctions as an instrument of foreign policy. Diplomacy is increasingly resorting to economic sanctions; this is illustrated by the UN's track-record (see Table 1). Prior to August 1990 only two UN sanctions came into force, but since the Berlin Wall fell, sanctions have become an important instrument of the UN security council. The UN has already used this economic weapon seven times in a four year period.

The fact that the role of the UN and the other international organizations has become more important, increases the potential scope of non-violent approaches to diplomatic conflict resolution, such as sanctions, arbitrage and financial

TABLE 1
UN Security Council Sanctions

Rhodesia	1966–1979
South-Africa	1977–1994
Iraq	1990–present
Former Yugoslavia	1991–present
Somalia	1992–present
Libya	1992–present
Liberia	1992–present
Haiti	1993–present
Angola	1993–present

Source: Schrijvers (1994), Appendix I.

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compensation. An example is the western aid to the restructuring economies in central and eastern Europe in the early 1990s: Article 1 of the Agreement establishing the European Bank for Reconstruction and Development (EBRD) limits eligibility for loads to those countries that are committed to and which are applying the principles of multiparty democracy, pluralism and market economies (Menkveld, 1991). Naturally, political factors have a long time played an important role in international economic exchange.[1] The fact, however, that this is now being openly proposed and implemented, points to changing opinions about the use of economic pressure to achieve policy goals that are essentially unrelated to either monetary or economic stability and prudence.

In the early 1980s and early 1990s many boycotts and embargoes have been shown to be effective both in terms of economic damage caused and in terms of political impact. The US sanctions against Nicaragua were effective, crippling the Sandinista economic policies.[2] Also the UN sanctions against the Iraqi occupatiion of Kuwait and the Soviet energy embargoes against Lithuanian anti-Soviet policies (and later in 1993 against Lithuanian anti-Russian policies) were very effective in causing economic damage to the target country although their political pay-off was limited (see, for example, Smeets, 1994). Recent examples of successful sanctions (i.e. sanctions which helped to change the target's behaviour in the desired direction), according to Hufbauer et al. (1990), comprise the sanctions of the United States against martial law in Poland; the Dutch-American sanctions against Surinam, encouraging this former Dutch colony to improve its human rights record and hold elections; India's sanctions against Nepal's intensified diplomatic relationship with China; and the UN and EC sanctions against South-Africa. All of these sanctions seem to have had a positive political pay-off for the countries which imposed them.

These four relatively successful cases, however, cannot hide the fact that only one of the sanctions listed in Table 1 can be considered to have been a success (namely, South Africa, and even here the evidence would seem to be ambiguous). Indeed, about two out of three sanctions failed to achieve their intended foreign policy goals in the period from 1946–1989 (see Table 2).

The track-record even deteriorated as only two out of twelve sanctions succeeded in the period 1983–1989 (i.e. only 17 per cent). Even excluding those cases where trade linkage was negligible or low, the success rate of sanctions did not exceed the fifty per cent level (van Bergeijk, 1994, pp. 23–26). Econometric evidence on the political impact of economic sanctions is mixed.[3] Since the success rate of the sanction instrument does not explain the popularity of economic sanctions as a tool of diplomacy either, it may be worthwhile to study

[1] See, for example, the seminal study by Frey and Schneider (1986).
[2] Graham (1987).
[3] See van Bergeijk (1989 and 1994), Lam (1990) and Dehejia and Wood (1992).

TABLE 2
Economic Sanctions (1951–1989): Costs, Numbers and Success Rate

Period	Annual Cost (Percentage of World Trade) (1)	Number of Sanctions Initiated (2)	Number of Successful Sanctions Initiated (3)	Success (Per Cent) (3)/(2)
1951–1960	1.5	15	6	40
1961–1970	1.0	20	11	55
1971–1980	0.3	37	9	24
1981–1989	0.1	23	6	26
1951–1989	0.8	95	32	35

Source: Calculations by the author based on Hufbauer et al. (1990), Table 1.3, Appendices and Supplement; subject to the usual reservations.

the question of why economic sanctions in the 19902 are increasingly being used, before we investigate the economic consequences of this increase in their use.

2. FACTORS BEHIND THE INCREASE

Why do policy makers consider sanctions more often as an instrument to solve a particular policy problem? Essentially six factors explain why sanctions are and will be increasingly used: the end of the Cold War; strategic trade policy considerations; the greening of trade issues; the proliferation of weapons of mass destruction and the related technology; scale economies in the implementation of sanctions; and the process of globalisation (van Bergeijk, 1994).

First, the end of the Cold War led to a decline of the legitimacy of the use of force (Arima, 1994). For a given level of international conflict this implies the need to use economic sanctions more often as an instrument. Moreover, military 'peace keeping' missions, for example in Somalia, turned out to be a major disaster.[4] Consequently, diplomacy will more often have to use economic peace keeping and economic warfare.[5] In addition, the end of the Cold War helped to solve an important bottleneck in the implementation of effective sanctions. More international cooperation and the disappearance of the antithesis between the

[4] See, for example, Crocker (1994).

[5] Actually, the possibilities for the skilful *non*-use of military force have increased since the super power conflict ended. Before the present *détente* it was almost customary that differing interests rendered many diplomatic efforts *a priori* useless, because in a bipolar world countries can always turn to the other super power for economic, political or military support.

super powers have made possible the large coalitions that make trade diversion and sanction busting much more difficult if not impossible. Indeed, the UN sanctions against Iraq have shown that the achievement of the political unity that is considered to be a necessary condition for a forceful — and difficult to circumvent — long-lasting embargo can be a matter of days (Smeets, 1990). Iraq is a unique case since the international community was able to impose severe, wide ranging and almost watertight sanction measures (Switzerland participated for the first time in history) and the world did so within the extremely short period of four days. It is thus likely that the end of the Cold War has made possible the grand coalitions that are considered by many economists to be a prerequisite for successful economic sanctions.

Second, strategic trade policy considerations increase the demand for any kind of trade interventionism and thus for foreign policy sanctions as well. Strategic behaviour is a general problem if policy making has global dimensions. Only a relatively small number of governments can induce strategic behaviour. Being endowed with market power, these governments can often effectively achieve an outcome that is superior for their own country, although it is (Pareto)-inferior for the world (Hahn, 1990). The New Trade Theory argues that government intervention in trade by means of quantitative restrictions and subsidies may shift the balance of profits (and other external benefits) between countries. Economic leverage could open foreign markets simply by threatening to raise new barriers to trade. Hence quantitative restrictions, such as sanctions, may help to create competitive advantage (van Bergeijk and Kabel, 1993) so that high moral motives may become the camouflage of right out protectionism. Indeed, Kaempfer and Lowenberg (1992, pp. 43–45), point out that such strategic considerations have, for example, helped to determine what kind of sanctions were implemented against South-Africa. It is hardly surprising that OECD countries boycotted coal, steel and textiles, where protectionism is already today's tune.[6]

Third, trade sanctions are increasingly being proposed to enforce environmental policies in other countries (see, for example, Esty, 1994). As the environment is an international public good, the 'green commons' need to be protected against free riders. Environmental agreements need to be enforced one way or another. Folmer et al. (1991) suggest that a country that suffers from transboundary pollution may threaten to limit economic relations if the polluting source country refuses to cooperate and change its environmental policy. Indeed, guided by popular sentiment and frightened by huge abatement costs, policy

[6] See also Levine's (1988) analysis of Section 232 of the US Trade Expansion Act of 1962 (that provides for import relief when the national security is at potential risk) and Carter's (1988, p.3) speculation that the steel industry would discover human rights violations in South-Korea or Taiwan in order to seek a ban on steel imports from these countries if the President's authority to impose import sanctions were expanded unconditionally.

makers seem increasingly willing to opt for trade regulation and trade impediments as instruments to protect the environment, thus spoiling the potential contribution of trade to sustainable development (van Bergeijk, 1991). Sorsa (1992) points to the growing need to prevent a rise in the environment related trade frictions, especially with respect to the unilateral use of trade sanctions.[7] Environmental agreements and national environmental pol,icies, moreover, increasingly focus on production methods rather than product characteristics (the Montreal Protocol on chloro-fluorcarbons is an example). This suggests a substantial enlargement of the scope of environmental policy related trade barriers. Another intensification of environmental sanction policy aims at achieving multilateral environmental agreements or at changes in specific extra jurisdictional environmental policies (Subramanian, 1992). So here the use of sanctions aims at 'consensus' building. On both accounts the practice of international environmental policy making so far points in the direction of an increase in the use of multilateral and unilateral economic sanctions.

Fourth, the proliferation of both nuclear, chemical and biological weapon production technologies, as well as of delivery systems for weapons of mass destruction, may explain the spread and increase of political trade restrictions. So while the end of the Cold War would seem to reduce demand for export control in general, specific cases (for example, the Iraqi and Libyan military build-ups) have shown that global arms trade and the international flow of arms-related technology should be intensively monitored and if necessary redirected and/or restricted. Indeed, as argued by Roodbeen (1992), *détente* in the Gorbachev era, at first sight appeared to have reduced the necessity for the embargo on technology in the context of the East-West conflict, which was administered by the Coordinating Committee for Multilateral Export Controls (CoCom). The (intra)regional instabilities, however, that surfaced since the Soviet Union collapsed vividly illustrate the inappropriateness of the case for a free and unrestricted flow of sensitive and strategic goods, services and knowledge. This, in a nutshell is the practical rationale for export control in the 1990s and beyond.[8] The CoCom has been dismantled, but new institutional and diplomatic arrangements will be needed for effective export control, as pointed out by, for example, the report of the US Committee on Science, Engineering, and Public Policy (1991). The Committee argues that the United States should opt for fully multilateral export controls, that the participation by China and the former Soviet

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[7] Presently, about 13 per cent of the 127 international environmental agreements over the period 1933–1990 contain trade-related measures (GATT, 1992, p.11).

[8] An important problem may become which goods to include in such a scheme. Many civilian goods have an alternative military application. Whenever such dual-use goods are the target of a sanction, spillovers to the civilian sector become unavoidable, as the range of dual-use goods runs from fertilizers to personal computers.

Union is a pre-requisite for viable export controls and, finally, that export controls should be tailor-made and reduced in number in order to address the enforcement issue.[9]

A fifth factor relates to the learning-by-doing effects of repeated implementation of economic sanction measures. Admittedly, the UN Secretariat needs to be strengthened with respect to option assessment, intelligence analysis and actual monitoring (Schrijvers, 1994). An important issue that needs to be addressed is that border countries which impose the sanctions under the UN Charter are entitled to compensation while no mechanism is as yet available for providing the necessary funds for such international burden sharing. The lack of burden sharing makes the imposition of sanctions unnecessarily costly for the bordering countries, thus possibly undermining the enforcement of sanctions.[10] On the other hand, 'Sanction Committees' have become a more or less permanent feature of the organisational structure of the Security Council, and the evidence suggests that these committees are sliding down the learning curve. It is to be expected that streamlining the organisation (for example, via the creation of a Standing Committee on sanctions and by decision-making via a qualified majority, rather than by consensus) may help to solve some of the bottlenecks, thus reducing the costs of implementation and the monitoring of sanctions, which in turn will stimulate the use of economic sanctions as an instrument of foreign policy.

A sixth factor is the increasing interdependence of countries. Globalisation is at the basis of the network of nations, as economies are linked through international trade in goods and services, through capital flows (foreign direct and portfolio investment, lending and aid) and, increasingly, through the migration of labour. Globalisation, on the one hand, is a potential source of substantial welfare gains. On the other hand, globalisation of its economy makes a nation vulnerable to foreign pressure. The scope and range of the instruments of economic diplomacy are positively correlated with the intensity of the international economic relationships: an autarkic country is not vulnerable to economic sanctions.[11] International interdependence is the basis for economic warfare and it may create diplomatic conflicts, for example between the United States and Japan over Japanese cars or between the European Union and the United States over

[9] These issues still have to be addressed by the international community. In CoCom's successor only the former East Block will work together with NATO and Japan in controlling exports of (technology for) bacteriological, chemical and nuclear weapons.

[10] Diny (1994), State Secretary at the Romanian Ministry of Foreign Affairs, recently estimated the annual direct costs imposed on his country due to the UN sanctions against Iraq and the former Yugoslavia at US$5 billion or some twenty per cent of GDP.

[11] A complicating factor, however, is the changing pattern of the centres of economic gravity due to globalisation. Such changes in the geography of the world economic system have a direct impact on national security issues and hence on foreign policy.

agriculture (see Gasiorowski, 1986). Policies that in the paste could rightly be considered as purely domestic, such as government procurement, may now generate external effects on other countries and lead to international conflicts.[12] Such frictions may pose a significant challenge to conflict resolution in the 1990s.

3. COSTS

It is generally accepted that trade measures are second-best instruments only. This lesson of two centuries of economic research implies that better, more direct, instruments are available to achieve the stated goal. A noteworthy aspect, however, of the increased use of economic sanctions as an instrument of foreign policy is that factual knowledge about the costs of economic sanctions is absent. Economists have exhaustively studied the welfare consequences of trade liberalisation and economic integration, but the costs of the diplomatic barriers to trade are seldom examined and play hardly any role in the discussion.[13]

The use of sanctions as an instrument of foreign policy often comes down to fighting a political conflict by trampling on consumers and firms that have relatively little outstanding with the political differences of opinion. Economic sanctions are essentially the heaviest non-military instrument in international conflict resolution. Their use should be restricted to those exceptional cases where other, possibly more appropriate, diplomatic measures have been exhausted. In reality, however, political decision-making often neglects other options such as formal protests at high political levels, the recalling of ambassadors and other non-economic sanctions. The bias towards economic sanctions *vis-á-vis* political measures is particularly worrying since international politics that resort to economic warfare and economic surveillance more often increases trade uncertainty and this yields a suboptimal allocation of factors of production. Indeed, interdependence and the mutual benefits that derive from international exchange are important economic incentives to reduce international political and military conflicts in the long run (Polachek, 1992). Sanctions undermine this positive contribution of international economic exchange. Such hidden, but real costs of international diplomacy are generally not considered.

Since the costs of diplomatic relationships are not exposed properly to decision-makers, decisions on the use of sanctions are currently inefficient. The use of economic sanctions is too large. Indeed, the lack of both transparency and proper information suggests that substantial diplomatic barriers to trade hinder the proper functioning of the world trade system and this may constitute an

[12] See, for example, Kindleberger (1986, pp. 9–10) on the neglect of international repercussions in domestic policy-making.
[13] See for a further elaboration of this issue van Bergeijk (1994, pp. 101–122).

important economic burden for the so-called New World Order. Hence it is useful to analyse these costs. In doing so, I will distinguish between the direct costs and the hidden costs of intensified use of the economic sanction instrument.

a. *Direct Costs of Economic Sanctions*

The most obvious and visible direct costs entail additional financial and real outlays that are immediately related to the imposition of sanctions. Examples are rising transport costs due to the fact that trade may only be possible with more distant markets (for long sub-optimal routes) and risk premiums that are to be paid to middle men and sanction busters.[14] In addition, the target's long-run development potential may be hurt. The growth of the capital stock (both quantitatively and qualitatively) is a very important determinant of growth so that investment sanctions may bite substantially in the long-run although their immediate impact often seems rather limited. Potential industries may simply not come into being (entrepöt functions, tourist accommodations, etc.).

If one is interested in the actual costs of economic sanctions only one comprehensive dataset is available. The study by Hufbauer et al. (1990) provides estimates of the direct costs to the target economies for 116 cases. Table 2 lists some of their findings for the second half of our century and gives some additional calculations. In the years 1951 – 1989, the average annual costs of the economic sanctions borne by the target, amounts to less than one per cent. Actually, sanction damage becomes increasingly less significant. Noteworthy is the fact that the damage exceeds the level of one per cent of the target's Gross Domestic Product in only one third of the sanction cases that are being studied by Hufbauer et al. (1990). So sanctions would not seem to be a serious threat to the world trade system. This remains true if one takes into account that the Hufbauer et al. data set does not cover all international sanctions and that the United States is over-represented (Bull, 1984). The Hufbauer et al. (1990, pp. 120 – 122) methodology neglects the long-run effects of sanctions; it assumes that the target can shift a part of the sanction induced terms of trade loss on the rest of the world (which is wrong since the target is often a small country) and does not consider the costs of the country which imposes the economic sanctions (*cf.* Bonetti, 1991). Such costs may be substantial. For example, Dinu (1994) estimates that the annual spill-over effects of the UN sanctions against the former Yugoslavia amounted to US$ 3.5 billion for Bulgaria, US$ 1.5 billion for the Ukrain, US$ 1.5 billion for Hungary and US$ 1.5 billion for Romania. The extent, however, to which these factors create too low an estimate of the direct costs of sanctions should be balanced against the tenfold increase of world trade after this period.

[14] The empirical side of these issues is covered in Hengeveld and Rodenburg (1995) for the case of the oil embargo against South Africa.

All in all, the welfare loss due to economic sanctions would not seem to be very substantial.

b. Indirect costs of Economic Sanctions

In addition to the direct welfare consequences of the increased use of economic sanctions, changes in the world economic system occur which also influence the economic opportunities of countries that are in no way involved in the international conflict. These are the external effects of economic sanctions (or the 'network costs') that do not play a role in the cost-benefit analysis of either the sanction's target or the sender country.[15] Srinivasan (1987, p. 387) and Eaton and Engers (1992, p. 919) point out that the threat of economic sanctions probably plays a much greater role in the international arena than their actual use in diplomatic relations seems to suggest.

Network costs: The problem is not so much that the probability of a specific country becoming a target of economic sanctions increases, since a potential target can influence this probability by behaving in accordance with the international standards set by the international community (or specific sender countries). Rather the problem of (global) trade uncertainty derives from the fact that political risk spreads through the world economic system as the overall probability increases that every country's trade partners will become the subject of economic sanctions. Moreover, in many cases the impact of boycotts and embargoes will spill-over to the trade partners (and to the trade partners' trade partners and so on). This will induce countries to specialise to a lesser extent and to limit their external trade in order to reduce the risk of foreign trade restrictions in the future. So there is a trade-off between, on the one hand, the probability that the international gains from trade an actually be reaped and, on the other hand, the extent of these gains. The less you want to trade the more probable it is that you can actually tradė the desired quantity (see Bhagwati and Srinivasan, 1976; and van Marrewijk and van Bergeijk, 1993). This trade-off may substantially change the global pattern of trade, especially since the target's firms may be able to reap monopoly profits in markets that are sheltered by the rest of the world's sanction measures. Lowenberg (1993) argues that domestic firms will then no longer have an incentive to lobby for liberalisation of the objectional policy. Firms will prefer to reinforce that policy in order to get a bigger chunk of the sanction rents for themselves. The result is that an increase in the use of sanctions may put economies on a more inward-looking track with a reduction of the world's potential for international trade as a logical consequence.

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[15] Such costs may be called the hidden costs of economic sanctions (van Bergeijk and van Marrewijk, 1994).

So in the end, other, presumably innocent, countries will suffer from the trade disruption that is aimed at specific 'ill-mannered' countries. Although gains from trade still do exist in such a scenario, the welfare gains decrease substantially below the level in a deterministic (or simply less uncertain) trade setting. In this way the general (and possibly endogenous) trade uncertainty, that results if international politics resorts to economic warfare and economic surveillance more often, may change the global patterns of production and comparative advantage. The implied suboptimal allocation of the factors of production may be a substantial hidden cost that should be taken into account in any policy analysis or policy recommendation of the use of ecnomic relationships as a source of international power.[16]

Reduced efficacy: The international community itself may also stand to lose. It can be shown that the impact of an increase of existing negative sanctions depends on the attitude towards risk and the target's expectations formation process which in general cannot be observed (van Bergeijk, 1987; and van Bergeijk and van Marrewijk, 1995). The use of these instruments may be counter productive and may induce misconduct rather than correcting or preventing it. The phenomenon of an increase in the threat of punishment possibly leading to a perverse result (a larger extent of misconduct) is important for policy makers. It is essentially this possibility of both a negative and a positive marginal impact of the deterrent concerned that impairs the suitability of negative economic sanctions, unless initially no threat was uttered. Indeed, Fischer (1984, p. 84) rightly stresses that in keeping peace with a potential adversary one should avoid subjecting the adversary to economic pressures, humiliation or threats as long as he keeps peace. Obviously, if a military strategy is complemented with economic warfare during peace-time, the value of peace for the other side is reduced. More importantly, however, such threats act as an incentive for (potential) targets to arm themselves against (future) punitive measures, for example, by stockpiling.

Econometric analysis of the Hufbauer et al. (1990) data base suggests that enhanced reliance on sanctions as an instrument of foreign policy will probably blunt negative sanctions as a diplomatic economic instrument (van Bergeijk, 1994, pp. 83–93). The findings suggest a negative influence from the number of prior economic sanctions on the probability that a specific sanction will succeed. This implies that a clear danger exists in excess, suggesting that using sanctions too often may deprive the world of its ultimate non-violent instrument. This reduction of the set of effectively available policy instruments for peaceful conflict resolution might actually trigger military interventionism.

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[16] See for an example of a possible approach van Bergeijk and Oldersma (1990), who calculate the world's annual efficiency loss due to suboptimal specialisation for the case of the Cold War at three per cent of the world's GDP.

4. CONCLUSIONS

Globalisation of both consumption and production has clear benefits that are not always fully recognised in the political decision-making processes. International exchange enhances efficiency both because comparative advantages and economies of scale can be exploited more fully, and because international competition is an important incentive for firms to minimise costs and to innovate products and production techniques. In addition interdependence and the mutual benefits that derive from international exchange are important economic incentives to reduce international political and military conflicts in the long run. There is a growing divergence of, on the one hand, the private supply costs (to one nation) of implementing sanctions and, on the other hand, the global supply costs. In other words, nation X faces lower private costs from implementing sanctions because of the end of the Cold War, learning-by-doing and increased interdependence, but there is a negative network cost to other potential sanctions from nation X imposing this policy.

Politicians and policy makers should take the network costs of these changes in the world economic system into account. Decisions about the use of economic sanctions should be based on economic analysis. This means that the costs and benefits of alternative diplomatic measures should be considered. As yet the impact of economists on such decisions appears to be rather limited. Hence reserve should be practised in the use of economic sanctions as an instrument of foreign policy. Only when fundamental interests are at bay can the sanction instrument rightly be invoked, because the obligation to maintain an open multilateral trading system is a very important obligation of any international actor.

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