

# **The Role of Third Countries in the Effectiveness of Economic Sanctions**

With a case study of sanctions against Russia

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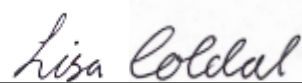
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## **Abstract**

This thesis examines the role of third countries on the effectiveness of sanctions imposed on Russia in response to its invasion of Ukraine in 2022. Despite the implementation of sanctions by numerous economically powerful countries, Russian forces continue to engage in conflict in Ukraine, and Russian trade has shown signs of recovery. To understand the factors influencing the effectiveness of sanctions and the role of third countries in their implementation, I present a framework based on the Crisis Bargaining Model by Fearon (1995). While bargaining theory provides insights into conflict and negotiation dynamics, it proves insufficient in comprehensively understanding sanctions. The literature on sanctions effectiveness and measurement is explored, highlighting the increasing importance of third countries in influencing sanctions outcomes. This thesis focuses on the role of third countries in the case of sanctions against Russia, analyzing their impact on Russian trade patterns and circumvention of sanctions. The findings suggest that while certain sectors of the Russian economy have been affected by sanctions, trade relationships with third countries have mitigated some of the intended effects. Addressing the involvement of third countries in sanction implementation becomes crucial to enhancing the efficacy of sanctions. These effects are also hard to avoid as long as sanctioning countries do not actively stop third countries from trading with the target.

“They have a right to do anything we can’t stop them from doing.”

– Joseph Heller, *Catch 22*

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# 1. Introduction

Sanctions encompass a range of non-military coercive measures that governments or international organizations employ to restrict or limit specific activities in pursuit of policy objectives. These measures can take various forms, such as diplomatic or economic sanctions, travel bans, arms embargoes, or financial restrictions. They are typically implemented as a response to violations of international law, human rights breaches, or to induce behavior or policy changes. By utilizing sanctions, authorities seek to achieve desired outcomes without resorting to military force, aiming to shape and influence the actions and behaviors of targeted entities or countries.

The subject of sanctions is significant and covers different disciplines, including economics, international relations, and politics. This thesis will focus on economic sanctions that concern trade and financial instruments. Sanctions with more diplomatic, military, or social characteristics will not be covered by this thesis. However, the theory that covers sanctions, in general, will also apply to these types.

This analysis specifically examines the qualitative aspects of sanctions imposed on Russia after the invasion of Ukraine in early 2022. While there is a wealth of empirical analyses available on the effectiveness of sanctions in general, this analysis takes a different approach by providing a unique perspective and focusing on the specific case of Russia. While quantitative analyses of sanctions are typically conducted after a significant period has passed, it is challenging to capture the immediate effects of sanctions just one year after Russia's invasion of Ukraine. Many of the trade-related effects may not be readily observable through empirical analysis until a later stage. Consequently, for a comprehensive and long-term examination of trade impacts, empirical research will be highly valuable. However, for a real-time and in-depth examination of ongoing sanctions, a qualitative analysis is chosen in this case, enabling a closer examination of the specific context and dynamics at play.

Empirical data analysis related to sanctions may risk overlooking valuable lessons specific to each case. For example, the relevance of investigating the effectiveness of multilateral versus unilateral sanctions may be questionable, as it fails to address the intricate economic dynamics between countries that truly determine the outcome of sanctions. While statistical analysis can help identify trends, it may not fully capture the individual characteristics of each case that are more important. Therefore, it is challenging to create a perfect recipe for sanctioning. The relationship between the senders and receivers should be the foundation for



determining the best approach to sanctions, and third countries should be considered. By analyzing the unique characteristics of the relationship, one can tailor sanctions that are more likely to be effective. Third countries will here be defined as any country that is not directly involved in sanctions as either sender or target state.

To establish some general theory for sanctions, the start of this thesis will focus theory on sanctions in crisis bargaining. I present a model that is built on an existing framework and aims to show how sanctions in theory are exceptions to the rule. It also gives more insight as to why some states choose not to sanction when it could seem as if every other state is doing so.

The case that wraps up this thesis will be based on three essential parts of the Russian economy: oil and gas, technology, and the financial sector. I will focus on these three because they are interconnected to a large extent and influential on the Russian economy. Technology is necessary for oil production, and the financial system is crucial for exporting oil overseas, as well as importing technology needed in production. These three are chosen to limit the scope while still being representative of the Russian economy and, to some degree, sanctions in general.

The research objective of this thesis is to identify the role of third countries in the effectiveness of sanctions, with application to the case of sanctions against Russia implemented after the 2022 invasion of Ukraine.

## **1.1. The History of Sanctions**

Even though sanctions have increased in popularity in recent years, it has long been a tool in the diplomatic toolbox. Evidence of sanctions is found as far back as ancient Greece in 432 BC (Hufbauer, Schott, & Elliot, 2007). However, sanctions have sharply increased, especially after World War II (Felbermayr, Kirilakha, Syropoulos, Yalcin, & Yotov, 2021). Hufbauer et al. describe how sanctions were primarily used in relation to war in one way or another before WWI. Economic sanctions were closely related to war well into the 1940s and 50s. After this period, the idea of using sanctions as a substitute for armed conflict rose in popularity.

To illustrate how different the effect of sanctions can be, I will use three well-known cases where they have been used. In the case of South Africa, we could see extensive use of sanctions over a more extended period. Whether these were successful and effective in ending the apartheid regime is not clear. In the case of Rhodesia, a case similar but not identical to

South Africa, sanctions were later considered one of the definitive and effective policies to end white minority rule. The case of Iran is more recent but a clear example of how much sanctions can affect a country's economy. These cases are meant as a crash course in sanctions history, briefly explaining how sanctions have been used previously and with what results.

Sanctions against South Africa were implemented by the United Nations in 1962 as a response to apartheid policies (Hufbauer, Schott, & Elliot, 2007). Resolution 1761 sought to break diplomatic relations and limit trade with South Africa. From the implementation of the resolution until the end of the apartheid in the mid-1990s, several sanctions and embargoes were placed. In addition to political pressure from foreign nations, domestic resistance eventually ended the system. Nelson Mandela, the former President of South Africa, and a renowned anti-apartheid activist, famously stated that "there is no doubt" that sanctions helped end the discriminatory apartheid system in South Africa (Time Magazine, 1993). The system was characterized by the segregation of people based on race, lasting over 40 years. Several studies, including Aidt, Albornoz, and Hauk (2021), have concluded that sanctions undoubtedly contributed to the regime's demise. However, other scholars, such as Levy (1999) and Hufbauer and Schott (1985), argue that the sanctions imposed on South Africa were ineffective. Despite differing opinions, it is generally agreed that sanctions played a role in dismantling apartheid, which officially ended in 1994.

In 1965 the United Kingdom and United Nations sanctioned Rhodesia (now Zimbabwe) after the Rhodesian prime minister Ian Smith issued unilateral declaration of independence from the UK. The sanctions included financial, economic, and trade sanctions on petroleum (Hufbauer, Schott, & Elliot, 2007). The reason for sanctions against Rhodesia was partly similar to the case of South Africa, with a white minority rule and racist policies. Sanctions ended in 1979 when the country transitioned to a majority rule. The sanctions against Rhodesia have generally been seen as successful in bringing majority rule to the country (Minter & Schmidt, 1988); (Pape, 1997)), but some parts of the sanction policies were considered ineffective. For example, the UK oil embargo on Rhodesia has been described as a "spectacular failure" (Rowe, 1999), showing that implementing sanctions can be a hit or miss, even in successful cases.

Another case worth mentioning is the case of sanctions against Iran. Iran was the most sanctioned country in the world until Russia invaded Ukraine in February of 2022 (Wadhams, 2022). Prior to this, Iran has been sanctioned in several cases. One of the most comprehensive

cases was EU and US sanctions against the Iranian nuclear program in the early 2010s. Iran agreed to sign the Joint Comprehensive Plan of Action (JCPOA) with the United States and several other world powers (Robinson, 2022). It is argued that Iran agreed to the deal because of economic pressure from the sanctions, which negatively affected the Iranian economy (Ghomi, 2022). The JCPOA terms were that Iran would start to build down their nuclear program in exchange for sanctions relief. Ghomi's analysis shows how the Iranian economy suffered from the sanctions for years, even after the sanctions were partly lifted in 2015. After President Donald Trump withdrew the US from the deal in 2018, Iran has slowly started rebuilding their nuclear activities. In this case, we see how sanctions can be helpful and effective, but policy decisions can jeopardize their intended effects.

These short overviews do not do each case justice; they are far more complex than what is presented in the introduction to this thesis. However, mentioning them plays an essential part in understanding how different the effect of sanctions can be.

## **2. Theoretical Framework**

In this section, my goal is to look into the theory behind conflict bargaining and applying this to sanctions. Sanctions can be viewed as a type of conflict that is relatively diplomatic but nevertheless represents a form of conflict. This analysis explores literature related to conflict, international relations, and war. The framework could give valuable insight into why some states choose to sanction, why some go to war, and why some do neither. While the model does not directly address the effectiveness of sanctions, it sheds light on the complex diplomatic and political relationships between countries that drive their decision to use sanctions or not. By analyzing these relationships, we can better understand why some states are more inclined to impose sanctions, and the factors that can either incentivize or deter conflict escalation. To understand the role of third countries, it is important to understand why some states sanction and others do not. Overall, the Crisis Bargaining Model provides valuable insights into conflict resolution mechanisms and can help policymakers make informed decisions about managing crises and preventing violence in international relations.

### **2.1. Crisis Bargaining Model**

The Crisis Bargaining Model is a simple framework that illustrates how bargaining can prevent war or conflict. Because conflict is costly, it reduces the potential value of victory. Say for example you go to war over a good worth 1 and win, but the conflict costs you 0.3. Your profit has been reduced to 0.7 from the original value of 1. Bargaining has the potential to create mutually beneficial outcomes because it can ensure that each party involved is in a better position than if they were to engage in conflict. It considers the difference between the revenue gained from winning and the costs associated with the conflict. I will start by drawing out the simple framework for the model. The model is commonly used in international relations and comes in different versions, for example, crisis bargaining, coercive diplomacy, and the bargaining model of war. Further, I will suggest additions to the model to give a Crisis Bargaining Model for sanctions.

#### ***2.1.1. The simple model***

The model I will use for my analysis is based on a theoretical framework presented by James D. Fearon in his paper "Rationalist Explanations for War" (1995). His framework uses basic game theory from bargaining theory and crisis bargaining. I will start by presenting the original framework before I suggest additions to the model that could be of help as a basic theory for sanctions.

In the simplest form of the model, two states are arguing over the division of a good. This could be territory, resources, money, or almost anything else. The first assumption we are going to make is:

*I. The good is infinitely divisible*

The 1 unit can be divided between the two states in infinite combinations. For example, 20% to state A and 80% to state B, or 45% to state A and 55% to state B, etc.

The probability of A winning the conflict is denoted by  $p$ . As an extension of this, B's probability of winning is equal to  $1 - p$ . In this model, we exclude the possibility of a draw for simplicity.

*II. War must result in victory for either state A or state B,  
and there is some positive probability  $p$  that one state will win*

From simple probability, we know that  $0 \leq p \leq 1$ . If  $p$  was either 0 or 1, one state would be certain to win. Resisting in such a case would be costly to the inevitable loser. The dominating strategy would be for the loser to give up. However, any case with either  $p = 1$  or  $p = 0$  seems unlikely. There will always exist some uncertainty about the outcome, and  $p$  will never be exactly 0 or 1.

In the case of war, there will be costs to each state. These reflect the costs of for example military power, destruction of property, or loss of lives. The costs for A will be  $c_A > 0$ , and likewise for B  $c_B > 0$ . These costs encompass not only the direct expenses associated with combat but also the economic repercussions incurred upon entering a war, such as trade disruptions and loss of human lives. It is important to note that this particular aspect of the model does not account for the duration of the conflict or the relative efficiency of states in warfare. Any potential correlation between the cost of the conflict and the probability of achieving victory is permissible.

A third assumption considers the states' risk preference:

*III. Both states are risk – neutral or risk – averse*

A risk averse state prefers a 50/50 split of the good to a 50/50 chance at all or nothing. A risk neutral state would be indifferent between the two options because the expected value is the same.

Using this simple framework, it is possible to calculate an expected utility value for states A and B based on their probability of winning, the cost that applies to each state by going to war, and the share taken of the good.

Formally, we can argue that the bargaining range exists under the following conditions. The two states are dividing the good  $x$  between them in the interval  $X = [0,1]$ . State A's preference is a solution as close as possible to  $x = 1$ , while B prefers  $x = 0$ . Each state has a utility of the division  $u_A(x)$  and  $u_B(1 - x)$ . From the assumption of risk-averseness or risk-neutrality the utility for both A and B is continuous, increasing, and weakly concave. We set  $u_i(1) = 1$  and  $u_i(0) = 0$  for both states  $i = A, B$ . By using expected utility and the previous assumptions, we can show how there always exists a set of negotiated settlements that each state prefers to fighting (Fearon, 1995). For state A and B respectively, the expected utility of going to war is:

$$u_A^W = 1 * p + 0 * (1 - p) - c_A = p - c_A$$

$$u_B^W = 0 * p + 1 * (1 - p) - c_B = 1 - p - c_B$$

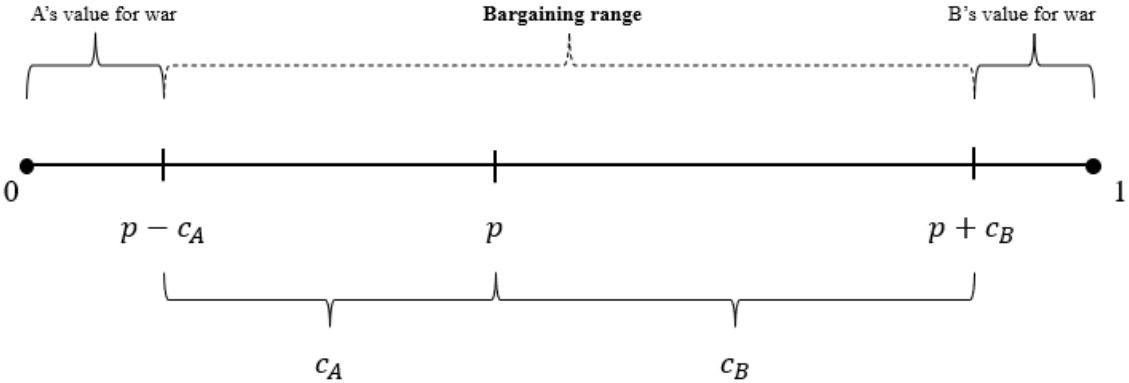


Figure 1 – Fearon's visualization of the bargaining range

The expected utility of agreeing to a bargained resolution of  $x$  is  $x$  for A and  $1 - x$  for B. As long as  $x > p - c_A$  and  $1 - x > 1 - p - c_B$  (which gives  $x < p + c_B$ ), both states will strictly prefer a bargained resolution in the interval  $(p - c_A, p + c_B)$ . The interval is represented visually in Figure 1 as the bargaining range. The visualization represents a risk-neutral case. Risk aversion will increase the bargaining range because the gamble of war is unfavorable to risk-averse states. The size of the bargaining range is equal to the cost for state A and state B for going to war ( $c_A + c_B$ ).

### 2.1.2. *Discussing the assumptions in the simple model*

The three assumptions in the model are necessary for the result of the bargaining range but require some discussion. First, it is assumed that the good is infinitely divisible between the states. However, there might exist conflicts where the good is not divisible in a way that allows for a peaceful agreement in the range  $(p - c_A, p + c_B)$ . Fearon (1995) describes this as a possible reason for conflict.

The second assumption considers the probability of winning a potential war. Each state might have their own estimate of  $p$ , even though there exists some true value. If both states are optimistic about their own abilities, this skews the perceived bargaining range. However, if the states are rational, they realize that their estimate could differ from the true value of  $p$  and therefore know that there must exist a set of agreements that all states prefer to fighting. The model also excludes the possibility of conflict that ends in a draw, which might make the model simpler but excludes a realistic outcome.

Finally, it is assumed that the states are either risk-averse or risk neutral. In the previous example, risk-neutral states are indifferent between a 50/50 split and a 50/50 chance at all or nothing. In this example, risk-neutral states are indifferent between war and a peaceful resolution if the expected value is the same. A leader that accepts this kind of gamble seems unlikely, and the assumption of risk-averse states seems more probable.

## 2.2. **Applying the Crisis Bargaining Model to Sanctions**

In this part of the thesis, I will apply the model from Fearon (1995) of crisis bargaining to a context suitable for sanctions. The goal is to show how sanctions can affect the bargaining range.

The framework for Fearon's simple bargaining model applies to two states either going to war or bargaining over a good. We need to translate this to sanctions. In this model, a good is still distributed or fought over, but I add in the option of sanctioning. The cost of sanctioning is denoted by  $s$ . Here,  $q$  is the probability that state B wins through sanctions. The expected utility for state A and B of sanctioning then gives:

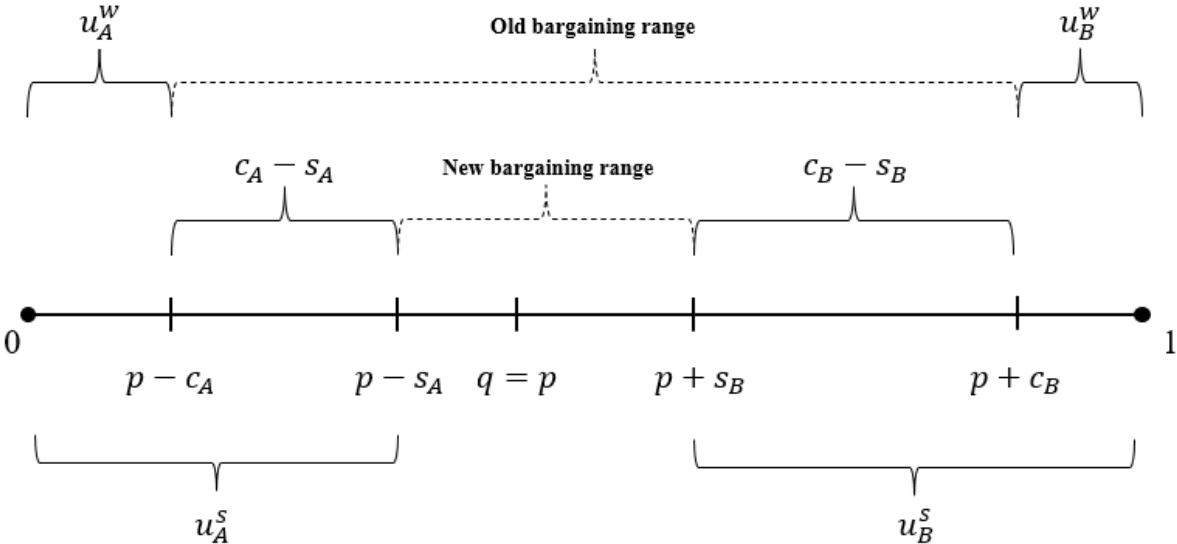
$$u_A^s = 1 * q + (1 - q) * 0 - s_A = q - s_A$$

$$u_B^s = 0 * q + (1 - q) * 1 - s_B = 1 - q - s_B$$

For now, we assume that the probability of winning a war is equal to winning a conflict of sanctions,  $q = p$ . The costs, in this case, would be the economic costs of imposing and receiving sanctions. For example, trade could be lost because of the sanctions or costs related to redirecting trade elsewhere when the trade flow between the sanctioned and sanctioning states is no longer an option. We then add a new assumption:

*IV. The cost of sanctions are lower than the costs of war*

While it is a simplification to state that sanctions are generally less costly than war, it is a reasonable assumption. Sanctions circumvent expenses related to military engagement and loss of lives. However, it is important to note that sanctions may have enduring economic effects that are challenging to quantify and could potentially be greater than initially anticipated. Sanctions can in some cases create additional income for one party, but this will not be discussed in the model.



*Figure 2 - Bargaining range with sanctions*

Under the assumption that  $p$  is the same for war and sanctions, we see that the expected utility of sanctioning is larger than the expected value of war  $p - s_A > p - c_A$  because  $s_A < c_A$ . The same logic applies to state B with  $1 - p - s_B > 1 - p - c_B$ . This means that if the costs of sanctioning are less than the costs of going to war, no rational state will choose war over sanctions. As in Fearon’s model, as long as  $s_A + s_B > 0$  there exists a bargaining range that is preferable to sanctions. However, the bargaining range has now been reduced from  $(p - c_A, p + c_B)$  which equals  $c_A + c_B$ , to  $(p - s_A, p + s_B)$  which is  $s_A + s_B$ . The total reduction of the range is equal to  $(c_A + c_B) - (s_A + s_B)$ . Figure 2 shows how lower costs reduce the



bargaining range compared to the range presented in Figure 1. When the bargaining range becomes narrower, the likelihood of reaching a peaceful settlement decreases, increasing the chances of the conflict escalating into violence or war. Naturally, if conflict becomes less costly it also becomes a more attractive alternative.

For the next step we no longer assume  $p = q$ , but rather that both  $p$  and  $q$  can be values between 0 and 1.

*V. Sanctions must result in victory for either state A or state B,  
and there is some positive probability  $q$  that one state will win*

The fifth assumption states that the probabilities for winning a war and winning through sanctioning can be different values,  $q$  and  $p$ . As with assumption II, states could over- or underestimate their  $p$  or  $q$ . This changes the perceived bargaining range but if states are rational, they will know that there exists a bargaining range. The value of  $p$  is determined by factors that affect state A's ability to win war, and  $q$  is determined by factors that affect A's ability to win through sanctioning. These values can be similar, but seeing as they are determined by different factors, we cannot assume them to be the same.

A similar result to what we saw in Figure 2 is still possible if  $p$  and  $q$  are sufficiently close in value. However, we now have two additional potential scenarios. First, we have a scenario where for state A, sanctions have a higher expected value than war, and for state B war has a higher expected value than sanctions. The opposite is also possible.

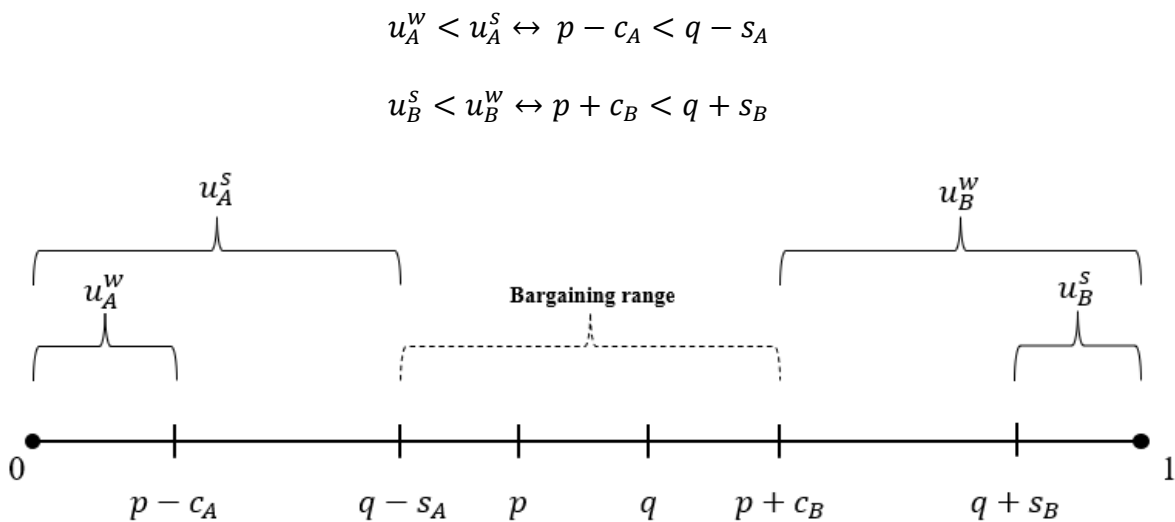


Figure 3 - Bargaining range when state A and state B have differences in expected utility for war and sanctions.

In this example, the bargaining range will shrink, as seen in Figure 3. The reduction of the bargaining range is similar to previously seen in Figure 2, namely that lower costs shrinks the range. Any division of the good that lies outside the range  $(q - s_A, p + c_B)$  will be worse outcomes for A and B, because there still exists a bargaining range that divides the good better for both states. The bargaining range is smaller than if the only options were war and bargaining, or sanctions and bargaining.

The second scenario occurs when the values of  $q$  and  $p$  are sufficiently different, eating up the entire bargaining range. This happens when  $p + c_B < q - s_A$  or  $p + s_B < p - c_B$ . The first example is when  $p \ll q$ , the second is the opposite case where  $q \ll p$ . For the sake of simplicity, we will stick with the first example for this scenario, but intuition is similar for both. Initially in this case there exists no value of  $x$  where both states are better off with bargaining. At this point, we are stretching the model to the unrecognizable from what Fearon first presented. Theoretically, this scenario is possible, but we are reaching the limits of what is reasonable to assume with such a simple static model. Interestingly my conclusion is still that there will exist a bargaining range that is preferable to conflict between state A and B.

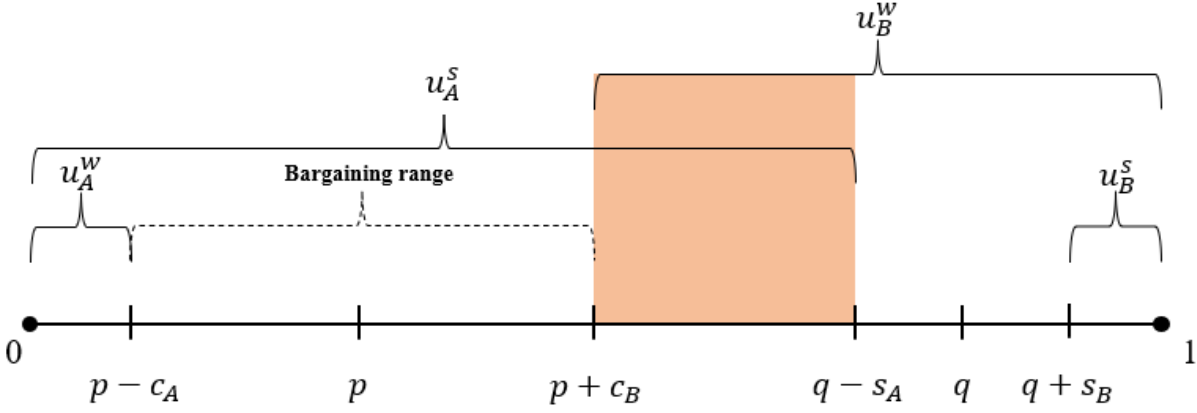


Figure 4 - Bargaining range when  $p$  and  $q$  are sufficiently different.

In Figure 4 we see that for any given  $x$  either state A or B has a preferred response that is not bargaining. There exists no  $x$  such that  $x > u_A^s$  and  $1 - x > u_B^w$ . For any  $x > p + c_B$  state B will have a higher expected value of going to war. For any value of  $x < q - s_A$  state A will have a higher expected value of sanctioning. Since these two fields overlap, there is no immediate bargaining range. In Figure 4 the overlap is highlighted in orange. However, if  $x < p + c_B$  where state A will choose to sanction, state B will prefer to go to war because  $u_B(w) > u_B(s)$  or  $p + c_B < q + s_B$ . The overlap will occur if:

$$p \ll q \text{ and } p + c_B < q - s_A$$

or

$$q \ll p \text{ and } q + s_B < p - c_A$$

As previously stated there exists no value of  $x$  that exceeds the utility of war or sanction for the two states. However, it is still possible to assume that there will be room for bargaining. When state B strictly prefers war, we would expect this to be the outcome even if state A prefers sanctions. However, if state A is rational, it will predict this and choose not to sanction. Choosing not to sanction is the dominant strategy for A because the expected value of bargaining is higher than the expected value of war. As seen in Figure 4, the bargaining range  $(p - c_A, p + c_B)$  is now the current alternative, because this is a strictly better outcome for state A when  $x > p - c_A$ .

This final scenario might be theoretically possible but is where we reach the absolute limits of the model. For this scenario to make sense we must assume that the states either go to war or sanction, they cannot do both. We also must assume that it is possible that  $p$  and  $q$  are sufficiently different, and that the states involved are able to estimate these somewhat correctly. In order to create a model for crisis bargaining for sanctions, it would make sense to allow sanctions to be implemented together with war. Adding the possibility of analyzing different strategies of negotiations would also add to the richness of the model.

### **2.3. Concluding Remarks on the Crisis Bargaining Model With Sanctions**

In the updated model that includes sanctions, it becomes evident that sanctions have the effect of reducing the bargaining range. This reduction occurs because the costs of implementing sanctions are lower compared to the costs associated with engaging in war, resulting in a smaller impact on potential revenue. A narrower bargaining range implies a decreased likelihood of reaching a negotiated resolution. Nevertheless, the overall conclusion aligns with Fearon's (1995) original model, indicating that the bargaining range consistently offers a more favorable allocation of resources for both states involved.

Though the model presents an appealing argument for bargaining between two states, it concludes that bargaining is always the best outcome for rational states. In reality, both sanctions and wars happen. However, conflict is the exception to the rule. In the next chapter we will explore what decides why some states sanction, and others do not.

## 2.4. Why Some States Sanction and Others Do Not

Neither war or sanctions are desired outcomes according to the Crisis Bargaining Model with sanctions. There are several reasons why some states still chose to sanction. One alternative is that a state overestimates its probability of winning using sanctions, or underestimates the costs associated with sanctioning. A perfectly rational state would, as mentioned, still know that a bargaining range will always exist. Another reason could be that there are costs or gains related to the conflict between state A and B that are not captured in the model. This could be that a country decides to sanction out of solidarity or moral reasons and is willing to accept the costs. Or, that states can reduce the costs that sanctions inflict by increasing trade with third countries.

Even though theory tells us that not sanctioning is the optimal solution, this might not always be the number one motivation that some states avoid sanctioning. If there are several states involved, and state A sanctions state B, a third state (C) could profit from replacing state B's lost trade from A. There could also be other reasons not to sanction, such as political alliances or geographical distance from the conflict or problem. These reasons will be important later, when analyzing the role that third countries play in cases of sanctions.

In his book *Why We Fight* (2021), Chris Blattman summarizes why conflict and war arise and why peace persists. Many of his arguments apply to sanctions and could clarify why theory and reality do not align. Based on the bargaining model we explored earlier, peace and bargaining should be the outcome and not conflict. Conflict is the exception to the rule. Blattman lists five main reasons for conflict:

1. Unchecked interests
2. Intangible values
3. Uncertainty
4. Commitment problems
5. Misperceptions

These can be applied to sanctions in the following ways:

*Unchecked interests* cover a principal/agent problem where a leader or state head decides to sanction even though this is not in the interest of the people who bear the cost of the sanctions. Sanctions can be motivated by the desire to protect and promote a country's

economic or political interests. They may be imposed to prevent a targeted state from pursuing actions that could undermine or compete with the imposing state's interests.

*Intangible values* are values like honor, power, and prestige that can only be achieved through war. For sanctions, countries, or countries' leaders, might sanction because it is considered the "right thing to do" to show sympathy to those afflicted by the reason for the sanctions. In the case of Russia, it could be that countries choose to sanction to show support or sympathy towards Ukraine and to seem like powerful and empathetic states and leaders.

*Uncertainty* covers any uncertainty that could skew the bargaining range or a state or leader's perception of where the bargaining range is and how big it is. Some countries might believe sanctions are always very effective and a good solution to a conflict which could cause them to sanction more often. Uncertainty can disrupt negotiations when the involved parties lack trust in one another. It introduces risk aversion, as parties become cautious and hesitant to make concessions or reach agreements due to the fear of unfavorable outcomes. Information asymmetry arising from uncertainty can erode trust between parties, making it difficult to establish common ground. Strategic behavior may surface as parties strategically withhold information or take defensive positions to protect their interests. Uncertainty also affects value perception, as parties may discount potential benefits or overestimate risks. Loss aversion further complicates negotiations, as parties tend to prioritize avoiding losses over acquiring equivalent gains.

*Commitment problems* arise when two or more parties involved do not believe the other will hold up their end of the bargain. This means that countries chose to sanction because they do not think negotiating will have any effect or that if they reach an agreement with a counterpart, they will not follow up on this. There can be concerns that the imposing state may not fully lift the sanctions even if the targeted state complies with the demanded changes. Similarly, the targeted state may hesitate to make the necessary changes if it doubts the commitment of the imposing state to lift the sanctions once compliance is achieved.

*Misperception* involves inaccurate estimates of success and overconfidence. This could mean that a country chooses to sanction and inaccurately estimates its loss in trade. Parties involved may have different interpretations of events, intentions, or capabilities, leading to misunderstandings and miscalculations. Misperceptions can hinder negotiations and hinder the resolution of disputes, potentially prolonging the use of sanctions.

These five, as well as being reasons for war, can also help us understand why we sanction. Blattman also has four main reasons why peace persists or how peace could become the best long-term solution. These can be viewed as additions to the conclusion from the Crisis Bargaining Model, which is strictly based on mathematical analysis. They can also help understand why some states take on roles as third countries in sanction cases. The four paths to peace, according to Blattman, are:

1. Interdependence
2. Checks and balances
3. Rules and enforcement
4. Interventions

*Interdependence* means that parties depend on each other, making conflict more costly. Economic dependency is one such example. The EU has been unable to place a total ban on some types of petroleum products from Russia because of dependency. Other countries could choose not to sanction because the loss of trade is too high, or the possibility of increased revenue is high. This interdependence can be overcome over time, such as the EU moving away from all Russian petroleum products.

*Checks and balances* concern how power is distributed in a country. Power that is more distributed might reduce the chance of conflict. If several interest groups have a say in decision-making, this could change the outcome of policy making and be more peaceful than otherwise. For sanctions, this could apply to interest groups such as producers and workers not wanting to sanction out of self-interest and profit.

*Rules and enforcement* is about rules and agreements between two entities. Two countries that are allies with trade agreements might be more inclined to keep their allies than to sanction, especially if there are rules and agreements between the two.

The last one is *Interventions*. In cases of war and conflict, which Blattman describes, sanctions might be a perfect example of intervention. This point describes incentivizing the other party to keep the peace rather than encouraging conflict. If the question is whether to sanction or not, examples could be negotiations or new trade agreements.

These are all reasons to help us understand what makes some countries sanction when others choose not to, and vice versa. Each country has a different relationship with the potentially sanctioned country, and many factors come into play when deciding whether to sanction. The

Crisis Bargaining Model with sanctions gives us reasons why sanctions do not occur, but Blattman helps to give a deeper understanding of why some states still choose to sanction, and why some choose not to. However, the theoretical framework does not give us insight into the role of third countries. Blattman's paths to peace might shed some light why some countries choose to remain as third countries but does not explain their role in cases of sanctions.

In exploring the dynamics of the Crisis Bargaining Model, this chapter has delved into the theory of bargaining. It emphasizes how it serves as a superior alternative to conflict, such as the imposition of sanctions or engagement in war, for achieving mutually beneficial outcomes between states. However, the efficacy of various diplomatic tools, including sanctions, has been a subject of significant scholarly discourse. This brings us to the second part of this thesis, where the focus shifts to the literature surrounding the effectiveness of sanctions and the role of third countries in influencing their impact.

By examining the interplay between these two realms—the theoretical framework of bargaining and the practical realities of employing sanctions—we can gain a comprehensive understanding of the complex dynamics at play in international relations. It allows us to explore the nuanced factors that shape outcomes in diplomatic interactions. Thus, by bridging these two chapters, we shed light on the connections between bargaining theory and the practical implementation of sanctions. This ultimately contributes to a more holistic perspective on the intricacies of international negotiations and conflict resolution and the role of third countries in sanctions.

## **2.5. Third Countries and the Bargaining Range**

In short, we see that the bargaining range is most affected by changes in costs for state A and B. The model only includes two states and does not initially open up to a third counterparty. However, we can make some clarifying assumptions surrounding a potential third country in this model. As we will see in the next chapters, third countries usually affect sanctions by trading with target countries. In the model, this could affect the costs for each state. If state B is sanctioned by state A, the costs inflicted on state B could be reduced if it is easy to replace lost trade by trading with a third country. If we assume that third countries reduce the costs of the target country it means that the bargaining range will shrink. As previously stated, a smaller bargaining range increases the probability that conflict, or sanctions, will occur. In other words, third countries reduce the probability that state A and B find a bargained solution.

### **3. Literature Review**

This chapter seeks to explore the occurrence and dynamics of sanctions, despite the prevailing theory of bargaining that suggests they are suboptimal outcomes. The objective is to gain a deeper understanding of sanctions by examining relevant literature. The literature encompasses two main areas: the factors that contribute to the imposition of sanctions and the effectiveness or ineffectiveness of sanctions. By delving into these aspects, we aim to enhance our comprehension of the complex nature of sanctions and their outcomes.

The effectiveness of sanctions has been a field of interest for research for decades. Empirically measuring how effective sanctions are, has proven to be a difficult task. One reason for this is that it is disputed when a sanction is considered “effective” or “successful”. Hufbauer et al. (2007) consider approximately 35% of all sanctions effective, and several other analyses reach the same approximation (see for example (Morgan, Bapat, & Kobayashi, 2014)). However, some researchers argue that the threshold for a sanction to be considered effective should be higher. Pape’s (1997) paper argues that only 5 of the 115 cases studied by Hufbauer et al. could be considered effective under a much stricter definition of success. This means that we must approach the theme of effectiveness with caution because definitions of effectiveness often differ from researcher to researcher.

An arms embargo is an example of a targeted sanction with disputed effectiveness. There exist several cases of arms embargoes where the goal has been to limit or end armed conflict, where there has been no notable change in the level of conflict: “Only the use of force convinced the warring factions in Sierra Leone to lay down their arms, and seven years after the Angolan arms embargo, civil war remains in full swing” (Hufbauer & Oegg, 2000).

#### **3.1. Smart Sanctions**

The nature of sanctions has changed in the years after World War II and the Cold War. Mulder (2022) describes the evolution of economic sanctions as extraordinary because they are no longer just an addition to armed conflict, but a coercive tool that can also be used in peacetime. After 1945 there have been at least 1,400 cases of economic sanctions (Aidt, Albornoz, & Hauk, 2021), and according to the Global Sanctions Database (2021), there are currently approximately 400 ongoing sanctions cases. As already mentioned, sanctions historically have been used as an additional tool in armed conflict. They are now often observed as diplomatic tools on their own and as an alternative to armed or military conflict.



One of the developments observed in the implementation of sanctions and sanctions literature is the emergence of more specified and targeted sanctions. Targeted sanctions are also called *smart sanctions*. Smart sanctions emerged in the 1990s to cover a need to enforce sanctions without breaching human rights (Tostensen & Bull, 2002). It could be considered an evolved version of older economic sanctions. Previously, the goal with sanctions was to choke an aggressor's economy as much as possible to achieve a goal without going to war. Although not military or armed conflict, these types of sanctions caused significant damage to innocent people and lower socio-economic groups (Mulder, 2022). Smart sanctions aim to target more precisely and spare innocent victims from collateral damage. They aim to target and penalize political elites and influential individuals more effectively.

## **3.2. Databases of Sanctions**

In the literature, several collections of data on sanctions and their cases are frequently used. Among these, the most prominent databases are the Global Sanctions Database (GSDB), the Hufbauer, Schott, and Elliot (and Oegg) database (HSE/HSEO), Threat of Imposition and Economic Sanctions (TIES), and the Targeted Sanctions Consortium Database (TSC) (Felbermayr, Kirilakha, Syropoulos, Yalcin, & Yotov, 2021); (Hufbauer, Schott, & Elliot, 2007); (Morgan, Bapat, & Kobayashi, 2014); (Biersteker, Eckert, Tourinho, & Hudáková, 2018)). These lay the basis for most empirical research within the field of sanctions. None of them fully cover the recent sanctions of Russia, which will be relevant for the case study later in this thesis. On the other hand, they supply crucial insight into the effectiveness of sanctions and an overview of historical sanctions.

### **3.2.1. *The Global Sanctions Database***

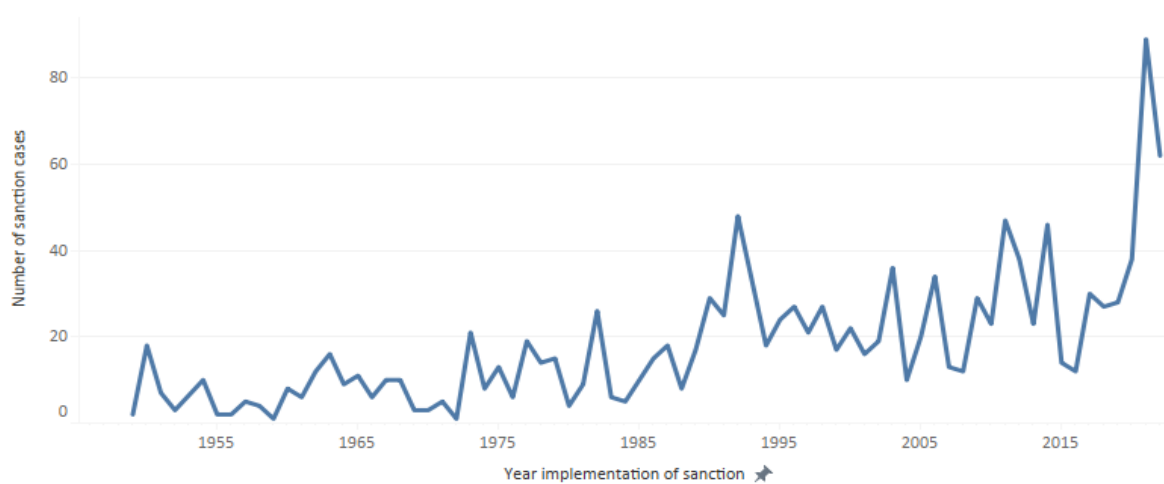
The Global Sanctions Database (GSDB) is a database that covers 1325 sanctions from 1950 to 2022. The database was built for research purposes and includes variables on success, type of sanction, sanctioned and sanctioning country, duration, and other vital factors. It is updated bi-annually and was recently updated (2022) to include sanctions against Russia following the invasion of Ukraine. However, sanctions have been implemented after the last update of the database.

The database classifies sanctions over three main dimensions (Felbermayr, Kirilakha, Syropoulos, Yalcin, & Yotov, 2021):

1. Type(s) of sanctions
2. Political objective(s) behind the observed sanction(s)

### 3. Perceived degree of success for each identified sanction

In the first dimension, the database classifies sanctions into types, the extent of the sanctions, and senders and receivers. In addition to this, the sanctions are classified as unilateral or multilateral, making it possible to perform separate analyses. The second dimension can help compare different policy goals. The third dimension looks at the outcome of the sanctions and is arguably the most essential dimension when looking at the effectiveness of sanctions. The GSDB team informs on their website that the policy outcome is based on information from official government statements and international press announcements.



*Figure 5: Increase of implementation of sanctions from 1949-2020.  
Data source: Global Sanctions Database. Visualization: own work.*

Figure 5 presents a graphical representation of the growing trend in sanctions implementation. The figure displays the annual count of new sanctions imposed over time. Notably, there has been a substantial increase in the number of sanctions implemented during the 1990s, and this upward trajectory has persisted throughout the 2010s and 2020s. This pattern underscores the increasing popularity of sanctions as a means of coercion. Considering this observation within the framework of the earlier presented bargaining model, it can be inferred that the relative cost-effectiveness of sanctions plays a pivotal role. By reducing costs of sanctions, the bargaining range narrows, thereby enhancing the likelihood of their implementation.

The growing frequency of sanctions cases in recent years has highlighted the necessity for a comprehensive database like the Global Sanctions Database. Such databases play a crucial role in facilitating detailed analysis of sanctions by providing accurate and up-to-date documentation. Additionally, these databases enable researchers to delve into the underlying

reasons behind the implementation of sanctions, thus enhancing our understanding of their motivations and objectives. The availability of a robust database not only streamlines the analytical process but also contributes to a more nuanced comprehension of the complex dynamics surrounding sanctions.

### **3.2.2. *Hufbauer, Schott, and Elliot***

Hufbauer, Schott, and Elliot's "Economic Sanctions Reconsidered" (2007) is a database that also offers a case-by-case analysis of each sanction. The HSE database is one of the most essential work collections covering sanctions. It covers cases from 1914 up until 2007 and gives an in-depth description of each case. This is helpful for empirical analysis and understanding each case and the political landscape and period. The database does not cover any of the sanctions against Russia but gives a deeper understanding of earlier cases that could make room for comparison against newer cases.

Hufbauer et al. (2007) argue that sanctions have a role as a coercive policy instrument but are ineffective at achieving their intended goals. In addition, they argue that sanctions often have unintended consequences, such as harming innocent civilians or strengthening a government's resolve to resist pressure. Hufbauer et al. conclude that approximately 30% of sanctions are effective in their analysis. This result has been criticized by Pape (1997), among others.

Another argument made by Hufbauer et al. (2007) is that sanctions are most effective when they are multilateral and when the targeted country is heavily reliant on trade with the sanctioning countries. The argument is that sanctions with more significant economic effects are more likely to be successful. Furthermore, the authors argue that sanctions should be used in a bigger picture because they are more likely to have an effect when used together with other diplomatic and economic tools.

The two databases of sanctions that are highlighted in this chapter are the most prominent ones that are used for analysis of economic sanctions. However, none of them cover data on third countries. Next chapter will cover some reasons how the limitations of these databases can affect the literature and its results.

### **3.3. Selection Bias**

There are discussions and disagreements on how sanctions should be constructed, how effective they are, what effects they are expected to have, and even if they have an effect. There is no clear consensus on whether sanctions are effective. The literature on effectiveness

often arrives at an estimate of sanctions effectiveness between 5% and 30% (see, for example (Pape, 1997) and (Hufbauer, Schott, & Elliot, 2007)). Critics have pointed out that these analyses only include implemented sanctions. The TIES database (Threat and Imposition of Economic Sanctions) also includes threats of sanctions, where sanctions can be considered “effective” even when not implemented if the threat of sanctioning is enough to achieve a policy goal. Sanctions are often considered more effective when threats of sanctions are also analyzed. Some of the possible selection bias in analyses can be covered by also looking at threats of sanctions.

However, an important point of Blattman’s book *Why We Fight* (2021), also mentioned by Kaempfer and Lowenberg (1999), sometimes the most interesting cases are the cases that never happen. The threat of sanctions is one example. Countries who choose not to sanction is another example. The relationship between the receiver of sanctions and third countries who choose not to sanction is important to the sender. The nature of this relationship could affect the effectiveness and rate of success for the sender.

The role of third countries is important for several reasons. Trade flow is affected by sanctions, which is often the goal of specific sanctions. If the sanctioning state has a low trade flow with the targeted state, the sanctions do not necessarily have a significant impact beyond a symbolic or political value. When larger or close trade partners do not sanction, it could be easier for the target state to avoid sanctions. If the targeted state has low costs associated with redirecting trade to non-sanctioning trade partners, this could harm the intended infliction of the sanctioning state. Moreover, seeing as sanctioning states accept some loss in trade when sanctioning another state, it could leave the sender state as the loser and the target state indifferent. The use of databases in analyses on sanctions increases the need for databases that also cover information on third countries.

### **3.4. Gravity and the Effectiveness of Sanctions**

The Gravity Model is a tool usually used to analyze bilateral trade relationships and is widely recognized as a successful empirical model in economics (Anderson, 2011). In sanctions literature, the model is often used to examine the effect of sanctions ex-post. It is especially helpful to analyze trade changes between two countries to identify the effect of sanctions as barriers to trade. The model can be expanded to include other barriers to trade, for example, one state being an island state, cultural or linguistic differences, or religion. The model is often used to evaluate the effectiveness of sanctions by estimating lost trade between two

states after the implementation of sanctions. Anderson and van Wincoop (2003) famously used the Gravity Model to present a solution the “Border Puzzle”, which considers why countries who border each other have different economic outcomes. In short, sanctions are barriers to trade, driving states "further apart" in the Gravity Model, thus reducing trade.

Felbermayr et al. (2019) use the structural Gravity Model to estimate the effect of sanctions on international trade. The structural Gravity model provides a more comprehensive analysis by considering a wider range of factors that influence international trade. Their study on sanctions against Iran finds that complete bilateral sanctions are effective at reducing trade by 85-86%. Complete bilateral sanctions here mean both imports and exports between two states. They also find that the effect of the sanctions differs according to the initial level of trade between the two states.

Hufbauer et al. (1997) use the gravity model to estimate lost trade for the sender country of a sanction. By comparing the actual trade flows before and after the imposition of sanctions, Hufbauer et al. estimate the lost trade resulting from the sanctions. However, they note that the gravity model may underestimate the actual costs of sanctions, as it does not account for non-tariff barriers and other distortions that often accompany sanctions.

In addition to estimating the immediate economic impact of sanctions, Hufbauer et al. (1997) also investigate the so-called "echo effect" of sanctions, which refers to the long-term decline in trade that persists even after the sanctions are lifted. This effect may result from the loss of business contacts, reputational damage, and the emergence of alternative trading partners during the period of sanctions. However, the analysis yields inconclusive results regarding the magnitude and persistence of the echo effect, suggesting that more research is needed to understand the long-term consequences of sanctions on trade fully.

In a study from 2003, Hufbauer and Oegg (2003) use Rose's Gravity Model (2004) to look at the effect of economic sanctions on US bilateral trade flows. They conclude that on current sanctions, extensive sanctions "have a large depressing effect on bilateral trade flows, and the coefficients are highly significant" (p. 5). For limited and moderate sanctions, the results are not statistically significant at the usual levels of significance. In the case of effects after sanctions have been lifted, the authors find little evidence that sanctions continue to suppress bilateral trade after they have been lifted. As a matter of fact, the case is often the opposite: trade picks up after sanctions are lifted. In this study, the Gravity Model indicates that

bilateral trade is affected negatively in cases of sanctions, at least in the case of extensive sanctions.

Afesorgbor (2019) uses the Gravity Model to compare threats of sanctions against implemented sanctions. The analysis looks at changes in trade flow between countries that threatened with sanctions, and countries that implement them. The author concludes that imposed sanctions decrease trade flow, but threatened sanctions lead to an increase in trade. One explanation of this could be due to stockpiling during the threat stage of the interaction. This analysis shows how the Gravity Model of Trade can be used to analyze trade relationships in respect to sanctions.

The Gravity Model can give interesting results in analyses of changes in trade before and after the implementation of sanctions. We have seen studies that look at the effect it has for both sender and target country, in addition to long term effects. It could be a useful tool to analyze changes in trade for third countries, but few or no such analysis have been executed. This means that we cannot yet say anything about the role of third countries using existing literature that utilizes the Gravity Model.

### **3.5. Unilateral Versus Multilateral Sanctions**

Similar to various other political tools, sanctions exhibit differentiation and manifest in diverse formats. One difference found in sanctions is unilateral versus multilateral sanctions. Unilateral sanctions are sent by one country and target another country. These can be caused by political disagreements and work as a coercive tool between two countries where the issue is usually not of greater interest to international politics. Multilateral sanctions have several senders put sanctions on one receiving country. Often the senders are allies in one way or another and have similar interests. In the case of Russia's invasion of Ukraine, we see large-scale, multilateral sanctions from 45 countries, including the EU and US. We can also observe cases of several countries sanctioning a group of countries, but we will stick with the first two instances for now.

In a newer analysis by Hufbauer and Schott (2010), it is concluded that multilateral sanctions are not more effective than unilateral sanctions and that, in fact, they might be less effective. This contradicts Hufbauer et al.'s (2007) previous analysis from "Economic Sanctions Reconsidered." One of the reasons for this result could be a selection bias in the data. Multilateral sanction cases are often more significant and of international concern, and cases like these might be less likely to be solved through sanctioning. It could also be that unilateral

sanctions are more effective when the sanctioned country is heavily dependent on trade with the sanctioning country.

In the book “Sanctions Paradoxes” (2003), Drezner argues that unilateral sanctions could be more effective than multilateral sanctions because they require less coordination between countries and can be imposed quicker. He utilizes the case of unilateral sanctions to illustrate that dominant economic powers could attain greater success. An example is the implementation of sanctions by the United States against Iran.

Bapat and Morgan (2009) reach a different conclusion using the TIES dataset. In the analysis, it is concluded that multilateral sanctions are more effective than unilateral sanctions. The first argument is that more countries can put more pressure on a sanctioned country, reducing the sanctioned party's ability to find new trading partners. Secondly, Bapat and Morgan also note that the severity of the sanctions is an essential factor in determining their effectiveness. Sanctions that are too mild will have no effect, and sanctions that are too severe could provoke resistance. The third argument is that economic interdependence between countries is an essential factor in effectiveness. Overall, multilateral sanctions could be more effective, but the effectiveness is contingent on several economic and political factors. Some analyses also suggest that unilateral sanctions cannot be successful or have desired economic effect simply because trade will “leak” to other trade partners unless the sanctioning state has monopoly power in the sanctioned goods (see for example (Martin, 1992)).

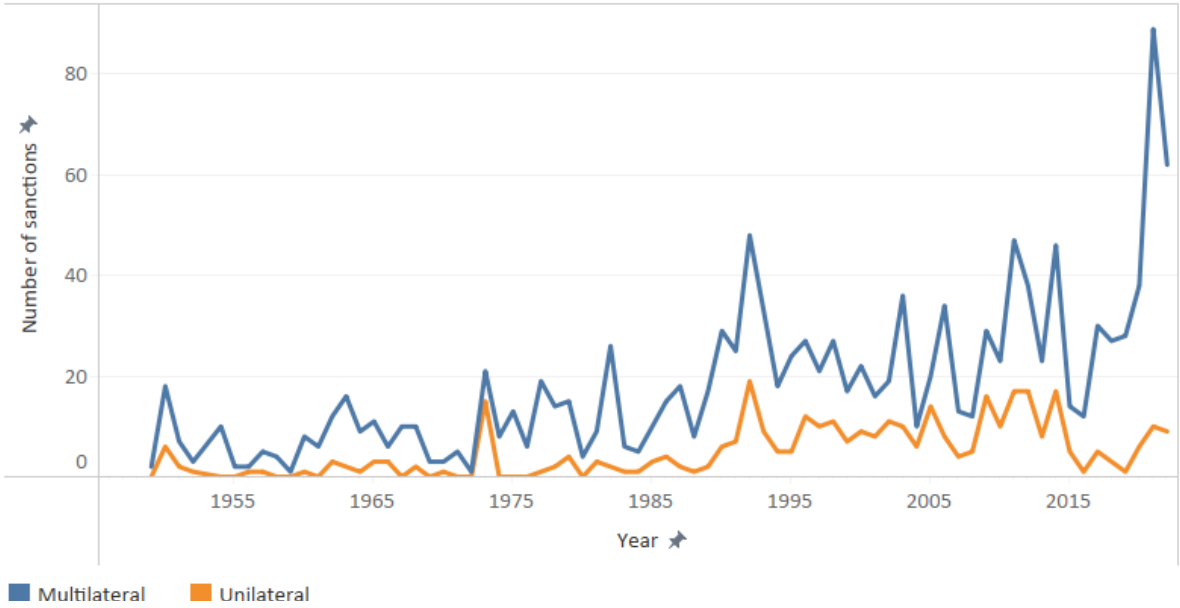


Figure 6: Change in the number of unilateral and multilateral sanctions from 1949-2020. Data Source: GSDB. Visualization: own work

In recent years, after the 1990s, multilateral sanctions have become increasingly common, as seen in Figure 6. The figure shows the number of sanctions cases implemented in a given year. The UN is an example of how states come together to implement significant multilateral sanctions. The most prominent issuer of unilateral sanctions is the United States, noted to have issued sanctions against 35 countries between 1993 and 1996 (Kaempfer & Lowenberg, 1999). According to the Global Sanctions Database (2021), the United States has ongoing sanctions against 78 countries as of 2022. Kaempfer and Lowenberg conclude that multilateral sanctions often end in a more significant effect on trade for a sanctioned country. However, they also highlight a significant difference between economic and political impacts. Because of this, they conclude that unilateral sanctions might be more effective in reaching the political goal.

Hufbauer, Schott, and Elliot (2007) conclude a positive correlation between economic damage and political success. However, Kaempfer and Loewenberg's analysis suggests that multilateral sanctions might be no more, or even less, effective at reaching the political goal than unilateral sanctions. Kaempfer and Lowenberg address the contradicting logic of existing literature: empirically, sanctions are more effective if they have a more significant economic impact, and multilateral sanctions generally cause a greater economic cost to the receiving country. However, multilateral sanctions do not seem to be any more effective than unilateral sanctions.

Once again, we realize that attempting to generalize sanctions only gives us more questions than answers. From existing literature, we cannot say whether unilateral or multilateral sanctions are more efficient. What we can say, however, is that the economic and political ties between sanctioning and sanctioned state are important pieces in the sanctions puzzle. Moreover, as put by Kaempfer and Lowenberg: "[...] multilateral sanctions are characterized as much by which countries do not join the sanctioning coalition as by those that do" (1999, s. 55). Not only do we need to consider which states are sanctioning, but also which countries are *not* sanctioning. These third countries might take up more trade with the sanctioned country, which could help mitigate the impact of the sanctions. In the following paragraphs, I will further investigate sanctions-busting and transshipment, which can be reasons for sanctions not having the intended effect with the participation of third countries.



### 3.6. Sanctions-Busting

Sanctions-busting occurs when a third country acts against the interests of the sanctioning parties. For instance, a third country can compensate for lost trade when an imposing state enforces sanctions on a targeted state. This could undermine the effectiveness of the sanctions for the sender and make the situation easier for the sanctioned state. Target states that are subjected to sanctions by their close trading partners are more likely to succumb to the imposed measures compared to states that have readily available and cost-effective alternatives to replace the trade relationship (Early, 2015). Early defines sanctions-busters as “third-party states that respond to the imposition of sanctions by increasing their economic engagement with target states in ways that ameliorate the sanctions' adverse consequences” (2015, p. 21).

Not all forms of sanctions-busting look the same. Early (2015) describes at least two different types in *Busted Sanctions: Explaining Why Economic Sanctions Fail*. One type of sanctions-busting includes third countries exploiting the trade opportunity of sanctions. When one country sanctions another country, the sanctioned country will have some uncovered demand that third countries can profit from. The other type is what Early describes as aid-based sanctions-busting. Aid-based sanctions-busting occurs when third countries employ foreign aid for the sanctioned country to resist imposed sanctions. The third party does not necessarily mean it to resist sanctions but could still contribute to the target country's ability to resist. Examples of aid-based sanctions include military aid, financial subsidies, and direct grants. Aid-based sanctions-busters are often governments, and the role tends to be publicly announced for international recognition.

Sanctions-busting is one example of how complex sanctions can be, and it can potentially spoil otherwise effective sanction schemes. A target country with easy access and low costs related to changing trade partners, and third countries with economic interests in busting sanctions, could prove fatal to a potential plan for sanctions. It is essential for sanctioning states not to rule out the possibility of sanctions-busting when creating their sanctions policies. Neglecting the possible effects of sanctions-busting could harm the intended effect from the sender. In the worst-case scenario, sanctions could hurt the trade flow of a sender-state more than the receiving party.

### **3.7. Transshipment**

Transshipment is a term originally used in the shipping industry to refer to transferring goods from one ship to another to complete the shipping journey. However, it has also been applied to the context of economic sanctions, where transshipment points refer to states or countries that import goods and export them to a country under sanction by the original sender of the goods. This practice is sometimes used to bypass sanctions and can have significant implications for the effectiveness of the sanction regime (see for example (David, Stewart, Reid, & Alperovitch, 2023)). This is one form of sanctions-busting. It does not necessarily include intent to transship from the sender country. However, it could be a deliberate action taken by the original sender country to avoid trade embargoes and sanctions. This does not only apply at state level but also firm level. It is not necessarily the intention of each state to either export or import to or from a sanctioned country, but firms might try to avoid sanctions via transshipment. Transshipment is closely related to re-export. However, transshipment does not add value to the goods at hand, while re-export might involve value-addition.

Studies find that export from target countries to thirds countries increase after the implementation of sanctions (Haidar, 2017). This means that there is reason to suspect that sanctions do not have the intended effect and that third countries do indeed play a part in the effectiveness of sanctions. Haidar (2017) found that two-thirds of Iranian export affected by sanctions in 2008 was redirected to non-sanctioning countries. Subsequently, exports from these countries to sanctioned countries increased. In the following case study of sanctions against Russia, we will see similar effects.

### **3.8. Bridging Theory, Literature, and Real-World Application**

The preceding sections have established the theoretical foundation regarding bargaining and conflict, specifically in the form of sanctions and war. The literature review has further examined the effectiveness of sanctions and explored the intricate role of third countries in shaping their impact. While these theoretical and empirical insights provide value, it is imperative to examine their practical relevance and applicability within real-life scenarios.

To illustrate the tangible implications of the discussed theories and the effectiveness of sanctions, the attention turns to a compelling case study: the sanctions imposed against Russia after the invasion of Ukraine in 2022. This case study offers a nuanced lens through which we can evaluate the theories on bargaining and the real-world consequences of sanctions, while also accounting for the intricate dynamics involving third countries.

This case study not only provides a real-life context to examine the effectiveness of sanctions but also sheds light on the diverse factors at play, including the involvement of third countries. Furthermore, analyzing the sanctions against Russia allows us to explore the multifaceted dimensions of the case. By examining the interplay between theory, empirical evidence, and the specific circumstances of the case, we can draw conclusions about the effectiveness and ramifications of sanctions as a diplomatic tool.

The case study on sanctions against Russia serves as a bridge between theory and the practical application of the concepts discussed in the preceding sections. It provides an opportunity to challenge or refine the theoretical frameworks through a real-world lens, ultimately contributing to a more nuanced understanding of the complexities and the efficacy of sanctions.

## 4. Russia

At the time of writing this thesis, it has been over a year since Russia invaded Ukraine. In the aftermath of the invasion, there has been constant analysis of the following sanctions. In this section, I will examine three important parts of the Russian economy; oil and gas, technology, and the financial sector. The goal is to get an overview of sanctions in each domain, highlight their intended effect, and look at how non-sanctioning states might be hurting the effectiveness of these sanctions.

Russian trade has changed significantly since the outbreak of the war, most likely to compensate for sanctions. Even though Russian imports are almost back to pre-war levels (European Central Bank, 2023), the selection of trade-partners is far less diverse than previously. This could make the Russian economy more fragile. China now provides half of Russia's import of goods. In addition, the European Central Bank points out that new imports could differ in quality from previous trade partners, which could affect the Russian economy's productivity.

Amid all the analyses of change in Russian trade, it could be helpful to remember that change in a country's economy does not equal a successful sanction. As van Bergeijk put it: "In the end sanctions are not about imposing damage but about changing behavior. Sanctions that are effective in the sense that they create a lot of damage must be considered a failure if they do not change the target's behavior" (2022, p. 10). It is crucial to recognize that the impact of sanctions on an economy does not necessarily guarantee the desired outcome of inducing change. Kaempfer and Lowenberg (1988) conclude that "Economic damage is also not the only, or even the most important, dimension of the effect of sanctions on the target country." (p. 793). This thesis, and indeed this case, will not suggest the most crucial dimension of a sanction. However, understanding how sanctions affect a country might give some understanding as to why they turn out to be effective or not. Furthermore, as has been the focus of this thesis, looking at the role of third countries in cases of sanctions.

### 4.1. Changes in Russian Trade

We can look at trade data to support the claim that third countries are increasing their trade activity with Russia after the implementation of sanctions. I have gathered trade data from the US, EU, India, Türkiye, and China for this section. The US and EU are sanctioning parties. India, Türkiye, and China are currently not sanctioning Russia and are potential third countries. The following figures (Figures 7-11) present export and import data from January

2021 to March 2023. The intention has been to show the general trend in trade with Russia before the invasion. Nevertheless, it is important to acknowledge that trade with Russia may have been influenced by factors such as the Covid-19 pandemic and the 2014 sanctions prior to the current data representation.

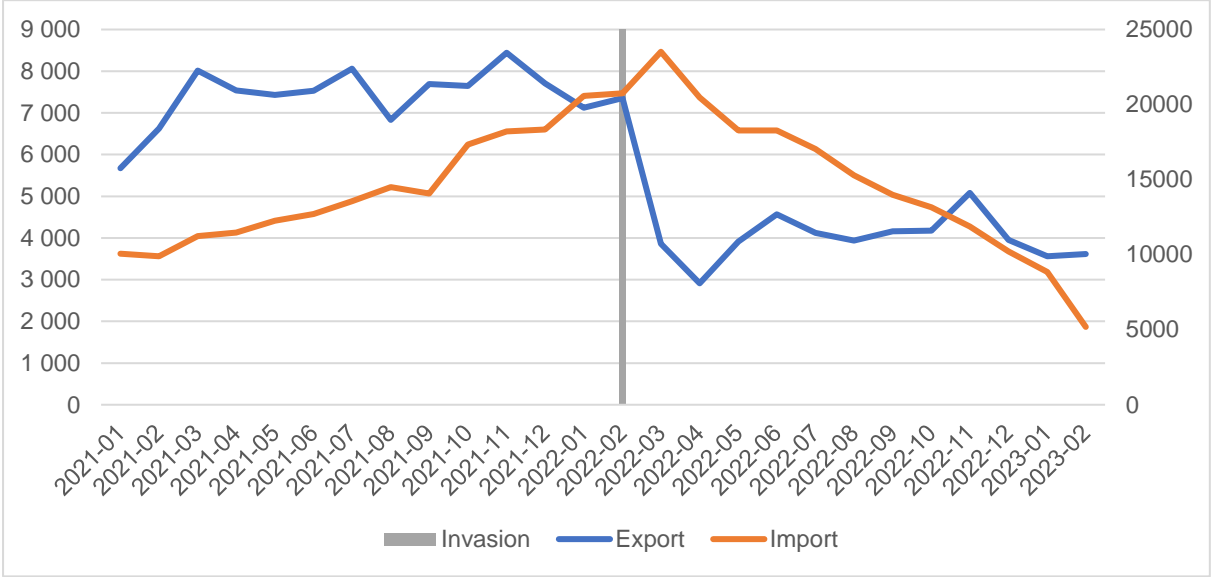


Figure 7: EU trade with Russia in mill. EUR. Exports on left axis, imports on right axis. Data source: Eurostat. Visualization: own work.

EU countries experienced a more gradual adjustment after the invasion, but still a dramatic drop in exports initially as seen in Figure 7. Imports appear to still be sinking, which could be caused by the EU gradually moving away from Russian oil and gas. Imports have sunk by approximately half and have reached almost 1/4 of pre-war levels (Eurostat, 2023). Looking at these numbers, it is evident that Russian trade has changed substantially after the invasion and implementation of sanctions.

The United States is less dependent on Russian oil compared to EU countries. According to the Gravity Model of Trade, the geographical distance between Russia and the US compared to the EU could also explain the lower degree of economic interdependence between the nations. Before the invasion, US imports from Russia were around \$2.5-\$3 billion. Following the sanctions, imports have sunk below \$500 million (United States Census Bureau, 2023).

A look at US trade with Russia in Figure 8 shows that trade has declined dramatically after the Russian invasion of Ukraine and the implementation of sanctions. There is a slight lag in the decline in imports, which could be caused by a transitional period following the sanctions. Firms with contracts with Russian exporters might have been unable to terminate these immediately. Replacing Russian trade with other trade partners could also have taken a few weeks. Trade with Russia in both directions has stabilized at a much lower level than previously.

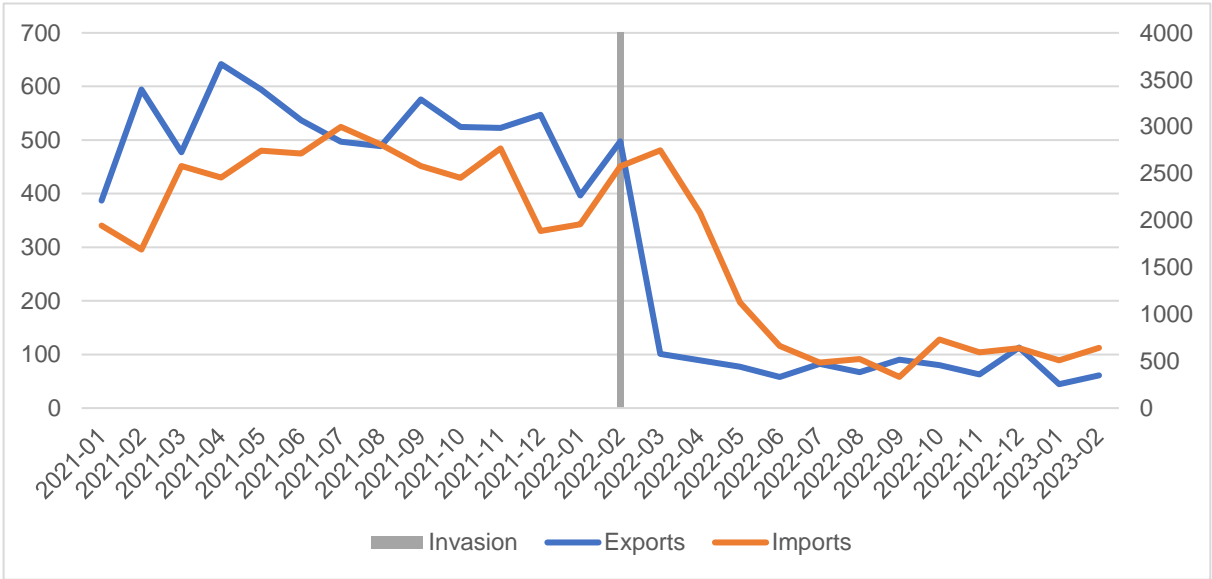


Figure 8: US trade with Russia in mill. USD. Exports on left axis, imports on right axis. Data source: United States Census Bureau. Visualization: own work

The focus of this thesis has been third countries in relation to sanctions. Especially interesting in the case of sanctions against Russia have been countries who choose not to sanction. For at least China, India, and Türkiye, trade has changed drastically after Russia invaded Ukraine. They seem to have regained their trade after the shock the invasion had on international trade with Russia (Figure 9, 10, and 11). There might be a reason to suspect that their trade patterns have changed to accommodate Russia's lost trade with sanctioning countries.

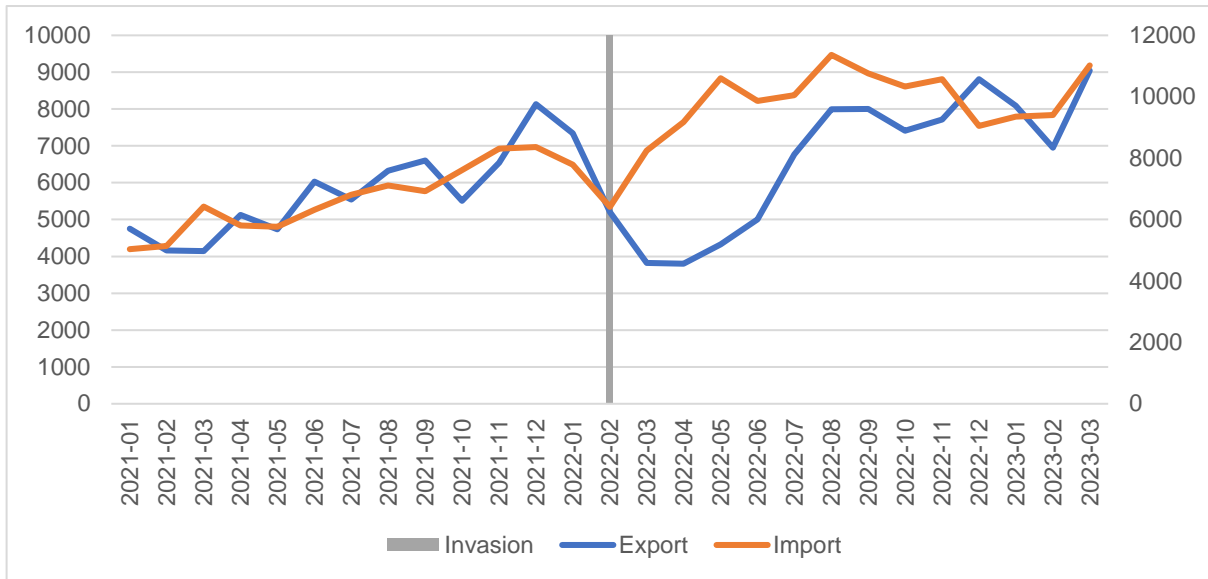


Figure 9: China's trade with Russia in mill. USD. Exports on left axis, imports on right axis. Data source: General Administration of Customs of the People's Republic of China. Visualization: own work.

China's trade seems to have reached pre-war levels (General Administration of Customs of the People's Republic of China, 2023). As seen in Figure 9 there are also indications that imports have increased, along with what appears to be an increasing trend in exports. It seems that, for all three countries, exports took an immediate hit but recovered after a 3-4 month period. Both for Türkiye (Figure 10) and India (Figure 11) we see increases in imports from Russia. Türkiye's export to Russia has also increased from approximately \$500 million to \$1-1,2 billion (Turkish Statistical Institute, 2023). An increase in exports to Russia could indicate transshipment, but to prove this, tracking the shipment of goods on a firm level is necessary.

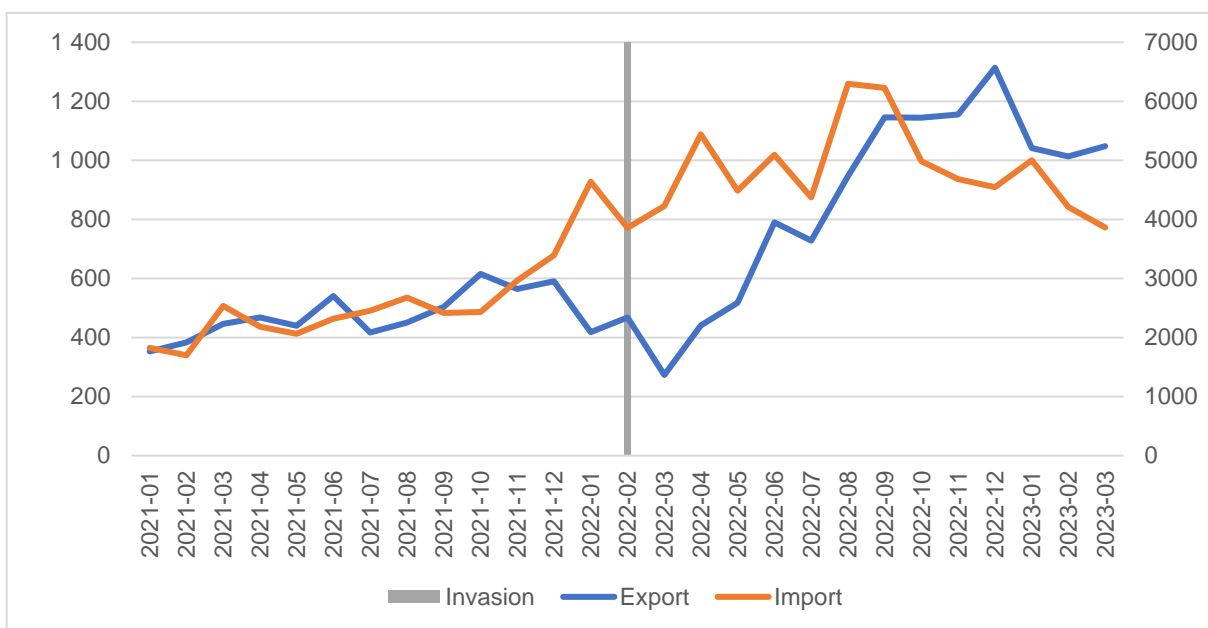


Figure 10: Türkiye trade with Russia in mill. USD. Exports on left axis, imports on right axis. Data source: Turkish Statistical Institute. Visualization: own work.

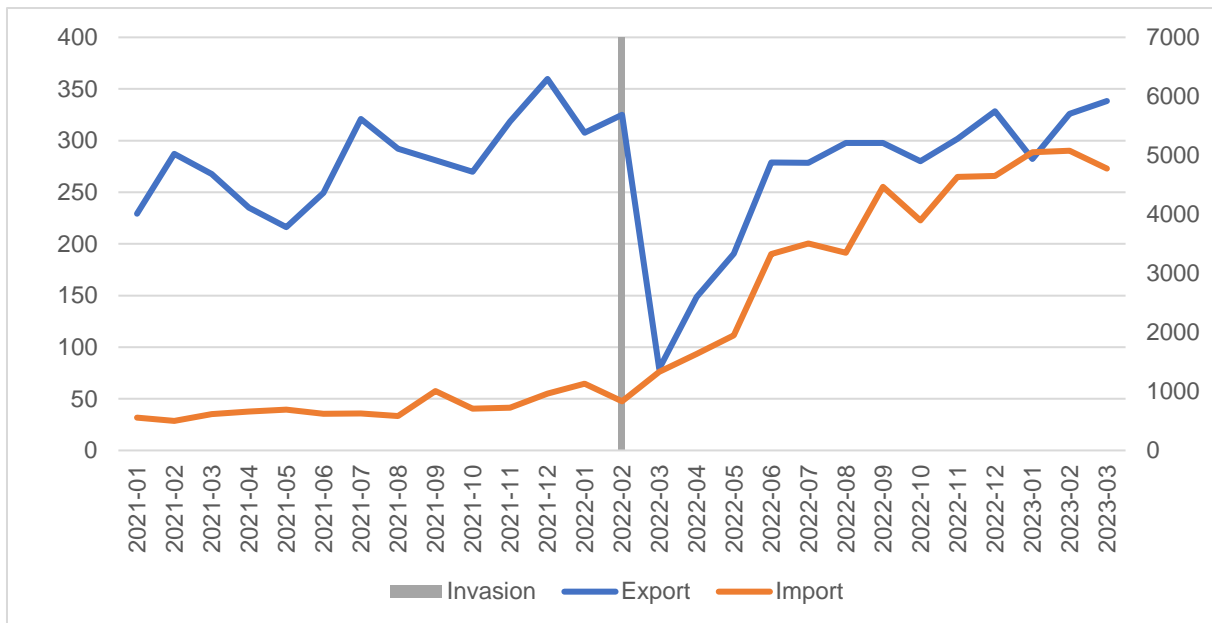


Figure 11: India's trade with Russia in mill. USD. Exports on left axis, imports on right axis. Data source: Government of India, Ministry of Commerce and Industry. Visualization: own work.

India had similar trends (Figure 11), with an immediate decline in exports to Russia that has recovered. Import has increased by almost 450% from February 2022 to March 2023 (Government of India, 2023).

In the following chapters, this thesis will focus on three specific sanctions that cover oil and gas, technology, and the financial sector. This will cover explanations as to why EU and US trade has changed the way it has and why third countries' trade has changed in a different way.

## 4.2. Oil and Gas

### 4.2.1. Types of sanctions

Oil and gas are among the most critical parts of the Russian economy. According to the Ministry of Finance of the Russian Federation, 39.3% of the federal budget revenue in 2019 came from oil and gas (Makarov, 2022)<sup>1</sup>. This, according to Makarov, made up 14.2% of the Russian GDP in the same year and 60% of Russian exports. Russia was also the third largest oil producer in the world in 2020, accounting for 40% of Europe's gas in 2021 (BP., 2022).

Sanctions related to oil and gas from Russia have been complicated due to Europe's dependence on Russian petroleum products. Sanctions from the EU on Russian crude oil were

<sup>1</sup> Ministry of Finance of the Russian Federation data accessed through this article. It is currently impossible to access the Russian MinFin website for unknown reasons.



not implemented until December 2022, more than half a year after the invasion of Ukraine. Sanctions on refined petroleum products applied as of February 2023 (European Council, 2023). The US has banned the import of Russian oil and gas, and Germany froze its plans to open the gas pipeline Nord Stream 2. The EU has implemented an import ban on Russian seaborne crude oil and petroleum products which took effect on December 5, 2022, for crude oil and February 5, 2023, for petroleum products.

In addition to the EU sanctions on Russian crude oil and petroleum products, the EU, G7<sup>2</sup>, and Australia agreed on a price cap on seaborne Russian petroleum products (diesel and fuel oil) and seaborne Russian crude oil (European Commission, 2023). This coalition is known as the Price Cap Coalition. The price cap is set at \$60/barrel. In addition, there are two price levels on Russian petroleum products that differentiates between “premium-to-crude” and “discounted-to-crude”. The first includes diesel, kerosene, and gasoline. The second includes fuel oil and naphtha. “Premium-to-crude” is capped at \$100/barrel, and “discount-to-crude” is capped at \$45/barrel. This comes on top of the EU ban on Russian petroleum products. The European Commission states this is to “allow European operators to transport Russian oil to third countries, provided its price remains strictly below the cap” (European Commission, 2023). In comparison, other types of crude oil (e.g., Brent, WTI, Murban) has been trading at between approximately \$65 and \$85 during March 2023.

The price cap affects the price that sanctioning countries pay for Urals crude oil. In addition, third countries are unable to buy crude oil from Russia for more than \$60 if shipment must go through sanctioning countries, or uses shipment owned by sanctioning countries.

#### ***4.2.2. Intended effect of sanctions***

The goal of the Price Cap Coalition and the EU ban on Russian crude oil is divided into three main goals:

1. Maintain some supply of Russian oil and gas to keep markets stable.
2. Reduce pressure on prices of petroleum products globally.
3. To reduce Russian earnings from oil and gas as much as possible to limit their ability to finance their war in Ukraine.

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<sup>2</sup> The G7 (Group of Seven) countries are: Canada, France, Germany, Italy, Japan, The United Kingdom, and The United States.

In addition to harming the Russian economy, the EU has also focused on avoiding harming third countries: “The EU continues to ensure that its sanctions do not impact energy and agrifood exports from Russia to third countries.” (European Commission, 2023). This is one way of implementing smart sanctions. The coalition has made it possible for countries dependent on Russian oil to take part in sanctioning Russian oil revenues without hurting themselves too much. Shipments that involve EU or G7 vessels are bound by the price cap, even if the destination is a third country.

The cap on Russian oil also aims to avoid a price shock in the market if Russia stops producing oil. It is, therefore, essential to keep the price cap higher than Russia’s estimated production cost of \$10-15. It is estimated that each \$1 reduction in the price cap will hurt Russian oil revenue by \$2.7 billion per year if we assume an export level of 2.7 billion barrels (The International Working Group on Russian Sanctions, 2022).

A price cap like the one against Russia is unprecedented in history. This makes it difficult to make a case-by-case comparison to say anything about the possible outcomes of the Price Cap Coalition. Sanctions on oil are, however, not a new phenomenon. Iran has previously been heavily sanctioned by the EU and the US, and sanctions on oil are one of the devices utilized. Just like in the case of Russia, the sanctions against Iran have been many, and the economic picture is complex. Iranian oil has been sanctioned by the US, UN, and the EU. Most recently by the US, after the Trump administration withdrew the country from the JCPOA deal in 2018. Iranian crude oil exports fell from 2,125,00 barrels per day (bpd) in 2017 to 651,131 bpd in 2019 (CEIC, 2021). This means that even if it was an alternative for Iran to export its oil production to other non-sanctioning countries, they have not been able to maintain export levels prior to the latest US sanctions. An American report from 2013 concluded that half of Iran’s government expenditures are funded by oil (Katzmann, 2013).

Extracting the exact effect of sanctions on Iranian oil has been difficult because of a composite and complex selection of sanctions. In this case, sanctions on oil have, in some periods, been combined with SWIFT sanctions (Society for Worldwide Interbank Financial Telecommunication), in addition to trade sanctions. To begin with, SWIFT sanctions affect banking and international payments, which could halt or complicate the trade of oil between counterparties that have no sanctions between them. This detail makes the case of Iran more comparable to Russia than other cases; they are the two only countries ever to have been sanctioned for the export of oil and from using the SWIFT system. I will go further into detail on the financial sanctions, including SWIFT, in the chapter concerning this specific sanction.

### 4.2.3. *Effects of sanctions*

Babina et al. (2023) investigate the impact of international sanctions on Russian oil exports. They focus on Russian crude oil exports after the EU embargo and the G7 price cap on seaborne crude oil. The analysis concludes that the export volume is not affected too much because Russia could redirect its trade to other markets, such as India, China, and Türkiye. However, earnings from exports were substantially negatively affected because Russian exporters had to accept lower prices in these regions. They also suggest, together with The International Working Group on Russian Sanctions (2022), that the price cap can be lowered to \$35/barrel.

Sanctions against Russian oil do not necessarily curb Russia's ability to export its crude oil. However, it reduces profits from their exports. If the main objective is to hurt the Russian economy and earnings, this could be considered an economically effective form of sanctioning. Russia is still exporting almost the same levels of oil and gas, but revenue has decreased sharply. In March 2023, Russia announced that they would cut oil production by 500,000 bpd (Reuters, 2023), which could mean that they are either trying to put upwards pressure on international oil prices or struggling to sell what they already have.

Data from the European Central Bank shows that Russian exports to sanctioning countries have decreased since the start of the war and decreased even further after implementing the sanctions and the Price Cap Coalition. However, there has been almost an identical *increase* in exports to non-sanctioning countries. India has had an increase from practically nothing to almost 2,000,000 bpd from pre-war levels to post-sanction levels (Feveile Adolfsen, Gerinovics, Manu, & Schmidt, 2023). The European import of gas from Russia had in February 2023 fallen 90% lower than the historical average (European Central Bank, 2023) and been replaced with alternatives from non-sanctioned countries. Babina et al. (2023) suggest that exports to non-G7 countries such as India, Türkiye, and China have increased to further export this to sanctioning countries.

Despite increasing Russian oil exports, revenue fell from \$20 billion in February 2022 to \$11.6 billion in February 2023 (The Moscow Times, 2023). This means that the Price Cap Coalition has influenced the demand and price of Russian crude oil, ostensibly affecting Russian oil revenue. In this sense, the Price Cap Coalition has had the intended effect of hurting Russian earnings. The Price Cap Coalition has also lost Russia the European energy market. Pre-war levels for European dependence on Russian energy at 46% coal, 27% oil, and

41% gas (Nell, et al., 2023). After the sanctions, Europe has found its energy elsewhere, reducing the levels to 0%, 5%, and 8%, respectively. However, increasing exports to non-sanctioning countries has hurt the full potential effect of the sanctions by allowing Russia to keep producing and exporting most of their oil.

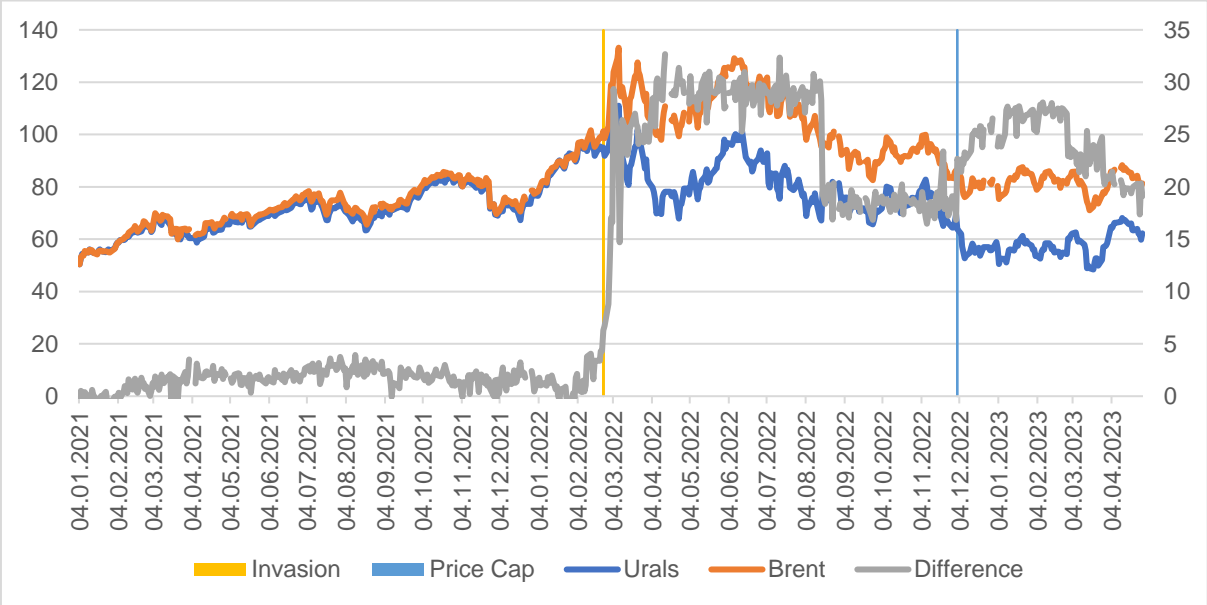


Figure 12: Price difference USD between Urals crude oil (blue) and Brent crude oil (orange) between 01.01.2021 and 24.04.2023.

Data source: EIA and Investing.com. Analysis and visualization: own work

Figure 12 shows the price difference in crude oil and covers the data from the invasion (yellow line) and the implementation of the price cap (blue line). The left axis is the price of crude oil, and the left axis is the difference in price between Brent crude oil and Urals crude oil. Looking at the historical price difference between the two, there has, previous to February 24, 2022 been little to no difference in price. After the Russian invasion of Ukraine, demand for Urals crude oil fell, creating a price difference of \$25-30/barrel. Among other things, the US banned the import of Russian oil, gas, and coal in March 2022 (The White House Press Release, 2022). In August 2022, there is a decrease in the price difference of approximately \$10/barrel. This is caused by a slight decrease in the price of Brent crude and a larger increase in the price of Urals crude. The new price difference from August 2022 to the implementation of the price cap is stable at around \$18-20/barrel. The price cap increased the price difference up to \$30, but the difference appears to once again be decreasing. The decrease in the price difference could be caused by Russia being able to sell Urals above the price cap to non-sanctioning countries (Babina, Hilgenstock, Itskhoki, Mironov, & Ribakov, 2023).

If we keep the assumption that Russia exports 2,7 billion barrels of oil annually and assumes a price difference of \$20, the price cap could cost Russia \$54 billion in revenue from Urals crude every year. However, if the change in price difference in August 2022 is caused by third countries changing their demand towards Urals crude, this could amount to a reduction in price difference from \$30 to \$20/barrel. The additional \$10 difference equals a potential loss of \$27 billion on top of the \$54 billion. From the previous estimation we see that every dollar change in the price of Urals could change Russias revenue from oil by \$2.7 billion. If third countries are buying more Urals and increasing the price, this has effect on revenue.

### **4.3. Technology**

One important piece in the sanctions puzzle has long been technology, not only in the case of Russia but in most cases of sanctions related to military conflict in recent years. Technology is a broad term, but it concerns, for example, software or hardware for computers, vehicles, military equipment, and weapons. Not only will sanctions on technology have an economic effect, but they could weaken a country's military capabilities. In the time following the Russian invasion of Ukraine, there has been little time to analyze the effects of the sanctions. However, I will summarize what the existing literature and reports have found so far.

Sanctions on technology against Russia were first set in motion in 2014 after the annexation of the Crimean Peninsula. There are significant differences between the sanctions that were implemented in 2014 and the sanctions that were implemented in 2022. The first sanctions in 2014 sanctions have been described as "half-hearted" (IISD, 2022) because they were very vaguely formulated and still allowed some types of technology to enter Russia. For example, technology sanctions from the EU shielded Russian gas companies such as Gazprom and Novatek. The 2022 sanctions implemented after the invasion of Ukraine have been much stricter.

In a report for Silverado Policy Accelerator, David et al. (2023) ran case studies on Russian imports in specific parts of the technological sector. Their findings support previous suspicions that certain Russian imports shifted to countries like China and Türkiye after the start of the war in February 2022. David et al. also report that imports to Russia increased leading up to the outbreak of the war, pointing towards deliberate planning and possibly increasing inventory of specific technologies as preparation for the war. Another point to take away from this report is that even though technological exports to Russia have decreased, they are also possible to work around. For example, Russia has shifted imports of integrated

circuits to China instead of the EU and US. Even though the volume is lower than previously, it could be enough to undermine sanctions if this is true for other critical technological sanctions.

#### ***4.3.1. Types of sanctions***

In Russia's case, sanctions regarding technology are mostly export bans. This means that countries adopting these sanctions will not export certain technological goods to Russia. Oil and gas sanctions were mostly import-bans, meaning that sanctioning countries would not import Russian oil and gas products. The direction of the sanctions is part of making them more targeted. Export sanctions targeting technology have a more precise and focused objective than a broad-based bilateral sanction that applies to all goods. This is because technology sanctions are designed to restrict the export of specific technologies or products that could be used for military or strategic purposes while allowing other types of goods to be traded freely. By targeting technology exports, governments can aim to limit a specific country's access to advanced technology while minimizing the impact on other aspects of their economy. In contrast, a general sanction on all goods could have a more widespread impact on the target country's economy, affecting both strategic and non-strategic industries.

Sanctions from the EU in the technology sector include cutting-edge technology, energy industry equipment, aviation and space industry technology, drones, software, firearms, and oil-related equipment and technology (European Council, 2023). Most other sanctioning countries have adopted the same or similar export sanctions. The sanctions on technology are broad and cover various types of goods. They target the production of oil and gas and technology needed for military operations. This includes vehicles, weapons, aircraft, radar systems, software, semiconductors, and other components that could be used in Russia's warfare.

#### ***4.3.2. Intended effect of sanctions***

The implementation of technology sanctions against Russia aims to significantly hinder its ability to sustain its military operations in Ukraine. By imposing restrictions on the supply of technological components from the European Union, G7 countries, the United States, and other nations involved in the sanctions, the intention is to create a situation where Russia's access to crucial technology is severely limited. This strategic move aims to disrupt Russia's military capabilities and logistical infrastructure, making it more difficult for them to continue their aggression in Ukraine.

Russia's reliance on imported technology becomes a vulnerability under these sanctions. Despite its size and resources, Russia still heavily depends on external sources for the development and production of advanced technological components. By cutting off the supply from key nations, the intention is to create a situation where Russia's ability to acquire the necessary technology is hampered. This approach seeks to weaken Russia's military capabilities, reduce its operational efficiency, and put pressure on the country to reconsider its actions in Ukraine, ultimately aiming for a peaceful resolution to the conflict.

### **4.3.3. *Effects of sanctions***

One of the foremost challenges associated with the implementation of export sanctions lies in the potential for Russia to engage in alternative trade arrangements. In addition to this, it is still exceedingly difficult for sanctioning countries to stop transshipment via third countries to Russia. In the case of Russia, and specifically for sanctions on technology, third countries might be the main reason export sanctions do not have the desired effect. This section will summarize how several technology exports circumvent the sanctions through third countries.

Exports from the EU, US, and G7 countries have decreased considerably after the war's start and the implementation of sanctions, seen in Figure 7 and 8 for the EU and US respectively. As previously stated, Russia's imports did take a hit but are back to pre-war levels. Exports from China, Belarus, Türkiye, Kazakhstan, Kyrgyzstan, and Armenia are among those who have gone up after the start of the war (David, Stewart, Reid, & Alperovitch, 2023). The Silverado report by David et al. state that China, Russia's largest supplier, increased exports in Harmonized System (HS) chapters 87 and 84 by 120% and 16%, respectively. Chapter 87 covers Vehicles other than railway or tramway rolling-stock, and parts and accessories thereof, and chapter 84 covers nuclear reactors, boilers, machinery, and mechanical appliances; parts thereof (World Customs Organization, 2017). This amounted to \$463 million and \$228 million, respectively, and shows that Russia is still able to import important technology related to vehicles and machinery.

The Silverado report (2023) covers case studies in five specific products: Integrated circuits, smartphones, washing machines and refrigerators/freezers, passenger vehicles, and motor vehicle parts. In all categories, the trends are similar. Transshipment through third countries has increased after the war, and non-sanctioning countries claim market share after withdrawal from sanctioning countries. Russia has re-established almost pre-war level of import in most categories: "The firm withdrawals had a significant short-term impact on

imports and prices, but little long-term impact on Russia's ability to import products and a more muted long-term impact on prices” (David, Stewart, Reid, & Alperovitch, 2023, s. 19). The reason for the quick recovery of the Russian import could be that Chinese, Belarusian and Turkish firms have taken advantage of the sanctions to gain market share. The report mentions two specific examples of transshipment: cell phones and passenger vehicles through Armenia. Armenian imports of both these products have increased notably after the start of the war. Even more interesting is that exports of the same products to Russia have increased by about the same amount as the imports have increased, making Armenia a point of transshipment from sanctioning countries to Russia.

The same report presents data on the Armenian import of smartphones (David, Stewart, Reid, & Alperovitch, 2023). After February 2022, there was a significant increase in the import of smartphones to Armenia and an almost identical increase in the export of smartphones from Armenia to Russia. Many of these smartphones were exported from China and then transshipped through Armenia. The report especially points out post-Soviet countries as potential transshipment points.

In an article by Reuters (Stecklow, Gauthier-Villars, & Tamman, 2022), it is investigated how technology from Western countries that are sanctioning Russia still ends up in Russia. Among other things, they find that computer and electronic components worth at least \$2.6 billion made their way to Russia between the invasion and October 31, 2022. At least \$777 million out of this was made by Western manufacturers based in sanctioning countries. The article states how technology from many well-known tech companies ends up in Russia despite the sanctions. They find that the Western companies ship to companies in third countries, which in turn export to Russia.

We see how complex and complicated sanctions can be in the technology sector. Compared to the import sanction and price cap on oil and gas, it has proven much more difficult to sanction export goods to Russia efficiently. Both Russia and third countries have incentives to do everything in their power to make certain technological goods from sanctioning countries make their way to Russia, even if that means shipping through a detour.

#### **4.4. Financial Sector**

Financial sanctions affect banks and financial activities in Russia, and activities connected to Russia. There are a few different types of financial sanctions currently held against Russia. In this section, I will explore the most prominent ones. These include SWIFT sanctions and



freezing of assets. Sanctions against the Russian financial sector aim to paralyze or harm Russia's ability to trade freely and transfer assets internationally. Financial sanctions will be tied closely to Russian exports within, for example, oil and gas, where the intention is to hurt Russia's ability to trade their products freely.

#### ***4.4.1. Types of sanctions***

On March 12, 2022, Russian banks were cut off from the SWIFT system. SWIFT is an international messaging system to transfer money between banks in different countries. SWIFT is an institution based in Belgium and does not hold funds or assets. It works as an intermediary between banks and financial institutions for internationally safe and efficient transfer of funds and information. Banning Russian banks from SWIFT could impair their ability to transfer money internationally and trade with other countries. Initially, on March 12, only some banks were banned from SWIFT. The list was extended later the same year to include more critical banks, including Russia's largest bank Sberbank. Initially, it was excluded due to Sberbank's role in facilitating energy payments between Russia and Western countries.

Several countries and their central banks have come together to freeze Russia's access to their overseas reserves. This means that Russia cannot access its foreign exchange reserves in the US, EU, Canada, and Japan, to name a few. About 48.6% of Russia's foreign exchange reserves are estimated to be frozen (Congressional Research Service, 2023), which is about \$300 billion. In addition, the same countries have implemented sanctions on Russian financial institutions, making it very difficult for Russian banks to perform transactions in several currencies, among them USD and EUR.

#### ***4.4.2. Intended effects of sanctions***

Financial sanctions are intended to put pressure on the Russian government and individuals to inflict financial distress. The goal is the same as with other sanctions; to pressure Russia to end its war in Ukraine. When financial sanctions are imposed on Russia, the ability of Russian banks and individuals to conduct international transactions can become severely restricted. This can result in partial paralysis of the economy as businesses struggle to access the financial resources they need to operate effectively. The impact of financial sanctions on Russia can be particularly severe due to the country's heavy reliance on oil and gas exports as a source of revenue. As a result, the goal of financial sanctions is to pose a significant threat

to Russia's economic stability and its ability to maintain its position as a significant player in the global economy.

The use of SWIFT sanctions as a tool for exerting economic pressure is relatively rare, with only one other notable case before the sanctions imposed on Russian banks in 2022. In 2012, Iranian banks were banned from SWIFT as part of a broader package of sanctions targeting Iran's nuclear program. The effects of this earlier sanction case are widely debated and remain a subject of ongoing analysis. While some argue that the sanctions helped to weaken the Iranian economy significantly, others suggest that the impact of the sanctions was less significant than anticipated (see for example (Hufbauer, Schott, & Elliot, 2007); (Katzmann, 2013)). Despite the mixed views on the effectiveness of SWIFT sanctions in the Iranian case, the decision to impose similar sanctions on Russian banks in 2022 signaled a growing trend toward using financial measures to exert political pressure in global affairs. Russia developed its own messaging- and transfer system, SPFS<sup>3</sup>, after the invasion of Crimea. This is just one of many ways that could undermine the effect of sanctions, as getting around them proves not to be difficult if economic incentives are strong enough.

SWIFT is not a payment system but a messaging system. The messages can be sent and received through other channels, such as the SPFS. If there are banks in third countries willing to help Russia work around the sanctions and outside SWIFT, that is entirely possible and could undermine the effectiveness of the SWIFT sanctions. However, it still inconveniences the Russian financial system in international trade.

#### **4.4.3. *Effects of sanctions***

The immediate action taken by G7 and EU countries created difficulties for the Russian financial system. By implementing financial sanctions, we saw a near financial crisis in March-April 2022 (Nell, et al., 2023). The sanctions triggered an increase in demand for liquidity in Russia. The Ruble fell sharply, and the central bank interest rate reached 20%. The imposition of an oil price cap inflicted additional damage on the economy, negatively impacting Russian oil revenue.

Some factors have reduced the possible impact of financial sanctions against Russia. Firstly, initiating sanctions against Russia started with the annexation of Crimea in 2014. Since then,

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<sup>3</sup> Система передачи финансовых сообщений - Sistema Peredachi Finansovykh Soobscheniy, translates to "Financial messaging system"

Russia has gained resilience against sanctions and developed alternative methods to maintain the same level of financial activity. The development of SPFS system to replace SWIFT is one example. The Russian central bank has also been quick in its policy response to the sanctions, with a hike in interest rates, imposition of capital controls, and helping Russian financial institutions with liquidity (The International Working Group on Russian Sanctions, 2022). Their aggressive response has helped calm the Russian financial market, and interest rates are back down to 7,5% (Bank of Russia, 2023). Strong external accounts combined with high oil prices and low imports have stabilized the foreign exchange (FX) reserves and the Ruble (The International Working Group on Russian Sanctions, 2022).

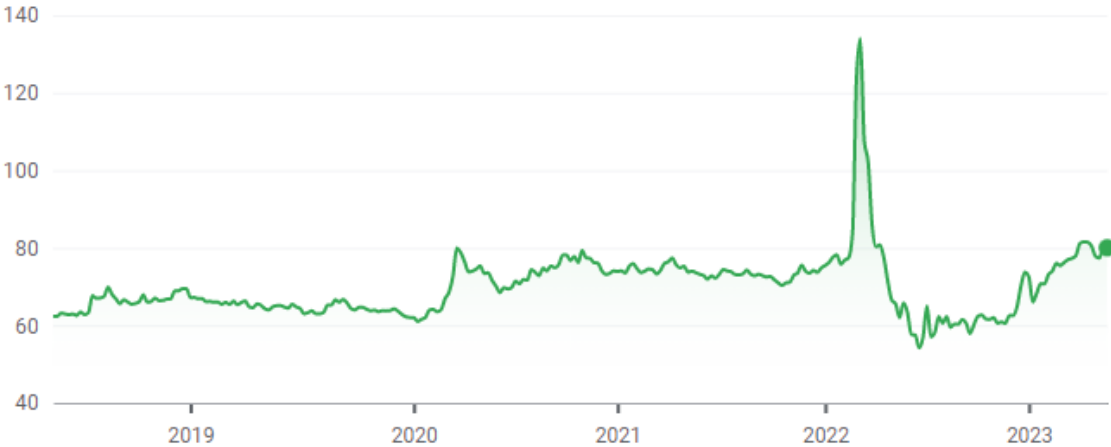


Figure 13: RUB/USD exchange rate between 2005 and 2023. Source: Google Finance

The quick response by the Russian central bank stabilized the Ruble from an all-time high of 134 RUB/USD on March 11, 2022, to a value around 60 RUB/USD between May and December 2022 as seen in Figure 13. The Ruble has fallen additionally from January to May 2023 to a current level of 78 RUB/USD. A weaker Ruble could pose a risk of inflation, seeing as import prices would increase (KSE Institute Sanctions Team, 2023). A further weakening Ruble could also mean potential increases in the Russian interest rate. However, it is difficult to precisely establish what caused the weakened Ruble. Most likely, it is a combination of sanctions and changed demand for Russian exports. The sanctions have at least made the Russian financial market less available and flexible.

## 5. Discussion

The goal of this thesis has been to identify the role of third countries in the effectiveness of sanctions. I have used and further developed a theoretical framework, investigated existing literature, and used the case of sanctions against Russia after the 2022 invasion of Ukraine to do this.

According to theory on crisis bargaining, conflict is never the preferred option. In practice, coercive economic tools such as sanctions are often a preferable alternative when war is too costly and bargaining or ignoring the conflict is not an option. Fearon's Bargaining Model (1995) tells us that there is always a solution that is preferable to conflict. My expanded model gives the same result. However, the bargaining range shrinks when costs are lowered, which can increase the possibility of conflict. Trade with third countries can reduce the cost for target countries.

The Expanded Crisis Bargaining Model is not an attempt to perfectly explain how sanctions work but aims to give insight as to what affects each state's ability or will to bargain for a peaceful settlement. Every state assesses their preferences and their utility differently, and every case is weighted differently by each state. I conclude that there will always exist a theoretical bargaining range. Third countries have the effect that they reduce costs for the target state, which reduces the bargaining range and decreases the probability of a bargained solution. However, conflict is the exception to the rule. Conflict still does occur and Blattman's (2021) reasons for war give us a deeper understanding as to why this is the case.

Existing literature on sanctions tries to explain effectiveness through empirical analysis, using models such as the Gravity Model of Trade. There seems to be no definitive answer to the question of whether sanctions are effective. However, case analyses suggest that sanctions can have significant impact on a state's economy that extends beyond the intended objectives of the sanctioning party. For instance, the influence of US sanctions on Iran has been observed to affect lower socio-economic classes negatively (Ghomi, 2022). This underscores the notion that the observed effects may not necessarily guarantee the desired outcome. The objective of implementing smart sanctions is to mitigate harm to the general population, but they can be challenging to design.

Researchers do not seem to agree on the level of success or effectiveness for sanctions. Firstly, it is often contingent on how we define effectiveness. The more optimistic analyses conclude that around 30% of sanctions are effective (Hufbauer, Schott, & Elliot, 2007). The

more conservative ones arrive at an approximation of 5% (Pape, 1997). The definition of effectiveness and success varies from researcher to researcher. A large economic effect does not necessarily equal success in changing policies in the sanctioned state, but large costs can be helpful in producing a desired outcome. Smart sanctions aim to “hit where it hurts”, so that the economic impact on the general population is minimized and the result of the sanctions is maximized. A part of making smart sanctions even smarter could be to acknowledge the role of third countries, and design policies that mitigate effectiveness-loss due to increased trading between target country and third countries.

Some sanctions never have to be implemented because the threat of them is enough to encourage change, such as seen in the TIES database (Morgan, Bapat, & Kobayashi, 2014). We could argue that implemented sanctions are in themselves ineffective, because the threat of them should be enough to change the behavior of the potential receiver. If a state is willing to bear the burden of sanctions, it signifies that their assessment of the costs suggest a preference for enduring these over complying with the demands put forth by the sender. It could also be an indication to the sender that the sanctions have been designed improperly, and that the receiver could redirect their trade elsewhere at a lower cost than first assumed. This should be a signal to the sender that sanctions need to be re-evaluated, as sanctioning is also costly to the sender. The TIES database indicates that there is more to the effectiveness of sanctions than just the relationship between sender and target state. I would suggest that the relationship with third countries might be an element that has been overlooked in the literature in a similar way that the threat of sanctions has been prior to the TIES database.

The complicated and intricate world economy makes it difficult to completely isolate one state’s economy through sanctioning. Trade will always leak to other potential trade partners that are willing to engage with the sanctioned state. Considering the role of these third countries is therefore a crucial part of understanding how sanctions are affected by outside factors. Ignoring these could prove costly for the sanctioning state, and in the worst-case scenario, sanctions could be worked around by the sanctioned state through third countries. This undermines the economic effect of the sanctions which in turn can affect the potential for success. It also makes sanctions costly to implement, without having enough effect to justify them. The role of third countries is particularly important if the goal is to prevent the target country from importing certain goods, or if the aim is to hurt revenue by reducing exports.

The sanctions against Russia are comprehensive, and the long-term effects will not be evident until some time has passed. However, we can see that the sanctions have affected the Russian

economy from several fronts. The price cap has been very effective in reducing Russian oil revenue. Sanctions on the financial sector slightly destabilized the Russian financial system for a short while, but it quickly recovered. The sanctions on the SWIFT messaging system have made it more challenging for Russian firms to trade internationally, but the SPFS has reduced these effects somewhat. Sanctions on technology has made it more difficult, but not impossible, for Russia to import certain types of technology related to military equipment. These sanctions have proven easier to get around than for example the price cap. Transshipment is one challenge, but also changes in Russian import patterns. Even though it is challenging, Russia is still able to import Western technologies through third countries. What they cannot import through transshipment they can import directly from new suppliers in third countries, at least to some degree.

Trade with Russia has been drastically reduced with sanctioning countries and are not looking to pick up, as seen in Figure 7 and 8 with the EU and the US, respectively. Furthermore, imports and exports with third countries quickly recovered after the initial shock of the invasion and are continuing to increase. We can see examples of this in the cases of China, Türkiye, and India (Figure 9, 10, 11). The numbers from this analysis include all imports and exports with Russia and each counterparty. Individual firms might not be reporting their trade correctly if they are deliberately circumventing sanctions. This can affect the aggregated numbers for both export and import, which means that analysis based on numbers where any party has an incentive not to fully disclose their trade must be done with caution. We cannot see detailed effects by using aggregate level data, and effects might vary from sector to sector. There might be sectors where imports and exports have had larger effects, and others where there is no effect. The Silverado report (2023) looks at smaller sectors and individual goods and gives a more detailed presentation of third country trade with Russia. However, even through aggregated trade data presented in this thesis it is clear to see that Russia has changed its trade relationship with third countries. It requires further investigation to estimate exactly to what degree it affects the sanctions that have been implemented.

The goal of sanctions against Russia are multifaceted. There are many sanctioning countries that could all have their own motives for sanctioning. Some of the more evident reasons include ending the Russian invasion of Ukraine and harming Russia's ability to wage war in Ukraine. The goal could also be preventive, i.e., to reduce Russia's ability to expand their war, either in Ukraine or to new territory. The sanctions have not yet been successful at ending the war in Ukraine. Even if it was possible to prove that the sanctions are substantially

less effective due to the involvement of third countries, this might not make a difference to sanctioning countries. Many sanctions are implemented to send a signal to the target. Infliction of economic loss might not be the main objective for many senders. However, making sanctions as smart and targeted as possible can help reduce economic loss for the sender and should therefore be of interest.

### **5.1. Suggestions for Future Work**

In this thesis, the focus has been sanctions implemented against Russia after the invasion of Ukraine in 2022. For a more comprehensive analysis, it could be interesting to include the first sanctions implemented in 2014 after the annexation of Crimea and analyze the first effects. One example is the development of SPFS to replace SWIFT that started already in 2014. The sanctions and threats against Russia in 2014 might have started a transitional period in Russian trade. Future work could include a more in-depth analysis of changes in Russian trade from 2014 and up until sanctions implemented in 2022. This might also give answers as to whether changes in trade were planned in advance to the invasion of Ukraine.

This thesis barely scratches the surface of the complicated field of sanctions. As stated in the introduction, no two sanctions cases are the same. Russia is not Rhodesia, and Iran is not South Africa. One thing that I found particularly interesting while writing this thesis, is that third countries are rarely mentioned in academic literature but play a leading role in most policy reports and government recommendations. In the future, I believe that there is room for improvement in the identification of a target country's potential to redirect trade, especially with third countries. An example of future projects could be a database that covers a target country's closest trading partners before and after, or closer analysis of changes in trading patterns with third countries after implementation of sanctions using for example the Gravity Model of Trade

## 6. Conclusion

Sanctions are complicated. The effectiveness of sanctions will be a topic of research for as long as sanctions are implemented. We are already seeing more specialized sanctions that aim to achieve the desired outcome without hurting the general population of a country. Smart sanctions will keep evolving and are becoming increasingly targeted to their intended receiver. Future development of smart sanctions should consider the role of third countries.

States choose to sanction even though theory tells us that conflict is never the optimal solution. Lower costs increase the probability of conflict and could explain why we are seeing sanctions as a more popular coercive tool than military conflict. States that choose not to sanction might be doing this out of self-interest or simply because it is the less costly thing to do. Political and economic ties between countries often play a crucial role in how high the barriers to impose sanctions.

Through this thesis, states who choose not to sanction have been equally important in the understanding of sanctions as both sender and target country. Third countries play an important part in the effectiveness of sanctions through their role as potential new trading partners. However, as seen in the case of Russia, third countries cannot absorb all trade or revenue lost from sanctioning countries. The price cap is an example, where Western countries have reduced the demand and thus the price of Russian oil by, currently, \$10-20/barrel. Every dollar reduced in the price per barrel is costing Russia approximately \$2.7 billion dollars in revenue from Urals crude oil every year. Sanctions in the financial sector has been challenging for Russia but have been worked around for the most part. Sanctions on technology seems more political or symbolic, as technology from Western countries are still finding their way into Russia through third countries. Here, the role of third countries is damaging the senders' intention.

The role of third countries is at its most prominent for any type of sanction where the sanctions concern a good or product that can easily be replaced. In addition to this, having close trade partners as third countries prior to sanctions will lower the costs of changes in trade. Third countries should be carefully considered when sanctions are designed to avoid unnecessary losses to the sender, and to increase the efficacy of implemented sanctions.



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