



## **DOLLAR & SENSE: THE BROOKINGS TRADE PODCAST**

**“Why US economic sanctions often fail”**

**Washington, D.C.  
Tuesday, February 21, 2023**

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*Episode Summary:*

Agathe Demarais, global forecasting director of the Economist Intelligence Unit, speaks with host David Dollar about her new book, *Backfire: How Sanctions Reshape the World Against U.S. Interests* (Columbia University Press). In the conversation, Demarais explains why sanctions are a frequent U.S. foreign policy tool, why sanctions are often ineffective, and how China and Russia are developing ways to circumvent sanctions.

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**DOLLAR:** Hi, I'm David Dollar, host of the Brookings trade podcast *Dollar and Sense*. Today, my guest is Agathe Demarais, global forecasting director of the Economist Intelligence Unit and author of a new book on economic sanctions. That's going to be our topic today. Her book has the interesting title, *Backfire: How Sanctions Reshape the World Against U.S. Interests*. So, that's going to be our topic. Columbia University Press just published this book. So, welcome to the show, Agatha.

**DEMARAIS:** Hello, and thank you so much for having me. It's a pleasure to be with you today.

**DOLLAR:** So, let's start with the logic of economic or financial sanctions. What makes the U.S. and the dollar uniquely suited to this approach to diplomacy?

**DEMARAIS:** Well, U.S. dollar hegemony, I think, is the short answer. Essentially, I think that we have to take a step back and wonder how sanctions work in practice, because we talk a lot about sanctions, but sometimes we don't really know how they work in practice.

Financial sanctions have been used for the past two decades, about two decades, and they actually rely on U.S. financial hegemony—the dollar dominance pretty much—and also the U.S. dominance of financial channels. But what I mean here is the SWIFT, for instance, which is the global rolodex of banks, well, when the U.S. applies pressure on SWIFT, SWIFT will cut off the access of some banks or entire countries, as happened in Iran to its network.

So, the U.S. is uniquely suited to do that because it has the U.S. dollar, because it controls Western financial channels. And this is the reason why sanctions have been such a popular tool for U.S. policymakers over the past two decades. And I discuss in the book how sanctions have become so central for U.S. foreign policy.

**DOLLAR:** Yeah, no, I think that's very clear in the book that almost any foreign policy issue that comes up now the first response of the United States is to turn to some kind of economic or financial sanction.

**DEMARAIS:** Yeah, I think that's a very clear thing, actually if we take a look at the data sanctions at the moment target about 10,000 individuals, companies in around 70 different countries. And actually the U.S. is really the sanctioning power. It has imposed more sanctions over past decades than the EU, Canada and the U.N. combined. So, I think that it is very clear, as you've said, that sanctions are usually the default foreign policy response for U.S. policymakers.

**DOLLAR:** So, can you cite a case where sanctions have worked well in the sense of meeting U.S. objectives?

**DEMARAIS:** Well, I think Iran comes to mind immediately. And actually, there are a number of lessons that we can draw from the Iran case. Actually, one thing that I want to mention also, and it works well with what we've discussed, is I think it's

important to keep in mind the fact that sanctions fill in a gap between, on the one hand, empty diplomatic declarations—these are not going to be effective, we know that, against someone like Vladimir Putin—and on the other end of the diplomatic spectrum, deadly military interventions. And this is why they have been so popular.

So, to go back to your question, Iran, I think, is a real sanctions success story. I think that since 2010 approximately, the U.S. and—and it is very important European countries and other Western allies have imposed very stringent and tough sanctions on the Iranian regime with regards to Iran's nuclear program. And after a few years, what happened is that Iran decided that this was too high a price to pay and Iran decided to sign the nuclear deal.

But I think there are two very important lessons to draw from this example. The first one is that sanctions work better when the population of the targeted country has a way to signal its displeasure with the economic hardship that sanctions create. As I discussed in the book, Iran is a theocracy with a dismal human rights record. But Iranians were still able to elect what is for Iranian standards a reformist, Hassan Rouhani, who had pledged to get sanctions lifted via a nuclear deal. This is exactly what he did. And so, the lesson here is that sanctions work better when, well ideally, they target a democracy. But this almost never happens because democracies, well, they can discuss their problems, but at least when the population has a way to signal its displeasure.

And the second thing, and this is a story that I tell throughout the book, sanctions work better when the U.S. engages its allies. I think that sanctions against Iran were powerful and successful because the U.S. and the EU were, for the nuclear deal, really aligned. And I think this is what made Iran sanctions success story.

**DOLLAR:** I know you were representing the French Treasury in various countries during that time period and by coincidence I was representing the U.S. Treasury in Beijing while we were developing the Iran sanctions. And while China is not happy about sanctions in general, they went along with a lot of the sanctions on Iran on that first round because big Chinese banks and companies did not want to be sanctioned by the U.S. Treasury. So, it was interesting to see that. But while that's a great case that you're citing, one of the important arguments in your book is that more often than not, sanctions fail. So, can you explain that kind of argument?

**DEMARAIS:** Yes, absolutely. I think that we need to make a very important distinction, and it is sanctions up to February 2022 and the invasion of Ukraine, and then the latest sanctions on Russia. So, I'm sure that we will discuss these, but I will make them a completely separate case because I would argue that sanctions on Russia are working and are extremely effective.

To go back to your question, we need to have a think about the criteria that make sanctions effective. And I discussed these in the book. The first criteria is that sanctions are typically more effective when they are imposed for a short period of time. So, for instance, in 2018 the U.S. imposed sanctions against Turkey to get a pastor, an American pastor, released, Pastor Andrew Brunson. And these sanctions were imposed for a short amount of time. And typically such sanctions tend to work better.

And this leads us to the second criteria for sanctions to be effective. They have a narrow objective, that is to say, not regime change. We know for regime change it just never works. But for the release of a pastor, well, it did work in the case of Turkey.

Third criteria—and the Turkey sanctions also fit this criteria very well—sanctions need to be imposed against a partner. If you impose sanctions against a country that you have no ties with, it is not going to do anything pretty much because it will sever ties that are already cut.

The fourth criteria, we have discussed it already, it is that sanctions work better when the population has a way to signal its displeasure, for instance, in the face of rising inflation. So, that is an important factor.

And the fifth criteria and it goes back to the Iran sanctions story, is that sanctions work better when the U.S. engages its allies, when it is working in collaboration with its allies.

So, if we take a look at these five criteria, it is very clear that most U.S. sanctions regimes do not meet these criteria. And so, that means that they have low chances of success. It doesn't mean we need to get rid of sanctions entirely. It means that these sanctions have a low chance of success. These too represents a diplomatic tool. But I think one needs to be realistic about what they can achieve.

**DOLLAR:** So, there are a lot of interesting ideas there. This notion that if sanctions are not short, they're likely to be less effective. And I think one reason for that is countries start finding workarounds. And just more generally, this overuse of sanctions by the U.S. threatens the development of some serious workarounds that will make U.S. sanctions less effective in the future. So, what kind of workarounds can a country like Iran or Russia today, what can they develop to try to circumvent these sanctions?

**DEMARAIS:** Well, they're really at work to not even circumvent sanctions but to vaccinate themselves against sanctions. I think there are a number of parallels we can make with medicine. Actually, I would argue that sanctions are a bit like antibiotics. They are critically important. Antibiotics save lives. Sanctions are very important diplomatic tools. But if there is overuse of one of these tools, then we have resistance. If we overuse antibiotics, we have antibiotic resistance. If we overuse sanctions then we have sanctions resistance.

And it goes back to your first question about, well, how sanctions work—they target financial channels. So, unsurprisingly, sanctions resistance, this movement, is taking place in the financial sector. I would say there are three main ways for countries to really vaccinate themselves against sanctions. So, it's really a preemptive thing. The first thing is not to use the U.S. dollar. That is very simple, very, very cheap fix, I would say. And unsurprisingly, a number of emerging countries are having a think about using the U.S. dollar a bit less for their trade. I think this was to be expected, you know, that developing countries would want not to stay dependent on the Western financial channels or currencies. But this is decreasing the bite of U.S.

sanctions a little bit. And actually, since 2020, China and Russia have been conducting most of their bilateral trade in either Russian rubles or Chinese renminbi. And this is not random. So, that's the first tool, de-dollarization.

The second tool actually is about SWIFT. So, I've mentioned SWIFT already, the global rolodex of banks. You can de-dollarize all you want, but if you still use SWIFT, then, well, the U.S. will have leverage over your economy because the U.S. can put pressure on SWIFT to cut a financial sector from a given country from its network. This happened in Iran in 2012, actually, and has put Iran in complete financial isolation. I tell this story in the book, *Backfire*.

Well, China is really hard at work to develop an alternative to SWIFT. It is called CIPs. It is far smaller, about 100 times smaller in terms of the volume of transactions, but it works. And so, China has a plan B in case it is disconnected from SWIFT from one day to another. And this also gives China an offensive capability because China is the world's second largest economy. One day, could well become the world's largest economy, and it could say, well, if you want to do business with us, you need to use our financial system, you need to use CIPs. And so, China could cut off entire countries from the Chinese market just like the U.S. does with sanctions.

And finally, the third tool is central bank digital currencies. About 300 million Chinese people already use such a currency that is completely immune to sanctions. We're not talking about circumvention, we're really talking about, well, vaccination against sanctions, I would say. And of course, this comes with added benefits for a Chinese leadership with surveillance capabilities, for instance.

So, these are the three main tools: de-dollarization, alternatives to SWIFT, and central bank digital currencies that a number of countries are putting in place to escape U.S. sanctions.

**DOLLAR:** So, those are essentially aimed at getting around sanctions, as we've discussed. There's also a more general discussion about the potential, particularly for China's currency, the renminbi, or the yuan, as we call it, to supplant the U.S. dollar or at least challenge the U.S. dollar as a global reserve currency and as a global means of finance. So, what do you think the prospects are for the Chinese currency to compete seriously with the dollar and maybe even displace the dollar?

**DEMARAIS:** Not yet, I think. I'm not sure this is a very realistic perspective. I'm sure as a former U.S. Treasury official based in China, you would have thoughts about that. I think as long as there are capital controls in China, this prospect is not a realistic one.

What I think could happen after the re-liberalization of the Chinese currency, we could have the emergence of a fragmented financial landscape. This is the story that I tell in the book. I think the key word here is fragmentation. We could have a block that is U.S.-led that would have a regional clout over, say, the Americas, North America, South America. We could have a European-led bloc, because I think we shouldn't forget that the euro is used for about 40% of global trade these days. So, that is significant. It's on a par with the U.S. dollar, actually 40% for the U.S. dollar and 40% for the euro. And so, maybe the euro would be used, of course, in Europe,

but also in some African countries. And then there would be a Chinese-led bloc, or renminbi-led bloc, that would have influence over Asia and possibly some African countries, because we're seeing China having a strong presence in Africa.

And I think this fragmented financial landscape is the likeliest scenario in my view. And I think that what is interesting is that talking to U.S. policymakers, usually the debate about U.S. dollar hegemony is framed in black and white terms. The U.S. dollar is completely dominant or completely not dominant. And of course, if you take a look at things from this lens, well, you could argue, well, no, the U.S. dollar will still be around. And then you have to say the U.S. dollar will still be dominant.

I'm not entirely sure this is the case. I think the reality will be more nuanced and I think it will be a fragmented financial landscape. But what that means, and it goes back to your question about sanctions resistance, it means that countries and also groups involved in clandestine, nefarious, illegal activities such as nuclear proliferation, will have the ability to escape Western financial channels. And I think this is a more dangerous world we would live in.

**DOLLAR:** So, what you're describing, for me, it highlights the dilemma that a lot of Asian countries particularly experience, because as you say, China is clearly going to be the dominant economic player in Asia. It's the largest trading partner for just about everybody. And yet a lot of these countries have security relations with the United States, very strong for Japan, South Korea, Australia, but also Philippines has security arrangements. Thailand, even Vietnam is becoming something of a strategic ally of the United States. So, it's to me a very interesting situation that the economic fortune of these countries is shifting more toward their relations with China. And on the other hand, they still have this security relationship with the U.S., which they value, frankly, because they do worry about Chinese excess.

**DEMARAIS:** Yes, they're extremely worried about China's moves, for instance, regarding Taiwan or in the South China Sea in general. But they know that they rely on China for trade. As you've said it, China is the biggest trading partner of actually a majority of countries around the world. So, it's really difficult for these countries, not only in Asia, actually, but I would say also in Africa and in Latin America to really balance the ties with both the U.S. on the one hand and China on the other hand, which is the trade power, the manufacturing power also.

And I think that what this points to is that we already have two blocs that are very well defined. The first bloc is U.S.-led. I would like to say, as a French former Treasury official, that there could be an EU-led bloc, but so far we're not seeing it. I would hope that it could emerge, but I think a Western bloc is very well defined. Then we have a Chinese-led bloc. Well, Russia has joined it very much. It is the junior partner in its relationship with China. But then the question is, where will emerging countries be? Who will they side with? And I think we don't have an answer yet to this question, and it will probably be a challenge in the coming decades for both blocs to try to win hearts and minds in developing countries. And we're seeing Russia and China actually do that quite a lot in Africa with disinformation campaigns.

**DOLLAR:** So, let's talk a little bit about how sanctions are viewed by a range of different countries. And let's start with the key Western allies of the United States,

and France is a great example. And you've worked for the French Treasury. So, what is the role of an ally like France, the European Union, more generally in the sanctions? And would you say that our European allies are perfectly aligned with the U.S. on this issue, or is there a little bit of daylight there, as we say?

**DEMARAIS:** I think that we need to make a distinction between before February 2022 and after February 2022. I think there have been a lot of sanctions disputes. I think we can call them disputes between both sides of the Atlantic. I tell two of these stories in my book *Backfire*. So, I'm going to give these two examples. The first one was the U.S. exit from the nuclear deal in 2018, because it put European companies in a very strange position because European governments were still in the nuclear deal and were trying to convince European companies to stay in Teheran because they wanted to show Tehran that it was better for Iran to remain in the deal and to continue to comply with the deal, at least from a national security perspective, from Western countries perspective.

And so, that was really a tense moment because European governments tried to convince European companies to stay in Iran, but they didn't want to because they were worried about U.S. secondary sanctions. What are U.S. secondary sanctions? I think there's a lot of confusion about them. With secondary sanctions, and so far these mostly apply only to Iran—there are no secondary sanctions on Russia so far, only the on the Russian military, these are very limited. When the U.S. goes down the secondary sanctions route, it says to all businesses around the world, Well, if you want to do business with Iran, be our guest. There's no problem. But then you need to leave the U.S. market and stop using the U.S. dollar. And that's obviously not really a choice for most businesses around the world.

And so, this situation was a very difficult one for European companies that were working in Iran because they all had to leave the Iranian market pretty much. They just couldn't choose to ditch the American market. And so, that led to a lot of disputes, trans-Atlantic disputes.

And the second example that I give is Nord Stream 2 saga. So, of course, in hindsight, it wasn't a great idea to build a pipeline connecting Russia to Germany to bring more Russian gas to Europe. I think this is very easy to say in hindsight. But there were actually a lot of disagreements in Europe about the, well, this pipeline. Is it a great idea or not to build it? This was all pre-February 2022. But I think there was an agreement about one thing: the U.S. was absolutely adamant that this should not happen. And the U.S. imposed a lot of sanctions, including secondary sanctions actually, to derail the construction of this pipeline. And there was a consensus, even among those who opposed a pipeline in Europe, that the U.S. was going one step too far by even, in the words of some U.S. congress people, they wanted to impose sanctions on German ports' stevedores. And I think that the U.S. really shot itself in the foot here because it fueled, again, the trans-Atlantic dispute. And in my view, this is what I tried to say in the book, these only benefit countries under sanctions. And we can be sure that Putin rejoiced every time that he saw cracks in the trans-Atlantic partnership regarding Nord Stream 2.

**DOLLAR:** So, another important group of countries would be emerging markets, particularly some of the big ones. In the BRICS grouping, you've got Russia and

China, which we've already discussed a little, but you also have South Africa, India, Brazil. These are all pretty well functioning democracies. A lot of developing countries now are democratic. So, as the U.S. rolls out these sanctions often aimed at authoritarian states, can you generalize on the reaction or maybe give us a little differentiation of the reaction of some of the important emerging markets in developing countries?

**DEMARAIS:** Well, I think I'm going to use the war in Ukraine example here, because obviously it's very hard to generalize. Everything is different, every sanctions regime is different. I think that there is one statistic that I find really interesting. It's something that we've worked on at the Economist Intelligence Unit: 66%, two-thirds of the world's population, live in countries that are either neutral or Russia-leaning when it comes to the war in Ukraine. So, it does show that Russia has deep pockets of support in emerging countries. This is also due to Russian disinformation campaigns that are fueling resentment that is already here, but it is fueling it further—resentment against former colonial powers and now, something new, against sanctions also. So, for instance, Russian disinformation campaigns are claiming that sanctions are fueling food insecurity. This is wrong, but this narrative is gaining traction in a number of African countries.

And so, I think that it is very clear that in the emerging world, there is a lot of resentment against Western countries. There is a feeling that there have been some double standards from developed countries when it comes to military intervention. And so, obviously this is used against Western countries these days. And I would say also for a number of countries they are saying, This is not our war, we don't really care about it, which is, to me very worrying because I think it's everyone's war. And the fight for Ukraine is everyone's war for those who stand with democracies. But I think there is really this feeling in emerging countries, and I would hope that there is a recognition of this among Western democracies and that this topic should be tackled. So far I'm not seeing it, but I would hope that this will be a big thing for 2023.

**DOLLAR:** Yeah. Just listening to you, Agathe, I'm really struck at how much hostility there is toward the advanced Western countries, the United States in particular, is the most powerful. And I think our diplomats do not always understand that there is this level of hostility. The last episode of *Dollar and Sense* focused on Brazil. Here we have a newly elected democratic leader, Lula. He's criticized the Russian invasion of Ukraine, but Brazil is not sanctioning anything and Brazil is not interested in joining up an alliance of democracies with the United States. I mean, most of the important developing countries are not on board. What do you think of this effort to divide the world into democracies versus authoritarians as an organizing principle?

**DEMARAIS:** Well, I think that it stands, you know, if we take a look at how things are looking, but we still need a third category because we have democracies that are very well defined, certainly the countries that we live in. So, the U.S., the UK, France. We also have authoritarian regimes like Russia and China. So, that classification stands. But we still need a hybrid category for a number of countries that do not want to side with Western democracies to defend Western democratic principles.



And so, that goes back actually to the point about fragmentation and discussion that we had a few minutes ago. The world is becoming more fragmented. The U.S.-led order that emerged after the Second World War is being challenged. And it's very interesting that you mentioned resentment; actually, when one goes on Twitter, on social media, I try to read all of the comments that are posted when I do tweets about sanctions, and resentment against France, against the U.S., is incredibly strong in very crude language, I would say.

And I think this trend is underestimated, but it is very important and I had seen it emerge actually during the COVID pandemic. I did a lot of work at the time on vaccine inequity, and there were the same comments, almost word for word, accusing Western countries to hoard vaccines to keep the vaccines only for them. And in parallel, we could see Russia and China do vaccine diplomacy and come with Sinopharm and Sinovac and Sputnik vaccines and just vaccinate the population, who was very grateful, by the way. I think this has been underestimated. But it was a life and death question. And again, this has been underestimated. But I think that this will be a very important trend in the coming years.

**DOLLAR:** I'm David Dollar and I've been talking to Agathe Demarais about her new book, *Backfire: How Sanctions Reshape the World Against U.S. Interests*, available from Columbia University Press. And it's got a lot of powerful arguments about how financial sanctions can be a useful tool of diplomacy and certainly important dealing with Russia after its invasion of Ukraine. But we tend to overuse these is one of the main messages they take away, and we could make them far more effective. So, thank you, Agathe, for joining us.

**DEMARAIS:** Thank you so much for having me.

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**DOLLAR:** Thank you all for listening. We release new episodes of *Dollar and Sense* every other week. So, if you haven't already, follow us wherever you get your podcasts and stay tuned.

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Until next time, I'm David Dollar and this has been *Dollar and Sense*.