Transcript of IMF podcast:

Nicholas Mulder on Sanctions as a Weapon

Nicholas Mulder:

I think what history really shows is that the effects of sanctions can be radically different depending on the cases and the episodes in which they are used. It also very much depends on timing and on the particular moment. And that's key right now.

Bruce Edwards:

So sanctions are not new, but placing a wide array of trade restrictions on an economy the size of Russia's, today, has far greater consequences on the global economy than ever before.

Nicholas Mulder:

My name is Nick Mulder, I am assistant professor of history at Cornell University, and I've just published a book called "The Economic Weapon: The Rise of Sanctions as a Tool of Modern War," which came out with Yale University Press in January, should be out in paperback by October. And I write a lot about international politics and economics with a particular focus on the history of economic sanctions.

Bruce Edwards:

Nicholas Mulder is also the author of "The Sanctions Weapon," an article published in Finance & Development.

Thank you so much for being on the podcast.

Nicholas Mulder:

Yeah, very glad to be here.

Bruce Edwards:

So, we've seen a lot of economic sanctions in the past- and some that continue today. And I'm thinking of North Korea in particular, but there are other examples, like Cuba and Iran, that have been dragging on for years without too much impact on the rest of the world, actually. So, what's so different about these sanctions on Russia?

Nicholas Mulder:

So, for a long time sanctions were something that was mainly used by Western countries as a tool to contain certain governments, or express disapproval towards the policy of governments. And it tended to be a tool that was used by Western states against small countries, smaller, medium-sized economies oftentimes, also lower and middle income countries. And, as a result of that, there wasn't that much of a spillover effect into the rest of the world economy.

And I think that's the first place to start when we want to understand why these sanctions against Russia are so different. The size of Russia in the world economy is very different. It's the 11th largest economy in the world. And it's very connected with a lot of other economies, both advanced economies for which it acts as an energy supplier, and a lot of emerging markets that it's connected with as well, and developing countries to which it supplies, especially food and fertilizer.

So, when you then impose sanctions against an economy like Russia, this will have dramatic spillover effects. And I think that's one of the reasons why we're having this conversation also, right? under the auspices of the IMF, because previously sanctions didn't really feature as a microeconomic event because they were usually imposed against countries too small to really register.

Bruce Edwards:

So, in your book and in this piece in Finance & Development, you essentially lay out the geopolitical landscape in the '30s when the first real effort was made by the international community to try and persuade a country to change its ways through economic sanctions. And that was triggered by Mussolini's invasion of Ethiopia. So, what was the story then and how much did Italy and its allies actually feel the pinch from those sanctions?

Nicholas Mulder:

Yeah so, the reason that I picked that comparison is because I think it's important to try and grasp the significance of these sanctions to look for episodes we can compare to that are similar in size, scale, and proportion to not compare things of a radically different quality with each other. And that's what brought me back to the 1930s, also, because I study that decade in a lot of detail. But also because I think that, even though it's a bit further removed from us in time, it looks at sanctions with macroeconomic spillover effects and used against large countries.

And Italy was at that point, I think the seventh or eighth largest economy in the world. And it became a target for sanctions by the League of Nations because it invaded another league member state, Ethiopia. And this was the first time that an international coalition of countries came together to use sanctions. And one of the things that they had to figure out was whether to impose very severe sanctions very quickly, or to gradually build up the pressure- begin with some measures, and then expand them to things like an embargo on oil and coal exports to Italy. And, in that sense, there are quite a lot of similarities with what we're seeing today. That we have begun with sanctions against Russia in Western countries, and now, have to see if we want to continue further with them or keep the pressure at its current level, given the kind of economic effects that it has on the rest of the world.

Bruce Edwards:

So, how would you compare that scenario with what's going on today with Russia, I mean, in terms of the overall impact of economic sanctions?

Nicholas Mulder:

Well, one of the important things to remember is that in the 1930s, these sanctions were taking place in the wake of the Great Depression, which was a huge economic crisis that actually led to the globalization of the early 20th century coming undone in many ways. So, there was a lot less world trade than in previous decades. And this also meant that countries were already gripped by a lot more economic nationalism. There was less interdependence between them. And as a result, actually, the spillover effects of sanctions against Italy were relatively modest. They weren't necessarily very big also because Italy wasn't a crucial exporter of essential goods that weren't obtainable in other places. Then, as now, for example, is very advanced in high quality, luxury and fashion exports, textiles... But those aren't exactly the sort of things like oil and gas that are vital to entire economies.

So, the spillover effects from Italy being put under sanctions were relatively minor. But what was not minor was that this was taking place in a context of real geopolitical tension and militarization. And, of course, there was a war going on. And Italy militarized further in response to the sanctions. Rather than actually give in and accept the demands of the sanctions to withdraw from Ethiopia, they doubled down on their campaign. They began to wage a more brutal war. And then, afterwards also became permanently militarized against a lot of the liberal countries in the world. So, it's also a kind of cautionary tale and it shows that there was a threat at that time of military escalation.

Now today there's of course also a lot of military tension, but I actually think that the chances of military escalation are somewhat lower due to a variety of factors: the power balance between NATO and Russia, the existence of nuclear weapons. So, in that sense, that's good news. And I explained in the article why I think the chances of military escalation today are somewhat lower. But the economic spillover effects today are more significant. That's because Russia is more connected to more different countries. And because, in general, the degree of globalization that we have in the world today is higher than in the 1930s. So, these ripple effects travel much more quickly and across many more countries. So, that's how I would compare the two episodes. At that time, limited economic, but quite a lot of military escalation risk. And today, less pronounced military escalation, but a much higher chance of economic spillover effects as indeed, we're seeing at the moment.

Bruce Edwards:

So, essentially, the nature of the effects of sanctions has changed. And all your writing is about sanctions as a weapon. Would you say it's more of a weapon today, in that context?

Nicholas Mulder:

It depends on the eye of the beholder in a way, and where you're located in the world. I think one thing that is more important even today than it was ever before is how to manage the effect of sanctions on third countries that are not involved in the actual dispute, at least the sanctions. And I think that's particularly important today when it comes to emerging markets and developing economies because they're having to deal with much higher energy and food prices- and due to no fault of their own. This is simply something in global markets that is hitting them, and they already have a number of serious issues and challenges that they're facing from recovery from the pandemic to debt burdens, the energy transition and all sorts of other issues.

So I think in that sense today, we need to think much more carefully about how do we craft macroeconomic policy at a global level that can offset some of the shock of these sanctions on third countries, because it's also very important if we want to make an argument that some kind of sanctions are important to enforcing important international norms, like respect for territorial integrity, we should also figure out how to keep them legitimate. If this is something that simply goes hand-in-hand with economic impoverishment, for a large part of the world, they're going to lose their legitimacy much more quickly.

Bruce Edwards:

And you mentioned a little earlier there, globalization and how that kind of exacerbates the problem today given that economies are so integrated, or I guess much more integrated than they were in the '30s and '40s. So how much does all of this have to do with the US dollar dominance in the international financial system? How much does that have to do with all this?

Nicholas Mulder:

Yeah, well, I think it certainly has a great deal to do with it, but not in every respect. So, let me explain a little bit more, what I mean by that. The US dollar is a really important conduit for the ability of the United States and its allies to impose sanctions. And one of the ways in which it works is, of course, that many banks and many financial institutions do a lot of their borrowing and lending in US dollars. Their balance sheets are very largely denominated in US dollars.

And one of the effects of that is that the United States government oftentimes, confined a leg of every financial transaction, even if it happens in a totally different region like Asia Pacific or Latin America, and exploits the fact that there is a dollar leg to that transaction that takes place in a US jurisdiction, and that gives them sanctions power.

So, in this case, what you are seeing is that the sanctions are focused on the Russian financial system and on particular large financial institutions, but a lot of banks, also Western banks and Asian banks, including Chinese banks for example, are no longer doing trade finance for all sorts of trade, including trade that is not under sanctions, such as grain, food shipments, commodities in metals of various kinds. So, there's a larger effect, a chilling effect you might say, of the sanctions, and that is influencing the lending decisions of banks in the global dollar system. And that's affecting trade that is not strictly speaking under sanctions, but that is thereby affected. So, you can see, for example, that fertilizer exports from Russia have fallen by 25%, even though there are no sanctions on fertilizer exports. That's- insurance, finance issues, compliance risks, all these things, as a result, I think affect a wider range of transactions than they normally would.

But then, there's also still a large degree of old-fashioned trade interdependence... in Central Asia, there, it is very important- they are very interconnected with Russia. In February and March when the ruble saw a steep collapse before it recovered, these economies- currencies- so Kazakhstan, Tajikistan, Turkmenistan, Uzbekistan also saw their currencies collapse. They have large migrant worker populations that are working in Russia, and they, through remittances, uphold a lot of the balance of payments in these countries. So, for them, this is going to be a big adjustment too.

And then, another effect is that because Russia cannot import high-tech components anymore, its manufacturing exports have also dropped off. These countries buy a lot of old Russian hardware, and they also are importing less of that as a result. So even though Central Asian economies, which have actually expressed quite a lot of disapproval of Russia's actions in Ukraine, are not the target of our sanctions, they are being affected in a variety of ways.

Bruce Edwards:

So in the end, I mean, do you believe that sanctions are in fact an effective means of persuasion?

Nicholas Mulder:

Well, I'm a bit wary of trying to answer the question in general terms because that's definitely the temptation for social scientists, for political scientists, economists, to try and come up with some sort of generalizable answer. But I think what history really shows is that the effects of sanctions can be radically different depending on the cases and episodes in which they are used. It also very much depends on timing and on the particular moment. And that's key right now, we are in a moment in the world economy where we're coming out of the recovery of the pandemic, but there's also a shift happening in the global financial cycle now, as advanced economy central banks are beginning to tighten financial conditions. All of that's playing into this. And you cannot run sanctions in a totally controlled experiment. You're always dealing with other circumstances that are interfering with them- legacies from the past.

And so, that's why I think that even the same measures against the same country, at two different moments, can have very different effects. And right now the circumstances are not particularly propitious, or beneficial when it comes to creating those effects. There's also just a limit right now, as a result of these difficult economic circumstances to how far the sanctioning countries can push these measures without imposing real damage on themselves. And you're already starting to see that in advanced economies, which have much more fiscal space, much more ability to adapt than emerging markets and developing economies. Even there, we're beginning to see public opinion turning against the idea of further pressure, if this will lead to higher oil and gas prices, for example.

So, in general, there are cases where sanctions have worked, but you require also, an element of luck, and the right background conditions. And those can be influenced, but only to a limited extent.

Bruce Edwards:

And so, how do we protect people from the perils of economic coercion? to use your own words...

Nicholas Mulder:

Yes. So, there's a number of things that we can do in order to offset the damage done by sanctions, but the basic idea that we need to keep in mind is that sanctions are a conscious policy intervention. And if they have negative effects, then we might be able to think of other policy interventions that could mitigate some of those effects.

Bruce Edwards:

Nicholas Mulder is the author of "The Economic Weapon: The Rise of Sanctions as a Tool of Modern War." Thanks for joining us today.

Nicholas Mulder:

Thank you for inviting me to the podcast, Bruce.

Bruce Edwards:

Nick Mulder is also the author of an article titled "The Sanctions Weapon" published in the June issue of Finance & Development Magazine. Check it out at imf.org/fnd.

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I'm Bruce Edwards, thanks for listening.