Friendly Fire: Third Country Effects of Sanctions

Julian Hinz*

June 2016

Abstract

Economic sanctions are a frequent instrument of foreign policy. They aim to elicit a change in the policies of foreign governments by damaging their economy. However, aside from the direct effects on the target (and sender) economy, the general equilibrium effects of sanction regimes lead to distortions of trade flows to and from third countries.

This paper evaluates these general equilibrium effects for sanction regimes put in place over the course of the 20th century until today. I re-evaluate the global trade impact of sanctions and find substantial general equilibrium effects. The effect of sanctions is estimated using a structural gravity setup that allows to compute consistent general equilibrium counterfactuals. The quantification of "lost trade"—the difference between predicted and observed flows—puts a price tag on the respective measures for all countries, including those not directly targeted.

The results indicate substantial distortions of flows of third countries, in particular for those that previously had strong trade ties to the targeted economy. Looking at the specific regional impacts over time, countries in the Middle East and Latin America that have not been directly implicated in any sanctions measures appear to be, albeit unintentionally, particularly hard hit by this instrument of foreign policy.

Keywords: Sanctions, trade barriers, foreign policy, gravity equations
JEL Classification: F51, F14, F13, F52

*Paris School of Economics and Université Paris 1 Panthéon-Sorbonne, 106-112 Boulevard de l'Hopital, 75013 Paris, France. E-mail: Julian.Hinz@univ-paris1.fr.