

ABSTRACT

Sanctions are a popular non-lethal, diplomatic tool for countries to enforce objectives like ending terrorism, preventing war, condemning humanitarian crises and political demands, or punishing countries that don't comply. There is an ongoing debate among scholars about whether sanctions as a tool are effective in reaching the above-mentioned goals. This paper looks to determine the consequences of sanctions, regional trade agreements (RTAs), and bilateral agreements on bilateral trade flows among the sender, target, and third-party countries (countries that aren't involved in the sanctioning process). We use the Poisson Pseudo-Maximum Likelihood (PPML) estimator to estimate the gravity equation with time and country-pair fixed effects. Following Heid et. all (2015) we use international trade flows between countries as reported by Comtrade (WTO) to avoid endogeneity bias. The estimates reveal that there is a negative impact on trade flows between the sender and target countries with the presence of a sanction and travel sanction is found to be the most effective among the different sanction subtypes at actively reducing the trade flow. Third-party countries that don't actively take part in the sanction process countries are found to trade excessively with the sender countries with the presence of a military or a trade sanction. We also find that third party countries don't necessarily reduce trade with a target country unless it's a travel or a financial sanction. The presence of Regional Trade Agreements (RTA), bilateral treaties or military alliances (such as NATO) between the third-party country and the sender/target country boosts trade flows significantly. These alliances can even strengthen the economy of target countries from the aid provided to them by the member countries. These empirical results are in line with the trade diversion theory put forward by various economists over the past decades.

Keywords: Sanctions, Sender & Target countries, Third-party countries, Trade flows, Poisson Poisson Pseudo-Maximum Likelihood, Comtrade, Regional Trade Agreements, Bilateral treaties, NATO