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Unintended Consequences of Sanctions on Russia

by Dennis Avorin and Judith Levy

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EXECUTIVE SUMMARY: The Russian annexation of Crimea in 2014, the downing of a civilian aircraft, and the Russian military aggression in Ukraine were serious violations of the international order that required a powerful response from Western powers. But what is the right response to such provocations – and who might be affected other than the intended target?

Economic sanctions are a tantalizing tool with which to counter aggression and punish hostile action, as they allow a moral stand to be taken without the immediate risk of direct military confrontation. But a corollary to almost every tenet of international relations is the tendency of well-intended actions to have unintended consequences. Sanctions have the potential to be severely disruptive – indeed, the creation of a motivating problem is largely their purpose. Yet sanctions, which disrupt global value chains, can create as many problems as they solve, and not always in the expected quarters.

For the past year, the debate on Russia sanctions has dominated the foreign policy debate in the US. Various initiatives introducing additional sanctions policies have been proposed by both the administration and Congress. Europe, too, is examining both how to manage existing sanctions policies and whether to introduce new ones.

Because of the risk of causing global financial turmoil, the US Treasury Department is apprehensive about expanding sanctions on the Russian sovereign debt market. This poses a dilemma for the Trump administration, as pressure from Congress for additional sanctions is mounting in Washington.

Sanctions have amounted so far to the freezing of assets, travel bans for individuals designated as members of the Russian elite, suspension of EBRD loans, a ban on large public banks and defense corporations, a military equipment embargo, and a ban on exports of dual-use items. These sanctions, although targeted, have been costly not only for Russia but also for the economies doing the sanctioning.

A research paper by the Kiel Institute for the World Economy calculated that Germany bears almost 40% of the Western trade loss, compared with a mere 0.6% incurred by the US. This indicates strong "friendly fire" effects of the economic sanctions on Russia.

A substantial literature exists investigating the variety of unintended consequences of sanctions for target countries – consequences that range from the disproportionate and counterproductive punishment of large civilian populations, to the intensifying of local violence, to the wholesale erosion of political rights. A new policy paper by the think tank European Centre for Entrepreneurship and Policy Reform (ECEPR) extends this scope by looking at effects on trade with Russia on the two Western economies that have *not* engaged in the sanctions: Israel and Switzerland.

Israel elected to abstain from participating in the sanctions regime against Russian aggression in Ukraine on the grounds that diplomatic efforts to resolve the crisis had not yet been exhausted. That decision might appear surprising in view of Israel's profound friendship and unquestioned alliance with the US. But while that alliance remains strong, Israel has found it necessary over the past decade to chart an independent course in its relations with Russia – particularly in view of Moscow's substantial military presence in Syria and close collaboration with Tehran in shoring up the Assad regime. As Iran has become increasingly emboldened in its pursuit of an unbroken Shiite corridor to the Mediterranean, it has become more and more urgent for Israel to have good relations not only with Washington but also with Moscow, which has emerged as the primary force that can restrain Tehran's growing presence in Syria and thereby contain the correspondent risk of an Israeli-Iranian confrontation.

One might initially presume that non-sanctioning countries are bound to benefit from any sanctions regime, as they have a narrower field of competition for the targeted country's trade. But according to the data compiled and analyzed in the ECEPR study, the reality is counterintuitive: in terms of exports, both Israel and Switzerland have been harmed, not helped, by the sanctions imposed on Russia.

In observing trade volumes through the end of 2016, the ECEPR study found that exports to Russia by the four largest sanctioning states (the US, Japan, Germany, and the UK) fell to 70% of pre-sanctions levels. The reduction in Switzerland and Israel was remarkably similar, with average exports falling to 74% and 75%, respectively, of pre-sanctions levels. The export losses of Israel and Switzerland amount to US$680 million and US$2.3 billion, respectively.

The explanation for this appears to be that Israel and Switzerland are part of the same global value chains as other Western economies. Sanctions interfere with these chains, and that interference hinders trade even among non-participating countries. Sanctions thus have a multi-level negative effect: they harm participating countries through loss of trade, and they harm non-participating countries through their interdependency on the same financial mechanisms and relationships that bind the participating countries to the target.

The ECEPR study warrants close attention because it highlights a little-recognized danger inherent in economic sanctions. The world is now profoundly interconnected, more so than ever before. The global value chains that link nations underpin global security. Sanctions may well be justified in the instance of the Russian intervention in Ukraine – but in addition to their unintended consequences of driving Russia and China closer together, encouraging Russia to further intensify its economic relationship with Iran, and potentially nudging Europe towards Russia rather than away from it, they have the further deleterious effect of inhibiting trade with non-sanctioning economies.

This has implications not only for the economies concerned but also for global security, which depends more and more on interconnected, interdependent global value chains.

The sanctions, so far, have had a limited effect on Russian policy while imposing a heavy burden on US allies. A report by the Centre for European Policy Studies suggests that Putin's popularity has risen to its highest-ever point during the course of the sanctions – not an uncommon side effect of isolation policies.

Policymakers in Washington should bear in mind that trade fosters long-term global stability, and their arsenal of economic sanctions will be depleted once Russia is fully alienated from the West. As the 19th-century economist Otto T. Mallery wrote: "If goods don't cross borders, soldiers will."

This article is a revised version of an op-ed that appeared in The Jerusalem Post *on February 14, 2018.*

Dennis Avorin has a Masters in Interdisciplinary Research and Studies on Eastern Europe from the University of Bologna, with a special focus on Russian foreign policy and transition economics. He previously served as Desk Officer at the Swedish Ministry for Foreign Affairs.

Judith Levy is English Publications Editor at the Begin-Sadat Center for Strategic Studies.

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