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Political economy of international sanctions

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1. Introduction

Over the last decades and especially since the end of the Cold War, international sanctions have risen dramatically in importance as a tool for coercion in international politics (see, e.g., Aidt et al. 2021; Felbermayr et al. 2020). This chapter explains what sanctions are meant to do and what they actually do. Our focus is on sanctions imposed on states and state actors, although sanctions are also used against non-state actors, especially those considered terrorist organizations (see Özdamar and Shahin 2021). Moreover, we focus on sanctions imposed by states, although sanctions can also be organized or enforced privately (Hart et al. 2024).

We largely ignore the debate on the effectiveness of sanctions here and refer interested readers to Peksen (2019), Attia et al. (2020), Kavaklı et al. (2020), Felbermayr et al. (2021), or Morgan et al. (2023). The sanctions effectiveness literature suffers from at least two major limitations. First, it is difficult to define and measure what exactly the goal of a sanction is and when it is achieved. It might be the official goal declared by policymakers, it might be another goal than that communicated publicly, or it might simply be the appearance of acting decisively in front of citizens or the international community. Second, the imposition of international sanctions, just like that of sanctions in domestic legal systems, does not only serve to change the specific behavior for which they are imposed, but they can also deter future undesirable activities. If country A sanctions country B with the goal that country B ends its policy B_1 , an important side effect of this is the signal to both country B and other countries that future policies similar to B_1 are also likely met with sanctions, which increases the expected cost of these policies and, hence, reduces the likelihood that they will be used. If B is sanctioned because it violates international law, then country A is effectively contributing to the public good of enforcing international law. Moreover, sanctioning B increases the credibility of threats of sanctions by country A against countries that adopt other undesirable policies. Therefore, an evaluation of the effectiveness of sanctions based only on whether country B ends policy B_1 may ignore most of the value generated for country A (and other countries) by imposing sanctions on B (see also Baldwin 1985; Eaton and Engers 1992, 1999). This may explain to some extent why sanctions are increasingly used although research frequently does not find them to be effective in a narrow sense.

Another issue omitted here is sanction-busting behavior, that is, the incentives of third states to trade with and invest in a sanctioned state, thereby undermining the

effectiveness of sanctions (Barry and Kleinberg 2015; Early 2015; Gutmann, Neuenkirch, and Neumeier 2024; Haidar 2017; Lektzian and Biglaiser 2013). Finally, this survey does not address the legality of sanctions under international law (see, e.g., Steinbach et al. 2023).

Tools that can influence the policies, politics, and institutions of states by providing material incentives can be organized in three categories. Agreements are consensual and the least intrusive form of foreign influence. Physical coercion is the most extreme form of foreign policy influence. In between the promise of benefits and the threat of violence falls a third category. Sanctions are the denial of benefits from exchange of people, goods, capital, or knowledge and technology. It is, thus, not surprising that in an ever more globalized world sanctions play a more and more important role. A fourth category of foreign influence would not provide incentives for desired actions, but information (or misinformation) that can change the target state's decision-making (e.g., Gorodnichenko et al. 2021; Martin et al. 2019).

All these instruments can be targeted at the population at large or (especially in a non-democratic setting) at powerful elites. The latter are referred to as targeted or smart sanctions and are supposed to minimize humanitarian collateral damage (see, e.g., Ahn and Ludema 2020; Besedeš et al. 2024; Draca et al. 2023). The sanctioning entities are either states or inter- or supranational organizations of states. Felbermayr et al. (2020) distinguish five types of sanctions covering trade, financial activity, travel, arms, military assistance, and a residual category. The first three types of sanctions target flows of goods, capital, and people. Arms and military assistance overlap with these categories, but they are of a different nature and of particular relevance to preventing or ending conflicts and terrorism. Felbermayr et al. (2020) also use an inductive categorization of commonly declared goals of sanctions. They observe sanctions aimed at (i) policy change, (ii) regime destabilization, (iii) territorial conflict, (iv) preventing war, (v) terrorism, (vi) ending war, (vii) human rights, (viii) democracy, and (ix) other goals. Aidt et al. (2021) provide a useful categorization of foreign influence in general. They distinguish (a) agreements, (b) measures to induce short-term policy changes via coercion, and (c) measures to induce long-term policy changes via coercion. Categories (i), (iv), (v), (vi), and (vii) by Felbermayr et al. (2020) often aim at short-term policy changes (i.e., b), whereas categories (ii), (iii), and (viii) aspire changes in political leadership or institutions that will alter policy in the longer run (i.e., c). The empirical categorization by Felbermayr et al. (2020) can, thus, be

understood as a refinement of the broader and theoretically derived categorization by Aidt et al. (2021). While agreements (i.e., a) do not fall into the same category as sanctions, there is a discussion of the respective merits of rewards versus sanctions in international law (Aaken and Simsek 2021).

The remainder of this chapter is organized as follows. Section 2 uses economic theory to explain why sanctions are used and how they work. Sections 3 and 4 give an overview of the empirical literature on the economic and political effects of sanctions. Section 5 speculates what future studies on sanctions might focus on.

2. Public choice theory of international sanctions

The public choice literature on international sanctions is largely based on the seminal contributions by Kaempfer and Lowenberg (1988, 1989, 1992, 1999). Sanctions are supposed to inflict economic harm with the goal of forcing the target country to change its policies. Hufbauer et al. (2009) show that sanctions are more likely to be successful the harder the target country's economy is hit. The basic idea of sanctions is that costs are imposed either on politicians themselves or on their supporters and they are only lifted once a particular policy is ended. Sanctions are imposed if a country causes externalities (Aidt et al. 2021) or if the sender has an interdependent utility function with parts of the target's population. An example for the latter is the desire to prevent human rights violations or to protect the interests of groups characterized by a particular nationality, ethnicity, or religion. Interdependent utility functions can also motivate sanctions against target populations that are disliked by the sender (see Becker et al. 2015).

The simple mechanism of sanctions is complicated by two facts. The first one is human psychology. In spite of imposing costs, sanctions can backfire when they create a rally-around-the-flag effect. Under a perceived external threat, citizens may increase their support for their government rather than punishing it for the economy's bad performance, as they think unity is required to defend the nation (see, e.g., Alexseev and Hale 2020; Gold et al. 2024). An analogous effect can exist in the sanctioning state. In that case, sanctions might not be introduced because of interest in a policy change, but simply for political reasons – to increase the incumbent government's popularity.

The second complicating fact is the creation of economic rents when sanctions are imposed. Sanctions create winners and losers in both the sanctioning and the target

country (see, e.g., Halcoussis et al. 2021; Kaempfer et al. 2004). If a sanctioned government experiences a rally-around-the-flag effect and is able to create and extract rents, for example, because it controls an industry that is shielded by sanctions from international competition, it could even gain in terms of both popularity and wealth. When sanctioning governments are maintaining sanctions in such situations over long periods of time, it is likely for expressive purposes, for example, to be seen as doing something.

Since sanctions regulate flows between countries, sanctions always have the potential to also hurt the citizens of the sanctioning state. This risk is reduced if the sanctioning state's economy is larger than that of the targeted state and if the sanctioning state is able to substitute the missing flows of goods, capital, information, and people. Rents are also created in the sanctioning state, which means that lobbyists or politicians may support the imposition or maintenance of sanctions because of their private economic gains (Pond 2017), even if they are not in the interest of the general population. However, domestic special interests may also lobby against sanctions that would be favored by the general population (McLean and Whang 2014). For example, in the discussion of an energy embargo against Russia after its illegal invasion of Ukraine, German employers and labor unions spread inflated estimates of the anticipated economic costs to sway public opinion.

The costs of sanctions differ between the short run and the long run. In the short run, costs can be reduced if stockpiles are available that can substitute for sanctioned imports. However, the costs of sanctions are to a large extent adjustment (i.e., transaction) costs. Over time, economies can establish new trade ties, find new investors, attract new consumers, or change their production processes. This will dramatically reduce the costs of existing sanctions and may necessitate the imposition of new sanctions to maintain pressure. As sanctions are costly to both parties, it is in the interest of sanctioning countries to induce policy change already with the threat of imposing sanctions, as threats are comparatively cheap (see, e.g., Grauvogel et al. 2017; Whang et al. 2013). For these threats to be taken seriously, a government needs to build up a reputation of formulating credible threats.

3. Economic and social effects of sanctions

Sanctions have been shown to have important effects on human development, especially on the level and distribution of income. Neuenkirch and Neumeier (2015) show that sanctions, especially those imposed by the UN, lower income per capita. In an event study, Gutmann et al. (2023) demonstrate that this effect is particularly pronounced in the first years of a sanction period. Consumption, investment, trade, and FDI are reduced. This evidence is consistent with the extant literature, which has demonstrated reductions in trade (Afesorgbor 2019; Crozet and Hinz 2020) and foreign direct investment (Biglaiser and Lektzian 2011; Mirkina 2018). Long-lasting sanctions, however, appear not to harm target countries significantly after the first years and might therefore be of limited use in bringing about policy change. In addition, Biglaiser and Lektzian (2020) demonstrate that the marginal negative effect of sanctions on stock markets in target countries declines as the number of sanctions increases. One way in which sanctions can harm economies in the short run is by triggering economic crises (Hatipoglu and Peksen 2018; Peksen and Son 2015). This effect is amplified by a reduced willingness of the International Monetary Fund to lend to countries under sanctions (Peksen and Woo 2018). The effect of sanctions on the informal economy appears to be ambiguous (Early and Peksen 2019; Farzanegan and Hayo 2019), but sanctions reduce economic freedom and property rights protection (Lee et al. 2023; Lektzian and Mkrtchian 2021; Peksen 2016b).

Sanctions do not affect all members of society equally. Although they are often supposed to exert most pressure on politically influential elites, empirical evidence shows consistently that poverty and income inequality increase under international sanctions (Afesorgbor and Mahadevan 2016; Choi and Luo 2013; Ghomi 2022; Moteng et al. 2023; Neuenkirch and Neumeier 2016). Sanctions also reduce manufacturing employment and especially that of women (Demir and Tabrizy 2022).

Target governments react to sanctions by changing the composition of government expenditures. Dizaji and Farzanegan (2021) and Farzanegan (2022) show that Iran has reduced its military spending due to international sanctions. Escribà-Folch (2012) shows that the response of sanctioned dictatorships depends on their regime type (see also Cho 2019). Single-party regimes increase spending on subsidies and transfers, which largely benefit their key constituencies. Military regimes increase spending on goods and services, which include military equipment and soldiers' and officers' wages. Sanctioned personalist dictatorships reduce spending in all categories. Gutmann et al. (2023) show

that democracies under sanctions increase the share of their total government expenditures spent on the military.

The effect of sanctions on human development is, of course, much broader than merely changes in income levels and the distribution of resources. A major topic of research is how sanctions affect target populations' health and life expectancy. The findings of Allen and Lektzian (2013) indicate that highly effective sanctions have adverse health effects that are comparable to those resulting from major military conflicts. Peksen (2011) studies the effect of sanctions on child mortality rates and finds that the human cost of sanctions is largely conditional on the extent to which sanctions are costly for the target's economy. Parker et al. (2016) study sanctions against firms operating in specific parts of the Democratic Republic of the Congo under Section 1502 of the United States' Dodd-Frank Act. They find that the boycott on mineral purchases meant to disrupt the finances of local warlords increased infant deaths in villages near the targeted mines by over 140%. The boycott, *inter alia*, reduced mothers' consumption of infant health care goods and services.

Gutmann et al. (2021) show that sanctions cause on average a decrease in life expectancy of about 1.2 to 1.4 years during an episode of UN sanctions and of 0.4 to 0.5 years under US sanctions. Women are affected more severely by the imposition of sanctions, which confirms claims in the qualitative literature on the effects of sanctions. In that sense, sanctions are adverse shocks on a society that are comparable to violent conflict and natural disasters, which have been shown to affect women more than men. Gutmann et al. (2021) also detect effect heterogeneity. The reduction in life expectancy accumulates over time under lasting sanctions and countries with a better political environment are less severely affected by sanctions. An increase in child mortality and Cholera deaths as well as a decrease in public spending on health care are transmission channels through which UN sanctions adversely affect target populations' life expectancy.

In contrast to the effects of sanctions on health, there is little evidence on how target populations' education is affected. Moeeni (2022) shows that sanctions imposed on Iran in 2006 decreased children's total years of schooling by 0.1 years and the probability of attending college by 4.8 pp. Iranian households reduced education spending by 58%. The effects were larger for children that were exposed to the sanctions for longer.

Given the adverse economic and social effects of sanctions, it is not surprising that sanctions cause increased emigration from target countries. The effect is most pronounced in countries that limit free speech (Gutmann, Langer, and Neuenkirch 2024).

Economic effects can not only be measured for target countries, but also senders pay a price. This has been illustrated based on sanctions aimed at particularly large economies: the sanctions against Russia after its illegal annexation of Crimea in 2014 (Bělin and Hanousek 2021; Crozet and Hinz 2020; Gullstrand 2020; Kholodilin and Netsunajev 2019) and against China after the Tiananmen Square Incident in 1989 (Webb 2020).

4. Political effects of sanctions

At this point, the political effects of sanctions are as well understood as their economic consequences. A main political goal of sanctions is to cause public unrest and weaken the government's popularity, such that the government is replaced or becomes willing to make concessions. Allen (2008) demonstrates that sanctions indeed promote antigovernment activity and, according to Grauvogel et al. (2017), sanction threats can already trigger domestic protest. Marinov (2005) shows that, intended or not, sanctions do destabilize political leaders. Another political motive for sanctions is ending conflicts. There, the evidence is less supportive. Sanctions in general rather escalate than deescalate conflict. An exception are arms embargoes, which are indeed able to reduce conflict violence (Hultman and Peksen 2017).

Since sanctions are a threat to the political goals and the survival of political regimes and leaders, it is not surprising that these regimes take strong measures to hold on to political power and to continue extracting rents from their office. The adverse economic shock caused by sanctions not only motivates infringements of economic and political rights through the confiscation of private property (Lee et al. 2023; Peksen 2016b) and political repression (Adam and Tsarsitalidou 2019; Peksen and Drury 2009, 2010), but also violations of basic human rights (Escribà-Folch 2012; Peksen 2009; Wood 2008). Carneiro and Apolinário (2016) provide evidence that targeted UN sanctions against African states do not have less detrimental consequences in that respect than regular sanctions. Sanctions have also been found to amplify discrimination against women (Drury and Peksen 2014) and marginalized social groups, especially ethnic minorities

(Peksen 2016a). On a more positive note, Soest and Wahman (2015) find that sanctions aimed at promoting democratization do indeed coincide with democratic transitions.

Unlike previous studies, Gutmann et al. (2020) find no support for adverse effects of sanctions on economic rights or basic human rights, once the endogenous selection of sanctioned countries is modelled. With respect to women's rights, their findings even indicate a positive effect of sanctions, especially on women's economic rights. Gutmann et al. (2020) find that only political rights and civil liberties significantly deteriorate under international sanctions. Their results underline that it is important to account for the potential endogeneity of sanctions and to distinguish different dimensions of rights, as the effects of sanctions along those dimensions may vary considerably.

5. Outlook

The theoretical literature on international sanctions is well-developed. In contrast, the empirical literature on the use, the effectiveness, and the effects of sanctions has only begun to answer the most important questions. There are at least two paths that should allow us to generate more and more reliable empirical evidence in the coming years. First, more detailed data is needed on characteristics of sanctions, their goals, and the political process in which they are designed. Second, empirical studies will need to invest more into demonstrating causal effects (see also Egger et al. 2024; Felbermayr et al. 2021; Morgan et al. 2023). Many previous studies have ignored potential problems with endogeneity altogether and should be reestimated using a more rigorous research design. In recent years, several studies have introduced more credible research designs into the sanctions-literature. Gutmann et al. (2020) is a first attempt at using IV regression. Gutmann et al. (2021) and Neuenkirch and Neumeier (2016) apply entropy balancing as a matching technique. Gutmann et al. (2023) is an example for the use of an event study design and panel diff-in-diff estimation. Farzanegan et al. (2022) applies the synthetic control method to study a single country case.

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