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HAS THE US REACHED "PEAK SANCTIONS"?

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The last decade has been a golden age of sanctions. The U.S. dramatically expanded the number of people, companies, and foreign government instrumentalities it sanctions each year: In 2022 and 2023 the U.S. imposed more than three times as many sanctions annually as it did a decade earlier.[1] U.S. export controls show a similar trend.[2] By the early 2010s, sanctions had become a tool of "first resort" for a dizzying array of international policy problems from the Iranian nuclear program to global human rights abuses.[3] Sanctions policymakers have been remarkably innovative, designing new ways to target trade and financial flows. The question today is whether the popularity and utility of these measures will continue or whether we have reached "peak sanctions" and will see a future of declining impact, even if the measures remain politically popular.

The popularity and economic power of U.S. sanctions is not happenstance. U.S. policymakers have seen the international role of the dollar as a strategic asset since at least the end of the Second World War with the establishment of the Bretton Woods system. During the Arab oil embargo in 1973 and 1974, then-National Security Advisor Henry Kissinger and Treasury Secretary William Simon negotiated with the Saudis to keep pricing oil in dollars and to buy U.S. Treasuries even as Riyadh continued to boycott oil sales to the United States.[4] In the 1990s, American bankers flooded Eastern Europe and Russia to spread the gospel of privatization and, in the process, linked America's former adversaries to the U.S. financial system. Currency swap lines to address 1990s financial crises, the need for a stable currency for global commerce, and American financial innovation combined to cement the power of the U.S. dollar during post-Cold War era of hyper-globalization.[5] In the early 2010s global financial uncertainty and the Eurozone crisis reinforced demand for dollars, resulting in an uptick in the dollar share of most measures of global finance.

Following the 9/11 terrorist attacks, U.S. policymakers in the George W. Bush administration came to understand that this dollar dominance could give the U.S. unprecedented influence over global trade and financial flows, even trade and financial flows that did not directly involve the U.S. American sanctions on Iran in the late 2000s and early 2010s, for example, strangled Iran's ability to be paid for its oil exports or to use hard currency to purchase imports for its domestic industries, despite the fact that the U.S. had banned most direct trade with Iran decades earlier. By restricting Iran's ability to access the dollar, U.S. banks, and large global banks that were deeply intertwined with the U.S. financial system, Iran found it exceedingly difficult to get paid for its oil or to pay international suppliers for products Iran wanted to import. Under the pressure of financial sanctions even countries that continued to buy Iranian oil, like South Korea and Japan, did so by escrowing their payments to Iran and letting Iran use its oil revenues only to purchase a tightly circumscribed set of consumer goods. The Obama administration parlayed these sanctions, which reduced Iran oil flows by more than 1 million barrels per day, into a diplomatic deal in which Iran agreed to sharp limits on its nuclear program in return for sanctions relief.

This success, combined with American fatigue at the exercise of military power, spurred a steady proliferation of sanctions in the 2010s. The U.S. and its allies subjected Syria, Russia, North Korea, global human rights abusers, cyber hackers, transnational criminals, and corrupt officials in the developing world to sanctions. President Trump withdrew from the Iran nuclear deal and launched a “maximum pressure” sanctions campaign designed to force Iran to make concessions not just on its nuclear program but on a wide range of regionally destabilizing activities. Trump also pursued maximum pressure sanctions against Venezuelan dictator Nicholas Maduro hoping to force a democratic transition in Caracas.

For the Biden administration, sanctions have been central to the Western response to Russia’s February 2022 invasion of Ukraine. President Biden and other G7 leaders used the threat of economic sanctions, alongside diplomacy, to try to dissuade Putin from invading Ukraine. After Putin invaded, G7 governments imposed waves of sanctions to limit Russia’s export revenues and access to currency. But having failed to deter, the goal of these sanctions shifted from one of altering Russia’s behavior to one of degrading its capabilities. Sanctions such as a price cap on Russian oil and targeting Russia’s major banks were designed to reduce revenues and cause macroeconomic pain, forcing Putin to make tradeoffs between financing his war and keeping the pact he had long made with the Russian people, in which they received economic stability in exchange for accepting Putin’s authoritarian rule. The U.S. also used sanctions and export controls to try to degrade Russia’s military industrial base and weaken its capacity to wage war. The Treasury Department alone administers 38 different sets of sanctions.

HAVE SANCTIONS WORKED?

So what has worked and what has not?

Sanctions have certainly proven effective at changing the behavior of individual firms. Companies are investing heavily in systems to make sure they are stopping dealing with sanctioned parties. A recent study by LexisNexis, an IT provider for sanctions compliance, found that companies in the U.S. and Canada spent $65 billion last year on financial crimes compliance, which includes anti-money-laundering (AML) as well as sanctions.[6] In the Asia-Pacific region, compliance costs were estimated at $45 billion.[7] In 2020 then-Hong Kong Chief Executive Carrie Lam complained publicly that she had to stockpile cash in her apartment after the U.S. sanctioned her because no banks would deal with her—meaning even Chinese banks changed their behavior as a result of American sanctions, even if Lam refused to change the way she ruled Hong Kong.[8] The Treasury Department maintains an active program to un-sanction, or “delist,” specific companies and individuals who negotiate with the U.S. government to cease engaging in prohibition activities and agree to comply with sanctions in the future. Historically, dozens to hundreds of companies have been delisted annually, most without attracting significant media or public attention.[9] These represent cases of sanctions success, where success is measured by convincing at least corporate actors to do things differently.

American-led sanctions also have clear economic impacts on their strategic targets, a product of America’s centrality to global finance and economics. After Trump withdrew from the Iran nuclear deal, U.S. sanctions were able to drive Iran’s oil exports down from 1.8 million barrels per day in 2017 to a low of 450,000 barrels per day in 2020. And this occurred despite widespread opposition to the sanctions even by many of America’s allies. Venezuela’s economy, already suffering from years of mismanagement and corruption, declined by an additional 50% between 2017, when Trump ramped up U.S. pressure, and 2020, when he closed out his presidential term.[10] While Russia’s economy has been more resilient than Western policymakers initially hoped, the sanctions and export controls have had real impacts: The West froze more than $300 billion in Russian reserves, the oil price cap has contributed to revenue losses of $50 billion,[11] and Russia's GDP growth is well below pre-sanctions forecasts.[12] Recent measures to tighten the G7 cap on Russian oil prices may be renewing its effectiveness.[13]

But the policy outcomes of many of the toughest sanctions programs since the 2015 U.S.-Iran nuclear deal have been decidedly mixed. Since Trump withdrew from the Iran nuclear deal and reimposed sanctions, Tehran has reacted by escalating its destabilizing activities and speeding up its nuclear development rather than making additional policy concessions. After narrowly surviving an ouster attempt in April 2019, Venezuela's Maduro appears entrenched in power—and has largely spurned recent Biden administration efforts to offer sanctions relief in exchange for democratic reforms. Russia has made military gains in recent months in Eastern Ukraine and has mobilized a war economy that appears sufficient to maintain his war effort, albeit with lower po¬-tential than it had in 2022, before the invasion. President Biden is the 12th American president to administer sanctions on Cuba, even as photos earlier this year showed Raul Castro sitting under the Havana sun at a celebration marking the 65th anniversary of revolution he and his brother Fidel led decades ago.[14]

Political scientists and historians consistently find a sanctions success rate of around 40%. A seminal academic study of 170 cases of sanctions between World War I and the early 2000s found overall success rates in the range of 30%, depending on goals and other criteria, with sanctions designed to achieving modest goals succeeding in about half of studied cases.[15] A 2016 think tank report found that in 24 cases of post-9/11 U.S. sanctions, the success rate was 38%.[16] Cornell historian Nicholas Mulder's recent book, "The Economic Weapon," catalogues how World War I policymakers in the United Kingdom and its allies used sanctions to disrupt German wartime trade with countries outside of Europe, with important economic effects that complemented the war effort against Germany. After WWI, these same policymakers sought to develop a doctrine of using sanctions to punish adventurism and prevent war in the future.[17] World War II dashed those hopes.

Of course, in the world of foreign policy, a 38% success rate is quite good given how difficult the world is. This is particularly true given that U.S. policymakers have generally succeeded in keeping the costs of sanctions, while admittedly large for many individual firms, low from a macroeconomic perspective—far lower, for example, than the estimated $3 trillion cost of America's unsuccessful war in Iraq in the 2000s and 2010s[18] or the $2.3 trillion that the U.S. spent on Afghanistan over 20 years following the 9/11 terrorist attacks.[19]

Where sanctions have not achieved maximalist policy goals in recent years, the reason often has less to do with poor targeting and more to do with the tendency of American policymakers to ask too much of our economic tools. In 1998 Richard Haas, then serving as vice president of the Brookings Institution, said that "Under the right circumstances sanctions can achieve (or help to achieve) various foreign policy goals ranging from the modest to the fairly significant."[20] Haas's phrasing remains apt today. Sanctions can achieve, or help to achieve, foreign policy goals ranging from the "modest" to the "fairly significant." A core lesson of the last decade is that policymakers need to be clear-eyed about this reality.

Take Venezuela. The sanctions policy that President Biden inherited in 2021, "maximum pressure" in support of regime change, was proving to be a dead end. Since narrowly surviving an ouster attempt in 2019, Maduro had become more entrenched in Caracas, and the Venezuelan opposition had fractured. There was no evidence that sanctions were going to bring about a democratic restoration. Venezuela's economic crises and political repression, meanwhile, had spurred millions of Venezuelans to flee, straining neighboring governments and contributing to migration to the United States. Against that backdrop, in the fall of 2023 President Biden made a rational bet that easing oil and some other sanctions was in America's interest: A degree of economic stabilization in Venezuela and a resumption of repatriation flights from the U.S. to

Caracas could help with migration, and comparatively modest increases in oil production could help settle global oil markets, particularly at a time when the U.S. was also trying to target Russian energy revenues. Diplomatic engagement also secured some pledges of democratic progress, though as Maduro's crackdown on the opposition this year shows, no one should expect that Maduro will voluntarily retire from his nation's politics. Still, from the perspective of America's national interests, the situation with respect to Venezuela today is modestly better than it was two years ago.

Sanctions have been effective at achieving other more modest goals. Even as G7 sanctions on Russia have not reduced the scope of Putin's ambitions against Ukraine, sanctions and export controls have reduced Russia's economic capacity. In the context of Russia's war on Ukraine, reductions in capacity serve as an important supporting line of effort. Moreover, a recent plan by the G7 to use the interest earned from frozen Russian assets to aid Ukraine represents an innovative use of sanctions to directly assist a victim of international aggression and may send a valuable message to other countries contemplating wars of territorial aggression that their assets, too, could be at risk. President Trump's sanctions on Turkey over its attacks on Kurds in the fall of 2019 proved effective at getting Turkey to pause the attacks, prompting Trump to lift the measures within weeks.[21]

In addition to having realistic goals, political leaders should speak honestly with the public. Rhetoric like "maximum pressure," "crippling," and "harshest ever" sanctions, combined with promises that sanctions can bring about profound changes in adversaries' behavior at little or no cost to the U.S., set unrealistic expectations and make it hard to change course even when, as with Cuba, policy has objectively failed. Much as American leaders have learned to avoid over-promising military interventions, political leaders should not over promise the outcomes of the economic weapon.

CHANGES FOR THE FUTURE?

Realism is particularly important because structural changes in the world economy and particularly in the world of finance will likely reduce the economic effectiveness of at least U.S. unilateral financial sanctions in the future. Geopolitics and market forces are giving rise to more effective alternative payment and financial channels over which the U.S. can exert much less direct control.

Already, Russia has shown a remarkable ability to move money outside the ambit of the U.S. and Western financial system. In early 2022, the U.S. and Europe cut most of Russia's major banks off the "SWIFT" payments network, long seen as a "nuclear option" for sanctions. The U.S. and Europe sanctioned most Russian banks as well, cutting off their access to correspondent relationships and the Western financial ecosystem. But Russia, which had spent years planning for this contingency, showed remarkable resilience. Domestic payments within Russia migrated almost seamlessly to domestic credit cards and interbank payment rails. International payments were more challenging, but Russia has been able to work out alternative payment routes that have allowed Russian trade to rebound strongly from post-invasion lows, albeit with different trading partners.[22]

Russia also built mechanisms to circumvent the price cap that the U.S. and Western countries imposed on Russia's oil sales. The price cap was structured, at a conceptual level, as giving Russia a choice: Russia and the buyers of Russian oil could abide by the price cap and use Western services to ship Russian oil—Greek tankers, London insurance, German banks. Or Russia and its buyers could use non-Western service providers and sell at whatever price the market deemed fair. Unsurprisingly, Russia's response has been to take the second option to the greatest extent possible, building a "ghost fleet" of tankers and working to extricate itself from Western services as quickly as possible, while using the price cap option (or engaging in outright evasion, with false documents) where it must. While the existence of the price cap does give buyers leverage to demand discounts even for sales avoiding the use of Western services, as Russia has expanded the scale of its ghost fleet the price differential between Russian crude and relevant global benchmarks has narrowed.

China, likewise, is actively seeking to build a payments architecture of its own so that it will be able to trade with the rest of the world even if it one day finds itself economically isolated from the West. China is seeking to sign up new members for its CIPS cross-border payment system. The numbers of institutions participating remains small. But since 2020, China has seen the share of its external trade denominated in RMB rise from approximately 20% to approximately 35%.[23]

To be sure, Russia, China, and their gang of misfit allies are not going to displace the dollar, irrespective of the statements coming out of BRICS summits.[24] The dollar is too attractive and too practical for most users, barring some catastrophic U.S. economic mismanagement. But displacing the dollar is not their goal. The goal, rather, is more limited: to build enough of an ex-U.S. financial infrastructure that America's adversaries and the non-aligned countries of the world can trade amongst themselves outside the jurisdiction of the United States. One major lesson of the last two years is that these efforts can be successful.

HOW SHOULD AMERICAN POLICYMAKERS RESPOND TO THIS DEVELOPMENT?

First, the U.S. should go on offense with respect to maintaining the primacy of the United States in payments. The U.S. can't stop Russia and China from trying to build alternatives. But the U.S. can make it harder for them to convince important non-aligned middle powers to participate.

The U.S. should throw sand in the gears of Russian and Chinese efforts to internationalize their payments networks. For example, after the U.S. and Europe cut off most of Russia's banks from Western financial networks, Russia promoted its "MIR" payment network as an alternative, seeking out banks in third countries to connect to it. It was not until earlier this year, two years after Russia's invasion of Ukraine, that the U.S. finally sanctioned the MIR network, making it much riskier for third country banks to join. Sanctioning China's international payments platforms is not diplomatically viable. But the U.S. can certainly work to slow their internationalization.

Even more critical is ensuring the continued attractiveness of the U.S. financial system. The attractiveness of the Western payments infrastructure is not driven solely, or even primarily, by geopolitics—it is driven first and foremost by how well the infrastructure works. The U.S. should continue modernizing its financial infrastructure for payments, for example, by moving forward with a speedy and reliable "digital dollar," either a direct U.S. central bank digital currency or, more likely, via effective regulation of U.S.-dollar linked digital stablecoins, so that the dollar—and U.S. power—remains at the center of the emerging global digital currency ecosystem.

Second, the U.S. should be prepared to rely more heavily on so-called secondary sanctions. Secondary sanctions are sanctions where the U.S. threatens to sanction a third country firm, such as an Indian firm, simply for transacting with a party already sanctioned by the United States. The U.S. has historically been wary of secondary sanctions because they impose substantial diplomatic costs—other countries don't like being told to cut off business with third countries. But secondary sanctions are an important part of American leverage.

Take the price cap. The U.S. could, in principle, threaten to impose sanctions on oil refineries in countries like India and China that currently buy Russian oil at a price that exceeds the cap by using Russian or other non-Western ships and services, or on banks that process payments for Russian oil that exceed the cap, even if the payments are denominated in foreign currencies and never touch the U.S. The threat of secondary sanctions would dissuade many oil importers and refiners from buying oil above the cap given that they would then lose access to U.S. dollar financing, technical expertise, and other services.

Perversely, the U.S. reluctance to use secondary sanctions may have encouraged the creation of non-Western trade and financial networks. The threat of secondary sanctions means that an Indian refiner or a Chinese bank faces the risk of costs for trading Russian oil above the cap regardless of how the transaction is structured. Without the threat of secondary sanctions, the refiner or bank has an incentive to structure the transactions to avoid using U.S. services and payment channels.

Finally, American policymakers need to continue to innovate. The three decades since the 1990s have seen a period of remarkable innovation in sanctions. The current concept of U.S. targeted sanctions, the "SDN list," was effectively invented in the 1990s. Since then, the U.S. has created myriad different kinds of sanctions that seek to use different types of leverage. The Trump administration came up with a major innovation in export controls when it subjected Huawei, the Chinese telecoms firm, to the "foreign direct product rule," effectively saying that if a U.S. widget, or U.S. software, was used in the design or manufacture of a computer chip, that chip could not be sold to Huawei—even if the chip was made outside the United States. If our financial infrastructure becomes a relatively less impactful source of leverage, we need to find alternatives to replace it.

Sanctions will remain a popular policy tool for American policymakers. Even if they don't achieve stated objectives, they can address a political need to act and can, at the very least, signal opprobrium to global audiences. But America also needs to recognize its limits and the need to adapt to a changing world.

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