The Impact of Economic Sanctions as a Foreign Policy Instrument: The Example of U.S. Sanctions on Russian Energy Industry

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Abstract

Economic sanctions, especially during the twentieth century, emerged as a foreign policy tool. Economic sanctions were a perfect tool of the Cold War as a deterrent for employing military power. The main objective of employing economic sanctions is to make the other party to reexamine and potentially revise its policies causing the unrest, and ultimately comply with the requirements of the coercer.

However today the level of effectiveness of employing economic sanctions as foreign policy instrument is subject to wide debate. This study is prepared with the objective of contributing to the debate using a case study to answer the question of whether economic sanctions are a viable deterrent to achieve the desired outcome. In the study we examined whether the US sanctions placed on the Russian energy sector was an effective deterrent after Russia's annexation of Crimea. The study examined the background and the purpose of these sanctions and evaluate their effectiveness by discussing their impact on the Russian energy sector. This case study helps to answer the broader question of the efficacy of economic sanctions. Based on this case study, we argue that a better way to assess whether the sanctions reach their desired outcome is to consider the overall profile of the country that is the subject of sanctions. This study was compiled from the author's thesis, titled as "The Impact of Economic Sanctions as a Foreign Policy Instrument: The Example of U.S. Sanctions on Russian Energy Industry".

Keywords

Economic sanctions; energy; foreign policy; Russia; sectoral sanctions

INTRODUCTION

This study aims to analyze the efficiency of economic sanctions as a foreign policy instrument specific to U.S. sanctions on Russian Energy Industry after annexation of Crimea by the Russian Federation in 2014. Therefore, this study focuses on explaining the impact of economic sanctions which are imposed by a “super power” on a country that heavily depends on the revenues generated from the energy sector. Russia is one of the key players in international energy industry and the country generates significant revenue from this industry. Russian Energy sources are not only important for Russia, but also for other third parties in the energy market which are dependent to Russian energy sources. On the other hand, as a coercer country, U.S can be also considered as an important player in terms of capabilities of the sanctioning country. This study evaluates economic sanctions as a tool in order to achieve political ends. In this regard, this instrument can be considered as a tool in foreign policy decision making alongside other components of foreign policy: military and diplomacy.

Since the end of Cold War, Economic Sanctions have been significant foreign policy instruments for the states to create oppression on target states. No doubt, ultimate aim of this policy is to convince and force target states to re-shape their policies which are the reason for the sanctions. Sanctions can be defined as an instrument which targets various industries, firms and/or individuals of the aggressor states to coerce for a change in their behaviors. Therefore, sanctioning countries would be able to change the sanctioning state’s policies which threaten the interest of sanctioning country. Economic Sanctions were mostly known as an instrument used by intergovernmental or supranational organizations. However, economic sanctions are also important tool for the states themselves to impose their policies on target states. Therefore, public opinion has witnessed to what extent economic sanctions are used as an efficient foreign policy instrument when two states disagree on various issues.

Although efficiency of the sanctions depend on the parties (sanctioning/coercer and sanctioned/target), requirements of effective sanctions are counted as follows according to Hufbauer et al. (1990)’s criteria : (1) The sanctions effectively work if the goals of sanctioning country are limited, (2) target country has already economic difficulties, (3) there are generally friendly relationship between sanctioning and target country, (4) sanctions are forcefully implanted in single step, (5) sanctions create significant costs for the target, (6) the costs for sanctioning country are modest, (7) the sanctions are not accompanied by covert action or military operation and (8) few countries are needed to implement the sanctions (Hufbauer et al.1990).

The purpose of this research is to identify the impact of economic sanctions by using a recent case as an example, that is the U.S Sanctions on the Russian Energy industry, imposed in 2014. In order to clarify the study's title, it needs to be elaborated "impact on what." The word "impact" refers to "efficiency" of economic sanctions in altering the outcomes of International Relations and foreign policy decisions. Therefore, the study will be fulfilled through decision process of the U.S policy-makers and its effect on Russian Energy industry which is quite important for the Russian economy. This study will concentrate on observing whether economic sanctions are effective and relatively low-cost tool as a foreign policy instrument. This research will also serve to analyze another debate regarding reactions and coping skills of target/sanctioned country. Reactions and correspondingly its results will be also significant indicator to understand how do target states cope with the challenges which are arisen from imposing economic sanctions.

Understanding the components of foreign policy instruments are also crucial in order to conceptualize economic sanctions. Foreign Policy instruments generally consist of 3 main pillars: Military (use of power), Diplomacy (institutional and or bilateral efforts) and Economy (establishing economic ties among the actors). Having said that, Laswell (1936) also suggested that statecraft was pursued through four primary instruments. These are defined as information, diplomacy, force and economics. He evaluates information as a words and propaganda whereas economics is treated as goods and money (Laswell, 1936). Foreign policy instrument is defined as necessary tool in conducting foreign policy on behalf of the government.

Economic sanctions have different scopes in terms of sanction imposing dimension. Countries and/or organizations may impose sanctions on individuals, entities, countries and even political parties. At this point, the scope of economic sanctions may determine to what extent these names would be subject to the sanctions. Scope of the sanctions may vary, depending on sanction policy of coercer country against sanctioned country.

Coercer country may only prohibit certain industries if designated country is heavily dependent on those industries. On the other hand, coercer may choose imposing "comprehensive" sanctions if it really aims to devastate sanctioned country's economy. The term of "Comprehensive Sanctions" represents the scope of sanctions for the target party. Comprehensive sanctions include broad measures for the target state. This type of sanction generally prohibits all kind of commercial relations and it particularly does not allow to use the financial institutions in its jurisdictions. Only exception is licenses which are issued by the sanction regulator of the coercer.

On the other hand, selective sanctions are another term for the scope of sanctions. Parties which are subject to selective sanctions, are partially restricted in their trades and financial transactions. The limit of sanction may vary in accordance with the sanction strategy of sanctioning country. For instance, U.S Sanctions on Russian Energy is an example for selective sanctions which is also called sectoral based sanctions. (Specifically called as "Sectoral Sanctions Identification" in U.S Sanction program).

RESULTS

Sanctions imposed on Russia are tailored. Before imposing U.S sanctions, OFAC performed investigation regarding feasibility of these sanctions to understand whether it could create economic disturbances for the U.S and allies. Therefore, Russia was not fully isolated from international banking system unlike Iran. Payments of Russian government and state-owned enterprises through financial institutions continued.

First observable impact of the US sanctions on Russian energy industry was reduced of equity value of Russian energy companies, which made difficult to borrow loan from energy projects which also reduced the value of Russian ruble. However, when we look at oil production capacity of Russia in 2016, we identify a record high although Russia committed to the Organization of the Petroleum Exporting Countries ("OPEC") to decrease its production (Coote, 2018).

Business relationship was not prohibited with Russian state-owned enterprises. Rather, U.S ultimately aimed restricting Russia's ability to international financial markets such as preventing generating income through debt instruments. Therefore, U.S would avert passive income for Russia. This measure is mostly targeting Russian banks and also some other Russian companies which issue bond and security for the investors.

On the other hand, one of OFAC directives (directive 4) is directly targeting Russian energy companies. Although this directive excludes financial services and does not directly relate financial institutions, the scope is directly related to non-Russian energy companies which currently do business with Russian energy companies or plan to do business. Therefore, Russia would deprive of potential investments in their projects.

There are observable consequences of U.S sanctions on Russia

- Firstly, Russia did not leave Crimea which was the reason of the sanctions, basically. Russia did not change its stance towards Crimea such as softening situation.
- Oil and gas projects that involved U.S companies were disrupted.
- Since maturity of the loans for Russian energy companies (in Directive 2) was shortened (60 or 90 days), these firms had difficulties in their cash flow.
- Russia was able to pay its debts but it also means that Russia couldn't benefit from foreign credits at the same time which is another reason of not increasing the ratio of indebtedness.
- Foreign direct investment has remained limited. Foreign investors abstained from investing due to risk of being sanctioned.
- Economy of Russia has barely grown due to imposed sanctions. GDP of Russia is fluctuating between 2014-2020. However, there is a dramatic decrease in 2015 (Aslund & Snegovaya, 2021).
- Particularly, Germany is reluctant to take against Russia. They were currently in a process of Russian Gas pipeline from Russia to Germany through the Baltic Sea before the explosion of Nord Stream.
- As of May 2023, Putin is still aggressive in Ukraine crisis, aggression continues in various parts of Ukraine this time. Sanctions are not enough coercive to change (and even soften) his policies/stance.

Results of this study reveal two determinations in regards to the effectiveness of economic sanctions:

1. The effectiveness of economic sanctions depends on capability difference between sanctioning and target country. It is likely that economic sanctions can be effective if the sanctioning country has capability to destroy the target country economically and target country does not have the capability to withstand these challenges.

2. However, above mentioned conditions are not solely sufficient to make sanctions efficient. The sanctions can be effective, depending on 1) to what extent sanctioning country would be eager to convert its capabilities to power through sanctions and 2) to what extent the target country would be eager to convert its capabilities to power in order to cope with the challenges.

If the sanctioning country would be eager to convert its capabilities to coercive power and the target country is lacking in capabilities to cope with these challenges or reluctant to convert its capability to power, the sanctions can be effective. On the other hand, if sanctioning country would be reluctant to fully convert its capabilities to power and the target country has the capabilities to resist the sanctions, the sanctions may not work. The outcome of this study reveals the last scenario. The U.S abstained from imposing blocking program (except the parties which are listed in SDN list as well) and secondary sanctions for the energy sector of Russia in 2014 Sectoral Sanctions program (except the prohibition for investments on energy export pipelines initiated on or after 2 August 2017 under CAATSA law).

DISCUSSION

The literature for economic sanctions includes different perspectives, particularly in terms of efficiency of economic sanctions. Some authors emphasize the importance of foreign policy objectives that need to be achieved in the end of process. On the other hand, some authors criticize the measure of being successful in economic sanctions. For instance, Pape (1997) in his famous work "Why Economic Sanctions Do Not work?", he starts by criticizing those who are in favor of economic sanctions. He particularly targets Gary Clyde Hufbauer, Jeffrey J. Schott, Kimberly Ann

Elliott's book, called as "Economic Sanctions Reconsidered". Hufbauer et al. (1990) mount their arguments over 120 economic sanctions cases between 1914-1990 which they deeply reviewed. Hufbauer et al. (1990) argue that 40 out of 120 cases represent clear success for the efficiency of economic sanctions since all these 40 cases achieved different foreign policy objectives.

Pape's (1997) main question is whether economic sanctions are an effective tool for achieving international politics goal. He identified main problems in the study of Hufbauer et al. (1990), particularly in counting of cases, which were reviewed as samples. Pape (1997) argues that 5 cases out of 120 are counted twice. Pape (1997) criticized Hufbauer et al. (1990) and their way of measurement that the database used thereby has become indicators to measure how much economic sanctions have been effective was not accurate.

Pape (1997) does not agree with the study of Hufbauer et al. (1990) and he does not accept the cases which were interpreted as successful. Pape (1997) revealed 2 challenges: how do target states cope with the economic sanctions and why these economic sanctions are not effective as much as Hufbauer et al. (1990) proposed? Pape (1997) argued that most modern states resist external pressure and nationalist feelings which are fueled by the attempt of initiating economic sanctions, also make states and societies, willing to resist this punishment (Pape, 1997). Pape (1997) argues that the states which have modern capabilities are also able to mitigate the economic damage of sanctions through substitution.

Neither Pape (1997), nor Hufbauer et al. (1990) referred to what extent other countries – even coercer state- need exported product of target state. On the other hand, none of them mentioned the quest of alternative ways of target states to not be affected from sanctions. These could have been shown as main indicators to understand how much economic sanctions can be successful though. In this context seeking alternative ways and notion of "dependency" are related terms since third parties seek alternative ways to trade as long as they need the product of target states.

Russia is one of the largest oil producers in international market and Russian energy companies play important role in energy market. Therefore, it is imperative to discuss how much third parties (consumers) need Russian oil and gas and how much they are eager to find alternative ways to evade sanctions. All these efforts will help us to identify the efficiency of economic sanctions in this case study.

Theoretically, economic sanctions of international relations theories were discussed in the past primarily as a part of the debates between realism, liberalism and constructivism. I would like to give a detailed evaluation of these three approaches contributing to the theory of Economic Sanctions. It will be further discussed hereby and relate these approaches to the present research on sanctions against Russian energy sector.

Realists see economic sanctions as an instrument which achieve foreign policy goals and it is mainly concerned with the efficient use of the economic sanctions for the national interests (Sedliar, 2017). For instance, Barber (1979) defines economic sanctions as “economic measures directed to political objectives” and he argues that realists also think that economic sanctions are not law enforcement but it is rather foreign policy instrument (Barber, 1979). This can be rationalized by assuming that realists see “anarchy” as a central concept in international relations and power is the main component of this field. Thus, economic sanctions have the characteristics of “coercive” and “bully”.

While discussing the role of economic sanctions in foreign policy, Morgenthau’s concept of power is also critical. Because, efficiency of economic sanctions is theoretically connected to power debate in international relations theory. As Morgenthau (1978) defines, “power may comprise anything that establishes and maintains the control of man over man”. Since this study discusses the efficiency of sanctions over a case study, I will be assessing the impact of economic sanctions from realist perspective. In this regard, the relation between the one who exerts dominance and the one who is more recessive, reveals another discussion: the capacity of the actors. Kenneth Waltz (1979) discusses the structure of neorealism through his observations over domestic politics and questions how they are applied to international system. Thus, there are 3 characteristics of domestic political structures: First one is ordering principles which refer to hierarchical structures in domestic politics whereas he defines same level as an anarchic for international politics. Second one is regarding the functions which are fulfilled by different units in domestic politics. Third one is about the distribution of capabilities which is also relevant concept in terms of determining sanctions efficiency in this study. Waltz (1979) suggest that the distribution of capabilities leads to change in international structure. He argues that change in international system might be possible if there is also change in the capacity of the states. According to Waltz (1979) the states rely on their own powers and resources to survive in international system. Considering this fact, the relationship between sanctioning and target country is significant in terms of using capability to achieve its goal or cope with challenges.

CONCLUSION

Sectoral sanctions imposed on Russia were mainly targeting finance, national defense and energy industries. The scope of sanctions was not intended to have mid-term or immediate impact on Russian energy industry. For instance, when we look at Directive 4, the characteristic of these measures is more applicable to be effective in the long-term. Because this directive targeted exploring and drilling oil and gas from arctic and deep offshore regions whose impact can be materialized in the long term. Briefly, the Directive 2 aimed to create impact for foreign borrowing capability of Russian energy firms which was intended to have impact on financing of energy projects in arctic and offshore. However, it could not impact Russia as it was expected. Because, Russia pursued two strategies consecutively: 1) Using financial reserves in the central bank 2) Attracting the foreign investment except US firms. Russia managed to attract huge investment from Germany for its projects. They also continued to trade with China and India. In this regard, these sanctions were only “primary sanctions” that concern only US persons. Briefly, Russia was capable not to decrease export and production numbers in oil and gas.

Briefly, based on the findings in this study, it can be concluded that US sectoral sanctions imposed on Russian energy industry did not create a significant impact for Russia as they managed to sustain their energy operations. Moreover, although the ultimate of the sanctions is to change the behavior of target state, Russia did not change its stance about Crimea and further they continued their aggression in Ukraine in 2022 as well. In this regard, it can be concluded that the economic sanctions can be successful and create significant impact as long as the measures are designed to create immediate impact on the target state. Briefly, the scope of the sanctions needs to be comprehensive to create impact, rather than limited scope as the U.S did in Russia sanctions.

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