

## Appendix 4

# Deterrence as a security concept against threats in the economic domain

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### Current situation

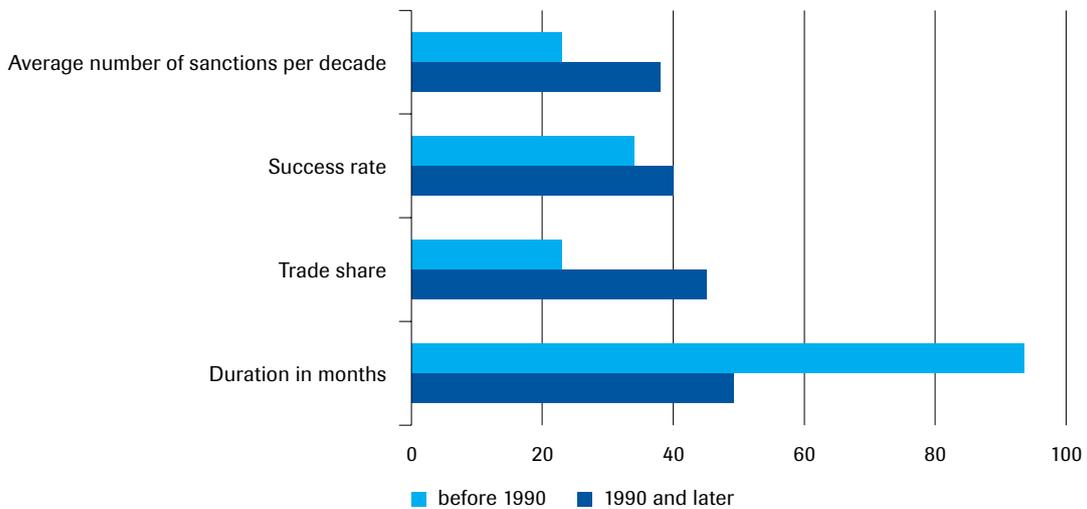
With its open and internationally oriented economy, the Netherlands is potentially vulnerable to external security threats that reach it through the economic domain. Additional attention must be given to this vulnerability because of the increasing geopolitical tensions in the world and the instability in regions close to Europe as outlined in the summary report of the Clingendael Monitor 2015. In this context, the 'economic domain' includes all external economic contacts of the Netherlands. On the one hand, the threat concerns activities that disrupt economic core processes, i.e. processes that are of vital importance to the functioning of the economy (energy production, communication, transport, monetary transactions and so on). The threat may involve a core process being disabled or the undermining of confidence of members of the public and the business community in that core process. A stable supply of energy and other raw materials from abroad is of vital importance to the functioning of economic key processes. A cyber attack on Dutch payment transactions, for example, would be an attack directed against an economic core process that, even if it failed, could undermine confidence in the uninterrupted functioning of the process. In the same sense, a physical attack on the energy supply (on a distribution point, for example, whether or not in the Netherlands itself) or a blockade that prevents the supply of certain raw materials could disrupt economic core processes. On the other hand, in addition to these core processes, the threat also concerns the interest that the Netherlands has in free trade and access to foreign markets, and in attracting foreign investment as a foundation for employment and a dynamic business sector. The disruption of international trade and investment in particular could result in major macroeconomic damage. The more unexpected and prolonged the disruption, the greater its impact. The Netherlands is vulnerable in the economic domain in all these senses. Van Bergeijk and Mennen (2014) discuss numerous economic disruptions that were analysed in the context of the National Risk Assessment.

Deterrence may be relevant in this context with respect to actors who deliberately perform acts that harm the national security of the Netherlands. Three relevant groups of actors are criminals, terrorists and states. Internationally operating criminal organisations that harm the Netherlands usually do so through the economic domain. Drug trafficking, human trafficking, fraud, money laundering and cybercrime are directly linked to economic processes. Terrorism is linked to the economy in terms of the funding of terrorist organisations, or indeed when terrorist attacks are aimed at disrupting economic core processes. The activities of criminal and terrorist organisations and the relevance of these activities to national security are discussed elsewhere in this study.

The actions of states in the economic domain can pose a threat to national security in a number of ways. First, economic vulnerabilities can be exploited by another state by

intervening directly in the economy in order to strengthen its own competitive position at the expense of Dutch competitiveness. A government can do so by, for example, favouring national companies in the home market, providing state aid to national companies, carrying out or supporting industrial espionage (through the cyber domain or otherwise) and using political and diplomatic influence to restrict access to markets or raw materials in third countries. A foreign government may also use state-run enterprises or companies that it influences in some other way to effect corporate takeovers and thereby eliminate Dutch competitive advantages and/or create dependencies. Whether or not such measures pose a threat to national and economic security depends on their scale and relevance to economic core processes.

Second, a foreign government may try to exert political pressure by means of carrying out economic sanctions, or by implicitly or explicitly threatening with sanctions. Then there are fuzzy sanctions, which are derivatives of sanctions. These are consumer boycotts that harm Dutch economic interests but are not led and were not initiated by a foreign government. At the international level, the past decade has seen a significant increase in the use of economic sanctions. This trend started in the 1990s, when the collapse of the Soviet Union led to the end of the conflict between the two superpowers, which entailed that UN sanctions were less limited by geopolitical considerations. Figure 1 illustrates the increase in the average number of sanctions in relation to a higher success rate, possibly caused by closer trade links between the side imposing the sanctions and the target of the sanctions.



**Figure 1 The changing characteristics of economic sanctions (before and after 1990)**

Source: calculated from Van Bergeijk, 2009, Table 6.6, p. 134

It is unclear whether the higher success rate is the result of a more judicious use of sanctions or a reflection of the trend towards internationalisation of all economies. Whatever the case, sanctions are used more frequently and the flows concerned are larger than they were in the past. It is therefore reasonable to expect that the Netherlands will be involved in economic sanctions more often, also as a target. In addition, sanctions against countries other than the Netherlands may also indirectly affect important Dutch economic interests. This development is both quantitative and qualitative. Another new type of sanction is the targeted sanction

or smart sanction. Smart sanctions target specific decision makers and their associated groups rather than entire populations. Smart sanctions have as yet not been used against the Netherlands.

In summary, security interests possibly harmed by economic influence are mainly economic security, social and political stability and territorial integrity (in the sense of undesired restrictions on the autonomous functioning of the Dutch state). Threats are posed by terrorist organisations, criminal enterprises, consumer boycotts, great powers and governments of countries that have a high degree of influence over specific international production chains, raw materials or technologies, or that have large financial reserves.

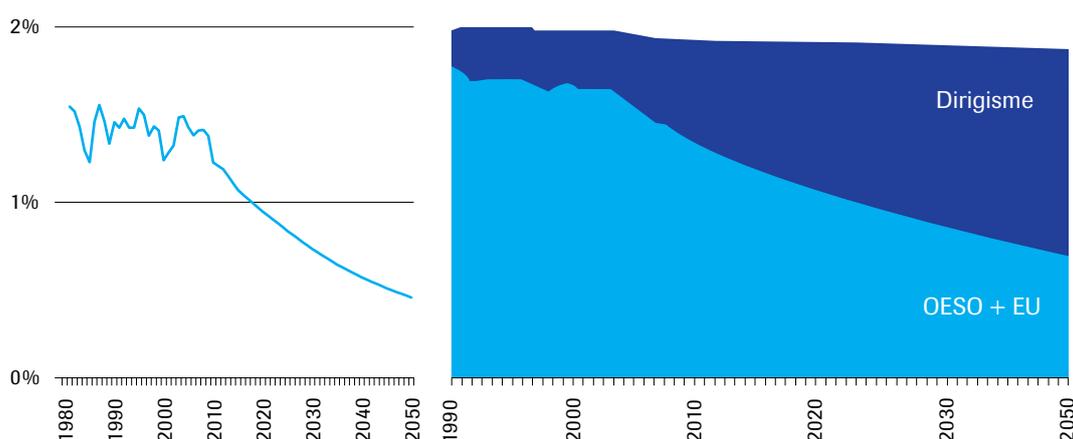
## Expectation for the coming five to ten years

Economic core processes are becoming more complex, more dependent on technology and are more strongly influenced by the situations in other countries. The extension and branching out of international value chains both increase economic security (international value chains softened the impact of the 2008/9 slump in world trade) and give rise to new risks. The creation of added value in the Netherlands is becoming more dependent on supplies from and sales in other countries. There are risks of disruption in all parts of the value chain. As both a hub of international trade and a participant in the international economic system, the Netherlands is vulnerable, (Van Bergeijk and Mennen, 2014) and will remain so in the coming years. This vulnerability applies to attacks from all relevant groups of actors: criminals, terrorists and states. It is likely that, as discussed elsewhere in this report, the threats posed by criminal and terrorist actors will remain relevant, and will become more acute in the future, also through the cyber domain. As the internet becomes an ever more integral part of society and the economy, state actors will have more opportunities to wage ambiguous warfare on the economies of other states.

Based on events in the past five years, it is more likely that the Netherlands will be a target of sanctions or of sanctions targeted at other countries that nevertheless affect Dutch economic interests. Sanctions or boycotts could be directed against the Netherlands for religious and geopolitical reasons, for example. Religious considerations have already prompted fuzzy sanctions (because of the Dutch short film *Fitna*), cancellations of state visits (because of the Parliamentary Support Agreement concluded with the PVV) and threats to boycott Dutch companies (Saudi Arabia). Sanctions among third parties that may indirectly affect the Netherlands could be initiated for geopolitical reasons – a further exacerbation of the recent trade war between Russia and the West, for instance. But it is also conceivable that frictions between the US and China impact the Netherlands in some way. The risk of geopolitical escalation with respect to trade and investment will become greater as the share of emerging economies increases, on the one hand, because economic power translates into political power, and on the other hand, because these emerging economies are becoming less dependent on OECD countries. Dutch companies have already had to deal with US and European sanctions against countries such as Cuba, Iran and Russia. Possible US sanctions against Chinese targets in the future could have more far-reaching consequences for Dutch business interests.

An important change in the coming five to ten years is that the ability of the Netherlands to use its international influence to limit threats in the economic domain will wane. This key change will take place because the Netherlands' share in gross world product (GWP) will decrease, not because the Netherlands will become poorer, but because the new

economic powers are undergoing strong growth (Figure 2). The power base/influence of the Netherlands will halve before 2030 and it is likely that this decrease will start to increasingly affect the policy latitude of the Netherlands already in the near future. The country's relative decline on the international stage means that privileged information and key positions will no longer be a matter of course. Although the decrease in policy latitude cannot accurately be expressed in terms of money, it is clear that there may be macroeconomic costs. In the past, the Netherlands was able to play a key role in shaping institutions that were of vital importance to the country's well-being. It is becoming increasingly unlikely that senior Dutch policymakers will be able to continue playing that key role.



**Figure 2** Decreasing share of the Netherlands (left) and shift of the share according to policy orientation (forecast up to and including 2050)

Source: calculated from Fouré, J., et al., underlying data set

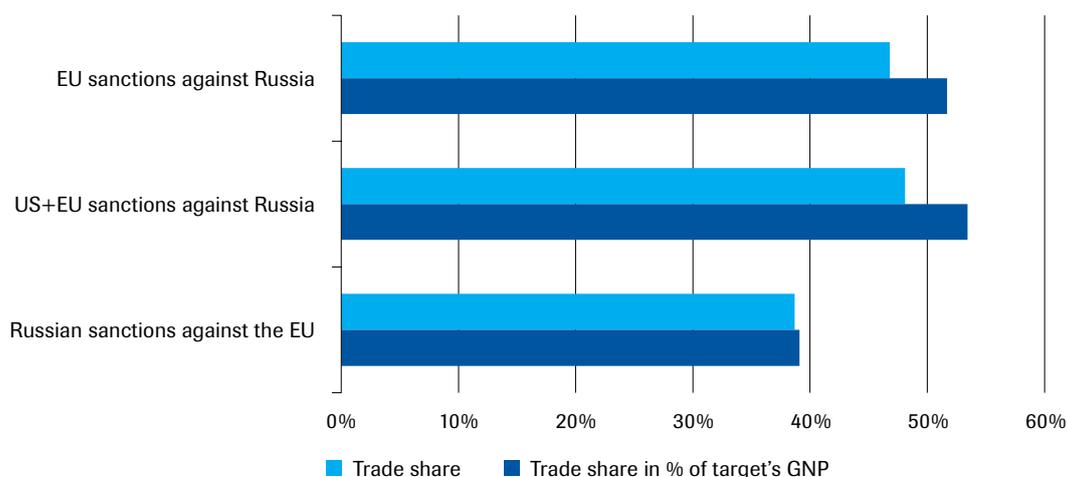
Nevertheless, the Netherlands remains an important open economy. Schiphol airport and the port of Rotterdam are global hubs and although there is significant international competition, it may be assumed that the Netherlands will maintain its leading position for the medium term. By contrast, the Netherlands will not remain a leader in the financial sector. This is not only due to the banking crisis, but also due to policy choices regarding, for example, development cooperation, including the reduction of the standard for development cooperation relative to GNP. Relative decline is of course not a uniquely Dutch problem. At the global level, the share of the market economies that have supported and developed the multilateral system since the Second World War and that adhere to the OECD's rules is decreasing. The crisis has undermined the credibility of the Washington Consensus. The Chinese development model is effective and offers a clear alternative. The current international situation will inevitably lead to changes in the standards and rules of the international system. The traditional values of the major democratic economies will also lose ground. It is clear that the BRIICS countries (Brazil, Russia, India, Indonesia, China and South Africa) are proactively trying to fill the vacuum (cf. Morse and Keohane, 2014). Steps are being taken to establish an alternative to the World Bank. Unlike the OECD's Development Assistance Committee, the BRIICS countries do not attach any special value to emancipation, reaching the poorest and human rights in bilateral international cooperation. As their economic power grows, the BRIICS countries will probably be less reluctant to place economic relations in general in a geopolitical context that is relevant to them as opposed to a relevance defined exclusively by Western powers.

A complicating factor in all of this is that essential facilities (hard and soft infrastructure that is necessary for international business, such as communications satellites, secure data exchange for commercial credit and international payments, international rules and enforcement options and so on) are increasingly being established in jurisdictions other than the 'traditional' ones. This trend will become more pronounced as the relatively new jurisdictions gain further economic clout and interests. Since this development may have extraterritorial effects, it may pose a threat to national security. The SWIFT sanctions against Iran are an example of hard infrastructure (communications channel for international payment transactions) that was no longer available to Iran. It is not possible to predict where providers of new global essential facilities will be located in exact terms. What is certain, however, is that more of them will be based in BRIICS countries and that it will be more difficult to shape multilateral policy or control global essential facilities in a multilateral way. The multilateral system has traditionally protected small and medium-sized countries. In the current context, regional cooperation is becoming increasingly indispensable as a means for offering the necessary counterweight.

### **The relevance of deterrence as a security concept**

The deterrence concept, as in causing a change in the assessment of expected costs and gains of deliberated actions - plays an important role in the literature on economics. The application of the concept within the framework of rational choice theory is established primarily in analyses pertaining to criminal behaviour and the prevention of such behaviour ('*Law & Economics*'). More recently, as an extension of this, the focus has been on various forms of terrorism (Miller, 2013, Schneider et al., 2014). The analysis of economic sanctions (both positive and negative interaction) has been placed in a similar framework (Dizaji and Van Bergeijk, 2013). In essence, the findings are as follows. Actors who are considering behaviour that could threaten national security may be temporarily or definitively persuaded to refrain from such behaviour by a change in their expected costs and gains or their assessment of them. This effect may be temporary in the event of substitution, modification and innovation. In addition, a shift to other forms of misbehaviour or other, possibly easier targets often occurs.

Deterrence is effective if it increases the *costs* that the attacker must incur, which can be achieved by investing in preventive, protective barriers and more intensive investigation. Making punishments heavier does not have a deterrent effect if the attacker and his property are not on Dutch territory. Because of globalisation, in certain domains economic threats can originate from anywhere in the world (cybercrime is an example). This makes it more difficult to identify the source of the threat. The harder it is to identify the perpetrator, the less effective deterrence becomes as an instrument. Concrete deterrence measures that can be used against criminal or terrorist organisations are: additional protective measures, the threat of smart sanctions, the threat of punitive measures aimed at the environment of the individual that poses a threat and policy designed to influence the milieu from which the threat originates. In addition, increasing the likelihood of being detected is a deterrence measure that can be used against individual criminals or terrorists. The threat of countersanctions and increasing resilience against sanctions may have a deterrent effect on state actors.



**Figure 3 Success rate of sanctions in the context of the Ukraine crisis**

Source: Voxeu, 25 April 2014

With respect to politically motivated perpetrators, the *gains* can be lowered by reducing the actual or potential impact of a disruption (prioritisation, replacement production capabilities, greater resilience and clear communication of solutions). Excessive dependence on a single area or region in terms of supplies and sales must be prevented to the greatest extent possible, on the one hand in order to ensure that there are alternatives for supply and sales, and on the other hand because a greater spread means that an attack must be carried out against several channels to affect economic core processes or interests. In addition, measures can be taken to increase the resilience of the population and the business community (Frey, 2009) and protective measures can influence a would-be perpetrator's assessment of potential gains.

A complicating factor is the high degree of heterogeneity on both the origin side (the determinants of terrorism, for example; see Kis-Katos et al., 2014) and the target side (the influence of the form of government on the effects of sanctions, for example; see Von Soest and Wahman, 2014). The implication is that findings for a certain domain (religious terrorism, for example) are not necessarily relevant to another domain. In addition, the effectiveness of all deterrence measures is substantially greater if they are taken as part of a bilateral or multilateral alliance (the EU or other alliances). The ability of the Netherlands to use deterrence to counter threats in the economic domain without such cooperation is extremely limited.

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