ECONOMIC SANCTIONS: FAILED FOREIGN POLICY TOOL AND A COST TO AMERICAN BUSINESS

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In recent years the US government has increased its use of economic sanctions in order to punish countries, organisations and individuals. This form of foreign policy has become an increasing burden on US business and adversely affects US competitiveness and perceived reliability in the global marketplace. In addition, economic sanctions are generally ineffective in producing the desired changes and often harm the people they were intended to help. This paper argues that economic sanctions are an increasing menace to US business, represent an ineffective tool of foreign policy, and do not meet generally accepted ethical standards.

Introduction

During a recent conference held at the Hotel María Isabel Sheraton in Mexico City, the absurdity of American economic sanctions became clear to conference participants and all who read about the event in the international newspapers. At the conference Cuban government officials, together with American business representatives, were discussing the future of the energy industry and the possibility of future joint ventures between Cuba and the USA. The hotel, partially owned by Sheraton (an American company) received notice from the US Treasury Department's Office of Foreign Assets Control that it was operating in violation of the Trading with the Enemy Act. In order to avoid prosecution under the Act, the Cuban delegation would have to leave the hotel. Risking large fines from the US government, Sheraton ordered the Cuban officials to vacate the hotel. Outraged Mexican officials then closed the hotel for violating Mexican law, charging hotel management with illegal discrimination (Colvin, 2006; Watson, 2006). The hotel has since been able to reopen, but now faces large penalties from the Mexican government. The Sheraton was placed in a no-win situation – abide by US law and face Mexican penalties, or abide by Mexican law and face US penalties. Complying with the growing list of economic sanctions has become an increasing burden to American business.

The growing use of economic sanctions also reduces consumer choice and makes American consumers potential criminals. Consider the case of the Oasis Hotel and Convention Center near Tijuana, Mexico. In September of 2002, US Customs agents passed out flyers to American citizens crossing the border into Mexico warning them not to do business with this hotel. The Oasis Hotel was blacklisted by the US government under the Foreign Narcotics Kingpin Designation Act and any American who was found doing business with the hotel was subject to a $1 million fine. The fine could be assessed even if the citizen was unaware of the sanction (Duncan, 2005). While many sanctions are imposed for good causes, such as the reduction of drug trafficking, the collateral damage they do has made their use controversial. Sanctions undermine the economic freedom of American businesses and citizens, cause unnecessary pain and suffering in foreign countries, and usually don't achieve their objectives.

Increasing menace to business

Economic sanctions have been around for a number of years, but their use has rapidly increased since the 1980s. Prior to World War II, the use of sanctions was infrequent and often used as a prelude to armed conflict (Duncan, 2005). The use of sanctions by the United States increased after World War II and expanded significantly during the 1980s and 1990s. The United States currently has major economic sanctions imposed on 12 countries or country groups: the Balkan countries, Burma (Myanmar), Côte d'Ivoire, Cuba, Iran, Iraq, Liberia, Libya, North Korea, Sudan, Syria and Zimbabwe (US Department of the Treasury, 2006). In addition, the United States has limited sanctions against many more countries including sanctions related to anti-terrorism, narcotics trafficking, diamond trading and non-proliferation of weapons of mass destruction. The US Department of the Treasury and its Office of Foreign Asset Control (OFAC) maintains a list of Specially Designated Nationals (SDN), people and firms that US citizens are prohibited from doing business with. This list is published on the Treasury Department's website and the document currently takes 227 pages to list the thousands of SDNs. Penalties to American citizens and businesses for violating the OFAC regulations include fines of up to $1 million and possible imprisonment of up to 30 years.

The USA is by far the leading sanctions-imposing country. Economic sanctions are created either through legislation, or executive order of the President. Economic sanctions have become a popular tool of foreign policy for the executive and legislative branches of the federal government. State and local governments have also begun imposing their own sanctions. In some cases the legality of the sanctioning activity is questionable. For example, a number of executive orders imposing sanctions refer to the power of the President to act based on the International Emergency Powers Act (IEEPA), Title 50, Section 1701. A careful reading of the Act shows that the use of this power is limited. Section 1701 states that the Act, '. . . may only be exercised with an unusual and extraordinary threat with respect to which a national emergency has been declared for purposes of this chapter and may not be exercised for any other purpose' (Federal Register, 28 July 2003). Executive Order 13310 – Blocking Property of the Government of Burma and Prohibiting Certain Transactions (2003) – was imposed using the justification of Section 1701 of the Act. Even a liberal interpretation of the situation in Myanmar (Burma) would find it difficult to conclude that a national emergency for the USA exists as a result of the lack of democracy in that country. Likewise, an earlier executive order (EO 13047) in 1997 imposing sanctions on that same country stated '. . . the actions and policies of the Government of Burma constitute an unusual and extraordinary threat to the national security and foreign policy of the United States and [I] declare a national emergency to deal with that threat' (Federal Register, 22 May 1997). A reading of these executive orders would lead one to conclude that the Burmese government was developing nuclear missile technology and aiming it at the United States, which is not the case. The sanctions have been imposed due to the current regime's refusal to accept democracy and its human rights abuses of minority populations within its borders. While this behaviour is deplorable, it does not represent an emergency to the national safety of the USA. In fact, the consequences of sanctions may produce the opposite of the desired outcomes. Since sanctions were imposed against Burma the regime has cracked down even harder on political dissent and has forged stronger political ties with China, North Korea and Iran. The Chinese have been eager to take the opportunities previously available to American businesses, especially in Burma's developing energy industry. My earlier article in *Economic Affairs* (Rarick, 2006) highlights the shortcomings of sanctions against Burma.

Economic sanctions harm American business interests and generally do not achieve their intended objectives. The current wave of sanctions began in 1980 when President Jimmy Carter imposed a grain embargo on the former Soviet Union in response to the Soviet invasion of Afghanistan. The embargo brought protests from American farmers who stood to lose sales of 25 million tons of wheat and corn. The estimated value of the lost sales was $2–3 billion. Moreover, since excess grain was being produced by the farmers, some of it was purchased by the government and placed in storage at a cost to the taxpayer of billions of dollars (USA Engage, 2006). Since the United States was not the only source of grain, the Soviet Union simply purchased it from other countries. The grain embargo did not get the Soviets out of Afghanistan, but did act as a form of foreign aid to our competitors in agricultural products.

Also in the 1980s the United States began to prohibit the exporting of equipment used to build the Siberian pipeline. US policy-makers feared that a pipeline from the Soviet Union to Europe would make Europeans too dependent on Russian energy. The US sanctions were intended to slow progress on construction of the pipeline, perhaps enough for the project to be abandoned. Sanctions did not stop the pipeline but did give European and Japanese companies an opportunity to gain experience in Arctic drilling, and to become competitors to US firms on future international construction projects. Also during this time, the American company Caterpillar held the dominant position in heavy machinery sales to the Soviet Union. The pipeline sanctions prevented Caterpillar from selling to the Soviets and their sizeable sales went instead to Caterpillar's main Japanese competitor (USA Engage, 2006). In another case, a delay in lifting sanctions cost American business an opportunity. With the prospects of trade normalisation with Vietnam, Boeing negotiated a lease agreement with

Vietnam Airlines. When the lifting of the embargo was delayed, Vietnam Airlines instead got its aircraft from Boeing's main competitor, Airbus. Vietnam Airlines continued to purchase from Airbus, resulting in lost sales to Boeing of an estimated $1.6 billion (USA Engage, 2006). In addition to the immediate loss of sales, sanctions run the risk of portraying American suppliers as unreliable sources and thereby deterring future sales.

According to Losman (1998), the cost of sanctions to American businesses can be divided into three types. *Direct costs* of sanctions are loss of sales and earnings, loss of asset value in the targeted countries and reduced employment. *Indirect costs* include higher costs due to lower production runs and lower economies of scale, and increased lobbying expense to avoid sanctions. Also, *potential costs* arise as indigenous firms develop in the sanctioned market to fill the void left by foreign companies and then become future competitors. Politicians increasingly use economic sanctions as a foreign policy tool because they are viewed as cheaper and cleaner than military action (Haass, 1997). Although cheaper and cleaner than military action, economic sanctions deprive the liberty of the citizens of both the sanctioned and sanctioning countries. Boycotts and other 'supply interruptions' produce significant consumer welfare loss in the sanctioned country (Fershtman and Gandal, 1998) making life very difficult for ordinary citizens. The costs of economic sanctions, and the pain they cause, could perhaps be justified if their success rate was particularly high; however, that is not the case.

Ineffective instruments of foreign policy

Economic sanctions are frequently a response to the urgencies of the moment in international affairs (Malloy, 2001) and in many cases are motivated by special-interest groups. Many economists and political scientists agree that public choice economics, the belief that politicians make decisions based upon self-interest, is a contributing factor in the proliferation of economic sanctions. In other words, politicians are office-seeking vote maximisers (Whaples and Heckelman, 2005). Special-interest groups such as Cuban refugees in Florida, or Burmese pro-democracy activists in California, push for sanctions to advance their causes. The benefits of their actions are concentrated and the costs are diffuse, making the probability of political action in their favour likely. Kaempfer and Lowenberg (1988) have proposed that sanctions are used because they are intended not to change behaviour in the sanctioned country, but rather to achieve objectives in the sanctioning country. Public choice advocates propose that special-interest groups operating in the sanctioning country put enough pressure on politicians to impose sanctions. Most citizens know very little about the sanctions, nor do they generally care enough to question their application. Economic sanctions, in the view of public choice advocates, represent a classic case of 'government failure', as opposed to the usual stated rationale for governmental intervention, market failure.

The public choice economics argument would also point out that economic sanctions are not applied universally. Politicians have imposed sanctions on Cuba and Burma for their undemocratic governments and human rights abuses; however, no similar sanctions are imposed on China, Saudi Arabia or Pakistan. In the case of China, the Chinese people want democratic reform as much as the Burmese, as witnessed by the mass demonstrations in Tiananmen Square in 1989. Democratic countries impose sanctions more than non-democratic countries and are more likely to impose those sanctions on non-democratic regimes (Lektzian and Souva, 2003). Democratic governments have a self-interest in maintaining non-interference in each other's economies. While sanctions may make the sender country feel good about doing something, the people of the receiving country suffer from this form of foreign policy. Typically, those hurt the most by sanctions are the people the sanctions were intended to help (Major and McGann, 2005). Economic sanctions deprive the people of the sanctioned country their basic right to a better standard of living.

It has been argued that political change may best be achieved through economic opportunity, rather than economic pain. Kenneth Derr, CEO of Chevron, while speaking on the topic of economic sanctions, observed: 'Once the free market genie is out of the bottle, it's hard to keep the hunger for political freedom bottled up' (Derr, 1998). As this argument goes, economic freedom and development lead people to expect better government, which is a common objective of economic sanctions. A policy of engagement may produce better results in some of the cases than imposing economic sanctions.

Parker (2000) argues that looking at the economic costs of sanctions alone distorts the picture, since the overall cost to a large sender economy is typically small. A better approach, he argues, is to look at the effectiveness of the sanctions compared to the *political cost* to the sender government. For example, in the case of Burma, US economic sanctions have resulted in a closer relationship between Burma and China. China is now a major political supporter of the Burma regime and a supplier of military weapons (Roy, 2005). In addition, the Russian Deputy Foreign Minister recently visited Burma and expressed Russia's support for the regime and interest in increasing its economic and political connections (Aye, 2006). Burma has a strategic location, between the two great emerging countries of China and India. US economic sanctions have closed American opportunities in that country and strained diplomatic relations with the current regime, forcing it to form relationships with other countries.

Sanctions have also caused closer ties between Cuba and other troubling regimes in the region and beyond. In addition to the potential economic loss to the United States due to Cuban sanctions, the development of closer ties between Fidel Castro and Hugo Chavez is troubling for political watchers of Latin American politics. Combining Venezuela's oil wealth with Castro's political skills could begin a renewed campaign of anti-American sentiment in the region (Barrionuevo and de Cordoba, 2004).

In addition to high costs, sanctions simply do not appear to be effective tools of foreign policy. Research by Elliott and Hufbauer (1999), examining 170 cases of economic sanctions, found that in only a quarter of the cases did the sanctions achieve their aims. In another comprehensive study of economic sanctions, by the Institute for International Economics, it was found that sanctions were effective in only 20% of the cases (Lukas and Griswold, 2003). In a report issued by the National Bureau of Asian Research, it was found that economic sanctions against Burma were undermining a reform movement within the government hierarchy. The sanctions have shifted power further towards those opposed to reform (Hiebert, 2004) and provided a scapegoat for the failed economic policies of the current regime. In the case of Cuba, sanctions have been ineffective for over 40 years.

Miljkovic (2002) shows that economic sanctions work most effectively when the following conditions are present:

- Modest policy change is sought.
- Both trade and financial sanctions are imposed.
- The receiving country does not get support from a third party.
- The sender country's economy is much larger than that of the receiving country.
- International co-operation exists in imposing sanctions.
- The receiving country is economically and politically weak.

With such limiting factors and a poor track record of success, it is difficult to understand why sanctions are such a popular instrument of foreign policy.

The ethics of sanctions

An additional argument against the use of sanctions can be made on ethical grounds. Economic sanctions could be evaluated using a number of different ethical perspectives. The *practical imperative* of Kant (1785) – 'So act that you use humanity, whether in your person or in the person of any other, always at the same time as an ends, never as a means' – can be used to argue against the use of sanctions. Sanctions are a means to an end. The theory operating behind sanctions is to cause as much pain as possible to the people of the receiving country in order for pressure to be brought on the government. The citizens of the sanctioned country are used as a means to achieve the foreign policy objectives of the sanctioning country.

Similarly, a consequentialist analysis of sanctions finds them lacking an ethical quality. Consequentialism contends that an act is right or wrong depending on its actual consequences. The consequences of sanctions in most cases have been to lower the economic, educational and healthcare systems of the sanctioned countries. A common theory of the consequentialist school of thought is utilitarianism, which proposes an act is ethical when it provides the greatest good for the greatest number of people. If sanctions were effective most of the time, it could be argued that the positive results gained by the people of the sanctioned country justified the necessary pain they experienced in the application of the sanctions. This is not, however, the case.

Sanctions do not stand up to the principles of social justice proposed by John Rawls (1971). According to Rawls, ethical action involves providing each person with equal rights to basic liberties and taking action beneficial to the least advantageous members of society. Economic sanctions imposed on most countries have not harmed the country's leaders and the least advantageous members of society carry the burden. Unlike the utilitarians who argue for 'the greatest good for the greatest number', social contract theory argues for justice delivered via a social contract between free and equal citizens (Kelly, 2004). Economic sanctions do not achieve the goal of allowing the greatest benefits to the least advantaged of society.

Rawls's theory can be further explained by using his 'thought experiment'. Under the 'original position', a group of individuals are asked to create a society in which they will be living, without knowing anything about their abilities or interests. Operating behind this 'veil of ignorance', participants create a society where everyone has equal opportunity and where privileged life-styles are minimised. The theory operating behind this process is that no one would be willing to risk the chance of ending up in a very bad position in the new society. In order to protect themselves, since they do not know where they will be positioned in the new society, participants select an option that ensures the least bad outcome for themselves. It seems reasonable to conclude that if politicians were operating behind the veil of ignorance, and did not know if they would wake up tomorrow as common citizens in Cuba, Burma, Haiti or Iraq, their view of sanctions would be very different.

Humanitarian issues

In addition to their unethical nature, sanctions represent an inhumane form of public policy. Dennis Halliday, former co-ordinator of United Nations Resolution 986 (Food-for-Oil in Iraq) describes economic sanctions as a 'totally bankrupt concept'. Sanctions in Iraq caused the price of basic food products to greatly increase, resulted in inadequate nutrition, caused a decline of healthcare and led to the collapse of the national currency (BBC, 1998). According to UNICEF, economic sanctions against Iraq resulted in a doubling of the death rate for children less than five years of age and a skyrocketing of infant mortality. The organisation reports that the sanctions made it very difficult for parents to provide needed medicine, food and safe drinking water for their children, and that an estimated 500,000 children under the age of five died between 1991 and 1998 as a result of the sanctions (Pigler, 2004). Economic sanctions themselves can be called instruments of mass destruction (Mueller and Mueller, 1999) when one compares the human toll inflicted on the innocent people of sanctioned countries.

In a study of the impact of economic sanctions imposed against Haiti from 1991–94, Gibbons and Garfield (1999) determined that sanctions resulted in declining incomes, rising unemployment, decreased attention to child welfare and education, poor nutrition and increased family breakdowns. The sanctions decreased the standard of living of the most disadvantaged members of Haitian society. The authors of the study concluded that the effect of the sanctions continued long after they were lifted in 1994.

One of the longest surviving cases of economic sanctions, the embargo against Cuba, has resulted in decreased healthcare. Two studies, one by the American Association for World Health and the other by the University of South Florida, both concluded that economic sanctions have reduced the quality of healthcare in Cuba. While the socialist policies of Fidel Castro have made medical services available to all citizens of Cuba, the lack of medicine, medical supplies and equipment have decreased the effectiveness of healthcare providers. The sanctions imposed by the United States require that pharmaceutical firms obtain special licences when selling to Cuba. The increased regulation results in increased costs to Cuba, a country that can ill afford the additional expenditure (Newman, 1997). The dire economic conditions in Cuba, of course, cannot all be blamed on US economic sanctions. Fidel Castro has made choices that have not been beneficial to economic development on the island (Shiffman, 2002). He has, however, been able to blame his failed policies on US-imposed sanctions (Katz, 2005).

Conclusion

Although sanctions in most cases are imposed with good intentions, the probability of their success is not high. In some cases sanctions have been successful in bringing about the desired change, such as in the case of South Africa. Sanctions may have their place in foreign policy, and this paper does not advocate ending all economic sanctions. What is proposed is that sanctions are more carefully applied and that they are designed to maximise their effectiveness.

The increasing use of economic sanctions as tools of foreign policy is troubling to American business and to advocates of economic freedom. It is not suggested that sanctions imposed for national security reasons (such as restricting the sale of advanced technology to unfriendly countries) should be abandoned. What is suggested is that economic sanctions used to produce political change desired by US policy-makers are carefully examined before being implemented and that other alternatives are considered. While it is certainly true that the people of many sanctioned countries live under tyrannical government, it is also true that most citizens of those countries do not want sanctions imposed. Sanctions make their lives more difficult and in some cases place their health in jeopardy. The human cost of this unethical and often inhumane and ineffective form of public policy requires a search for alternative means of producing change. In some cases a policy of constructive engagement and/or multinational political pressure can be a more effective form of intervention. At the very least, some restraint in imposing sanctions is recommended – in contrast to the hair-trigger approach now employed.

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