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ECONOMICS STATECRAFT: FROM NEGATIVE SANCTIONS TO POSITIVE SANCTIONS

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Economic Statecraft: from Negative Sanctions to Positive Sanctions

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Abstract: *This paper presents some insights on economic statecraft with a special focus on economic sanctions. Taking some evidence on negative economic sanctions as point of departure the paper is an attempt to throw light on aspects and factors which could be considered relevant while designing 'positive' economic sanctions. Two aspects have been highlighted as being crucial. First, a proper consideration of interest and social groups has been proven to explain the failure of comprehensive negative sanctions, the success of smart sanctions and – more interestingly – the potential success of positive sanctions. Secondly, the existence (or the lack) of some institutional arrangement between sender states also explains the failure of negative sanctions as well as the potential success of positive sanctions.*

Keywords: economic sanctions, positive sanctions, negative sanctions, effectiveness, trade, interest groups

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1 Introduction

International economics sanctions are economic policies undertaken by states towards other states in other to influence their strategies and actions. Needless to say, any reasoning about sanctions takes as point of departure that economic interdependence may have a substantial impact on foreign politics of states. In this respect, the case of sanctions is to be linked to the argument of interdependence as expounded by Angell (1911) in its *Great Illusion*. There, the author had challenged the traditional idea of supremacy of military power in establishing advantages for states. In brief, according to Angell, the idea that war was an essential tool for improving the position of a state, its economic condition and the well-being of its population, was to be regarded only as a "great illusion": an illusion made anachronistic by the growth of international trade and increasingly by closer economic interdependence between all the countries of the world. The application of sanctions as economic instruments to influence, persuade or coerce rival countries descends from this idea.

In fact, sanctions can be either negative or positive. First and foremost, it is essential to underline the distinction between negative and positive sanctions as presented by Baldwin (1971). Such distinction is widely accepted. In general, the positive sanctions can be defined as the assignment (or promise of assignment) of economic benefits by *sender state*(s) with the aim of shaping the behavior and strategy of a *target state*. Positive sanctions consist often of trade policy measures that favor trade between two or more countries, but also cover such items as development aid, technological co-operation, cross border infrastructure, repayments. On the contrary, negative sanctions are punitive measures that a sender state puts in place in order to cause or threaten economic damage to a target state. In fact, negative economic sanctions are a foreign policy tool alternative to war. In the presence of some hostility between states negative sanctions are used to force hostile regimes to bow to the directives of one or more states. In simple words, economic sanctions interrupt existing economic relations or prevent the creation of new ones. Both type of sanctions can be divided into unilateral and multilateral. In the first case, they are imposed by a single country while in the second case they are imposed by the international community (or by a group of states). Although such distinction is more used for negative sanctions, it can be adopted for positive ones too. The US after World War II is the country that has used negative sanctions more frequently. Multilateral sanctions are often designed and approved within the United Nations Organization and "may include a total or partial interruption of economic relations and railway, sea, air, postal, telegraphic, radio and other communications, and the severance of relations diplomatic "(Article 41 of the Charter of the United Nations). The sanctions can then be partial or global. In the first case, they concern the exchange of particular goods (in many cases they concern weapons, military technology). In the second case, they concern almost all commercial exchanges together with financial ones. The most famous examples of comprehensive sanctions are constituted by Cuba, Iraq and Yugoslavia against which the blockade of economic relations has been almost total.

The aim of this short paper is to shed light on a set of insights which can be eventually used to design a comprehensive framework for shifting from negative sanctions to positive sanctions. In order to do that, I first briefly present the well-known elements of the debate on the effectiveness of negative sanctions and the evidence on arms embargoes. Finally, drawing some insights from previous sections, I present some points to be considered to design successful positive sanctions. A final paragraph summarizes and concludes.

2 Effectiveness of sanctions: consensus on no consensus

A long-lasting debate exists about effectiveness of negative sanctions. In brief there is no clear-cut consensus on this. More precisely, there is no clear-cut assessment on sanctions performance. Hufbauer et al. (1990) estimated that sanctions are effective tools about 34% of the time. Pape (1997) has shown out that in many of these cases sanctions were combined with the use of military force. Thus, he points out that sanctions by themselves are effective less than 5% of the time. Bonetti (1998) had used 104 episodes highlighting that failure is most likely if there is significant third party assistance to the target, and if the pre-existing trade linkage between sender and target is small. In general, the main argument supporting the lack of effectiveness of sanctions appears to be that of sanctions-busting which descends from lack of coordination between states. Van Bergeijk (1995, 1994a, 1994b) expounds the emergence of sanctions-busting and negative network effect as outcomes of sanctions. The first in-depth study in the literature on the emergence of both sanctions-busting and negative network effects is Caruso (2003) which is focused on the sanctions imposed by the US in the period 1960–2000. In order to study the comprehensive impact of US sanctions on global trade, the analysis focused not only on the volume of trade between the US (sender country) and the target countries, but also on the trade flows between the other countries of the G-7 group (Canada, France, Germany, Japan, Great Britain, Italy) and the target. In fact, the other G-7 countries in the light of similar productive structure and technology, were to be considered the only potential competitors to US as supplier countries for the target countries, especially of manufactured goods. Therefore, applying a counterfactual experiment, the study showed that the US, had it not unilaterally applied negative sanctions, would have traded approximately 60% more with target countries. The figure is clearly more relevant for cases of global sanctions for which the missing trade exceeds 80%. Sanctions-busting emerged clear when considering that the other G-7 countries would have traded 17% less in the absence of US sanctions. In fact, the unilateral US sanctions thus favored the exports of the other G-7 countries. It is clear at this point that in order to understand the effectiveness of negative sanctions, one cannot ignore the characteristics set out above. Unilateral and partial sanctions can hardly be considered effective. The sanctions-busting takes shape easily and therefore the international isolation of the country is not actually properly enforced. Partial but multilateral sanctions can be more effective as long as the coordination of the international community is effective. In this case, both direct effects (trade between sender countries and target countries decrease) and negative network effects may appear. This would be desirable for sanctions imposed against oppressive and dictatorial regimes involving arms transactions. In the case of total but unilateral sanctions, both the negative network effects and the sanctions-busting phenomenon emerge. For example, when the US applied the total embargo to Nicaragua, all European countries continued to maintain their trade relations and even Canada allowed Nicaragua to move its foreign trade office from Miami to Toronto, trying to favor the circumvention of sanctions. It is clear that in the presence of multilateral sanctions the emergence of sanctions-busting is more difficult and less likely. In the presence of total sanctions, even if unilateral, negative network effects still emerge. The brilliant book by Brian Early (2015) describes in details sanctions-busting. In brief, evidence about sanctions-busting is somehow confusing because a significant number of states engaged in trade-based sanctions-busting. Then, this poses a serious concern on the potential effectiveness of trade sanctions and this appears to be even more concerning nowadays in the light of the increased interdependence. In other words, probability of sanctions-busting increases in the number of trade ties of the target country. The debate on effectiveness of negative sanctions re-gained momentum in the very latest years. Recent works by Van Bergeijk et al. (2019) and Peksen (2019) highlight factors which are relevant for negative sanctions for being successful. In particular, Van Bergeijk et al. (2019) focuses on three main aspects: (i) intensity of trade linkage; (ii) timing of sanctions (sanctions probably need to be quick and unexpected to have a maximum impact) and (iii) prior relations between sender and target (sanctions may work better against friends than rivals). Peksen (2019) points out the conditions that have been identified as more likely to lead to successful sanctions outcomes in the literature. He also presents four major shortcomings of the current literature: (1) there is a sender-biased interpretation of sanctions effectiveness. This finally overestimates the number of failures; (2) the use of static data reduces the study of various time-specific factors affecting the probability of sanctions success; (3) the dominant state-centric bargaining model in the literature offers limited insight into measures directed at non-state actors and (4) the study of sanctions in isolation of other instruments that frequently accompany them, such as incentives and diplomatic pressure, leads only to a partial understanding of the specific weight of sanctions into foreign policy initiatives.

However, there is another major argument which is often underestimated in the sanction's literature, namely the regime type of the target countries. Effectiveness of negative sanctions have to be expected different when they are implemented against autocracies or democracies. In line with Mc Guire and Olson (1996) we can expect that autocrats are committed to maximize the transfer from society without regard for the welfare of his subjects. This implies that whenever its rents are maximized, an autocrat is not willing to change its own strategy and behaviour. Since negative sanctions like trade embargoes generate rents, autocrats could also paradoxically end up in an enviable scenario. So, this contributes to explain why negative sanctions often do not work. In this vein, Lektzian and Souva (2007) empirically show that success of sanctions is conditional to political institutions of target countries. Escribà-Folch and Wright (2010) use data on sanctions imposed against authoritarian regimes from 1960 to 1997 to highlight dissimilarities between different types of autocrats. They point out that only personalist dictators are more vulnerable to foreign pressure than other types of dictators so confirming that most autocrats are less sensitive to negative sanctions. In fact, single-party and military regimes are to increase their revenues even when targeted by sanctions, by shifting fiscal pressure from one stream to an alternative one. They also increase repression to thwart the domestic opposition which could be determined by a smaller set of economic opportunities. In the light of this last point, it is clear that comprehensive negative sanctions can be expected to fail particularly in autocracies.

The failure of some sanctions and the growing awareness about the above-mentioned aspects have eventually led some scholars and analysts to suggest the implementation of 'smart' negative sanctions, namely those measures which are intended to hurt only a specific sector or individuals of ruling elite. Drezner (2011) highlights how that unsuccessful case of Iraq sanctions had determined a loss of consensus on comprehensive negative sanctions. On the one hand, humanitarian cost of sanctions was massive and on the other hand, Saddam Hussein and its elite remained in power. Therefore, no doubt that comprehensive sanctions become politically unsustainable. Therefore, the 'smart' sanctions seemed to be a feasible alternative. Among negative 'smart' sanctions, the case of arms embargoes appears to deserve a particular attention. Even in the case of arms embargoes sanctions-busting practices are often suspected to explain their failure [see among others Boucher and Holt (2009); Tierney (2005); Cortright & Lopez, 2009]. Other studies, however, find evidence of compliance to arms embargoes. Brozska (2008) analyzing arms embargoes between 1990 and 2005, shows that arms embargoes do reduce arms imports. Similarly, Erickson (2013) argues that arms embargoes restrain exports of both small and major conventional weapons from 1981 to 2004. Moore (2010) finds that in cases of UN arms embargoes, a large part of sender countries do not export conventional weapons to target countries. In a recent working paper Baronchelli et al. (2020) investigate the impact of arms embargoes on the trade in small arms and light weapon from 1990 to 2017. By means of a gravity-model, the analysis focuses relies on transfers of small arms between 9,275 pairs of countries and territories. Results show that embargoes are effective in reducing transfers of small arms. Interestingly findings show that both UN and EU sanctions decrease trade, but the quantitative impact is different. An EU embargo determines a decrease of 39% of imports of Small Arms and Light Weapons (SALW) whereas in the presence of UN sanctions the negative impact is 24%. In brief, EU embargoes appear to be more effective than UN embargoes. Since it is often maintained that sanctions-busting is more likely with small arms, authors also investigate whether embargoes on neighbor countries stimulate imports from target countries. Findings shows no evidence of sanctions-busting.

Finally, it can be maintained that 'smart' negative sanctions appear to work better than comprehensive ones because they are based upon the relaxing of the assumption of states as 'unitary actors' which had led scholars and policy-makers to wrongly associate the destiny of dictators and their elites with that of citizens.

3 Shifting to Positive Sanctions?

Causes of failure of negative sanctions in this context were instrumental to draw some insights in order to point out which factors can be considered in a specular reasoning about positive sanctions. As mentioned above, following Baldwin (1971), *positive sanctions are defined as actual or promised rewards* to another actor. It is possible to distinguish between two types of sanctions, with reference to the objective and the different time horizon that are proposed: the first form of incentive (specific positive linkage) translates into the promise of "*a well-specified economic concession in the attempt to alter a specific foreign or internal policy of the target country* '; the second form (positive linkage or "long-term commitment") "*involves an effort to employ a continuous stream of economic benefits to change the balance of political interests in the target country*". These definitions of positive sanctions are very broad. That is, in this vein positive sanctions can take different shapes but more generally they are economic policies which are supposed to favor another state, namely some trade policy or foreign aid. Hufbauer and Jung (2020) highlight that such definitions are too broad, so they propose to [...] *situations where the promise of monetary rewards is twinned with the imposition or threat of negative sanctions in a quid pro quo fashion [...]*[2].

[2] Hufbauer and Jung (2020) p. 5.

In what follows I am willing to underline briefly some points to be considered when shifting from negative to positive sanctions, namely (i) the role of interest groups in designing trade policies (ii) a relevant policy-mix including disarmament; (iii) the institutional setting; (iv) the engagement of civil society; (v) the credibility of sender governments.

Needless to say, among positive sanctions, trade policies appear to be the most considered as potentially successful. For example, the establishment of a free trade area was among the policies suggested in the unheard proposal produced in Keynes (1919) in the aftermath of the First World War I. Generally speaking, optimistic expectations about positive sanctions rely upon the liberal idea of peacefulness of economic integration. Three points are worth noting:

3.1. economic interdependence

In order to have peaceful spillovers, first and foremost, economic interdependence has to be unambiguously beneficial. The classical reference to analyse benefits of economic integration is Viner (1950) and since then a substantial literature has shown gains descending from trade integration. In addition, a vast literature had demonstrated that peace and international economic integration between democratic countries are positively associated [Polachek et al. (2011); Hegre et al. (2010); Reuveny (2000)]. The argument echoes the Kantian liberal peace and it is structurally different from deterrence's underlying theoretical construction. Whereas deterrence is grounded on the idea of a zero-sum game, trade and economic integration are based on the idea of positive-sum game. In sum, albeit non-cooperative, rational agents are capable to recognize the incentives to trade instead of engaging in a continuing conflict. In the latest years, a substantial stream of economic literature took as point of departure the work by Polachek (1980) which provides a model is based on a country social welfare function assumed to be derived from the preference sets of the entire population. Following a standard trade model, when a country is engaged in a conflict, a restriction in trade fosters a deterioration of terms of trade given the impact of conflict on prices. Then, a rational government will be choosing an optimal level of hostility that maximizes the welfare function given the balance of payments constraint. The equilibrium is reached when results of the model that the net cost associated with extra hostility equals the welfare benefit of more hostility. In the light of this literature, trade policies are assumed to be unambiguously beneficial as tools of conflict resolution. However, this literature has often underestimated the crucial role of interest groups in designing trade policies as explained in Grossman an Helpman (2020, 2002, 2001) and therefore expectations about the potential effectiveness of positive sanctions could be excessive. In addition, the importance of intra-industry trade and global value chains in world economy [see among many others Melitz and Trefler (2012) and Timmer et al. (2014)] dictates the necessity of considering the role of special interest groups. In brief, proper models and mechanisms of positive sanctions ought to relax the basic assumption of state as a unitary actor. With regard to negative sanctions, Kaempfer and Lowenberg (1988, 1992; see also Chapter 7 of this Handbook by Halcoussis, Kaempfer and Lowenberg) and Kaempfer, Lowenberg, and Mertens (2004) used a public choice framework to explain how sanctions had distributional effects on interest groups within the target country. In this vein, albeit specular, Verdier and Woo (2011) embed a sanction game-theoretic model in a trade model, assuming that the sanction sent takes the form of a trade embargo. Trade embargo is a sanction with redistributive effects and the model considers two groups, a group that is hurt by the embargo and another that benefits. Depending on the relative economic importance of each group, the government then chooses the policy outcome. The game yields unambiguous results, namely a sanctioner should prefer reward promises to sanction threats. This model has the merit of considering different groups and it shows that this aspect is not a severe constraint to the implementation of positive sanctions. Woo and Verdier (2020) revisit the results of the previous model so showing that sanctions and rewards work better with well-defined democracies and dictatorships than with the intermediate category of limited autocracy. IN the latter case, only rewards work.

3.2 Policy mix

The second point is about a crucial component of an effective policy-mix, namely a disarmament policy. That is, although economic benefits can be expected to be substantial, positive sanctions can be ineffective in the presence of a high risk of military conflict. In some cases, dynamics of military spending can lead to a higher risk of conflict escalating until the outbreak of a war. Therefore, reducing military spending is crucial. A copious literature on arms race has highlighted this aspect [see among others Mitchell and Pickering (2017), Glaser (2000), Sample S.G. (1997), Intriligator and Brito (1984)]. In addition, trade and military confrontation between rival states can coexist [see Levy and Barbieri (2004), Croft (1989)]. A recent experimental study by Abbink et al. (2019) shows that mutually beneficial trade does not decrease necessarily the likelihood of costly arms races. A reasonable interpretation behind this is that between rivals, military spending can be interpreted as a signal of hostility. In this perspective, Collier and Hoeffler (2006) developed a signaling model to study the impact of military spending on risk of renewed conflict in post-conflict societies. In particular, a war-averse government can choose a low level of military spending as a signal towards a rebel group in order to sustain a peaceful settlement. By means of a similar reasoning, plausibly positive sanctions cannot bring to more peaceful relations between states if not associated with a policy of disarmament.

3.3 Institutions

The third point is about the set of institutions governing commitment of states in trade policies. In fact, economic interdependence is more beneficial if it is managed under the umbrella of a legitimate institution [Caruso (2006); Mansfield and Pevehouse (2000)]. Particularly, in Caruso (2006) I developed an analytical model of conflict in which rational parties have to choose to be engaged in a continuing conflict or to settle and exchange under the umbrella of an institution. In any case, parties rationally spend in military capabilities, but the latter scenario would be more peaceful because the aggregate level of guns would be lower. A stable Nash equilibrium can be reached if and only if the cost (broadly defined) of joining an institution is not prohibitive. Moreover, the model also shows that results in terms of peacefulness hold even if the settlement between parties does produce unequal gains within certain boundaries. That is, even in the presence of unequal gains from trade, countries may still prefer rationally to settle at a lower level of guns rather than being engaged in a destructive conflict. In brief, the model suggests that a reasonable level of unequal benefits from trade is acceptable if and only if the parties take part into some institutional arrangement. This is inherently a crucial issue because the emergence of unequal gains from trade is commonly used by adversaries of liberal theory, to highlight risks and deficiencies of economic integration.

This aspect is also emphasized by Dumas (2011) that mentions it as one of the core principle of a peacekeeping economy. In this respect, it might be argued that the role of WTO becomes crucial. In particular, the role of the Dispute Settlement System could the most relevant.

Interestingly, when relaxing the assumption of states as unitary actors, a substantial attention ought to be paid also to civil society. To the best of my knowledge, with regard to negative sanctions, at the times this paper is being written, only few studies point out the relevance of civil society. Recently, the role of civil society has been founded relevant in Pospieszna and Weber (2020). They have shown that sending democracy aid through civil society organizations enhances the effectiveness of sanctions as a democracy promotion tool because the civil society is empowered to introduce democratic changes. In their interpretation, there is a bottom-up pressure exerted by the civil society which is to be added to the top-down pressure on the target government created by sanctions. The empirical results point out that sanctions imposed by the EU and the US are more likely to have a positive effect when aid flows bypass the government. Conversely, aid channelled through the public sector mitigates the generally positive effect of sanctions on democracy. In brief, composition and attitudes of civil society matter significantly.

While all of these points have to be considered for implementing effective positive sanctions, a major concern is credibility of sender countries. Credibility is often taken into account when debating about deterrence and threats. In fact, among economists it is well known that credibility plays a crucial role when implementing economic policies. Macro-economic stabilization, for example, is definitely linked to credibility of governments. In fact, credibility may play a crucial role. Eng and Urpelainen (2015) analyse the case of donors' credibility in foreign aid by shedding light even here on the role of domestic interest groups. In simple words, domestic groups are expected to support donor's implementation of rewards and therefore a credible instrument choice also depends upon preferences of interest groups. This is by no means a negligible point. It implies that multilateral positive sanctions may appear less credible than unilateral positive sanctions. That is, since credibility of states differ widely, multilateral positive sanctions can be less effective than unilateral positive sanctions. In this respect, it is likely that positive sanctions undertaken by a relatively homogenous group of countries turn to be more effective than a more diverse group of countries. In this line, EU positive sanctions can be inevitably more credible than measures announced by larger set of countries (ex. UN). Nevertheless, among all existing regional organizations, the EU is the organization that has made most progress in integrating foreign economic policies of member countries. In fact, EU has across many policy fields that can be included within a large set of foreign economic policies, such as trade, development assistance and international finance among others. In trade policy, in particular, the EU has had sole competence since the Treaty of Rome.

Finally, it can be maintained that the design of a framework for successful positive sanctions has to be based first upon the proper consideration of social groups within the target country. Then, from this, several suggestions emerge with regard not only economic interest groups, but also social groups broadly defined. Secondly, it is rather predictable that a successful positive sanction may be not only a punctual policy (trade or aid) but rather a policy-mix combining the economic instrument with disarmament and participation into a larger institutional setting.

4 Conclusion

This short paper has been an attempt to plot a thin interpretative line between evidence on negative sanctions and a plausible outline of positive sanctions. Two aspects have been highlighted as being crucial. First, a proper consideration of interest and social groups has been proven to explain the failure of comprehensive negative sanctions, the success of smart sanctions and – more interestingly – the potential success of positive sanctions. Secondly, the existence (or the lack) of some institutional arrangement between states also explains the failure of negative sanctions as well as the potential success of positive sanctions. On the first aspect, the lack of institutional coordination explains why sanctions-busting cannot be avoided whereas the existence of an institutional setting favours a more peaceful trade integration associated with a reduction in military capability of rival parties.

Finally, if considering a methodological point of view, it can be maintained that evidence on negative sanctions is worthwhile and helpful also when dealing with positive sanctions. Scholars and analysts would gain from developing comprehensive frameworks of research.

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