

Impact of lifting economic sanctions on poverty and growth

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Question

What are the impacts and consequences of lifting economic sanctions on poverty and economic growth? With the purpose of informing policy in Sudan, use case studies with similar dynamics to formulate lessons from other countries that have had sanctions lifted.

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1. Overview

A number of scholars have highlighted the negative impact that economic sanctions have on the average population, whilst arguing that elites generally find ways to negotiate the sanctions (Mack & Khan, 2000; Neuenkirch & Neumeier, 2015, 2016; Oechslin, 2014; Peksen & Drury, 2010). Moreover, these scholars also demonstrate the failure of sanctions to reach their desired result in most cases. Thus, the lifting of sanctions has a considerable impact on both poverty and economic development. However, the impact of the previous sanctions often creates a more vulnerable socio-economic environment which requires specific interventions to encourage economic development once the sanctions are lifted in order to encourage economic development and to ensure that the poverty gap does not increase.

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This rapid review synthesises findings from rigorous academic, practitioner, and policy references, focusing on recent and seminal works with the aim of highlighting the impact of lifting sanctions on poverty and economic development. There is a further aim of helping to inform policymakers in Sudan in the event of sanctions being fully lifted. Therefore, an analysis of the impact of lifting sanctions in other countries – Myanmar and Iran – with an economy also reliant on hydrocarbons will form the basis of this review. Countries like Cuba (where tourism dominates the economy), who have also recently had their sanctions lifted, were discounted as the dynamics of their economies bore little resemblance to Sudan and therefore minimal lessons could be gained.

It must be noted that all countries respond differently to sanctions, and the lifting of sanctions, due to political, historical, geographical and economic factors. However, there are still lessons available, provided they are contextualised within the dynamics of the country studied.

The literature regarding sanctions does not often focus on the impact of lifting sanctions and studies that do are predominantly prediction orientated analyses. Consequently, the impact of lifting sanctions will be analysed based on extracting evidence from the countries' responses, policy suggestions, and prediction model analyses using the case studies of Iran and Myanmar.

Key findings are as follows:

- The structural, economic, and social damage caused by sanctions is immense, and thus significant investment is needed to rebalance the society.
- For oil producing countries where significant income will be achieved in one area following the lifting of the sanctions, it is recommended that an independent sovereign wealth fund for investment is created in order to address the above imbalances.
- Technologies and standards are developed during the time of the sanctions, leaving industries behind their international competitors when sanctions are lifted. Thus, investment is needed for modernisation in order to make them competitive again.
- Following the lifting of sanctions, banks and businesses are often sceptical of the reputational risk and the lack of clarity of the sanctions lifted and these fears need to be eased in order to boost business and investment.
- Sanctions result in the financial and banking sector falling behind in international standards of practise, thus they require considerable restructuring in order to attract international business.
- In oil-rich countries, sanctions often lead to the rest of the economy being left behind and oil becoming the centre of the economy, upon the lifting of sanctions the influx of foreign currency can lead to considerable appreciation of the local currency, which further damages the rest of the economy as imports become cheaper.
- Following the lifting of sanctions the pressure on the exchange rate needs to be balanced through expansionary monetary policies that allow the currency to appreciate within a reasonable limit.
- Serious investment and resources are needed for the diversification of the economy following the lifting of sanctions.
- Financial legislation and industrial and trade policies need to be adapted in order to create an attractive environment for foreign direct investment and increase access to capital, technology, and market opportunities.

- The lifting of sanctions can worsen the income gap, as elites manage to take advantage of the opening up of the markets and cheap imports become available, thus funds must be spent on developing the wider economy and creating jobs.

2. Lifting Sanctions

Sanctions have a significant impact on the economic growth and levels of poverty of the sanctioned countries. For instance they:

- lead to an increase in the poverty gap with deprived sections of the population feeling the impact the most (Neuenkirch & Neumeier, 2016);
- damage income inequality (Afesorgbor & Mahadevan, 2016);
- create regional imbalances, as resources are refocused to power and production centres (Lee, 2016);
- can result in leaders magnifying the sanctions' negative effect on the economy to prevent the population from revolting (Oechslin, 2014);
- significantly decrease the GDP per capita of the sanctioned countries (Neuenkirch & Neumeier, 2015);
- damage the economic growth of women, minority communities and other marginalised groups (Drury & Peksen, 2012);
- have a negative impact on the living standards and humanitarian situation of the population (Rarick, 2006).

Therefore, once sanctions are lifted there is a great deal of damage that needs to be repaired. Alnasrawi (2001) argues that the damage caused by sanctions on the economy, poverty gap, standard of living, and infrastructure greatly impact the cost and period of reconstruction and economic growth following the lifting of the sanctions or regime change. Whilst Afesorgbor and Mahadevan (2016) argue that the widening income equality caused by sanctions is difficult to address even once sanctions are lifted. This further compounds the issue of the economic recovery and negatively impacts the process. Thus, even though the lifting of sanctions creates new opportunities, not everyone can take advantage of these and this can often lead to segments of the society being left behind.

Beyond the structural and socioeconomic damage that sanctions cause, they also change the dynamics of the economy, which needs to be considered when lifting sanctions. For instance, sections of the economy that previously relied on markets which they may no longer have access to, for either the sale of their goods or the purchase of parts or equipment, would need significant investment and development once sanctions are lifted in order to make them competitive again. Economies, particularly mineral rich ones, also tend to refocus on areas where they can still attract business, thus making the economies overly dependent on these areas, therefore significant investment and resources need to be focused on diversification in the event of sanctions being lifted. Finally, the opening up of the world markets also has dangers, as if not managed properly it can lead to currency appreciation, which in turn would have a negative impact on local production as international markets become cheaper.

Below, these elements are contextualised using the case studies of Myanmar and Iran, which like Sudan have economies largely dependent on oil exports and have recently gone through the process of having sanctions lifted.

3. Myanmar

The EU and US first imposed sanctions against Myanmar in 1991 and 1997 respectively. These sanctions were gradually increased as Myanmar was perceived to be making no progress towards democracy nor demonstrating respect for human rights. Alongside the targeted sanctions, the EU (1997) and US (1989) withdrew the Generalised Scheme of Preferences (GSP), which allows exporters from developing countries to pay less import duties or none at all. Since 2011, Myanmar has initiated vital political and economic reforms and the EU and US suspended sanctions, with the exception of the arms embargo, in 2013 and 2016 respectively (Giumelli & Ivan, 2013; Hadar, 1998).

Impact of Sanctions

According to Portela (2014), the arms embargo has had little impact on Myanmar, as they have managed to buy arms from China, Russia, Ukraine, Serbia, India and North Korea, and would not be able to afford much of the arms available from the US or EU. The gems and timber embargoes impacted legal traders mainly, as it forced trade to go through intermediaries in Thailand. GSP suspension is argued to have affected the economy generally, rather than directly impacting the areas it targeted, thus by implication penalising the population at large. Portela argues that sanctions in Myanmar shielded the country from external influence while contributing to its underdevelopment by giving an excuse for economic under-performance in Myanmar due to economic mismanagement. The majority of the sanctions did not impact the regime at the same level, as they aligned themselves closer to China, India, and Thailand, managing to sell natural resources whilst the rest of the economy struggled (Portela, 2014). An indirect effect of the sanctions imposed on the mining industry is that it is now lagging behind in terms of standards and efficiency (Grabo, 2016).

Impact of Lifting Sanctions

Using a gravity model to distinguish if the actions of imposing and lifting the sanctions on Myanmar had significant effects on the EU's imports from Myanmar, Grabo (2016) argues the EU's imports from Myanmar were positively affected by the lifting of the sanctions, but the imposition of sanctions did not have a significant effect. However, sanctions did influence the post-sanction era, as new requirements, technologies, and standards were developed during the time of the sanctions, which prevented the industries reaching their full export potential after the lifting. At the same time, following the lifting of sanctions banks and businesses were still sceptical of the reputational risk and the lack of clarity of the sanctions lifted, leading to some still avoiding doing business in Myanmar (Grabo, 2016).

During the sanction era in Myanmar there was a significant rise in the exports of natural resources; in 2000 it only accounted for 5.4 percent of total exports, whereas by 2008 this figure stood at 48.8 percent. During this time, Myanmar's per capita exports (\$159 in 2010) have remained the lowest among members of the Association of Southeast Asian Nations (ASEAN).

The sharp rise in resource exports, along with the poor performance of the rest of the economy, has increased the concern about the effects of Dutch disease.¹ Kubo (2014) measures trade potential with the theoretically predicted trade value by using an augmented gravity model with data from 10 neighbouring countries in South Asia and South-East Asia. According to Kubo, if the possible Dutch disease effects of natural resource exports are taken into account the counterfactual prediction values are less than the actual non-resource exports, implying limited room for non-resource export growth even after the lifting of sanctions. The lifting of sanctions restored access to EU and US markets, and reinstated the benefits of GSP, which in turn enhances Myanmar's exports to these destinations. Apparel, including footwear, will be an important item for export to the US and EU in the immediate future. However, when the impact of Dutch disease is taken into account, Myanmar may not follow the growth path of other resource-rich South-East Asian countries that achieved economic diversification despite their abundant natural resources, such as Indonesia, Malaysia and Thailand. This is due to Myanmar having the highest ratio of natural resource exports to total exports in South-East Asia (Kubo, 2014).

4. Iran

Iran first faced sanctions from the US during the 1979-81 hostage crisis following Iran's Islamic Revolution. Iran has since faced international sanctions for its nuclear programme, which violates its obligations to the Non-Proliferation Treaty (NPT). These sanctions were implemented by the UN in 2006 and the EU in 2007 (more substantially since 2010), whilst the US has steadily increased its sanctions since 1979 (Patterson, 2013). Due to Iran's compliance with an agreement that was reached and endorsed by Iran and the P5+1 in July 2015, the sanctions were largely lifted in January 2016 (Einhorn, 2016).

As sanctions against Iran were only lifted, and in some cases eased, in January 2016, there is not much written yet as to the impact it has had on the economy. However, there are many projections as to what the impact would be, which can be analysed to gain a better understanding of the impact of lifting the sanctions in Iran. However, it is first important to examine the impact of the sanctions themselves on poverty and economic development.

Impact of Sanctions

Sanctions against Iran have had a negative impact on the economic growth as the economy has gradually contracted as a result of the limited markets. Since the tightening of sanctions in 2012 growth dropped to negative 6.8 and 1.9 percent in 2012 and 2013 respectively, with oil production dropping by one million barrels a day. Production in the auto industry declined by half and in the construction sector by 3.6 and 3.1 percent in 2012 and 2013 respectively (World Bank, 2015).

¹ Dutch disease is the negative impact on an economy of anything that gives rise to a sharp inflow of foreign currency, such as the discovery of large oil reserves. The currency inflows lead to currency appreciation, making the country's other products less price competitive on the export market. It also leads to higher levels of cheap imports and can lead to deindustrialisation as industries apart from resource exploitation are moved to cheaper locations.

In 2014, GDP per a head fell a significantly by 17% from \$6376 to \$5293; this contraction was said to be the result of sanctions affecting the energy, banking and financial sectors, since increased sanctions in 2012. The sanctions targeted oil exports, which is the Iranian economy's main source of funds. As a result the oil output in Iran drastically decreased between 2012 and the lifting of sanctions in 2016. At the same time, inflation in Iran increased from 10.7% in 2009/10 to 39.266 % in 2013/142, resulting in more people living below the poverty line. High inflation was partly down to the significant increase in the cost of importing and exporting goods. Male youth unemployment stood at 26.4% in 2013, whilst female youth unemployment stood at 41.7% in 2013. Thus, sanctions had a dramatic impact on the economic growth and poverty levels in Iran, leading to high levels of unemployment, high inflation and a falling GDP (Farzanegan, 2015).

Impact of Lifting Sanctions

As already highlighted, due to sanctions Iran's economy contracted and hydrocarbons became the main economic driver, albeit at a reduced level. Using a global general-equilibrium simulation model to quantify the global effects of lifting Iran's economic sanctions, Ianchovichina et al. (2016) argue that lifting Iran's economic sanctions would lead to a per capita welfare rise of 3.7 percent, mainly due to the lifting of the oil embargo. However, the benefits in the short-term would stem from the hydrocarbon industry, rather than any significant expansion of the rest of the economy. If the lifting of sanctions lead to Iran's oil exports returning to the pre-2012 levels, one million barrels per day could be added to the world market, which in turn would bring down prices and lead to potential Dutch Disease (Ianchovichina et al., 2016). In order to deal with Dutch disease Iran established an oil stabilisation fund in 2000 with the aim of reducing the volatility effects of oil revenues on the macro economy. However, according to Farzanegan (2015) the board lacks independence from the centres of power in Iran, thus politicising the institute and preventing it from carrying out its duties for the benefit of the country rather than the ruling elite.

In Iran, the possibility of Dutch Disease is a tangible reality, as Iran's strong reliance on oil exports could lead to an appreciation of the local currency. It is predicted that local non-tradable goods' price will rise, as they are not set by the international markets and the labour will gravitate towards them away from local production. Moreover, as the Iranian Rial rises, so will the cost of their exports, thus making them less competitive on the international market. At the same time, imports will become cheaper, further antagonising the issue. Therefore, the increase of oil production and the resulting increase of revenues need to be managed carefully and there needs to be adequate support for exports and diversification (Holtz et al., 2017).

According to Holtz et al. (2017) to counteract Dutch disease Iran should:

1. Use its sovereign wealth fund to manage the inflow of investments and invest in economic diversification, thus directing and controlling the demand surging into the economy in order to keep the non-oil sector competitive and promote long-term sustainable growth.
2. Adapt financial legislation as well as industrial and trade policies in order to create an attractive environment for foreign direct investment and increase access to capital, technology, and market opportunities.
3. Balance pressure on the exchange rate through expansionary monetary policies that allow the currency to appreciate within a reasonable limit. For example, providing more currency to slow the Rial's appreciation whilst monitoring inflation.

Using annual data from 1970-2012, Farzanegan (2016) examines the response of income inequality to the positive oil rent shocks in Iran with the purpose of examining the impact of lifting the sanctions on income equality. He finds that oil booms worsen income distribution in Iran. Therefore, the increase of oil production and export following the lifting of the sanctions will result in a widening of the poverty gap, rather than having a positive result on the wider population, as oil incomes are not distributed beyond the elites.

Aside from the hydrocarbon industry, sanctions heavily impacted the automobile and pharmaceutical industries in Iran, with the production of cars falling from 1.6 million prior to the tightening of sanctions in 2012 to 700,000 after. This was mainly down to the increased cost, as well as ban, of importing parts as well as the machinery to make production more efficient. Therefore, these industries are highlighted as needing investment and development in order to make them competitive and allow the economy to grow beyond the hydrocarbon industry. However, the labour market in Iran has deteriorated to such a level that it is estimated that the Iranian economy needs to create five million jobs over the next 5 years to keep the unemployment rate at 10 percent, thus diversification needs to extend well beyond these two industries (Word Bank, 2015).

As development in Iran has stagnated as a result of the sanctions there are a number of areas that need investment and new technologies. For instance, the aviation and rail infrastructure sectors in Iran need to be updated. However, due to the ambiguity of the US' long-term position on the deal there is an unwillingness of banks to commit to doing business with Iran over fears of future prosecution by the US. Therefore, more needs to be done to encourage international organisations to invest in, and do business with, Iran. At the same time, Iran's financial and banking sector has fallen far behind in international standards of practise as a result of the sanctions, thus it requires considerable restructuring if it is to attract international business and financing and this is an area the Iranian government needs to focus on (Sharab, 2016).

5. Lessons for Sudan

The economy of Sudan has long been neglected with the majority of funds being spent on arms and localised conflicts, leaving education and technological developments severely behind international standards. Moreover, the exports of hydrocarbons have become the basis of the economy, as the rest have suffered due to the sanctions (Aluoch, 2015; Nour, 2014). Sudan is neither an attractive place to invest nor do business due to excessive regulations, as well as the regressive financial and banking sector. Additionally, due to a lack of investment in, and access to foreign, technologies the industries are far behind their international counterparts which will impact their competitiveness in the light of sanctions being lifted (Arabi & Abdalla, 2013). Sudan has also failed to deliver basic services during the sanction period or develop infrastructure often using sanctions as an excuse, thus needing significant development and investment upon the lifting of sanctions (Elsheikh and Elamin, 2016). Sudan also has high unemployment rates of 17 percent, as well as low employment opportunities, which contribute to the economic disparity found in many regions of Sudan.²

² <https://borgenproject.org/poverty-sudan/>

Correspondingly, there are many lessons for Sudan from both the actions taken in and the actions developed for Myanmar and Iran to deal with the issues above once sanctions are lifted. Namely:

1. The creation of a sovereign wealth fund in Iran is an important lesson, as it allows for the wealth from hydrocarbons to be used to finance development, manage and diversify the economy, and control the currency. However, as highlighted with the case of Iran, independence is key so that the fund works for the interests of general population and not the elites. Many of the lessons below are connected to having a funding scheme available in order to carry out these policies.
2. Due to the technologies and standards having developed considerably during the time of the sanctions, investment is needed for the modernisation of the industries in order to make them competitive again.
3. As an oil-focused economy, like Iran and Myanmar, Sudan will have to manage the effects of Dutch Disease carefully to ensure the economy doesn't falter.
4. Serious investment and resources are needed for the diversification of the economy following the lifting of sanctions.
5. The exchange rate needs to be balanced through expansionary monetary policies that allow the currency to appreciate within a reasonable limit.
6. Financial legislation and industrial and trade policies need to be adapted in order to create an attractive environment for foreign direct investment and increase access to capital, technology, and market opportunities.
7. At the same time, the financial and banking sector need restructuring in order to attract international business.
8. The economy and job market need to be developed carefully so that the population as a whole can benefit from the lifting of sanctions, rather than elites managing to take advantage of the opening up of the markets at the expense of the wider population.
9. Clarity needs to be created, by and amongst the international community, over the position of the sanctions in order to ensure that banks and businesses are do not fear a reputational risk or future fines as a result of doing business in, and with, Sudan.

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Key websites

- World Bank Open Data: <http://data.worldbank.org/>
- World Bank Sudan: <http://www.worldbank.org/en/country/sudan>
- Rural Poverty Portal: <http://www.ruralpovertyportal.org/country/home/tags/sudan>

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