ISSUE

REPORT Nº 25 – September 2015

On target? EU sanctions as security policy tools

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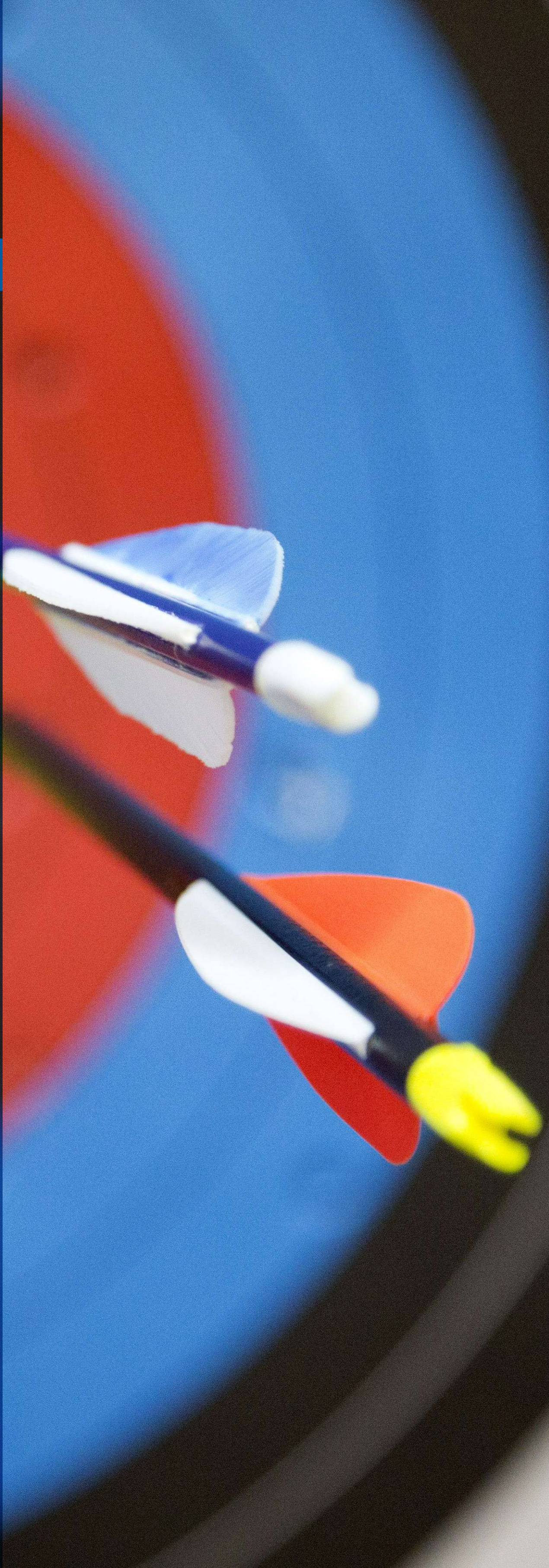

Reports

European Union Institute for Security Studies

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75015 Paris

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ISBN 978-92-9198-369-8

ISSN 2363-264X

QN-AF-15-003-EN-N

Doi: 10.2815/710375

Published by the EU Institute for Security Studies and printed in Condé-sur-Noireau (France) by Corlet Imprimeur.

Graphic design by Metropolis, Lisbon.

Cover photograph: credit: Charles Sykes/AP/SIPA

CONTENTS

ACKNOWLEDGEMENTS

This report is the outcome of an EUISS Task Force on sanctions that has worked throughout the spring of 2015. The Task Force has involved personnel from the European External Action Service (EEAS), the Council, high-level European academics, and the EUISS.

We would like to thank in particular Thomas Biersteker (Graduate Institute of International and Development Studies), Peter van Bergeijk (Erasmus University of Rotterdam), Clara Portela (Singapore Management University) and Francesco Giumelli (University of Groningen) for being actively engaged throughout the project as core members of the Task Force and for authoring several EUISS publications and contributing to this report. We would also like to thank the EEAS Sanctions Policy Division for their helpful feedback in the run-up to the report's publication. In addition, we extend our gratitude to Anete Stipniece (Latvian Permanent Representation to the EU) and Matej Pedíček (General Secretariat of the Council) for their valuable participation and input throughout the meetings.

We also wish to thank Sara Bazoobandi (Regent's University and Chatham House), Edward Hunter Christie (NATO), Richard Connolly (University of Birmingham and Chatham House), Maria Lipman (European Council on Foreign Relations), Erica Moret (Graduate Institute of International and Development Studies), Rouzbeh Parsi (Lund University), Stanislav Secrieru (Polish Institute of International Affairs), Peter Seeberg (University of Southern Denmark), Ali Vaez (International Crisis Group) and Rachel Ziemba (Roubini Global Economics) for having offered their input during the various events organised as part of this project.

Nicu Popescu and Florence Gaub, Senior Analysts at the EUISS, actively participated in most of the Task Force group meetings and provided helpful input for the preparation of the Iran, Syria and Russia-focused roundtables. José Luengo-Cabrera, Associate Analyst, and Iana Dreyer, Senior Associate Analyst at the EUISS, have managed the project.

The responsibility for the content of this report lies exclusively with the EUISS.

FOREWORD

Sanctions have increasingly become important security policy tools – by design as well as by default. Whenever countries (especially Western countries) are confronted with an international security crisis in which they agree that they cannot (or will not) use military force, resorting to various types of restrictive measures has proved to be a way of showing a willingness to react and to influence developments – past, present and future.

Sometimes symbolic, and therefore mainly declaratory, but often aimed at exercising some form of 'civilian' deterrence – by other means, so to speak – EU sanctions have recently increased in frequency, intensity and saliency. But we tend to forget that European 'foreign policy' used sanctions from the outset (against South Africa, in the late 1980s) and always waved them as a possible form of political pressure on reluctant interlocutors – whenever positive diplomacy, based on incentives and rewards, failed.

Over the years, subsequent 'generations' of sanctions have been enforced – by the international community as well as the EU itself: comprehensive or, more recently, targeted; multilateral or, as is increasingly the case, unilateral – or rather mini-lateral. Opinions regarding their 'effectiveness' have varied significantly, depending also on the political lenses of the beholder – but empirical expert analysis can now offer a judicious evaluation of their intended and unintended consequences.

The EUISS Task Force that, under the stewardship of Iana Dreyer and José Luengo-Cabrera, has produced this report aimed from the outset at combining the functional and regional expertise of academics and the operational experience of policymakers with a view to offering a balanced assessment of the impact of EU sanctions in contexts in which they served an explicit security policy function: in Iran, Syria and, since last year, Russia. After first addressing the topic in 2012/13 – with the publication of an *Occasional Paper* by Charlotte Beaucillon and a *Chaillot Paper* by Francesco Giumelli[1]– the Institute has revisited this aspect of EU 'foreign policy' by trying to highlight the complexity of the discourse on sanctions, their use and their alleged 'effectiveness', while providing an original narrative to evaluate their impact and scope. This report, coupled with the other short(er) publications produced by the Task Force, offers valuable insight into a practice that is now part and parcel of the Union's 'security' policy toolbox – although it is rarely conceptualised and evaluated as such.

Antonio Missiroli

Paris, September 2015

1. See Charlotte Beaucillon,'Comment choisir ses mesures restrictives? Guide pratique des sanctions de l'UE', *Occasional Paper* no. 100, EUISS, December 2012, and Francesco Giumelli, 'How EU sanctions work: a new narrative', *Chaillot Paper* no. 129, EUISS, May 2013.

INTRODUCTION

Iana Dreyer and José Luengo-Cabrera

Sanctions are part of a panoply of tools used by the European Union to further the goals of its Common Foreign and Security Policy (CFSP). Called 'restrictive measures' in official EU language, they are imposed against target governments, commercial entities and individuals to penalise a policy or course of action that contravenes international law and political norms.

Over the past two decades, the EU has made increasing use of sanctions. Its role as an international sanctions 'sender' is now comparable to that of the United States, the world's biggest sanctioning power. While its position has historically been complementary to the United Nations' (UN) sanctions regimes, the EU has in recent years imposed unilateral sanctions more frequently.

EU sanctions goals vary and aim to address different CFSP objectives which include: conflict management (Afghanistan in 1996, Libya and Syria in 2011); democracy and human rights promotion (Belarus in 2006, Syria in 2011); post-conflict institutional consolidation (Guinea in 2009); nuclear non-proliferation (Libya in 1994, Iran since 2006); countering international terrorism (Libya in 1999 and terrorist organisations on the EU list); and, more recently, condemning and containing the violation of a sovereign state's territorial integrity (Russia 2014).

Sanctions come in different forms: asset freezes; travel, visa and investment bans; withdrawal of financial aid; arms, commodities and trade embargoes; restrictions on banking transactions – just to name the most important ones. They serve multiple purposes by way of coercing a change in proscribed behaviour, constraining a target's capacity for discretionary action, or acting as a signalling device to deter future transgressions of international norms.

The EU's sanctions policy (along with that of the US and the UN) has evolved in tandem with the rising number of sanctions regimes. Prompted by the need to mitigate the unintended negative consequences of comprehensive sanctions (such as large-scale trade or oil embargoes) on civilian populations, senders have increasingly shifted their sanctions policy to a system of 'targeted' or 'smart' sanctions such as asset freezes or travel bans. These specifically target commercial entities (both private and state-owned) or top-level decision-makers engaged in the activities that the sender seeks to penalise. Moreover, this fine-tuning of sanctions as policy instruments has been driven by an attempt to avert the counterproductive effects brought about by comprehensive sanctions, which often generate rent-seeking opportunities that can entrench the power positions of the targets at fault.

It is now largely recognised that sanctions – whether comprehensive or targeted – tend to be embedded in wider strategies that involve other policy instruments, ranging from diplomatic engagement to the threat or actual use of force. It is therefore important to view sanctions in context as they are seldom imposed in isolation from other measures. Consequently, while the complementarity of different policy instruments serves to reinforce their overall intended impact, it hinders the capacity to isolate and identify the causal effects of sanctions, thereby raising questions regarding their underlying effectiveness.

At a time when the EU's track record as a sanctioning actor remains somewhat mixed, assessing the conditions under which restrictive measures tend to deliver on their desired outcome appears as a necessity to improve the way in which future sanctions regimes are strategically designed. Through the lens of an empirical framework and a selection of applied case studies, this report aims to support evidence-based policymaking.

Although imperfect statistical data and the ubiquitous confluence of factors often undermine evaluations of the causal effect of sanctions, this report corroborates the assertion that (pre-)conditions matter in determining when and how sanctions work. Amid lingering questions over their utility in restraining the proscribed actions of the Assad regime in Syria, curbing Iran's nuclear programme or softening Russia's aggressive stance on Ukraine, the EU stands to benefit from a balanced, empirically-informed assessment on how sanctions have been implemented, monitored and enforced.

The EU as a sanctioning actor

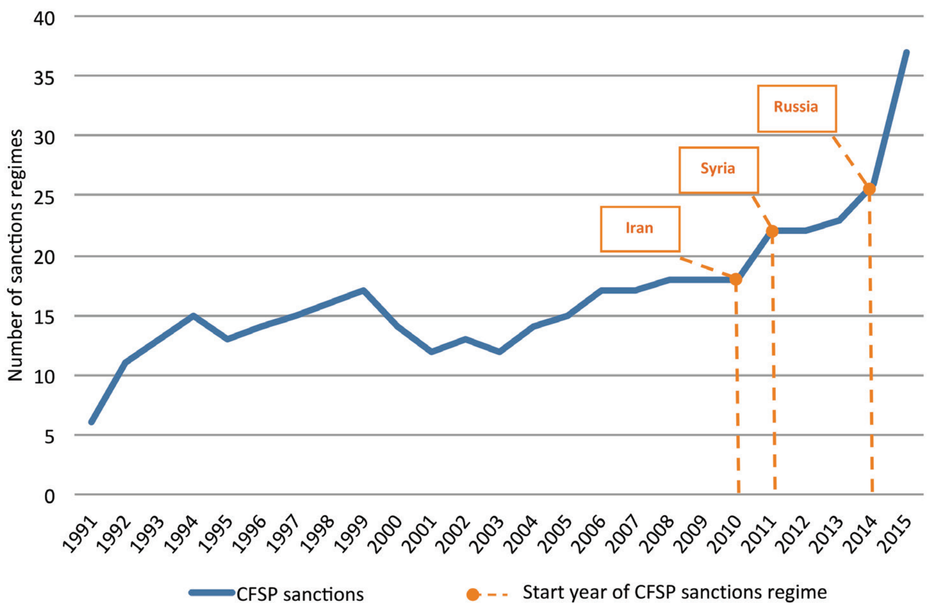
The EU's increasing activity in the field of sanctions has enhanced its visibility as a foreign policy actor on the international stage. The incorporation of restrictive measures within the CFSP 'pillar' serves to further the Union's endeavour to become an increasingly active security provider. Consequently, it has been relying on the imposition of sanctions as a way to address security issues within and beyond its neighbourhood.

As the cases of Iran, Russia and Syria highlight, EU sanctions have been imposed to address situations that constitute a threat to international security. By way of penalising policies or activities deemed to be spreading insecurity within a targeted state and beyond, the EU has implemented sanctions as security policy tools. Amid significant financial constraints, EU sanctions have emerged as cost-effective instruments. Currently constituting a relatively minor drain on the EU budget, they represent an attractive option in the absence of alternative means of coercion.

Lacking significant military capabilities of its own, the EU has a comparative advantage in the use of economic sanctions as a form of coercive diplomacy. As the world's largest trading entity, a major global investor and the largest global aid donor, it has real economic leverage *vis-à-vis* sanctioned targets. Nonetheless, the EU's share of global output is progressively shrinking as the world economy's centre of gravity shifts to Asia and other emerging markets, with potential long-term implications for its sanctions policy.

The growing volume and political salience of EU sanctions points to the fundamental role they play as CFSP tools. To date, the EU has 37 sanctions regimes in place – a fivefold increase when compared to 1991 and more than double the number that existed in 1999 – with a record list of targeted non-state entities and individuals. While the EU has become a prolific imposer of restrictive measures akin to the US, as a *sui generis* supra-national entity, the Union continues to encounter significant challenges that hinder its ability to deliver on its sanctions expectations. Overcoming (or at least attenuating) these hindrances would contribute to reducing the downside risks with which the EU is recurrently confronted as a sanctioning actor.

Figure 1: Evolution of CFSP sanctions regimes



Source for data: De Vries, Portela & Guijarro-Usobiaga (2014); European External Action Service

Decision-making

The mere fact that the Union is composed of 28 member states already sheds light on the complex nature of its decision-making structure. Reflecting the degree to which sanctions are a highly politicised issue, positions on sanctions vary significantly across member states, with opposition to implementation often being greatest when commercial ties with targets are highest. The required Council unanimity on decision-making procedures acts as a barrier to setting up sanctions regimes in an expeditious manner. Cases such as the oil and gas embargo on Iran highlight the disparities that emerge when some member states are more adversely affected than others. Given Greece, Italy and Spain's heavier reliance on Iranian oil imports, the EU's oil ban was implemented six months after it was agreed so as to allow these three countries to secure new sources of provision. Although compensatory schemes are often put in place, domestic political consensus on the reasons for initiating the sanctions regime may trump short-term economic considerations, as is currently the case with restrictive measures against Russia in some Central European countries. Consequently, the protracted negotiations required for reaching consensus inside the EU often provide targets with breathing space to adapt and circumvent future sanctions. Streamlining the decision-making process would provide an opportunity to shorten the implementation time-frame, but there seems to be little appetite for doing that.

In Brussels itself, the Council Secretariat, the Commission and the European External Action Service (EEAS) all have a role in sanctions design and decision-making. This fragmentation often slows down implementation in crisis contingencies that require rapid action. Although the Council managed to swiftly achieve unanimity in the case of sanctions imposed against Russia, there is no guarantee that this will become standard practice. The inevitable internal compromises over the extent and nature of EU sanctions imply that decisions can be sub-optimal.

Implementation and enforcement

Weak implementation and enforcement procedures appear as additional limitations to the effectiveness of sanctions regimes. Once restrictive measures are adopted, the resources dedicated to monitoring and compliance at EU level fall short of what is effectively required. Indeed, given that these competences fall within the purview of member states' law-enforcement agencies, measuring the extent to which sanctions are being implemented and enforced inevitably lacks EU-wide coordination, leading to uncertainty over whether sanctions are fulfilling their intended objectives. In the absence of an EU agency akin to the US Office of Foreign Assets Control (OFAC), there is no standard procedure to verify the degree of compliance. With disparities in the capacity (as well as willingness) of member states to implement, monitor and enforce sanctions, loopholes which targets can exploit are more likely to appear.

Legality

In addition, the EU has been faced with a series of challenges filed by sanctioned entities and individuals at the European Court of Justice (ECJ). This derives principally from the difficulty of providing sufficient evidence regarding the alleged links between sanctioned entities or individuals and the target regimes at fault. The Kadi II case has been telling in this respect, following a ruling by the ECJ in favour of three Syrian businessmen who were unlawfully listed under the Syria sanctions regime. Citing a lack of substantive evidence to prove any links between the three individuals and the Assad regime, the EU was obliged to pay them damage compensation.

Similarly, the ongoing contestations filed by the Russian company Rosneft and the National Iranian Oil Company (NIOC) have raised concerns about the evidence put forth by the Council to justify the listing of commercial entities under sanctions regimes as well as the extent to which classified information can or should be used in such proceedings.

In sum, although the EU has taken major steps to hone the way in which sanctions regimes are designed, it is still confronted with a learning curve with regard to its ability to implement and enforce them. There is indeed much to be celebrated *vis-à-vis* its rising reputation as a responsive sanctioning actor, especially in view of its readiness both to condemn and penalise reprehensible behaviour and to reward progressive compliance – yet challenges remain, and addressing them effectively is made more difficult by the Union's own internal economic difficulties.

Report overview

This report is the product of a EUISS Task Force on EU sanctions that ran from February to July 2015, which included academics and think tank experts – combining *functional* knowledge of sanctions and relevant *regional* expertise – as well as EU officials. A series of roundtable meetings were organised to engage participants in an open discussion about the EU's sanctions regimes against Iran, Russia and Syria. Resulting from the expert insights gathered throughout the meetings – as well as some participants' contributions to a series of shorter EUISS publications dedicated to the issue – this report represents a collection and synthesis of the Task Force members' insights and findings.

Through a mix of quantitative and qualitative evaluations, individual chapters take an in-depth look at a selected sample of sanctions regimes and offer informed insight showcasing what the available evidence can tell us about the conditions under which EU sanctions tend to have their biggest impact. The Task Force was not expected, however, to assess the economic cost of sanctions on the EU itself nor the possible ways in which the EU institutions could be streamlined to impose and implement sanctions in a more *efficient* manner – however important these issues may indeed be. Finally, given that the sanctions regimes considered here are all ongoing, the contributions in this report need to be seen as a preliminary evaluation of the situation as it stood at the time of writing (mid-2015).

The most important feature – and added value – of this report is the fact that the cases are seen through the lens of an empirical analytical framework presented by two eminent sanctions scholars: Thomas Biersteker, from the Graduate Institute in Geneva, and Peter van Bergeijk, from Erasmus University in Rotterdam. Thomas Biersteker has steered the UN Targeted Sanctions Consortium, which has worked for many years on the evaluation of UN sanctions' effectiveness. Peter van Bergeijk is an economist who has written extensively on sanctions policy and is familiar with the outstanding work on sanctions carried out by the Peterson Institute for International Economics in Washington DC. These scholars have synthesised the latest insights offered by empirical research and academic literature on sanctions, drawing from various disciplines (economics, political science, sociology and psychology). This literature has so far focused strongly on UN and US sanctions. Yet, as this report shows, its findings offer a powerful prism through which to also assess current EU sanctions regimes.

By building on the framework presented by Francesco Giumelli in the Institute's *Chaillot Paper* no. 129 on EU sanctions (2013), the report adopts a 'new narrative' on how sanctions' effectiveness can be conceptualised. Acknowledging the validity of mainstream interpretations, the report endorses a paradigm shift whereby the 'success' of sanctions is not merely determined by the extent to which they coerce targets into changing their proscribed behaviour. Indeed, alternative (or complementary) interpretations of effectiveness vindicate an approach based on the *relative*, as opposed to absolute, impact of sanctions. By measuring the success of sanctions through the degree to which they constrain targets in pursuing their discretionary course of action – as well as how they can act as signalling devices to deter future wrongdoings – such an approach counters the pessimistic views that have long pervaded the sanctions literature. In an attempt to assess whether EU sanctions are 'on target', the case studies examine the appropriateness of adopting a more nuanced framework of analysis whereby sanctions' effectiveness is interpreted as the degree to which their coercing, constraining and signalling effects prompt targets to comply progressively.

Last but not least, this report aims to shed more light on an EU policy area that is still under-researched at a time when sanctions are becoming more important in terms of their number, scale and political salience. The editors therefore hope that this report will provide impetus for others to undertake more evidence-based and open-minded research and analysis.

* * *

The report is divided into six chapters. Chapter I provides the analytical framework for the report. Thomas Biersteker and Peter van Bergeijk offer a non-exhaustive exploration of the conditions under which sanctions are likely to be successful.

The chapter posits that sanctions pursue multiple goals and that their effectiveness needs to be assessed against how they achieve three main goals: (1) *Coercing* – the extent to which sanctions modify the target's cost-benefit calculation of pursuing its proscribed policy; (2) *Constraining* – the extent to which sanctions reduce a target's ability to pursue its objectionable actions; and (3) *Signalling* – the extent to which the threat of future sanctions allows the sender to notify targets of its intended actions and likely course of action in the foreseeable future.

The text outlines seven major (pre-)conditions for sanctions success: pre-sanctions trade volumes need to be important enough for economic sanctions to bite; sanctions tend to succeed most in the initial years of implementation; the psychology of sanctions is extremely important (expectations, credibility and strategic interaction) in shaping their outcome; sanctions are more likely to succeed if the target is more democratic (or rather, less authoritarian); strong multilateral political commitment makes sanctions more effective; narrowly defined goals and multiple policy instruments increase the success rate of sanctions; and 'targeted' sanctions can be almost as effective as comprehensive sanctions in achieving their intended goals. The chapter concludes by highlighting that senders tend to find it very difficult to end sanctions regimes, whether sanctions have proved to be successful or not.

Chapter II, written by Richard Connolly, offers an initial assessment of the economic impact of the trade and financial sanctions imposed on Russia in response to its annexation of Crimea in March 2014, its subsequent interventions in Eastern Ukraine, and its suspected involvement in the shooting down of the MH17 flight in July 2014. Connolly highlights the difficulty in estimating the exact impact of sanctions on the Russian economy given their interaction with other major shocks that have befallen it at the same time, notably a sudden fall in the oil price and a dramatic depreciation of the rouble. These shocks came at a time when investor confidence in the Russian economy was already waning due to its underlying structural weaknesses and capital flight already high. The chapter highlights that the impact of sanctions has been greatest in the financial sector, principally due to the fact that so many Russian corporations heavily depend on access to Western capital markets for external financing. The author argues that the financial sector restrictions imposed by the West will most likely have their strongest impact in three to five years. The chapter also briefly assesses the impact of Russia's countersanctions (bans on food imports from Western countries) on its own economy.

In Connolly's view, sanctions have had the counterproductive effect of strengthening elite cohesion in Russia. The state has channelled its resources to politically connected patrons and to state-dependent economic sectors in industry and agriculture. This, in turn, has bolstered popular support for the regime in constituencies that have benefited from import substitution and has contributed to strengthening the country's protectionist mindset. There has also been a strong 'rally around the flag' effect in Russian public opinion, whereby support for the country's leaders has reached record levels as reflected in independent opinion polls. Russia's responsiveness to sanctions thus appears limited.

Chapter III is complementary to the previous one and focuses on the interactions between the EU's sanctions policy and Russia's actual behaviour on the ground in Eastern Ukraine since 2014. Stanislav Secrieu argues that, contrary to statements from Moscow and to frequently aired views in the public debate, sanctions have to some extent contributed to limiting the Kremlin's options in the Donbass. Although Russia has been partially successful in its endeavours to weaken the Ukrainian state both economically and politically regardless of sanctions, the EU restrictive measures have played a role in limiting Russia's territorial ambitions. Sanctions have astutely interplayed with diplomatic efforts via the Minsk ceasefire negotiation process and contributed to bringing Moscow to the negotiating table. Secrieu also contends that sanctions (in tandem with other support measures from Ukraine's Western partners) were critical in providing breathing space for the Ukrainian state, giving it room to strengthen its military capabilities.

Chapter IV, written by Peter van Bergeijk, offers a preliminary economic evaluation of the impact of sanctions against Iran. The chapter presents an econometric model that helps assess their impact. The author argues that some key pre-conditions were met for the sanctions to be effective: important trade linkages with the sanctions sender, limited options for import substitution and the comprehensive nature of the restrictive measures. Van Bergeijk further analyses how sanctions have impacted on the Iranian polity and infers a link between the imposition of sanctions and higher political turnover. In other words, sanctions have indirectly influenced the recent change in political leadership in Iran under President Rouhani, who had campaigned under the pledge to resume negotiations over the country's nuclear programme.

In chapter V, Sara Bazoobandi explores why the recent sanctions imposed against Iran have been so severe and how they have impacted the domestic political sphere. In combination with macroeconomic mismanagement in Tehran, the comprehensive nature of sanctions (the oil embargo, the country's exclusion from the SWIFT international payments system) has affected the Iranian economy very negatively. The chapter further offers an insightful breakdown of how sanctions have hit different segments of the population according to their levels of income, and shows that middle class households were most adversely affected. This, in turn, explains the latter's support for regime leaders favourable to negotiating a deal over the country's nuclear programme. Bazoobandi shows that individuals with affinities to the regime have benefited from the rent-seeking and corruption opportunities provided by sanctions, thus reinforcing inequality between the richest and poorest segments of society. The chapter further argues that sanctions have been effective in inducing the Iranian authorities into making concessions during negotiations over the country's nuclear programme, resulting in the July 2015 Joint Comprehensive Plan of Action (JCPOA).

In chapter VI, Peter Seeberg explores how the complex conflict dynamics in Syria and the lack of international coordination have undermined the potency of sanctions. Although constraining, their impact has been partial due to shifting dynamics on the ground, in particular the way in which the expansion of Islamic State (IS) arguably prompted targeted individuals to reinforce their ties with the Assad regime. Moreover, the lack of a coherent multilateral coalition of sanctioning actors enabled targets to capitalise on regional and international circumvention channels. The chapter puts forward the idea that although sanctions have had a constraining effect by way of undermining the regime's access to economic resources, adverse security developments have distorted the channels through which sanctions tend to work most effectively.

The concluding chapter, co-authored with Clara Portela and Francesco Giumelli, reviews all these case studies through the lens of the analytical framework presented in chapter I. The chapter discusses some policy implications and priorities for the EU based on the findings of this report as well as the discussions held during the EUISS Task Force meetings, especially how to build up EU capabilities in designing sanctions, engaging third countries, and devising viable exit strategies. The chapter also suggests some further avenues for research and analysis.

I. HOW AND WHEN DO SANCTIONS WORK? THE EVIDENCE

Thomas Biersteker and Peter A.G. van Bergeijk

Introduction

The debate on the usefulness of sanctions as a foreign and security policy tool follows a familiar pattern. Proponents of sanctions cite well-known success stories, while opponents highlight evident failures. This is not surprising, because sanctions are a highly political issue, with both sides of the debate persuasively arguing their case. But the choice of examples selected to make a case for or against sanctions is often biased, and not much can be learned from case studies drawn from skewed samples.

The aim of this chapter is to move the debate forward, in the direction of more evidence-based policymaking. Our point of departure is that the use of sanctions should be preceded by a strategic evaluation of their appropriateness in a specific case. This will help to improve the selection of distinct types of targeted sanctions, because gaining a clear understanding of the determinants of success and failure of sanctions in the past is a prerequisite for better evidence-based sanction design. Evidence-based policymaking needs to consider both failures and successes. It is only by studying successes, failures and intermediate outcomes that we can understand the determinants of sanction efficacy.

One important fact that emerges from empirical research on sanctions is that their rate of success is low. But this same empirical research also reveals under what conditions sanctions *do* work. The widely used Peterson Institute for International Economics sanctions database, which covers almost 200 cases, shows that sanctions fail to achieve their policy goals in about two out of three cases. The more recent research of the Targeted Sanctions Consortium (TSC) on United Nations (UN) targeted sanctions suggests an even lower rate of success: on average, in less than one in four instances.

The fact that the majority of sanctions policies fail, however, does not necessarily imply that sanctions are not effective. Firstly, the effectiveness of sanctions depends on the alternative policy instruments available to policy practitioners. Secondly, if basic conditions for success are not met or if the agreed measures are not implemented, then a sanction should actually be expected to fail. For example, if no or very little economic or diplomatic exchange was taking place before sanctions were enacted, then the impact of sanctions will inevitably be weaker.

It is also important to emphasise at the outset that sanctions are rarely, if ever, implemented alone or in isolation from other foreign and security policy instruments. Active negotiations, peace mediation efforts, threats of force, use of force, peacekeeping operations, and/or covert operations: all co-exist with the application of sanctions. Accordingly, sanctions should be evaluated from the standpoint of an integrated approach to international peace and security that takes these other measures into consideration and looks at their interactive effects.

Sanctions tend to have a strong economic dimension to them. But economic sanctions – such as trade or commodity embargoes or financial sanctions – should not be studied as purely economic phenomena: they require a multidisciplinary analysis in order to be understood. Economists can and do contribute to this understanding by identifying the actual sanction damage *ex post* and, more importantly, the potential *ex ante* sanction damage that constitutes the threat of (further) implementation. Economic models can also clarify how targets behave and engage in activities to substitute for trade losses due to sanctions. Beyond those questions, however, the economist needs to work with scholars from other disciplines including law, political science, sociology, and (applied) psychology. These disciplines bring in institutional analysis, implementation processes and important elements such as legitimacy and reputation.

The key issue, then, is not the probability of sanctions' effectiveness, but why sanctions succeed and why they fail. What are the conditions for success? And how do sanctions actually work?

This chapter addresses these questions and offers an overview of the key lessons the most up-to-date academic and empirical research on sanctions can provide for those designing and analysing sanctions policies.

Goals of sanctions

In order to understand how and whether sanctions work, a first step is to realise that sanctions goals are multiple, and that effectiveness is best measured against the actual goal of each (set of) sanction(s).

Most of the public, policy, and scholarly discussions of sanctions proceed from the assumption that sanctions are intended primarily to coerce a change in the behaviour of the targeted party. While this is most certainly one of the principal reasons for the application of sanctions, and often a central part of the rhetorical justifications for their use, coercion is not the only goal of sanctions.

When it is highly unlikely that a target can be coerced into giving up power or reneging on some larger revolutionary cause (whether that cause is motivated by political ideology or religious extremism), the goal of sanctions can be to constrain a target in its ability to engage in proscribed activities. Sanctions can raise the costs of the target's activities or force it into costly changes with regard to strategy and the procurement of supplies necessary to its activities or economic survival.

At the same time, sanctions may be intended to send a signal to a target or some other relevant constituency. The signalling aspect of sanctions is under-appreciated in the scholarly and policy literature on sanctions. Dismissing sanctions as 'merely symbolic' gestures fails to appreciate their role in the articulation and reinforcement of global norms. Sanctions impose costs on both the target and the sender, and backing the rhetorical conviction of diplomatic condemnations with costs imposed on one's own constituents is a powerful way to communicate norms. Sanctions also send signals to multiple constituencies, not only the target, but also other actors tempted to pursue similar policies. They can even be used as signals to prevent allies from escalating a conflict and resorting to the use of military force, as they were in the case of recent EU sanctions against Iran.

These different goals are inter-related in complex ways. An asset freeze intended to coerce an individual to stop financing acts of terrorism can simultaneously be utilised to constrain a group from being able to commit those acts. Constraining a rebel group's access to resources to purchase arms can tip the balance on the battlefield and influence their calculations about a negotiated settlement of a conflict. If potentially imitating states see the stigmatising effects of signalling sanctions on their peers, they may be persuaded into compliance with burdensome treaty obligations.

Given that the goals of sanctions are multiple, their effectiveness in achieving those goals should be evaluated in analytically separate terms. If a sanction fails to coerce a change in the behaviour of the target, it is not necessarily a failure in policy. Sanctions might succeed in constraining a target, in buying time for a negotiated settlement, or in signalling resolve about a norm that has important implications for the policy behaviour of other parties.

By differentiating the effectiveness of sanctions according to their purpose, the research of the TSC has shown that sanctions intended to constrain or to signal targets are nearly three times as effective (27% of the time) as sanctions intended to coerce a change in behaviour (only 10% of the time).

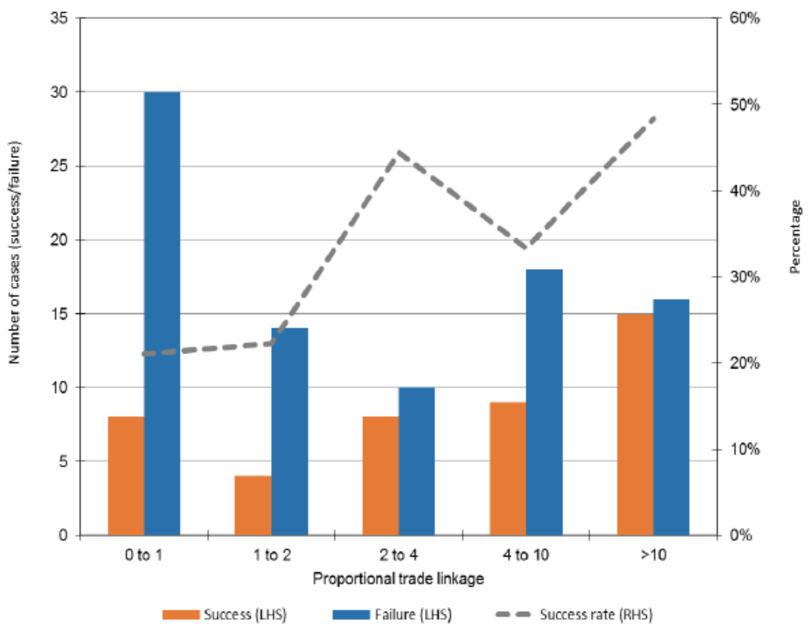
Seven conditions for sanctions success

1. Pre-sanctions trade volumes need to be important for economic sanctions to bite

Sanctions on an entire economy or a sector of an economy can only coerce change or constrain targets when pre-sanction trade between the sanction-imposer and the sanction target is important for the target. This means (a) that the lower the level of pre-sanction trade, the higher the probability of failure, and (b) that boycotts and embargoes of highly valued products that cannot be replaced, re-sourced or (re)sold have more impact. This is common sense, but all too often students of sanctions have overlooked this basic requirement. They either do not consider trade at all, do not measure trade linkages before the sanction is imposed or threatened, or consider only the development of bilateral trade (not taking potential trade diversion into account).

Figure 1 shows how the expected result of a sanction is linked to the amount of bilateral trade between sender and target as a percentage of the target's GDP (measured in the year before the sanction is imposed). Clearly when trade linkage is low, failures to coerce a change in behaviour exceed successes by far. Once proportional trade linkage is above 10%, the rate of success is almost 50%, a strong improvement of the 33% success rate observed for all sanctions.

Figure 1: Trade linkages and sanctions success



Sources for data: calculations based on Peter A. G. van Bergeijk, *Economic Diplomacy and the Geography of International Trade* (Edward Elgar, 2009). The primary data set for the outcome of sanctions is the Peterson Institute sanction database.

2. Sanctions tend to succeed most in the initial years of implementation

Adjustment by the target reduces the potential impact of economic sanctions. Here two mechanisms operate.

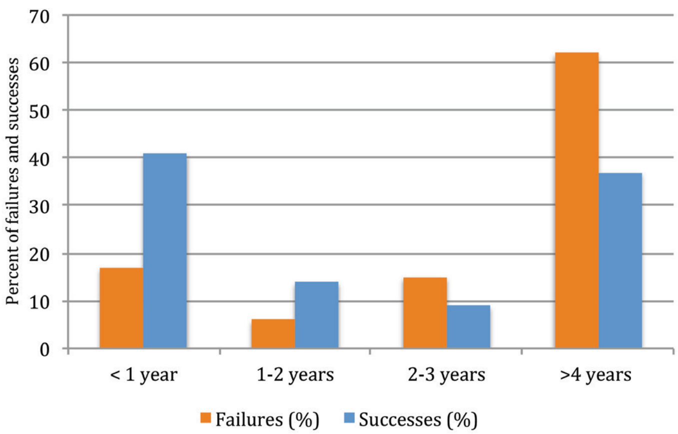
Firstly, a sanction implies that the pre-sanction pattern of international specialisation is no longer optimal and needs to be changed. This process of reallocation of labour and capital towards other sectors (e.g. from the export sector to the import sector) requires time. The longer the duration of the sanctions, the better the sanction target can adjust to the new situation.

Secondly, during the adjustment process economic performance will improve. From a political economy perspective it is important that this creates the perception that the worst is over. Indeed, while economic activity will remain below pre-sanction levels, growth rates may be positive, fuelling the expectation that the sanctions can be overcome.

Given that targeted countries tend to adjust their economies under sanctions, the potential sanction damage is largest before adjustment can undercut the (potential) costs of sanctions.

Figure 2 illustrates the importance of duration. About 40% of the successes in changing behaviour occur in the first year of a sanction regime; a good 60% of the failure cases are characterised by duration in excess of three years.

Figure 2: Duration and sanction success/failure



Source: Sajjad Faraji Dizaji and Peter A. G. van Bergeijk, 'Potential early phase success and ultimate failure of economic sanctions: A VAR approach with an application to Iran', *Journal of Peace Research*, vol. 50, no. 6, 2013, pp. 721-36.

3. The psychological factor: expectations, credibility and strategic interaction play a major role

The actual application of sanctions is uncertain, and the very threat of sanctions can play a major role in changing target behaviour. A sanction does not only impose costs on the target, but also on the country that imposes the sanctions. After all, both countries have to forego the benefits of international trade. Therefore the actions and reactions of the actors involved need to be analysed comprehensively, and the analyst needs to deal with expectations.

This implies, first of all, that we need to acknowledge that the expected outcome *ex ante* may be different from the observed outcome *ex post* (for example, the target may think it unlikely that the sanction threat will actually be applied).

Sanctions 'bite' most when they are unanticipated

Sanctions that are expected by the target give rise to activities that reduce their impact, such as stockpiling, setting up import substitution, refocusing exports and imports on non-traditional markets and reducing dependency on foreign capital and trade in general. Unexpectedness can be achieved by contingency planning, short deliberations, quick implementation, the engagement of unexpected (non-traditional) sanction imposers, and the use of instruments (new types of sanctions or restrictive measures) that have not been used before.

The threat of sanctions is more effective than the actual imposition of sanctions

Strategic interaction is an important element. Both target and sender have to consider the implications of their behaviour for their reputation. A history of strong sanctions may enhance the sender's reputation and make its threats more credible (it may, however, also provide incentives to future sanction targets to avoid having too close trading links with such a sender). Giving in to sanctions may reveal weakness on the part of the target, and this may spill over to and have an adverse effect on other international negotiations.

The actual imposition of sanctions represents a failed strategy of bluffing on both sides. The target underestimates the resolve of the sender, while the sender is unable to persuade the target to weigh accurately the costs and benefits of changing behaviour. This is linked to the above insight about the short-term nature of sanctions effectiveness when it comes to efforts to coerce a change in behaviour. For example, the threat of international sanctions was reportedly an important factor in former Yemen President Saleh's decision to step down from power in 2012, just as it played into the decision of President Kiir to sign the South Sudan peace agreement in 2015.

The credibility of sanction threats can be enhanced by a track record of effective sanctions implementation. A threat of sanctions that is not followed up by actual measures that bite undermines the credibility of the use of sanctions in future cases. This reputational consequence implies that the use of sanctions should be restricted to cases where the sanctions can be imposed, monitored and implemented. Likewise, sanctions that cannot be sustained, or for which the coalition imposing the sanctions is unstable, should be avoided.

Sanctions are less effective the higher the risk tolerance of targets

We also need to consider the risk tolerance of the sanction target leadership. Decision-makers are not risk neutral: sometimes the target is risk averse and sometimes the target has a risk preference and is willing to take the gamble even if the expected outcome is negative.

Sanctions against targets whose leadership has a short horizon of survival are less likely to succeed in changing target behaviour. A short time horizon is associated with more risky behaviour. Government officials who may have to fear for their lives if they comply with sanctions will show risk-taking behaviour in the sense that they may gamble that the sanctions will not be implemented (effectively). Targeted entities that are participating in a civil war may be thought to act irrationally if they do not give in under extreme economic pressure, but if no viable alternative exists, sanctions have a low probability of succeeding. Under these conditions, sanctions designed to constrain the target may be more appropriate, such as the travel bans and asset freezes imposed on individuals deemed responsible for war crimes or seen as a potential threat to the peace processes in Angola and Liberia in the 1990s and early 2000s.[1]

'Failed' sanctions can create a new baseline for engagement with the target

The presentation of costs and benefits matters. People have different assessments of losses and benefits, even if they are relatively of equal magnitude. In cases where the 'stick' (the threat of sanction damage) does not prove effective in bringing about a change in behaviour, the 'carrot' of incentives or positive inducements might succeed. One reason for sanction implementation may thus be to create a new baseline. Lifting sanctions can then be framed in a positive way, as they have in the case of Iran. The same happened with Libya in the 1990s, when the promise of a suspension of sanctions triggered a diplomatic breakthrough.

Sanctions intended to send a signal to the target (or to others observing the sanctions dynamic), often perform a stigmatising function. Most targets are not shamed by sanctions (in the sense of naming and shaming), because they tend not to share the norms being articulated by those sending the sanctions. They can, however, be stigmatised or isolated among some relevant communities by being sanctioned. Some of the individuals designated by the UN Security Council for their financing

1. See Biersteker et. al., *SanctionsApp*, Angola, episode 3 and Liberia, episode 4, for details. Available online at: http://www.sanctionsapp.com.

of terrorism, were not shamed by their listing (because they viewed their cause as just), but they were shunned and stigmatised by their neighbours.

4. Sanctions are more likely to succeed if the target is more democratic (less authoritarian)

Sanctions are mediated by political systems. The effectiveness of international sanctions is often determined by the nature of the political system or political economy in place in the target state. Economic costs of sanctions cannot be assessed in a unitary cost/benefit manner, but affect different communities and regions of the target country in different ways.

The stronger the autocratic institutions *vis-à-vis* democratic institutions, the lower the opposition's political effectiveness; sanctions will thus lead to stronger and more effective opposition in democracies as compared to autocracies. Authoritarian regimes also have the capacity to distribute the losses (and gains) from sanctions in ways that penalise their opponents and reward their supporters, thus often strengthening authoritarian rule in the process, as observed in Iraq during the 1990s.

The target's institutional framework is not black and white: some countries are more authoritarian than other countries (as for example can be seen in the discussions on Russia and Iran in chapters II and V respectively). Among authoritarian states personalist regimes and monarchies are also more vulnerable to sanctions than military regimes and single party states, because they have a track record of relying more heavily on external financial support.

Sanctions may strengthen rather than weaken popular support for the regime

An external threat may generate a 'rally around the flag' effect, as has been observed in Russia under sanctions (see chapter II). This is particularly the case when the target population approves of the behaviour that the sender is opposing and seeking to change. Targets of sanctions in authoritarian regimes often mobilise popular support through their control of the media and their ability to depict the sanctions as targeted not against the proscribed activities of the regime in power, but against the entire nation. Religiously motivated behaviour is thus difficult to change. Military activity to safeguard fellow nationals who are minorities in other countries can also count on strong popular support, as in Russia. In these cases, sanctions often fail to tip the balance.

Targets with a strong ideological motivation are almost impossible to coerce

Sanctions targets with a strong commitment to a political-economic ideology, to religious extremism, or targets engaged in a struggle for survival and self-determination are difficult to coerce with sanctions. A change in their behaviour might undermine the rationale or basis on which they rely for political legitimation, survival and support. As a result, they are willing and able to bear very high costs.

Groups engaged in carrying out acts of terrorism that are highly resistant to attempts at coercion, such as the al-Qaeda terrorist network, are more appropriately targeted with sanctions intended to constrain their activities rather than to force a change in their behaviour. The same applies to most targeted sanctions against non-state armed groups.

5. Strong multilateral political commitment makes sanctions more effective

Most sanctions regimes are the product not of unilateral decisions taken by a single state, but of collective decision-making within a multilateral institutional framework. As such, the dynamics of decision-making, implementation, monitoring, and resolve are influenced by institutional factors.

The more multilateral the sanctions are, the fewer the options for sanctions evasion or trade diversion by the target. Moreover, sanctions imposed by universal member institutions like the United Nations have more international legitimacy than sanctions imposed by a single state as an instrument of its foreign policy. Sanctions imposed by regional organisations of which the target is a member also have greater legitimacy than sanctions imposed by a regional organisation on third parties who are not members of the regional institution.

Multilateral decision-making is not always based on a collective, unitary, consistent or strategic logic. Rather, the text and content of many international sanctions enacted by international organisations is the product of negotiation, bargaining, separate bilateral deals, and side-payments. The texts of international sanctions resolutions often contain what diplomats refer to as 'constructive ambiguity,' which, although useful for negotiation purposes, can render the terms subject to multiple, and conflicting, interpretations. When sender ambiguity is visible to targets, targets are more likely to wait out the sanctions or to develop counter-strategies to sow dissent among sender states, as Libya did by mobilising OAU and Arab League opposition to the implementation of UN sanctions in the 1990s.

Political will is indicated by unanimity in sanctions resolutions, unambiguous texts, devoting resources to sanctions implementation, active monitoring and enforcement activities, and by a visible willingness by the senders to bear the costs of the measures.

6. Narrowly defined goals & multiple policy instruments increase success rate of sanctions

Targets are more likely to comply with narrowly articulated goals – such as convening elections (DRC), turning over suspects (Libya in the 1990s), providing access to a disputed territory (Russia) – that give them some room for manoeuvre than to comply with multiple, vaguely defined, general goals (like improving the human rights situation in the territory under their control).

The simultaneous application of other policy instruments, such as referrals to international legal tribunals, the application of other (regional) sanctions, and the introduction of resource certification schemes, is also correlated with effective efforts to coerce a target to change their behaviour. Applying sanctions to an entire country is more effective than trying to limit them to a single territory or region of the country, due to the complexity of implementation of the measures by companies called upon to restrict their transactions to a targeted region.

Some cases, such as post-conflict situations handled by the UN over the last two decades, show that an even more fine-tuned strategy can effectively constrain targeted actors. When the UN tries to stay neutral and avoids taking sides in a conflict, as it often does when it first becomes involved, its sanctions (typically imposed on 'all parties to a conflict') tend to be ineffective.

After a peace settlement is negotiated, and the UN uses sanctions to constrain one party (potential spoilers to the transitional arrangement), the sanctions have a higher probability of effectiveness. Since virtually all international sanctions today are targeted, focusing on key regime supporters and core family members is more important than focusing directly on the political leadership of the regime. When appropriate, cutting off access to sources of revenue (diamonds, timber, oil, diverted charitable donations) is highly effective in constraining targets, as seen in the cases of Liberia and Sierra Leone.

When only one type of targeted sanction is imposed in isolation, it is never effective

Based on the data accumulated by the TSC for UN sanctions, imposing a single type of sanction in isolation (an arms embargo or a travel ban, for example), is never effective. On average, the simultaneous application of at least three (and closer to four) different types of targeted sanctions is necessary for effective coercion, constraint or signalling.

The most common combination of targeted sanctions imposed by the UN is an arms embargo, travel ban, and an asset freeze. When commodity sanctions are added to the mix, as they frequently are in the African conflict cases (Angola, Liberia, Sierra Leone, Somalia), the effectiveness of such measures tends to increase. Sanctions effectiveness is also associated with simultaneous use of other policy instruments (threats of force, use of force, peacekeeping operations, legal referrals to international tribunals, covert operations, and sanctions imposed by more than one organisation).

7. 'Targeted' sanctions can be as effective as comprehensive sanctions

Even though they invariably affect fewer people and have lower humanitarian consequences, targeted sanctions, on average, do not appear to be significantly less effective than comprehensive sanctions. The aggregate figures of the effectiveness of 63 cases of UN targeted sanctions from the TSC suggest an average of 22%, as opposed to the Peterson Institute for International Economics data that suggest 33% for all types of sanctions (comprehensive and targeted).

This has implications for the debate about how to strengthen sanctions. It suggests that there are different ways to bolster sanctions – both a widening (to additional segments of the population) or a deepening (applying secondary sanctions to evaders). Public discourse tends to equate strengthening with widening, not deepening, the measures, but secondary sanctions on evading parties tend to be under-utilised.

In the final analysis, sanctions can be effective, even when targets prove resistant to changing their behaviour. There are situations in which sanctions communicate a strong signal to other parties to avoid embarking on a proscribed policy activity. This applies particularly to the non-proliferation sanctions regime. While the sanctions imposed on individual countries to cease their 'weaponisation' of nuclear programmes have not always yielded success, other countries contemplating similar programmes have been deterred from embarking on them. Thus, while the sanctions may have failed at one level, they have succeeded at another.

Collateral damage as a result of broad-based sanctions is inevitable

Opponents of sanctions often point out secondary or unexpected outcomes of sanction cases, drawing principally on the case of comprehensive sanctions against Iraq in the 1990s. Collateral damage occurs in terms of health (including lower life expectancy, increased child mortality and contagious diseases), education (reduced spending and completion rates) suppression of minorities, and effects on the gender division of labour. A deterioration of human rights situations has also been documented, as have increases in corruption and a legacy of criminality once sanctions are lifted (because networks originally established to evade sanctions can be utilised to engage in criminal activities – as seen in the former Yugoslavia). While these effects appear and often are unintended, they are not unexpected. Indeed a large body of literature exists that clarifies that economic slow-downs, such as recessions, leave their marks on these important determinants of individual well-being – and comprehensive economic sanctions contribute to (and are mostly intended to) slow down an economy.

Conclusion: ending sanctions remains difficult

Ending *unsuccessful* sanctions is difficult. The sanctions have been imposed because the target behaves in a way that is deemed unacceptable. If the sanctions do not change that behaviour or constrain the target, there is no logical reason to end the sanctions. Typically the ending of such sanctions needs a change of government, often in the sanction target country, but sometimes also in the sanction sending country. A new leadership can set new rules of engagement and this may offer an opportunity to reevaluate the utility of economic sanctions that are still in place. Monitoring the impact of sanctions, especially of their unintended consequences, may provide arguments to review the sanction regime.

Ending *successful* sanctions looks straightforward but in reality it is also complicated. Sanction goals may be adjusted over time or be only partially met. Still, for sanctions to work, the commitment to lift sanctions and transparency about the conditions under which this will be done needs to be clear. The negotiation among senders over the sequencing of the suspension or lifting of sanctions has important consequences for both target and senders and can have significant benefits for those who first renew business activities with the targeted entity.

Failure to suspend or lift sanctions creates two problems for the senders of sanctions. First, they place an administrative burden on sender states or institutions. The UN never had more than six or seven sanctions regimes in place at the same time during the 1990s. Today, the number has grown to sixteen simultaneous regimes in place. Second, failure to lift sanctions after the situation changes undermines the legitimacy of sending institutions and makes it more difficult for them to secure compliance by others.

II. THE IMPACT OF EU ECONOMIC SANCTIONS ON RUSSIA

Richard Connolly

Introduction

In the aftermath of Russia's annexation of the Crimean Peninsula in March 2014 and its involvement in the conflict in Eastern Ukraine, the EU, the US and their allies imposed a series of sanctions on Russia. This chapter focuses on the impact of these sanctions on the Russian economy and the implications these effects have for Russia's political system.[1] The economically most important sanctions include a ban on loans of a maturity of longer than one month, a ban on investments in new energy projects, and a ban on arms sales to Russia. This chapter also briefly dwells on how Moscow's counter-sanctions on Western food imports have impacted on the Russian economy.

There has been a range of varying estimates of the economic impact of Western sanctions. In November 2014, Russia's Finance Minister, Anton Siluanov, suggested that sanctions had cost Russia $40 billion. More recently, President Putin stated that sanctions have cost Russia $160 billion. Outside Russia, numerous politicians have also assigned great importance to the effect of sanctions on the performance of the Russian economy.

However, estimating the impact of economic sanctions on the Russian economy over the past year is fraught with difficulty. In addition to the methodological challenges inherent to any such exercise under even 'normal' conditions, the performance of the Russian economy over the past 12 months has also been affected by additional complicating factors that extend well beyond the imposition of sanctions.

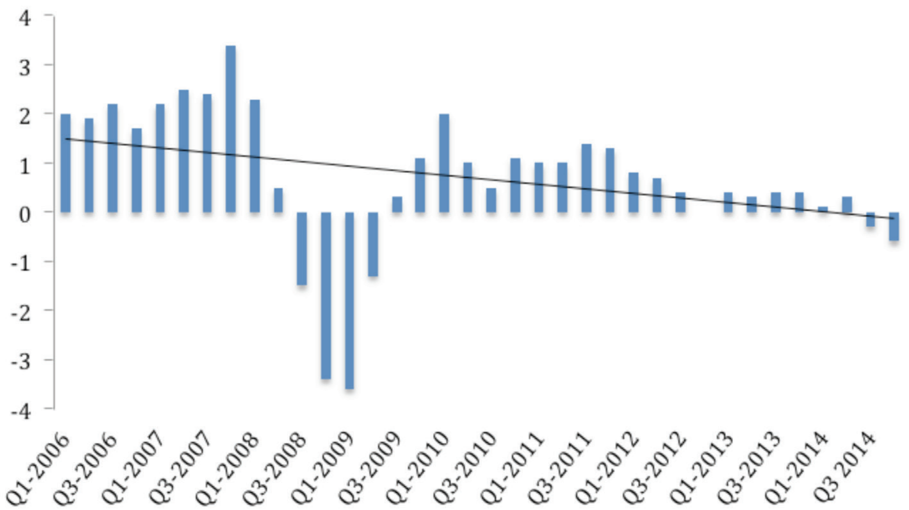
This chapter is structured as follows. The first section provides an overview of the economic context against which sanctions have been imposed. The next section examines the direct impact of sanctions on those sectors targeted by Western sanctions and Russian counter-sanctions. The third section examines the effects of Western sanctions on the Russian domestic political economy. The final section summarises the key findings.

1. Editor's note: this chapter focuses on the economic impact of sanctions on Russia and on important spill-over effects that these have had on the domestic political economy. The aim of this chapter is to help establish whether the sanctions are likely to create conditions under which the Russian government might change policy in Ukraine, which was the initial rationale of these sanctions.

Context matters: slowing economic growth and the collapse in the oil price

An accurate assessment of the impact of sanctions requires that the *ceteris paribus* – ‘all other things being equal’ – condition be satisfied. However, in 2014, all other things in the Russian economy were far from equal. It is important to be aware of two highly significant factors that influenced the performance of the Russian economy at the time that sanctions were imposed.

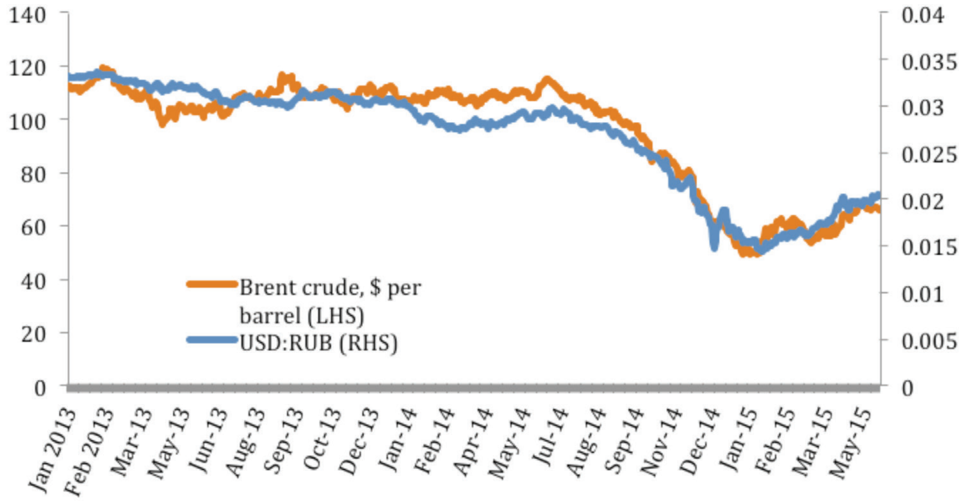
Figure 1: Real GDP, 2006–14, percentage change from previous quarter



Source for data: Rosstat (August 2015)

First, Russia was already in the grip of a slowing economy that was drifting towards stagnation even before the imposition of sanctions. This slowdown is structural in nature and has been exerting a negative influence on a number of key economic indicators for some time now. Second, the dramatic decline in oil prices over the second half of 2014 was of profound importance to a country that was, in 2013, the world’s second largest producer and exporter of oil.

Figure 2: Rouble-dollar exchange rate and oil price (Brent, $), 2013–15



Source for data: International Monetary Fund, *International Financial Statistics* (June 2015)

The structural slowdown in economic growth in Russia and the decline in the price of oil both make it difficult to isolate the economic impact of sanctions. To illustrate this point, consider the dramatic depreciation of the rouble, Russia's currency, in the final quarter of 2014. Some commentators have suggested that this depreciation was caused at least partially by sanctions. It is, for example, intuitively appealing to suggest that sanctions may have led to a loss of business confidence in Russia, which in turn caused a rise in capital outflows, generating downward pressure on the exchange rate. However, closer inspection of the data reveals that daily fluctuations in the price of oil act as a more reliable predictor of rouble-dollar exchange rate movements: between January 2013 and May 2015, the correlation in movements between the two was almost perfect (Figure 2). Thus, the single best explanation for the depreciation of the rouble is the slide in oil prices.

The simultaneous nature of the shocks affecting economic performance in Russia over the past year or so is highly significant from an analytical point of view. No single factor from the structural slowdown, the fall in oil prices, or the imposition of sanctions, can solely explain the country's deteriorating economic fortunes over this period. Nevertheless, it should be clear from looking at the macro indicators presented above (GDP, exchange rate) that the immediate overall economic impact of sanctions has been relatively muted, at least when compared with the influence of the structural slowdown and falling oil prices.

'Direct' effects of Western sanctions on economic performance in Russia

If the overall impact of economic sanctions appears modest, it is nevertheless plausible that sanctions may have tangibly affected the targeted sectors. Western sanctions were targeted at three main sectors – energy, defence and finance, while Russian counter-sanctions resulted in a one-year ban on imports of fruit, vegetables, meat, fish, milk and dairy products from all EU countries, as well as additional Western countries, including the USA. The impact of sanctions in each of these four sectors is discussed below.

The defence industry

Defence industry production grew in 2014, despite sanctions, due to growing demand from abroad and from domestic orders (i.e., due to the rise in procurement from the state armaments programme to 2020).

The aggregate effect of the arms embargo on Russia is, however, modest due to the fact that only a small proportion of Western arms exports go to Russia, and a correspondingly small proportion of Russian arms exports go to Western countries. As a result, despite the imposition of sanctions, Russia recorded well over $13 billion worth of arms exports in 2014, making Russia the world's second-largest exporter of armaments.

This healthy export performance was achieved while domestic orders also rose to high post-Soviet levels. As part of the state armament programme (GPV) to 2020, which aims to reequip and modernise Russia's armed forces, military spending as measured by SIPRI has risen from 3.2% of GDP in 2000, to 4.5% in 2014. Of this, half was spent on procurement and research development (R&D). In 2015, military expenditure is expected to peak at 5.4%, with 60.5% of this amount earmarked for procurement and R&D.

Notwithstanding such healthy production data, the arms industry has encountered some problems in implementing production orders because of the Ukraine crisis. Some of these problems have emerged not just as a result of Western sanctions, but also because of severed links with Ukrainian defence industry enterprises that were previously closely integrated with the Russian defence production network. The Ukrainian ban on arms exports to Russia has, for example, caused shortages of helicopter engines and power supply units for naval ships. The impact of Western sanctions has been felt in the form of reduced access to some components rather than final weapon systems.

The hydrocarbons sector

The impact of sanctions on current oil production has been negligible, with post-Soviet record levels of oil production registered in 2014. This is because Western sanctions target projects oriented to future rather than current production. This has been done by the imposition of restrictions on technologies related to Arctic and deep-water exploration, as well as onshore tight oil extraction (e.g., from the giant Bazhenov formation).

The vast majority of Russia's existing oil production comes from onshore deposits in Western and Eastern Siberia, both of which continue to yield large volumes of hydrocarbons. However, production from existing 'brownfield' deposits is expected to decline over the next decade. Unless massive investment in 'greenfield' deposits is undertaken – especially in the offshore deep-water, Arctic and tight oil deposits targeted by sanctions – declining production may not be replaced. As a result, sanctions should only be expected to affect Russian oil production over the medium term (i.e. 3-5 years).

In addition to restrictions on equipment, many Russian energy producers have been blocked from accessing capital. This is important for two reasons. First, and as stated previously, continued production requires massive capital investment. Financial sanctions have created a clear mismatch between projected investment and availability of capital to fund it. Second, many Russian energy producers – not least the state-owned Rosneft and Gazprom – are highly leveraged, with high debt-revenue ratios, much of which is denominated in foreign currencies.

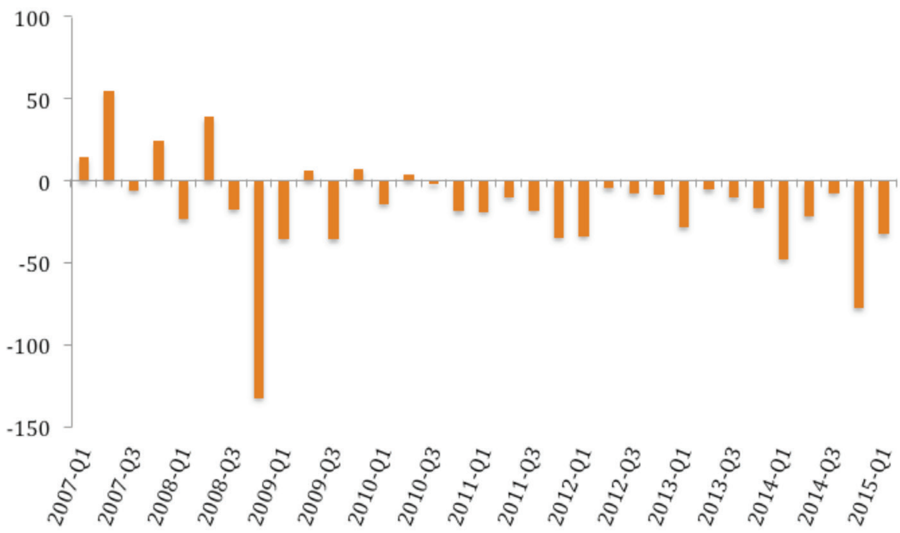
Unable to refinance existing stocks of debt, targeted Russian energy companies have simply carried out scheduled repayments. Despite the decline in oil prices, foreign-currency denominated revenues, as well as existing cash piles, have been used to finance these repayments. Some firms, such as Rosneft, have also tapped public foreign currency reserves (such as reserves managed by the Central Bank). Perhaps in a sign of financial distress, Rosneft is rumored to be considering opening credit lines with state-owned banks, as well as applying for access to the country's sovereign wealth fund (NWF). It has also been suggested that Rosneft may sell a 19.7% share in the company to raise capital.

Inevitably, high debt servicing costs have reduced the availability of capital to finance investment, although the low price of oil has caused a retrenchment in capital investment across the global energy industry, and not just in Russia.

The financial sector

Financial sanctions have exerted the most observable influence over the Russian economy. Access to Western capital markets has been effectively closed to a large number of Russian corporations, and not just those directly targeted by sanctions. Firms in sectors directly targeted by sanctions – such as those in the energy, defence and construction industries – have suffered. But so have firms not directly sanctioned, due to a 'contagion' effect as lenders became reluctant to lend to Russian firms because of fears that sanctions may be extended in the future.

Figure 3: Quarterly net private capital flows, 2007–15 ($ billion)



Source for data: Central Bank of Russia, External Statistics Database (June 2015)

This has resulted in many Russian firms being forced to repay, rather than refinance, their external debt obligations, causing a significant rise in net private capital outflows and a reduction in the pool of capital available to fund investment in the wider economy (see Figure 3). Indeed, the size of capital outflows in 2014 was more severe than the 'sudden stop' of capital inflows that accompanied the recession of 2008-09.

Total non-financial corporate (which includes many large state enterprises, such as Rosneft and Gazprom) and financial sector external debt fell from around US $715 billion (€650 billion) in January 2014 to $597 billion (€545 billion) at the end of 2014. The total stock of external debt has declined due to a combination of repayments (to Western banks), rescheduling of existing debt (to banks or other corporate entities that either own or are linked with the Russian debtors), or because of a reduction in the dollar value of rouble-denominated debt.

The surge in private capital outflows, at least partially driven by external debt repayments, contributed to the reduction in Russia's foreign exchange reserves. It has been suggested that this threatens the financial stability of Russia because (a) Russia's international reserves are not liquid enough to be used to meet external financial obligations; and (b) Russia's foreign debt obligations in the near future exceed the stock of reserves. However, such claims are in all probability exaggerated.

First, Russia's reserves *are* liquid. Although a substantial share are held in gold or assigned to the two sovereign wealth funds – the Reserve Fund and the National Wealth Fund – both can be utilised by the authorities, if required. Indeed, it should be noted that the domestic spending obligations attached to the Reserve Fund and the National Wealth Fund are denominated in roubles. Consequently, domestic obligations could be met by simply instructing the Central Bank to print roubles to 'purchase' their holdings of foreign exchange reserves.

Second, Russia's external debt obligations are exaggerated by financial arrangements employed by Russian corporate groups, which result in a considerable amount of 'intra-group' debt. These debts owed by subsidiaries to 'parent' companies are much softer loans than those taken out from Western banks. Indeed, many corporate groups have postponed payments on such debt. These intra-group debts account for nearly a quarter of Russia's total stock of external debt (i.e., around $133 billion at the end of 2014). Moreover, intra-group debt repayments account for a proportionately larger share of scheduled external debt payments over 2015 (55% of all scheduled repayments) and 2016 (42%). In addition, Russian corporations also hold significant cash reserves abroad (well over $100 billion).

Third, as a country that consistently runs a large surplus on the current account of its balance of payments, Russia should be able to generate annual flows of dollar income in the region of at least 2-3% of GDP.

Russia has been stretched by financial sanctions and has seen capital availability dwindle. However, Russia has likely passed the peak of external finance pressure. Because increased access to capital from alternative sources (such as Asian capital markets) has not yet materialised, sanctioned Russian firms are now reorganising their financial arrangements so that they rely more on domestic (usually state-owned) banks.

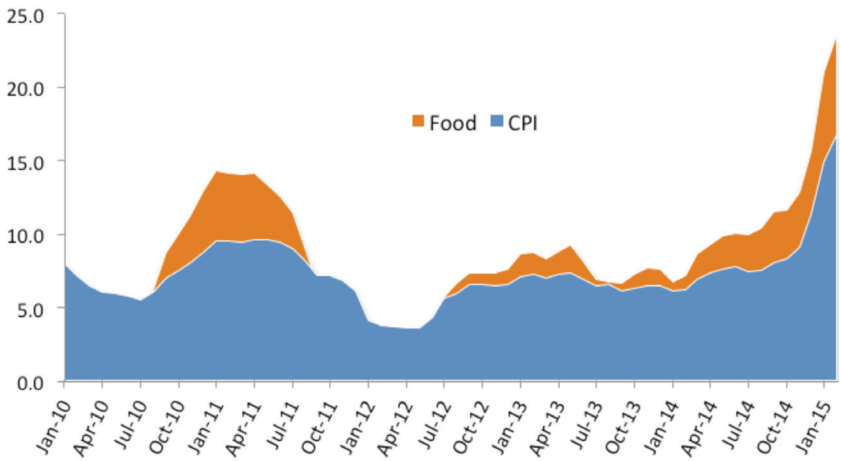
Agriculture

The effects of Russian counter-sanctions in the agricultural sector can be examined both on the producer side (i.e., on Russian agricultural producers) and the consumer side (i.e., on the price and availability of food products to Russian consumers).

Domestic producers of agricultural goods are seemingly well placed to benefit from the limitations imposed on Western producers. However, Russian producers tend to be weakest in those sectors where Western producers were most active such as pork and beef products, as well as specific categories of fruit and vegetables. As a result, domestic production did not rise as dramatically as some initially hoped. In 2014, agricultural production grew by 3.7%. Thus, domestic production has expanded, but only modestly. Instead, trade data reveal that substitutes for European products have been found in third countries, such as Argentina, Belarus, Brazil, Chile, China and Turkey.

The reduction in imports from Western countries, and the costs associated with seeking new suppliers, has resulted in food prices rising above the average rate of consumer price inflation. Again, it is difficult to separate the impact of the food embargo from the rouble depreciation that has contributed to a wider rise in prices for all imported products (see Figure 4). It is also worth noting that historically it is not unusual for food prices to diverge from the headline rate of inflation.

Figure 4: Consumer price index (CPI) and food (including restaurants) prices, 2010-2015 (year-on-year)



Source for data: Rosstat (July 2015)

Impact on domestic political economy

To date, the evidence available from an analysis of the impact of sanctions imposed on Russia confirms the various hypotheses described in chapter I of this report.

Different types of sanctions affect leaders and populations in different political systems in different ways, as highlighted in chapter I. In Russia's political setting – an authoritarian regime – thus far, the Russian leadership has been successful in channelling resources to politically well-connected allies. Sanctioned individuals – such as the billionaires Gennady Timchenko and Arkady Rotenberg – have received access to lucrative construction contracts, while systemically important firms, such as the state-owned oil giant, Rosneft, have successfully lobbied for access to financial resources from the government's sovereign wealth fund.

Not only can non-democratic regimes allocate scarce resources to allies of the incumbent regime in order to strengthen elite cohesion, they are also able to redistribute resources to important socio-economic constituencies that will ensure popular, as well as elite, support for the regime. Indeed sanctions can create the conditions for the rise of powerful constituencies in the target nation that benefit from international isolation. This is because in the long run, sanctions often foster the development of domestic industries in the target country, thus reducing the target's dependence on the outside world and the ability of sender countries to influence the target's behaviour through economic coercion.

The economic policy climate in Russia since the imposition of sanctions has emphasised support for just those industries that are targeted by sanctions. Import substitution – popular among only a minority before 2014 – is becoming increasingly fashionable among policymakers and experts in Russia. The longer Russia is isolated from the global economy, as will happen the longer sanctions persist, the more likely it is that these forces will grow to dominate economic policymaking. Indeed, the interruption of supply chains has prompted a reallocation of resources to domestic industries through import-substitution programmes.

Over the past year, extra resources have been allocated to the oil and gas equipment industry, the pharmaceutical industry, the agricultural machinery and production industries, and, of course, the military-industrial complex. All of these are key economic constituencies that account for a large share of employment in Russia, and all are benefiting from friendly public policies implemented as a direct result of the imposition of sanctions.

Finally, previous episodes of sanctions reveal that sanctions can also generate a 'rally round the flag' effect in target countries, in which sanctions lead to an increase in political cohesion within the target state. The imposition of sanctions enables targeted leaders to pinpoint a clear external threat, which can be used as a focal point for a leader to unify the state. Leaders can also place the blame for economic hardship on the sender state rather than on their own economic policies, suggesting that sanctioned populations might rally against the enemy or sender state.

In Russia, there is strong evidence of such a 'rally round the flag' effect. Not only do all opinion polls show that public support for the leadership is near record high levels – i.e., with the President consistently receiving over 80 percent approval ratings since March 2014 – but the Western sanctions regime has also given the leadership a convenient alibi for the structural downturn in the economy described earlier in this chapter. [2] Without sanctions, it is possible that the leadership would have come under much greater public scrutiny for its poor stewardship of the economy. However, the leadership has been able to assign blame for any economic hardship onto external enemies. On a broader level, there is also evidence that 'standing up to the West' has given many (although not all) Russian citizens a greater sense of pride in their country's international standing.

Conclusion

Although not insignificant, the economic impact of sanctions has been overshadowed by the impact of Russia's own structural economic slowdown and the sharp and deep decline in oil prices that began in the summer of 2014. However, Russia's overall financial position remains comparatively strong.

The impact of sanctions has been most observable at the domestic political level. Because sanctions tend to affect non-democracies differently to democracies, the Russian leadership has been able to reallocate resources to its allies within the elite, and also to key economic constituencies across Russia. Under the mantra of import substitution, economic policy is taking an increasingly introverted and *dirigiste* turn. Nevertheless, this blend of economic nationalism has proven, to date, to be very popular among large swathes of the Russian population.

Thus, with the economic impact of sanctions reduced by the factors outlined in this chapter, it is reasonable to question whether Western sanctions are having the effect that sender countries hoped.

2. The Levada Centre Indices, available at: http://www.levada.ru/indeksy (accessed 20 August 2015).

III. HAVE EU SANCTIONS CHANGED RUSSIA'S BEHAVIOUR IN UKRAINE?

Stanislav Secrieru

Introduction

In March 2014 the EU initiated a series of diplomatic and economic sanctions against Russia in reaction to its violation of Ukraine's sovereignty and territorial integrity. The EU was not alone in rolling out a sanctions regime against Russia: the fact that the introduction of sanctions and their upgrade was coordinated with major international players, notably the US, Japan and Canada, has given the sanctions greater political and economic weight. Furthermore the sharp fall in oil prices since June 2014 has intensified the effect of sectoral sanctions on Russia. Moscow has argued that sanctions will do little to change Russia's stance on Ukraine, despite their palpable effect on Russia's economy.

The Kremlin's rhetoric has, however, diverted attention away from Russia's actual policy shifts in Ukraine. This essay argues that EU sanctions – enforced alongside those of the US and other allies – and the threat to implement more such 'restrictive measures', have tamed Russia's behaviour in Ukraine, and reduced to some degree the Kremlin's policy options.

This chapter builds on an analytical model [see Sherr, 2013], which offers a three-level approach to assess Russia's power projection abroad. The three levels of analysis concern Russia's *strategic* objectives with Ukraine, its *operational* goals on the ground in the conflict, and its *tactical* means. Distinguishing these three levels helps evaluate what the imposition of EU sanctions has changed or not changed in Russia's approach towards Ukraine between March 2014 and June 2015. A detailed chronology of events that helps illustrate the underlying analysis is provided in the timeline on pages 44-47.

Unaltered: Russia's strategic objectives in Ukraine

The EU's sanctions have not altered and are unlikely to modify Russia's strategic objectives in Ukraine over the mid-term.

In the post-Soviet period Russia has pursued two sets of overriding strategic goals in Ukraine. These can be divided into 'positive' and 'negative' objectives.

Russia's 'positive' agenda for Ukraine envisions a weak but functional client state. According to this logic, the Kremlin is the final arbitrator in the power struggle in Ukraine. It wields power primarily through politically connected business networks, mainly in the energy sector and in heavy industry. Full membership in Russian-led regional integration projects – such as the Eurasian Economic Union project – represents the external dimension of this 'positive' agenda for Ukraine.

Russia's 'negative' agenda for Ukraine foresees a fractured and a dysfunctional state paralysed by internal infighting, with the Kremlin playing the role of indispensable peacebroker. 'Negative' strategic objectives involve hampering Ukraine's efforts to build closer relations with the EU and NATO, and avoiding Ukraine acceding to membership in these two organisations.

Until 2013 Moscow had alternated between its 'positive' and 'negative' agendas, depending on developments in Ukraine. Russia was ready to push its 'positive' agenda as far as possible and had avoided going too far in its 'negative' one. As Russia moved to annex Crimea in 2014 and ignite war in Eastern Ukraine, the Kremlin's preferences visibly swung towards the latter agenda.

Nonetheless, EU sanctions have been part of a cumulative set of factors that have prevented Russia's strategic objectives from being fully accomplished at times when Ukraine's state was too weak to resist a multi-dimensional (military and non-military) attack by Russia.

Partially successful: hindering Russia's operational goals

Russia has been partially successful at the operational level since March 2014. In order to advance its 'negative' strategic objectives, Moscow pursued several operational goals: to seize parts of Ukrainian territory, to establish provisional authorities and military structures, to use the latter as a springboard for more small territorial gains, and to foster permanent destabilisation in other parts of the country.

Russia hoped these factors combined would drain Ukraine's limited resources and foment unrest against the central authorities in Kyiv. Success at the operational level would have created a setting for partial reintegration (excluding Crimea) of parts of Donbass into Ukraine, but on Russia's terms. Such a development would have given birth to a strategically deadlocked Ukraine. The accord would have included constitutional changes on the right for self-determination of other regions in Ukraine, further encouraging the unravelling of the Ukrainian state. The constitutional proposals circulated in May-June 2015 by the self-proclaimed Donetsk and Luhansk People's Republics (DNR and LNR) confirm this conjecture. Russia has partly succeeded in weakening Ukraine.

Nonetheless, Western sanctions have partially paid off as well. Sanctions were part of the effort to freeze the military conflict along the post-Minsk demarcation line agreed in September 2014. As they were adopted at critical junctures in the conflict on the ground, they have prevented Russia's further military expansion in Ukraine. The second wave of sectoral sanctions in September 2014 stopped Russia's offensive against almost defenceless Mariupol. The threat of new sanctions impeded the full legitimisation of the separatists' political structures in Donbass: at the last moment, Russia refrained from recognising the results of the November 2014 'elections' in DNR and LNR[1].

Sanctions contributed to lifting Russia's opposition to the deployment and expansion of the OSCE Special Monitoring Mission (SMM). Despite the mission's slowness in developing its capacities as neutral observer, it has been the only international actor able to monitor the situation on the ground and to offer insights into the conflict that do not corroborate Russia's propaganda. Hence OSCE SMM activity forced Russia to make more efforts to camouflage its troops surge in Eastern Ukraine in January-February 2015.

Sanctions have made Crimea's absorption more expensive for Moscow, prompting Russia to divert state funds earmarked for other projects. The peninsula has turned out to be the region most dependent on federal budget transfers, along with the North Caucasus republics. As Russia confronted the substantial costs of its annexation of Crimea, the EU's direct financial support and mobilisation of international funds (from the IMF and the World Bank) saved Ukraine from economic collapse.

Russia's territorial gains in Eastern Ukraine have led to an operational dilemma for the Kremlin: what to do next with war-torn parts of Donbass (now cut off from Ukraine) for which Russia has no interest in assuming the financial burden?

1. Engaging in a subtle game of semantics, Moscow declared that it 'respected' the results of the elections while it did not recognise them.

Relative tactical success and respite for Ukraine

The EU's sanctions on Russia have been most effective at the tactical level.

To mount concentrated and relentless pressure on Ukraine, Moscow has employed a variety of military, economic, political, legal, diplomatic, and information tools. In 2014 Russia deployed (unmarked) troops to Crimea and Eastern Ukraine, trained and armed locals and Russian volunteers, and denied Kyiv control over the Ukrainian-Russian border in the Luhansk and Donetsk regions (along a 409 km strip of land). Gazprom suspended gas deliveries to Ukraine for more than half a year. Among the first concerns of Russian-led rebels in the captured towns and cities of Eastern Ukraine was to turn off Ukrainian TV channels and switch exclusively to Russian ones. Not surprisingly, the fighting around TV transmission towers was particularly intensive. At the same time the Russian Federal Migration Service sabotaged Ukraine's military mobilisation by extending the visa-free stay in Russia of Ukrainian citizens of conscription age to more than 90 days. The Kremlin actively promoted the narrative of the Maidan as a 'coup' fomented in Kyiv and led by a far-right movement. Russia stressed its own peaceful intentions. This combination of tactics aimed to discourage the EU from providing support to Ukraine by portraying it as a failed state, and by undermining Ukraine's efforts to rebuild state capacity.

The use of military force, in particular throughout 2014, represents the most destructive behaviour demonstrated by Russia in its approach to Ukraine. In that regard, sanctions have been responsible for limiting the scale of Russia's use of military force in Ukraine. Sanctions partially worked as a deterrent in the short-term by raising the cost of military escalation (e.g. Mariupol in September 2014). The threat of *more* sanctions forced Russia to de-escalate in order to prevent the emergence of an intra-EU consensus on sanctions and/or to soften the scope of an imminent new wave of restrictive measures. The threat of sanctions may have not prevented the takeover of Debaltseve, a key railway transport hub, in February 2015, but ensured in the aftermath a relatively quiet few months on the front. Deliberations in the EU in the spring of 2015 over further extension of sectoral sanctions are likely to have been among the factors that have forestalled a major military offensive in Donbass.

Judged through this tactical prism, sanctions have provided Ukraine with some breathing space before the next round of fighting. Thus, it was 'thanks' to the EU's sanctions that the Minsk negotiations and an imperfect ceasefire were made possible at all. Such moments of brief respite were essential for Ukraine to strengthen the core structures of its state (notably its defence sector and security services), which was previously deeply infiltrated by Russia. Ukrainian state performance remains weak in terms of governance, but sanctions against Russia bought invaluable time for Ukraine to elect a new political leadership, buttress its defences and become more resilient than it was at the beginning of the conflict. Russia's failed assault on Marinka in June 2015 appears to reflect Ukraine's improved military capabilities. Today, Russia would have to significantly step up its use of violence to alter Ukraine's defence lines. This would in all likelihood trigger more painful economic sanctions by the EU and its partners.

Conclusions

The EU's decision to extend sectoral sanctions against Russia until January 2016 has been an investment in its reputation as a credible sanctioning actor and coherent foreign policy player. Sanctions have certainly not reversed the annexation of Crimea nor prevented Russia from waging a hybrid war in Ukraine. The slow pace at which the EU has scaled up sanctions has put it at a disadvantage in the face of a more agile and determined Russia.

EU restrictions have increased the costs to Russia of its annexation of Crimea. They have constrained Russia's ability to pursue its strategic objectives in Ukraine and limited its use of military instruments. In this regard, sanctions have provided a minimum of deterrence against Russia.

Sanctions have helped Ukraine's political regime to survive in the short term and mid-term. Yet without a concerted and ongoing effort on the part of the EU to assist Ukraine with its programme of political and economic reform and on the part of Ukraine to pursue reforms (thus addressing more effectively the preconditions that facilitated Russia's aggression), the positive payoff of sanctions for Ukraine may not last.

Timeline of events in Eastern Ukraine & Crimea: military action, ceasefires and sanctions

- **27 February 2014:** pro-Russian militias and Russian regular troops wearing no identifying insignia seize the building of the Crimean parliament and erect security checkpoints between continental Ukraine and the Black Sea peninsula. The local legislative votes down the government and installs a new prime minister. In the following days Russia reinforces its troops, and blocks Ukrainian ground forces and navy in Crimea. The parliament in Simferopol schedules a 'plebiscite' on accession to Russia.
- **3 and 6 March 2014:** the EU decides on first measures against Russia. Preparations for the G8 summit to be held in Sochi, Russia, are suspended. Other bilateral policy processes such as the EU-Russia visa dialogue and talks on a new comprehensive economic and political accord with Russia are put on ice. EU heads of state task EU institutions to work on a first round of sanctions against individuals seen as responsible for the violation of Ukraine's territorial integrity.
- **18 & 20 March 2014:** after the 'referendum' in Crimea, a treaty of accession of Crimea to Russia is signed and ratified in Russia.
- **16 and 21 March 2014:** the EU adopts a first list of sanctions against 33 Russian and Ukrainian citizens (visa bans and assets freezes). The EU cancels a planned EU-Russia summit in spring 2014. EU capitals agree to limit the number of high-level bilateral meetings with Russia. Russia is expelled from the G8 group. Western states block ongoing negotiations on Russia's accession to the OECD and International Energy Agency.
- **March 2014:** in parallel to the annexation of Crimea, Russia foments protests across Southern and Eastern Ukraine (in and around Kharkiv, Donetsk, Luhansk, Odessa) against the new authorities in Kyiv. In the same month the EU Council instructs the EU Commission to prepare a new set of targeted measures.
- **21 March 2014:** in response to the growing instability, OSCE members decide to deploy a Special Monitoring Mission (SMM) to Ukraine, whose mandate has been extended several times since then. The Mission itself has expanded from 100 to around 500 civilian observers.

- **April 2014:** pro-Russian protests become more violent, though only a small number of persons are involved. Attacks on administrative buildings intensify (e.g. Luhansk and Donetsk on 7 April), whereas a first group of towns fall under the control of Russian-led militias (e.g. Slovyansk and Kramatorsk on 12 April).
- **15 April 2014:** Ukrainian authorities launch the so-called Anti-Terror Operation (ATO).
- **17 April 2014:** the heads of the United States, European Union, Russian and Ukrainian diplomacy meet in Geneva and agree on steps to de-escalate tensions and restore order in Ukraine.
- **May 2014:** pro-Russian militias seize more territory in Eastern Ukraine and evict Ukrainian border guards from the Russian-Ukrainian border.
- **11 May 2014:** in parts of the Donetsk and Luhansk region, 'referendums' are held on the independence of the self-proclaimed Donetsk and Luhansk Peoples Republics (DNR and LNR).
- **12 May 2014:** the EU scales up individual sanctions and warns Russia against disrupting presidential elections in Ukraine scheduled for 25 May.
- **6 June 2014:** leaders of Germany, France, Russia and the newly elected president of Ukraine Petro Poroschenko discuss ways to defuse the crisis at a meeting in Normandy. A Trilateral Contact Group on Ukraine is set up, composed of Russia, Ukraine and OSCE representatives.
- **18 June 2014:** after reestablishing partial control over the border with Russia and recapturing towns (e.g. Mariupol), President Poroshenko proposes a peace plan, and on 20 June declares a unilateral 7-day ceasefire. On 23 June, representatives of DNR and LNR agreed on the ceasefire.
- **23 June 2014:** the EU imposes a ban on import of goods from Crimea.
- **27 June 2014:** the EU threatens more sanctions.

- **1 July 2014:** after multiple violations of the ceasefire by pro-Russian fighters, Ukraine re-launches ATO, which involves efforts to regain control over parts of Donbass and of its eastern border with Russia. In response, Russia ramps up heavy weapons supplies to the conflict zone.
- **16 July 2014:** the EU's new sanctions aim to curb the financing of projects in Russia by the European Investment Bank, the European Bank for Reconstruction and Development and the EU Commission.
- **17 July 2014:** flight MH17 from Amsterdam to Kuala Lumpur is shot down over the separatist rebel-controlled territory in Eastern Ukraine, killing all 298 people on board.
- **24 July 2014:** OSCE members agree to send an observation mission to Russian checkpoints (Gukovo and Donetsk) at the border with Ukraine.
- **25 & 29 July 2014:** the EU tightens sanctions against individuals, and adopts economic sanctions targeting Russia's financial sector, arms trade and technologies transfers in the military and oil sectors. The EU further restricts trade and investment with Crimea in several sectors (30 July 2014).
- **August 2014:** by mid-August the Ukrainian forces substantially reduce the area controlled by Russian-led fighters. To prevent the total collapse of the DNR and LNR, Russia delivers more heavy weapons and regular troops to Eastern Ukraine. By the end of August, Ukraine loses control of the border with Russia along the Donbass region, rebels break the encirclement of Donetsk and Luhansk, defeat Ukrainian forces at Ilovaisk and advance along the Azov Sea coast towards the strategic seaport of Mariupol.
- **5 September 2014:** following several meetings of the Trilateral Contact Group on Ukraine its parties sign the so-called 'Minsk protocols'. These include an immediate ceasefire clause.
- **8 September 2014:** the EU Council deepens sectoral sanctions against Russia.
- **October to December 2014:** the intensity of fighting in Donbass decreases relatively. The hottest spot on the frontline remains Donetsk airport.
- **2 November 2014:** DNR and LNR hold 'general elections'.

- **28 November 2014:** the EU expands its list of sanctioned individuals in Eastern Ukraine.
- **18 December 2014:** the EU introduces a comprehensive ban on investments in Crimea, prohibits the provision of tourist services, and forbids exporting technologies or equipment in the telecommunication, transport and energy sectors.
- **21 January 2015:** pro-Russian fighters capture the ruins of Donetsk airport and mount an offensive on Debaltseve with support of Russian troops.
- **29 January 2015:** the EU takes the political decision to extend its sanctions on individuals until September 2015.
- **12 February 2015:** a new package of peace measures is agreed in Minsk after high-level talks in the so-called Normandy format. The OSCE was given a prominent role in monitoring the armistice.
- **16 February 2015:** the EU adds more people and organisations to its blacklist. The list includes 150 persons and 37 organisations or companies.
- **18 February 2015:** Russian-led forces capture the town of Debaltseve.
- **13 March 2015:** the EU extends its restrictive measures on individuals until 15 September 2015.
- **March - May 2015:** the intensity of fighting visibly subsides.
- **3-4 June 2015:** Pro-Russian forces launch an attack on Marinka in the Donetsk region which is repelled by Ukrainian troops.
- **19 and 22 June 2015:** the EU extends its prohibitive measures on Crimea until 23 June 2016 and its sectoral economic sanctions on Russia until 31 January 2016.

IV. SANCTIONS AGAINST IRAN – A PRELIMINARY ECONOMIC ASSESSMENT

Peter A.G. van Bergeijk

Introduction

This chapter seeks to contribute to the academic and policy debates on the merits of sanctions against Iran by providing an empirical analysis of their economic impact.[1] It starts by taking a look at stylised facts[2] in order to establish whether sanctions are effective – measured by the degree to which they have constrained the Iranian authorities' ability to sustain their ambitions in the nuclear field as a result of the costs sanctions have inflicted on the country. Having established the conditions under which sanctions meet the criteria for success (as developed in chapter I), the rest of the chapter explores the results of an econometric model that not only tracks the economic mechanisms through which sanctions operate, but also analyses their spillover effects in the political realm.

The Iranian case meets the economic requirements for success

The Iranian case would *a priori* seem to meet the underlying conditions under which sanctions should have a significant economic impact. Among them we can identify a sufficient level of pre-sanctions trade linkage between senders and the target country, combined with limited capabilities to substitute import and export products, as well as an unexpected broadening of the sanctions imposed and the use of a new tactic, namely the exclusion of Iran from the SWIFT worldwide messaging system.

Trade sanctions

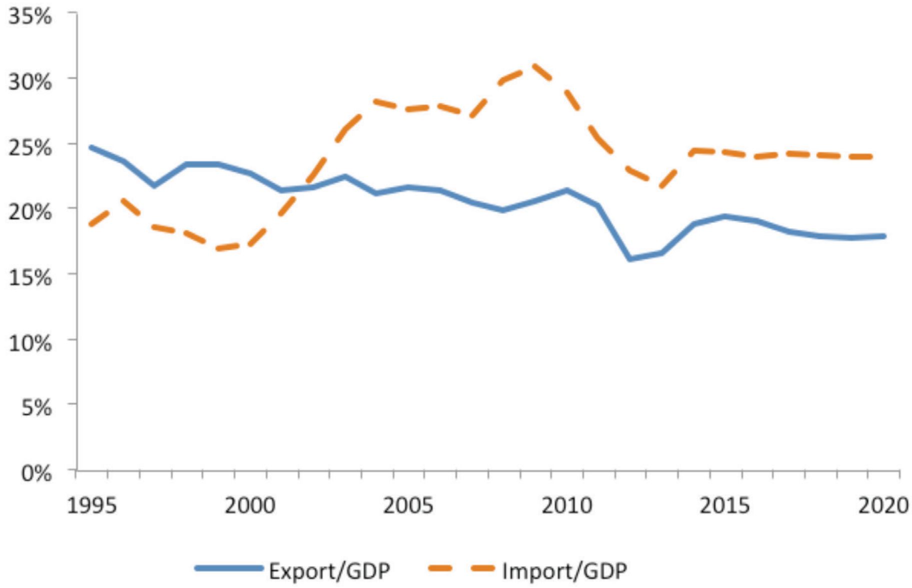
One of the most robust pre-conditions determining the degree to which sanctions have a significant economic impact is through the levels of pre-sanctions trade linkages. Figure 1 primarily shows that there was a significant level of pre-sanctions trade openness. Moreover, trade between Iran, the EU and the US covered some

1. Editor's note: This analysis is an *ex ante* assessment of the effects of sanctions on Iran and the likelihood of their success. It is based on economic modelling. The analysis, building and expanding on a paper co-authored with Sajjad Dizaji (2013), was undertaken before the July 2015 agreement between the E3+3 powers and Iran on the country's nuclear programme. At the time of writing of this report in July 2015, it turns out that this model has proven highly predictive. The analysis offered in this chapter offers powerful insights into the dynamics of sanctions.

2. This term, originally devised by the economist Nicholas Kaldor, refers to broad insights and deductions derived from empirical analysis of the behaviour of a set of economic variables.

18% of Iran's total export earnings. Between 2011 and 2013 (the 2013 numbers still being estimates), both trade ratios decreased by about four percentage points or a 14-18 % decrease. This is in line with Iran's 2010/11 export-to-GDP ratio of 21% and the share of the EU and US in Iran's exports of 18% (these ratios in combination imply that trade at risk is 3.8% of Iran's GDP). Figure 1 also shows the substantial decrease in Iranian overall trade, pointing to the possibility that sanctions may have contributed to this trade contraction. Given that exports are dominated by oil and that this specific product cannot be used as substitute for the import of capital goods, commodities and food, the effects of the imposed oil embargo are exacerbated. The reduction in oil export revenue as a result of the oil embargo spills over, first to the government budget and next to private consumption and investment.

Figure 1: Trade to GNP ratios for Iran (1995-2012 and estimates and forecasts for 2013-2020)



Sources for data: GDP, exports and imports at constant 2000 prices and dollars for 1995-2007 are from World Bank, World DataBank, http://databank.worldbank.org (accessed December 2012) and calculated from their real growth rates for 2008-13 as reported and estimated in IMF, April 2015 World Economic Outlook database (accessed May 2015)

Financial sanctions

The EU and US financial sanctions that accompanied the oil boycott may explain why the sanctions are biting much harder than expected – on the basis of pre-sanctions trade patterns. One of the measures taken within the EU's financial sanctions package was to exclude Iran from the SWIFT worldwide messaging system, which is used to arrange international money transfers. This makes it significantly harder to process international payments, while simultaneously constraining other bilateral economic flows. Most importantly, the financial sanctions imposed are characterised by their unexpected scale (concretely through the involvement of the EU); while Iran's exclusion from SWIFT is a measure that was used for the first time in history, and thus represents a new and innovative step.

Economic dimension: key findings

- Pre-sanction trade linkage was substantial.
- Substitution possibilities between exported and imported products remain limited.
- Scale of the trade and investment sanctions was unexpected.
- SWIFT sanctions were unexpected.

These four key findings do *not* imply that the sanctions regime will succeed in achieving its stated goal – but rather that the expected likelihood of sanctions having a significant economic impact is rather high.

The political economy of sanctions

While the economic analysis suggests that sanctions are likely to have an important economic impact, we need to dig deeper into the knock-on effects brought about by restrictive measures from a political economy perspective.

Sanctions goals

First, it is important to note that the formally stated goal of the sanctions regime against Iran is to halt its nuclear programme, due to the suspicion that it is not being developed for peaceful purposes. As a result, it is important to check if the existing cases of sanctions regimes to enforce non-proliferation are statistically different from other sanctions regimes in general. After all, if it is more difficult to enforce non-proliferation, then we need to discount this in our assessment of the likelihood that sanctions will succeed in constraining or prompting a behavioural change on the part of the target.

The Peterson dataset lists 21 sanctions regimes that aim to change nuclear policies. Six cases are successful (28%): it should be noted that the median duration for successes and failures are 1-4 years, respectively. Additional testing with a probability model that takes into account controlling factors such as trade linkage, duration, political stability and sender reputation, does not find a statistically significant difference for non-proliferation sanctions regimes [van Bergeijk, 2009]: the non-proliferation cases can thus be analysed as if they were general sanction episodes.

Many commentators have linked sanctions to democratisation and in the Iran case perhaps this is an even more important goal for some of the current sender countries. Indeed, sanctions also appear to have been implemented with the hope of facilitating a democratic breakthrough in the target country. The implication is that the non-proliferation cases can be analysed and sanctions episodes aimed at strengthening democracy. This is yet another reason to focus our discussion below on the political changes in Iran.

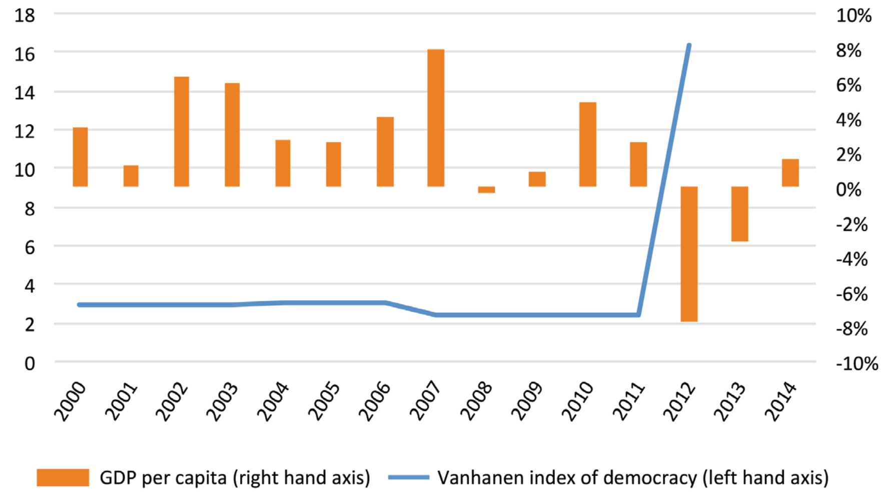
Interest groups and regime change

The second issue to be noted is that we need to qualify the implicit assumption of a rational unitary actor – one that makes a cost-benefit analysis for society as a whole and acts accordingly. This is rather simplistic. The 'public choice' approach to economic sanctions in which interest group competition and political institutions are an important determinant of the impact of sanctions focuses attention on the extent to which sanctions hurt the supporters of the target government directly or compromise that government's ability to reward supporters or, alternatively, suppress opposition. A body of empirical research shows a direct link between oil revenue and government expenditure, especially regarding military spending.

The strength of the economy has been associated with the likelihood that the target's leadership will survive. Typically growth slowdowns are associated with higher political turnover. Sanctions may either help to replace the target country's government or open up a bargaining range, making the target country's leadership more willing to compromise due to the increasing political costs of not complying (i.e. a higher likelihood of government turnover). The key point is that the variations in economic wealth resulting from the imposition of sanctions matters empirically.

Figure 2 takes a closer look at the evolution of this sanctions effect, bringing the growth and decline of GDP *per capita* as well as an index for democratisation into one picture. The simultaneous reduction of *per capita* income and the extent of democracy are remarkable, even if the causal relation could be deemed tentative at best.

Figure 2: Development of GDP per capita (growth rate) and Vanhanen index of democracy



Sources for data: IMF World Economic Outlook database (April 2015) and Tatu Vanhanen, *Measures of Democracy* 1810-2012 [computer file]. FSD1289, version 6.0 (2014-01-31). Tatu Vanhanen & Krister Lundell, [data collection]. Tampere: Finnish Social Science Data Archive [distributor], 2014.

From this we can infer that sanctions have adversely affected the middle class. The imposed sanctions created hardship and may have been one of the important motivating forces behind the 2013 democratic change of leadership that brought Rouhani to power. In our discussion we fortunately do not have to answer the question of whether the sanctions actually *caused* this shift. What matters is that sanctions have a better chance of succeeding in more democratic targets.

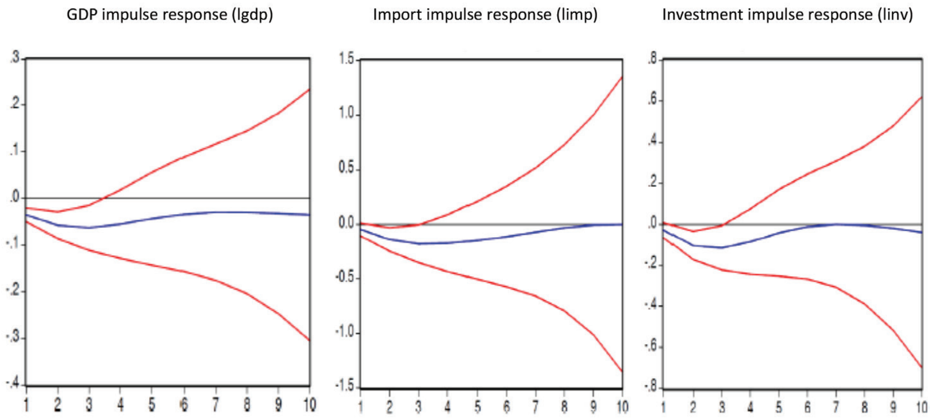
Political dimension: key findings

- The sanctions did not generate support for the existing regime (no rally around the flag effect).
- Very significant increase in democracy index.

Modelling economics and politics

In order to shed light on the causal mechanisms, a *Vector Auto Regressive* (VAR) model for Iran is used. A VAR model is based on the historical evolution of the data rather than on some preconceived theory and is able to capture the dynamics of an economy. Our model ably describes the history (1959-2006) of both key economic variables (oil and gas rents, government consumption, imports, gross capital formation, GDP) as well as political variables that either measure the autocracy-democracy dimension (the so-called Polity IV indicator) or the Vanhanen index, that measures political competition and participation. We estimate the VAR model on the basis of annual data for the period 1959-2006. In this model a shock is introduced in the economic system that mimics the sanctions and thus offers a prediction of sanction outcome.

Figure 3: Sanction impact on GDP, imports and investment in Iran



Source for data: Dizaji and van Bergeijk, 2013, *Generalized impulse responses - statistical appendix* appendix (internet resource available at : http://jpr.sagepub.com/content/50/6/721/suppl/DC1)

Economic variables

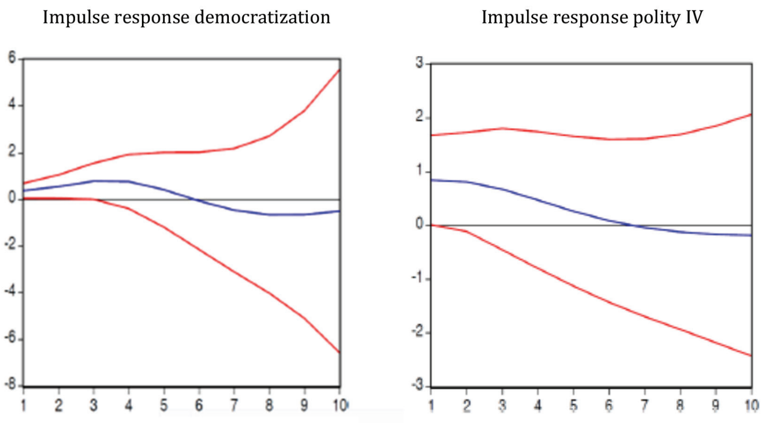
The blue lines represent the impulse response functions (first graph for GDP, second for imports and third for investment). The patterns of the economic impulse response functions are similar: a negative and initially large impact that becomes larger in size up to the third year after the sanction shock is administered and then becomes smaller as the economy adjusts.[3]

3. Note that the red lines report the confidence interval's upper and lower bounds; the negative impact is thus only significant in the first three years - that is, until the upper bound crosses the horizontal axis.

Political variables

Figure 4 reports the key findings for the variables of interest: the impact of sanctions on political outcomes in Iran. The left-hand panel in Figure 4 focuses on the impact of the sanctions on the extent of democratisation; a positive impact implies that the sanctions stimulate democracy. The right-hand side panel in Figure 4 reports on the Polity IV indicator that measures Iran's location on the democracy-autocracy continuum. An increase in these two measures is associated with more democratic (less autocratic) outcomes. The two approaches show similar results, thus giving us some confidence in the robustness of the findings: an initially significant positive shock that turns negative after six to seven years. While the shift towards more democracy is reflected by the 2013 elections, it is too early to tell if the model's prediction of a turnaround in 2017-18 is on track.

Figure 4: Sanction impact on index of democracy and polity-IV



Source for data: Dizaji and van Bergeijk, 2013, *Generalized impulse responses - statistical appendix* (internet resource available at http://jpr.sagepub.com/content/50/6/721/suppl/DC1)

Key findings

- The impact of an oil boycott on the Iranian economy is considerable: oil and gas rents are important drivers of key macroeconomic variables (GDP, imports and investments) and ultimately of its political system.
- A reduction of oil and gas rents creates economic costs that act as incentives to move towards a more democratic setting.
- In the first two years, sanctions have a significantly positive impact, but the VAR model predicts that this effect wanes and in the long run the political effect of sanctions is negative.

A final note on the phasing-out of sanctions

Adjustment of the economy does not only reduce the negative impact of sanctions. It also reduces the direct benefits of terminating the sanctions regime. This is a logical consequence emanating from a lowering of the economy's dependence on international trade (more autarky). While this does not influence the long-run free trade benefits, the fact that the economy needs to re-adjust implies costs that should be discounted properly. Again, the implication is that the sanctions can only help to soften the Iranian position in the short run. Long-term sanctions against Iran, in contrast, may run counter to the cost-inducing effects of the initial years of implementation.

Summary of key findings

- Theory and empirical evidence lead to the conclusion that the economic impact of sanctions on the Iranian economy is considerable.
- Sanctions create economic costs that act as incentives to move toward a more democratic system.
- This effect is only significant in the first two years and turns negative after 6-7 years due to economic adjustment.
- Increasing global pressure will initially cause effective damage pushing for more democracy or less autocracy and thereby leading to a softening of the Iranian negotiation position.
- In the long run, sanctions, however, are likely to have the opposite effect. In this sense sanctions have created a window of opportunity, but it is important to realise that this window is likely to close if the sanctions regime is prolonged.

V. SANCTIONS AGAINST IRAN: WINNERS AND LOSERS

Sara Bazoobandi

Introduction

Iran has been subject to sanctions for more than three decades. The United States (US) has been the primary sanctioning power since the Tehran US embassy seizure and hostage crisis in 1979. Since then Washington has expanded the range of punitive measures taken against Iran in response to government actions deemed reprehensible by the White House. After the hostage crisis of 1979, the aggressive tactics of the Iranian military in the Persian Gulf during the Iran-Iraq war, Tehran's support for terrorist organisations, and most recently, the revelation of the country's nuclear programme, the US has essentially relied on 'restrictive measures' as an alternative to military action to signal its disapproval. The European Union emerged as a primary sanctioning actor alongside the US after 2006, incrementally broadening its panoply of sanctions since then, and adopting so-called 'autonomous' sanctions since 2010.

While the escalation of unilateral and international sanctions has had an adverse effect on the Iranian economy over the past few decades, the latest international campaign to impose extensive sanctions in response to Iran's nuclear programme has had a much greater impact.

This chapter will review two dimensions relating to the international sanctions regime against Iran. Firstly, it will elucidate the reasons why the latest round of sanctions has had a more pronounced negative impact on the country, and, secondly, it will evaluate their repercussions on Iran's domestic politics.

In answering the first question, it is important to examine what made the most recent round of sanctions different from the sanctions which preceded them. Looking at post-2006 sanctions on Iran, two key issues can be identified: the US's relative success in persuading most of Iran's key economic partners, both in Europe and Asia, to join the sanctions regime, and the Iranian government's record of macroeconomic mismanagement. A combination of these two phenomena has clearly been the key driver behind the greater impact of the most recent round of sanctions. With regard to the second question, an assessment of the domestic political, economic and social impact will serve to evaluate the effect of sanctions and how the Iranian authorities have responded to the economic and societal pressures that these have generated.

Post-2006 sanctions: a global economic campaign against Iran

Since 2006, the EU has joined the US in incrementally tightening unilateral sanctions against Iran. By targeting a wide variety of sectors (nuclear, military, energy, shipping and transportation, insurance, and, most importantly, financial) the economic impact has been significant [Arnold, 2015]. The United Nations has also adopted six resolutions in response to the Iranian nuclear file since 2006, four of which included a gradual expansion of sanctions.

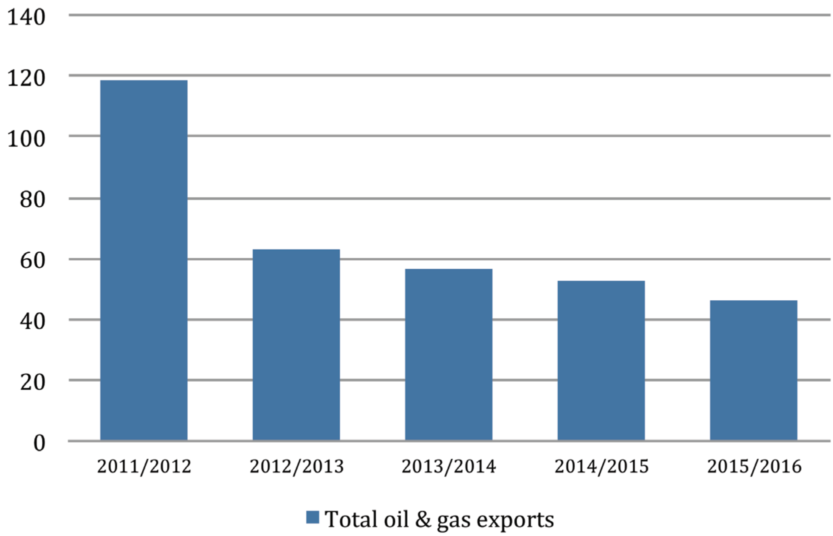
By 2012, the EU had adopted a series of autonomous sanctions to put additional pressure on the Iranian economy, particularly on the oil and banking sectors. The limitations on international financial transactions, the EU oil embargo as well as banking and insurance restrictions have squeezed Iran's oil exports and severely constrained the country's capacity to generate 'petrodollars'. Japan and South Korea, two major buyers of Iranian oil, have also begun to reduce their imports from Iran dramatically in response to US pressure. As a result, Iran's crude oil production has fallen dramatically in recent years.

In addition to insurance sanctions on oil tankers, which had a direct impact in curbing Iranian oil exports globally, Iran's forced exit from the SWIFT worldwide messaging system used for international money transfers has severely curtailed the flow of oil revenue into the economy. Consequently, not only have the country's major oil buyers in Europe and Asia begun to reduce their imports of Iranian oil, but also the oil payments from the remaining exports have been delayed significantly. Meanwhile, replacing the US dollar as the currency used to buy and sell oil – which was utilised as a temporary measure to settle oil trades – has not resolved the issue. Since 2012, the country's crude oil production has plummeted. As a result, Iran lost its position as second-largest producer within the Organisation of the Petroleum Exporting Countries (OPEC) and fell to fourth position, behind Saudi Arabia, Iraq, and the United Arab Emirates (UAE).

Domestic economic mismanagement

Although escalation of international sanctions on Iran has indeed led to severe economic difficulties, it is also important to consider that the government's mismanagement has made the economy more vulnerable to the effect of sanctions and indirectly contributed to its deterioration over the past few years. In other words, in combination with already existing problems besetting the economy, international sanctions have magnified Iran's economic woes.

Figure 1: Iran's total oil and gas exports

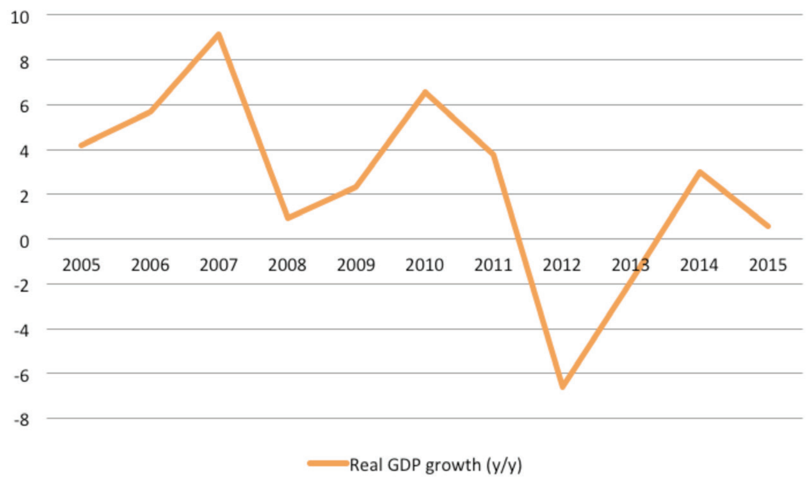


Source for data: IMF, *Islamic Republic of Iran: Country Report* no. 14/93 (2014); 2015/2016 = forecast.

For nearly four decades, the Iranian economy has suffered from high unemployment, widespread inefficiency and corruption, rampant inflation, budget deficits, and excessive reliance on oil revenues to finance government expenditure (50-60%). The government has been the biggest economic player in Iran since the 1979 Revolution. Since then, various public sector companies and financial institutions have been targeted by a panoply of unilateral international sanctions, specifically by the US. As a result, Iran has become increasingly isolated, with relatively limited exposure to the global economy.

A combination of the above-mentioned factors has created an unhealthy economic environment with long-standing structural challenges. The rates of real economic growth have frequently been negative. The private sector has performed weakly and its economic activities have been limited. The country has suffered from the flight of capital and talent for nearly four decades. Countries neighbouring Iran like Turkey, the United Arab Emirates, and Saudi Arabia have been quite successful in attracting foreign investment. In contrast, the Iranian market has failed to lure foreign investors.

Figure 2: Iran real GDP 2011-2015 (% change y/y)



Source for data: IMF (2014)

These structural economic problems deepened between 2005 and 2013. During this period, the government of former president Ahmadinejad began to apply new macroeconomic policies in various areas (such as banking and finance), to enact subsidy reform, and to privatise government assets. The economic programmes of this period were aimed at empowering lower income groups and the poorer regions of the country.

The key component of the government's policy to achieve this aim was to distribute the economic benefits of the government's oil revenues among lower-income households. The resulting distribution of cash payments – particularly through a targeted subsidies programme and small 'quick return' loans – led to a substantial increase in the money supply. This, combined with the country's high levels of imports, led to soaring inflation, and damaged small-to-medium sized producers. Consequently, over the years, the government's interventionist policies in favour of lower-income groups have exacerbated the country's economic problems.

These problems were in turn magnified by the tightening of international economic sanctions on Iran.

The domestic political consequences

Hassan Rouhani was inaugurated as new Iranian president in August 2013, at a time when the country's economy was at its lowest ebb since the Iran-Iraq war. The economy was experiencing stagflation, with a negative growth rate of -5.4%, and 44% year-on-year inflation. The unemployment rate was unofficially estimated to stand at levels as high as 20% – with women and young people being the most affected groups.

President Rouhani was perhaps the only presidential candidate in the 2013 election who promised to bring change. During his presidential campaign, he committed to resolve the nuclear deadlock so as to ease the imposed economic sanctions.

Who was mostly negatively affected by sanctions?

Iran's official position in relation to sanctions has been to frequently deny the hardship caused by the imposition of these measures. This was perhaps a negotiating tactic for Tehran to avoid encouraging further sanctions, as the nuclear discussions under the new administration resumed. When analysing the domestic impacts of the sanctions on Iran, a few general observations can be made however on the way in which they have affected the economy, society and politics of the country.

Iranian society can be divided into three main strata: the wealthy upper-middle class (including those that are well-connected to the Islamic Republic elite); the middle classes (most of whom are well-educated, professional liberal-minded residents of the larger cities); and a large lower-class group (the majority of whom are low-income citizens, often residing in rural areas or poorer suburban areas and who have traditionally had a fairly low standard of living).

The first group has remained relatively invulnerable to sanctions, as their disposable income has been high enough to cushion them from the full effects of the measures. The third group, which had quite a low standard of living even before the sanctions were tightened, has experienced lesser impact on their livelihood partly because of the tangible rise in income generated by the subsidy reform cash handouts. It is the middle class which has suffered most from the sanctions.

Who benefited from sanctions?

The sanctions have spawned creative evasion strategies both inside and outside of Iran. In the thriving black market, new and lucrative business opportunities have been created for individuals and interest groups adept at devising ways of bypassing the sanctions regime. To mitigate the impact of sanctions, the Iranian government has been constantly seeking to find alternative payment systems. Selling oil at discounted rates, accepting non-dollar and oil-for-goods trades, and selling Iranian oil disguised as other crudes using ship-to-ship transfers, are among the subterfuges to which Iran has resorted in order to avoid a complete collapse of its crude export income. Relying on such mechanisms has been rather expensive and using unofficial trade channels has created opportunities for interest groups to generate hefty profits from sanctions.

The scandal of Babak Zanjani that erupted in 2014 is one example of such corrupt and illicit business practices. Mr. Zanjani, a Dubai-based Iranian businessman, helped the government circumvent the US-led sanctions, for example by organising illegal oil exports and laundering oil money. The affair was made public after the launch of a parliamentary corruption investigation. Other cases, like the recent purchase of 15 second-hand civilian aircraft through an Iraqi firm, are evidence of the extent to which extensive corruption channels exist both within and outside Iran.

As a result of the widespread corruption within the country's economic system which sanctions have encouraged, the gap between rich and the poor in Iran has widened. For example, it transpired that over USD 2 billion of subsidised funds earmarked to finance the import of medicines were instead used to import luxury cars, to the benefit of upper-class Iranians.

Dynamics of the Iranian political system

The success of President Rouhani during the 2013 presidential election was partly due to his campaign promise to lift the economy out of its protracted stagnation. Although that promise remains yet to be fulfilled, Rouhani's administration has at least managed to lower inflation by more than half (from over 40%). Despite the remaining economic problems, the administration has been somewhat successful in convincing the population of the potentially fruitful outcome of the ongoing nuclear negotiations.

Rouhani's popular support has remained untouched while the July 2015 nuclear deal was being finalised. Rouhani's supporters, largely drawn from the urban middle-classes, have been watching the negotiations, and speculating about the difference that the nuclear deal will make to their lives, patiently. They have not yet lost trust in his ability to deliver on his economic promises despite the limited visible improvements over the first years of his term in office. But in the long run, a failure to deliver clear progress in terms of living standards will undermine the president's popularity.

As the next phase of the July 2015 agreement on the country's nuclear programme with the E3+3 group sets in, the establishment needs a figure to associate with its success – or failure. The Supreme Leader, Ayatollah Khamenei, has placed himself cautiously in between the pro-deal camp and those against it. This may be interpreted as Khamenei's strategy to take the credit for a deal, if it is successful, but to avoid being blamed by the anxious Iranian public for any potential failure.

The often-ambiguous position of the Supreme Leader in the negotiations has allowed the hardliner camp that oppose any nuclear deal – particularly in the Parliament (*Majles*) – to put pressure on the negotiating team. Given mounting economic hardship, the anti-nuclear deal factions would not stand much chance in selling their agenda to the majority of the Iranians. However, they can put the administration under pressure now that the deal is finalised. Therefore if the deal were to fail this would undoubtedly push the Islamic Republic into a more hardline position in which the moderate elements of the establishment will lose their bargaining power domestically and the trust of the Supreme Leader.

The Islamic Republic has been convulsed by an internal power struggle, which led to a full-scale legitimacy crisis in the aftermath of the 2009 presidential election. As a result, the reformist elements in the parliament, who became known as the leaders of the 'Green Revolution', have been put under house arrest and labelled as 'seditionists' by the hardliners. As the parliamentary election of 2016 looms, various conservative hardliners, including those known to be closer to the Supreme Leader, have raised concerns over the 'seditionists" plans for the takeover of the *Majles*. Undoubtedly, the race for the *Majles* elections will be eventful and if the transparency of the election is maintained, as Rouhani promised publicly, the result will reflect public support for a moderate, if not reformist, legislature.

Sanctions' effectiveness: an evaluation

As outlined in the first chapter of this report, sanctions can raise the costs of the target's activities or force it into costly changes of economic strategy. The case of Iran reveals that sanctions have indeed been effective in constraining Tehran's discretionary policies, particularly in the oil and financial sectors. The pressure imposed by sanctions means the country was obliged to make concessions during negotiations with the E3+3 (France, Germany, the UK, China, Russia and the US) in Lausanne, leading to the July 2015 agreement.

In addition, in their opening chapter Biersteker and van Bergeijk have highlighted that sanctions might succeed in constraining a target, in buying time for a negotiated settlement, or in signalling resolve about a norm that has important implications for the behaviour of other parties. Because of the nature of the sanctions imposed, particularly the autonomous ones, Iranian authorities became more responsive to the E3+3 demands as the pressure of sanctions mounted after 2011. While Iranian policymakers demonstrated willingness to compromise during the nuclear negotiations, this may well be tentative and could be reversed should the agreement reached in 2015 come to unravel.

According to Biersteker and van Bergeijk, sanctions entail a theory of change. Indeed, the EU's specific targeting of major sectors has been crucial in softening Iran's position and encouraging the Iranian establishment to make more significant concessions. Moreover, the domestic political environment in Iran has shifted in response to sanctions. As noted above, the election of President Rouhani has been a clear signal of a change of the government's stance and of people's demands for a change of attitude both domestically and internationally.

Finally, as Biersteker and van Bergeijk argue, 'sanctions bite most when they are unanticipated.' As the economic growth and oil export graphs above show, sharp declines occurred at the early stages of the tightening of the sanctions, but figures gradually stabilised over the following years. This may be partly due to the temporary freeze of sanctions during the negotiations as the E3+3 agreed not to impose any further major sanctions on Iran during the talks. But another important factor has been the alternative policies that the Islamic Government of Iran has adopted as a response to the escalation of sanctions.

All in all, the imposition of sanctions on Iran has led to a softening of Tehran's stance in relation to the international community. However, they have also created domestic winners and losers whose respective interests are closely bound up with the future of the sanctions regime. While middle class and liberal-minded citizens are in favour of normalising relations with the international community and hope that the sanctions will ultimately be lifted, there are some interest groups which have made significant financial gains from the sanctions and who are therefore not necessarily happy about the prospect of their removal.

Conclusion

The Iranian economy has been plagued by various structural problems over the past few decades. The imposition of comprehensive sanctions on the country over its controversial nuclear programme has compounded these problems. Removal of sanctions after the July 2015 deal would certainly help the Iranian economy. But unless serious economic reforms are introduced, the country's many structural problems will still remain.

Since the sanctions were tightened in 2012, Iran has been able to manage a 'siege economy', or as the Supreme Leader put it, a 'resistance economy'. The Iranian economy has continued functioning, albeit with difficulty, despite the external constraints of the past few years. It is also important to keep in mind that, should the implementation of the nuclear deal fail for any reason and the sanctions remain in force, with some reshuffling of its macroeconomic policies, the government would still be able to manage economic affairs over a long period without the country facing a full-scale economic collapse. After all, Iran has become amply experienced at bypassing sanctions for almost a decade. However, under this scenario, middle-class Iranians who have hitherto borne the brunt of the sanctions would continue to pay a heavy price.

VI. THE LIMITS TO THE SANCTIONS REGIME AGAINST SYRIA

Peter Seeberg

Introduction

Since the spring of 2011, international and regional actors have imposed a wide range of comprehensive sanctions on Syria, as well as targeted sanctions on individuals linked to the Assad government. Starting from May 2011, the European Union launched a set of sanctions aimed at putting pressure on the Assad regime and thereby inducing a change in its condemnable behaviour. While the EU's different sanctions and embargoes have had a negative impact on the Syrian economy, the targeted members of the Syrian elite have – to a certain degree – been able to circumvent the individual sanctions, principally with the help of Russian and Iranian intermediaries. In addition, although the sanctions regime has been prolonged, its effectiveness – as measured by the degree of compliance by the Syrian authorities – has been undermined by a series of developments that have hindered progress.

Firstly, a lack of consensus at the United Nations Security Council (UNSC) made it impossible to undertake concerted multilateral action. Secondly the sanctioning states have not been able to constitute a coherent coalition. In addition, the Syrian regime's reliance on allies in the UNSC, as well as on regional partners (particularly Hezbollah and Iran) have made it possible for the regime to survive, albeit precariously. Moreover, following the expansion of the Islamic State (IS) into Syrian territory, the targeted individuals in the regime's inner circle have arguably chosen to reinforce their ties with the Assad regime rather than distance themselves from it. As a result, although sanctions have had a constraining impact by way of limiting the regime's access to economic resources, complex conflict dynamics and shifting alliances have significantly muted their potency.

The initial aim of EU sanctions was to put pressure on the Syrian regime to stop its violent repression of the protests and demonstrations in Dar'a and other locations in Syria: Homs, Idlib, Deir ez-Zour, and later Aleppo and Damascus. The Syrian regime decided not to enter into dialogue with the protestors. Rather, the crackdown on demonstrations was intensified. Unclear and unfulfilled promises of reforms and the lifting of a state of emergency did not have much significance in a country where the systematic deployment of security forces and combat troops to brutally suppress demonstrations effectively eliminated any chances of reconciliation. The confrontation did not immediately become militarised, however, and even though the local protests in some cases developed into armed resistance, it took almost a year before the situation developed into a full-scale civil war.

Relatively early (and before the conflict had escalated into a civil war), the EU – via Council Regulation No. 442 of 9 May 2011 – took the first step in launching a series of restrictive measures against the Syrian regime. The first round of sanctions targeted 13 persons but by 19 May 2015, 222 persons and 71 entities had been included on the sanctions list. In addition to the sanctioning of persons, entities and bodies, a wide range of other types of sanctions were imposed including: an arms embargo, mandatory cargo inspections on vessels and aircraft travelling to and from Syria, an import ban on oil and petroleum products, a ban on investments within specific sectors (e.g. the oil and natural gas industries, construction of electricity power plants), as well as a ban on exports of strategically significant equipment and technologies. Syria was also subjected to sanctions by regional actors like Turkey and the League of Arab Nations (Arab League) and by other international actors, primarily the US.

The sanctions regime against Syria: five phases

Phase one

The Syrian uprising originated in Dar'a, a town in a mainly agricultural province close to the Jordanian border that, like many other provinces, was suffering the devastating effects of one of the worst droughts in the country's recent history. Dar'a was perceived both by the regime and the opposition as largely loyal to the Baath government in Damascus. But the arrest and subsequent torture of 15 schoolchildren who had painted anti-regime graffiti on the walls of a school in the town to protest against the government's inaction towards the drought led to local gatherings of protestors, which on 18 March 2011 culminated in mass demonstrations. The local protests spread to other Syrian cities and later escalated into armed confrontations between the Syrian forces and uncoordinated local militias. As the confrontations became more and more violent and ultimately militarised, opposition groups' original demands for reform gradually gave way to regime change as the only acceptable solution.

This had consequences for the way in which the sanctions were implemented. The sanctions regime initially had a relatively limited tangible impact. However, as the situation in Syria deteriorated, the sanctions regime became more hard-hitting and focused on sending a message to powerful political and economic actors that their support to the regime would come at a cost. It was hardly surprising that the first person who was exposed to EU targeted sanctions was Maher al-Assad: commander of the army's 4th division, member of the Baath Party Central Command, strongman of the Republican Guard (and thus principal overseer of violence against demonstrators) and brother of President Bashar al-Assad. Twelve other persons were also listed, the majority of whom belonged to the Syrian intelligence and security circles.

It took only a year from the first round of sanctions before comprehensive EU sanctions were enacted. Since the objective was to use the first round of sanctions to pressure the regime to alter its proscribed behaviour, it was important for the EU not to include the President, thus leaving open the option for concessions in negotiations.

Ultimately, the intention was to let the regime in Damascus know that the EU was aligning with the US when it came to sanctioning – and that the EU supported the Syrian opposition, as implied in statements on Syria by the then High Representative Catherine Ashton.

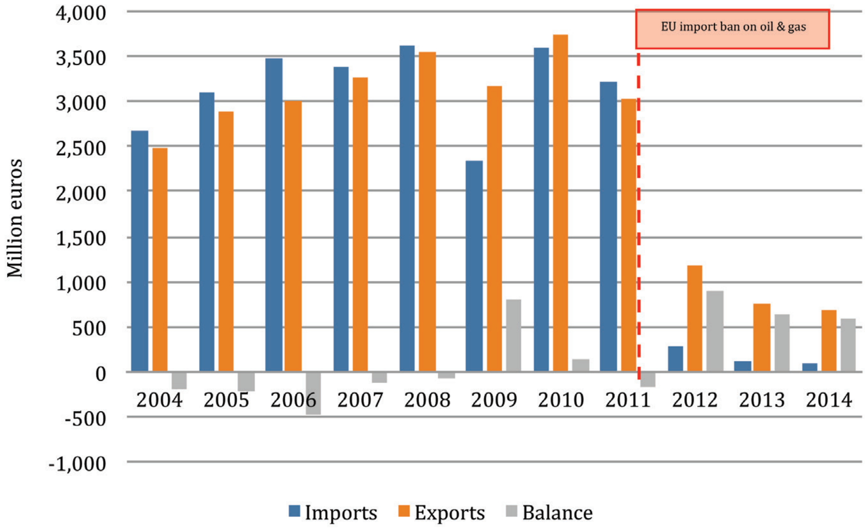
In the sanctions imposed on 23 May 2011, the President was added to the list together with nine others, so that the number of targeted persons rose to 23. Over the summer of 2011, further new names and entities were added to the EU sanctions list. Compared to earlier EU sanctions of this kind, which often took years to be implemented, the sanctions against the regime in Syria were imposed quite swiftly. Together, these sanctions constituted a first phase, and the measures were bolstered over the course of the next few months. In this initial phase, international actors took part, but without deliberate coordination. The policy aimed at putting pressure on the political system by imposing restrictive measures on the decision-makers and their supporters.

Phase two

In a second phase of sanctions, lasting from August 2011 until June 2012, the EU's goal changed from seeking to alter the behaviour of the regime to working to bring about a situation where Bashar al-Assad would be forced to step down. In a statement on 19 August 2011, High Representative Catherine Ashton argued that the regime in Damascus had lost all legitimacy. The sanctions list continued to expand, with additional individuals and entities targeted, including key Syrian ministers responsible for the escalation of the war in Syria.

Furthermore, from September 2011, an EU import ban on oil and petroleum products was included in the sanctions, leading to a 90% and a 61% fall in EU imports and exports from and to Syria, respectively. Regional actors also entered the scene, thus putting further pressure on the regime by imposing sanctions in what looked like a coordinated effort to create a rift between Syria's rulers and the political elite supporting them.

Figure 1: EU trade flows and balance, annual data 2005 - 2014



Source for data: EU Commission, DG Trade (2014)

Phase three

The next year saw a third phase emerge, characterised by a continuation of the restrictive measures from phases one and two. This phase lasted until April 2013, and since few new restrictions were added to the already imposed sanctions – in combination with little EU action *vis-à-vis* the situation in Syria – it seemed that the sanctions regime was losing momentum. This bears out the commonly observed trend whereby sanctions tend to have the greatest impact in the initial years of their implementation, principally due to the fact that targeted regimes frequently become adept at finding ways to circumvent sanctions.

Phase four

A significant turning point marking the emergence of a fourth phase took place in April 2013, when certain sanctions were modified due to changing circumstances. This included lifting the ban on exports from opposition-controlled areas of the country, a move intended to help the civilian population and support the opposition. Also in May 2013, new names, entities and bodies were added to the sanctions list, so that the fourth phase marked a return – compared to the relatively passive third phase – of a more active EU policy. However, from July 2013 until the end of the year no new sanctions were launched, while the civil war in Syria escalated further.

Syrian rebel and opposition forces began to be pushed back at the battlefield, partly because Hezbollah intervened on the side of the Syrian regime (a step which may have contributed to the decision to add Hezbollah's military wing to the EU's list of terror groups). In addition, the opposition continued to be torn by internal divisions and thus unable to present a reliable alternative to the regime. Furthermore, the need to deal with the issue of Syrian chemical weapons made negotiations necessary, resulting in the successful removal and destruction of the regime's chemical weapons arsenals. Responding positively to calls for a solution to the conflict, the EU supported different peace conference initiatives, in the hope that some kind of political resolution of the deadlocked situation in Syria might be found. The initiatives did not materialise in subsequent action, which led to significant changes on the ground in Syria.

Phase five

Finally, a fifth phase can be identified following the advent of a number of radical Islamist militias, the most notorious being IS. In 2013, Jabhat al-Nusrah merged with IS, branding themselves as the Islamic State of Iraq and the Levant (ISIL). Given that both groups had already been taking part in the fighting in Syria, their military capabilities increased. As a result of their merger, they renamed themselves Islamic State in June 2014, and proclaimed the creation of a global Islamic caliphate. Their emergence added a complex security dimension to the already problematic realities on the ground in Syria, with which the EU continues to struggle. The sanctions policy aimed at constraining the Syrian regime was henceforth indirectly integrated under a more comprehensive EU security strategy adopted by the Council on 16 March 2015.

This did not however mean that the sanctions policy had been abandoned, as in May 2015 the EU added four persons and two entities to its Syrian sanctions list, this time targeting the Syrian business sector. In reality, however, the EU was increasingly focused on counter-terrorism and how to develop a strategy for a region in turmoil, in particular given the existential threat posed by IS.

The EU sanctions and the Syrian regime

Impact of sanctions

There is hardly any doubt that the sanctions have had significantly negative consequences for the Syrian regime, yet not to a degree where the survival of the regime has been jeopardised. In principle, sanctions like those imposed on Syria should be expected to constrain the ability of a targeted regime to continue pursuing a reprehensible course of action. During the first phase, it seems that the sanctions had only a limited success in inducing defections from loyalists in the Syrian elite.

Apparently, this changed during the second phase, where some army officers defected and an increasing – yet still relatively small – number of business people fled to the Gulf or elsewhere in search of safety.

The regime-loyal Syrian business elite were well aware that the continued existence of their economic resources was linked to the survival of the regime. In order to protect their economic interests they applied a variety of strategies. They attempted, with some success, to bypass the sanctions by doing business via accounts in Russian and Iranian banks. Furthermore they adopted a strategy of 'hedging their bets' by trying to diversify their economic activities or, if possible, reestablish production or trading activities elsewhere in the region.

As the internal crisis in Syria intensified during the third and fourth phases, this trend gradually disappeared. Most likely, the absence of a coherent and credible opposition played an important role in persuading the political and business elite not to risk turning away from the regime. Furthermore, in phase five, the increasing involvement of IS (and other radical Islamist groups) in the civil war also tended to strengthen the backing of the regime in Damascus. Fearing that the alternative (a Syria dominated by IS) would be much worse, the Syrian elite stayed loyal to the regime, thus reducing the intended impact of the EU's targeted sanctions.

At the regional level, Syria was suspended from the Arab League and found itself on a collision course with Turkey, Egypt and the Gulf States. Hit by regional sanctions (as well as by the international sanctions) the regime experimented with a 'Look East' campaign, urging Syrian businesses to approach partners in Iran, Iraq, India and China, apparently with only moderate success. It should be mentioned, however, that this goal of tapping into the potential of eastern markets was part of a Syrian trade liberalisation strategy that preceded the current crisis, but never really worked.

The international actors have imposed heavy sanctions on Syria, and in the case of the EU these have been enacted on an unprecedented scale. Through the combination of the oil embargo and other general sanctions, as well as the targeted sanctions (so far) on 222 persons and 71 entities, the regime has been severely constrained in its ability to carry out transactions and to operate on international financial markets. However, in order to understand the reason for a changing EU security strategy, it is necessary to go back to the years before the start of the Arab uprisings.

Change of focus: from the Syrian regime to regional security

Several years before the inception of the Syrian crisis, attempts at reaching an agreement between the EU and Syria within the framework of the European Neighbourhood Policy (ENP) took place. In 2008, a draft Association Agreement (AA) was updated to take into account changes in Syrian customs rules and also important institutional changes on the EU side. The AA was agreed upon in December 2008 and the EU declared that it was ready to sign the document a year later. The importance of the agreement relates to the fact that it represented a potentially new and promising situation for Syria in its (often highly problematic) relations with the West. In July of the same year, Bashar al-Assad also participated in the launching of the Union for the Mediterranean in Paris.

The EU member states agreed in October 2009 that they wanted to sign the AA, but the Syrian regime responded with a request for more time to further examine the agreement and then the process was postponed. In May 2011, in connection with the launching of the first restrictive measures, the EU froze the AA and also suspended all bilateral programmes with Syria. Four years later, the EU presented a counter-terrorism strategy (January 2015) and a regional strategy (March 2015), the latter entitled 'Syria and Iraq as well as the ISIL/Da'esh threat' – at the same time as it underlined that it would continue its sanctions policy, imposing additional sanctions against the Syrian regime, which is seen as bearing the main responsibility for the cataclysmic developments in Syria since early 2011.

Neither of these strategies were meant to stand alone, but should be seen in the context of the EU's wider foreign and security policy towards Syria (and Iraq), including support to the moderate Syrian opposition with the aim of restoring political stability in the region. It was thus envisaged that counter-terrorist actions should be combined with renewed efforts to bring about a political transition in Syria.

Conclusion

All evidence points to the fact that EU sanctions have clearly had a negative economic impact, particularly on Syrian foreign trade. It is however more difficult to assess their actual impact on the targeted individuals, although there is hardly any doubt that the international and regional sanctions together have substantially constrained the Syrian elite as a whole. Nonetheless, the negative effect of the restrictive measures has – to a certain degree – been counteracted by the ability of targeted individuals to circumvent them by resorting to alternative economic channels, particularly Russian and Iranian banks, or through strategies of 'hedging their bets'.

In line with these observations, and despite appeals for united and concerted action to help end the escalating violence in Syria, Russia and China have repeatedly blocked resolutions in the UNSC, which could have otherwise led to an intervention campaign. The conflicting interests among the permanent member states in the UNSC have without doubt contributed to making the EU sanctions less effective. The same goes for the US sanctions and the many other sanctions applied by actors within or outside of the MENA region. The states sanctioning Syria have never constituted a strong and coherent coalition, and generally the outcome of the sanctions has been relatively limited. They have contributed to the crippling of the Syrian economy and created constraints for the Syrian elite, but apparently have not succeeded in severing the links between the regime and its close supporters in the army and business elite.

The Syrian regime has been able to build its survival strategy in part due to the weaknesses affecting the coalition marshalled against it. Knowing that they had strong allies in the UNSC (Russia and China) and that they could rely on regional allies (Hezbollah and Iran), the Syrian leaders calculated that they were able to withstand the pressure. They could have reached out to moderates in the opposition and attempted a negotiated transition, but decided not to, probably because they knew that this might result in the end of the Baathist regime. In light of what happened in Tunisia, Egypt and Libya, the regime instead chose a strategy based on violent suppression of the internal opposition and rejection of any external interference, except regarding the removal of chemical weapons.

The EU sanctions have without doubt contributed to a relative weakening of what used to be key institutions of the Syrian regime: the Baath Party, the ministries, municipalities, government-related organisations and government-run NGOs. The corrupt political culture based on nepotism and patronage has come under pressure and been undermined by the sanctions. Nevertheless, in a situation where the regime and the internal elite have been able to rely on significant external support from their allies throughout the crisis, the EU's abilities to control Syria's external relations have been limited.

As security policy tools, the sanctions have had a constraining impact rather than a strong coercing one. In response to the sanctions, the Assad regime has not significantly moderated its internationally reprehensible actions but its ability to access economic resources has been constrained. Nonetheless, by focusing attention on the ongoing atrocities occurring within Syria, sanctioning actors have clearly signalled that the international community will not tolerate the state-instigated human rights abuses that have taken place in Syria. So far, however, the intransigent Assad regime has appeared impervious to international condemnation and threats.

CONCLUSIONS

Iana Dreyer, Francesco Giumelli, José Luengo-Cabrera and Clara Portela

This chapter draws conclusions from the various case studies presented in the report. In the first section, the case studies are considered in light of the 'success criteria' outlined by Biersteker and van Bergeijk in chapter I. The second section identifies possible policy implications and points to further areas for research.

I. Key findings

Effectiveness

Although the effects of sanctions are experienced differently depending on how they are implemented and what form they take, their overall impact is one of raising the cost of pursuing the proscribed activities carried out by the target. As a result, sanctions act as instruments intended to change a target's cost-benefit calculation *vis-à-vis* its objectionable behaviour.

Sanctions have traditionally been seen as 'working' only when they induce or prompt a behavioural change on the part of the target, but the factors influencing the target's behaviour are often affected by causes other than the sanctions. Therefore, the confluence of causal factors and mechanisms emerges as a hindrance to the ability to isolate the true impact of sanctions – thereby raising potential questions regarding their underlying utility.

Standard practice has viewed sanctions' effectiveness on the basis of whether they achieve ultimate – as opposed to piecemeal – goals. This has often led to misguided conclusions that have tended to view sanctions as ineffective foreign and security policy tools. In order to counter this trend, the analytical framework that has guided this report has given greater importance to *piecemeal* goals: the compliance demands to which targets respond progressively and incrementally.

All sanctioning actors set out ultimate goals when designing their sanctions regimes. In the case of the EU, ultimate goals are viewed through the lens of full compliance, but targets rarely comply fully within short time-frames. This has raised questions as to whether the litmus test for effectiveness should be based on ultimate goals. Were that to be the case, it would be appropriate to consider sanctions against Iran and Russia as being effective only if and when the Islamic Republic suspends its nuclear programme or the Kremlin decides to pull out of Eastern Ukraine, for example.

This threshold or benchmark of effectiveness has appeared to be too stringent for preliminary assessments of sanctions regimes, principally as it omits or simply neglects the progressive steps through which compliance tends to work. Consequently, this report has proposed a new narrative whereby the efficacy of sanctions is not limited to the eventual behavioural change but, rather, to the way in which sanctions have induced targets to comply with the demands of the senders over time through their coercive, constraining and signalling effects.

In the cases of Iran, Russia and Syria, sanctions have had an approximate impact in prompting Iranian authorities back to the negotiating table to strike a deal on a Joint Comprehensive Plan of Action (JCPOA), limiting Russia's military expansion in Eastern Ukraine and preventing the Assad regime from having access to important economic resources. As a result, the report points to an underlying utility of sanctions as security policy tools by way of demonstrating how they have reduced the capacity of targets to continue pursuing policies or actions deemed to spread insecurity within their territory and beyond.

Signalling and constraining

Signalling is a primary driver of sanctions policy in all three cases. Signalling is about reaffirming international treaties and norms (such as nuclear non-proliferation, respect for human rights and the territorial integrity of other states), as well as stigmatising the targets so as to increase their international isolation. In the Russian case, sanctions were initially about signalling disapproval of Russia's violation of Ukraine's territorial integrity. Signalling was also paramount in the case of Syria, where the threat and actual imposition of further sanctions materialised as the Assad regime remained unresponsive to the demands of sanctioning actors. As for Iran, the credible prospect of the imposition of further sanctions served to force the hand of the Iranian authorities and persuade them to return to the negotiating table with a view to striking a mutually acceptable deal.

All three EU sanctions regimes also aimed at *constraining* the ability of targets to carry out their proscribed activities. In the case of Russia, sanctions made it more costly for the Kremlin to continue its aggressive stance towards Ukraine through restricting state-owned and private enterprises' access to capital markets. In the case of Iran, the EU's imposed oil and gas embargo (coupled with the US determination to freeze Iranian assets in overseas foreign escrow accounts) significantly constrained Iran's ability to generate vital economic revenue. Given their crippling effects, sanctions were seen as primary drivers in prompting Iranian leaders to reconsider their stance *vis-à-vis* the nuclear programme.

Trade matters

The importance of trade linkages between the sender and the target is highlighted throughout all three case studies. The impact of sanctions on the Iranian economy became much more significant when the EU – one of Iran's most important trading partners pre-sanctions – joined the US in imposing restrictive measures against the Islamic Republic. What is more, the sanctions adopted since 2010 were far-reaching, involving an oil and gas embargo as well as cutting off Iranian banks from international payments via the SWIFT worldwide messaging system.

High degrees of trade integration also help explain why EU sanctions towards Russia may remain limited in their severity, due to the fact that sanctions can also hurt the sender. Russia was the EU's third largest trading partner in early 2014. It delivers one third of the EU's hydrocarbons needs, is a sizeable export market for European industry, and its financial sector is deeply integrated with the European financial sector. These realities have added to the political and diplomatic considerations which have so far deterred the EU from taking drastic measures (such as sanctioning Russia's gas export monopoly Gazprom directly or cutting off SWIFT payments). Also, a bigger trading partner may retaliate with counter-sanctions. This is precisely what happened with Russia, as the country banned the import of food from the EU and imposed travel bans on Western officials.

In contrast, comparatively low economic integration between Syria and the EU – in tandem with Syria's drift towards a war economy – may explain the limited effects of the EU's trade embargoes in prompting the Assad regime to change policy. Moreover, the regime's ability to circumvent sanctions by resorting to alternative economic channels has mitigated the negative impact deriving from important trade restrictions.

Waning effects

The argument of chapter I that sanctions tend to succeed best in the initial years of implementation is clearly corroborated by the case studies. The immediate economic and psychological shock induced by the sanctions has undoubtedly led to a change in tactics by the targets in all three cases. Van Bergeijk's Iran case study highlights that the effects of sanctions tend to wear out over time. Despite the relatively direct effect of sanctions on the Russian economy, Moscow has nonetheless actively engaged in a strategy of economic adjustment, as explored by Richard Connolly in chapter II. The targeted sanctions against officials in the entourage of Syrian President Bachar al-Assad contributed to a series of defections shortly after they came into force. But, as Peter Seeberg's case study shows, the rise of the Islamic State (IS) had the counterproductive effect of rallying the Syrian elite closer to the regime.

Staying credible

Credibility issues and 'strategic interaction' play a fundamental role in the dynamics shaping the Iran and Russia case studies.

The Iran case is self-evident: the difficult but eventually successful negotiation process over the JCPOA reveals how uncertain a deal can be until the very moment of its conclusion. Once an agreement is struck, the degree to which sanctions can be deemed successful depends – to a large extent – on the compliance 'responsiveness' of the target. Yet the degree to which Tehran will abide by the terms of the July 2015 JCPOA will also be crucially influenced by the sanctioning actors' own credibility in rewarding Iranian compliance with concomitant sanctions relief.

In the case of the Ukrainian crisis, the challenge for the EU appears to have been that of *building* credibility *vis-à-vis* Russia. Stanislav Secrieru's study shows that Russia's responsiveness to sanctions, albeit limited, can be explained by its apparent surprise at the EU 28's unanimity in adopting and extending the sanctions.

Strengthening the rulers?

The sanctions regimes studied in this report have also had counterproductive effects by way of creating rent-seeking opportunities for the targets at fault. Sanctions seem to have strengthened the current political regime in Russia and empowered the most nationalist and state-dependent factions in the Kremlin. Similarly, they bolstered certain interest groups attached to the Iranian regime who profited from the illicit business opportunities created as a result of sanctions. The sanctions against Russia have also had the often-observed effect of most sanctions regimes: rallying the population 'around the flag'. Sara Bazoobandi's and Peter van Bergeijk's Iran case studies show that the 'rally around the flag' effect has not been quite as strong in Iran. Strengthened sanctions coincided with (but did not cause) a relative opening up of Iran's political system. In the very different Syrian case, the target appears to have little to gain from being responsive to the demands of the sanctioning actors in a situation where regime survival takes precedence over everything else. Under this scenario, their risk-calculations become skewed as holding on to power trumps all other alternatives.

Leveraging multilateralism

The unresponsiveness of the Assad regime may also be ascribed to the failure of the different regional and international actors to stick to a common multilateral sanctions strategy. In the Iran case, sanctions are not only UN-backed but also complemented by unilateral sanctions coordinated between the US, EU, Canada, Australia and Japan, thus offering high international legitimacy, as well as effective enforcement.

The case of Russia – a permanent member of the UN Security Council – intrinsically precludes the possibility of high-level multilateral commitment. The US, the EU and their close allies (including Canada, Norway, Switzerland, Japan and Ukraine) have not been able to rally other governments – such as China and other emerging powers – to the idea of imposing restrictive measures against Russia, thereby limiting the sanctions' economic bite and support at global level.

Clear goals and multiple instruments

Biersteker and van Bergeijk find that 'narrowly defined goals and multiple policy instruments increase the success rate of sanctions'. In the Russian case, the EU has gradually made more explicit the conditions under which it would roll back *or* escalate sanctions (notably by tying the lifting of sanctions to compliance with the February 2015 Minsk-II ceasefire agreement). This offers a potentially more effective basis for discussion and interaction with Russia in the coming months.

In the Iran case, the goals of the UN sanctions were clearly articulated from the outset and the multilateral pressure has increased over the years. Other tactics, including the more or less veiled threat of military force, were also part of the panoply of instruments used to pressure Iran back to the negotiating table.

Targeted vs. comprehensive

Chapter I indicates that targeted sanctions (against individuals or specific entities) achieve comparable success rates in delivering their intended goals. In the case of Iran, the sanctioning of individuals supporting the regime, as well as important state-owned oil and gas companies, played a significant role in restricting Iran's economic output. Though much less drastic than the Iran sanctions, the financial restrictions against Russia of July and September 2015 have also prompted a certain degree of response from Moscow.

When it comes to wide-reaching, comprehensive economic sanctions, political decisions over whether to take such measures hinge on what economic costs a sender is willing to accept to 'pay' in order to achieve its international security objectives. They also hinge on what level of responsibility it wants to bear for potential negative humanitarian consequences on a target country's population.

The EU, in contrast to the US, faces specific challenges with its sanctions targeted at individual and commercial entities, mainly because these are often contested in the European Court of Justice (ECJ). Several Syrian individuals were delisted after the Court ruled in their favour – obliging the EU to pay compensation for damages. The Russian company Rosneft and the National Iranian Oil Company (NIOC) have also filed complaints at the Luxembourg-based court, with both cases ongoing. Legal setbacks risk undermining the severity of 'targeted' sanctions, their international credibility, and ultimately their effectiveness.

One recurrent problem the EU has faced in court is its inability to provide adequate evidence on the alleged links between an individual or a commercial entity and the targeted regime. Evidence gathered through national intelligence services cannot be easily divulged in court. In response to this problem, the EU took the decision in July 2015 to introduce closed hearings at the General Court in Luxembourg.

II. Policy implications

The policy implications drawn below do not aim at offering a detailed blueprint for the EU's future sanctions policies. This section simply attempts to pinpoint some areas on which the EU can focus – taking the Union's current institutional setup and financial constraints as a given – in order to gradually enhance its ability to conduct more effective and evidence-based CFSP sanctions policies.

Strengthening capacities

The number of EU sanctions has increased significantly over the last two decades. It is likely that EU policymakers will continue to deal with a high number of sanctions regimes in the upcoming years.

Well-designed sanctions require significant local knowledge. Sanctions professionals and academics consulted throughout the duration of the EUISS Task Force have regularly highlighted the need for officials and experts to be involved in designing sanctions regimes in Brussels in order to better grasp the often obscure and complex realities of a political regime and of the rapidly changing situations on the ground. The most frequent challenge lies with deepening knowledge of the evolving developments within a target country, how sanctions targets (governments, individuals, companies) behave pre- and post-sanctions implementation, and how a regime, an economy and a local society react to the sanctions.

Information on individuals targeted by sanctions is particularly challenging to obtain. Sufficient evidence needs to be gathered to ensure sanctions do not end up being annulled by the ECJ. And some (but not all) EU member states have greater analytical capacities, more foreign policy experience and more sophisticated intelligence capacities than the nascent group of sanctions professionals within EU institutions in Brussels (in the Commission, Council Secretariat or EEAS).

The case of the EU's sanctions on Russia shows that, over the past year, the EU has been able to adjust and improve its strategy, communication and interaction with Russia in Eastern Ukraine. This has coincided with greater efforts in staffing and expert mobilisation on behalf of the Brussels-based institutions. If the EU had been better equipped before 2014, however, it could have taken decisions more swiftly and articulated clearer conditions for escalation or de-escalation of sanctions. The bloc could probably have gained greater leverage over Russia at an earlier stage.

Streamlined and better integrated decision-making, information-sharing, and implementation procedures could contribute to more responsive and effective sanctions policy. In the absence of more exclusive CFSP-related competencies and/or a dedicated agency for sanctions comparable to the US's Office of Foreign Assets Control (OFAC) – both unrealistic objectives under current treaties – other options may be explored to coordinate and centralise information at a pan-European level. Such options could include: more systematic and structured exchange of information with member states' intelligence services; a stronger role for the 'sanctions group' in the Council dedicated to foreign affairs (RELEX); more systematic collaboration between the Commission, the EEAS and the Council, as well as an increase in national experts seconded to Brussels. Over the medium to longer term, a gradual build-up of in-house knowledge and expertise within common institutions can help the EU become a more credible, flexible, and effective sanctions sender. In this regard, having systematic recourse to *ex-post* and (when possible) *ex-ante* evaluations of sanctions regimes by relevant experts could contribute to achieving that goal.

Engaging partners

As highlighted in this report, multilateral sanctions tend to be more effective than unilateral ones. Multilateralism not only enhances the sanctions' international political legitimacy, it also diminishes the likelihood of the target's trade and financial flows being diverted to third countries (thus cushioning the impact of sanctions). When the EU works with the UN, the US, and other allies, the effectiveness of sanctions appears to be clearly enhanced. The Iran case examined in this report showcases this fact clearly. But this is not always how sanctions policies work out. Other regional or international players may disagree with the sanctions senders and/or hope to gain economic advantage from the trade diversion opportunities offered by restrictive measures.

Coalescing with 'pivotal' rising powers – like for instance India, Brazil, Turkey and Indonesia – on international sanctions will remain challenging. Yet working more closely with like-minded emerging powers would undoubtedly contribute to broaden support for multilateral sanctions regimes. This is becoming all the more important at a time when the UN Security Council continues to be divided, and when the global relative economic weight of the EU and the US – the world's main sanctions senders – continues to decline.

Attention to sanctions design and communication can also increase the international legitimacy of sanctions. Defining clearly articulated, relatively narrow sanctions goals aimed at resolving concrete situations that evidently violate international law can help reduce the exposure to criticism that sanctions pursue foreign policy goals (e.g. 'regime change') of which many countries disapprove.

Exit strategies

Sanctions policies need a dynamic element that facilitates their (rapid) adjustment, as often required by developments on the ground. Escalation and de-escalation are central in most crises, and sanctions policies need to react and adapt. 'Exit strategies' – recognised as a particular challenge in chapter I - are easier to frame and implement when a sanctions regime specifies the flexibility and adjustability of its goals from the outset.

While CFSP sanctions often spell out the reasons for their imposition, they are not always backed up with concrete compliance demands that condition any future lifting of sanctions. Yet the targeted nature of EU sanctions packages, normally composed of multiple measures, already makes it possible to link specific demands to individual measures. The sanctions towards Russia are a case in point: the Crimea/Sevastopol package refers to the annexation of Crimea and remains separate from the measures addressing the destabilisation of the Donbass region. This approach communicates to the target that the lifting of restrictive measures is conditional on the fulfilment of different demands and, therefore, offers a clearer basis for interaction with the sanctions target.

The question of how best to lift sanctions is a central yet scarcely analysed issue in the design of sanctions regimes. Currently, EU policy already presents a set of features favourable to a smooth transition between sanctions regimes and full resumption of normal relations with a target country or group. Instead of being open-ended, EU sanctions regimes are endowed with so-called 'sunset clauses' which foresee their expiration in the absence of a positive decision on continuation. Sanctions regimes are routinely phased out in several steps. Most importantly, the lifting of sanctions follows a gradual and conditional logic that eases restrictions as the target edges towards compliance, with a view to incentivising further progress. Ideally, the easing of sanctions should be prompted by the target's visible progress towards compliance. Under this scenario, the lifting is organised in several phases, whereby restrictions unrelated to the disputed policy are likely to be removed first.

Yet the desire to ease sanctions might be motivated by reasons other than those set out in the initial sanctions policy. At times, the EU grows uneasy with situations of prolonged and ever less effective sanctions, which leads it to consider creative 'exit strategies'. Also, concern for the suffering of the population in target countries at war, such as in Syria, might compel the EU to ease some measures. This can be initiated by expanding humanitarian exceptions and exemptions, while those measures that convey political condemnation of a government's course of action are left in place.

More often than not, multiple actors target the same situation with measures differing in scope and objectives. Regarding Syria, the US, the EU, the Arab League and Turkey currently target the Assad regime, yet they do not constitute a coherent coalition. The co-existence of multiple but uncoordinated and sometimes overlapping sanctions regimes creates a number of difficulties that make any future lifting more difficult. By contrast, the Iran deal offers an example of successful – if atypical – multilateral cooperation.

Areas for further research

This report is an initial assessment of ongoing EU sanctions regimes as security policy tools. The EUISS Task Force's goals have been circumscribed to assessing three ongoing cases in light of current knowledge and expertise on international sanctions. But much more can be done to obtain a better understanding of how EU sanctions 'work'. The ultimate goal of gradually building up knowledge is to shape more effective policies in the future. Key areas that have been identified by Task Force members for further analysis and research include the following:

- *Sanctions enforcement,* i.e. gaining a better understanding of how EU sanctions are enforced in practice by EU member states.

- *Role of the private sector,* i.e. understanding how companies from sanctioning countries cope with sanctions regimes; how far financial institutions 'over-comply' with the legal requirements of sanctions regimes – or, conversely, when targets manage to circumvent sanctions (and why).

- *'Efficiency' of sanctions,* i.e. undertaking more systematic cost-benefit analyses of sanctions, assessing the economic costs for the sender as set against the international security goals these sanctions intend to achieve.

Needless to say, unexpected developments in the near future may mean that this tentative checklist needs to be further elaborated.

ANNEXES

TASK FORCE MEETINGS

1. **EU sanctions as security policy tools: Launch meeting**
   Thursday 26 February 2015
2. **EU sanctions as security policy tools: Syria & Iran**
   Wednesday 25 March 2015
3. **EU sanctions as security policy tools: Russia**
   Thursday 23 April 2015
4. **EU sanctions as security policy tools: Final meeting**
   Tuesday 19 May 2015

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LIST OF TASK FORCE BRIEFS & ALERTS

- Iana Dreyer & Nicu Popescu: **Do sanctions against Russia work?** *Brief* no.35 - 12 December 2014
- Francesco Giumelli: **Sanctioning Russia: the right questions** *Alert* no.10 - 13 February 2015
- Iana Dreyer & José Luengo-Cabrera: **Sanctions against 'aggressors'** *Alert* no.23 - 24 April 2015
- Nicu Popescu: **Sanctions and Russia: lessons from the Cold War** *Brief* no.10 – 24 April 2015
- Cameron Johnston: **Sanctions against Russia: evasion, compensation & overcompliance** *Brief* no. 13 – 13 May 2015
- Bernt Berger: **Sanctions against North Korea: a tricky dilemma** *Brief* no. 23 – 9 July 2015
- José Luengo-Cabrera & Erica Moret: **Sanctions against Iran: the role of pivotal rising powers** *Brief* no. 25 – 9 July 2015
- José Luengo-Cabrera & Clara Portela: **EU sanctions: exit strategies** *Alert* no. 35 – 16 July 2015
- Thomas Biersteker & Clara Portela: **EU sanctions in context: three types** *Brief* no. 26 – 17 July 2015
- Francesco Giumelli: **Sanctions: moving targets and goalposts** *Alert* no. 36 – 23 July 2015

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ABBREVIATIONS

AA	Association Agreement
DNR	Donetsk People's Republic
DRC	Democratic Republic of Congo
ECJ	European Court of Justice
EEAS	European External Action Service
ENP	European Neighbourhood Policy
GDP	Gross Domestic Product
IMF	International Monetary Fund
IS	Islamic State
ISIL	Islamic State of Iraq and the Levant
JCPOA	Joint Comprehensive Plan of Action
LNR	Luhansk People's Republic
MENA	Middle East and North Africa
NATO	North Atlantic Treaty Organisation
NGO	Non-Governmental Organisation
OPEC	Organisation of the Petroleum Exporting Countries
OSCE	Organisation for Security and Cooperation in Europe
R&D	Research and Development
SMM	Special Monitoring Mission
TSC	Targeted Sanctions Consortium
UAE	United Arab Emirates

UN	United Nations
UNSC	United Nations Security Council
USD	United States Dollars
VAR	Vector Auto Regressive

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