

INTERNATIONAL TRADE AND ECONOMIC CONFLICT:
THIRD PARTY STATES' RESPONSE TO SANCTIONS

by

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(Under the Direction of DOUG STINNETT)

ABSTRACT

This manuscript examines the factors affecting bilateral trade between the targets of economic sanctions and third party states. Particularly, it examines how the relationships between third party states and the sanctions' primary sender and the third party states' relationships with the target state can each encourage or discourage trade. Through the use of a triadic approach, this piece investigates whether economic or political factors play a more determinative role in shaping how third party states respond to economic conflict between the sender and target. The paper quantitatively tests the competing liberal, realist, and economic explanations for states' trading behavior using observations from eight different U.S.-sponsored sanctions cases. It further conducts an in-depth case study on the United Arab Emirates' sanctions-busting activities on behalf of Iran. The analysis reveals strong supportive evidence for the economic and liberal explanations of states' trading behavior and contradictory evidence for realist and security-based explanations.

INDEX WORDS: Sanctions, Sanctions-Busting, Trade, Transshipment, Economic Conflict, Triadic, Iran, United Arab Emirates

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B.A. in Politics, Washington and Lee University, 2004

A Thesis Submitted to the Graduate Faculty of The University of Georgia in Partial Fulfillment
of the Requirements for the Degree

MASTER OF ARTS

ATHENS, GEORGIA

2006

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DEDICATION

This thesis is dedicated to my parents, Pam and Walt Early. Without their constant encouragement and support of my education over the years, I doubtless would not be where I am today. Thanks for everything Mom and Dad.

ACKNOWLEDGEMENTS

I would like to thank the Center for International Trade and Security for granting me the wonderful opportunity to travel to the United Arab Emirates and learn so much firsthand about my topic. I would also like to thank Chris Allen, Gary Bertsch, Damon Cann, Doug Stinnett, and Jaroslav Tir, from whose classes I drew extensively from in writing this thesis. Finally, I would also like to thank my committee members: Doug Stinnett, Gary Bertsch, and Jeff Berejikian.

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Chapter 1: Introduction

In terms of money spent, lives disrupted or lost, and in the opportunity costs of forgone international trade, sanctions and war represent two of the costliest diplomatic tools that states have at their disposal. For decisionmakers, these two policies intersect with their desires for security and prosperity. While often the pursuit of security and prosperity coincide, they can frequently diverge from one another. Though few states have the willingness or incentive to carry engage in either military or economic conflict (Most and Starr, 1989), a much more common foreign policy dilemma is to be “caught in the middle” of conflicts between other states. For states pursuing policy ends through either economic or militarized conflict, a crucial factor determining their success relates to the behavior of third party states, who often do not share identical policy ends. Even though scholars have theorized about the determinants of third party behavior with regard to military conflict (Polachek, Robst, Chang, 1999; Bueno de Mesquita and Lalman, 1992; Bueno de Mesquita, 1980), the behavior of third party states with regard to sanctions regimes has received little attention. While the sanctions literature has operated under the assumption that states not part of the sanctions regime tend exploit whatever profitable gains can be made through trade with the sanctioned state, findings from the trade and conflict literature have asserted that “primacy of politics” with regard to states’ trading behavior (Keshk, Pollins, and Reuveny, 2004). To move both research programs forward, the influences of third party states’ relationships with both the sanctions sender and the target state on the third party states’ trade with the target need to be better understood.

Significant disputes exist within the sanctions literature as to whether having third party assistance aids in the effectiveness of sanctions (Drury, 1998; Martin, 1992; Hufbauer, Schott,

and Elliot, 1990) or whether third parties can actually hinder sanctions' effectiveness (Drezner, 2000). However, no research has been done to understand why variation might exist amongst third party states in how they respond to their trading partners being sanctioned. The common assumption has been that if states choose not to join the sanction regime, then they will conversely attempt to maximize the gains they can accrue from the trade imbalances created within the target state (Hufbauer and Oegg, 2003; Drezner, 2000; Kaempfer and Lowenberg, 1999; Martin, 1992). However, such an assumption contradicts the prevalent findings from the trade and conflict literature which assert that states trade more with their allies and less with potential enemies (Long, 2003; Mansfield and Bronson, 1997; Gowa 1994; Gowa and Mansfield 1993; Pollins, 1989a & 1989b). For instance, the United Arab Emirates (UAE) has had close military ties¹ with the United States throughout the 1990s. At the same time, Iran emerged as the UAE's greatest regional threat. Yet, the UAE's response to American sanctions against Iran has been to become one of Iran's largest trading partners—particularly prospering from the re-export and transshipment of sanctioned goods from the U.S. While clearly the UAE's policies towards Iran have potentially significant security and economic ramifications, the two most relevant scholarly literatures that could explain the UAE's behavior provide contradictory predictions.

The relationship between economic interdependence and conflict stands as one of the most active research programs within international relations; yet, for all the research conducted on the subject, the explanation for the relationship still remains a “horse race” between liberalism and realism (Simmons, 2003: 32). Brian Pollins and Edward Mansfield contend that relationship between interdependence and conflict still suffers from a lack of theoretical development into the causal mechanisms underlying both the liberal and realist arguments (Pollins and Mansfield, 2003). Various authors have demonstrated that increased international trade can both increase

¹ No formalized treaty alliance exists, however.

the likelihood of conflict (Barbieri, 1996) and decrease the likelihood of conflict breaking out (Russett and Oneil, 2001). Further studies have examined the affects that conflict and security arrangements have on trade. Notably, Omar Keshk, Brian Pollins, and Rafael Reuveny tested whether trade has a greater affect on conflict or whether conflict exercises a greater influence on trade, finding that political conflict proved to be the better explanation (Keshk, Pollins, and Reuveny, 2004). This finding is consistent with the broader pool of scholarship that security considerations have substantial affects on with whom states trade (Long, 2003; Mansfield and Bronson, 1997; Gowa 1994; Gowa and Mansfield 1993; Pollins, 1989a & 1989b). Works by both Katherine Barbieri and Jack Levy (1999) and Quan Li and David Sacko (2002) particularly have challenged the conventional wisdom that conflict hurts trade. Overall, the research program has overwhelmingly focused on the relationship between international trade and military conflict, while neglecting the relationship between international trade and economic conflict. Almost remarkably, the interdependence-conflict literature and sanctions literatures—which addresses the latter—have developed quite divorced from one another. While authors such as Hirschman (1980) and Baldwin (1985) have come with broader theories of economic statecraft, much of the sanctions literature has been narrowly focused on questions of: “Are sanctions effective? How do they work? What are their costs? And, what can make them more effective?” Little effort has been made to include the study of sanctions within the broader theoretical debate regarding interdependence and conflict.

Though third party state’s importance to sanctions’ effectiveness has been acknowledged for a long time, it remains a theoretically underdeveloped topic. Hufbauer, Schott, and Elliot (henceforth referred to as HSE) first addressed the role of third parties with the inclusion of “Black Knight” variable in their analysis, meant signify the presence of a political ally that

provided the sanctioned state with significant assistance (Jing, Kaempfer, and Lowenberg, 2003; HSE, 1990). In Lisa Martin's *Coercive Cooperation*, the motive behind the primary sender state's efforts to coerce third party states into joining their sanctions regimes against other states was that "Without such cooperation, their efforts will probably be futile" (Martin, 1990: 3-4). Underpinning this perspective is the theoretical assertion that third party states will seek to "earn excess profits, or rents, arising from the sanctions-induced improvement in their terms of trade with the target [of the sanctions]" (Kaempfer and Lowenberg, 1999: 44). While agreeing that third parties have significant incentives to trade with the target state, Daniel Drezner challenged the contention that their participation in multilateral sanctions makes sanctions more effective (Drezner, 2000). Indeed, he finds that in the absence of institutional support, multilateral sanctions are actually less effective than unilateral sanctions alone because of the third party states' incentives to cheat and/or renege. Yet, Drezner cannot explain why third party states represent more of a threat to sanctions' effectiveness by participating in the regime than they would have had they never joined it to begin with. While a burgeoning body of empirical works has grown to show that non-participant states are indeed affected by sanctions (Yang et. al 2004; Hufbauer and Oegg, 2003; Caruso 2003), no attempts have been made to explain cross-national variation in how states respond. Present theories cannot explain why some non-participant states exploit the improved terms of trade with sanctioned states while others exercise restraint.

Thus, the puzzles driving this inquiry into the indirect effects of economic conflict between two states upon their trade relations with third parties are both of an empirical and a theoretical nature. Explaining the United Arab Emirates' trading behavior towards Iran in the midst of its cultivation of a strategic alliance with the United States represents a challenging case that defies an intuitive explanation. Furthermore, attempting to reconcile the contradictory

predictions proposed by the sanctions and trade and conflict literatures represents an important step in developing a more unified understanding of the relationship between international trade and different forms of conflict.

The application of the theoretical lenses developed within interdependence-conflict literature to the study of sanctions can provide useful insight into the trading behavior of third party states. This literature provides an established set of theories about how third party states' political relations with both the sender and target would influence their willingness to trade with the sanctioned state. Indeed, much of the sanctions literature operates under the little scrutinized assumption that the economic relations with the sanctioned states are more important to non-participants than their relationship with the sender. Indeed, even if no cross-national differences were found in this study, it would reconfirm the current conventional wisdom that most states are primarily motivated by economic gains. In addition, expanding the substantive field in which realist and liberal theories on economic interdependence and conflict can be tested should prove to be valuable for that research program as well. Working towards a more unified understanding of the relationship between interdependence and both militarized and economic conflict should help bridge the islands of theory that have separated the study of these two topics.

The following study develops a unified model of third party state behavior in response to the imposition of sanctions, which in turn is used to test three explanatory theories of international trade: realism, liberalism, and economic opportunism. The subsequent analysis uses a triadic approach that accounts for the role played by the three interstate relationships between the sanctions sender, target state, and third party state that could affect the third party state's trade with the target state. Following the triadic approach, the study includes a quantitative test of 20,478 observations of the yearly trade relationships between states targeted

with sanctions and third party states spanning 8 different sanctions cases. It further fleshes out the mechanistic logic of the triadic approach advocated within the piece through a detailed case study of the trade relationship between the UAE and Iran in the wake of the United States sanctions against Iran. As the analysis subsequently reveals, third party states' trading behavior towards sanctioned states defies realist predictions. Indeed, third party states' trading behaviors appear to be indifferent to security considerations and focused solely on the acquisition of profits. Economic opportunism and liberalism demonstrate significantly greater explanatory power in explicating the underlying motives driving states' willingness to trade with sanctioned states. The analysis also provides evidence challenging some longstanding assumptions within the sanctions literature about the roles played by allies in assisting sanctioned states.

The body of the study unfolds over the next five sections. Chapter Two provides a review of the relevant sanctions and trade and conflict literatures. The next chapter begins with the development of a model of third party state behavior in response to sanctions. Then, it fleshes out the realist, liberal, and economically opportunistic theories of international trade and proposes sets of hypotheses for each to be subsequently tested. Chapter Four presents a quantitative test of the proposed theories through the construction of a regression model developed to evaluate the various factors associated with higher or lower trade flows during sanctions than would have been predicted had sanctions not been in place. The fifth chapter evaluates the results of the model's findings in light of the theories being tested. Finally, Chapter Six contains a detailed case study of the sanctions-busting relationship that developed between the UAE and Iran, which provides a detailed look at the various factors tested within the quantitative model. The manuscript ends with a conclusion that puts the study's findings into

perspective within the two literatures in which it is nested and looks forward to future areas of study on the topic.

Chapter 2: Literature Review

The international trade and conflict literature has largely been defined in terms of studying conflict's effect on trade and trade's effect on likelihood of conflict. Realist explanations of international trade assert the "primacy of politics" with regard to nations' and private actors' decisions regarding with which they trade (Keshk, Pollins, and Reuveny, 2004). In this literature, past histories of frequent conflict and the prospects of future conflict deter states from trading with one another (Morrow, Siverson, Taberes, 1998; Pollins, 1989a & 1989b), while alliances between states encourage states to trade with one another (Long, 2003; Mansfield and Bronson, 1997; Gowa, 1994; Gowa and Mansfield, 1993). Contrastingly, liberal explanations for the relationship between trade and conflict assert that high levels of economic interdependence (Gartzke, Li, and Boehmer, 2001; Irwin, 1996; Polachek, 1980), shared democratic regimes (Bliss and Russett, 1998, Gartzke, 1998; Oneal and Russett, 1997; Oneal et al., 1996), or the combination of thereof (Russett and Oneal 2001; Russett, Oneal, and Davis, 1998) between states reduce conflict. Reinforcing these conclusions are the findings that democratic states do indeed trade more with one another than do with autocratic states (Mansfield, Milner, Rosendorff, 2000; Moon and Dixon, 1993). In an impressive attempt to settle the dispute, Keshk, Pollins, and Reuveny (2004) provide robust empirical proof that the political relations between states has the greatest impact on how much states trade with one another, than bilateral trade has on the likelihood that two states will come into conflict with one another.

While much of the literature that examines the relationship between trade and conflict has used states as the primary unit of analysis, another vein of the literature has examined the behavior of individual economic actors. As Quan Li and David Sacko surmise, “States fight and firms trade. While states fight for survival, firms trade for profit” (Li and Sacko, 2002: 13). This vein of literature emphasizes that while conflict must be accounted for on the state level, understanding its effect upon trade requires looking at the economic agents that actually conduct it, not the political entities they inhabit. This perspective was pioneered by Brian Pollins (1989a; 1989b), who first used public choice models to show how international security considerations influenced the international trading behavior of individual economic actors. As Pollins demonstrated, individual economic actors’ utility functions have security components built into their decisions regarding with whom to trade, including: “the desire to reward friends, to punish adversaries, and to minimize risk” (Pollins, 1989b: 741). Pollins showed that individual economic actors’ behavior tended to follow the lead of their home state in its relations with other countries (Pollins, 1989a). James Morrow (1999) has further argued that economic actors not only respond to state behavior, but factor such expectations of the future into trade relations. The empirical findings from approach have found both that conflict has negligible effects upon trade (Li and Sacko 2002; Barbieri and Levy, 1999) and that the political relations between states does significantly affect their inhabitant firms’ willingness to trade with one another (Pollins, 1989a; 1989b).

Most of the academic literature examining the successfulness of economic sanctions has focused on the dyadic relationship between the sender and the target states (Yang et. al, 2004; Hufbauer and Oegg, 2003; Pape, 1997; Dashti-Gibson, Davis, and Radcliff, 1997; HSE, 1990). The predominant factors studied have been: the senders’ pre-existing political and economic

relationship with the target, the kind of sanctions imposed (import, export, or financial), the duration of the sanctions, and whether the sanctions have been unilateral or multilateral (Drezner, 2000; Martin, 1992). Daniel Drezner has further demonstrated a counter-intuitive aspect of sanctions effectiveness, in that sanctions tend to be more effective when used against friendly nations than against hostile ones (Drezner, 1999). The predominant view held by scholars who assume that states are rational, unitary actors holds that the degree to which sanctions impose real costs upon target states is the primary determinant of whether or not the sanctions will be effective (Dashti-Gibson, Davis, and Radcliff 1997; HSE, 1990; Doxey 1980). More recent scholarship has examined how the economic pressures sanctions place on target states translate into political pressure on the sanctioned state's government and affect domestic political outcomes, finding that the nature of the economic pressure affects the kind of political pressures created (O'Sullivan, 2003; Rowe, 2001; Morgan, 1996). Within this vein of literature, the regime structure of the target state and the distribution of power amongst its various sub-state actors dramatically affect the nature of its political response to being sanctioned (Brooks, 2002; Rowe, 2001; Kaempfer and Lowenberg, 1999). Another sanctions subfield has focused on how states and sub-state actors adjust to the new economic conditions imposed by the sanctions regimes: through restructuring their legitimate international trade networks (Van Bergeijk, 1994 & 1995), through government hoarding and rationing (Curovic, 1999), and through black marketeering and smuggling (Andreas, 2005; Naylor, 2001). A critical component of how states respond to trade sanctions is what other trading opportunities they have within the international marketplace to replace the market denied to them through sanction; thus, highlighting the need to understand the role played by third party states.

Except for Van Bergeijk's (1995) piece that looks sanctions' effect on trade networks, little attention had been paid to the effects of sanctions on third parties until recent years. More recently, contributions from the economic field have started including variables measuring trade levels between sanctioned states and non-participants within their econometric analyses. Several studies have demonstrated that the imposition of sanctions has led sanctioned states to redirect their trade lost with the sanctions' sender to non-participant states, with the effects even lasting beyond the sanctions' duration (Yang et. al, 2004; Askari et. al, 2003; Hufbauer and Oegg, 2003; Hufbauer et. al, 1997). Raul Caruso (2003) has conducted the only study to date that has attempted to test Van Bergeijk's theory that sanctions decrease trade between the sanctioned state and third parties against the sanctions-busting theory that sanctions increase trade between the sanctioned state and third parties. Caruso finds that in the cases in which the sanctions were the harshest, there was an aggregate negative impact on third-party trade, but when they were weak or moderate, third-party actors' trade increased with the target state (Caruso, 2003). However, Caruso's study only examines the ultimate effect of sanctions upon the aggregate trade relationships between sanctioned states and third parties—it does not look at state-level determinants that could effect how the third parties responded to the sanctions.

The study of sanctions can be significantly improved through acquiring a better understanding what has been identified as one of the principle determinants sanctions' success—the rest of the world's response. If the Soviet Union hadn't supported Cuba against the US sanctions during the Cold War or if South Africa under apartheid had not been so politically isolated, the sanctions' effects likely would have been different. Currently, most sanctions studies have been limited to dyadic-level analysis between the sender and target states. However, as the rest of the states not participating in the sanctions regime ultimately structure the opportunities

the sanctioned state has at its disposal to respond with, understanding third party behavior is a crucial component of understanding the strategic behavior of sanctioned states. However, existing theories within the sanctions literature cannot tell us anything more about the behavior of third party states beyond that those states not joining the sanctions regime have strong economic incentives to exploit the imbalanced terms of trade with the sanctioned state, as do private economic actors from both participant and non-participant states. Herein lies the benefit of applying the insight gained into states' trading behavior, especially with regard to security issues, from the trade and conflict literature. Transposing this literature's theoretical perspectives onto the study third party state trade behavior can provide a more nuanced understanding of the motivations behind their responses. The subsequent section, will examine the theoretical underpinnings that could account for third party states' opportunity and willingness to trade with sanctioned states: the third party state's political relationship with the sanctions target, the third party state's economic relationship with the target, and the third party state's political relationship with the primary sender of the sanctions.

Chapter 3: Theory and Hypotheses

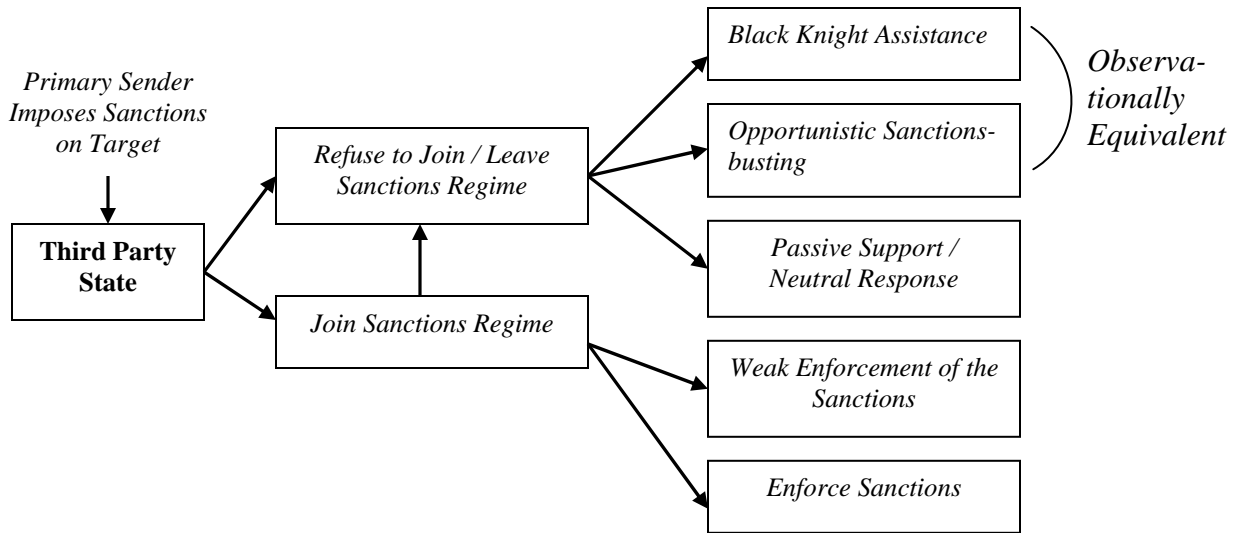
Foreign Policy Substitutability—Third Party State's Trading Behaviors

In choosing which foreign policies to pursue, states' decisionmakers are guided by their goals, but constrained by the means they have at their disposal with which to pursue them. Most and Starr's (1989) foreign policy substitutability framework thus serves as an excellent tool for structuring how policymakers choose between the variety of strategies they have available to them. What has been problematic of the literature is that various authors hold different views as to what behaviors are available to third party states. While often clear in their assumptions about the particular behaviors they are studying, most authors fail to put the particular behaviors they are studying within the broader context of the other possible choices available to the states. Thus, this section seeks to develop what Most and Starr (1989) would refer to as a policy choice menu for third party states in how to respond to their trading partners being sanctioned. One of the value-added undertakings of such an endeavor is that no previous attempts to construct a unified framework for third party behavior from the disparate sub-fields of the sanctions literature has ever been constructed.

The policy choices available to states are much more complex than a dichotomous between joining the sanctions regime and sanctions-busting. Thus, we need a more nuanced understanding of the policies available to and pursued by third parties states after their trading partners have been sanctioned. The framework provided in *Figure 1* integrates the existing and hereto disparately discussed explanations for third party state behavior into a unified choice set of policy options available to third party states, ranging from full compliance with the sender's sanction regime to politically-motivated sanctions busting on behalf of the target. The rest of

this section will explain the rationale behind categorizing third party states responses into the five responses depicted within the model.

Figure 1: Third Party Response to Sanctions against Target State



Active Sanctions Busting Behaviors

While black knight behavior and opportunistic sanctions-busting may both lead to the same outcomes, each behavior is premised on a different underlying motive and explicitly carried out on different levels. The opportunistic explanation of sanctions-busting focuses on the role played by individual economic actors in determining the aggregate trade observed between states, while the politically-oriented black knight explanation theorizes directly about decisions made on the state level to increase or decrease interstate trade. With respect to determining which theory most accurately explains sanctions-busting behavior, the underlying causal mechanisms supporting each theory need to be explicated and differentiated.

The underlying assumption upon which most sanctions studies rest upon is that third party states will universally attempt to exploit the imbalanced terms of trade with the target state for economic gain. The "Opportunistic Sanctions Buster" category primarily focuses on the pursuit

of profits by individual economic actors. Kaempfer and Lowenburg (1999) identify the “catch-22” of sanctions economics in that: “The larger the deterioration in the target’s terms of trade, the greater the potential gain to a renegade nation that remains willing to trade with the target...” and to the individual economic actors who may be acting with or without their state’s approval (Kaempfer and Lowenberg 1999: 44). The principle assertion of this “sanctions-busting” theory is that on the state and individual levels non-participants will seek to maximize their economic gains whenever possible. Thus, as Martin (1992) notes, the primary senders of sanctions must seek to coerce other states into joining the sanctions regime with them—either through arm-twisting or incentives. Even when the secondary senders of sanctions agree to join the sanctions regime, private actors may still seek to sanctions-bust despite their home state’s policies (Morgan and Bapat, 2003; Drezner 2000). This can give rise to illicit black marketeering, as private actors seek to take advantage of lucrative smuggling opportunities (Li and Sacko, 2002; Naylor 2001). Indeed, Peter Andreas (2005) has shown how sanctions can help create transnational criminal networks amongst both the target and neighboring states to exploit gains through illicit trade. This vein of the sanctions literature coincides with the findings of Li and Sacko (2002) and Barbieri and Levy (1999), which found that militarized conflict creates only temporary disruptions in trade between two parties in conflict — it neither stops trade overall nor affects it significantly in the long term. The basic logic of this theoretical stream is that regardless of the so-called "high politics" of international relations involved, international trade will still occur in one form or another when it is profitable for economic actors to engage in it (Li and Sacko, 2002).

While the above actions can be explained in terms of economic incentives, the proposed black knight theory uses state-centric political-military motives to explain third party state

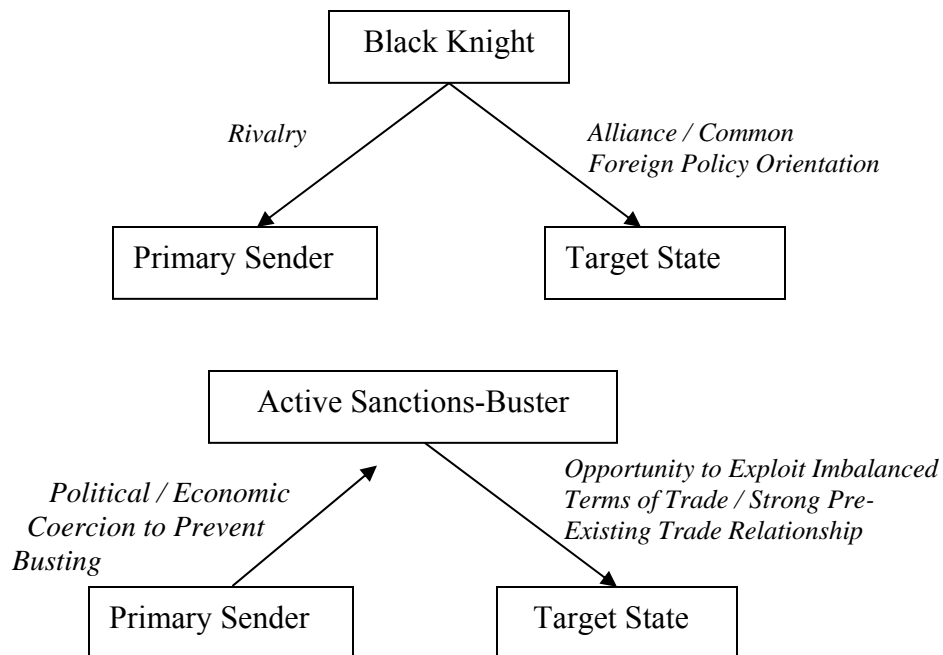
behavior. As HSE's (1990) groundbreaking study noted, the presence of a "black knight" state willing to provide assistance to the sanctioned can significantly affect sanctions' success (HSE 1990). The primary problem with the black knight typology is that it has been ambiguously operationalized and the motivations behind the typology are theoretically underspecified (Jing, Kaempfer, Lowenberg, 2003). Indeed, a state sanctions-busting for political-military purposes is qualitatively different from one doing it for economic gains, in that the politically-motivated state often provides extensive, free aid to the sanctioned state that is not economically exploitive. In "revisiting" of HSE's study, A. Cooper Drury may have obfuscated this concept by including an interaction term for the presence of a black knight and the amount to which the "black knight" traded with the sanctioned state (Drury, 1998). As the archetypical black knight case demonstrates, profit did not motivate the Soviet Union's assistance to Cuba in the wake of American sanctions. Within this analysis, black knight states' motivation is explicitly considered to come from political-military motives, such as a third party state having a strategic alliance with the target state or an ongoing rivalry with the sender state—not from potential gains made through economic exploitation. While the amount of aid given and/or level of discounted trade that black knights provide certainly affects sanctions effectiveness beyond the regular trade engaged in,² understanding the purpose behind the third party state's trade with the target itself is important.

The two active sanctions busting categorizations described above should produce the greatest increases in bilateral trade between the third-party and target states after the imposition of sanctions. While the increase in observed trade levels in both cases of active-sanctions busters

² Free aid and discounted trade would mitigate the net cost of the sanctions that the target state endures. Thus, a more powerful state could subsidize a weaker state through aid, thus allowing it to endure sanctions it otherwise could not afford to bear alone. Conversely, exploitive trade by sanctions busters will drain the target state of resources, adding to the cost of sanctions.

and black knights may make the cases observationally indistinguishable from one another, the causal mechanisms at work in each case are different. In the case of the black knight, both the third party’s political-military relationship with the sanctioned state and the primary sender may affect their determination to assist the target. Allied states or those with similar foreign policy orientations may be motivated to assist military allies or friendly states that have been sanctioned. Conversely, they may be motivated to thwart the foreign policy goals of the primary sender if it is a rival, which could hold true under the “enemy of my enemy is my friend” mentality even if the target is not a close ally.

Figure 2: Causal Mechanisms for Active Sanctions-Busting Behavior



For opportunistic sanctions busters, the primary causal mechanisms affecting third party states’ decision to increase trade with the target state come from their economic relationship with the target state, while the sender can attempt to use political or economic coercion to enforce

compliance. Drawing upon Martin's (1992) the coercive cooperation logic and strategies such as extra-territorial sanctions (Rodman, 2001), the onus rests on the primary sender to convince the third party not to exploit the imbalanced terms of trade with the target; unless the sender exercises as substantial effort, the third party's relationship with the sender should not deter it from trading with the target.³

Passive Support / Neutral Response

Another possible third party state response is to passively support the sanctions regime, whereby state and non-state non-participant do not seek to exploit the economic advantages available to them. Rodman (2001) explores such behavior within nonstate actors in his study of extra-territorial sanctions, which are sanctions applied by the primary sender state upon firms in third party states for not adhering to the primary sender's sanctions against another state—even if the firms' home states are not a party to the regime. Rodman shows that even while the coercive mechanisms the primary state has at its disposal are weak, foreign firms frequently abide by such mandates or adjust their business to work around them, rather than directly challenging their validity. Rodman found this sometimes held true even when some firms' home states vehemently rejected of the primary sender's right to issue extra-territorial sanctions and passed domestic legislation to forbid their firms from complying (Rodman, 2001). For instance, after the U.S. passed the Cuban Democracy Act in 1992 that “reimposed the Cuban embargo on foreign subsidiaries” both Canada and Great Britain forbade their companies to comply with the U.S. edict (Rodman 2001: 114). Despite the strong political objections from their home state governments, Rodman found that many companies indeed complied with the measure. While

³ Exploring how each of these third party strategies affects overall sanctions outcomes on sanctions should be a topic of future research, but remains beyond the scope of this study.

Pollins et al. (Keshk, Pollins, and Reuveny, 2004; Pollins, 1989a) may have found that indeed “trade follows the flag,” Rodman’s analysis begs the question of whose flag does it follow? These cases illustrate that the political and economic relationship between the primary sender state and third party states can influence their willingness to trade with the sanctioned state—even if such states refuse to join the regime.

On the state level, neutral or ambivalent responses may share an observationally equivalent position with passive support from non-state actors. Opportunity provides the simplest explanation for many neutral responses in that the third party state could be so disconnected from the target state that its policies would not affect the two countries' bilateral trade one way or another. Mongolia simply could not do much to affect the sanctions regime against Nicaragua, even if it had wanted to do something about it. An additional explanation for an ambivalent response could arise when a third party supports the underlying justification for the sanctions, but is unwilling to bear the economic burden of punishing the transgressor. Despite its refusal to join the regime, the state in question may agree to limit the degree to which it will allow domestic firms to undermine the sanctions regime because it supports the underlying justifications for the sanctions. The states that have passive or neutral responses to the sanctions will likely experience the greatest variance in the how their trade is affected, as the interaction between trade network disruptions and light sanctions busting activities may cancel one another out.

Joining the Sanctions Regime / Why Comply?

More often than not in the international system, states' interests are not in what Robert Keohane would designate as being in "harmony" with one another—especially in cases where

substantial costs are involved (Keohane, 1984: 51). Even when states have a collective interest in seeing a state punished by sanctions, strong economic incentives exist on an individual level to free-ride (Martin, 1992). Thus, even after a state has been convinced / coerced into joining the regime by the primary sender, it faces a choice as to how stringently it will seek to enforce compliance of those sanctions. As Drezner (2000) notes, enforcement issues plague multilateral sanctions regimes as the costs of and difficulty in enforcing them can be quite high. Drezner identifies two ways in which states can defect from their agreement to cooperate: “Either private agents engage in illicit trading in order to seek greater than normal profits, or secondary senders could announce an official change in policy and overtly trade with the target country,” which he refers to as “backsliding” (Drezner 2000: 83). Morgan and Bapat (2003) have further analyzed the problem of domestic sanctions enforcement through examining the strategic interaction between the states imposing sanctions and the domestic economic actors whom they often must coerce into compliance. Thus, the framework above contains two different categories for the enforcement of sanctions to account for the differing levels of willingness third party participants in sanctions have to enforce the sanctions to which they are a party. This category is particularly appropriate for UN-backed sanctions, which have often have few practical enforcement mechanisms in place to ensure member-state compliance beyond reputational considerations. The prevalence of sanctions-busting that occurred during the Iraqi sanctions regime (1991-2003) provides ample evidence of this behavioral response. What is problematic about attempting to integrate the extent and ultimate effect of illicit trading into standard quantitative analysis is that good data on black market trade does not exist. Especially for states that are geographically proximate to the sanctioned state, this can lead to a significant underreporting of the actual ongoing trade between states because of its illicit nature. Within this

categorization, observed trade will likely decline in the immediate aftermath of the sanctions imposition, especially with regard to broadly multilateral UN-imposed sanctions (Slovov, 2004). As participant states' resolve wanes, bilateral trade between third party states and the target state may resume through either illicit or legitimate channels.

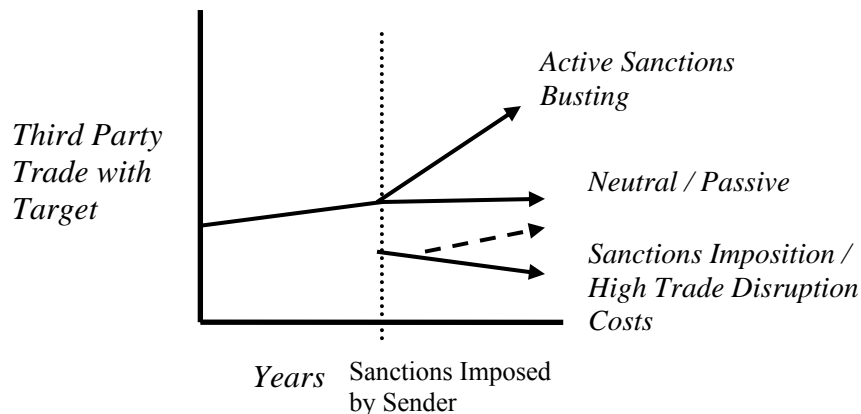
The final categorization that exists is full compliance and enforcement of the sanctions regime. Both Martin (1992) and Drezner (2000) have addressed the factors affecting how successful primary senders are at first getting members to join the sanctions regime and then to fully abide by it. As both authors conclude, achieving international cooperation and compliance on sanctions imposition is difficult in the best of circumstances. As Morgan and Bapat (2003) demonstrate, it cannot even be expected that the primary senders of sanctions will be able to enforce full compliance; thus, the compliance of the secondary states participating in the regime should certainly be the subject of scrutiny. For states that do join the regime, it can be predicted that their trade with the target state will drop in the immediate aftermath of sanctions imposition. That trade may further decline as non-sanctioned business sectors within the target state redirect their trade to other states due to the uncertainty as to whether they could be sanctioned in the future.

Predicted Results of Each Behavior

Before constructing predictive models of how third party states in each of the five categorizations should be affected, the discussion must be placed within the context of the empirical findings of Beregeijk (1994; 1995), Raul Caruso (2003), and Barbieri and Levy (1999). Beregeijk posits that uncertainty and the increased transaction costs associated with readjusting trade networks after sanctions have been imposed decreases overall levels of trade amongst third

party states with the target state. Similarly, even though Barbieri and Levy (1999) posit that conflict has insignificant lasting effects on trade levels, the initial disruption created by conflict is bound to hurt trade at least in the short term. Additionally, Caruso (2003) found that harsh sanctions created trade network disruptions that overwhelmed the sanctions-busting effect in the aggregate, while light sanctions allowed gains from sanctions busting to overpower trade disruptions in the short term. Li and Sacko (2002) found that bilateral trade diminished between to states as the transaction costs imposed both as a direct result of conflict and through expectations of conflict. For example, states' anticipating being sanctioned may take action to reduce their trade dependency on the primary sender state before the sanctions are initiated (Morrow, 1999). Iran's recent withdrawal of most of its foreign assets in Europe in the wake of the UN Security Council referral from the IAEA serves as a good example. Or as Curvic (1997) details, target states could hoard goods before they are sanctioned. Thus, third party states could either see a spike in their trade with the target state before sanctions are imposed or a drop in trade if the target is concerned the state will join the sanctions regime. The trade levels of actively busting states can vary with regard to how long it takes to mobilize a response to the sanctions. The initial trade disruptions caused by the sanctions, in addition to the transaction costs involved in creating new international trade networks, could forestall the effective emergence of clearly-evident sanctions busters for several years. Indeed, most of the slack during this readjustment period is likely taken up by illicit trading activities that will not be readily observable from recorded trade data. Keeping those considerations in mind, these are the expected resultant trade flows that would be the consequence of the various responses outlined above.

Figure 3: Predicted Effects of Third Party State Responses on Bilateral Trade with the Target State



For the most part, *Figure 3* is fairly straightforward in the predictions it makes. Active sanctions busters will trade more with the target state, neutral / passive states should experience slight declines in their trade, while sanctions participants should see more significant declines in their trade. The dashed line represents those states who are "backsliding" members of the sanctions regime. Two important caveats exist, however. Firstly, bilateral trade levels in the immediate aftermath of the imposition of sanctions may be fairly volatile, as the market re-establishes a new equilibrium adjusting to the sanctions. The trade disruption effects described by Van Bergeijk (1994; 1995) could very well cause an aggregate decrease in all states' trade with the target state in the immediate aftermath of sanctions imposition, even states pursuing active busting activities. Secondly, the categorizations do not provide hard and fast predictions that will be true in all circumstances. Potentially, the trade disruption effects of the sanctions could overwhelm even the most strident efforts of a state to sanctions bust or such efforts could flow through illicit channels; thus, the observation may appear to fall into the neutral

categorization. Indeed, the greatest amount of positive and negative variation will emerge the neutral categorization.

Explanatory Theories and Hypotheses

This section provides details three different theoretical perspectives that can account for third party states' behavior toward the sanctioned state. Within the opportunistic model, the geographical and economic relationships are examined. This theory is driven by the assumption that if non-state actors / firms have the ability to trade with one another, they will—regardless of their home states' relations with one another. The realist model taken from the trade-conflict literature can explain third party states' behavior in terms of the strength of their strategic relationships with the sanctions sender and the target state. Within this perspective, the political-military relationships between states and system structure should be determinative of third party state behavior. The final explanatory framework comes from the liberal / interdependence literature, which posits that transparent, democratic institutions, high levels of bilateral trade, and economic cooperation forge strong transnational links that diminish the likelihood of conflict. This theory would emphasize the economic relationships between the third party and the target and sender states as the primary determinative of the third party's response. Each of the theories will be drawn upon to make predictions about third party state behavior.

From Dyads to Triads—The Power of Three

The typical approach to studying both international trade and conflict and sanctions has focused on studying the bilateral relations between two states. While Martin's (1992) integrated the relationship between the primary sender state and potential sanctions regime joiners into her

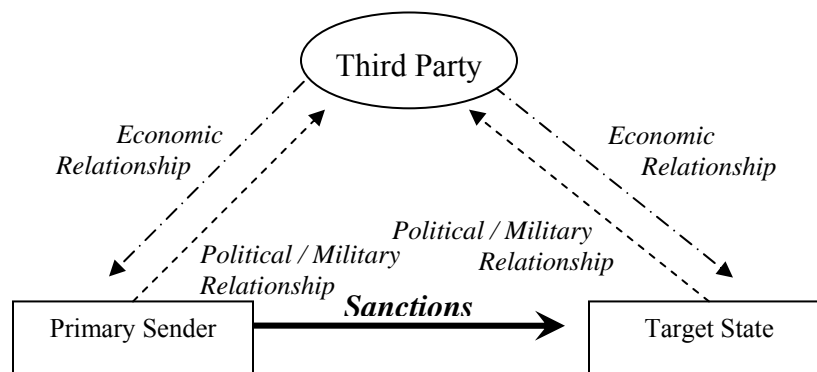
analysis, her models did not factor the economic and political relationships between third party states and the target state. Similarly, Drezner (2000) discusses the relationship of third party states to the target state, but does not construct a testable, unified framework for evaluating whether the third party states' relations with the sanctions sender or target influence their behavior more. However, the focus of both Martin and Drezner's studies was upon the target state and the determinants of the sanctions success—not in elucidating a broader theory of third party state response.

Within the context of the League of Nations sanctions against Italy, Tatjana Curovic (1997) was the first to construct a formal model that integrated how third party states' trade relations with the sender and target were affected by sanctions.⁴ Solomon Polachek, John Robst, and Yuan-Ching Chang later went on to build an integrated model of economic interdependence and conflict that included third party states within the analysis (Polachek, Robst, and Chang, 1999). Through the use of formal models, Polachek et al show how a state actor's economic relations with a target state can have security externalities that spillover to the actors' relations with third party states. While the authors present the underlying formal logic behind triadic relationships, such as "a rival of a rival is a friend," "a rival of a friend is a rival," and "friend of a friend is a friend" and discuss how such models could be applied to sanctions regimes, they do not explicitly test their models with regard to sanctions (Polachek, Robst, and Chang, 1999: 410-411). In subsequent analysis, Chang sought to analyze whether the "friend of a friend is a friend" and the "enemy of a enemy is a friend" propositions hold true for third party states' affect on relations of other states (Chang, 2005: 210-215). Change constructs separate regression models for whether the target and third party states are friends or rivals, and measures the subsequent

⁴ Curovic's created a two-good model of international trade between three states and focused primarily on how the terms of trade were affected by the imposition of sanctions.

affect of cooperative/combative behaviors directed towards the target by a primary actor on relations with the third party state. Chang finds the strongest support for her "friend of a friend is a friend" hypothesis, in that increased trade between the primary actor and third party can positively influence bilateral relations (in terms of a conflict-cooperation continuum) between the primary actor and third party state (Chang, 2005).

Figure 4: Triadic Relationship between Sender, Target, and Third Party



The model that I have constructed is similar in form and logic to that of Chang's model, but seeks to test a much more specific research question in which each of the states already have specified relationships with one another. The triadic model I have specified integrates the political and economic relationships between the third party and sender and third party and target state into a single explanatory model for explaining how the third party's trade relations change with the target state after sanctions are imposed by the sender. The model controls for the relationship between the sender state and target in that the sender's relationship with the target is defined by the imposition of sanctions. While political conflict and cooperation is the dependent variable in Chang's analysis, bilateral trade between the third party state and target state serves as the dependent variable in my analysis. The model attempts to explain how third party states use

trade to respond to the indirect effects of economic conflict between two other states, within the confines of interdependent relationships with both states. Thus, my model attempts to explain how the third party state's relationship with the sender can "push" the sender away from trading with the target and how the third party's relationship with the target can "pull" it into closer trading relations after sanctions have been imposed.⁵ The subsequent sections draw on three previously established theoretical streams established by the trade and conflict literature to explain how the relations of the sender and target states with the third party will affect the third's response towards the target state.

Prefacing the Third Party State's Response: Target Behavior

The first operative assumption that applies to all of the following theories, but especially the opportunistic one, is that the target state will actively seek to undermine the sanctions imposed against it (Li and Sacko, 2002; Naylor 2001: 385). R.T. Naylor contends that depending upon the strength of the regime and its comparative economic development, "sanctions-busting machines" form within target states through the establishment of "parastatal corporations," the privatization of sanctions-busting into a legitimate business, or through the creation of extensive criminal entrepreneurial networks (Naylor 2001: 385). Thus, target states often are aggressive in pursuing alternative trade opportunities with third party states at both the state and non-state levels to make up for the losses imposed by the sanctions regime. The private sectors' response in target states to sanctions' imposition would be to reach out directly to the private sector within third party states, bypassing the third party state governments' involvement in the decision as to whether such trade is appropriate. It may be argued that only in the cases

⁵ While examining how the third party state's trade with the third party subsequently affects its relationship with the sender state would be an interesting extension of this research, it is beyond the scope of this study.

when such trading activities take on significant political, economic, or security implications would the third party states have the incentive to shift from a passive to more active role in setting a “state” policy on trade with the target state. Determining whether economic or political interests take primacy in how third party states respond will be one of the key questions the subsequent analysis can hopefully shed light on.

Opportunistic Perspective of Trade

The opportunistic perspective of trade is a hybrid of the sanctions-busting assumption, Barbieri and Levy’s (1999) insight into conflict’s negligible affect on trade, the role played by geographical proximity, and logistical trade capabilities. Within this theory, the economic and geographic relationship between the third party and target states should play the most determinative role in affecting the two states’ bilateral trade. The opportunistic theory would further predict that the bilateral trade with the target state would be unaffected by the relationship between the sender and the third party. This could explain why an ally of primary sender would undermine the sender’s sanctions by trading heavily with the target state. The opportunistic theory essentially predicts that given the opportunity to profitably trade with the target state, the third party should sanctions-bust. Though opportunistic sanctions busting may be observationally equivalent to black knight behavior, it could be differentiated from black knight behavior with findings demonstrating that strong economic ties and close geographical proximity with the target were positively associated with higher bilateral trade, while political factors played an indeterminate role.

Beginning with the opportunity aspect of the theory, the positive relationship of geographical proximity, and especially of contiguity, with bilateral trade has been strongly

established within both economic and political models of international trade. Intuitively, the relationship can be understood in terms of the minimal transaction costs involved in trading with one's immediate neighbors. Geography is also constraining in that it limits in practical terms with which some states can be trading partners with. In terms of Most and Starr's (1989) opportunity-willingness framework, policymakers can be constrained or empowered by the environment in which they make their choices. As states trade the most with whom their trade has the lowest transaction costs, states' largest trading partners tend to be those they are geographically proximate to. Especially in the case of sanctions, where the sender state might be activity attempting to enforce them through blockades and border patrols, proximity to the target states dramatically affects the ability of third party states or its sub-state actors sanctions-bust. As switching to the second-best trading partner already may involve substantial costs and disruptions (Keohane and Nye, 1989: 8-13), target states will thus be willing to pay more to keep their relations with third party states intact to counteract the sender state's attempts to achieve compliance from the third parties. For third party states, both in the imbalanced terms of trade the target is forced to accept and the further concessions it might be forced to make because of its vulnerability to the third party, trade with the target state becomes comparatively more profitable than with the rest of the global market. The high-levels of bilateral trade also means that when it comes to the enforcement of UN sanctions, border states have the most to lose (Slovov, 2004) through imposing sanctions and raises the incentives for the private sector to turn towards illicit trade.

The principal assumption of this opportunistic theory is that states, and their sub-state actors, will always try to sanctions-bust when it is economically profitable to do so. This theory presumes that firms and individuals will seek to maximize their economic gain through rent-

seeking activities vis-à-vis the target state (Li and Sacko, 2002; Kaempfer and Lowenberg, 1999). Additionally, it presumes that non-state actors are mostly indifferent to political-military considerations with regard to either the sender state or to negative relations with target state. Morgan and Bapat (2003) explain how politically-driven sanctions policies often impose significant economic burdens on home-state firms and create incentives for private economic actors to either circumvent or politically challenge their home states' policies (Morgan and Bapat, 2003). This theory contradicts assertions that on an individual-level, traders have independent incentives to follow their home-state's nationalistic policies (Pollins, 1989a); rather, states compel domestic firms to accept the costs of the states' policies "whether or not they agree with the goals of the...government" (Morgan and Bapat 2003; 66). Li and Sacko assert that "...under the constraint of uncertainty, rational firms continuously formulate and update their expectations of future returns and adjust trade accordingly" (Li and Sacko, 2002: 33); thus, their theory allows for firms to calculate the expected costs of conflict into their trade behaviors, weighting risks and profits into their decisions. The divergence of opinion between governmental policies and private sector opinion and the distribution of costs upon the private sector to carry out the government's policies [directly or in the form of opportunity costs], can create strong incentives for private economic to undermine their home government's sanctions policies. Thus, even if on the state-level legitimate trade is forbidden, sub-state actors will merely shift their trade to illicit channels (Andreas, 2005; Naylor, 2001).

HYPOTHESIS 1A: The imposition of sanctions on the sender state will make it more economically attractive for third party states to trade with, thus leading to higher than predicted amounts of international trade with third party states based than economic size would predict had sanctions not been imposed.

HYPOTHESIS 1B: The degree to which the third party state is geographically proximate to the sender should be positively associated with *higher than predicted* trade values after the imposition of sanctions.

One further element involving the opportunistic theory of international trade is that sanctions-busting is driven by the pursuit of profit, which can explain both why and how sanctions busting occurs. Sanctions busters' concern for profits will indelibly shape the location they choose from which to carry out their activities. The principle tenant behind transaction cost economic (TCE) theory is that there are costs involved any sort of trade or exchange between multiple parties, and that these costs rise as uncertainty does due to the risks of opportunism (Dyer 1997: 535-536). Within the transact costs literature, four different types of have been identified: search cots, contracting costs, monitoring costs, and enforcement costs (Dyer 1997).⁶ Indeed, Ronald Coase makes two straightforward assumptions about the conduct of trade that are relevant here:

- “There are transactions costs and... they are large” (Ellickson 1989).
- “People tend to arrange their affairs so as to minimize the sum of their (a) transaction costs and (b) deadweight losses arising from their failures to exploit gains from trade” (Ellickson 1989).

These tenants tell us *a priori* that the costs of cooperative trade are high and, secondly, that in looking for out potential cooperative partners, people will seek to be maximize their utilities through minimizing their transaction costs. What can be extrapolated from this perspective of trade, then, is that under the conditions of high uncertainty created by sanctions and the often illicit nature of sanctions busting, is that sanctions busters will seek to minimize the transaction costs involved in the physical and logistical costs of trade as much as possible.

⁶ Dyer defines the costs as being the following: “*Search costs* include the costs of gathering information to identify and evaluate potential trading partners. *Contracting costs* refer to the costs associated with negotiating and writing an agreement. *Monitoring costs* refer to the costs associated with monitoring the agreement to ensure that each party fulfills the predetermined set of obligations. *Enforcement costs* refer to the costs associate with *ex post* bargaining and sanctioning a trading partner the does not perform according to the agreement” (Dyer 1997: 536).

While this particular theory cannot be readily tested in the quantitative analysis, the case study will demonstrate how certain commercial areas can present comparatively beneficial sites for sanctions-busting activities. In particular, ports and cities with highly developed trade infrastructures, high trade flows, and lax commercial regulations will be particularly well-suited locations from which to carry out sanctions busting activities. In attempting to identify those locations most likely to emerge as focuses of sanctions-busting activities, transshipment hubs present one of the most likely candidates.

Realist Perspective of Trade

The realist perspective of trade offers a more robust set of potential predictions about how the relationships between the sender and target states with the third party could affect its willingness to trade with the third party. Within this theory, the political-military relationships and orientations of the states should play the determinant role. Realism tends to view trade as being of little consequence in international relations. To the extent that realism does consider trade to matter relates to how it can affect state power. Thus, realist theories tend to tie political explanations for trade to the security considerations that each state has with potential trading partners (Keshk, Pollins, and Reuveny, 2004; Morrow, Siverson, and Tabares, 1998; Gowa, 1994; Gowa and Mansfield, 1993). The clearest prediction that realism would make with regard to third party states' trade response to the target being sanctioned would be to say that the friendlier the third party is to the target, the more likely it would be to trade with it / offer it economic assistance. Realism's predictions about the third party's relationship with the sender state are less clear. Following the "enemy of a friend is an enemy" logic, it could be extrapolated that the friendlier the third party is to the sender state, the less likely the third party would be to

undermine the sender state's sanctions through trading extensively with it. Specifically, this section will discuss the potential effects of: third party states' similarity of political interests with the sender and target, third party states' alliances with the sender and target, and the effect of system polarity.

Third Party State's Political Relationship with the Target State

The realist prediction for international trade is relatively straightforward in predicting that states with similar interests trade more actively amongst one another than they do with states with diverging interests. Within the literature, the foundations of these predictions have both individual and state-level explanations, the latter of which realism directly addresses. Morrow, Siverson, and Tabares (1998) have tested whether states with greater "degree[s] of common interest" trade more than those who have less in common, using tau-b scores as their measure of state similarity, finding that indeed states with greater degrees of common interest do indeed have larger trade flows with one another (Morrow, Siverson, and Tabares, 1998: 650). The overall conclusion of this perspective is that "trade relations are most likely to prosper under conditions where diplomatic conflict is least likely to pose a serious threat" (Moon and Dixon, 1993: 11). Though the link between state-similarity has already been established, it warrants scrutiny under the present circumstance because the sanctions-busting theory is value-neutral whether third party states will trade more with those states whose interests coincide with theirs than those whose does not.

HYPOTHESIS 2A: Third party states should trade more than predicted with sanctioned states in which they have greater similarities of international interest than those with whom they do not.

Alliance between the Third Party State's and Target State

The anarchic nature of international relations and the attendant need it creates for states to pursue power as a means of guaranteeing survival means that states must always be cognizant about their relative power vis-à-vis other states in the system (Waltz, 1979). As Gowa (1994) has demonstrated, international trade creates security externalities that can accrue to states' trading partners to be used in enhancing their military capabilities (also see, Brooks, 2005); as such, states have incentives to direct their trade towards allies and away from rivals (Gowa, 1994). Specifically, alliances have been theorized to positively affect inter-alliance trading partners—leading to more trade openness amongst allies—and to discourage trade amongst competing alliance blocs (Gowa and Mansfield, 1993). Andrew Long cleared up some of the empirical ambiguity in the relationship between general alliances and trade by demonstrating that defense pacts were specifically the only alliance category that increased inter-alliance trade (Long, 2003). In summarizing his findings, Long concluded in short that: “Military cooperation can influence commercial exchange” (Long 2003: 550). The interaction between alliances and trade further can be used as a means of guaranteeing good behavior amongst alliance partners because their close economic linkages make opportunistic behavior towards one another more costly (Long, 2003; Mansfield and Bronson, 1997; Williamson, 1985; for a more general discussion, see Brooks, 2005).

Thus, it should be expected that when the target state gets sanctioned by the sender government, its alliance partners, if it has any, should be the states most likely to come to its assistance. Indeed, HSE's black knight typology is premised on the willingness of politically/militarily aligned third party states to intervene on the target state's behalf. In terms of their own security concerns, third party states should be concerned about the strength of one of

their alliance partners to whom their security is tied. Even as the hindrances sanctions impose upon the target's terms of trade creates the potential security threat to the third party, the easiest solution to the problem is for the third party to step in and make up for the target's lost trade. Such behavior would seemingly be predicted by the aforementioned literature on trade and conflict, as alliance partners in the absence of sanctions are thought to conscientiously forgo trading with rivals and emphasize trade with allies. Furthermore, as sanctions can serve as a signal of the sender state's resolve to get what it wants from the target state (Hart, 2000; Morgan and Schwebach, 1996), the third party could become concerned that the sanctions may be a precursor to a militarized conflict that it could be drawn into.

Defense pacts demonstrate a tangible sign of two states' military connectedness, and, as Long (2003) has shown, are strongly associated with higher trade flows amongst member states. If security concerns truly do drive states' trading behavior, then third party states with close military ties to the target state should have the greatest incentives to assist the target in responding to sanctions. On the basis of both HSE's predictions from the sanctions literature and of those by Gowa, Mansfield, and Long, it could be strongly predicted that third party states having defense pacts with the target state should be the most willing states to come to its aid after it has been sanctioned.

HYPOTHESIS 2B: Third Party states having defense pacts with the target state should increase their trade with the target state more than non-aligned states after the imposition of sanctions.

Third Party State's Political Relationship with the Sender State

The predicted effects of the sender state's influence over the third party state's ability to prevent the third party state from trading with the target state are less clear-cut. As the political

relationship between the third party and target directly pertained to the third party state's willingness to trade with the target, the sender's states relations with the third party have only an indirect effect. As Martin (1992) detailed, the ability of the primary sender state to coerce the third party state into joining its sanctions regime against the target depends heavily upon the third party's payoffs for participating and the primary sender's willingness to incur the necessary costs that coercing the third party state may intend. The broader question is whether the primary sender can still influence/coerce the third party state's behavior even if it fails to coerce it into joining. Additionally, it could be the case that the similarity of interests between the target state and sender might provide for partial compliance without the need for coercive measures to be employed. The primary sender's ability to benefit from this similarity of interest will likely be constrained by the third party state's similarity to the target. Within realism, trade represents a path through which states can pursue individual power and their national interests; thus, third party states should be willing to break off trade ties with the target states if it is more in their national interests to align themselves with the sender state.

HYPOTHESIS 2C: The more closely that the third party state's common interests coincide with the sender state's, the more the third party's trade with the target will diminish after the imposition of sanctions.

Alliance between the Third Party State's and Sender State

If the third party is allied with the sender state, the third party state should have stronger incentives than non-allies to diminish its trade with the target states if potential security threats are involved. At the very least, the close cooperative ties between the third party and sender state on military issues should carry over into improved policy coordination/cooperation on issues that may affect bilateral security than could be expected of non-allies. Following a logic based upon "the enemy of a friend is [at the very least] a potential threat," the third party state

might exercise restraint in trading with the target state because of the security externalities associated with trading with a [potential] enemy (Gowa, 1994; Gowa and Mansfield, 1993). The neutral/passive response could be a likely observed behavior that could be expected out of third party states that do not join the primary sender's sanctions regime against the target.

Additionally, it might be easier for the sender state to convince third party states it is allied with to restrict the trade of strategic goods with the target state, even if the third party will not participate in a broader-based sanctions regime. The effect of an alliance with the sender would be most effective in cases in which the third party also did not have alliance with the target.⁷

Once again, operationalizing the relationship in which realism would predict military ties would have the strongest effect on trade, it could be predicted that if the third party state has a defense pact with the primary sender, then the third party would trade less with the target state than those without such agreements after sanctions are imposed.

HYPOTHESIS 2D: If the third party state has a defense pact with the sender state, it will trade less with the target state than those states without defense pacts with the sender.

System Polarity

While Long's analysis (2003) discredits the theory that alliance partners within bipolar distributions of power trade more with one another than they do in multilateral distributions, HSE's (1990: 111) assertion that black knight sanctions busters are more likely to emerge in bipolar systems remains untested. The logic behind HSE's assertion is that the rigidity of bipolar systems gives states stronger incentives to aid allies, especially if the sender state is party to the rival alliance bloc. Under bipolar systems, the operational heuristic underlying third party states' risk perceptions are much more likely to use the "enemy of an enemy is a friend" and the "enemy

⁷ Unfortunately, as the dataset I have compiled only has five observations in which the third party simultaneously has defense pacts with both the target and sender, testing this relationship remains beyond the scope of this project.

of a friend is an enemy” rationales. This sort of logic in action is readily observable in the United States’ costly airlift operation to sustain West Berlin after the Soviet Union imposed a surface blockade of trade into the city in 1948. Only three years after the U.S. had concluded a significant war to defeat the citizens of West Berlin, it was sanctions-busting to keep the city free at great individual cost—mostly to spite the Soviet Union. Though determining why individual states emerge as black knights would require a different method of analysis than the one currently being used, a first-cut test would be to simply see if bipolarity increased the aggregate amount of sanctions-busting that occurs. A second, more refined test would be test whether system polarity has an interactive affect with defense pacts, as allies under bipolar distributions of power are presumed to be most likely to become black knights. Moreover, if such a test were to garner significant results we could be confident that the results are unrelated to a pre-existing proclivity of so-allied states to trade with one another.

HYPOTHESIS 2E: Sanctions-busting activity is more likely to occur within bipolar distributions of power, than in multipolar distributions of power.

HYPOTHESIS 2F: Allies with defense pacts are more likely to sanctions-bust on behalf of one another in bipolar distributions than they are in multilateral distributions of power.

Liberal Perspective of Trade

Third Party State’s Economic Relationship with the Target

The existing economic relations between the third party state and target state most likely do play a significant role in determining how the third party state will react to the target being sanctioned. The presence of strong, preexisting economic ties with particular third party states would likely create lower transaction costs for the firms in the target state to adjust and/or relocate their economic activities to those states as compared to those in which no economic ties exist. Testing that relationship quantitatively creates considerable problems with simultaneity

bias, in that the including the target's bilateral trade as an independent variable when it is already part of the dependent variable would obviously generate a substantial correlation. So while this relationship cannot be factored into the quantitative analysis, it will be factored into the qualitative analysis the case study.

Third Party State Trade Openness

The liberal perspective of trade contends that international trade enhances international cooperation and reduces the likelihood of international conflict. Going back as far as Emmanuel Kant, the liberal tradition has relied upon the logic that enmeshing states within increasingly complex, interdependent webs of commercial and political ties creates disincentives for conflict, by raising the opportunity costs associated with it (Oneal and Russett, 2001; Nye and Keohane, 1989). The liberal tradition emphasizes the role of economic interests in shaping state's policies far beyond which realism does, viewing economic gain as an end unto itself, not just as a means of obtaining greater power. It further explicates a greater, more independent role for private economic actors in influencing the foreign policies that their states adopt, instead of just reacting to those policies after they have been adopted. Using this logic, it could be assumed that private economic actors within the third party state who would have their business hurt by their state imposing sanctions or restrictions on trade would pressure their government against such policies. The greater the extent to which international trade comprises a significant proportion of the economic and commercial activity of the third party state, the larger would be size and power of the interests available to pressure the government towards maintaining the openness of the state's economy. Thus, the more reliant the third party state's economy is on international trade, the less likely it will be to initiate economic conflicts with its trading partners (Russett and Oneal, 2001: 137)—even if the state has close ties to the sender.

HYPOTHESIS 3A: The higher the third party state's degree of trade openness, the less likely it will be to participate in economic conflicts that would disrupt trade with the target state.

Economic Relationship with the Sender

Rodman's work on extra-territorial sanctions provides insight into how the primary sender can influence individual economic actors within the third party states outside the regime (Rodman, 2001). In contrast to Pollins' assertions that individual economic actors' interests reflect the security interests of their home states, scholarship by Rodman and Morgan and Bapat demonstrate that individual economic actors' interests diverge with those of their home-state (Morgan and Bapat, 2003; Rodman, 2001). Rodman found that both the U.S. imposed Helms-Burton Act, which imposed extra-territorial sanctions on firms trading with Cuba, and the Iran-Libya Sanctions Act, which imposed extra-territorial sanctions on firms trading with Libya and Iran, had "a chilling effect" on foreign investor's willingness to invest in those states (Rodman, 2001: 190). In the case of the Helms-Burton Act, the punishment proscribed for breaking the American embargo was that so deemed illicit "traffickers" would be denied visas to the United States (Rodman, 2001: 177). Rodman found that especially in cases in which foreign firms had significant amounts of money invested in the United States, the potential threat and uncertainty such measures created was enough to influence their behavior. Thus, the third party state's trade dependence upon the primary sender could be a measure of the third party state's vulnerability to economic coercion by the sender. As well, the effectiveness of these measures could also potentially be explained by Drezner's "sanctions paradox," in which he finds that sanctions are most effective when used against allies, who are more indifferent to incurring near-term losses if they provide for long-term gains (Drezner 1997). While the foreign governments adamantly

rejected the form of coercion used by the United States to gain compliance, their retaliatory actions were negligible and their firms often complied.

On the individual level, MNCs with operations or subsidiaries in both the sender state and target might have to comply with the sanctions by virtue of their geographic presence in the sender state. Additionally, Stephen Brooks (2005) outlines how, foreign direct investment often involves cooperative projects and joint-ventures between MNCs of different national origin. Hence, another passive means of restricting the third party state's trade/investment with the target would be the preclusion/inhibition of the target state's involvement in cooperative ventures between firms in the sender and third party state. On the basis of these factors, it can be asserted that the primary sender's leverage over the third party state's willingness to trade with the target state is affected by the sender state's ability to exercise "soft power" in influencing the third party state's economic actors (Nye 2002).

HYPOTHESIS 3B: The higher the third party state's trade dependence upon the sender state, the more likely its trade will diminish with the target state after sanctions are imposed.

Joint Regime Effects

One of the principal linkages from the democratic peace literature that provides a base for Oneal and Russett's "Kantian Tripod" (2001) is that democratic states trade with one another in higher levels than other states (Bliss and Russett, 1998). Moon and Dixon provided one of the first analytical studies linking political similarity in social and institutional terms to enhanced trade levels (Moon and Dixon, 1993). Edward Mansfield, Helen Milner, and Peter Rosendorff found that democratic pairs of states tend to have more open trade relations than do mixed autocratic-democratic dyads (Mansfield, Milner, and Rosendorff, 2000). Within their

explanatory framework, the authors posit that the institutional structure of democratic regimes makes it more likely for them to arrive at lower trade barriers (Mansfield, Milner, and Rosendorff, 2000: 306). A further supposition of this theory is that since democracies have less to fear from one another, they are free to engage in higher levels of trade with one another less concern over potential security externalities.⁸ Christopher Gelpi and Joseph Greico contend that “combined influence of democracy and interdependence may create a power constraint that reinforces the zone of peace among increasingly interdependent democracies” (Gelpi and Greico, 2003: 45). While the democratic peace literature speaks specifically to the likelihood of states to engage in militarized conflict with one another, the same could be used to conjecture about whether the same underlying forces that prevent militarized conflict between democracies can mitigate the likelihood of politically-driven economic conflict.

With regard to the incentives of private economic actors, Moon and Dixon (1993) argue that individuals in democratic regimes more likely to direct their trade to states holding similar political systems and foreign policies. Moreover, they contend that: "Even absent the threat of serious diplomatic hostility, states will prefer trade relations that are least likely to invite manipulation by others. At the extreme, nations would want to avoid trade relations likely to yield to boycotts or embargoes, but there are many less serious potential interruptions: conflict over respective trade policies, health and safety regulations, compliance with security restrictions, etc" (Moon and Dixon, 1993: 11). Within the sanctions literature itself, David Lektzian and Mark Souva found that jointly democratic dyads returned to their previously established trade levels faster after one of the states had employed sanctions against the other than in mixed dyads (Lektzian and Souva, 2001). The authors posit that democratic institutions

⁸ None of the authors above were able to extend their findings to the expected trade relations between jointly autocratic regimes.

play an important role in reducing the transaction costs of international trade between democratic dyads by helping to re-establish "trust" and certainty between the economic actors in both states (Lektzian and Souva, 2001: 63). The enhanced transparency offered by democratic institutions help economic actors in both states gauge the intentions of their counterparts' governments and understand the rules binding economic actors in those states, thus reducing uncertainty. As uncertainty and higher transaction costs are two of the principal costs sanctions impose, democratic institutions potentially stand to play an important role in mitigating those costs. Thus, it could be hypothesized that a democratic state are less inclined to respond cooperatively to politically-driven sanctions against fellow democratic states and more resilient in recovering from the costs they impose.

Within the literature examining sanctions' effect on the target state, the study of regime type has tended to focus on how the target's political institutions affect its ability to endure/respond to sanctions (Kaempfer, Lowenberg, and Mertens, 2004; McGillivray and Stam, 2004; Bolks and Al-Sowayel, 2000). Amra Festic and Adrian Rausche's have shown how autocrats, such as Radovan Karadžić, used the economic powers accorded to the ruling regimes in former Yugoslav states after the Dayton Agreement to extort rents from international trade and the support of transnational crime as an alternative source of regime revenue (Festic and Rausche, 2004). Andreas (2005) and Naylor (2001) have further explored cases demonstrating how economic sanctions have empowered autocratic regimes to exploit sanctions shore up domestic political power. Indeed, the rationale behind smart sanctions has been to design sanctions that prevent regime leaders from passing off the sanctions' costs onto innocent bystanders or political opposition groups. To the extent that autocratic regimes are more effective at distributing rents/benefits among those in the selectorate than democratic regimes

(Bueno de Mesquita et al., 2003), the regime of the third party state may be more pro-active in pursuing gains from trading with sanctioned states, especially if the targets have pariah status in the international community. Thus, it could be hypothesized that the more jointly autocratic the target and third party states are, the better both parties would be at exploiting rents created by the imbalanced terms of trade, creating mutual incentives for both parties to pursue sanctions-busting activities. Obviously, this position contrasts with the liberal trade theory's predictions about the effects of regime type on trading relationships. According to the logic of the liberal theory, being jointly autocratic should not bring about higher than predicted trade values.

Following Pollins' logic (1989a; 1989b) that individual economic actors include security considerations in their decisions on whether or not to engage in international trade, it would follow that states that both have democratic regimes and have similar political interests would trade with one another in higher than expected levels because of lower information costs, increased certainty about the stability of the relationship even in the wake of sanctions, and common security considerations. Thus, political similarity and joint-regime type could also have an interactive effect.

HYPOTHESIS 3C: If the third party state is a democracy, it will have higher than expected trade flows with the target state than non-democratic states.

HYPOTHESIS 3D: If the target and third party regimes are jointly democratic, they will have higher than expected levels of bilateral trade after the imposition of sanctions.

HYPOTHESIS 3E: If the target and third party regimes are jointly democratic, there will be a positive interactive effect with their degree of political similarity on their level of bilateral trade after the imposition of sanctions.

HYPOTHESIS 3F: Having jointly autocratic regimes should not lead to higher than expected trade flows between target and third party.

Chapter 4: Research Design and Quantitative Analysis

Testing the hypotheses requires a roundabout methodological approach, because the research question requires comparing observed trade in sanctions cases against a baseline prediction of what bilateral trade between third party states and targets would have been had there been no sanctions. Thus, I first construct a global gravity model to predict in general terms what bilateral trade should be between nations. Next, I take the actual amount of observed trade values and divide them by the predicted values of trade generated by the gravity model to get a differential value. This differential value can be understood as the degree to which observed trade was greater or smaller than was counterfactually predicted by the gravity model. I then build an explanatory model to account for the variation between third party states with a cross-sectional time series data set comprised of 8 sanctions cases. The complete dataset contains 20,478 directed-dyad observations between third party and target states from 1961-2000 and includes eight different sanctions cases involving the United States as the primary sender. Using this dataset, I run a Prais-Winsten OLS regression that constructs panel-corrected standard errors for each directed-dyad pair and factors in contemporaneous correlation amongst the panels.

The Gravity Model

The first order of analysis requires the construction of a predictive model for bilateral international trade. The standard econometric approach to deriving predictive bilateral trade

values relies upon using what is known as the gravity model of international trade,⁹ which operates loosely on the principles of Newtonian physics. Essentially, the gravity model predicts that the closer to nations are to one another and the larger their economies are, the more they will trade with one another. Conversely, the model predicts that the farther nations are from one another and the smaller their economies, the less they will trade with one another. In economic terms, the gravity model operates on the principle that as the transaction costs of international trade increase between two nations increase, trade will diminish between them. In its original form, the gravity equation's independent variables are multiplicatively related to one another. To be more conducive to regression analysis, the equation is generally expressed in its log-linear form. The standard gravity model includes the logged variables of GDP, population, and distance. Country GDP is operationalized in terms of yearly real GDP in US dollars, population is recorded in the thousands, and distance refers to the distance between countries' capitals in kilometers. The model also includes dummy variables to signify whether the two states were ever engaged in a colonial relationship and whether or not the two states share a land border or are within 24 nautical miles of one another (the limit to which both states' 12-mile national water boundaries can extend to and still be proximate). In the gravity equation below, the subscripts simply denote the two different states in the dyad.

$$(1) \ln (\text{Trade}_{ab}) = (\text{GDP}_a * \text{GDP}_b) + \ln (\text{Pop}_a * \text{Pop}_b) + \ln (\text{distance}_{ab}) \\ + \text{Contiguity}_{ab} + \text{Colony}_{ab}$$

⁹ The gravity has been the most frequently used method of modeling international trade, seeing use by: (Keshk, Pollins, and Reuveny, 2004; Long, 2003; Askari et al., 2003; Caruso, 2003; Russet and Oneal 2001, Hufbauer, 1997).

The Problem of Zero-Gravity

While it remains the generally accepted method of estimating the gravity model, the logarithmic approach has a significant weakness when it comes to estimating real-world trade data. Specifically, logarithmic transformations are undefined for values of zero. As the dependent variable of the gravity model is bilateral trade and for a variety of reasons (distance, transportation costs, lack of information, sanctions, coding or rounding error, etc.), states frequently do not actively trade with all other states in the international system (Silva and Tenreryo, 2003: 11). Of the 522,341 dyadic observations in Kristian Gleditsch's dataset, 226,320 have bilateral trade flows of 0 (Gleditsch, 2002). Two standard approaches exist to addressing the challenge posed by the lack of gravity. One approach is to transform the bilateral trade flows by adding one to all observations, which will in turn produce logarithmic transformations of zero for all dyads in which no trade actually occurred, as $\ln(1)=0$. The downside to this method, is that including so many observations in which trade is zero will heavily bias the predicted estimator towards 0. There are many more states in the system that do not trade with one another in significant levels than there are ones that do. Including such states will diminish the predictive accuracy of the model for states that actually do trade with one another—especially at high levels. On the upside, this method allows a greater number of observations to be included within the analysis, which will be important when the dataset is winnowed down to the final sample set. The other, and more frequently used alternative, is to drop all observations in which bilateral trade is recorded as zero. Out of these choices, I have chosen to keep the dyadic observations in which observed trade was zero and use the additive approach to making the logarithmic transformations. Considerations of the additional observations available by including zero-trade cases and the relevance of sanctions' effect on

states that have only marginal amounts of trade before sanctions' imposition drove the adoption of this approach.

The Gravity Model Regression

With over 500,000 dyadic observations, the sheer size of Kristian Gleditsch's dataset (2002) created several obstacles in conducting methodologically appropriate analysis. The initial dataset has over 19,000 distinct dyadic pairings, which exceeded the technical capacity of both STATA and available computer technology in the use of regression techniques that control for dyad-specific effects. Thus, it was necessary to parse down the available data into a more manageable subset. To begin, I first excised the 20,787 observations from the eight sanctions cases used in the second regression to estimate predicted trade so the predicted values generated would not be biased by the observations whose behavior was to be predicted. Next, I randomly sampled 20% of the available dyad pairings from which to construct sample dataset. This set included 3,575 distinct dyads and 101,432 dyad-year observations. The regression equation was run using feasible generalized least squares (FGLS) regression, also known as "Park's Method" (Beck and Katz, 1995), in the presence of first order autocorrelation for all dyads, contemporaneous cross-sectional correlation, and groupwise heterogeneity among the dyads.¹⁰ Indeed, Xiujian Chen, Shu Lin, and W. Robert Reed found in comparing FGLS to ordinary least squares regression with panel corrected standard errors (PCSE) that FGLS does a better job of calculating accurate coefficients, while the PCSE method is better for theory testing (Chen, Lin,

¹⁰ While OLS regression with panel corrected standard errors (PCSE) might have been the preferable method, the computational capacity of available technology prevented me from using this method. The GLS method will not give me as accurate of standard errors as the PCSE (Beck and Katz, 1995); however, as this model is being used in a predictive capacity this is a not as important of a consideration. Indeed, Geoffrey Allen (2001) posits that in creating forecast models simpler methods and equations are often better. Thus, the gravity model used to predict trade was rather basic, including only the most relevant economic and geographic variables.

and Reed, 2005: 1). That the data displayed strong autocorrelation does not detrimentally affect the predicted power of the model, which is its sole use. So while the PCSE technique has been predominately used over the FLGS approach¹¹ for this type of cross-sectional time series analysis, the FGLS methodological approach used best fits the model's purpose.

As the results below indicate, all of the independent variables are highly statistically significant. Except for population, the signs for all of the other variables follow in the same predicted vein of the gravity model predictions. Within the model, the combined size of each state's GDPs, having had a previous colonial relationship, and contiguity positively affect trade. Conversely, distance has a negative effect on the amount of bilateral trade conducted.

Table 1: Gravity Model FGLS Regression	
N = 101,432 Dyads = 3,575 $X^2 = 17749.38$	1 st Order Correlation Coefficient = .9079
Independent Variable	Coefficient (Robust Std. Error)
$\ln(\text{Pop}_a * \text{Pop}_b)$.3848818* (.0041549)
$\ln(\text{GDP}_a * \text{GDP}_b)$.5911065* (.0064874)
$\ln(\text{distance}_{ab})$	-.4532741* (.0155195)
Contiguous_{ab}	.6972666* (.0780923)
Colony_{ab}	1.406824* (.0979368)
Constant	-11.34566* (.1876175)

* Indicates significance $p < .001$

¹¹ The fixed effects regression technique advocated by Green, Kim, and Yoon (2001) was not deemed appropriate for this analysis because of the significant role played by variables that remained constant over time, such as distance, contiguity, and colonial relationships.

The positive sign on population stands against the prevalent findings that as countries' populations increase, the countries will need to trade less internationally to be self-sufficient. The sign for population remained constant across a variety of different regression techniques and samples and should not be considered anomalistic within the context of the dataset used.

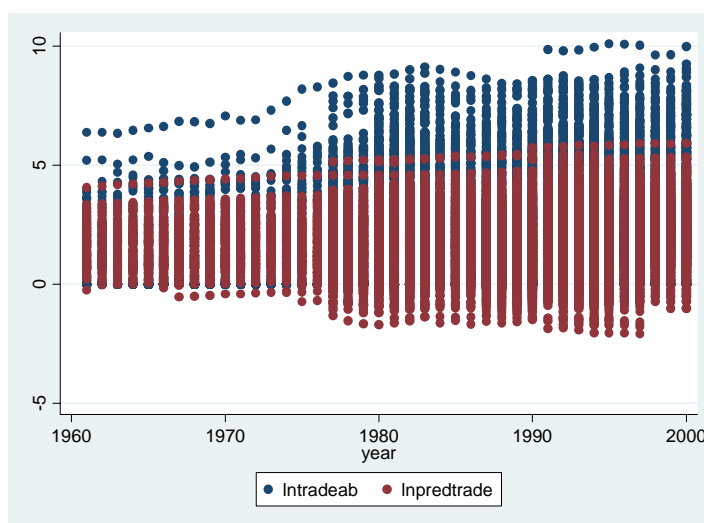
The Predicted Values

The gravity model above was created to serve as an econometric forecast model for what trade should have been in countries had sanctions not been imposed against them. While the FGLS model above demonstrated significant autocorrelation, Armstrong (2001) contends that the trend has not been shown to demonstrably hurt the predictive accuracy of forecasting models.¹² Using the coefficients for each of the variables derived from the model, a predicted value was generated for each dyad year within eight sanctions cases (discussed below). As the dependent variable was a log linear transformation, the predicted value generated by the regression equation is also in log linear form. As Armstrong (2001) advises that it is often better to make predictions in log linear forms that reduce the in-sample variation that the predictions must account for; thus, I left the predicted value in its log linear form for the differential calculation. Within the subsequent analysis it should be noted that the degree to which the second regression can explain the difference between actual versus predicted trade values is limited by the predicted trade values' ability to predict accurately what trade should have been. As the graph below shows, the predicted values for bilateral trade are comparatively lower than observed trade values. This implies that a lot more bilateral trade is occurring than my predictive model can account for. While this bias demonstrates the gravity model's predictive susceptibility

¹² As much as possible, I attempted to use the forecasting approach laid out by Armstrong for constructing predictive forecasting models (Armstrong, 2001:303-362).

to the inclusion of variables in which no trade occurs, it also stems from the predictive model's simplicity and the difficulty of predicting bilateral trade amongst thirty-five hundred dyads over 50 years. Building a perfectly predictive model is just not possible.

Figure 5: Scatter Plot of Logged Predicted and Observed Values of Trade



The Sanctions Trade Differential Model

Case Selection in the Second Regression Sample Set

The sample set contains observations from eight different sanctions cases¹³ in which the United States was the primary sender that vary according duration, sanction severity, multilateral involvement, and the region in which the sanctions were imposed. In selecting the relevant cases to include, the purposeful choice was made to include cases of substantive significance; thus, the sanctions cases of the United States against Cuba, Iraq, Iran, and South Africa were selected to form the core group of the cases included. The next four cases were chosen to provide variation in geography, duration, and sanction severity. The sanctions case histories provided by HSE

¹³ For semantic purposes, I have lumped together both the UN and US sanctions against South Africa as one case, the two different periods of sanctions against Iran, and the three different sanctions regimes against Nicaragua as constituting one “case” apiece. In several cases, the sanctions severity varied in the midst of the same case.

(1990) and Caruso’s (2003) operational designation of the sanctions’ severity guided the selection and categorization of the rest of the cases selected. All eight of the sanctions cases within the dataset were imposed for reasons of “high politics,” which involved political-military disputes between the sender and target, as opposed to “low politics” sanctions involving economic or environmental disputes like U.S. “Section 301” cases (Drezner, 2003; 2001).

Table 2: Political Sanctions Cases in the Data Set: 1950-2000 (Parentheses indicate the sanctions lasted beyond 2000)				
Sanctions Sender / Target	Weak Sanctions	Extensive Sanctions	UN Sanctions	# of Dyad Observations
<i>United States vs. Cuba</i>		1961-(2000)		5,812
<i>United States vs. Iran</i>	1984-1994	1980-1981 ¹⁴ 1995-(2000)		3,402
<i>United States vs. Nicaragua</i>	1977-1980 1992-1995	1981-1990		2,804
<i>UN vs. South Africa</i> <i>United States vs. South Africa</i>		1985-1994	1977-1994	2,848
<i>United States vs. Zaire</i>	1990-1997			1,399
<i>United States vs. Panama</i>	1987-1990			648
<i>United States / UN vs. Iraq</i>		1991-(2000)	1991-(2000)	1,972
<i>United States vs. Indonesia</i>	1991-2000			1,825
Total				20,478

With regard to the cases’ regional variation, two cases involved targets in the Middle East, three cases involved targets in Latin America, two cases involved targets in Africa, and one case involved a target in Southeast Asia. With regard to sanctions severity, five cases involved weak sanctions, five cases involved extensive sanctions, and two cases also involved the imposition of UN sanctions. As for sanctions duration, providing a large degree of variation proved difficult. Necessarily, the cases that last longer will include more observations than cases

¹⁴ In the case of the sanctions against Iran in response to the Iranian hostage crisis, the sanctions were initially imposed in November of 1979. As the initial sanctions were only of military goods and an oil embargo (which has an open market as a commodity) and occurred so late in the year, I have coded the sanctions within the quantitative analysis as having begun in 1980 instead of 1979.

that are relatively short. Additionally, as the second regression uses the dyad pairings between the third party and target as the basis for calculating its standard errors for the equation—large numbers of dyadic observations with only a single observation year provide little leverage with regard to the final quantitative analysis. Ultimately, the shortest duration case chosen was Panama, in which sanctions lasted four years. For the observations included in the final data set, the average number of dyad years in which sanctions were imposed was 13.8 years (within the dataset’s timeline). However, within their study of sanctions duration Bolk and al-Sowayel found that the average duration of sanctions lasted 16 years (Bolk and al-Sowayel, 2000: 242). Based on Bolk and Sowayel’s findings, I am confident that even though a lot of short cases are not included, the sample accurately reflects the broader population. Finally, two of the cases studied involved military action (Panama and Iraq), two cases were imposed to destabilize regimes (Nicaragua and Cuba), one of the sanctions cases was imposed for nonproliferation and terrorism purposes (Iran), and three cases were meant to compel the targets to make democratic reforms (South Africa, Indonesia, and Zaire).¹⁵ The final sample should provide a rich amount of variation with regard to the contexts in which the third party states had to react to the target states being sanctioned.

Wherein the sample lacks variation is with regard to the primary sender state, which was held constant as the United States. Keeping the primary sender constant provides for unit homogeneity among the sampled cases that already include a significant degree of interactive complexities. Additionally, as the United States is by far the most frequent user of economic sanctions as a tool of economic statecraft, the cases reflect the circumstances under which states most frequently have to make their decision on whether to trade with the target state. However,

¹⁵ The designation of each sanctions purpose was derived from HSE and sanctions case studies available on the International Institute of Economics’ website (IEE, 2006; HSE, 1990).

the robustness of this study is limited by the fact that that the political-military relationship of the third party state with the primary sender is always with a great power state. This could bias the subsequent results in favor of over-estimating the influence of the primary sender state on third party states' behavior, which should be taken into consideration in the subsequent analysis.

The Dependent Variable – Operationalizing the Trade Differential

The purpose of constructing this model is to determine which relational factors between the third party state and the target state and the third party state and the sender can best explain the variance amongst third party states' trade relationships with the target. Thus, the dependent variable that this model seeks to explain is the degree to which observed trade differed from the amount of trade the gravity model predicted it to have been. To calculate this trade differential, I subtract the logged predicted value generated by the gravity model from the natural log of observed bilateral trade for each dyad year. While it may not be intuitive at first glance, this operation provides the logged ratio of observed trade as a quotient of predicted trade.¹⁶ Finally, I exponentiate the logged differential by e to arrive at the ratio by which observed trade during the sanctions periods differed from the predictions calculated by the general gravity model. Fractional values of the trade differential indicate that observed trade was less than the gravity model would have predicted, while values greater than one represent values in which trade between the third party and target state was greater than the predicted value. This differential value is used as the dependent variable in the second regression equation.

¹⁶ Mathematically, this is true because: $\ln(\text{Observed Trade} / \text{Predicted Trade}) = \ln(\text{Observed Trade}) - \ln(\text{Predicted Trade})$.

Independent Variable Operationalization

Opportunistic Perspective Variables

- **Economic Opportunity to Trade:** Drawing directly from the same premises that the underlying gravity model used to predict what trade should have been under normal conditions, the size of the target state's economy represents the potential economic opportunity of which third party states could take advantage. The logic behind using including this variable again is that after being sanctioned, the imbalanced terms of trade within the target state will make it an even more attractive trading partner—thus magnifying the effects of economic size beyond what was captured in the gravity model. This variable is operationalized using the target state's real GDP as used in the gravity model.
- **Geographic Proximity:** Similar to the logic expressed above, the effect of sanctions should only magnify the advantageous effects of geographic proximity on third party states' trade with the target state. Thus, I use the same measures of contiguity and capital-to-capital distances in second regression model as I used in the gravity model.

Realist Perspective Variables

- **Political Similarity between the Third Party and Target State:** This variable represents the congruence of international political interests between the third party and target state. To operationalize this concept, I use Signorino and Ritter's (1999) similarity score, which measures the similarity between states' alliance portfolios along a continuum between -1 and 1. The similarity score can also account for the value of alliance partners by including weights for national military capabilities and taking

distance into account (Signorino and Ritter, 1999: 128). Weighting similarity scores by capabilities and distance allows factors into measures of states' alliance portfolios the fact that some alliance partners count more than others. The trade differential model uses the global, weighted similarity score between the third party and target state generated by EUGENE (Bennett and Stam, 2000).

- **Political Similarity between the Third Party and Sender State:** The similarity variable represents the congruence of international political interests between the third party and the sender state (Signorino and Ritter, 1999). This relationship is similarly operationalized using the global, weighted similarity score between the third party and sender state as generated by EUGENE (Bennett and Stam, 2000).
- **Defense Pacts between Third Party and Target State:** This variable has been operationalized as a dummy variable, with a one signifying the presence of a bilateral defense pact between the third party and target state and zero otherwise.
- **Defense Pacts between Third Party and Sender:** This variable has been operationalized as a dummy variable, with a one signifying the presence of a bilateral defense pact between the third party and sender state and a zero otherwise.
- **Bipolarity:** This variable has been operationalized as a dummy variable to represent the presence of a bipolar distribution of power within the international system. The period from 1950 to 1990 contained within the dataset has been coded as one to represent the bipolar distribution of power during the Cold War and as a zero from 1991 onwards.

Liberal Perspective Variables

- **Third Party's Economic Dependency upon Sender ($\text{Trade}_{3S} / \text{GDP}_3$):** This variable represents the extent of the third party's economic ties with the sender state. The third party state's economic dependence upon the sender state is operationalized as a function of proportion of the third party state's GDP that trade with sender state makes up, which is a measure that has frequently been used in the interdependence and conflict literature (Barbieri, 1996; Oneal and Russett, 1999a, 1999b).
- **Third Party State's Trade Openness ($\text{Total Trade}_3 / \text{GDP}_3$):** This variable represents the degree to which the third party state is engaged in international trade. Conceptually, it should distinguish between those states whose trading activities comprise a significant portion of their economic activity from those who trade less. This variable is operationalized by taking the third party state's total international trade as a proportion of its GDP (Russett and Oneal, 2001: 137; Bliss and Russett, 1998).
- **Third Party State's Regime Type:** This variable measures the extent to which the third party state's political institutions are democratic or autocratic. I use the polity2 variable from Marshall and Jagger's Polity IVE Dataset that measures states' political institutions along a 21-point continuum, with negative ten being the most autocratic possible and positive ten being the most democratic possible.¹⁷ The variable was compiled using the EUGENE data editor (Bennet and Stam, 2000).
- **Joint Democracy between Third Party and Target:** This dummy variable signifies whether both the third party and target states are democracies. Drawing on the Polity IV

¹⁷ The polity score stresses five aspects of states' institutions to differentiate between democratic and autocratic institutions: "(1) the competitiveness of the process through which a country's chief executive is selected, (2) the openness of that process, (3) the extent to which there are institutional constraints on a chief executive's decision-making authority, (4) the competitiveness of political participation within a country, and (5) the degree to which binding rules govern political participation" (Mansfield, Milner, and Rosendorff (2000: 313).

Dataset, which measures how democratic states' political institutions are, Joint Democracy is coded as a one if both the third party and target states received scores of six or above and as a zero otherwise. This designation of "coherent" democratic states has been previously used by Mansfield, Milner, and Rosendorff in their study of regime type's effects on international trade (Mansfield, Milner, and Rosendorff, 2000: 313).

- **Joint Autocracy Score:** This dummy variable signifies whether both the third party and target states are autocracies. Drawing on the Polity IV Dataset, which measures how democratic states' political institutions are, Joint Democracy is coded as a one if both the third party and target states received scores of negative six or below on the democracy-autocracy variable and as a zero otherwise. This designation of "coherent" autocratic states has been previously used by Mansfield, Milner, and Rosendorff (2000: 313).
- **Joint Regime Type * Similarity Score:** This concept comprises two interactive variables, which will measure the joint effects of having similar regime types and similar political interests. It was calculated by multiplying the joint-regime dummy variables by the dyad's respective political similarity scores.

Control Variables:

- **Conflict between Third Party and Target:** While it remains a source of contention within the trade and conflict literature as to whether conflict reduces trade, it would seem prudent to control for the effect of military conflict considering economic conflict is the primary topic of this study. The variable is operationalized by using a dummy variable, with a one signifying the presence of an ongoing militarized dispute (MID) in the

previous year and a zero otherwise. The choice to lag conflict one year was made because trade disruptions caused by military conflict more prevalently affect prospective trade than would necessarily be captured by the conflict's effect on trade in the year in which it occurs. The variable uses the variable for ongoing conflicts from Zeev Maoz's Dyadic MID Dataset V. 2.0 (Maoz, 2005).

- **Third Party State's Geographic Proximity to Sender:** The closer that the third party state is to the sender state, the more readily the sender state can influence the target state, as the sender's power vis-à-vis the third party will diminish with distance. Thus, we could expect that the closer the third party is to the sender state, the more lower the trade differential will be—reflecting the sender state's increased coercive power.
- **Weak Sanctions:** This dummy variable is coded as a one if the sender state has imposed weak sanctions upon the target state and a zero otherwise. The categorizations of the sanctions were taken from Caruso (2003) and HSE (1990).
- **Extensive Sanctions:** This dummy variable is coded as a one if the sender state has imposed extensive sanctions upon the target state and a zero otherwise. The categorizations of the sanctions were taken from Caruso (2003) and HSE (1990).
- **UN Sanctions:** This dummy variable is coded as a one if the United Nations had imposed sanctions on the target state and zero otherwise. These sanctions may have occurred in conjunction with the sender state's sanctions (UN vs. Iraq, 1991-2000) or be independent of them (UN vs. South Africa, 1977-1994).

The Trade Differential Regression Equation and Methodology

While the gravity model used in the first regression was used for predictive purposes instead of theory-testing, the purpose of this second regression is to explicitly test for the significance of the hypothesized independent variables. Thus, the requirements of the analytical method required to assess are significantly more stringent for the regression of the trade differential model. Indeed, much has been written in recent years upon the best methodological approach of theory-testing with cross-sectional time series datasets (Chen, Lin, and Reed, 2005; King, 2001; Green, Kim, and Yoon, 2001; Beck and Katz, 2001 & 1995). Since Beck and Katz's influential piece in 1995, the PCSE technique emerged as the standard method for conducting research on international trade with cross-sectional time series datasets. While Green, Kim, and Yoon's "Dirty Pool" article in 2001, sparked a controversial debate over whether fixed effects regression was a comparatively better method—its applicability has been limited by its inability to incorporate variables that do not vary over time. Thus, in accordance with the Chen et al.'s (2005) recommendations and with related papers on the subject area (Long, 2003; Morrow, Siverson, and Taberes, 1998; Bliss and Russett, 1998), I use OLS regression with panel corrected standard errors for the trade differential model. Within the regression, I specify that panels (dyads) share a common first order autocorrelation and use pairwise standard error calculations because the dataset is unbalanced. While I will make an alternate specification with interactive variables, the basic trade differential model is specified as the following:

$$(2) \text{Differential}_{3T} = \text{GDP}_T + \ln(\text{distance}_{3T}) + \text{Contiguity}_{3T} + \text{Silarity}_{3T} + \text{DefPact}_{3T} + \text{Conflict}_{3T} + \text{Silarity}_{3S} + \text{DefPact}_{3S} + \text{Bipolarity} + \text{TradeDependence}_{3S} + \text{TradeOpenness}_3 + \text{Polity}_3 + \text{JointDem}_{3T} + \text{JointDem}_{3T} * \text{Silarity}_{3T} + \text{JointAutoc}_{3T} + \text{JointAutoc}_{3T} * \text{Silarity}_{3T} + \text{WeakSanct} + \text{ExtSanct} + \text{UNSanct}$$

Where: T = Target State, 3 = Third Party State, and S = Sender State

Thus, the independent variables in this equation will be tested to see whether they increase or diminish the degree to which observed trade differs in relation to predicted trade.

Table 3: Trade Differential Model (OLS with PCSE)		
Variable	Base Model	Defense Pacts by Polarity
GDP _T	.000235* (.0001083)	.0002342* (.0001083)
ln(Dist _{3T})	-.859526* (.2290694)	-.8453118* (.2310656)
Contiguity _{3T}	.0432876 (.7053016)	-.0319109 (.7052635)
Silarity _{3T}	-1.444982* (.6256004)	-1.527696* (.6358969)
DefPact _{3T}	-.2495618 (.2516414)	
Bipolar DefPact _{3T}		-.152301 (.462918)
Unipolar DefPact _{3T}		-.2978839 (.2875457)
Conflict Prev. Year _{3T}	-.0101603 (1.010314)	.0040905 (1.011785)
Silarity _{3S}	-.2888932 (.5042358)	-.2855088 (1.006055)
DefPact _{3S}	.9083005** (.3612972)	
Bipolar DefPact _{3S}		1.075475** (.3937446)
Unipolar DefPact _{3S}		.6365218 (.3951244)
Bipolarity	.3422408* (.1589694)	.2138209 (.1504172)
TradeDep _{3S}	-.5916002* (.1156393)	-.5858617* (.115092)
TradeOpen ₃	.3584547* (.041048)	.3574992* (.0409421)
Polity ₃	.0534922* (.0162166)	.0526877* (.0161269)
JointDem _{3T}	-1.007719 (.987072)	-.9596308 (.993505)
JointDem _{3T} * Sim _{3T}	2.30079* (.9029393)	2.251005* (.9074704)

Variable	Base Model	Defense Pacts by Polarity
JointAutoc _{3T}	-.0855516 (.4624909)	-.093912 (.4610418)
JointAutoc _{3T} * Sim _{3T}	.2518371 (.5320131)	.2766918 (.5306373)
WeakSanct	-.0706119 (.5917546)	-.0753133 (.5926851)
ExtSanct	-.2921433 (.4662987)	-.2936939 (.4672457)
UNSanct	-.606069 (.6731696)	-.5989899 (.6750203)
Constant	9.331249* (2.424871)	9.345602* (2.425404)
N	20,043	20,043
R ²	.0545	.0546
X ²	162.46	165.38
P of X ²	<0.0001	<0.0001

Significance: * p<.05, ** for p<.01, * for p<.001

Results of Trade Differential Regression

Overall, the trade differential model provides a fairly varied account of the variables included within it. In the aggregate, the model is statistically significant with a chi squared score of p<.0001 in both cases. In both cases as well, the independent variables within the model was able to account for about 5.45% of the variation in the trade differential. While this value may not seem that significant, when placing that figure within the context of the indirect nature of the sanctions' effects upon the third party and target state's trading relationship the figure appears more robust. This model does not attempt to predict all the reasons that states trade with one another; rather, it is attempting to predict how states respond to other states in the system being sanctioned. The independent variables within model attempt to explain the variation in between states responses—given that each state is faced with the same imbalanced market conditions within the target states after the imposition of sanctions. As well, the variables used to control for the severity of sanctions were a crude measure. The three sanctions type designations do not impart the extent to which the target state's economy and trade relations were actually affected

by the sanctions. It follows that if the senders' sanctions do little to affect the target state, then the ripple effects on other states' trade relations with the target will similarly be minimal. However, it was still somewhat surprising that the value for UN sanctions did not elicit a significantly negative relationship. The rest of this section will focus on discussing the statistical results obtained from the regression, while the next chapter will seek to elaborate on how the findings should be interpreted and their implications for the hypotheses.

Opportunistic Variables

The opportunistic variables behaved according to the general expectations I had of them. Both the target state's real GDP and the natural log of distance between the third party and target were statistically significant. As expected, the target state's real GDP was positively related to the trade differential, representing the enhanced economic incentives of trading with the sanctioned state. The natural log of distance was negative, representing the higher than predicted transaction costs incurred through trade with the target state. Given distance's high degree of significance, it is somewhat surprising to see that although positively signed, contiguity was not statistically significant. However, this could be reflective in the large amounts of illicit trade and smuggling between border states and the target that would go unrecorded within officially reported trade data.

Realist Variables

The realist variables comparatively had the worst performance in that not only did they not turn out to be significant, but also in that those that were significant had opposite signs of realism's predictions. To begin, the similarity score between the third party and target state was

significant at the .05 level, but was negatively signed. This means that as the two states' international political interests increased in congruence, they traded with one another in lower levels than had been predicted. The presence of a defense pact between the third party and target state was also negatively signed, but not significant. This held true when presence of defense pacts was interacted with system polarity, proving to be insignificant in both unipolar and bipolar systems. With regard to the third party state's relations with the sender, political similarity was negatively signed but insignificant. Surprisingly, the existence of a defense pact between the third party state and the sender state was positively associated with higher than predicted between the third party and target states and was statistically significant at a .01 level. When taking system polarity into account, defense pacts with the sender under a bipolar system were positively signed and statistically significant, while defense pacts under unipolar systems were statistically insignificant, but still positive. This means that when the third party had a military alliance with the sender state, it was actually more likely to trade with the target state in higher than expected levels.

Liberal Perspective Variables

The liberal variables performed quite consistently according to the predictions that were made of them. Beginning with the monadic variables measuring characteristics of the third party state, both the third party state's trade openness and the polity scores were positively signed and statistically significant at the .0001 level. Thus, the greater the third party states' economic engagement in international trade, the more it was likely to trade with the sanctioned state in higher than predicted levels. Additionally, the more democratic the institutions of the third party state were, the more inclined it was to trade in higher than expect amounts with the target—

regardless of the target's regime. Both the variables measuring for the joint presence of democratic institutions and autocratic institutions within the third party and target states were negatively signed and insignificant. However, the term representing the interactive effect of political similarity and joint democracy between the third party and target was positively signed and statistically significant at a .05 level. While the sign for the interactive effect of joint autocracies and political similarity was positive, it was not significant. Most interestingly, the extent of the third party's economic dependence upon the sender state was associated with lower than expected trade with the target state and was statistically significant at the .001 level. So while the extent of the political engagement that the third party state had with the sender did not hurt its trade with the target state, high levels of economic dependency on the sender did adversely affect third party states' trade with the target.

Control Variables

That none of the dummy variables representing the severity of the sanctions imposed proved statistically significant was not particularly surprising. Given that the sample only extends to eight sanctioned countries, the categories were crude measurements of the costs imposed on the targets, and that the sample was confined to the subset of cases in which sanctions were ongoing, it is not surprising that there were no significantly discernable relationships in the severity of the sanctions imposed. As for the presence of a MID between the third party state and the target state, there was no statistically significant relationship. The constant term for the regression was positive and statistically significant at the .0001 level. This implies that bilateral trade was generally higher than the gravity model alone would have predicted it to be.

Chapter 5: Discussion of the Quantitative Findings

Evaluating the Opportunistic Hypotheses

The findings with regard to the opportunistic theory proved to be generally supportive of the position that, given the enhanced incentives of trading with the target states, third parties will increase their trade with the target state after sanctions' imposition. The first relationship that was tested involved the hypothesized positive effect of the target state's economy on the third party state's bilateral trade with it. The relationship between economic size and increased international trade is one of the foundational variables in the gravity model, as was evidenced from the strong relationship demonstrated by Target GDP in the first gravity model.¹⁸ However, this standard effect of economic size should have been controlled for in the dependent variable, as it already was already taken into account as part of the predicted trade estimate (in the denominator).¹⁹ Thus, the relationship that the variable is demonstrating in the trade differential model accounts for the "extra" effects that economic size has when the target has been sanctioned. The economic incentive to trade with the target, as measured by the target's economic size, elicits the sanctions-busting behavioral response within third party states. The finding coincides with the predictions of Kaempfer and Lowenberg on the response of individual economic actors in the international marketplace to the market conditions created within sanctioned states (Kaempfer and Lowenberg, 1999). This variable provides strong support for the common assumption that has been made by the sanctions literature that given the opportunity

¹⁸ While in the initial gravity model the variable was $\ln(\text{GDP}_T * \text{GDP}_3)$, this figure is mathematically equivalent to: $\ln(\text{GDP}_T) + \ln(\text{GDP}_3)$.

¹⁹ Indeed, to the extent that a simultaneity effect would exist would actually serve mitigate the potential influence of economic size, as the value would "pull" the ratio towards a value of one (which would indicate that there was no difference between observed and predicted trade).

to extract economic rents from the sanctioned state, third party states will do so. Thus, this finding supports Hypothesis 1A.

The results for the hypothesis regarding the effect of geographic proximity were mixed, as distance did have the strong negative effect on trade as predicted, but contiguity did not elicit a significantly positive effect. Distance hampers the ability of third party states to sanctions-bust and/or act as black knights by increasing the transaction costs on the logistical side of trade and by enhancing the ability of sender states to enforce their sanctions. As an example, the United States' blockade of Cuba during the missile crisis with the explicit intent of denying Soviet ships access to the Cuba was made effectively possible by the Soviet Union's geographic remoteness from Cuba. With regard to the latter, Van Bergeijk (1994; 1995) has shown how sanctions hurt third party trade by disrupting the networks through which international trade flows. Indeed, if the primary sender state is a key transshipment or transit point for trade going into the target state, then third party states may lose their main conduit through which goods had been trafficked into the target state. Moreover, the degree to which the primary sender is able to elicit cooperation from other states, the greater these disruptive effects will be (Van Bergeijk, 1995; Martin, 1992). The farther the third party state is from the target state, the less "enticing" the favorable terms of trade with the target will be, as the costs of such trade will mitigate the available benefits.

What is puzzling, then, is why contiguity did not demonstrate a significantly positive effect on bilateral trade between the third party and target—given the absence of the aforementioned transaction costs. The most compelling explanation for this outcome lies in the grey and, quite often, black market nature of sanctions-busting trade (Naylor, 2001; Andreas, 2005). In the case of UN sanctions that should have universal application in the international

community, third party states have no incentive to record the sanctions-busting trade going on within their borders. Even for cases of unilateral sanctions imposition, the primary senders often exert pressure on third party states to comply with the sanctions (Martin, 1992), giving sanctions-busting states strong incentives to downplay the extent of their sanctions-busting activities. And finally, it is much more difficult for third party states that share a land border with the sanctioned target state to control illicit cross-border trade by individual economic actors and criminal networks (Andreas, 2005; Naylor, 2001). Thus, while I still posit that the actual effect of being contiguous with the target state has a positive affect on third party states' propensity to sanctions-bust, the nature of that trade is also most likely to be of an illicit nature and thus go unrecorded in official figures. While explaining the failure of contiguity to attain significance on measurement error in observed the trade data used does not itself provide support to the hypothesis, it does explain why the model's results are not consistent with the findings of other qualitative studies of sanctions-busting behavior. The relationship between contiguity and illicit trade will be explored in further detail within the qualitative section. Based on the strong relationship demonstrated by distance and the inconclusive evidence based on contiguity, I would still conclude that the data supports Hypothesis 1B.

Table 4: Summary of the Opportunistic Theory's Hypotheses

<i>Hypotheses</i>	<i>Level of Support</i>
HYPOTHESIS 1A: The imposition of sanctions on the sender state will make it more economically attractive for third party states to trade with, thus leading to higher than predicted amounts of international trade with third party states based than economic size would predict had sanctions not been imposed.	Supported
HYPOTHESIS 1B: The degree to which the third party state is geographically proximate to the sender should be positively associated with <i>higher than predicted</i> trade values after the imposition of sanctions.	Supported

Evaluating the Realist Hypotheses

Of all the three theories tested to explain third party states' trading behavior towards sanctioned states, realism performed the worst. None of the six hypotheses tested turned out to be statistically significant in predicted direction, and three of the hypotheses were directly refuted by statistically significant evidence in the opposite direction. While such a strong refutation of realism might raise alarm bells among some who might think that the theory was either misrepresented or applied in area outside of its topical relevance, in this section I will seek to show the validity of the results obtained and explain the seemingly anomalous results obtained by the model with regard to realist theories.

To begin, the first puzzling result produced by the model was that political similarity between the third party and target states had a significantly negative relationship with the trade differential. Based on realism's emphasis of states' preoccupation with relative gains and the security externalities associated with international trade, it was expected that trade would have occurred in higher levels than among states with similar international interests (Morrow, Siverson, and Tabares, 1998: 649) and lower levels with states more likely to be potential rivals. The findings from the quantitative analysis, however, were much more consistent in line with those of Barbieri and Levy, in which they found states to be surprisingly indifferent to the security externalities created by trade during and in the immediate aftermath of conflicts (Barbieri and Levy, 1999: 464). Furthermore, these findings also stands in contrast to the theories that emphasize the congruence of private economic actors' with their homes states with regard to the security-based calculations they take into account with regard to their trading behavior (Keshk, Pollins, and Reuveny, 2004; Pollins, 1989a & 1989b).

So, what could potentially explain why both states and the private economic actors within them would be less inclined to trade with “friendlier” states that have been sanctioned? While the implications of the interactive effect of joint-democratic institutions and political similarity, which was significant and positively signed, will be explored in greater detail in the section, the work of Gelpi and Greico (2003) may shed insight on both that finding and the current one. Gelpi and Greico found that increasing amounts of economic interdependence could exacerbate conflictual relations between states, and only had a positive affect in mitigating conflict between democracies (2003). In reversing the causal arrow, one possible explanation for the finding could be that the introduction of economic conflict could have a more profound souring effect on the economic relations between mixed regime types or jointly autocratic regimes that might otherwise be similarly aligned. As autocratic states often have more rigid, autarkic economies that are less able to adapt to change and so they could be hurt more by the disruption effects than democracies—and further will experience the greatest losses with the partners with whom they are trading in the highest levels. So while jointly democratic states with similar interests can overcome the negative disruption costs and increase trade within one another in the wake of one of the partners being sanctioned, non-democratic dyads with similar interests do not have economic agility to follow suit and will experience declines in their bilateral trade. As realism discounts the effects of regime type and the finding has a logical explanation, this finding serves as a direct refutation of realist prediction of Hypothesis 2A.

With regard to the hypotheses involving the presence of a defense pact between the third party and target state, results from the trade differential model showed that they did not significantly affect the third party’s state predilection for trading with the target state. In the aggregate, and even after taking polarity into consideration, defense pacts exerted an

insignificant effect. This finding stands in contrast to what had been put forward as the justification for black knight behavior (HSE, 1990; Drury, 1998). Indeed, out of any of the hypotheses tested in this set, the effect of a close, military relationship between third party and target states should represent the subset of cases most likely for realism to hold up in. If relative economic gains do matter states, it would follow that states would be concerned when one of their alliance partners becomes involved in an economic conflict that could diminish its military power. Even if allies did not come to each other's "rescue" in all cases, it should be expected that the cases in which such behavior did occur would have exerted a strong enough influence to have created a positive relationship. While this finding does not discount Long's (2003) findings that alliances were associated with increased levels of bilateral trade, it does tell us that allies are not any more likely to come to one another's assistance than states with neutral relationships. Thus the results from the model lead me to conclude that Hypothesis 2B and 2F were not supported.

With regard to the third party's relationship with the sender, realism would tend to predict that that the third party's trading behavior would be shaped by its security considerations. Thus, it was posited that the closer the third party's political similarity to the sender state, the more likely it would be to refrain from sanctions-busting. However, the political-military relationship between the third party and sender displayed no statistically significant effect on the trade differential. While the indirect nature of this relationship makes it a comparatively much harder case for realism to predict, the lack of significant finding for this relationship undermines arguments that states use "the enemy of my friend is my enemy" heuristic to guide their trading behavior (Polachek, Robst, and Chang, 1999: 410-411). So while Polacheck et al. (1999) and Chang (2005) may have found evidence to support the position that trade can have indirect

effects on conflict in triadic relationships, this model's findings indicate that the presence of an economic conflict between the sender and target does not significantly hurt the third party's trade with target when the sender and third party have similar interests. Thus, I conclude that Hypothesis 2C was not supported by the evidence.

With regard to the proposed effect of defense pacts between senders and third party states, the model once again provided starkly contradictory evidence to the realist prediction. Indeed, the presence of defense pact between the sender and third party state has a statistically significant positive relationship with higher than predicted trade with the target state. This finding contradicts the common wisdom within the trade and conflict literature that military cooperation enhances cooperation in the commercial sector (Long, 2003). Considering that sender state was held constant as the United States, which throughout the examined period was the most powerful state in the international system, one would expect that if sender states are effectively able to exert a restraining influence on the basis of close military ties, the cases examined would be most likely candidates to exhibit such an effect. Even more surprising with regard to the sanctions literature, was that allies of the United States were even more likely to sanctions-bust during the Cold War than afterwards. While several high profile cases of black knight behavior, such as the Soviet Union coming to the aid of Cuba, have created the perception that alliances drive sanctions-busting behavior, the empirical findings of the trade differential model provide strong evidence discounting the role of military relationships in affecting states trading behavior with sanctioned states.

The failure of alliance relationships to exert effect restraint allies' trade is not an anomalous finding to this study, however. The literature exploring export controls, especially the subset that focuses particularly on the role played by COCOM during the Cold War, has

addressed similar findings.²⁰ (Cupitt, 2000; Martin, 1992; Mastanduno, 1998). Michael Mastanduno found that “the United States, despite possessing a preponderance of power resources and undertaking a sustained, high-level diplomatic effort, was ultimately unsuccessful in obtaining alliance support” for its preferred export control policies against the Soviet Union during the Cold War (Mastanduno, 1988: 122).

One potential explanation for the United States’ allies’ willingness to free ride on the U.S. would be its willingness to impose sanctions with or without support from the international community and in that allies often had much different threat perceptions than the U.S. (Hillenbrand, 1988). For the most part, American sanctions against Iran, Cuba,²¹ Nicaragua, Panama, and Indonesia had few, if any, security implications for the United States’ NATO allies. Martin (1992) and Mastanduno (1988) concluded that the only time the United States was able to get its COCOM allies to adopt its preferred export control policy occurred when the U.S. and its allies shared common threat perceptions of the Soviet Union during the Korean War. At the Korean War’s conclusion the United States’ Western European allies pushed hard to loosen the scope of COCOM export controls against Eastern European countries (Bertsch 1988: 6), preferring the benefits of trade over protecting against potential security externalities. Thus, the larger conclusion from this finding could be that alliances are not effective mechanisms through which friendly states can be coerced / convinced to cooperate on issues of sanctions’ compliance when the sanctions involve targets that allies do not see as a threat. On the basis of the contradictory findings and in lieu of supporting evidence from the export control literature, I contend Hypothesis 2D was refuted.

²⁰ COCOM was the export control regime created by the United States, its Western allies, and Japan to deny high technology exports to the former Soviet Union and Eastern Bloc.

²¹ While during the Cuban Missile Crisis there were significant implications, in the thirty plus years during which the sanctions have persisted those considerations have ceased to exist.

The final effect prediction that was tested regarded the effect of system polarity on the willingness of states to engage in sanctions-busting behavior. Within their seminal work, HSE (1990) speculate that black knight states would be less likely to emerge in the aftermath of the Cold War than they were during its midst. In the aggregate, bipolarity exerted a statistically significant, positive effect on states' willingness to trade at higher than predicted levels with the sanctioned state. The conceptual problems involved in testing this hypothesis relate to the difficulty in distinguishing the instances in which states opportunistically sanctions-bust for economic reasons and when they are acting as black knights. As the political-military relationships that the third party state has with the sender and target key are the causal variables leading to black knight behavior, the failure on all accounts of these variables to elicit the properly linkage between security interests and trade behavior strongly discounts the black knight theory. Indeed, the finding that states allied to the sender were more likely to sanctions-bust in bipolar systems implies that economic considerations predominantly drive how states respond to their trading partners being sanctioned. Thus, the model's conclusions discount the proposed effect that bipolarity would have on magnifying the importance of security considerations in the third party states trading behaviors with sanctioned states. Overall, realism performed quite poorly in predicting the effects of economic sanctions imposed for political and military purposes on third party state behavior.

Table 5: Summary of Realist Theory's Hypotheses	
<i>Hypotheses</i>	<i>Level of Support</i>
HYPOTHESIS 2A: Third party states should trade more than predicted with sanctioned states in which they have greater similarities of international interest than those with whom they do not.	Not Supported
HYPOTHESIS 2B: Third Party states having defense pacts with the target state should increase their trade with the target state more than non-aligned states after the imposition of sanctions.	Not Supported
HYPOTHESIS 2C: The more closely that the third party state's common interests coincide with the sender state's, the more the third party's trade with the target will diminish after the imposition of sanctions.	Not Supported
HYPOTHESIS 2D: If the third party state has a defense pact with the sender state, it will trade less with the target state than those states without defense pacts with the sender.	Not Supported
HYPOTHESIS 2E: Sanctions-busting activity is more likely to occur within bipolar distributions of power, than in unipolar distributions of power.	Partially Supported
HYPOTHESIS 2F: Allies with defense pacts are more likely to sanctions-bust on behalf of one another in bipolar distributions than they are in multilateral distributions of power.	Not Supported

Evaluating the Liberal Hypotheses

Out of the three theories tested, the liberal theory provides the most novel set of results—with economic interdependence and regime-type eliciting significant effects upon the way third parties respond to the imposition of sanctions. Beginning with economic interdependence, both the indicators representing the degree to which third party states were engaged in international trade and the extent of their economic dependency upon the sender state strongly influenced their trading behavior towards the target state. The positive relationship between the third party's trade openness and its tendency to engage in higher than predicted amounts of trade with the target state takes on further significance when considered within the context of Van Bergeijk's (1994; 1995) trade disruption theory. Indeed, the extent to which states engage in international

trade should make them more vulnerable to disruptions in the trade networks on which they depend. Even after taking the more significant trade disruption costs into account, heavily trading states were much more likely to trade with sanctioned states in higher than predicted amounts.

This variable likely indicates both the enhanced domestic political clout brought to bear within heavily free trading states on their governments not to impose trade restrictions, and such states' economic agility in responding to changes in the international marketplace due their extensive experience and engagement in international trade. In particular, ports serving as major transshipment hubs are well-suited to serve as primary sites through which trade can be re-routed in response to network disruptions. As the case study involving the United Arab Emirate's role in sanctions-busting on behalf of Iran demonstrates, Dubai has served as the locus through which trade has flowed into Iran after the imposition of sanctions. As such ports already experience extensive trade flows, transshipment points can serve as ideal bases for sanctions-busters because they enjoy low transaction costs, have high trade volumes that ease in diversions by making individual transactions difficult to trace, and are the focal points for global trade. In general, the more international trade that states engage in, the better the logistical infrastructure they must have to facilitate that trade. Thus, capability-wise, heavily trading states are the well-situated to take advantage of the economic opportunities presented by the target states' imbalanced terms of trade.

In turning now to the influence exerted by the third party state's economic dependence upon the sender, the trade differential model revealed that sender states can impose some restraints on the third party states' trading behavior. The strong negative relationship of economic dependency on the trade differential provides some support to Rodman's (2001) theory

about the effectiveness of extraterritorial sanctions; however, the Iran-Libya Sanctions Act²² and Helms-Burton Act²³ were the only extraterritorial sanctions present within the case sample. Thus, the effects of economic dependency cannot be written off as a resounding affirmation of their empirical success, but they very likely contributed to the effect. The more likely causal mechanism responsible for the effect would be the ripple effects that the imposition of sanctions by such a large economic power on the businesses of other countries, as foreign firms may have to comply with sender's edicts if they wish to do business directly with the sender government or adjust their behavior when dealing with companies from the sender state that must obey the laws. Thus, the "soft power" of economic leverage can compel compliance wherein political-military relationships have demonstrably failed. So while much of the sanctions literature has focused on the coercive measures adopted by sender states aimed at the governments of third parties to compel compliance (Drezner, 2000; Martin, 1992), the state-to-firm approach to inducing international compliance adopted by Rodman (2001) should receive more attention than it has.

Of all the variables considered, democratic institutions induced the most enigmatic effects on the third party states' trading behavior. To begin, the degree to which the third party state was democratic had strong, positive relationship with higher than expected trade levels. This finding indicate that democratic states' economies had the most flexibility in responding to the trade disruptions / new trade opportunities created by the sanctions. In moving to examine joint regime effects, however, the effect of democratic institutions becomes more puzzling. Within the model, the effect of the third party and target states being jointly democratic did not display a statistically significant effect. This finding contrasts with the logic behind Lektzian and Souva's (2001) theory that states with jointly democratic institutions are better able to reduce

²² Imposed by the U.S. and directed at foreign companies trading with Iran and Libya.

²³ Imposed by the U.S. and directed at foreign companies trading with Cuba.

the high transactions costs involved in international trade after the imposition of sanctions. However, the interaction between jointly democratic regimes and political similarity score had a highly significant positive effect on the trade differential. This finding coincides with the predictions made by Moon and Dixon (1993) that *political and institutional* similarities lead to higher trade. Thus, while the political similarity score between the third party and target has a negative relationship in the aggregate, the relationship flips around when both dyads are democratic. That neither political interest alone or the common presence of democratic institutions increased trade levels on their own, reveals that the transaction costs involved in sanctions-busting are multifaceted—demonstrating that economic actors consider both the congruence of their home state’s international and domestic relationships of their trading partners in their calculations of with whom to legitimately trade. While the sanctions literature emphasizes that autocracies can effectively manipulate the imbalanced terms of trade created by sanctions in the regime’s favor, both tests for the effects of joint autocracy between the third party and target provided no significant results. In the aggregate, economic interdependence and democratic institutions did a good job of predicting how third party states would respond to the imposition of sanctions.

Table 6: Summary of Liberal Theory Hypotheses	
<i>Hypothesis</i>	<i>Level of Support</i>
HYPOTHESIS 3A: The higher the third party state's degree of trade openness, the less likely to participate in economic conflicts that would disrupt trade with the target state.	Supported
HYPOTHESIS 3B: The higher the third party state's trade dependence upon the sender state, the more likely its trade will diminish with the target state after sanctions are imposed.	Supported
HYPOTHESIS 3C: If the third party state is a democracy, it will have higher than expected trade flows with the target state than non-democratic states.	Support
HYPOTHESIS 3D: If the target and third party regimes are jointly democratic, they will have higher than expected levels of bilateral trade after the imposition of sanctions than those that are not.	Not Supported
HYPOTHESIS 3E: If the target and third party regimes are jointly democratic, there will be a positive interactive effect with their degree of political similarity on their level of bilateral trade after the imposition of sanctions.	Supported
HYPOTHESIS 3F: Having jointly autocratic regimes should not lead to higher than expected trade flows between target and third party.	Supported

Tying Third Party State Behavior to the Statistical Results

The primary implication of the trade differential model for our understanding of how third party states respond to other states being sanctioned is that economic considerations, as opposed to security ones, drive the states' responses. The results discussed above also accord a significant role to the moderating effects of institutions on states' trading behavior with one another. The hypotheses that found support within the opportunistic and liberal theories tended to be premised on the underlying logic that supported the opportunistic sanctions-busting behavior. Given the opportunity to profit from enhanced terms of trade, the states most likely to trade in higher than expected levels were those that benefited from proximity and transaction cost reducing institutions. Conversely, none of the realist-based security variables that should have predicted black knight behavior amongst third party states proved to be significant. While

certainly cases have existed in which states have sanctions-busted for purely political reasons, the findings of this study indicate that such behavior is not part of more generalizable trend. Sanctions-busting to help friends and allies for political purposes tends to be an exception, rather than the rule. With regard to more passive responses, the effect of the third party's economic dependence upon the sender state demonstrates the leverage senders can exert on third party states that do not participate. However, as Rodman (2001) has showed, the effects of this relationship can occur not just through state-to-state agreements, but through state-to-foreign firm measures. Indeed, the same logic elaborated by Morgan and Bapat (2003) regarding how states deter their domestic firms from violating sanctions could be extended to foreign firms' calculations. While the relationships explored have focused on the relationship between states, individual economic actors are the agents who actually carry out such trade. The findings have tended to show that variables affecting these individual agents' costs and ability to carry out international trade as having much larger effects than the political relationships between the state governments themselves. With regard to how states' trading behavior changed over the duration of sanctions, the analytical method used would not have been appropriate to measure when states were most likely to "backslide" after joining the sanctions regime. Overall, the findings of this study imply the "primacy" of economic costs and incentives, not politics, in determining international trade with sanctioned states.

Chapter 6: Case Study Analysis of the UAE-Iran Relationship

The quantitative study paints a broad picture of how sanctions affect third party trade with sanctioned state without revealing many of the nitty-gritty details of sanctions-busting. Most analysis that has been conducted on sanctions busters has come within the context of broader works on the broader effect of sanctions on the target state; however, notable exceptions do exist (Andreas, 2005; Naylor, 2001; Rodman, 2001; Parsons, 1990: 293-321).²⁴ Particularly, Jack Parson's (1990) case study demonstrated that while politically Botswana opposed the apartheid regime in South Africa and publicly supported the international sanctions against the regime, its government had strong incentives to turn a blind eye to extensive sanctions busting behavior by its private sector. Since Botswana's bilateral economic ties with South Africa were crucial to its economic growth and development, the private sector and the government took the tacit position that: "Business is business and they could not be expected to judge the value of an investment through the prism of political change in South Africa" (Parson, 1990: 303). Indeed, the subsequent case study will highlight the preeminent role of the "dirham,"²⁵ as opposed to the flag, in motivating the UAE's sanctions-busting behavior. The case study also reveals that some of the measures used within quantitative analysis may have only had mixed success in accurately capturing the desired conceptual relationships. Examining the triadic relationship between the UAE (Third Party), Iran (Target), and the United States (Sender) should provide a more nuanced

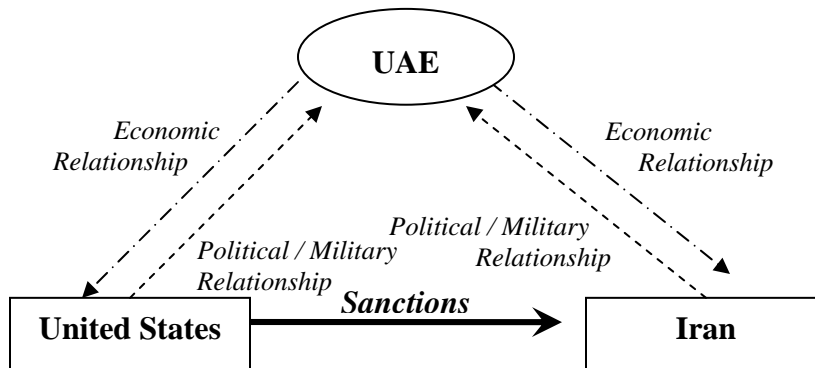
²⁴ Jack Parson's study on sanctions-busting by Botswana on behalf of apartheid South Africa serves as a good model from which to follow, in that he explicitly focused on both why and how third parties engaged in sanctions busting behavior.

²⁵ The dirham is the UAE's currency.

understanding of how both the direct and indirect effects of interstate relationships can influence international trade during sanctions.

The focus of this section will be on the trading relationship that has developed between the United Arab Emirates (UAE) and Iran since the first imposition of full trade sanctions by the United States in 1980.²⁶ Since the sanctions' imposition, the UAE has become the principal entrepôt into Iran for sanctioned / restricted goods and has emerged as the preeminent “offshore” investment destination for Iranian citizens and the Iranian Government. This case study illuminates how economic interdependence and interests, instead of security interests, tends to motivate state responses to the sanctioning of their trading partners, in addition to practical function of transshipment hubs in the grey and black market economics of sanctions-busting. It further serves as a template for future triadic analyses exploring the relationship between sanctions-busters, senders, and targets.

Figure 6: Triadic Relationship between the US, Iran, and the UAE



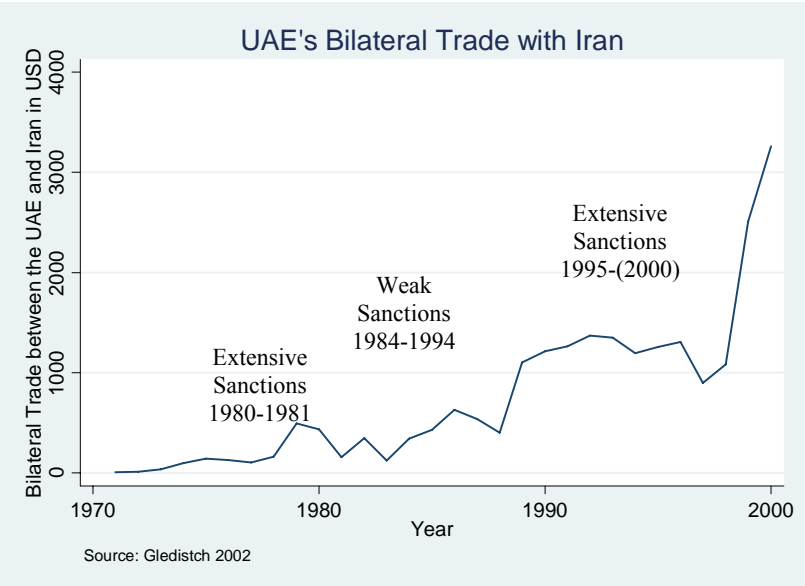
Sanctions Busting and Transshipment States: The UAE and Iran

Part of the difficulty in conducting triadic analysis is that it requires a detailed knowledge of three state-to-state relationships, instead of the single relationship needed within dyadic

²⁶ While U.S. first imposed an oil and arms embargo against Iran in November of 1979, full export and import sanctions were not imposed until 1980.

analysis. To begin, I will briefly discuss the context of the United States' sanctions against Iran, as the political and economic dimensions of that relationship have already been discussed at length by other others (IIE, 2006; Eizenstat, 2004; Askari et al., 2003; HSE, 1990). Then, I will introduce the UAE, detailing its economic and political structure. The next section focuses on describing the relationships between the UAE and Iran and between the UAE and United States. The final section will analyze how each of the economic and political variables contributed to the cultivation of a substantial trade relationship between the Iran and the UAE, even as the UAE and United States developed a closer military relationship. While the graph below does not provide a conclusive linkage between the substantial growth in bilateral trade between the UAE and Iran and the American sanctions against Iran, it at least puts sanctions as one of primary explanatory candidates. The conclusions drawn from the case study is that opportunism and interdependence played the most significant role in the UAE's emergence as the primary sanctions-buster on behalf of Iran.

Figure 7: UAE-Iranian Bilateral Trade from 1971-2000



The United States' Sanctions against Iran

The United States' sanctions against Iran were initially imposed against Iran in response to the Iranian hostage crisis that began after the Islamic Revolution in 1979. The hostage crisis, in conjunction the fiery anti-American and anti-Israeli rhetoric espoused by Revolutionary Government headed Ayatollah Khomeini and the regime's alleged links to terrorism, have served to sour long-term relations between the United States and Iran. While the degree of animosity between Iran and the United States has waxed and waned, the two states never reconciled their diplomatic differences. Even though the United States and Iran have not gone to war, American sanctions against Iran have been in place almost continuously for the past two and a half decades. However, the extent of those sanctions has varied over time with different resultant effects.

The United States' sanctions against Iran can be categorized as encapsulating three distinct periods. The first distinct period from 1979 to 1981 involved sanctions imposed explicitly in response to the Iranian hostage crises. In November of 1979, President Jimmy Carter imposed financial sanctions and embargoed oil and military sales to Iran. This initial set of sanctions was reinforced by a complete ban on imports and exports from Iran in April of 1980, which lasted until January of 1981 (Askari et. al, 2003: 188-189). The second distinct period lasted from 1984 to early 1995, and involved the imposition of sanctions for nonproliferation purposes and as punitive measures in response to Iranian state-sponsored terrorism. In January of 1984, the United States imposed sanctions restricting the sale of military and certain dual use goods to Iran. In 1987, the sanctions were further strengthened to include an embargo of Iranian goods, an embargo of Iranian crude by American companies, and the inclusion of 14 other categories of exports that Iran was restricted from obtaining (Askari et. al, 2003: 188-189).

While the import embargo certainly strengthened the sanctions, loopholes allowed American companies to largely skirt the oil embargo (Askari et. al, 2003: 190). The third phase began in 1995, when President Clinton imposed a complete ban on *all imports and exports* between the United States and Iran. In 1996, Congress further passed the Iran-Libya Sanctions Act that imposed sanctions on foreign firms that invested more than \$40 into Iran's energy sector in year's time span (Eizenstat, 2004). Within the quantitative analysis, the sanctions from 1980-1981 and from 1995-2000 were coded as being extensive, while the sanctions from 1984-1994 were coded as being weak.

The overall effects of the sanctions on Iran and their effectiveness of achieving their desired ends remains an unresolved point of contention amongst both analysts and academics. As it stands in 2006, the Islamic Republic ensconced by the Revolution is still the regime in power, the regime is still notably hostile to the United States,²⁷ and the regime is perceived to be pursuing and potentially near obtaining nuclear weapons. Thus, the sanctions have not been able to achieve their ends they were meant to—at best they have slowed Iran's acquisition of nuclear weapons technologies (Eizenstat, 2004). From 1996 to 2001, Askari et al. estimated that the total costs incurred by Iran ranged from roughly \$950 million-\$1.5 billion per year (Askari et al., 2004: 213). In the aggregate, the sanctions' economic costs imposed upon Iran have inflicted only minor harm upon the state's trade and economy, with most of losses occurring through higher financial costs, mark-ups on trade with third parties, and spoiled opportunities to develop its oil sector (Askari et al., 2004: 211). US sanctions have not seriously inhibited Iran's international trade—they have only made it more difficult and expensive. The reasons for the failure of the sanctions to impose meaningful costs are multifaceted, but Iran's ability to get the

²⁷ This stance has varied over the years, however, with Iran warming substantially to the West during the presidency of Ayatollah Khatami.

goods and technologies it has needed from elsewhere has certainly contributed to the failure. The rest of this chapter details the emergence of the United Arab Emirates, in particular the Emirate of Dubai, as Iran's middleman in skirting American sanctions and the profitable venture that has turned out to be.

*The United Arab Emirates: The Gulf's Merchant Princes or Profiteers?*²⁸

The UAE was consolidated in 1971 out of what had been seven separate and independent Shaikhdoms, which had comprised the British Trucial States of the Persian Gulf.²⁹ At the UAE's founding, the Federal State's stability and long-term viability remained uncertain. Until 1996, the UAE Constitution only held temporary status within the Confederation and had to be renewed every five years—leaving individual Emirates substantial freedom to pursue independent policies. Before unification, the Emirates had historically been rife with both internal instability and inter-Emirate rivalry, especially between the leading shaikhdoms of Abu Dhabi, Dubai, and Sharjah. After confederation, Abu Dhabi assumed the preeminent position within the Federal Government as it shouldered most of the budgetary burden for the Federal Government's activities, while Dubai and Sharjah assumed secondary leadership positions. Even so, Dubai consistently resisted giving up power to the Federal Government, preferring instead to pursue independent economic and even foreign policies on an emirate-level. Indeed, the special historical and economic relationship between Dubai and Iran led it to break with other emirates in the UAE in pursuing independent foreign and economic policies towards Iran. In particular, this case was chosen because it demonstrates how individual economic actors pursue their economic interests independently and in opposition of the state and how economic interests can

²⁸ Portions of this section have been drawn from my paper "Development through Institutions: The Evolution of Free Trade in Dubai" that is currently under review at *Studies in Comparative International Development*.

²⁹ These seven emirates are: Abu Dhabi, Dubai, Sharjah, Ajman, Fujairah, Umm al Qwain, and Ras Al Khaimah.

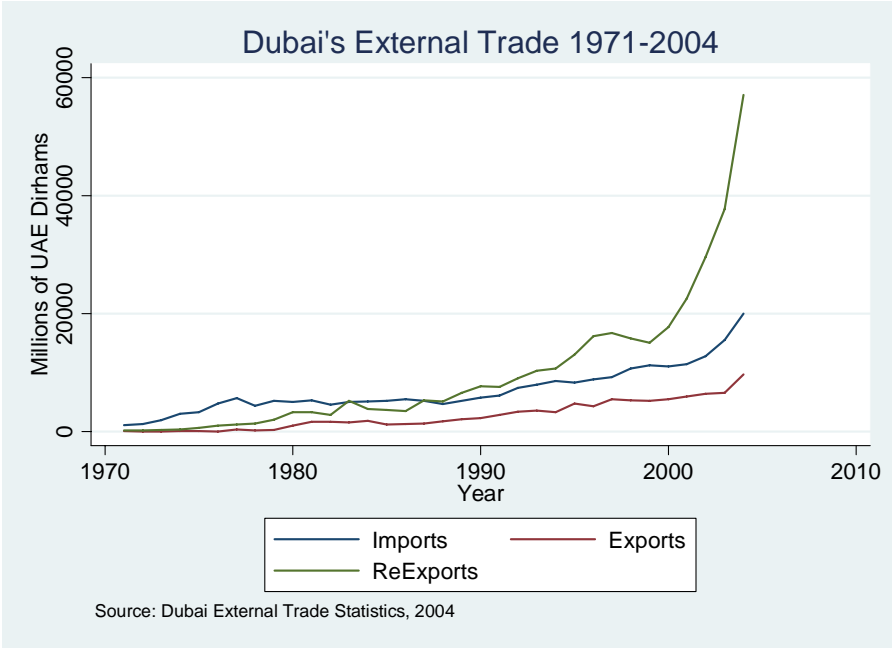
also mobilize to influence state policy. It further shows through Dubai's linkages to Iran how economic interdependence can serve to overcome/overwhelm potential threats of both militarized and economic conflict between states.

The unique structure of the UAE's confederation has allowed Dubai to pursue independent economic and customs policies, empowering it to develop institutions and infrastructures that diverged from those of other emirates. As Early (2006) demonstrates, the institutional orientation within Dubai towards free trade emerged as a path dependent outcome of its commercial legacy in the pearl trade the turn of the 20th Century, its political stability, and experience in civil-minded public development. Thus, even though it was gifted with UAE's second largest oil reserves and had access to the generous social welfare benefits offered by Abu Dhabi,³⁰ Dubai has pursued a commercially-oriented, independent developmental path that allowed it to escape the rentier trap (Early, 2006). Through the construction of the world's largest manmade port at Jebel Ali in the late 1970s, the establishment of the Jebel Ali Free Zone (JAFZA) in 1985, the rapid expansion of similar free trade zones (Early, 2006; Davidson, 2005), significant investments in public infrastructure (Ramin, Parsa, Younis, 2003), and an aggressive campaign to attract foreign direct investment, Dubai emerged as the Persian Gulf's preeminent commercial hub and as a "World City" (Marchal, 2005; Parsa and Keivani, 2002; Hirst, 2001; Beaverstock, Smith, and Taylor, 1999). In 2004, Dubai became the world's 10th largest container port by volume, the world's third most active transshipment port, and accounted for 70% of the UAE's non-oil exports (Dubai Ports Customs Free zone Corporation, 2006; UNCTD, 2005). So while the UAE, as a whole, sits on roughly 10% of the world's petroleum reserves,

³⁰ Abu Dhabi's oil reserves absolutely dwarf those of Dubai. Abu Dhabi has an estimated 92.2 billion barrels in reserves, while Dubai has only 4.0 barrels. (U.S. Energy Information Administration, 2005)

Dubai has pushed to become the Middle East’s freest market, most active commercial and financial center, and most attractive site for foreign direct investment in the high-tech sector.

Figure 8: The Emirate of Dubai’s External Trade



Trade Openness

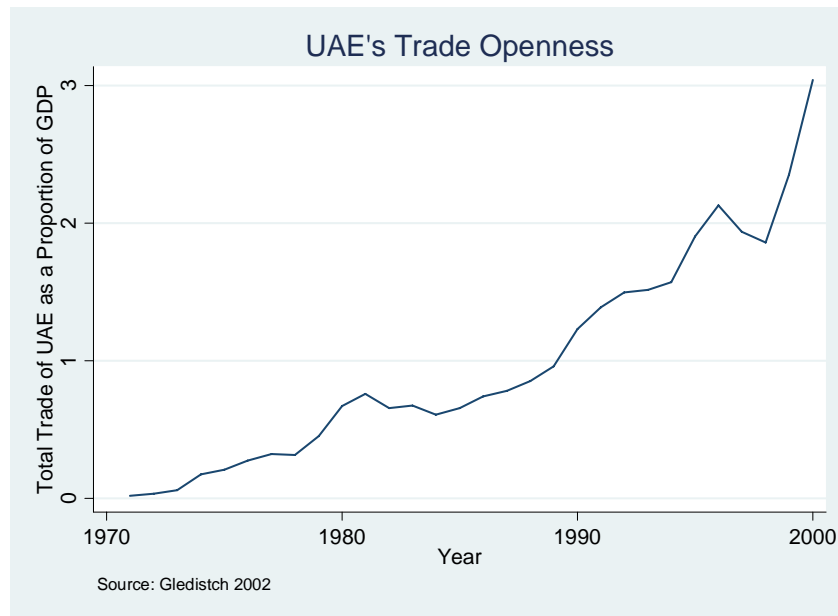
The United Arab Emirates’ trade openness has progressively increased since its founding, with the most rapid increases coming in the 1990s. As a proportion of its GDP, international trade comprised only a marginal amount of the UAE’s economic activity in 1971, but by 2000 the country’s trade flows were three times as large as its GDP. When the Gulf Cooperation Council (GCC), of which the UAE is a member, initiated its Customs Union in 2003, the UAE adopted a standard minimal tariff of 5% on products coming into GCC states; however, free trade zones were exempted from the mandatory tariff. Up until the Customs Union, the UAE had only enforced tariffs on certain categories of products, but had extensive investment and trade restrictions that forced international parties to work through indigenous agents. Dubai’s

free trade zones encouraged FDI in the manufacturing and industrial sectors, while also providing significant incentives for companies to set up their shipping and distribution centers in Dubai, as they exempted foreign companies from tariffs and nearly all labor and investment restrictions.

In more concrete terms, the physical infrastructures that Dubai has developed in its international shipping, airline, warehouse, and service sectors have made it one of the largest, most modern, and well-equipped commercial hubs in the world. The port at Jebel Ali, with its extensive dry dock facilities, was finished in 1979 and its attendant free zone was opened in 1985. While Dubai had traditionally played a central role in Persian Gulf trade (Heard-Bey, 1982), the new facilities, pro-business administrative operation of JAFZA, and the ongoing war between Iran and Iraq³¹ during the 1980s helped to focus Persian Gulf trade in Dubai. Jebel Ali Port currently has grown to contain over 67 berths and the Dubai Ports Customs and Free Zone Corporation has an aggressive plan to expand that capacity to over 120 berths by 2020, giving it the capacity to handle over 21 million containers per year (PCFC, 2005). Furthermore, Dubai has been a leader in adopting sophisticated, logistical information technologies in the operation of its ports and free zones operation and management, which has been effective in increasing bureaucratic efficiency, transparency, and lowering transaction costs for consumers (PCFC, 2005; Keivani, Parsa, and Younis, 2003). With 18 million passengers passing through Dubai International Airport (DIA) in 2003, an “open skies” policy that that opened up the airport to competition from foreign carriers, and an expansion program in the works, the DIA projects it could traffic 60 million passengers by 2010 (Lee, 2005).

³¹ The war made trade with not just Iranian and Iraqi ports more dangerous, but also trade with ports that were closer to where the conflict occurred. While geographically proximate to Iran, Dubai managed to maintain good relations with Iran throughout the conflict even though the UAE supported Iraq in the conflict.

Figure 9: The UAE's Trade Openness from 1971-2000



Dubai has further continued to use a free trade zone-base developmental strategy, branching out to include a free zone attached to the DIA in 1996 and to other sector specific FTZs that totaled over 14 by 2005. As the graph charting Dubai's trade demonstrates, the aggressive infrastructure development begun in the late 1970s started to pay dividends in the late 80s and early 90s, but really took off in the late 1990s. Dubai has further sought to position itself not only as the gateway into the Middle East, but also as the central East-West trade hub connecting the West to South Asia, cultivating close ties with India and Pakistan. In short, Dubai is the Persian Gulf's largest, most commercially open, technologically adept, and well-equipped trading hub.

In terms of the political pressure exerted by economic interests within the UAE with respect to international trade, the Maktoum Dynasty, which has ruled Dubai for almost the past two centuries, has held a consistently free-trade orientation since the beginning of the 20th Century (Early, 2006; Peck, 2001). This has been reinforced by the presence of a strong merchant class within Dubai, with close informal ties to ruling regime (Al-Gurg, 1998; Heard-

Bey, 1982). Given the high level of autonomy granted to individual emirates with the UAE, Dubai has been able to policies pursuant to freer and more open trade within the context of more protectionist-oriented UAE state.

Governing Institutions

While the United Arab Emirates has had constant polity score of -8 since the government's inception (Marshall and Jagers, 2003), through the clever construction of economic institutions Dubai managed to propagate extensive economic freedoms within with the confines of its autocratic polity. The UAE's seven emirates are each ruled individually by autocratic dynasties, which subsequently have representation at the federal level. While several of the emirates have advisory *majlis* that allow for some degree of democratic input, the UAE remains effectively a monarchical system. The value-added of this case study allows us to look towards other institutional factors within the state that could be related to the conceptual niche that the polity score was supposed to fulfill with respect to economic transaction costs. Instead of democratizing, Dubai pursued an innovative developmental strategy, whereby it has created a multitude of free trade zones designed to proxy democratic institutions with regard to their transparency, efficiency, and property right guarantees.

Free trade zones (FTZs) are administratively distinct territories considered to be outside the customs territory of a state and are often located near air- or seaports. FTZs normally have separate sets of business-friendly laws that minimize bureaucratic red tape, offer more economically liberal investment regulations to foreign companies, and allow FTZ firms and traders to import, store, manufacture, and export products free from duties. Free trade zones created at geographically strategic locations, which are also called free ports, can grow into trade

centers, becoming focal points for the regional distribution of goods, transshipment hubs for global air, sea, and land traffic, and servicing the import/export needs of the MNCs doing business within them. Moreover, successful ports—and FTZs are no exception—attract shipping business through creating efficient, cheap, and swift bureaucracies and processing facilities that save shippers and cargo owners time and money (Fink, Mattoo, and Neagu, 2002: 81-108; Limao and Venables, 2001).

The World Bank holds that FTZs represent a third-best developmental strategy, behind country-wide liberalization or the complete allowance of duty-free imports—considering them to be "a last resort in the effort to improve allocative efficiency in previously highly regulated and protected economies" (Baissac, 2004). However, it is more cost-effective for less developed countries to invest in high quality infrastructures within only limited geographical areas and easier to provide for the creation of efficient, tailor-made administrative institutions outside the corpus of the existing state bureaucracy. Quan Li and Adam Resnick (2003) have further identified MNCs concern with states' property rights as another critical variable in determining their willingness to invest foreign countries. The creation of specific administrative institutions devoted to bureaucratic efficiency, having institutional independence from the host government, and explicitly catering to MNCs' investment needs serves a signal to international investors that their investments will be secure. Thus, Dubai has used FTZs as a proxy for democratization and a developmental shortcut in attracting international trade and investment. The *laissez-faire* attitude prevalent within FTZs and high trade volumes are also particularly well-suited to sanctions-busting and other forms illicit trade.

The UAE's Relationship with Iran: Sleeping with the Erstwhile... Enemy or Ally?

Political-Military Relationship

While cultural and economic ties have served to tie Iran and the UAE closer together, the military threat posed by Iran has driven the UAE balance with its Arab neighbors against the country. Before the Islamic Revolution, the only significant foreign policy dispute between Iran and the UAE involved the ownership of several islands in the Persian Gulf [Abu Musa and the Greater and Lesser Tunbs] that Iran laid claim to and occupied as a condition of recognizing the UAE's independence (al-Alkim, 1989: 140-144).³² While Sharjah and Iran reached a settlement over the occupation of Abu Musa, in which they agreed to split oil revenues from the island, Ra's al-Khaimah refused to accept Iran's claim to the Tunbs (Davidson, 2005; al Roken, 2001). Iran did officially recognize the UAE in 1971, but the islands remained a contentious issue within the UAE. The UAE even brought the issue to the Arab League for intercession. Despite the Federal Government's chilled policy towards Iran throughout the 1970s Dubai pursued an independent foreign policy towards Iran—establishing much closer political and economic ties with Iran than any of the other emirates (al-Hakim, 1989). The Islamic Revolution was initially greeted positively by the UAE, as the Revolutionary Government in Iran renounced the Shah's hegemonic stance within the Gulf; however, the new regime refused to relinquish the islands that had been occupied by the Shah.

The Iran-Iraq War in 1980 had much larger implications for the UAE's relations with Iran, as one of the chief reason's Saddam Hussein used to justify the war was to recapture Abu Musa and the Tunbs on behalf of the UAE (a fellow Arab League state). The war placed the UAE in a difficult position, as it wanted the return of the disputed islands but was both

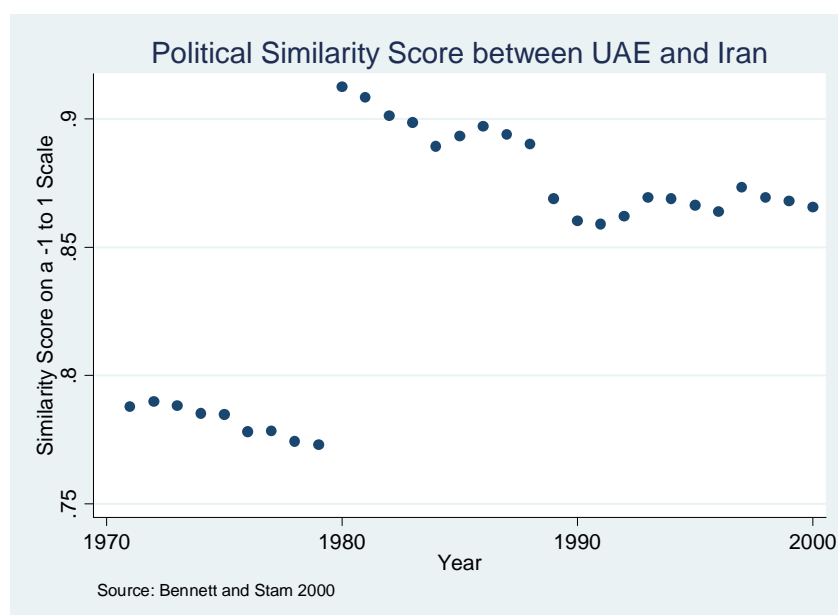
³² The three islands occupy strategically important positions in the middle of the Persian Gulf between Iran and the UAE and guard the approach to the Straits of Hormuz.

territorially and commercially vulnerable to Iran. Indeed, Iran's position at the lip of the Straits of Hormuz could (and still can) allow it to restrict access of commercial shipping into the Persian Gulf. While it pursued an officially neutral position at the beginning of the war, it offered Iraq under-the-table assistance for the first few years of the war. After it was clear that Iraq was unlikely to win a decisive victory that would return the islands, the UAE altered its position in 1982—with Dubai leading the way towards a warming of relations with Iran (al-Hakim, 1989). However, the UAE was not able to come to a consensus position on the war. Ra's al-Khaimah supported Iraq because it wanted its islands back, as did Abu Dhabi, Fujairah, and 'Ajman. With their closer cultural and economic ties to Iran, Dubai, Sharjah, and Umm al-Qawain favored Iran in the conflict (Davidson, 2005: 206). In the end, traded and provided assistance to both combatants—a pragmatic strategy that the UAE would continue to employ in the future. Though it was pressured by the Arab League and Iraq to take a more decisive stance, the UAE bided its time until the conflict's conclusion in 1988 with its neutrality mostly respected on both sides.

While Iraq's invasion of Kuwait 1990 had larger implications for the UAE's relations with the United States than it did with Iran, the power vacuum left after Iraq's defeat changed the balance of power within the Gulf. Iran was left unchallenged as the most powerful Gulf state. It tested its newfound prominence in 1992 by declaring its full sovereignty over the Tunbs and Abu Musa, which abrogated the agreement it had brokered with Sharjah. The UAE adamantly protested the Iran's annexation of the islands, making “the assertion of its sovereignty over Abu Musa and the Tunbs a focus of its foreign policy” and taking its case to numerous international organizations for resolution (Gause III, 2000: 228). In the mid-1990s, Iran built up its military use of the occupied islands, seeking to extend its strategic military presence into the middle of the Persian Gulf shipping lanes (al Roken, 2001). While it has sought to avoid direct conflict

with Iran, the UAE leadership recognizes the emergence of Iran as its chief military threat in the region (Sultan bin Zayed, 2000), and has responded with its own military buildup in the latter part of the 1990s. Following Dubai’s integration of hitherto independent defense force into the federally-controlled Union Defense Force in 1997, the UAE embarked on a 10-year \$15 billion program to upgrade its armed forces (Pike, 2005). From 1997-2000, the UAE expended the most money of any developing nation in the world on arms purchases—outlaying over \$13.3 billion³³ (Grimmett, 2005: 13). Yet even as the dispute over the islands remains unresolved, relations between Iran and the UAE steadily improved over the latter part of the 90s and on into the 21st Century.

Figure 10: The UAE’s Political Similarity Score with Iran from 1971-2000



So, how closely have the nuances of the Emirati-Iranian relationship been captured by the quantitative analysis? Unfortunately, Signorino and Ritter’s similarity of political interest variable can only account for two states’ portfolios of formalized alliances arrangements in

³³ This figure is in 2005 dollars.

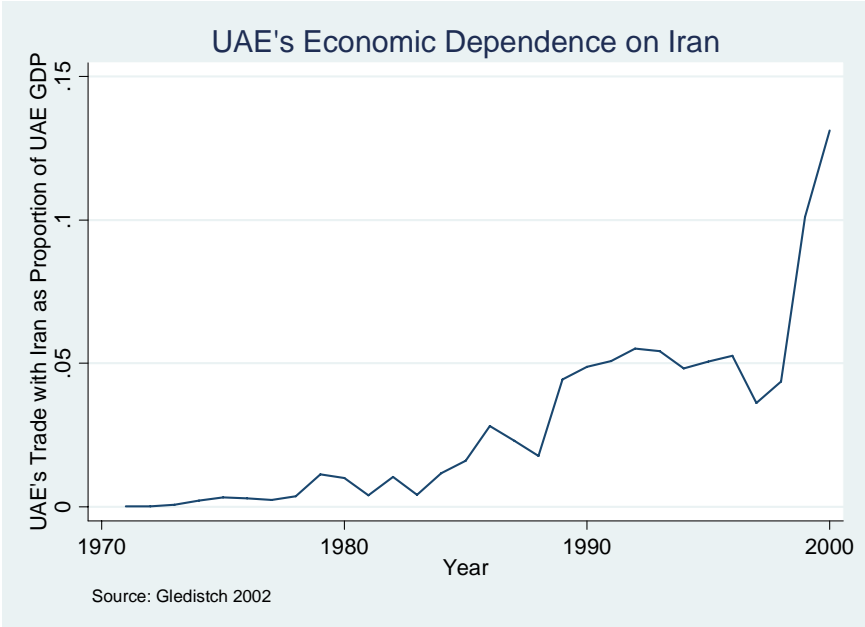
calculating the coincidence of state interest, not the nuances of under-the-table diplomacy (Signorino and Ritter, 1999). Thus, while Iran has territorially annexed portions of the UAE and Iran poses the single greatest military threat to the UAE, the similarity score between the two states have only fluctuated between high and really high. Despite this, the high political similarity scores do capture that the two states have not fought in any conflicts against one another.

Economic Relationship

The importance of the Iranian-Dubai commercial ties cannot be overemphasized with regard to Dubai's economic development. The historical linkages stem all the way back to the turn of the 20th Century, when Dubai's Shaikh Maktum bin Hashar lured the pearl merchant community from Lingah, one of Persia's most prominent ports with a large Arab expatriate population, to re-locate to Dubai with the promise of duty free trade after the Persian Government had imposed a tariff on the merchant's trade (Heard-Bey, 1982: 244-245; Al-Gurg, 1998: 4-10). The historical ties to Dubai were reinforced by the Iran-Iraq War and Dubai's substantial investment in its commercial infrastructures, as the two factors served to make Dubai both the most developed and safest port in the region. Davidson contends that "the advanced development of Dubai's Port Rashid and its Port Jebel Ali megaproject had led many Iranian merchants to assume that Dubai would soon become the one convenient stopping point for long-distance shipping and therefore the most sensible location for any long-term commercial base in the Gulf" (Davidson, 2005: 158). An Iranian report concluded that nearly a quarter of Dubai's inhabitants are of Iranian descent and that 4,650 Iranian firms now operate out of Dubai ("Luring

Minds and Money,” 2005).³⁴ Within JAFZA alone, there are over 442 Iranian companies in operation (Jebel Ali Free Zone Authority, 2005). As the table below demonstrates, the UAE’s economic dependence upon Iran has substantially increased throughout the late 1980s and on through the ’90s. In 2004, Dubai exported \$7.315 billion worth of goods to Iran in declared exports, which constituted 34.8% of its total exports—almost twice the amount of its next largest trading partner (Rettab and Morada, 2005). Ali Parsa and Ramin Keivani (2002) further contend that the development the Emirati and Iranian economies are inexorably linked, with Dubai serving as the focal point of a rapidly developing economic sector developing regionally along the Hormuz Corridor.

Figure 11: The UAE’s Economic Dependence on Iran from 1971-2000



Parsa and Keivani show how the technological and infrastructural developments have integrated the economies of the northern emirates and those of southern Iran into a cohesive economic

³⁴ Other reports have cited a number closer to 100,000 Iranian expatriates residing in Dubai (Parsa and Keivani, 2002).

entity (Parsa and Keivani, 2002). Thus, over the 25 years that the United States has had sanctions against Iran and even in light of its ongoing territorial dispute and potential military threat, Iran has become one of UAE's largest trading partners and a crucial part of the UAE's economy.

Opportunistic Factors

The case study approach allows for a more nuanced understanding of the role of opportunistic factors involved in the trade between the UAE and Iran. While roughly 1300 km separates the two states capital cities (Tehran and Abu Dhabi),³⁵ only 400 km separates Dubai from Bandar Abbas, Iran's most important international seaport. This places most sea vessels within less than a day's travel between the two ports, while speed boats can make the trip in roughly 4-5 hours. Persian Gulf trade has traditionally been serviced by fleets of small independently owned and operated trading vessels known as dhows. Within Dubai, the trade conducted by these vessels largely goes unregulated, as their trade volumes are dwarfed by the cargo and container ships moving through Jebel Ali and Port Rashid. For smugglers, however, dhows are a perfect mode of transport, as they are so small and numerous. Thus, while the UAE would not register as being contiguous to Iran, few geographic and/or legal barriers impede the flow of trade between Iran and the UAE.

On a much larger scale, the UAE's free trade zones and Dubai's emergence as a regional transshipment hub provide substantial opportunities for sanctions-busters to operate. As the principal transshipment hub for the Middle East, many of the goods passing onto Middle Eastern states from international origins are first sent to Dubai in bulk shipments, whereat the goods are distributed to smaller modes of conveyance for travel to their final destination. Conversely, regional states send smaller shipments of goods to Dubai from which they are transported en

³⁵ The quantitative analysis codes distance between capitals.

masse to other destinations. This means that Dubai sees a substantial amount of traffic pass through its ports that is destined for other locations but could potentially be diverted. The UAE's free zones also allow companies to store their goods free of duties for an extended period of time and allow firms to repackage, reprocess, or modify the goods while in the zones without charge. Sanctions busters operating out of free zones not only get to run their operations duty free, they also benefit from the lax regulatory systems and high volumes of legitimate trade upon which their illicit trade can piggyback (Na'im, 2005). As Scott Jones notes, illicit traffickers use "transit points [such as Dubai] in unsuspecting destinations to conceal the real nature of the transaction. They falsify cargo descriptions, do not enter end-user/user destinations, hide the final destination, use front companies, and try other ruses" (Jones, 2003: 22). In concert with the UAE's lack of an export control law, these conditions serve to make the UAE, and Dubai in particular, ideal places to transit both legitimate and illicit trade through to Iran.

The UAE's Relationship with the United States: Allies with Alibis

Political-Military Relationship

The United States was the third state to officially recognize the UAE after it formed in the aftermath of Great Britain's departure, and, in many ways, has taken on a similar hegemonic role in the Persian Gulf that the British once held. During the 1970s and early 1980s, political relations between the United States and UAE remained rather muted, with the largest point of contention coming over the United States' policies towards Israel and Palestine (al-Hakim, 1989: 80-81). Not until the first Persian Gulf War were there any substantial shifts in the two states' relationship. The UAE was a strong supporter of the US-led effort to liberate Kuwait, agreeing to allow US Naval vessels to dock in Dubai, contributing troops to the Coalition, and footing

\$3.5 billion worth of the bill (Peterson, 2003: 140). After the war, the UAE sought closer military relations with the US—in significant part to balance against Iran’s regional hegemony. In 1994, the US and UAE signed a defense “accord,”³⁶ and initiated further cooperative military arrangements that allowed the US to pre-position troops within the UAE, the use Jebel Ali as a US Navy port of call, and the use Emirati airbases to enforce the “No-Fly Zone” in Iraq (Katzman, 2005: 4). Evidencing the closer cooperation, the UAE shifted from its previous reliance on the British and French for military purchases to become one of the United States’ largest arms customers. From 1997-2000, the UAE bought \$8 billion worth of military hardware from the United States—including the sale of advanced missiles technologies and 80 F-16s (Peterson, 2003: 140). Considering the UAE’s lack of an export control system, the sales were notable because of the inclusion of the sophisticated Advanced Medium Range Air to Air Missile (AMRAAM) system, as the UAE was the first Persian Gulf state to receive the technology (Katzman, 2005). Even as military and diplomatic cooperation increased between the two countries, the UAE diplomatically broke with the United States’ sanctions and containment policies in Iraq in the latter half of the 1990s (Sultan bin Zayed, 2000: 277). The other significant divergence between the UAE and US involved the UAE’s official recognition of the Taliban Government in Afghanistan, being only one of three countries in the world to recognize the regime.

The aftermath of the 9/11 attacks served to strengthen the ties between the UAE and the United States, as the UAE became an important ally for the United States in War on Terrorism and a crucial staging point for the US-led invasion of Iraq in 2003. In light of the UAE’s

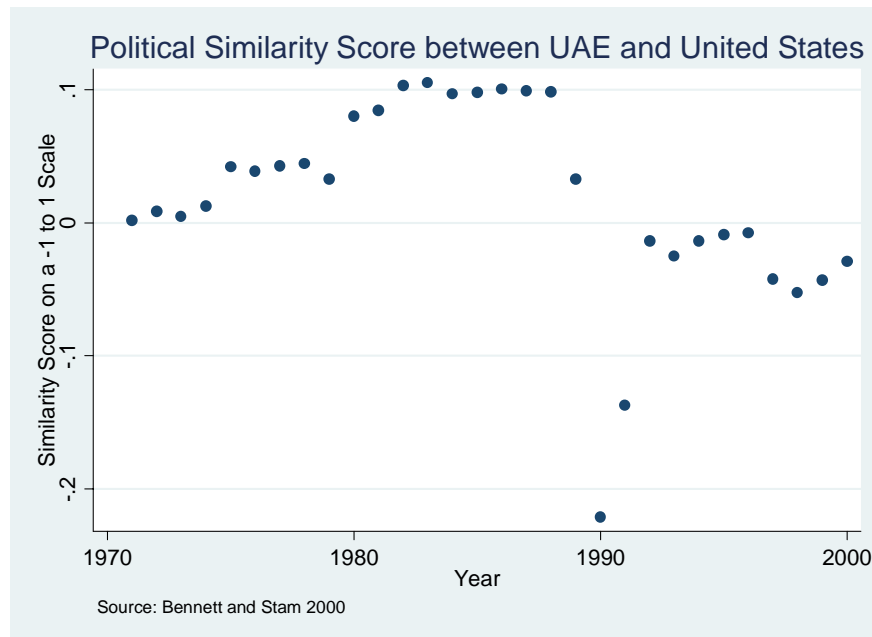
³⁶ This term has been ambiguously used to refer to the defense arrangement between the UAE and US. It has been referred to alternatively as a “Pact,” “Accord,” or “Agreement.” Within the quantitative analysis, the US and UAE are not coded as having a Defense Pact with one another. This most likely stems from the fact that the accord came in the form of an executive agreement and was not formalized into an official treaty.

recognition of the Taliban, evidence that al Qaeda had used UAE financial networks to fund its plots, and revelations that two Emiratis had been 9/11 hijackers, the UAE offered the United States a substantial degree of cooperation to make up for its checkered past (Katzman, 2005: 4). Furthermore, even as the UAE had opposed the United States policies towards Iraq throughout the late 90s, it supported the United States' invasion of Iraq in 2003 to remove Saddam Hussein from power. Indeed, the US State Department, the Pentagon, and even President George W. Bush have all praised the UAE for its significant amount of post-9/11 cooperation and importance as a strategic ally in the Middle East.³⁷

Once again, the quantification of the international interests shared between the UAE and United States only provides a partial account of the on-the-ground reality. While the distribution of similarity scores during the early 1970s and 1980s does accurately depict the two states ambivalence towards one another, the similarity scores during the 1990s did not capture the nuanced relationship between the US and UAE. While the score effectively only varies from .1 to -.2 over the thirty-year time span, a more accurate depiction of the UAE's and United States' similarity of interests would have increased from 1991 onwards, instead of diminishing. Despite the establishment of closer military relations, however, the UAE and US do have distinctly different international outlooks. While both may share an interest in checking the emergence of hegemonic power within the Persian Gulf, their international strategic priorities diverge significantly beyond that point.

³⁷ More recently, the United States' vociferous scuttling of the deal whereby Dubai Ports World, a logistical ports management firm owned by the royal family of Dubai, would have acquired the management rights to six American ports definitely hurt US-UAE relations. It remains to be seen, however, whether or not the political and economic fallout from the debacle will have long-term ramifications.

Figure 12: The Political Similarity Score of the UAE and U.S. from 1971-2000



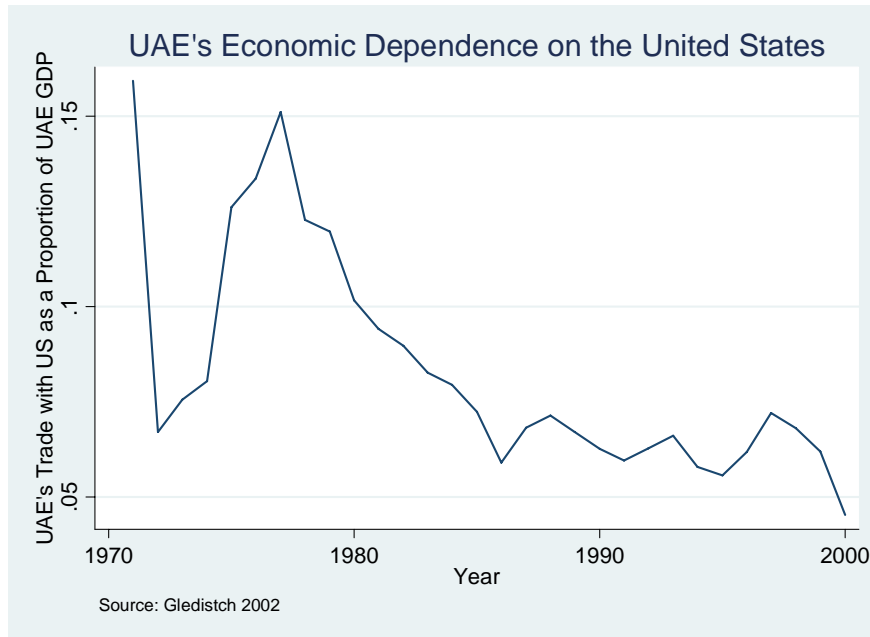
Economic Relationship

The United States and the UAE have enjoyed a mutually beneficial economic relationship, though the United States' has been extremely critical of the UAE with respect to international trade and security issues. In the decade after the UAE's founding, the United States comprised one of the UAE's largest trade partners in terms of imports (al-Alkim, 1989). While the UAE's economic dependence upon the United States has steadily declined, the UAE has continued to remain economically intertwined with the United States for reasons not immediately captured by the quantitative analysis. First, the UAE pegs its national currency, the dirham, to the US dollar. Secondly, oil payments paid in dollars have provided Emirates with vast foreign currency reserves in US dollars that the UAE must either invest or divest itself of (al-Alkim, 1989). Indeed, a substantial portion of the UAE's estimated \$250 billion in overseas investments have been directed towards the United States (Peterson, 2003: 140). As one staffer on the Senate

Banking Committee explained, the extent of United States' balance of payments deficit with the UAE has made the value of dollar vulnerable to the Emiratis' holdings of the currency (Senate Banking Committee, 2006). One of the consequences of the blown Dubai Ports World deal has been the decision of the UAE to divest itself of some of its dollar reserves and could stymie future Emirati investment in the United States. On the other side, Dubai has avidly sought to attract FDI from the United States in the high-tech, service, and financial sectors. Dubai's Internet City Free Zone has already lured a substantial number of high profile MNCs to move operations or establish new ones to the UAE, including: Microsoft, Oracle, Hewlett Packard, Cisco Systems, IBM, Compaq, Sun Microsystems, Visa International, Commerce One, Intel, and MasterCard. Peterson estimates that, as of 2003, the United States had roughly \$500 million invested in the UAE (Peterson, 2003: 140). Additionally, the United States and UAE began negotiating a bilateral Free Trade Agreement in 2004.

Wherein the states' economic interests have diverged has been with respect to the lax regulation of the UAE's commercial sector, which has created numerous security externalities in the eyes of the United States. The failure of the high profile Bank of Credit Commerce International (BCCI) in 1991 revealed the corruption and cronyism that had run rampant within the UAE financial sector (Davidson, 2005: 217-222). The ensuing investigation of the bank's collapse revealed that the BCCI had been involved in numerous money laundering schemes and had been used to finance illicit arms deals and smuggling. While these issues were supposedly redressed in the aftermath of the BCCI scandal, the UAE remained a money laundering haven throughout the 1990s and up until the government crackdown after 9/11.

Figure 13: The UAE's Economic Dependence on the United States from 1971-2000



The UAE's lack of an export control system for sensitive dual-use and military goods and technologies has been another significant issue for the United States. As the next section will detail, Iran has actively used Dubai as a transshipment and/or diversion point to acquire restricted goods and technologies. While transactions that could contribute to an Iranian nuclear weapons program are considered illicit by the United States, such transactions did not violate any Emirati laws. Moving beyond just the UAE's facilitation in Iran's acquisition of strategic goods, the UAE has made a cottage industry out of diverting US-embargoed goods to Iran (Swibel, 2004; Askari et al., 2003). As a notable step towards enhanced bilateral cooperation on trade security issues, Dubai joined onto the United States' Container Security Initiative in 2005—becoming the first Middle Eastern port to do so. While the United States has actively sought to engage the UAE on the development of an export control system, there had been little punitive fallout for its lax system of trade controls until the DP World Case. It remains to be seen

whether the bilateral cooperation on these issues has ultimately been hindered by recent events or will spur improvements in the Emirates' trade control system.

Sanctions-Busting! Profits, Proliferation, and Politics

That the UAE has extensively been involved in busting the American sanctions against Iran has been open knowledge (Swibel, 2004; Milhollin and Motz, 2004; Askari et al., 2003; US Department of Commerce³⁸); however, not until a *series* of high profile cases that involved Dubai in the proliferation of sensitive nuclear technologies did the sanctions busting become a major policy issue for the United States. Matthew Swibel contends that the sanctions busting machine first got started with the initiation of the American embargo against Iranian imports in 1987 and was “a well-greased mechanism” by the time the full sanctions regime came into effect in 1995 (Swibel, 2004). Swibel (2004) contends that roughly a quarter of the United States' exports to Dubai are subsequently re-exported to Iran. Conversely, Askari et al. (2003: 198) posit that roughly a quarter of Iran's exports to Dubai are re-exported to the United States. Thus, Dubai has acted as a revolving door for bilateral transfer of goods between the United States and Iran during the sanctions, helping Iran get access to the goods it has been restricted from obtaining directly from the United States and helping Iran's products find their way to the American marketplace from which it has been denied—all for a price.

Profiteering: The Man in the Middle Makes a Killing

Trade with the Iran has been a lucrative business for both the rulers of Dubai and its business sector. While Dubai's Shaikh Rashid was certainly a visionary in the construction of

³⁸ The author has documented numerous citations by the US Dept. of Commerce's Bureau of Industry and Security of individuals and companies within the United Arab Emirates responsible for export control violations.

the Port of Jebel Ali, it is doubtful he could have foreseen a more fortuitous set of circumstances for the port and free trade zone he authorized and financed. As Barbieri and Levy (1999) demonstrated, conflict can be profitable even for those who are involved in it, but it can be even more so for non-participants willing to exploit the situation. The Iran-Iraq War helped established lucrative smuggling networks radiating out from Dubai during the 1980s, which subsequently shifted their focus to sanctions busting in the aftermath of the war's conclusion. The traditional dhow-based merchant fleet proved particularly adept at smuggling, making up in discretion and stealth what was lost in efficiency.

Figure 14: A Dhow Transferring Cargo Street-Side in Dubai



A dhow motorboat loading up a cargo shipment of flat screen televisions curbside along the banks of the Dubai Creek in Diera, a business district in which many Iranian-owned businesses operate (Bryan Early, 2005).

While proving the extent to which war-time profiteering and sanctions-busting contributed to the commercial growth and success of the Dubai's ports may not be possible, it is almost certain that

the lucrative regional trade opportunities played a key role in luring commerce to one of the world's most volatile regions.

Similarly, accurately estimate the degree to which the United Arab Emirates has profited from sanctions-busting trade with Iran is also difficult. In terms of the costs to legitimate trade flows, Askari et al. estimate that UAE markup charges following the imposition of full spectrum sanctions by the United States in 1995 amounted to: \$5.3 million in 1996, \$20.2 million in 1997, \$18.3 in 1998, and \$12.3 million in 1999 (Askari et al., 2003: 200).³⁹ However, no one can be sure of the unrecorded volumes of illicit smuggling that has occurred over the years. Moreover, while mundane goods may provide the bulk of the bilateral trade going on between the UAE and Iran, trade in sensitive dual-use goods, American-made machine tools and aircraft parts,⁴⁰ and in sophisticated nuclear technologies offered the greatest profitability.

The Lucrative Business of Proliferation

Several of the most high profile and significant proliferation episodes in the modern era have used Dubai as a transshipment point in their transactions. The AQ Khan network used Dubai and SMB Computers, a company based out of the Jebel Ali Free Zone, as its primary transshipment point in its illicit nuclear smuggling network (Salama, 2004). The centrifuge components were to be produced in third countries, sent to Dubai, where they would be repackaged, and then re-routed to their final destinations in Iran and Libya (Albright and Hinderstein, 2005). Indeed, Milhollin and Motz contend Dubai was selected as the key

³⁹ Askari et al. make this calculation by assuming that all post-1995 increases in US-UAE trade were due to product re-exportation to Iran and that UAE middle men charged a 20% markup.

⁴⁰ As proof of the Iran's pressing need for parts and components to its American made equipment, one of Iran's aging fleet of American-built aircraft had a mechanical malfunction and crashed into an apartment building in December of 2005. Reinforcing this connection have been several export control violation cases charged against entities attempting to export aircraft parts/components to Iran (US Department of Commerce).

transshipment point as it “provides companies and governments a vital asset: automatic deniability” (Milhollin and Motz, 2004). The role that Dubai played in such transactions was not that its firms developed any of the sensitive technologies or produced any of the restricted products; rather, the crucial role played by Dubai was as a nebulous commercial destination, wherein a lot of commercial traffic entered, but to where it all subsequently went remained obfuscated.⁴¹ In 2005, Great Britain’s MI5 circulated a document to British businesses that identified the UAE as the preeminent country of concern with regard to the use of front companies (24 are listed) by states such as Iran, Pakistan, and Libya to acquire WMD technologies (Cobain and MacAskill, 2005). The sheer volume of trade going through Dubai and the laissez-faire administration of its free zones served to make it both an attractive destination for legitimate and illicit trade. Indeed, as the UAE has no cooperative agreements with the United States to help enforcement its sanctions against Iran and is not a member of the export control regimes, much of the sanctions-busting trade considered illicit by the United States does not violate any laws within UAE.

Going Bust from Sanctions Busting: Too much of a Good Thing

Once a crucial inertia was reached, Dubai’s sanctions-busting activities may have stopped playing such an important role, as the externalities of the interdependent relationship developed between Iran and the UAE bore fruit in other areas. The common wisdom of sanctions-busting dictates that the sanctioned state avidly seeks to cultivate its contacts with outside trading

⁴¹ While not directly involving Iran, the 2004 Asher Karni case, which involved the transshipment of dual-use medical technologies that could be used as nuclear triggers to Pakistan, via Dubai, also stands as proof of Dubai’s obstinacy in cooperating with international nonproliferation sanctions. In this case, the US had been tipped off about the transactions and had asked Dubai Customs to stop the shipment while it was on the ground at Dubai Airport. The Customs agency refused to cooperate with the request, however, and the shipment went on through to Islamabad (Swibel, 2004).

partners that will help it skirt the sanctions. In Iran's case, however, the country might have actually been too successful. Just as the merchants of Lingua made the savvy move to relocate their business operations to Dubai at the turn of the century when the investment atmosphere soured in Iran, their modern day counterparts have followed suit. Financial analysts have observed that much of the of private wealth withdrawn from the Tehran Stock Exchange since Iranian President Ahmadinejad's election in June of 2005 was reinvested in Dubai ("UAE Stock Exchange Tumbles," 2006). The sheer volume of re-exports from Dubai has led some within Iran to call for a ban on Emirati re-exports, seeing the cheap imports as undercutting domestic development ("Official Against Ban...", 2006). The same article goes on to estimate that over 4,500 Iranian firms are operating out of Dubai, with Iranian nationals contributing roughly 45% of the fixed investments in Dubai. It seems that for Iranians, it is more of a sure thing to invest in and acquire goods from Dubai than it is to do either within their own country.

The UAE's behavior throughout the American-imposed sanctions has been one of opportunistic sanctions busting. The UAE's Government, and in particular the Emirate of Dubai, have created physical and institutional structures highly conducive to the trafficking of goods to Iran. Within Dubai, the loosely regulated free trade zones and traditional merchant marine sector, in concert with strong Iranian expatriate populations, have served to turn the city into the central transshipment hub for goods going into Iran and around the Middle East. This categorization is strengthened further by taking into account the UAE's substantial involvement in helping Iraq bust the American and UN sanctions against it throughout the 1990s.

For Love or Money? The Competing Explanations for Emirati-Iranian Trade

As the research design of the quantitative analysis was constructed to handle a variety of different states, under varying conditions, the present case study cannot be used as a test for all the hypotheses laid out above. Instead, the theoretical value-added from the case study stems from being able to evaluate the validity of the underlying logic of the causal mechanisms assessed in the quantitative analysis. This section thus focuses on assessing the realist, liberal, and opportunistic theories in light of the findings from the case study. Additionally, particular attention will be given to assessing the validity of the untested theoretical assertions involving the logistical capacities of the third party state and the economic relationship it has with target state.

Realist Perspective

The UAE-Iranian case offers insight into the proposed causal relationships between the third party state's political-military relationship with the sender and target states. While the UAE may have more things politically in common with Iran than with the United States regarding its distribution of regional interests, Iran represents the single greatest threat to the UAE's security. Moreover, the UAE has had an ongoing territorial dispute with Iran that in the early 1980s at least tacitly contributed to a military conflict that at the onset the UAE supported in principle. Despite these facts, bilateral trade between the UAE and Iran increased immensely throughout the 1990s—just as Iran's emergence as a hegemonic threat in the Gulf was peaking. Conversely, even as the UAE sought a closer military relationship with the United States to protect itself from the Iranian threat, the UAE's efforts to profit through undermining the American sanctions against Iran took off. Especially remarkable from the United States' side

was its willingness to sell the UAE some of its most sophisticated military technologies, when the UAE had no export controls to protect such technologies and a proven track record of proliferation (Milhollin and Motz, 2004). From the UAE's perspective, even if the state sought to prosper and grow stronger vis-à-vis Iran by making relative gains through trade—it should have sought to restrict the transfer of military and WMD technologies and goods to Iran. While Dubai and the Federal UAE Governments did not deliberately seek to contribute to Iran's nuclear weapons programs or strengthen its military power through trade, both governments were at least complicit in allowing their private sectors to engage in such trade for its profitability. The UAE's policies of trading heavily with its largest rival—even in strategic goods—and undermining its strongest ally's efforts to weaken that rival simply cannot be explained by the realist propositions explored within this piece.

Liberal Perspective

The liberal perspective can provide insight into how the UAE's economic interdependence with both the United States and Iran factored into its behavior, as well as the role played by institutions. The liberal theory premises that high levels of shared information, economic cooperation and trade, and shared identities can mitigate international conflict. Within the relationship between Iran and the UAE, Dubai has played the role of a crucial interlocutor. Dubai's substantial Iranian expatriate community, strong commercial ties to Iran, and position as the second most powerful emirate in the UAE, has allowed it to serve as a bridge joining the two countries' interests. The autonomy granted to individual emirates within the UAE and the fact that Dubai has prospered to such an extent from its sanctions-busting and legitimate trade relations with Iran can explain how friendly commercial cooperation superseded realist-based

security considerations. By investing heavily in its trade infrastructure and opening up its economy to international commerce through free trade zones, Dubai created an economic environment conducive to exactly the kind of free flowing, unrestricted trade ideal for sanctions busting. While during the 1970s Dubai acted independently to pursue better individual relations with Iran, as its commercial and domestic power grew throughout the '80s and '90s and the strength of its relationship with Iran similarly strengthened, Dubai's policies towards Iran became the *de facto* UAE policies towards Iran. Dubai's independent pursuit of such a strong economically interdependent relationship with Iran, which subsequently tied the economic health of the entire state to that relationship, effectively constrained the policies of the UAE Federal Government and emirates such as Ra's al-Khaimah that viewed Iran as more of a threat. Furthermore, Iran's significant amount of direct investment in Dubai and strong economic stake in those investments' success would further serve to allay Emirati fears that Iran would have anything to gain by attacking it.

On the other side, even as the United States' military relationship with the UAE has grown stronger during the 1990s, its economic leverage over the UAE had dramatically declined. While the United States could dangle incentives, such as the sale of sophisticated military technologies to the UAE, the UAE already had plenty of British and French arms suppliers lining up to do business with them.⁴² As well, the United States could have done more to crackdown on the UAE's sanctions busting and export control violations. However, the United States did not want such considerations to jeopardize its military relationship with the UAE, which had become increasingly important to it strategically (Swibel, 2004). Moreover, the UAE's substantial oil reserves, large holdings of US currency, and significant portfolio of overseas

⁴² Indeed, the UAE is host to the Persian Gulf's two largest arms expositions: the Dubai Air Show and Abu Dhabi's IDEX.

financial investments may actually provide it with more economic leverage over the United States, than the United States has over it.

Opportunistic Perspective

On the basis of its geographic proximity to Iran, the physical and logistical trade infrastructures that it built up, and the high profitability of trade with Iran, the UAE has been perfectly situated to become the primary sanctions-buster on Iran's behalf. The short distance separating Dubai and Bandar Abbas, the two countries' busiest ports, imposes negligible transaction costs on bilateral trade. Furthermore, the traditional Persian Gulf dhow-based merchant system facilitates in both the legitimate and illicit traffic goods all along the Gulf Region. On a larger scale, the UAE's free trade zones have opened up the country to substantial foreign direct investment by Iranian firms that have turned Dubai into the primary hub from which to conduct Iran's international commercial transactions. Indeed, sanctions-busting is not just a profitable activity that Emirati merchants conduct on the side—it has been the foundation upon which modern commercial relations between Dubai and Iran has been built.

While the variable trade openness might have been able to capture some of the effects of having a well-developed trade infrastructure, the quantitative analysis did not adequately address the role played by this variable. Sorting out whether Dubai became the focus for so much transshipment trade to Iran because it already had so much other ongoing trade, or whether the opportunities for transshipment trade to Iran had the spillover effects of bringing a lot of other trade with it into Dubai is a difficult quandary. The likely answer is that both factors endogenously fed off one another as Dubai's involvement in international commerce grew. Dubai's ability to incorporate the rapidly increasing amounts of international commerce was

inexorably linked to its construction of its second port at Jebel Ali and the free trade zone-based commercial system that it set up. Having the physical and logistical infrastructure capable of handling the commercial traffic that being a transshipment port entails is a necessary, but not sufficient condition, to becoming one in full. As the quantitative analysis revealed, proximity alone is not a sufficient factor alone to become a major sanctions-buster. So why did the UAE emerge as Iran's primary sanctions-busting partner, instead of Qatar, Bahrain, Oman, or Pakistan? While a confluence of factors contributed to Dubai's ability to capitalize on the economic incentives created by the American sanctions against Iran, the extent of its success in doing so was predicated on the amount of sanctions-busting activities it could handle and the extent to which it could so profitably for both parties. One of the hypotheses that can be drawn from this study that warrants explicit quantitative testing in the future is the extent to which ports categorized as major transshipment centers board are active sanctions-busters.

Summary

In summation, the UAE-Iran sanctions busting case provides support for both the liberal and opportunistic theories, while providing contradictory evidence with respect to realism. In particular, Dubai played a central role in establishing the sanctions busting relationship through its economic openness, strong economic linkages to Iran, geographic proximity, well-developed trade infrastructure, and emergent position as a global commercial transshipment hub. The triadic relationship between the UAE, the United States, and Iran is loaded with security considerations on the part of all parties involved. The United States threatens Iran's security, Iran threatens the UAE's security, and Iran threatens the United States' strategic interests in the Persian Gulf. Within such a potentially risky security environment, overlaid with an active

ongoing economic conflict pursued by the United States against Iran, the sanctions-busting behavior demonstrated by the UAE defies realist-based explanations. Consistent with the findings in the quantitative analysis, the UAE engaged in active sanctions-busting behavior even after it had established a defensive pact with the United States. The conclusion to be drawn about third party behavior from the UAE case with respect to sanctions is that when both the opportunity exists and there are profits to be had, economic considerations take priority over political and security considerations. As one diplomat posted in Dubai aptly put it, "When the times are good in the region, Dubai prospers from trade. When things go bad in the region, everybody pulls there money out of their own countries and invests in Dubai. Thus, the Emiratis prosper in the good times and do even better in the bad times," which defines the very essence of economic opportunism (Interview in Dubai, 2005). While the Federal State worried about the military implications of a hegemonic Iran and pursued an alliance with the United States, Dubai and individual Emirati firms focused solely on pursuing profitable trade with Iran—even when such trade potentially undermined the state's efforts to bolster the UAE's security. This case provides resounding support for theory of economic opportunism and the contention that economic actors drive international trade and are not concerned with such trade's security implications (Li and Sacko, 2002).

Chapter 7: Conclusion

The questions I sought out to answer through this analysis were how do third party states respond to their trading partners being sanctioned and what can account for the variation in their behaviors. The answers to these questions lay at the crossroads of the disciplines involving economic statecraft, international trade, and interstate conflict; yet after arriving at the crossroads, I discovered that the literatures bypassed one another instead of intersecting. Thus, I attempted develop a unified approach to understanding how the findings from the sanctions literatures could be integrated with those of the trade and conflict literatures. I further sought to flesh out the previously under-theorized issue area of third party state behaviors in response to the imposition of sanctions on their peers. In sorting out the causal factors at work in shaping the trading behavior of third party states with sanctioned states, I drew upon liberal, economic, and realist theories of state behavior. Following an under-utilized triadic methodological approach, the preceding analysis used both quantitative and qualitative methodologies to trace out and test which theoretical perspective could provide the most leverage in understanding states' trading behavior when under the shadow of conflict and with competing state relations at stake. Within the context of my findings, the theories of economic opportunism and liberalism were found to provide ample explanatory power and were reinforced with strong evidentiary findings, while realism provided very little insight into understanding states' behavior.

From an academic perspective, taking an integrative approach to the trade and conflict and sanctions literatures provided potentially significant contributions to both disciplines. With regard to the sanctions literature, the use of the established set of hypothesized relationships

regarding trade behavior between allies and rivals provided insight into the most commonly predicated typology of sanctions-busters. While HSE's (1990) black knight has enjoyed an established place within the sanctions literature as the preeminent spoiler, the concept had occupied a conceptually ambiguous position. By nailing down the black knight typology to explicitly political and military motivations and testing the validity of its propositions quantitatively, it was revealed that political and military considerations have very little to do with state sanctions-busting behavior. It was further revealed that the general opportunistic sanctions-busting assumption that has enjoyed "common wisdom" status within the literature may not be so clear-cut. Even if states do not join a sanctions regime, does not mean the sender cannot use other effective means to restrain the behavior of foreign states' private economic actors. The case study analysis of UAE further revealed that some states can have a predisposition towards sanctions-busting based upon their trade infrastructures, institutions, and trade flows.⁴³ Indeed, the above analysis leads to a somewhat surprising prediction as to what types of states are likely to emerge as significant sanctions-busters. The results above indicate that heavily-trading democratic states that are allied with the sanctions sender, have well-developed commercial infrastructures, and are geographically proximate to the sanctioned state are greatest potential sanctions busters.

As well, there was a value-added in expanding the trade and conflict literature's theoretical reach to the study of sanctions in that the present study contributes to the discipline's understanding of the tradeoffs states make between security and prosperity. While various authors have established links between the security perceptions of both individual economic actors (Keshk, Pollins, and Reuveny 2004; Pollins, 1989a & 1989b) and states (Long, 2003;

⁴³ However, the generalizability of the above results is limited in that the only primary sender state examined was the United States.

Gowa and Mansfield, 1993) and their international trading behavior, the present analysis challenges those findings in some regards. This study revealed that under conditions in which states have strong economic incentives to sanctions bust, they are indifferent to the potential security externalities such trade could create. The quantitative analysis found that allies of the sender state were more likely to trade with the sanctioned state than neutral states.

Additionally, the quantitative analysis indicates that when high transaction costs exist that cannot be profitably overcome, allies of sanctioned states are not more likely to come to their assistance than non-allies. Thus, the findings serve to bolster the claims put forth by Barbieri and Levy (1999) and Li and Sacko (2002) that while international trade is affected by the presence of conflict, conflict neither halts nor impedes it when the trade is still profitable.

The substantive significance of these findings can offer several insights to sender states as to where they should invest their efforts towards gaining international cooperation with regard to their sanctions. To begin, sender states should not rely on the support of strategic allies against targets they do not perceive as a threat. Secondly, sender states should pay particular attention to the capabilities of the third party states that are geographically proximate to the target state. In particular, sender states should expect that if they sanction states that are near transshipment hubs, they should expect to face greater levels of sanctions busting from those third parties. The third lesson that can be extrapolated from this analysis is that sender states should use their soft economic power to coerce firms in third party states to comply with the terms of the sanctions even if their home states will not. The ability of the sender state to “coerce” cooperation does not end with the third party state’s decision on whether to join the regime or not; rather, the sender state can effectively take the onus of enforcing compliance of foreign companies into its own hands (Eizenstat, 2004; Rodman, 2001). However, the extent of

the sender states ability to enforce this type of compliance is dependent upon the degree of economic leverage/interconnected with the third party state. The final practical implication of this analysis is that sanction-busting behavior is primarily driven by economic, not political, motives; thus, to the extent that the sender state can make sanctions busting more costly / less profitably, the less likely it will be that sanctions busting behavior will occur.

Further research into this topic would likely yield further interesting results for both the field of trade and conflict and sanctions studies. While this research program would further benefit from more detailed triadic case studies, the first-cut triadic model certainly could be refined and extended to test other variables. Additionally, the sanctions field would especially benefit from the development of different tests, using different methodologies to explain the emergence of sanctions busters. At the cutting edge of this research program would be the development of a model of strategic interaction that could account for both the sender state's and target states' expectations of third party behavior to account for the sender's willingness to impose and maintain sanctions and the target's willingness to endure and/or acquiesce to the sanctions. Ultimately, the response of third party states is one of the preeminent determinants of whether sanctions will succeed or fail. The triadic model delineated here could very well serve as the jumping off point for subsequent studies that can interlink third party behavior with target states' willingness and ability to endure sanctions.

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Appendices

Appendix A: Data for the Gravity Model

The base economic, bilateral trade, and population data used to construct the global gravity model came from Kristian Gleditsch's "Expanded Trade and GDP Data," which contains dyad-specific economic, trade, and demographic data spanning from 1950-2000 (Gleditsch, 2002). The data for the contiguity, distance, and ongoing conflict variables were compiled with the EUGene data editor (Bennett and Stam, 2000). Specifically, the data for contiguity came from the "Correlates of War Project Direct Contiguity Data Version 3" (Stinnett, Tir, Schaefer, Diehl, and Gochman, 2002) and the distance data came from the COW 2 Set. The data for colonial relationships was compiled using Paul Hensel's "ICOW Colonial History Data Set" (Hensel, 1999). While the Gleditsch dataset contains economic information extending to microstates not included within the COW set, the final set included only observations for dyads present within the COW datasets.

Appendix B: Data for Trade Differential Model

Once again, I used Gleditsch's (2002) "Expanded Trade and GDP Data" for the economic and bilateral trade data used in the trade differential. For the political similarity scores, I used Signorino and Ritter (1999) equation calculated by the EUGene data editor (Bennett and Stam, 2000). For the conflict variable, I used Zeev Maoz's Dyadic MID Dataset V. 2.0 (Maoz, 2005). The alliance data came from Douglas Gibler and Meredith Sarkees's "Measuring Alliances: the Correlates of War Formal Interstate Alliance Data set, 1816-2000" (Gibler and Sarkees,

Forthcoming). For the regime data, I used Monty Marshall and Keith Jagers's Polity IVe Data Set that had been formatted for use with the EUGene editor (Marshall and Jagers, 2003). The data for the categorization of the sanctions regimes came from HSE's sanctions case studies (1990) and Caruso's (2003) operationalizations, unless otherwise noted.