FOREIGN POLICY RESEARCH INSTITUTE

E-NOTES

"A nation must think before it acts." - Robert Strausz-Hupé

DECEMBER 2014

ECONOMIC SANCTIONS RECONSIDERED: U.S. SANCTIONS AGAINST CUBA AND RUSSIA

By Felix Chang

Felix K. Chang is a senior fellow at the Foreign Policy Research Institute. He is also the Chief Strategy Officer of DecisionQ, a predictive analytics company in the national security and healthcare industries, as well as Chief Executive Officer of LMODQ, a data-driven marketing firm. He has worked with a number of digital, consumer services, and renewable energy entrepreneurs for years. He was previously a consultant in Booz Allen Hamilton's Strategy and Organization practice; among his clients were the U.S. Department of Energy, U.S. Department of Homeland Security, U.S. Department of the Treasury, and other agencies. Earlier, he served as a senior planner and an intelligence officer in the U.S. Department of Defense and a business advisor at Mobil Oil Corporation, where he dealt with strategic planning for upstream and midstream investments throughout Asia and Africa. His publications have appeared in American Interest, National Interest, Orbis, and Parameters. His other FPRI articles can be found here: http://www.fpri.org/contributors/felix-chang

How effective are economic sanctions as a policy tool? The United States appeared to answer that question in two different ways over the past year. Just last week, President Barack Obama announced a major shift in U.S. policy toward Cuba. He would begin to remove longtime U.S. economic sanctions against Cuba. He contended that "fifty years have shown that isolation [had] not worked" and that the sanctions represented "a failed approach." Thus, he argued, American engagement, through commercial and cultural exchanges, would offer a better chance of bringing about change in Cuba.[1]

But across the Atlantic Ocean, Obama championed what seemed like a contrary rationale. In March, he argued that economic sanctions against Russia were needed to discourage it from intervention in Crimea and Ukraine. Starting with financial sanctions against members of Russian President Vladimir Putin's inner circle, the United States and its European allies gradually expanded their sanctions, banning Western energy companies from helping Russia to extract oil from the Arctic, deep-water offshore fields, and shale formations, and then restricting all but short-term financing to Russian banks and selected defense and industrial firms. On Friday, the West levied new sanctions that barred investment and trade with Crimea and enlarged the number of Russian and Ukrainian individuals under sanction. The Obama administration underlined that "These actions… send a strong message to the Russian government that there are consequences for their actions that threaten the sovereignty and territorial integrity of Ukraine."[2]

So, are economic sanctions effective or not? The short answer is that it depends on the situation. From an economic standpoint, the direct impact of U.S. sanctions against Cuba was quickly blunted. Soon after sanctions were imposed in 1960, the Soviet Union began to provide large amounts of economic aid to Havana. That would last for 30 years. More recently, Cuba benefited from the largesse of anti-American Chavista Venezuela. Even so, Cuba has suffered. Long-term U.S. economic

---

[1] President Barack Obama, "Statement by the President on Cuba Policy Changes," Office of the Press Secretary, The White House, Dec. 17, 2014, http://www.whitehouse.gov/the-press-office/2014/12/17/statement-president-cuba-policy-changes.

[2] Peter Baker, "U.S. Tightens Crimea Embargo to Pressure Russia," *New York Times*, Dec. 19, 2014; "Ukraine and Russia Sanctions," U.S. Department of State website, http://www.state.gov/e/eb/tfs/spi/ukrainerussia, accessed Dec. 18, 2014; Angela Monaghan and Jennifer Rankin, "EU and US sanctions against Russia: which will they hurt more?" *The Guardian*, Jul. 30, 2014.

sanctions ultimately raised the cost of capital needed for it to develop its economy. While it is hard to separate the impact of sanctions from the deleterious effect of Cuban government policies, evidence of Cuba's failure to create a modern economy is clear.

At first glance, one might assume that economic sanctions against Russia have been more successful. Within ten months of their implementation, Russia's economy has materially deteriorated and the country is now closer to a financial crisis than at any time since the late 1990s. But observing the decline in Russia's financial fortunes, one can see a closer correlation to the drop in the global prices for energy and commodities (on which the Russian economy relies), than to the implementation of Western sanctions. Indeed, the fall in the value of the Russian ruble has closely tracked the fall in the global price for oil. Both began to weaken in July; and both tumbled after November.

From a political standpoint, economic sanctions did not elicit changes in Cuban or Russian (so far) behavior that the United States had desired. They did not deter Cuba from fomenting trouble in Central America and as far away as Africa, during the Cold War. Similarly, they have yet to alter Russian behavior toward Ukraine. Indeed, a month after the first sanctions were levied, Russia annexed Crimea and has continued to intervene in Ukraine since then. Only the shoot-down of a Malaysian airliner in July seemed to briefly restrain Russian efforts in eastern Ukraine. Western sanctions against Russia, however, have provided Putin with a scapegoat on which to pin Russia's economic woes—one of his often mentioned "external factors." Together with his control of Russian media, that has helped to sustain his domestic popularity. Meanwhile, those in the West who support economic sanctions against Russia believe that they will ultimately loosen Putin's grip on power.

Whether or not sanctions are effective is not an academic question. Cuba and Russia are but two of several cases where the United States has used economic sanctions as a policy tool since the end of the Cold War. In the months leading to the Persian Gulf Conflict in 1991, the effectiveness of economic sanctions was the subject of heated debate. A political chorus, fearful of war, argued that economic sanctions would be sufficient to compel Iraqi President Saddam Hussein to withdraw his army from Kuwait and even remove him from power. They were not. In the latter case, not only were economic sanctions insufficient, but neither were a decisive Allied military victory over his army nor a domestic uprising that followed. It would take the 2003 American-led invasion and occupation of Iraq to finally topple Saddam Hussein's regime.

On the other hand, economic sanctions were successful on a number of occasions during the 1990s. There is the case of Malawi. In 1992, the United States severed its economic aid to the country in order to compel it to improve its democratic practices and human rights. Substantially dependent on that aid, Malawi quickly succumbed to the pressure and made its government more open. There is also the case of Guatemala. The mere threat of U.S. economic sanctions encouraged Guatemalan business leaders to force out the country's president, who had dissolved the legislature and sought to rule by decree. Lastly, some have argued that economic sanctions against Serbia played a key role in the successful conclusion of the Dayton Accords, which split Bosnia and Bosnia and Herzegovina from Serb-dominated Yugoslavia. (However, others contended that NATO's bombing campaign against Serbia was responsible for putting more pressure on its leaders to reach a deal.)

Ultimately, the effectiveness of economic sanctions seems to revolve around three factors:

- First is the question of whether economic sanctions are suited to achieve the objectives of the sanctioning country. Does the sanctioning country have sufficient economic leverage over the target country? Is the objective of the sanctions to deter a target country from an action or to compel it to take one? Is the objective straightforward (like punishing a target country) or more complex (like supporting an opposition group within a target country)?

- Second is the matter of the type of economic sanctions that a sanctioning country chooses to impose. Will the sanctions have an immediate effect or will their effect take time to materialize? Are they sufficiently broad or narrow? Naturally, those that are broad are more likely to have a bigger effect, but they might also produce unintended consequences given the less discriminating approach. Conversely, those that are narrow may be less likely to produce unwanted consequences, but their effect might be limited.

- Third is the issue of the susceptibility of the target country to economic sanctions. What is the capacity of a target country to withstand or adapt to sanctions? How resilient are its political and economic institutions? Is its financial situation already precarious? Moreover, there are also other features that must be considered: highly cohesive societies or those under effective authoritarian rule may react far differently than others comprised of fractious ethnic groups or those with organized opposition groups.

To see how these factors can interact, one need look no farther than North Korea, a country that has been under stringent international economic sanctions for over 60 years. While it enjoyed Chinese and Soviet support during the Cold War, their support had largely faded by the 1990s. At that time, some believed that North Korea would eventually be forced to come to the negotiation table, lest it face total economic ruin. Already, reports had surfaced that mass starvation gripped parts of the country. But North Korea stood fast. It continued to pursue a nuclear weapons program and, on occasion, threaten Japan and South Korea. American policymakers had to accept that they had underestimated the resilience of the Pyongyang regime and overestimated the ability of economic sanctions alone to compel North Korea into genuine negotiations (or even deter its actions).

In some ways, Cuba's situation resembles that of North Korea. Both are relatively small countries ruled by despotic communist regimes. Both were also left in a lurch at the end of the Cold War when Soviet aid disappeared. Fortunately for Havana, tourism and high nickel prices provided the Castro regime with enough hard currency to keep its economy afloat. When high oil prices threatened Cuba after the turn of the millennium, Havana was again fortunate. Venezuelan President Hugo Chávez, an admirer of Fidel Castro, provided Cuba with free or low-cost oil that it could resell on the international market to raise even more hard currency. Hence, the plummet in the global price of oil since July has hit Cuba doubly hard. It has not only put into question whether Venezuela, itself grappling with budgetary problems, can afford to continue its largesse to Cuba, but also reduced the profits Cuba can earn from reselling its oil. The Cuba that the United States opened relations with last week is one that ran out of lifelines. While Obama may have been correct that economic sanctions failed to work, he could have rightly claimed that they did make the Cuban economy more vulnerable to the vagaries of the global economy by limiting its ability to adapt to them.

Unlike Cuba, Russia is an enormous country endowed with an abundance of natural resources. But the Russian government's dependence on those natural resources to fund its budget made it vulnerable. That is well known. Putin even pointed out the danger of that dependence in a news conference last Thursday. (He also reiterated the need for Russia to diversify its economy.) As a result, it is easy to understand why a number of U.S. and European sanctions targeted Russia's ability to profit from those natural resources. But those sanctions are not what threaten the Russian economy with recession now. Banning Western energy companies from providing their services and technology to Russia's oil exploration efforts really hinders its oil production in the *future* oil production, not its oil revenues *today*.

What has hurt Russia's ability to generate more revenue from oil is the precipitous decline in the global price of oil. That decline was the result of growing expectations of lower oil demand due to economic slowdowns in China and Europe and higher oil supply as a result of new shale oil production in North America and the reluctance of OPEC countries to slow the growth of their oil output. (Interestingly, had those expectations not existed, Western sanctions that restricted future Russian oil production may have actually raised the price of oil.)

Since half of Russia's government budget relies on revenues derived from energy production, the decline in those revenues has led to concerns that the Russian state may have trouble financing its dollar-denominated debts. It is widely known that Russia's 2015 budget balances only when the price of oil is over $105 per barrel. Today it is under $60 per barrel. Those concerns grew into alarm in mid-December when the value of the Russian ruble plunged 20 percent in two days, the sharpest fall the currency has experienced since Russia's sovereign debt default in 1998. But Moscow is not without financial defenses. Learning from its earlier experience, Russia has built up a massive foreign exchange reserve of $415 billion (as of late December 2014). Though that reserve was $100 billion larger only a year ago, it is still a substantial sum that Russia can use to defend its currency. However, Russia also knows that the need to use those reserves would be seen as a sign of weakness and might precipitate another run on the ruble. And so, the Russian central bank hiked its key interest rate to 17 percent in a bid to curb further market speculation. Unfortunately, the interest rate hike will also curb economic activity in Russia, likely pushing it into an even deeper recession. Even Putin expects that that economic downturn could last for two years.[3]

Politically, U.S. and European economic sanctions did not prevent Russia from annexing Crimea. Nor did they impede its intervention in eastern Ukraine. As one newspaper put it, "Sanctions have hurt the Russian economy, but they have had no discernible effect on Mr. Putin's military strategy." [4] Instead, Putin has mounted counter-sanctions against the West, banning its food exports to Russia. Clearly economic sanctions can be a double-edged sword. Policymakers should recognize that some sanctions can backfire and others can even turn out to be counterproductive to their intended goals.

---

[3] President Vladimir Putin, "News conference of Vladimir Putin," Presidential Press and Information Office, President of Russia, Dec. 18. 2014, http://eng.kremlin.ru/transcripts/23406.
[4] "Too smart by half?" *Economist*, Sep. 6, 2014.

After last Friday's round of economic sanctions, the United States and Europe have signaled that they are ready to do more, if Russia does not comply. One dramatic action they could take would be to block Russia's access to the all-important international payments system that is run by the Society for Worldwide Interbank Financial Telecommunications or SWIFT. Doing so would exclude Russian banks from dollar transactions (much as Iranian banks were in 2012) and further strain Russia's already weakened economy. But would even that alter Putin's behavior? At this writing it appears that any success will likely be partial, especially if the West brings to bear no other sort of pressure. Russia still has a number of avenues open to it, not to mention a wealthy neighbor, China, whose foreign minister recently said that his country was willing to help Russia if it needed it.[5] Ironically, tighter economic sanctions today against Cuba, which has far fewer resources at its disposal, might have delivered a more clear-cut success than they are likely to produce against Russia.

The debate over the effectiveness of economic sanctions will not be settled anytime soon. Indeed, the effectiveness of international sanctions against South Africa during the 1980s is still disputed. Certainly under the right conditions, they can work as a policy tool. But one should not expect more than partial success in all but the most exceptional cases. Over the long run, sanctions can make national economies more brittle—vulnerable to larger changes in the global economy. However, policymakers must recognize that they are difficult to use as a precise means to compel or deter those countries that are not easily isolated. Then again, many simply see them as a way to punish a country without having to resort to military force. But to do so without a reasonable chance to achieve some objective consigns them to being more symbolic than practical.

[5] Ben Blanchard, "China foreign minister says willing to help Russia," Reuters, Dec. 21, 2014.