



Sanction evasion: The case of recent Russian-Western sanctions



Piotr Lukaszuk, University of St.Gallen

Abstract

The paper assesses whether sanctions have been evaded in the context of the recent Russian-Western sanctions. I look at trade flows between the Western sanctioning economies and Russia's neighbouring countries, as well as those between the neighbours and Russia, to assess if a significant increase in trade of the sanctioned products has occurred since their imposition. The first results indicate that particularly agricultural products sanctioned by Russia are likely to have been evaded, notably through Turkey and Switzerland.

Methodology and Data

The analysis is based on the premise that sanction evasion takes place largely through countries neighbouring with the actual destination country, in this case Russia, and leads to increased trade between the sanctioning and neighbouring countries, as well as between the neighbours and the sanctioned country (Russia).

Given that not all products have been sanctioned, I use a standard Difference-in-Differences approach to identify if the trade flows of sanctioned products has increased more than those of non-sanctioned goods. Unlike previous research, the primary goal of this paper is to identify these effects at the sector and product level (using interaction terms between the sanction variable and sector/product dummies).

In order to distinguish sanction evasion from trade diversion effects, the former will only be identified as such if the evasion effect is significant at both stages of the regressions (see chart 2). This differentiation holds true in particular when looking at individual sectors and products (given unlikely diversion at both stages otherwise).

The identification of the sanction evasion effect is based on the premise that certain countries which introduced sanctions did not strategically select the products to be sanctioned themselves. This is in fact the case with Albania, Montenegro, and Norway, which instead had applied the list of EU sanctions without taking part in the sanction formation process.

The analysis is conducted using monthly trade flow data obtained from the UN COMTRADE database for the period from January 2013 until June 2016.

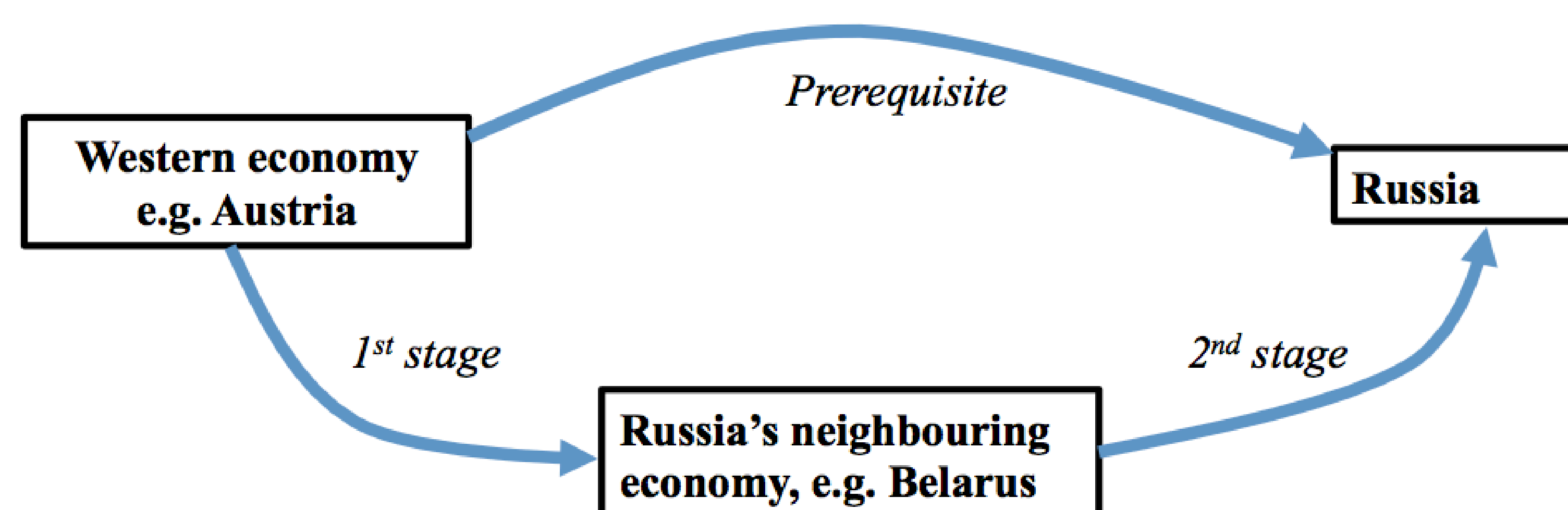


Chart 2. General visualisation of the applied methodology.

Contribution

To the best of my knowledge, this is the first paper to study sanction evasion explicitly at the sector and product levels^{3,4} (despite recent development in other disaggregations^{1,2}). Inter alia, such a disaggregate approach allows to distinguish between country-level time trends and the specific impact of sanctions.

The paper also looks to overcome the endogeneity issues usually faced in the sanction literature, as the timing and choice of the sanctioned goods are usually a product of political and economic motives of the sanctioning country (see Methodology & Data).

Contact

Piotr Lukaszuk
Swiss Institute for International Economics, University of St.Gallen
Email: piotr.lukaszuk@student.unisg.ch
Phone: 0(041) 71 224 3139

Introduction

Following the occupation of Crimea and invasion of Eastern Ukraine, Western countries imposed trade sanctions on Russia in August 2014 (Australia and Canada did so within a year later).

Both Western and Russian sanctions targeted exports from the West into Russia. Hence, this project looks exclusively at exports from Western sanctioning countries and imports into Russia.

Whereas the introduced sanctions also included financial and visa restrictions, as well as barriers on services, this paper focuses on the sanctions facing the trade in goods between the two sanctioning fractions:

- Russia introduced import bans on specific agricultural produce.
- The Western economies enforced an export license requirement for varying metal products, which would be denied for listed oil industry purposes.
- The EU also introduced an export ban for dual-use goods used for military purposes, later expanded to a number of specific firms and enforced also by Albania, Montenegro, and Norway.

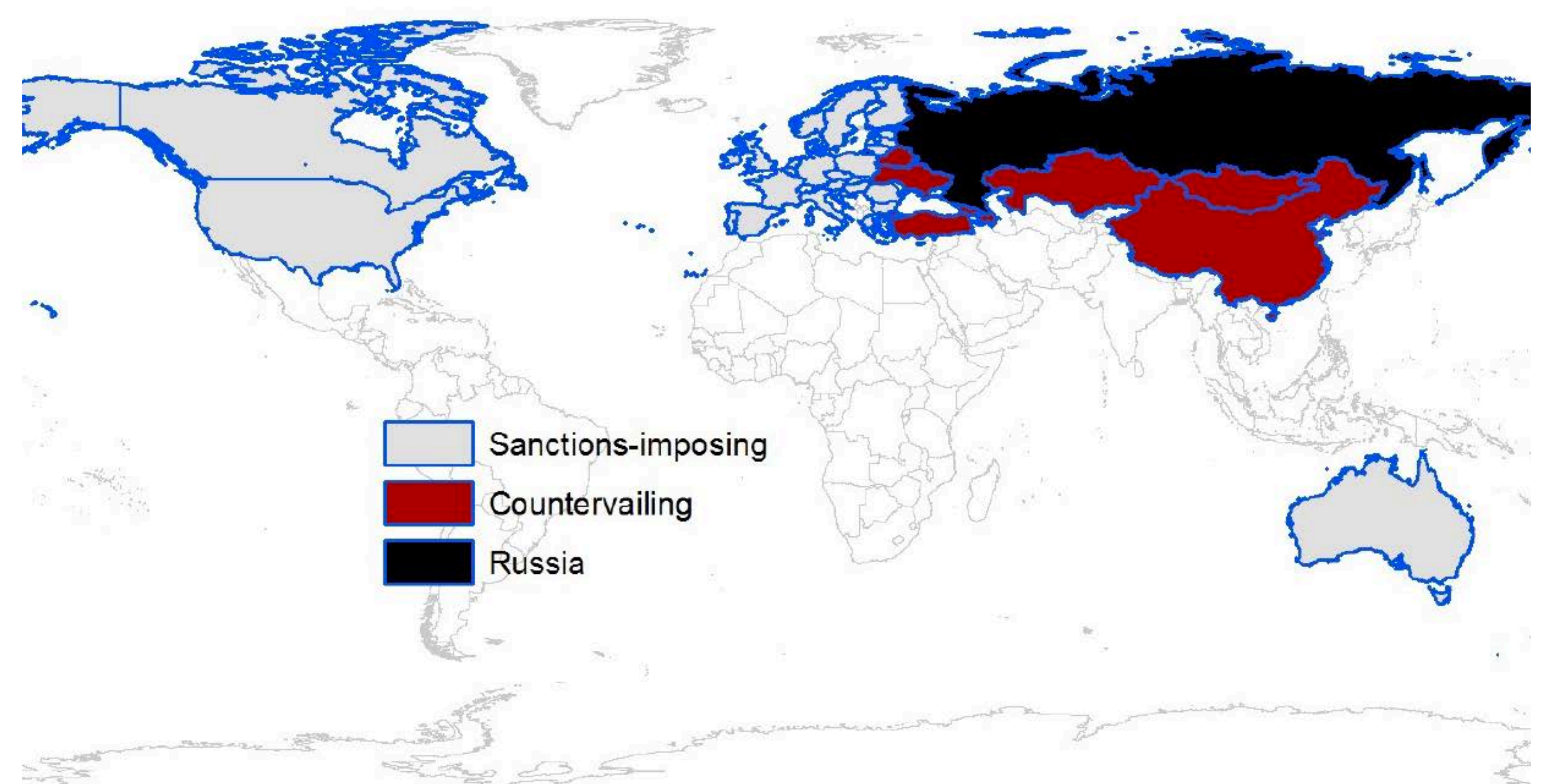


Chart 1. World map of countries studied in the project.

Results and Discussion

The preliminary results show that Russian sanctions may have been evaded, less so the sanctions introduced by the Western economies. This is line with the expected results as Russia explicitly banned the import of the products it sanctioned. Meanwhile, the Western economies only restricted the exports of the listed goods for particular purposes.

The countries through which sanction evasion is most likely to have occurred (based on significant sanction coefficients in both stages of the estimations) are Turkey and Switzerland. The remaining studied countries show significant coefficients at most at one of the two stages.

This latter evidence would point to trade diversion rather than sanction evasion effects for certain sectors; e.g. there seem to be statistically significant trade diversion effects for exports of steel products (sanctioned by the EU) from Belarus to Russia. No such effects have been identified for the products' exports from EU member states to Belarus.

In order to expand on the applied methods examining sanction evasion, the next step will be to apply a random forest regression on the recorded . The procedure is similar to the one applied above but improves on the identification of heterogeneous effects without imposing a parametric structure.

The last concern to be addressed involves potential data manipulation by the sanction-evading countries of interest. As these countries may face repercussions if caught abetting sanction evasion, they may be politically motivated to underreport trade flows related to the sanctioned products. A similar problem may be caused by illegal smuggling.

References

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