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Sanctions against Russia: implications, prospects and circumvention

Abstract

Prior to the conflict, the situation in Ukraine had been escalating for several years. The nation is now divided between pro-Europe and pro-Russia activists and there seems to be no solution in sight. Within the scope of the conflict, Europe and the US have closely scrutinised Russia, accusing it of purposely destabilising east Ukraine. The EU and the US imposed sanctions on Russia in 2014 in response to its actions in the Ukraine conflict and its annexation of Crimea. Russia responded with counter-sanctions, mainly affecting agri-foods imports into Russia. This article first discusses both western and Russian sanctions in depth. It then analyses the impacts on both parties, illustrating how bilateral sanctions between the EU and Russia influence trade flows and economies. Possible methods of circumvention for both import bans and sanctions against individuals are also analysed and recommendations made to European producers regarding their dealings with Russia. Subsequently, the article shows why current sanctions are rather ineffective and provides suggestions for their improvement. Lastly, future prospects are deliberated.

Keywords: *sanctions, Ukraine crisis, Russia, EU, US*

Introduction

In 2014, amidst the Ukraine crisis, Russia annexed the Ukrainian peninsula of Crimea. The annexation triggered significant conflicts between Europe and Russia. In the same year, both the EU and the US implemented sanctions against Russia in response to the annexation and its intervention in east Ukraine. These sanctions were intended to hinder the development of the Russian economy, thereby pressuring Russia to change its politics concerning Ukraine. However, the Russian government responded by imposing counter-sanctions against the EU.

Many analysts contemporaneously asserted that sanctions against Russia are ineffective. Debate over this issue continues inside Europe. The still-relevant question is whether the sanctions are actually having an impact on the Russian economy and, if so, whether they are powerful enough to change Russia's behaviour in the Ukraine conflict to achieve the EU's desired outcome (Dreyer and Popescu 2014: 1; Ananyev *et al*. 2018).

In Russia, it is frequently alleged that the sanctions have had little effect on the nation, as politics remain stable and the population continues to be united. Furthermore, Russia's 'strong relations' with Asian countries and relationship with the east are often praised (Wang 2015: 1; Sergi 2009, 2012 and 2018a). In this article, we examine the impact of bilateral sanctions on both Russia and the west. Furthermore, we examine possible circumvention methods and make recommendations on how sanctions could be improved to increase their effectiveness.

Sanctions

Sanctions can be defined as economic or international law measures, such as embargoes against states, firms or individuals. In practice, EU sanctions are frequently imposed by the UN Security Council and subsequently implemented by the EU in the form of regulations and EU Council decisions. The EU rarely imposes sanctions arbitrarily (Government of the Netherlands 2019: 1). Member states are obliged to implement restrictive measures within the scope of their joint foreign and security policy. The objective of sanctions is to put pressure on states which have, for instance, violated international law or principles (Deutscher Bundestag 2018: 4).

Sanctions against individuals frequently target terrorist activities and those who are connected politically to the regime as they pose a high risk of money laundering, tax evasion and other illicit activities. Sanctions against individuals frequently include freezing assets as well as loan and credit restrictions (Government of the Netherlands 2019: 1). Another option is travel embargoes. Furthermore, sanctioned states are often restricted in their foreign trade (WKO 2019: 1). Another possibility is arms embargoes, as illustrated by the UN and EU sanctions against Eritrea (UK Government 2013: 1).

The Ukraine conflict

Ukraine's geographic situation between Europe and Russia makes the country extremely important to the latter. Whereas the western parts of Ukraine are considered pro-Europe, the east is considered pro-Russia. The two areas are conveniently divided by the Dnieper River.

Conflict between Russia and Ukraine began on 21 November 2013, when then-Ukraine President Viktor Yanukovych suspended the signing of a European Association Agreement to curry favour with Russia, which led to public protest in the capital, Kiev. These protests escalated when the government ordered their disbanding, and citizens demanded that Yanukovych step down. When the opposition seized power in 2014, Yanukovych was replaced by Oleksandr Turchynov.

Pro-Russians in the east and Crimea then protested against the new regime. The conflict escalated in 2014 when Russia invaded Ukraine and annexed the Ukrainian peninsula of Crimea. Inhabitants of the autonomous Republic of Crimea voted in favour of splitting from Ukraine and joining Russia in a referendum on 16 March. The UN General Assembly rejected Crimea's decision, with one hundred countries refusing to recognise the referendum (Wang 2015: 2). The referendum escalated conflicts between pro- and anti-Russians in east Ukraine. In addition, Malaysia Airlines flight MH17 was shot down in Ukrainian airspace near the Russian border on 17 July 2014. The circumstances surrounding the plane crash remain unresolved. Due to the conflict, both NATO and Russia have 'strengthened their military forces around Ukraine' (Wang 2015: 2).

Russia, Ukraine, the Organization for Security and Co-operation in Europe (OSCE) and representatives from Ukraine's non-government armed forces met in Minsk on 5 September and agreed a ceasefire in the eastern Ukrainian Donbas region. Known as the Minsk Protocol (or later Minsk-1), this agreement was accompanied by the 19 September Minsk Memorandum detailing the ceasefire conditions and signed in an attempt to resolve the crisis. Subsequently, a Package of Measures for the Implementation of the Minsk Agreements (Minsk-2) was signed on 11 February 2015. Critics claim the Minsk Agreements have, thus far, brought little change (Wang 2015: 2).

Sanctions against Russia

In response to the Ukraine conflict, sanctions were imposed by the EU and the US, supported by Australia, New Zealand, Canada and Japan (Wang 2015: 2). The European Council, having accused Russia of illegally annexing Crimea and deliberately destabilising an independent neighbouring country, agreed to impose the first diplomatic measures in March 2014. These targeted Russia, as well as actors from Crimea and the Donbas region in Ukraine, and included diplomatic measures, restrictive measures, restrictions for Crimea and Sevastopol, economic sanctions and measures concerning economic co-operation (EU Newsroom 2015: 1).

The EU imposed a first round of sanctions on 17 March 2014. These restrictive measures against Russia consisted of asset freezes and visa bans in respect of 170 persons and 44 entities which held assets in the EU. Those targeted were allegedly:

> Responsible for action against Ukraine's territorial integrity, persons providing support to or benefiting Russian decision-makers. (EU 2015: 1)

Furthermore, action was also taken in respect of thirteen entities in Crimea and Sevastopol which had been confiscated or had their ownership transferred contrary to Ukrainian law. Generally, the EU was highly vocal in supporting Ukraine's territorial integrity and sovereignty.

Subsequently, the EU administered economic sanctions in July 2014, reinforcing these in September 2014. Action taken here entailed the suspension of preferential economic development loans by the European Bank for Reconstruction and Development, a two-way arms embargo and a ban on exporting certain energy equipment, as well as other measures (Dreyer and Popescu 2014: 1ff). In terms of economic co-operation, the European Council has 'Requested the EIB [European Investment Bank] to suspend the signature of new financing operations in the Russian Federation' while, in addition, 'The implementation of EU-Russia bilateral and regional co-operation programmes has been largely suspended' (EU 2015: 1).

In March 2015, the European Council announced that these sanctions would endure up to the point of 'The complete implementation of the Minsk Agreements' (EU 2015: 1). Indeed, throughout the process, the EU has stressed its willingness to lift the sanctions when Russia:

> Starts contributing actively and without ambiguities to finding a solution to the Ukrainian crisis. (EU 2015: 1).

An early diplomatic measure was to vacate the G8 summit, scheduled to be held in Sochi, Russia, and instead convene a G7 summit in Brussels on 4-5 June 2014. Here, negotiations over Russia joining the OECD and the International Energy Agency were suspended. Moreover, EU member states decided to refrain from holding regular bilateral summits and the EU-Russia summit was cancelled. Bilateral conversations on visa issues and a new agreement between Russia and the EU were also suspended.

Crimea and Sevastopol were also hit with economic sanctions, including a ban on imports from the region (where there were no Ukrainian certificates of origin) and a ban on investments in Crimea. This prohibited Europeans and EU-based companies from purchasing property or corporate entities in the area and financing Crimean companies or related services. Moreover, investments in infrastructure projects were prohibited in six sectors. The provision of tourism services was banned, covering European cruise ships and all ships owned or controlled by a European company or flying the flag of an EU member state. No exports of goods and transport technology, or deliveries of oil, gas and mineral resources, to Crimea were allowed. Lastly, technical assistance, brokering and construction or engineering services related to infrastructure were prohibited.

On 25 November 2018, 24 Ukrainian seamen who tried to pass through the Kerch Strait between Crimea and Russia were arrested by the Russian Federal Security Service (FSB). Russia and Ukraine had agreed in 2003 to allow both nations to use the waterway. Nonetheless, the FSB Coast Guard opened fire on the three Ukrainian navy vessels and captured their occupants. This incident led to the EU announcing new sanctions against Crimea, including preventing citizens from withdrawing cash using international credit cards and prohibiting international providers from offering a mobile service in the region. Russia's recent actions in response to the Ukraine conflict thus demonstrate that the 2014 sanctions have not, in fact, led to the desired outcome in terms of changing Russia's behaviour.

On 27 June 2019, economic sanctions targeting specific sectors of the Russian economy were extended to 31 January 2020. The sanctions had previously been extended on multiple occasions. Their link to the full implementation of the Minsk Agreements had led the European Council to decide to maintain the sanctions in place at its meeting on 20-21 June 2019. The Council also called for 'An urgent resumption of negotiation efforts' concerning implementation of the Minsk Agreements (European Council 2019: 1). The measures continue to target the financial, energy and defence sectors as well as the area of dual-use goods.

Moreover, the Trump administration is preparing new sanctions against Russia. The US previously imposed sanctions on Russia in 2018 in response to the chemical weapon attack in the UK on former MI6 informant, Sergei Skripal, and his daughter. Implemented under the Chemical and Biological Weapons Control and Warfare Elimination Act, these sanctions:

> Ban American lenders from granting loans to the Russian government but (do) not stop them from lending to Russian corporations in the language of the law. (Rapoza 2019: 1)

Investors holding large amounts of Russian debt, including Goldman Sachs, are not traditional lenders in the corporate loan business market.

On 1 August 2019, the US again instituted sanctions on Russia, triggering a crash of the Russian rouble according to Citibank (Rapoza 2019). This action was not preceded by any announcements or warnings from Washington, consequently surprising most observers. However, the US claimed that Russia had failed to provide 'reliable assurances' (Rapoza 2019) that it would not use chemical or biological weapons, which had been a condition for not imposing further sanctions. Moreover, Russia had allegedly refused to allow on-site inspections by the UN.

According to the Economist Intelligence Unit (EIU), Russia's national debt is merely ten per cent of its GDP; with fiscal accounts in surplus, foreign funders do not seem to be required. Nonetheless, recent sanctions could potentially lead to many international financial institutions deciding to withdraw from the Russian lending market. In the worst case, they could withdraw from the government bond market (Rapoza 2019). This would force Russia to reduce the use of US dollars in its economy in order to circumvent sanctions, which would have 'wide repercussions for the international financial system', according to EIU analysts.

On 26 August 2019, another round of US sanctions over the Skripal poisonings came into effect. Like the previous round, these sanctions block international financial institutions operating in the US from lending or providing technical or financial assistance to Russia and US banks from lending to Russia, except for agricultural products such as food. Furthermore, they:

> Authorize the US Commerce Department to deny Russia export licenses for chemical and biological goods and technology. (Moscow Times 2019: 1)

In addition, it is rumoured that the US Senate is preparing to impose sanctions against the construction of the Nord Stream 2 gas pipeline between Germany and Russia. The US argues the pipeline would threaten the Ukrainian economy, as it would 'Replace Ukraine as a European transit' (Rapoza 2019). In addition, it is believed that the US would 'love to capture' (Rapoza 2019) the European oil and gas market. Naturally, Germany would strongly oppose sanctions on Nord Stream 2. It is not yet clear if Russian companies other than those previously targeted by the sanctions would be affected by the new measures.

Russian counter-sanctions

In response to the European and US sanctions, Russia has taken 'retaliatory measures' (Wang 2015: 2). Russia's first sanctions consisted of a raise in the price of natural gas in Ukraine to put pressure on the country, which is dependent upon Russian natural gas, and a reduction in natural gas exports to Poland, Romania and Slovenia. Furthermore, in August 2014, Russia banned imports of meat, vegetables, fruit and dairy products from countries participating in the sanctions. Imports from the US, Canada, Australia, Norway and the EU were among those affected (Wang 2015: 3). The import ban has caused price rises for numerous goods; according to the Analytical Credit Rating Agency in Moscow, this has resulted in a two per cent drop in Russia's GDP.

Despite Russian manufacturers increasing their production due to the ban, prices have not fallen as producers use the absence of a regular market to maximise profits. Consequently, it is estimated that Russian consumers' costs of living have been around 4,400 roubles (€320) higher per year since Russia implemented counter-sanctions (Batalov 2018).

One positive outcome for domestic producers, at least in the short term, is that the decrease in imports (especially of meat) has promoted a rise in import substitution. The import ban led to niches in the food market being filled by Russian producers, whose share prices have, consequently, risen in the first two to three years since the implementation of counter-sanctions. In addition, imports from CIS countries, Latin America, Asia and Africa have increased (Batalov 2018). There has been some criticism that the immense increase in Russian production has allowed goods of inferior quality to enter the market, with milk and cheese particularly affected. Moreover, imports of palm oil have increased significantly since this is cheaper than milk fats (Batalov 2018).

Most products targeted by the counter-sanctions reach Russia through Belarus and Kazakhstan: two members of the Eurasian Economic Union (EAEU). This has resulted in tension with the EAEU's three other members (Russia, Armenia and Kyrgyzstan) over the pursuit of a common policy (Sergi 2018a). Furthermore, the EAEU Commission claims that Russian customs officials are checking trucks crossing the Russian border in contravention of EAEU rules (Batalov 2018). Moreover, orders to destroy illegally-imported European goods has caused nearly 26,000 tonnes of food to be destroyed, mainly consisting of Polish apples and Turkish tomatoes (Batalov 2018).

Meanwhile, connecting flights on Ukrainian Airlines were banned from flying through Russian airspace (Wang 2015: 3), while Russia threatened to ban flights from countries which had participated in sanctions. Moreover, President Putin announced the abandonment of the construction of the 'South Stream' gas pipeline, which has been intended to transport gas to Europe through the Black Sea. Instead, Putin announced that the pipeline would be constructed to flow to southern Europe via Turkey, which would be granted a six per cent discount on natural gas (Wang 2015: 3).

Furthermore, in the attempt to mitigate the negative impact of sanctions, Russia has shifted attention eastwards to seek closer co-operation with China, India, Vietnam and North Korea. In this regard, Russia's bonds with China are particularly significant. Both countries share numerous common interests, such as the 'Silk Road Economic Belt', which has been proposed and promoted by China's President Xi. Since the implementation of sanctions against Russia, the two countries have co-operated in areas such as foreign affairs, energy, military, finance, technology and science (Wang 2015: 3).

On 20-21 May 2014, President Putin visited China for a state visit and attended the Conference on Interaction and Confidence-Building Measures in Asia. Subsequently, the two presidents met in Shanghai and issued a joint declaration on a new stage of comprehensive strategic partnership (Wang 2015: 4). They also reached an agreement concerning trade in natural gas under the Memorandum on China-Russia Natural Gas Co-operation Project at the East Line as well as purchase and sales contracts between Gazprom and the China National Petroleum Corporation (Wang 2015: 5).

Elsewhere, Putin has collaborated with the General Secretary of the Central Committee of the Communist Party of Vietnam, Nguyen Phu Trong, on a Joint Statement advancing a comprehensive strategic partnership between Russia and Vietnam (Wang 2015: 5) under which the two countries agreed to co-operate in trade, energy, communications, media and technology. A free trade zone between Eurasian Customs Union members and Vietnam was also announced (Wang 2015: 5). Russian Deputy Prime Minister Yury Trutnev visited North Korea in April 2014, while Putin agreed to cancel ninety per cent of North Korea's debt to the former Soviet Union. North Korea and Russia have also agreed to simplify visa protocols to facilitate travel to North Korea and determined the rouble as the official currency in which trade between the two countries is conducted (Wang 2015: 5).

Despite these developments, international critics frequently contend that the counter-sanctions are having a negative impact on Russia. At the same time, Russia's desired outcome – that European producers urge governments to lift the sanctions – has, thus far, not manifested itself.

Impacts on Russia and on Europe

Since the sanctions began, Russia has suffered a financial crisis and a significant devaluation of the rouble. However, some critics argue that neither was the result of the sanctions, while several scholars claim that oil price volatility has had much larger macroeconomic effects on Russia than the sanctions (EU Directorate General for External Policies 2017: 13). Nonetheless, the rouble-dollar exchange rate has dropped nearly fifty per cent since the first sanctions in 2014; on 16 December 2014, it fell twenty per cent in one day. Russia's domestic inflation rate has also increased (Wang 2015: 3).

As Russia's oil and gas-related revenues contribute around fifty per cent of national income, the EU and the US sanctions have specifically targeted Russia's dependence on exports of natural resources, especially oil. Trade volumes between Russia and the EU have clearly decreased, which is attributable to the combination of western sanctions, a falling oil price and the depreciation of the rouble (EU Directorate-General for External Policies 2017: 1). Consequently, Russia's economy has suffered billion-dollar losses.

On the other hand, the counter-sanctions imposed by Russia have inflicted economic damage on some EU countries. Russia is a much larger agricultural importer than exporter, so its embargo on numerous western countries has had a 'major impact' (EU Directorate-General for External Policies 2017: 16) on the agri-foods trade. Whereas Russia mainly exports crops, goods such as meat, dairy products, fruit, vegetables and processed foods are imported, and the EU has been the largest supplier of these goods to Russia. After the US, Russia is the second most significant destination market for EU agri-food exports. The Russian embargo has led to the importance of the Russian agri-foods export market decreasing significantly throughout Europe. Before the ban was established, Greece, Lithuania, Ireland, Cyprus, Denmark and Latvia collectively accounted for at least thirty per cent of Russia's imports. By contrast, other EU countries – such as Germany, Romania, Sweden, the UK, Slovenia, Slovakia, Czech Republic and Malta – collectively supplied only five per cent of Russia's agri-foods imports. Thus, the embargo's impact differs significantly between countries.

The experience of Estonia provides a useful illustration of the impacts of Russian counter-sanctions on European exporters. Estonia's Ministry of Economic Affairs and Communications has published a report discussing how Russian counter-sanctions have hurt the European economy. At the beginning of 2014, Russian sanitary inspections had already critically scrutinised Estonian dairy products. According to Meelis Kitsing, the Ministry's Head of Economic Analysis, the Russian counter-sanctions have:

> Effectively closed [the] Russian market for dairy producers and forced [them] to look for new export destinations. (Kitsing 2014: 9)

Since then, Estonia's exports of dairy and fish products to Russia have decreased significantly, demonstrating the direct negative impact of the Russian counter-sanctions. Nonetheless, Kitsing argues that the overall impact has been rather insignificant, with Estonian producers able to find alternative markets for their exports (Kitsing 2014: 22).

In absolute numbers, Poland and Lithuania have been most affected, followed by Germany, the Netherlands, Denmark, Spain, Finland, Belgium and France (EU Directorate-General for External Policies 2017: 16). Following the ban, Russia has mainly relied on neighbouring countries for food imports. Since the ban had led to food product shortages and price increases, the Russian authorities have been forced to rely more on alternative trading partners. In particular, Belarus, Georgia, Serbia, Turkey and Kyrgyzstan have significantly increased their exports to Russia (EU Directorate-General for External Policies 2017: 17).

The EU has analysed the impact on international trade flows by considering a counterfactual situation in which there are no bilateral sanctions between Russia and the EU. Analysis of the counterfactual situation argues that the 'Strong downturn of the Russian economy' (EU Directorate-General for External Policies 2017: 32), caused mainly by the declining oil price and subsequent depreciation of the rouble, has depressed Russian demand. This explains the decrease in exports to Russia from EU and non-EU countries. Therefore, the decrease in exports to Russia cannot be attributed solely to the sanctions. However, the imposition of bilateral sanctions has ultimately caused countries affected by sanctions to diverge from the analysis by exporting even fewer goods to Russia, whereas those not targeted have diverged by exporting more goods to Russia (EU Directorate-General for External Policies 2017: 32).

Empirical evidence suggests that both Europe and Russia have managed to divert their trade to other international markets. The EU argues that trade diversions:

> Cannot nearly compensate for losses of EU exports to Russia and thus mitigate the economy-wide negative impacts. (EU Directorate-General for External Policies 2017: 1)

The report further claims that sanctions have been directly circumvented since their implementation in 2014, especially those concerning food and agricultural goods. In addition, Russia's agri-food imports have been purportedly affected negatively by 'Unfavourable exchange rate movements' (EU Directorate-General for External Policies 2017: 25).

The effects of Russia's counter-sanctions on individual firms are illustrated by the experience of French companies. One study cited in the EU External Policies Directorate-General report has found that only 25 per cent of firms which had previously been exporting to Russia remained in the market after the imposition of counter-sanctions. In addition, those firms which stayed in the market exported 89 per cent less than before. Exports of goods which had not been specifically targeted were also found to have dropped (Crozet and Hinz, cited in EU Directorate-General for External Policies 2017: 37). However, only nine per cent of lost exports have been directly attributed to Russia's ban on imports of agri-foods. Other factors explaining the decrease in exports to Russia include 'country risk, or political and legal instability' (EU Directorate-General for External Policies 2017: 37), to which the 2014 sanctions have arguably contributed. According to this analysis, firms which have lost revenues due to the embargo have been unable to recover their losses. It must be noted, however, that Crozet and Hinz's study is limited to the time period directly following sanctions being applied to Russia, since it analyses the effects in 2014.

The Russian economy has been severely affected by sanctions against the energy, finance and defence sectors, which have created massive capital outflows thus reducing foreign exchange reserves. Russia's annual GDP growth rate has been shrinking since 2011. According to economic experts, the sanctions will have a severely negative impact on the financial system and limit scientific and technological modernisation in the long run (Wang 2015: 3).

Opponents of sanctions against Russia argue that they unite citizens behind Putin, decrease trade turnover and western leverage and might push Russia towards China, thereby facilitating the formation of a 'Non-western global financial infrastructure' (Dreyer and Popescu 2014: 3). In contrast, those favouring sanctions argue that they have caused Russia to refrain from seizing more territory in Ukraine, thus preventing the spread of destabilisation to other parts of the country (Dreyer and Popescu 2014: 3).

Ultimately, Europe's sanctions are likely to have a medium- to long-term effect on the Russian economy, which is why their effectiveness can not be comprehensively evaluated after only one year. Though initially due to expire in 2015, the sanctions remain in effect. Nevertheless, Crimea is still under Russian control and Ukraine remains unstable, so it may be argued that western sanctions since 2014 have been largely ineffective. Despite economic indicators suggesting that the sanctions have crippled Russia's economy, the country has not taken any steps toward improving its relationship with the EU (Wang 2015: 4). Even so, Putin retains strong public support and Russia seems able to maintain its domestic stability (Wang 2015: 3).

Circumventing sanctions

Import bans

Few prior studies have explored the circumvention of import bans, this section of the article relies heavily on the literature discussing trade circumvention and so-called dumping. It will illustrate how the same techniques applied in trade circumvention and anti-dumping duty evasion can be utilised to circumvent import bans such as those imposed by Russia.

'Dumping' describes the sale of products or services at a cheaper price than their production cost. Reasons for dumping include increasing market share or even the complete elimination of competing producers from the market. Dumping can destabilise the competitive advantages of long-established market participants. As regards services, the objective is frequently to win over specific customers through an initial dumping price. The World Trade Organization (WTO) has declared international dumping illegal. However, it also defines dumping as the export of a product or service at a lower price than its domestic price.

Other forms of dumping include the cheaper production and sale of goods in countries with less strict environmental restrictions and the forgoing of health, workers' and injury insurance to reduce labour costs. Trade circumvention can be defined – in line with the OECD approach – as:

> Getting around commitments in the WTO such as commitments to limit agricultural export subsidies. (Berezowsky 2017)

According to the OECD, this includes avoiding quotas and other restrictions by altering the country of origin of a product as well as the measures taken by exporters to evade anti-dumping or countervailing duties.

A 2016 study by Xuepeng Liu and Huimin Shi showed that, between 2002 and 2006, US anti-dumping duties were effectively evaded by Chinese exporters through trade re-routing via third countries or regions. The authors analysed detailed monthly trade data reported by China and the US, and found a:

> Strong positive correlation between US imports from third countries and Chinese exports to the *same* third countries. (Liu and Shi 2016: 1)

They observe that this effect was more pronounced for products affected by anti-dumping duties. Accordingly, they argue that anti-dumping duties:

> May cause immediate and significant distortions to international trade flows. (Liu and Shi 2016: 2).

Re-routing is similar, but not identical, to re-exporting. Both re-exporting and so-called transhipment are legal ways to export goods indirectly through intermediaries in third countries or regions. Re-exports need to clear customs in third countries/regions, whereas transhipment does not (Liu and Shi 2016). Re-routing, on the other hand, entails illegally changing the certificate of origin. Less-differentiated products are especially likely to be re-routed, as it is more difficult to identify their production origins, which lowers the risk of detection.

Liu and Shi explain how anti-dumping duties can be evaded through re-routing. A Chinese company advertises its services for businesses seeking to evade anti-dumping duties. Initially, the products are exported to another country, such as Malaysia, at little cost. Thereafter, the company organises customs clearance and sends them to its warehouse. The products are subsequently reloaded to a new container, which is booked with Malaysia. Thereafter, the Chinese company finds a local Malaysian factory to provide original certificate of origin documents and then exports the goods to the final destination. This procedure is illegal because goods cannot be assigned a certificate of origin from a third country without actually being processed there (Liu and Shi, 2016: 9).

Provided the re-routing company prepares all the necessary documents, it can be difficult for third countries like the US to detect the evasion. In addition, the government of the re-routing country might have little interest in undermining the practice, as it may benefit domestic transportation and logistics sectors (Liu and Shi, 2016: 9). One option for the destination country (in this case the US) is to introduce anti-dumping duties against the third country. However, as re-routing is very difficult to identify, this measure is seldom employed. Most often, circumvention investigations are only initiated when domestic companies appeal.

In 2007, the US imposed an anti-dumping tariff against the imports of mattress innersprings from China, Vietnam and South Africa. Chinese producers received anti-dumping duties of 165 to 235 per cent, while Vietnamese and South African producers received duties of 121 to 116 per cent (Berezowsky, 2017). Consequently, Chinese producers resolved to ship their mattress innersprings initially to Malaysia and then re-export from Malaysia to the US, thus circumventing the duties.

In another case, four US steel producers filed a petition in September 2016 against China for its alleged circumvention of anti-dumping and countervailing duty orders for corrosion-resistant steel and cold-rolled carbon steel. They argued that substrate materials were being sent to Vietnam for processing and re-exporting. Trade data showed a spike in Vietnamese cold-rolled and CORE imports after November 2015, whereas imports of the same materials to China ‘drastically decreased’ due to the imposed duties (Berezowsky 2017).

The effects of evasion behaviours on economic welfare can be both negative and positive. If anti-dumping duties are justified, their evasion can be welfare-reducing, which means the overall level of financial satisfaction and prosperity experienced by participants in the economic system will decrease. By contrast, when imposed to protect domestic industries, for instance, they are not justified and thus:

> Do harm by rendering trade distorting policies ineffective. (Liu and Shi 2016: 20)

Regardless of the justification for such measures, trade re-routing reduces transportation efficiency. It might also be argued that re-routing does not imply an economic boom and export growth in third countries, as value added is usually low.

The most direct effect of anti-dumping duties is the destruction of trade, which implies a reduction in the imports of one country (e.g. the US) of the targeted products from another (e.g. China). Another direct effect is trade diversion or import source diversification, meaning an increase in imports from third countries (e.g. Malaysia). As shown by Liu and Shi, there is a positive correlation between the two effects, which is likely to be driven by anti-dumping duty evasion. Moreover, anti-dumping also has an indirect ripple effect in international trade under which Chinese exporters mainly focus on their domestic market. As domestic market competition increases in the nation which is subject to anti-dumping duties, imports from other countries will ultimately decrease. Generally, therefore:

> The evasion of anti-dumping duties through trade re-routing renders anti-dumping less effective. (Liu and Shi, 2016: 8)

The above-described means for evading anti-dumping measures can also be applied to circumvent sanctions. In Russia, banned EU goods are frequently re-exported via Belarus, Serbia or other countries not affected by sanctions. These activities are illegal under Russian law, but both EU producers of banned products and countries not affected by the sanctions share an interest in non-compliance. Nonetheless, the Russian authorities have been strict in their enforcement by preventing the import of targeted products, particularly within the EAEU (EU Directorate-General for External Policies 2017: 26). In the case of Belarus, imports to Russia increased by thirteen per cent between August and December 2014. Belarus utilises many EU agri-foods as inputs, but their import remains legal provided substantial value is added to the goods in Belarus. Russia's strict surveillance of the origins of agri-food products has resulted in disputes with Belarus (EU Directorate-General for External Policies 2017: 27).

Sanctions against individuals

Literature on the circumvention of sanctions and embargoes is scarce, so this section relies heavily on research into money laundering. The existing literature here focuses mainly on organisations and mechanisms which fight money laundering and terrorism financing. However, it does not sufficiently discuss how criminals proceed to launder their incriminated funds or circumvent sanctions. Despite international action against money laundering, the phenomenon remains a massive and global source of danger. Therefore, experts concur that current anti-money laundering efforts are largely ineffective (Harvey 2004: 333-346). The same is also true for sanctions and embargoes (Teichmann and Sergi 2019: 105).

Individuals affected by financial sanctions can employ straw figures to establish bank accounts or company structures for them. It is essential that straw figures have plausible background stories. For instance, a person launching a consulting company should be able to produce evidence of a degree in business or law. In addition, prices for offered services need to match market benchmarks. Moreover, those selected as straw figures must be trustworthy and, in some way, dependent on the person targeted for sanctions so that they will not abscond with the funds entrusted to them. In addition, multiple straw figures might be used to diversify the risk (Teichmann 2018: 3).

Individuals targeted for sanctions also frequently divide their transactions. Thus, instead of one large transaction (e.g. exceeding $10,000) intended for the payment of business partners, several smaller transactions may be conducted. This means that, if one transaction is found to be suspicious and banned, the others may not be affected. If necessary, assets can later be pooled again. In addition, a chain of multiple firms and bank accounts could be established in a number of different countries – ideally, those known to avoid co-operating with foreign authorities, which would hinder a possible prosecution. Even if suspicious transactions are reported, bureaucratic obstacles make it nearly impossible to discover who stands behind such a network.

To circumvent sanctions successfully, individuals must pay attention to plausibility. To avoid being flagged by automated analyses as a suspicious transaction, and thus triggering investigation by compliance departments, each transaction must match the profile of an alleged beneficial owner. Affected individuals also need to provide documents which support their story. Should a financial institution raise questions, they are then able to produce these documents immediately. Typically, these documents are notarised.

Specific methods include the utilisation of offshore bank accounts, consulting companies and lock boxes. Offshore banks do not usually scrutinise beneficial owners as much as EU or American banks. Therefore, straw figures can be employed to open bank accounts. For instance, one could deploy a straw figure to establish a consulting company for trade and marketing services in a free trade zone in Dubai. As soon as the affiliated bank account is established, the straw figure could then utilise incriminated and legal funds as start-up capital while conducting other payments with legal funds. For at least three months, the beneficial owner maintains a stable balance in the account to sidestep any possible compliance concerns. Next, the straw figure sends forged invoices to other offshore companies owned by people who wish to transfer money to the beneficial owner targeted for sanctions. In this scenario, the bank's compliance department is unlikely to be able to identify the true beneficial owner.

Consulting companies are another popular means of circumventing sanctions. For instance, one could establish a limited liability company in Switzerland with subsidiaries in other countries. To maintain a plausible image, one could rent office space in a known area and design a legitimate website to avoid unwanted attention. Typically, real and fictitious services are combined in the same company. However, this method is only applicable for an individual targeted by sanctions who has significant financial means at their command.

Lock boxes, by contrast, require little expertise and funding. They are a simple way of storing cash to get around banks' compliance concerns. Lock boxes are generally considered extremely safe and anonymous, as private renters do not usually need to follow compliance guidelines. For instance, someone targeted by sanctions could hire a straw figure to rent a lock box on their behalf. Lock boxes can also be used to transfer funds.

All of these techniques can be utilised by Russian individuals who are the subject of sanctions. In addition, beneficial owners of corporate structures, or individuals who own shares in Russian legal entities, could employ such methods to continue conducting business in Russia. Moreover, Russia is a patronage state which means that economic resources are distributed through a system of patron-client ties (Carpenter 2018). Therefore, individuals affected could be compensated with insider contracts and subsidies, as well as other forms of economic rents. The power of sanctioned 'cronies' and senior officials depends entirely on their demonstrated loyalty to the Kremlin, so they are unlikely to be severely affected by targeted sanctions. Nonetheless, visa and investment restrictions in the west arguably constitute a proportionate response to sidestepping and corruption at the hands of such cronies and senior officials.

Recommendations

Sanctioned producers

EU producers affected by bilateral sanctions between Russia and the EU should pay close attention to whether their business partners are also subject to sanctions. If a major shareholder in a European firm (i.e. with an ownership stake exceeding fifty per cent) is the subject of sanctions, the impact on the affected company and its business partners can be immense. Since the US imposed economic sanctions on the Russian economy in April 2018, no US citizen has been able to conduct business with the parties who are the target. Moreover, the assets of the latter remain frozen.

To be able to deal effectively with business partners subject to sanctions, companies need to plan ahead. It is also necessary to identify the extent and kind of business relationship at stake. If necessary, legal assistance must be sought to resolve the adaption of contractual relationships. Furthermore, companies must plan their communications with external shareholders, stakeholders and authorities in case they are affected by any sanctions.

Russia and the west

This article has shown how easily sanctions may be circumvented. In such a situation, the effectiveness of the current regime of sanctions is questionable. Public opinion is also divided on sanctions against Russia. In the US and Europe, many critics are demanding even harsher sanctions to have an impact simultaneously on multiple aspects, including economic, financial and political, even if Russian civilians are affected. Meanwhile, others argue that current sanctions are already crippling Russia's economy in the long run, which would be devastating to the nation and should, therefore, be reconsidered. Ultimately, it seems that the current sanctions are prolonging a lose-lose situation for both sides.

In the light of strong evidence that the current sanctions are ineffective, it would be reasonable for the EU, the USA and Russia to consider lifting, or at least loosening, them, thereby finally achieving some form of rapprochement between east and west. If the conflict between Russia and the west can be resolved, Ukraine may also find peace.

In September 2019, Russia and Ukraine made a significant step forward towards a peaceful future by exchanging 35 incarcerated individuals. Among the released Ukrainian prisoners were the 24 seafarers arrested in the Kerch Strait (Ackeret 2019). This exchange inspires hope for a harmonious future co-operation between Russia and the west (Sergi 2009, 2018b).

Conclusion

When sanctions against Russia were first introduced in 2014, the economic costs, particularly for European countries, were a major concern. Restrictions on trade and investment reduce the volume of production, value added and employment among all trading partners (EU Directorate-General for External Policies 2017: 39). It is questionable how much impact western sanctions have actually had on trade with Russia, as the prior significant drop in the international oil price ostensibly damaged the Russian economy; furthermore, the subsequent devaluation of the rouble reduced foreign import demand, thus contributing to a decline in trade volumes. Therefore, quantifying the impact of sanctions-induced economic costs remains challenging.

Naturally, companies affected by the consequences of sanctions have adapted to the changing conditions in an attempt to maximise profits. To compensate for the losses caused by the deterioration of one market, businesses are finding alternatives in other foreign markets. Bilateral sanctions between Russia and the EU have, thus, led to diversion effects. Over time, these effects might be successful in compensating at least partly for lost exports, thereby reducing the negative economic welfare effects. In addition, we should observe that companies do not necessarily comply with sanctions.

Together with the direct costs of trade restrictions, the implementation of financial sanctions may evoke additional, much higher costs. Furthermore, it must be noted that bilateral sanctions have significantly harmed business relations between the EU and Russia, lowering the exports not only of banned products but also goods which are not the subject of sanctions. Therefore, political tension between the two actors is another major concern.

In 2013, Russia was the EU's fourth largest export market while the EU was Russia's largest export market. These highly significant trade relationships have suffered as a result of the imposed sanctions and other external factors. In particular, Russian exports to the Baltic countries, Poland and the Czech Republic have declined significantly more than exports to the EU as a whole. This can be explained by the extent to which historically-formed economic relationships have suffered from the sanctions. In addition, trade diversions have only marginally helped to recover sales: the average drop in total exports from EU countries amounts to eleven per cent (EU Directorate-General for External Policies 2017: 40).

Other possible consequences of the bilateral sanctions are declining EU investments in Russia and lower total investment in the Russian energy sector. This could have long-term repercussions for energy production. A large share of Russian energy is exported to the EU and constitutes an essential source of income to the Russian government.

Russia has also been dealing with non-compliance with sanctions. Empirical evidence suggests that EU exports may have been re-exported to Russia through certain transit countries, namely Serbia, Macedonia and Belarus. In an effort to undermine non-compliance, the Russian authorities have paid particular attention to agri-food imports from those countries, with suspicious products blocked at the Russian border. In addition, countries not involved in the sanctions have begun to export products intended for the home market to Russia and, in turn, have replaced these products with EU imports. This can also be considered non-compliant activity.

It seems unlikely that Russia will accept western demands which have been set as the condition for lifting the sanctions imposed since 2014. Russia refuses to cede its influence in eastern Ukraine and it will most likely not retreat from Crimea. Thus, the linked sanctions will remain in place, causing Russia, the US and Europe to drift further apart. It is also unlikely that Russia will lift its counter-sanctions. Accordingly, the best option for Europe and the US seems to be to reconsider and, possibly, lift the current sanctions. In the long run, the Russian government will most likely be unable to gloss over the country's economic losses. On the other hand, the effects of Russia's counter-sanctions seem to be increasingly troubling Europe and the US, with demands to lift the sanctions on Russia becoming more frequent.

The only solution would be a compromise between Russia and the West.

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