Reponse to “The Economics of Sanctions: From Theory into Practice”

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Contributions of I&R

- Draws on trade theory to provide a theoretical framework for understanding the effects of sanctions; subtitle should probably be "from practice to theory"
- Provides empirical evidence in the case of Russia, supporting the anecdotal impression of Russian resilience under sanctions
- Highlights shortcomings in the design and enforcement of the sanctions on Russia – but most importantly offers a set of reasons why the impact was always likely to be limited

Trade sanctions: openness and elasticities

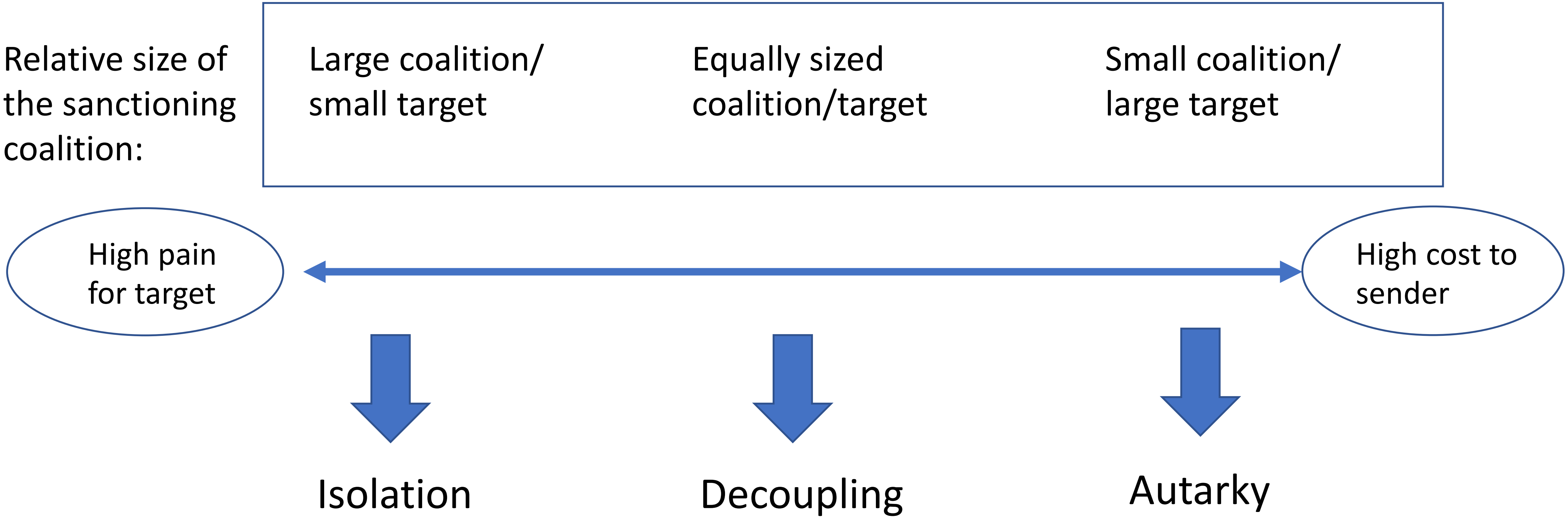
Practitioner's concept

- "Cost to sender" – the loss of critical inputs or export market share – is a major consideration in sanctions design
- "Backfill": avoid ceding an export market to companies from a country outside the coalition
- "Choke points" – technologies that cannot easily be substituted
- "Working with partners and allies"

Trade theory

- Gains from trade – and hence losses from trade sanctions – affect both sides
- Blocking the export of easily substitutable goods has minimal impact on target country
- Conversely, denying the target country access to goods with limited availability and low elasticity of substitution has much greater impact
- The size of the sanctions coalition relative to the target and its "black knight" allies is an important variable

Trade sanctions: relative size



Financial sanctions: they work in practice, but do they work in theory?

- I&R: “Financial sanctions operate by limiting the ability of countries to borrow to finance trade deficits, reducing the ability for risk sharing and intertemporal consumption smoothing”
- Practitioner’s view: sanctions are a “financial death sentence”
  - Dollar asset freezes
  - US banks reject all transactions involving persons on the SDN list – and all dollar transactions go through US banks
  - Enforced by banks themselves under threat of large fines
  - Even local transactions can be affected if they involve US card networks
- “SSI” sanctions limited the availability of dollar financing beyond specified maturities – but as a step along the path to full “SDN” sanctions

How effective have sanctions on Russia been?

- 2014-15 targeted sanctions aimed to induce a change in behavior
  - The message was that further advances would lead to heavier sanctions
  - Economic impact was amplified by falling oil prices – but that is wrong metric
  - Arguably they succeeded in halting Russia’s advance – but only for a while
- 2022 economy-wide sanctions aimed to impair Russia’s warfighting capacity. Russia has endured significant economic costs and is weaker relative to the no-sanctions counterfactual. But:
  - Russia is still buying imported components for its military hardware
  - The financial system survived an initial panic
  - Huge fiscal stimulus from military procurement and salaries causing economy to overheat
  - Most important metric: Russia is still able and willing to continue fighting

What explains the limits of their impact?

- Russia is a hard sanctions target
  - Producer of globally consumed commodities
  - Domestic military industrial capacity, import substitution post-2014
  - Land borders with friendly “black knight” countries outside sanctions coalition
  - “Fortress” fiscal and central bank balance sheets
  - Severe repression of political opposition
  - Domestic payment switch and other post-2014 preparations
- Novel sanctions mechanisms (price cap, technology controls) do not have well-established, decentralized enforcement mechanisms
- Unwillingness of sanctioning countries to endure high commodity prices; that may change

Additional questions

- Is it more effective to restrict emigration from the target country or to encourage it?
  - A brain- and body drain reduces the country's economic and military potential
  - On the other hand, the emigration reduces domestic opposition to the regime and lessens the need for costly repression
- Is it more effective to sanction wealthy individuals or to encourage capital flight?
  - Sanctioned oligarchs might lobby the country's leadership to scale back its war aims or foster domestic political opposition
  - On the other hand, if the regime turns out to be a monarchy rather than an oligarchy, capital flight might have a greater impact via financial stability