

A NEW PLAYBOOK: MAKING SANCTIONS MORE EFFECTIVE

By DR HELENA IVANOV and DR THEO ZENOU



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**CENTRE FOR
RESILIENT
SOCIETY**

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Foreword

In an increasingly complex and contested world, the ability of democratic nations to project influence and uphold international norms without recourse to force is more vital than ever. Economic sanctions, particularly financial sanctions, have emerged as one of the most effective tools in our diplomatic arsenal. When thoughtfully designed and rigorously enforced, they allow us to respond to aggression, corruption, and malign activity with precision and resolve.

This timely and incisive report makes the case for strengthening the strategic use of financial sanctions. It sets out the evolution of these measures, analyses their strengths and limitations, and, crucially, offers a clear-eyed assessment of the growing threat posed by sanctions evasion and exploitation of financial loopholes. As the report rightly argues, sanctions are not a silver bullet, but with coordinated international action and targeted enforcement they can exert real pressure on those who defy international rules.

To ensure sanctions remain a credible instrument of foreign policy, we must continually adapt. This report provides an important blueprint for doing so, and makes a compelling contribution to the wider debate on how liberal democracies can defend their interests and values in a dangerous world.

Dr Neil Shastri-Hurst

Conservative MP for Solihull West and Shirley



About Us



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About The Henry Jackson Society

The **Henry Jackson Society** is a think-tank and policy-shaping force that fights for the principles and alliances that keep societies free, working across borders and party lines to combat extremism, advance democracy and real human rights, and make a stand in an increasingly uncertain world. The Henry Jackson Society is a company limited by guarantee registered in England and Wales under company number 07465741 and a charity registered in England and Wales under registered charity number 1140489.

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About the Centre for Resilient Society

The **Centre for Resilient Society (CRS)** is a citizen-focused, international research centre within the Henry Jackson Society, which seeks to identify, diagnose and propose solutions to threats to the social resilience of liberal Western democracies.

The centre’s work includes addressing the twin challenges posed by radicalisation and terrorism. The centre is unique in addressing violent and non-violent extremism. By coupling high-quality, in-depth research with targeted and impactful policy recommendations, it aims to combat the threat of radicalisation and terrorism in our society.

The centre’s work also includes broader challenges of democratic resilience – including threats from both foreign interference and domestic issues. This includes the potential harm that various forms of social, cultural and political insecurity, conflict and disengagement can pose to the long-term sustainability of democracies, including the resilience of their institutions, public policy outcomes, citizens’ health and wellbeing, and economic growth and prosperity. It also explores the balance between free speech and hate speech, and encourages respectful debate between those of different views, rather than cancellation. Moreover, it underscores how social and political instability can make nations vulnerable to internal and external actors seeking to deepen cleavages, undermine consensus and, ultimately, to weaken democratic functioning.

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Executive Summary

Economic sanctions have become a cornerstone of modern international diplomacy, increasingly employed by governments around the world to advance a wide range of foreign policy objectives – from deterring armed conflict to disrupting illicit financial flows and combatting corruption. This report provides a comprehensive analysis of financial sanctions, tracing their historical evolution, operational mechanisms and real-world effectiveness.

As we demonstrate throughout, financial sanctions offer several advantages over alternative policy tools – notably traditional diplomacy and military intervention. However, these measures are not without their limitations. Chief among the challenges is the growing sophistication of sanction evasion tactics. This report examines, in particular, the risks posed by foreign investment in distressed debt, which can significantly dilute or circumvent the intended impact of sanctions.

Moreover, while financial sanctions do impose economic costs, their overall effectiveness is often undermined by the adaptability of targeted regimes, geopolitical fragmentation and the lack of coordinated enforcement across jurisdictions.

To address these vulnerabilities, this report puts forward a series of concrete policy recommendations. These include improving the design of sanctions, modernising compliance frameworks, closing loopholes in distressed debt markets and strengthening international cooperation – particularly through enhanced public-private collaboration.

We firmly believe that, if adopted, these measures would significantly enhance the strategic impact of financial sanctions and reinforce their role as a credible and effective instrument of foreign policy.

Introduction

In modern-day politics, financial sanctions stand among the most frequently employed tools in the foreign policy arsenal of governments worldwide. Often seen as preferable to military interventions that are politically untenable, and with diplomacy alone frequently insufficient in achieving desired results, the appeal of sanctions lies in their ability to exert pressure without use of force, offering a flexible and scalable response to a wide range of geopolitical challenges.

The US International Trade Commission defines sanctions as:

‘... the deliberate, government-inspired withdrawal, or threat of withdrawal, of customary trade or financial relations.’ More specifically, sanctions are punitive measures (for example, prohibiting trade, stopping financial transactions, or barring economic assistance) imposed by one country, group of countries, or a multilateral body (for example, the United Nations (UN)) on a target country, entity, or group of individuals that violate international norms.¹

While sanctions have been a tool at the disposal of governments for a very long time, according to the Federal Reserve Bank of New York:

... the use of sanctions, especially financial, has increased over the last seventy years. Financial sanctions have been particularly important whenever the goals of the sanctioning countries were related to democracy and human rights. Financial sanctions restrict entities – countries, businesses, or even individuals – from purchasing or selling financial assets, or from accessing custodial or other financial services.²

Thus, many Western governments frequently resort to financial sanctions in situations where they believe such measures can deter conflict or prevent a state from waging an unjust war. Sanctions may also be imposed on individuals in response to allegations of corruption or human rights violations, as well as on entities where there are concerns related to democratic backsliding or broader human rights abuses.³

As the use of sanctions increased in scope and frequency, governments around the world developed a broad and increasingly sophisticated toolkit of sanctions, allowing them to tailor their responses to a wide range of geopolitical challenges. Importantly, governments have also learned critical lessons from past sanctions regimes and have worked hard to refine and improve their design in order to minimise unintended humanitarian consequences. In earlier cases – such as Iraq or the former Yugoslavia in the 1990s – broad, comprehensive sanctions were imposed with the aim of weakening authoritarian regimes.

However, these measures often resulted in significant collateral damage, disproportionately affecting ordinary citizens rather than the ruling elites. Entire populations were subjected to shortages of food, medicine and basic services, exacerbating poverty and human suffering while doing little to dislodge entrenched regimes. In many instances, the most vulnerable – who were already victims of state repression – were further punished by the very international community that sought to help them.

¹ Sarah Krulikowski, “Economic Sanctions: An Overview”, Office of Economics, U.S. International Trade Commission, March 2024, https://www.usitc.gov/publications/332/executive_briefings/ebot_economic_sanctions_overview.pdf.

² Marco Cipriani, Linda S. Goldberg and Gabriele La Spada, “Financial Sanctions, SWIFT, and the Architecture of the International Payments System”, Federal Reserve Bank of New York, January 2023, https://www.newyorkfed.org/research/staff_reports/sr1047.html.

³ For a more detailed breakdown of countries and entities targeted by sanctions in the past see: Krulikowski, “Economic Sanctions: An Overview”.

Governments therefore began seeking ways to “accommodate the rising demand for multilateral sanctions while minimising the humanitarian cost such policies create.”⁴ And thus the so-called “smart sanctions” were created.

The logic behind smart sanctions is that for economic coercion to work properly, it is necessary to understand the domestic political economy of the targeted state. [...] What matters is not the target’s gross economic damage, but whether the target government and its key domestic constituencies feel significant economic pain from noncompliance. Smart sanctions are designed to raise the target regime’s costs of noncompliance while avoiding the general suffering that comprehensive sanctions often create. Like precision-guided munitions, smart sanctions target responsible parties while minimizing collateral damage. Examples include asset freezes, travel bans, and arms embargoes – measures that stand in stark contrast to the comprehensive trade ban against Iraq.⁵

Specifically, according to the US International Trade Commission:

Sanctions may be primary or secondary in relation to the sanctions target. Primary sanctions include international trade restrictions (e.g., trade embargoes and restrictions on particular exports to or imports from the target), financial sanctions (e.g., blocking of foreign assets or denial of foreign assistance, loans, and investments), and other prohibitions on economic transactions with the target. Secondary sanctions are used to maintain or put additional pressure on the sanctions target by penalizing third parties that engage with the primary sanctions target in activities that could undermine or evade the purpose of the primary sanctions. Depending on the circumstances, sanctions may be either selective (e.g., barring only certain trade and financial transactions) or comprehensive (e.g., halting all economic relations with the target country). Sanctions may vary in scope and involve broad prohibitions at the country level or targeted sanctions against an individual.⁶

Hence, sanctions now encompass a diverse array of financial, technological and individual-targeted measures. This growing versatility enables policymakers to apply sanctions in a more precise and strategic manner – whether to deter armed conflict, punish human rights abuses, curb the financing of terrorism or respond to cyberattacks and disinformation campaigns. The type and severity of sanctions is carefully calibrated based on the nature of the threat, the behaviour of the targeted actor (be it a state, an organisation or an individual) and the desired political or diplomatic outcome. This evolution reflects a broader shift in the international system – where economic and financial pressure has become a key instrument of statecraft in addressing complex security and human rights issues.

While sanctions remain a powerful instrument of international policy, they are not without significant risks and limitations. Chief among these is the ability of targeted regimes and individuals to circumvent restrictions, thereby undermining the overall effectiveness of the sanctions regime. A particularly striking example is Russia. Despite being subjected to an unprecedented wave of sanctions following its full-scale invasion of Ukraine, the Russian economy has displayed a surprising degree of resilience – outperforming many early forecasts. This economic stability has, in turn, enabled the Putin regime to sustain and finance its ongoing war effort.

⁴ Daniel W. Drezner, “Review: How Smart Are Smart Sanctions?”, *International Studies Review* 5, No. 1 (March 2003), <https://www.jstor.org/stable/3186500>.

⁵ Ibid.

⁶ Krulikowski, “Economic Sanctions: An Overview”.

Sanctioned countries often possess a range of strategies to mitigate the impact of punitive measures. One common approach is to reorient trade and financial flows towards non-aligned or neutral states. In Russia’s case, deepened economic engagement with countries such as China and India has helped offset the loss of Western markets. In addition, sanctioned individuals and entities may continue operations through companies based in jurisdictions not enforcing the sanctions, thereby creating parallel commercial channels.

Another less visible but highly consequential avenue of circumvention lies in the distressed debt market. This market involves the trading of debt belonging to financially troubled entities, often at steep discounts. For sanctioned actors, the sale of impaired assets through such channels can provide much-needed liquidity, even if at reduced value. Conversely, investors acquiring this debt – sometimes through opaque legal structures – may gain leverage or indirect control over key assets, thereby enabling further transactions or financial manoeuvres that blunt the impact of sanctions. These strategies often exploit regulatory grey areas and legal loopholes, making enforcement increasingly complex and resource-intensive.

In this report, we plan to examine the overwhelming benefits that sanctions regimes offer in comparison to the available alternatives – namely, military interventions and diplomatic pressure. In addition, we will examine the risks and challenges associated with sanctions – especially methods of circumventing them and eroding their effectiveness. Finally, this report will provide a set of clear policy recommendations that aims to resolve the aforementioned ways of evading sanctions, thereby further boosting their effectiveness. It is our belief that if these policies were implemented, sanctions regimes would prove more efficient in pressuring the sanctioned entities – individuals and states alike.

First, it is imperative to close the loopholes associated with distressed debt trading by introducing a blanket ban on the trading on secondary markets of bonds issued by sanctioned entities.

Second, we recommend the establishment of a dedicated sanctions regulator. This body would be tasked with auditing Western companies to ensure compliance and to prevent firms from exploiting legal grey areas to bypass restrictions.

Third, we argue for the continual refinement of smart sanctions. It is not enough to simply close existing loopholes; the design of sanctions must also evolve to ensure they effectively target sanctioned actors while minimising unintended consequences for the wider population.

Fourth, as the Russian case illustrates, continued trade with non-aligned states and private actors can significantly blunt the impact of sanctions. We therefore advocate for the introduction of measures that would deter non-aligned countries and businesses from engaging with sanctioned entities.

Finally, we stress the importance of regular review and adaptation. Sanctions must not be static; where they are found to be ineffective, they should be recalibrated. To this end, we propose the creation of an oversight body tasked with monitoring the impact and effectiveness of sanctions regimes and recommending adjustments where necessary.

The Benefits of Sanctions

Sanctions have proven to be one of the most effective instruments available to governments seeking to influence the behaviour of states, organisations or individuals engaged in activities that threaten international peace and security. While not without limitations, sanctions offer a powerful middle ground between diplomacy and military action, enabling states to respond forcefully without resorting to armed conflict.

When compared to traditional diplomatic tools – such as formal statements, bilateral negotiations or suspension of diplomatic relations – sanctions often yield stronger results, particularly in cases where the targeted actors have little incentive to abide by international norms. Countries such as Russia and China, for instance, have repeatedly demonstrated a willingness to defy global rules and norms when these do not align with their strategic interests. In such contexts, conventional diplomacy tends to fall short, as these actors are unlikely to be swayed by appeals to the rules-based international order. Sanctions, by contrast, can inflict significant and sustained economic pressure – through restricted access to capital markets, bans on critical technologies or freezes on overseas assets – which may ultimately compel behavioural change by raising the costs of defiance. Of course, that is not to say that sanctions combined with diplomatic tools cannot yield very effective results as well.

At the same time, sanctions are widely regarded as a preferable alternative to more extreme tools like military intervention. While armed force may, in certain cases, achieve swift results, it is fraught with risks – including loss of life among military personnel, civilian casualties, the destruction of infrastructure and the potential for conflict escalation. Furthermore, military engagements often lead to prolonged involvement, placing a heavy burden on the intervening state's resources and political will. In this light, the use or threat of force is generally considered a measure of last resort, only employed when all other options – sanctions included – have been tried and failed.

Furthermore, the development and widespread adoption of so-called “smart sanctions” has significantly enhanced the appeal and legitimacy of sanctions as a key instrument of foreign policy. Unlike comprehensive sanctions – which broadly restrict an entire nation's economy, as seen in the case of the former Yugoslavia in the 1990s – smart sanctions are designed to be more precise and targeted. They focus on specific individuals, entities, sectors or technologies deemed responsible for objectionable behaviour, thereby avoiding indiscriminate harm to the wider population. This shift represents an important evolution in sanctions policy, addressing many of the humanitarian and ethical criticisms levelled at earlier, more sweeping measures.

One of the most notable advantages of smart sanctions is their capacity to minimise collateral damage.⁷ By carefully tailoring sanctions to affect only those directly involved in wrongdoing – such as political elites, oligarchs, state-owned enterprises or military suppliers – governments can impose meaningful pressure on decision-makers without inflicting widespread suffering on ordinary citizens or destabilising the broader economy. In doing so, smart sanctions preserve the moral high ground of the sanctioning state, reinforce the legitimacy of the measures in the eyes of the international community and reduce the risk of sanctions fatigue or backlash among domestic and global audiences.

Moreover, the precision of smart sanctions also enhances their strategic effectiveness. By concentrating pressure on key nodes of power – such as financial networks, technological

⁷ Oleg Itskhoki and Elina Ribakova, “The Economics of Sanctions: From Theory Into Practice”, Brookings Papers on Economic Activity, September 2024, https://www.brookings.edu/wp-content/uploads/2024/09/6_ItskhokiRibakova.pdf.

infrastructure or international travel privileges – sanctions can disrupt the functioning of authoritarian regimes or malign actors in a way that is both focused and sustainable. This evolution marks a significant improvement over earlier blunt-force approaches and reflects a broader commitment to aligning sanctions policy with principles of proportionality, accountability and humanitarian responsibility.

In short, sanctions have emerged as a strategic tool of modern statecraft and have proven to be particularly effective in confronting actors that operate outside the bounds of international norms. Their ability to exert pressure without triggering open conflict makes them an indispensable component of contemporary foreign policy.

The Challenges of Sanctions

Sanctions have become the go-to move for foreign policymakers in the West. Whenever a rogue regime needs to be reined in, we slap sanctions on them. It is easy to see why. As we have seen, sanctions are more coercive than straight-up diplomacy but less risky than military action. “It is the only thing between diplomacy and war,” said Bill Reinsch, who was US Under-Secretary of Commerce under President Bill Clinton.⁸

The United States is the world champion in imposing sanctions. As of last year, it had issued roughly three times more sanctions than any other nation or international organisation. More than a third of the world’s 195 countries – or individuals and companies within them – are currently under some form of US sanctions.⁹ This should not come as a surprise: resorting to sanctions has become commonplace since the turn of the century.¹⁰

The results are mixed. Experts who have assessed the impact of sanctions say that they succeed in only about a third of cases. When they work, it is usually because they have narrow objectives (such as weakening an industry in a specific country) rather than wildly ambitious goals (such as changing the foreign policy of a country or bringing down an entire regime).¹¹ What is more, as the economist Edgar Morgenroth has pointed out, sanctions are most efficient when they are “multilateral” – that is, when they are enforced by many countries.¹²

Sanctions work best when “secondary sanctions” are applied on third-party countries doing business with the sanctioned country. Theoretically, as analyst Joshua P. Zoffer has observed, the US has an outsized ability to do damage with secondary sanctions because the dollar is the world’s reserve currency. As such, cutting off a third country from the US economy can have devastating effects.¹³ For that reason, secondary sanctions are seldom applied. And when they are, they target no more than a handful of entities in the third-party country. Their impact can therefore be lessened through shrewd economic planning.

But failure is only part of the problem. In some cases, sanctions backfire. For one, they often hurt ordinary people more than regime leaders. For another, regime leaders find ways to adapt by rerouting trade and financial flows. Some even use sanctions to tighten their grip on the economy. This section looks at these challenges.

Even regimes under coordinated, multilateral sanctions have proven remarkably resilient. Russia, Iran and Venezuela, to name the main ones, have all endured years of pressure. Rather than collapsing, these states have absorbed the hit and adjusted their strategies accordingly.

Take Russia. Since its full-scale invasion of Ukraine in February 2022, it has faced some of the toughest sanctions in modern history. Western governments have frozen the Russian central

⁸ Jeff Stein and Federica Cocco, “How Four U.S. Presidents Unleashed Economic Warfare Across the Globe”, *The Washington Post*, 25 July 2024, <https://www.washingtonpost.com/business/interactive/2024/us-sanction-countries-work/>.

⁹ Ibid.

¹⁰ Daniel Drezner, “Are Economic Sanctions Effective Foreign Policy Tools?”, *Tufts Now*, 8 July 2024, <https://now.tufts.edu/2024/07/08/are-economic-sanctions-effective-foreign-policy-tools/>; “Do Sanctions Actually Work?”, John Hopkins University, 12 February 2024, <https://washingtondc.jhu.edu/news/do-sanctions-actually-work-experts-evaluate-the-efficacy-of-this-widely-used-foreign-policy-tool/>.

¹¹ Drezner, “Are Economic Sanctions Effective?”.

¹² Edgar Morgenroth, “A Brief Review of the Effectiveness of Economic Sanctions,” The Institute of International and European Affairs, November 2023, https://www.iiea.com/images/uploads/resources/Effectiveness_of_Economic_Sanctions_Edgar_M.pdf.

¹³ Joshua P. Zoffer, “The Dollar and the United States’ Exorbitant Power to Sanction”, *AJIL Unbound*, April 2019, 113: 112-156, <https://www.cambridge.org/core/journals/american-journal-of-international-law/article/dollar-and-the-united-states-exorbitant-power-to-sanction/419F2FDF5BF6E052258DEE592853D6C3>.

bank’s overseas reserves, cut major Russian banks off from the SWIFT payment system, banned sovereign debt issuance and at one point even capped oil prices.¹⁴ The goal was to cripple Russia’s economy and therefore to reduce its ability to wage war. Yet, last year, Russia’s GDP grew by more than 4%, outperforming many Western economies.¹⁵

That is not to say that Russia is thriving. While that is the Kremlin’s line, it is little more than propaganda. Foreign direct investment into the country has plummeted and exports are down. The recent growth is driven by massive wartime spending acting as artificial stimulus.¹⁶ The result has been a huge increase in Russian debt, much of it hidden off the books by the Kremlin. In the medium term, this spells doom for the solvency of the Russian economy.¹⁷

Still, despite all this, one has to acknowledge that sanctions have not yet forced Vladimir Putin to the negotiating table. Nor have they meaningfully reduced his ability to fund his assault on Ukraine. Instead, Russia has successfully pivoted away from the West, deepening its ties with countries like China and India as well as Middle Eastern powers like Saudi Arabia.¹⁸ Russia has also found ways to circumvent sanctions by rerouting trade through third countries. It trades more with neutral states like Armenia, Kazakhstan and the United Arab Emirates. These countries, in turn, have increased trade with the EU and the United States, suggesting they might serve as intermediaries for goods no longer allowed in direct trade.¹⁹ Hong Kong has also been used as a hub to evade sanctions, as the Committee for the Freedom in Hong Kong Foundation showed in a report published in 2024.²⁰

Sanctions are meant to weaken a regime. But the paradox is that they sometimes do the opposite. This happened after the US imposed financial sanctions on Russia in 2014. Leading Russian firms lost access to foreign capital. But instead of shrinking, they were bailed out at home. The Kremlin gave them loans. This drained credit away from smaller Russian businesses. In the end, the sanctions helped the very firms that supported Putin’s regime. The economy became less competitive and more dependent on the state. And the Kremlin tightened its grip on key sectors. The result: the Russian state became more powerful, not less.²¹

Sanctions can have another unintended effect: they hurt the population. This happens with even “smart sanctions”, although they are supposed to spare the population. Nowhere is this more apparent than in Iran, which is among the most sanctioned country in the world.²²

And sanctions have hit ordinary Iranians hard. Around 80% are on welfare and 20% of the middle class has fallen below the poverty line. Yes, the regime has suffered too. But it has not

¹⁴ Rebecca M. Nelson, “The Economic Impact of Russia Sanctions”, U.S. Congressional Research Service, 20 February 2025, <https://www.congress.gov/crs-product/IF12092>.

¹⁵ “Russia raises 2024 GDP growth figure to 4.3%”, *Reuters*, 11 April 2025, <https://www.reuters.com/markets/europe/russia-raises-2024-gdp-growth-figure-43-2025-04-11/>.

¹⁶ Heli Simola, “Russia’s GDP growth reflects military spending, not economic strength”, *Bank of Finland Bulletin*, 28 November 2024, <https://www.bofbulletin.fi/en/blogs/2024/russia-s-gdp-growth-reflects-military-spending-not-economic-strength/>.

¹⁷ Craig Kennedy, “Russia’s Hidden War Debt”, *Navigating Russia*, 14 February 2025, <https://navigatingrussia.substack.com/p/russias-hidden-war-debt-full-report>.

¹⁸ Erika Szyszczak, “Sanctions effectiveness: what lessons three years into the war on Ukraine?”, *Economics Observatory*, 19 February 2025, <https://economicsobservatory.com/sanctions-effectiveness-what-lessons-three-years-into-the-war-on-ukraine/>; Anjana Pasricha, “India, Russia see deeper relationship”, *Voice of America*, 11 July 2024, <https://www.voanews.com/a/india-russia-see-deeper-relationship-/7693988.html>; Mostafa Salem, “Why is Saudi Arabia hosting talks to end the Ukraine war?”, *CNN*, 11 March 2025, <https://edition.cnn.com/2025/02/17/middleeast/saudi-riyadh-us-russia-talks-analysis-intl-latam>.

¹⁹ Drezner, “Are Economic Sanctions Effective?”.

²⁰ Samuel Bickett, “Beneath the Harbor: Hong Kong’s Leading Role in Sanctions Evasion”, Committee for Freedom in Hong Kong Foundation, July 2024, <https://thecfhk.org/beneath-the-harbor/>.

²¹ Ritt Keerati, “The Unintended Consequences of Financial Sanctions”, *SSRN*, 3 March 2022, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4049281.

²² “Do Sanctions Actually Work?”, John Hopkins University.

lost power. If anything, sanctions have strengthened its grip. Think of it this way: the Iranian Government now controls a bigger share of a smaller pie. Because if your imports are restricted, then your domestic sector becomes primordial. And in Iran, the domestic sector is controlled by the mullahs and the Iranian Revolutionary Guard Corps. The population, meanwhile, is too stretched to successfully organise against them.²³

Sanctions are also increasingly used as bargaining chips in diplomatic negotiations. The thinking is simple: offer temporary relief in exchange for concessions, such as allowing international monitors into elections or releasing political prisoners. In theory, this adds flexibility and makes sanctions more responsive. But in practice, it can also muddy the message. If sanctions are seen as something to be bargained over, rather than a firm consequence of bad behaviour, they risk losing credibility.

The case of Venezuela, which has been under American sanctions on and off since 2005, is a perfect illustration.²⁴ In October 2023, the US suspended sanctions on Venezuela's oil, gas and gold sectors. The decision followed a deal between the regime of Nicolás Maduro and the opposition to hold free and fair presidential elections.²⁵ And it represented a huge windfall for Maduro's regime, since Venezuela has the world's largest untapped oil reserves as well as significant gold reserves.

For the US, the move was meant as a carrot – a temporary reward for good behaviour. But the Maduro Government quickly spun it as a political win. It showed the strength of his regime and his ability to defeat the mighty American empire. More would come, he promised. “With the signing of these agreements we are taking the first step towards the full lifting of all sanctions,” Maduro said triumphantly, hailing a “new era”.²⁶

Critics pointed out that the regime hadn't yet delivered on its promises – the elections, after all, were a year away – and cautioned against easing sanctions since this would allow Maduro to gain the upper hand. “The risk here is that [the deal] is based on promises by Maduro, and Maduro is not known as someone who keeps promises,” Eric Farnsworth, a former US diplomat, told *The Wall Street Journal*. “Now Maduro is going to have a flush of new money that he will be able to use to spend lavishly on his base and bolster the regime's chances in the election next year.”²⁷

Farnsworth's warnings proved prescient. The elections were held and Maduro declared victory. Yet Maduro likely lost the election.²⁸ Independent analyses found that Edmundo González, the main opposition candidate, won around 67% of the vote. The Government, however, announced that Maduro had secured 52%. One expert called it “the largest electoral fraud in Latin America's history”. Even Brazil and Colombia – which do not oppose Maduro – refused to recognise the result. But Maduro held firm. He cracked down on opposition leaders and kept the military on his side.²⁹ Sanctions had been lifted, but democracy never came.

²³ “Do Sanctions Actually Work?”, John Hopkins University.

²⁴ Clare Ribando Seelke, “Venezuela: Overview of U.S. Sanctions Policy”, U.S. Congressional Research Service, 4 June 2025, <https://www.congress.gov/crs-product/IF10715>.

²⁵ Scott M. Flicker, et. al, “OFAC Issues New General Licenses for Venezuela, Suspending Sanctions in Certain Sectors”, Paul Hastings, 17 November 2023, <https://www.paulhastings.com/insights/client-alerts/ofac-issues-new-general-licenses-for-venezuela-suspending-sanctions-in>.

²⁶ Samantha Schmidt and Ana Vanessa Herrero, “Maduro, Venezuelan opposition agree to freer elections in 2024”, *The Washington Post*, 17 October 2023, <https://www.washingtonpost.com/world/2023/10/17/us-venezuela-sanctions-deal/>; Kejal Vyas and Patricia Garip, “U.S. Lifts Broad Sanctions Against Venezuela for Six Months”, *The Wall Street Journal*, 19 October 2023, <https://www.wsj.com/world/americas/u-s-lifts-broad-sanctions-against-venezuela-for-six-months-ca8eeb49>.

²⁷ Vyas and Garip, “U.S. Lifts Broad Sanctions”.

²⁸ Tiago Rogero, “Evidence shows Venezuela's election was stolen – but will Maduro budge?”, *The Guardian*, 6 August 2024, <https://www.theguardian.com/world/article/2024/aug/06/venezuela-election-maduro-analysis>.

²⁹ Ibid.

In conclusion, sanctions are hard to get right. As the cases of Russia, Iran and Venezuela show, they rarely topple regimes or even force major change. At worst, they entrench the power of authoritarians, hurt civilians and are used as bargaining chips. Sanctions will remain a key tool for Western governments, but they are no silver bullet.

The Role of Financial Markets

Sanctions don't work in isolation. Whether they succeed depends not just on who imposes them, but also on how the rest of the world reacts. And financial markets are key to that reaction. Hedge funds and investors all help decide whether sanctions hurt or fall flat.

Sanctions are meant to cut a country off from the global flow of capital. But, in reality, things are more complicated. There are perfectly legal ways for investors to keep buying and selling bonds issued by sanctioned countries, or by companies in sanctioned countries.

One clear example is the trade in "distressed debt" – or bonds that have crashed in value. In February 2022, after Vladimir Putin ordered the invasion of Ukraine, Russian bonds lost value fast. Some hedge funds, sensing an opportunity, jumped in. They bought the bonds cheap and paired them with financial tools known as credit default swaps. This strategy, called a negative-basis trade, was entirely legal.

It is important to remember that trading Russian bonds on secondary markets – where investors buy and sell debt – was not sanctioned.³⁰ According to CNN, hedge funds like Aurelius Capital Management and Silver Point Capital made big profits on these trades, with help from Wall Street banks like JPMorgan Chase.³¹

"JPMorgan representatives say they are acting as middlemen, simply looking to aid clients," CNN wrote.³² A spokesperson for the bank added: "As a market-maker, we have been helping clients reduce their risks and manage their exposures to Russia in the secondary markets. None of the trades violate sanctions or benefit Russia."³³

By March 2022, daily trading of dollar-denominated Russian bonds reached \$156 million – the highest in two years. Bonds from firms like Gazprom, Russian Railways and Lukoil were among the most popular.³⁴ Some investors were cutting ties with Russia. Others were looking for deals – and doing so lawfully. As an analyst at the Schwab Center for Financial Research put it: "This is Wall Street. It doesn't surprise that they saw some sort of loophole they could exploit to make money."³⁵ Nor, for that matter, should Wall Street financiers have acted differently. They were only doing their job.

To be clear, Russian entities did not directly profit from these trades. Since they took place on secondary markets, they occurred between Western financial players. That does not mean, however, that they did not indirectly benefit Russia. Although legal, these trades help keep Russian debt attractive in the eyes of the global market. As a result, financial actors in countries where Russia is not sanctioned are incentivised to keep doing business with Russian firms. Moreover, it weakens the stigma around owning Russian assets and, thus, ultimately, around working with Russia.

Something similar happened with bonds issued by Petroleos de Venezuela SA (PdVSA), the Venezuelan state-owned oil company. PdVSA has been under US sanctions since 2019. The

³⁰ Laura Benitez, "Sanctions Prove No Obstacle to Russian Debt Trading", *Bloomberg UK*, 30 March 2022, <https://www.bloomberg.com/news/articles/2022-03-30/russia-bond-trading-at-a-two-year-high-despite-all-the-hurdles>.

³¹ Nicole Goodkind, "Banks are making big money off of Russian debt", *CNN Business*, 11 April 2022, <https://www.cnn.com/2022/04/09/investing/russia-debt-wall-street-billions/index.html>.

³² Ibid.

³³ Ibid.

³⁴ Benitez, "Sanctions Prove No Obstacle".

³⁵ Ibid.

US Treasury has called it "a vehicle for corruption" due to its close ties with the government of Nicolás Maduro.³⁶

For years, trading most PdVSA bonds on the secondary market was banned. But, as we saw, in 2023, the US lifted that restriction ahead of the Venezuelan presidential election the following year. This was a gesture of goodwill towards the Venezuelan regime in exchange for the promise to hold free elections.³⁷

As such, it became legal again to trade PdVSA bonds. Investor interest piqued. According to Bloomberg, several funds started scooping up PdVSA notes for as little as 11 cents on the dollar. These included Gramercy Funds Management LLC as well as William Blair & Company.³⁸

The thinking was simple: the presidential election raised the odds of a political transition – and with it, the chance of a long-awaited debt restructuring. "They want access to capital markets," Robert Koenigsberger, managing partner and chief investment officer at Gramercy, told Bloomberg. "If you have a credit culture, you don't think about how you screw the bondholders."³⁹

In 2024, Gramercy filed lawsuits against PDV Holdings "to collect on certain overdue promissory notes issued by PDVSA and unpaid arbitral awards against the Republic of Venezuela", according to Gramercy's own Strategy Outlook published in January 2025. Legal proceedings are still ongoing as of this writing.⁴⁰

But not all market activity is about snapping up cheap bonds. In 2025, a different kind of trade emerged – one that focused on betting legally on Russia's future, not its debt

Some hedge funds began exploring how to profit if sanctions were lifted as part of a potential ceasefire between Russia and Ukraine. With Donald Trump back in the White House, and talks with Russia under way, this had become a likely possibility. According to the *Financial Times*, one option was to buy the Kazakh tenge – a legally accessible currency that tends to rise when Russia's economy improves.⁴¹

Another option is for traders to use a non-deliverable forward (NDF), a financial instrument that allows them to bet on the ruble's value without actually investing in Russia.⁴² The idea was simple: if sanctions eased and capital flowed back into Russia, the ruble would strengthen. The NDF position, in turn, would gain in value. Citi, for instance, recommended buying ruble NDFs to clients in early 2025, while other banks began quoting prices more actively.⁴³

Again, this is all lawful. "Western banks are obviously bound to sanctions," said Luis Costa, global head of emerging markets strategy at Citi Bank. "The non-deliverable forward is an instrument where you don't need to own the currency or any Russian assets."⁴⁴

³⁶ "Treasury Sanctions Venezuela's State-Owned Oil Company Petroleos de Venezuela, S.A.", U.S. Department of the Treasury, 28 January 2019, <https://home.treasury.gov/news/press-releases/sm594>.

³⁷ Vyas and Garip, "U.S. Lifts Broad Sanctions".

³⁸ Nicolle Yapur, Maria Elena Vizcaino and Vinicius Andrade, "Trades Move into Venezuela Oil Bonds as Presidential Election Nears", *Bloomberg*, 17 July 2024, <https://www.bloomberg.com/news/articles/2024-07-17/traders-move-into-venezuela-oil-bonds-as-presidential-vote-nears?embedded-checkout=true>.

³⁹ Yapur, Vizcaino and Andrade, "Trades Move into Venezuela Oil Bonds".

⁴⁰ "Decoding the Global Macro Environment, 1Q Strategy Outlook", *Gramercy*, January 2025, <https://www.gramercy.com/2025/01/decoding-the-global-macro-environment-1q-2025-strategy-outlook/>.

⁴¹ Joseph Cotterill, "Investors seek to profit from Russia as Trump pursues rapprochement", *Financial Times*, 17 March 2025, <https://www.ft.com/content/21a7fc36-8244-4806-aecd-fb268344d80c>.

⁴² Akhilesh Ganti, "Non-Investible Currency: What it is, How it Works", *Investopedia*, 27 October 2021, <https://www.investopedia.com/terms/n/nonconvertiblecurrency.asp>.

⁴³ Cotterill, "Investors seek to profit from Russia".

⁴⁴ Ibid.

At the same time, the Kremlin has begun signalling that it might welcome Western financial players back. In March 2025, Putin signed a decree allowing US hedge fund 683 Capital Partners to buy shares in Russian companies from a dozen other Western financial institutions and then sell them to two approved Russian investment funds – all with formal government approval.⁴⁵

Sanctions are supposed to isolate bad actors. But, as long as there’s a legal path to trade, investors will take it. They are not breaking the rules; on the contrary, they are strictly following them. That doesn’t mean, however, that the outcome supports our foreign policy goals. When sanctioned debt becomes a hot trade, sanctions lose their sting.

Even the rise of ESG (Environmental, Social and Governance) investing hasn’t changed this. Bonds from authoritarian regimes – sanctioned or not – still end up in major ESG indexes.⁴⁶ That means regimes with poor human rights records can continue to access global capital. Financial markets are not wired to enforce moral or strategic objectives. They are, to put it crudely, wired to seek yield.

This matters. The goal of sanctions is to apply pressure, not to feed speculation. Yet legal market activity often does the opposite. Financial markets chase short-term profit, not long-term regime change. And that means one of the West’s key tools – economic isolation – risks being undermined.

⁴⁵ “Putin decree authorises US hedge fund to buy foreign-owned Russian securities”, *Reuters*, 17 March 2025, <https://www.reuters.com/business/finance/putin-decree-authorises-us-hedge-fund-buy-foreign-owned-russian-securities-2025-03-17/>.

⁴⁶ Laurence Fletcher and Tommy Stubbington, “ESG investing: funds weigh sovereign debt profits against human rights”, *Financial Times*, 13 July 2021, <https://www.ft.com/content/bd2e752e-5afa-424a-af7e-433963dd7c34>.

Policy Recommendations

For quite obvious reasons, sanctions continue to represent the best tool available to Western governments when they want to exert pressure on rogue regimes. Thus, the need to make them more effective remains paramount for maintaining the stability of the global order. Given the challenges of sanctions that we discussed above, we argue that the time to act is now. Therefore, we propose several policies that we firmly believe will make sanctions more effective and evasion thereof more difficult.

We put forward five core policy recommendations designed to strengthen the effectiveness, integrity and adaptability of sanctions regimes. Importantly, we believe that the G7 countries should take the lead in implementing these policies and encouraging their adoption across allied nations. The G7 possesses the necessary leverage, tools, and resources to take on this responsibility, and action through this forum is likely to yield the most effective and far-reaching results.

First, it is vital to address legal trades on the secondary market, like the ones discussed in relation to Gramercy. We recommend a comprehensive ban on the trading of bonds issued by sanctioned companies on secondary markets. Changing the rules is essential to maintaining the credibility and coherence of sanctions policy.

Second, we argue for the creation of an independent sanctions regulator tasked with auditing Western companies to ensure full compliance. Without proper oversight, the risk remains that firms will exploit legal grey zones or adopt overly flexible interpretations of existing rules. A regulator with enforcement powers would not only serve as a deterrent against non-compliance but would also help build greater public and international trust in the sanctions process.

Third, sanctions design must be an ongoing process. We call for continual efforts to make “smart sanctions” smarter – by refining targeting mechanisms, tightening implementation and reducing collateral damage to civilian populations. This involves both closing technical and legal loopholes and investing in better intelligence and economic analysis to ensure sanctions hit the intended targets and not the broader economy.

Fourth, the experience of sanctions against Russia has revealed a critical weakness in current regimes: sustained trade with non-aligned countries can significantly blunt the impact of sanctions. To address this, we recommend the development of cooperative diplomatic and economic measures aimed at discouraging non-aligned countries from continuing to trade with sanctioned countries. This might involve diplomatic pressure, incentives for cooperation or the extension of secondary sanctions in key cases.

Finally, sanctions must not be treated as fixed or final. They are political tools whose impact can diminish over time or be rendered ineffective by changing circumstances. We therefore advocate for the establishment of a permanent review mechanism – an independent body charged with assessing the ongoing effectiveness of sanctions and recommending changes where necessary. This would ensure that sanctions regimes remain agile, evidence-based and responsive to both successes and shortcomings.

These recommendations apply across the West, from the US and Canada to the UK and EU countries. However, given its economic clout, the US will need to lead the charge in implementing them. At the same time, the EU should endeavour to build greater extra-judicial sanctions power. This is essential if it truly wants to develop “European strategic autonomy”.

Together, these five recommendations would significantly improve the effectiveness and legitimacy of sanctions as a foreign policy tool.

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