Sanctions Busting – A Game-Theoretic Analysis

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Abstract

Economic sanctions consist of penalties that one party (the sender) imposes on another party (the target) in order to affect the target's actions. In this paper, we develop a theoretical model to analyze the effectiveness of sanctions imposed by a sender, as well as the target's and its partner's incentives to comply or bust sanctions. We consider both primary sanctions – sanctions imposed on the target – and secondary sanctions – sanctions imposed on the target's trade partners. Sanctions impose costs on the target and its partners, but also on the sender. We model the three-way strategic interaction between the sender, the target, and the target's partner and determine the optimal primary and secondary sanctions in the presence of sanctions-busting trade.

We use a three-period model to distinguish between the short-run and long-run effects of sanctions as well as adjustment costs to long-run decisions of the sender and of the target and, in particular, its partner whose behaviour is not public information ex ante. The short-run effectiveness based on substitutions and resilience of the target and its partner may force adjustments to sender's sanctions imposed. Moreover, if the initial sanctions are sufficiently surgical to elicit long-term effects, the objectives are more likely to be attained.