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The Effects of Trade Related Sanctions on Russia on Kazakhstan's International Trade in Goods

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Abstract

The aim of this study is to explore the effects of sanctions on the international trade of Kazakhstan using data from TradeMap database. The Russia-Ukraine conflict has brought instability to the broader Eurasian continent and significantly affected neighboring states. Kazakhstan and Russia share the second-longest international land border and both participate in the Eurasian Economic Union with a high level of economic integration. Given Kazakhstan's landlocked status, the country relies on Russian territory for its main export routes. Despite expectations of potential issues with oil and gas transportation for Kazakhstan due to sanctions on Russia, there was an increase in mineral exports from Kazakhstan in 2022, resulting in a positive trade balance. High energy prices and inflation in the EU at the start of the invasion led to the delay of oil and gas import bans by the bloc until late 2022. There is also evidence of sanction evasion by Kazakhstani companies, reflected in changes in the structure of exports to Russia. This has prompted visits by officials from sanctioning countries and increased monitoring. Overall, the conflict and subsequent comprehensive sanctions have created uncertainty for investors and require scenario-based long-term planning and additional compliance costs. It is recommended to improve awareness of local companies about the possibility of violating sanctions through corporate training and cooperation with business associations. This will help local businesses to prevent the risk of being subjected to secondary sanctions.

Keywords: Economy, Sanctions Effect, Eurasian Economic Union, Sanctions Busting, Russia, Ukraine, Trade, International Trade

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1. INTRODUCTION

The Russia-Ukraine conflict and Western sanctions have placed the Kazakh government in a very difficult situation. On one hand, Kazakhstan is a member of the Eurasian Economic Union, sharing the second-longest land border with Russia, which happens to be its largest trade partner and currently under sanctions. On the other hand, Kazakhstan is part of the international community, heavily reliant on investments from and exports to European countries. Public opinion in Kazakhstan favors Ukraine due to its complicated history with the Russian Empire and Soviet past. During the St. Petersburg Economic Forum, President Tokayev, seated next to Putin, openly rejected the idea of recognizing the Donetsk and Luhansk “republics” by Kazakhstan, affirming the country's commitment to a peaceful resolution of the conflict. The Kazakh government is also cooperating with Western countries to prevent the re-export of sanctioned goods to Russia through Kazakhstan, though with limited success.

As members of the Customs Union since 2010 and the Eurasian Economic Union since 2015, Kazakhstan and Russia have eliminated customs borders for trade in goods. However, checkpoints and post-customs mobile monitoring groups remained in place due to a high number of exceptions from the Common External Tariff and concerns about re-export. It's worth noting that until 2022, Russia maintained a more protectionist stance among the EEU members to prevent the re-export of Chinese products through Kazakhstan and Kyrgyzstan, as well as to curb grey imports. However, in March 2022, Russia formally allowed grey imports and liberalized trade with its partners to encourage the re-export of banned goods through the territory of EEU members. This trade policy reversal, prompted by sanctions, has impacted trade flows among EEU members, including Kazakhstan's foreign trade.

The war in Ukraine has also led to disinvestment in the Russian economy, with Western companies closing their Russian branches or selling them to local companies for symbolic sums. Many Russian companies and investors have found it challenging to operate within the jurisdiction of an occupying country and have started relocating to other territories. The Kazakh government has seized this opportunity to attract foreign investment, with the Ministry of Digital Development, Innovations, and Aerospace Industry of the Republic of Kazakhstan being particularly active in this regard.

There are other direct and indirect effects of sanctions on the Kazakh economy, including migration, logistical challenges, and political risks. The influx of Russian youth escaping mobilization has led to skyrocketing rent prices in major cities of neighboring countries. The war and sanctions have disrupted logistics, lengthened trade routes, increased insurance fees, and raised transportation costs. While some companies in Kazakhstan have been able to profit from increased investment and business activity, the overall situation with the war has made it difficult to plan strategically for long-term growth. Though sanction have affected different aspect of Kazakh economy, this article focuses solely on the influence of trade-related sanctions on Kazakhstan's international trade flows.

The main purpose of this article is to explore effect of sanction on international trade of Kazakhstan by comparing trade flows in 2022 with previous year exports and imports.

2. LITERATURE REVIEW

Economic sanctions, frequently used as a tool to exert political pressure or achieve foreign policy objectives, have garnered substantial attention in the fields of international relations and economics. These measures lack universal applicability, with their impact on the economies of targeted nations being the result of a complex interplay of various factors. This literature review aims to discuss the overall effect of sanctions, their impact on international trade, and their consequences on third countries that are neither the senders nor the targets of sanctions. One of the most immediate and conspicuous effects of economic sanctions is the reduction in economic output experienced by the targeted nations. Studies indicate that nations subjected to sanctions typically witness a decline in their Gross National Product (GNP). For instance, sanctions imposed on Iran from 2011 to 2014 caused a 17% decline in the country's GNP (Gharehgozli, 2017). This economic downturn can be attributed to various factors, including trade constraints and financial instability. Such sanctions-induced economic downturns often lead to increased inflation rates and volatile exchange rates (Wang et al., 2019). Furthermore, these adverse impacts extend to the labor market, with unemployment rates tending to rise as a result of sanctions (Hatipoglu & Peksen, 2018). The next subsection delves into the literature regarding the effects of sanctions on international trade.

Sanctions and International Trade

Economic sanctions, in the form of export or import bans, have significant effects on international trade. When sanctions are comprehensive, they lead to a substantial reduction in trade volumes experienced by the sanctioned country due to the disruption of trade networks (Caruso, 2003). In cases of non-comprehensive sanctions, they may lead to an increase in trade opportunities for third-party countries. While sanctions may curtail commerce between the sender country and the targeted nation, international firms can step in to offset the losses through trade with the sanctioned country via its allies to benefit from extra rents (Early, 2009). Thus, economic sanctions can inadvertently redirect trade flows and create opportunities for businesses in third-party countries.

The impact of sanctions extends beyond the confines of the targeted nation and can potentially affect global trade volumes. Calculations by Felbermayr et al. (2019) show a sharp increase in the effect of sanctions on global trade in 2002, estimating its value to be equal to 2 trillion USD. The anticipation of sanctions can divert trade flows before bans are imposed, resulting in trade-related costs. Some case studies show the persistence of negative effects after sanctions are lifted due to "sunk costs" (Özdamar & Shahin, 2021) and the possibility of the sanctioned country's government continuing to protect local producers (Pond, 2017).

Moreover, the ability of each party to reduce expenses while enhancing their capacity to harm the opponent is dictated by their relative strengths in exports and internal production. Sanctions tend to be effective when the imposing country has an edge in products exported to the targeted nation. However, they are prone to failure if the targeted country has a varied range of exports or holds a competitive advantage in its exports (Kavakli et al., 2020)

The sanctions imposed on Russia in response to its full-scale invasion of Ukraine in 2022 had limited effects on Russia's overall GDP and economic growth. The expectations of a plummeting GDP were not realized as Russia continued to export its natural resources, maintained exchange rate stability, and benefited from high prices for commodities and agricultural goods. The trade surplus reached a record 198 billion USD in 2022, thanks to the delay in sanctions, high energy prices, and a decline in Russian imports (Demertzis et al., 2022).

Despite effective management by the Bank of Russia to initially mitigate financial instability and protect the real economy, the broader impact of the sanctions began to manifest. Russia's fiscal revenues started to suffer, and as the sanctions continued to broaden, it became evident that the economy would face significant medium to long-term challenges (Demertzis et al., 2022; Wiśniewska, 2023). The withdrawal of numerous western firms from the Russian market as a result of a 'self-sanctioning' trend had its own set of consequences. This voluntary exodus, coupled with the eventual energy decoupling by the EU and Russia's inability to find equal alternatives, posed a severe threat to the Russian economy, undermining its stability and growth prospects (Wiśniewska, 2023). The estimation of the economic effects of sanctions shows that the most significant negative effect in the coming years is expected from the withdrawal of foreign direct investment (Mahlstein et al., 2022). Finally, a critical consideration is the potential for countersanctions.

Economic sanctions can also have significant effects on third countries, which are countries not directly involved in the imposition of sanctions but have economic ties with the sanctioned country. Some studies suggest that sanctions can create trade opportunities for third countries as they may step in to fill the void left by the sanctioning countries (Early, 2009). Recent studies on sanctions have focused on the effects of sanctions busting (Jeong, 2023; Peterson, 2021; Preble, 2023). For sanctions to achieve political objectives, the sender countries should involve multilateral institutions and signal third countries about the consequences of sanctions busting (Jeong, 2023).

Overall, sanctions tend to decrease trade between the sanctioned country and its partners. Studies of firm behavior show that sanctions lower the probability of companies trading with target countries, though the effects depend on company and market characteristics (Crozet et al., 2021). Third-party states also incur the economic costs of sanctions. These costs can influence sanction costs for senders and targets, depending on these states' actions. When sanctions are imposed through institutions like the UN, which requires the compliance of all member states, countries with close economic ties to the target economy face significant costs (Özdamar & Shahin, 2021). However, if the target country is of high political and economic importance to third countries, alignment with senders' sanctions is less likely.

Economic sanctions imposed on Russia after the occupation of Crimea but before the full-scale invasion in 2022 had limited indirect effects on Kazakhstan. Kazakhstan is not directly involved in the imposition of sanctions but has strong economic ties with Russia. The restrictions had no effect on transportation costs for Kazakh oil and gas, and there was no sanction busting effect for multilateral sanctions. On the other hand, the sanction busting effect was more evident in the case of Russian counter-sanctions, with the possibility of re-export of sanctioned goods via Kazakhstan to European markets (Aituar, 2021). The effects of the 2022-23 multilateral and comprehensive sanctions on Kazakhstan and other members of the Eurasian Economic Union (EEU) require investigation based on emerging trade and other economic data.

3. METHODOLOGY

The main purpose of this article is to explore the effects of sanctions on Russia on the trade patterns of Kazakhstan. This article is based on a descriptive analysis of secondary data. Trade data is obtained from the Trademap database and is based on statistics as reported by Kazakhstan. Information related to sanctions is sourced from the European Commission's official website and US government pages. Sanctions in the form of export bans are categorized based on HS 6 digits, and a more detailed analysis of trade in goods is conducted at this level. The supportive evidence of governments' actions related to sanctions is based on reports from official or established private media outlets. Data on inflation, interest rates, and other macroeconomic indicators is obtained from the National Bank of Kazakhstan.

While previous studies have focused on the effects of sanctions on targeted countries, this study explores their impact on a third country – Kazakhstan, a trading partner of Russia. Sanctions typically affect trade networks by diverting trade flows (Caruso, 2003). Companies in sanctioned countries establish new routes and may cooperate with rent-seeking firms in third countries, potentially leading to sanction-busting. This study investigates trade diversion and possible sanction-busting by examining changes in Kazakhstan's trade flows, with a particular focus on exports to Russia.

First, overall trade data is presented, followed by a discussion of the most significant changes in 2022. As most of the changes were related to Kazakhstan's export structure, a comparison of these changes with Russian imports and the list of sanctions is provided.

4. FINDINGS AND DISCUSSION

For the Kazakh economy, which highly depends on the production and export of mineral products, the biggest challenge was the issue of transportation. More than eighty percent of Kazakh oil is exported through the Caspian Pipeline Corporation's (CPC) pipeline that goes through Russian territory. Although Western countries introduced export and import bans on many goods and sanctioned individuals and companies in Russia, there was little distortion in resource transportation volumes (see Table 1).

TABLE 1. Overall exports and imports of goods (Kazakhstan – World)

Indicator	2020	2021	2022
Exports	46,949,697	60,321,024	84,391,615
Imports	38,081,411	41,415,435	50,043,643
Trade Balance	8,868,286	18,905,589	34,347,972
Note: compiled by author			

Rising energy prices in the EU, combined with Russia's dependence on oil revenues, resulted in a steady flow of oil and gas. Exports of Kazakhstan increased by 39.9% in 2022 compared to the previous year, exceeding eighty-four billion USD. Imports also increased slightly, and the positive trade balance for 2022 exceeded thirty-four billion USD.

The composition of trade partners has not changed significantly in 2022. Figure 1 shows the main trade partners of Kazakhstan and their share in the country's total trade over the last five years.

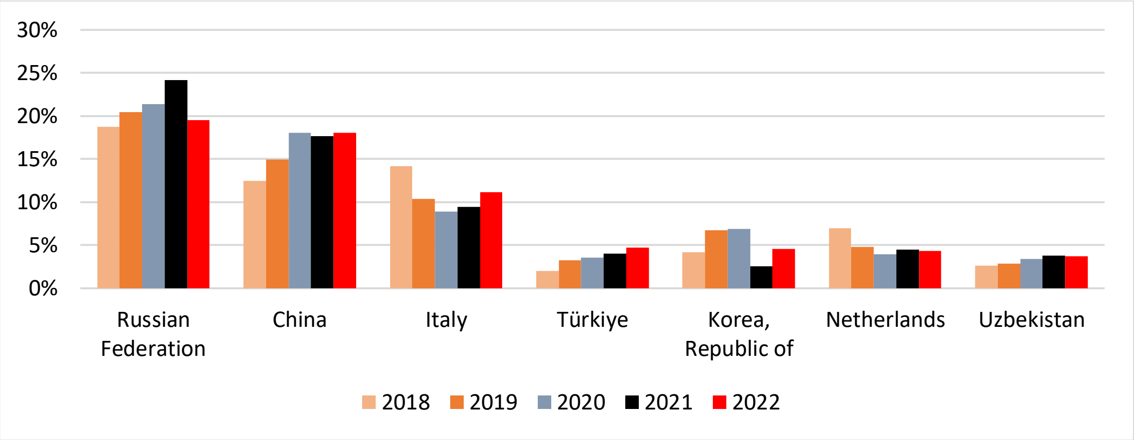

FIGURE 1. Main trade partners of Kazakhstan 2018-2022

Note: compiled by author

Russia still remains the main trade partner of Kazakhstan. However, there is a sharp decline in Russia's share of Kazakhstan's total trade, reversing the trend of recent years. China is moving towards becoming the main trade partner, and Uzbekistan's share has been increasing.

The structure of exports mostly remained the same with a dominance of mineral products (see Table 2, which covers around 95% of Kazakhstan's exports).

TABLE 2. Main exports categories (Kazakhstan to World)

Code	Product label	2020	2021	2022	Increase in 2022 (value)	Increase (compared to 2021)
'TOTAL	All products	46,949,697	60,321,024	84,391,615	24,070,591	39.9%
'27	Mineral fuels, mineral oils and products of their distillation; bituminous substances; mineral	27,329,211	34,820,911	51,803,184	16,982,273	48.8%
'72	Iron and steel	3,175,924	4,973,319	5,561,961	588,642	11.8%
'26	Ores, slag and ash	3,141,746	4,195,622	4,243,169	47,547	1.1%
'74	Copper and articles thereof	2,792,950	3,392,545	3,821,047	428,502	12.6%
'28	Inorganic chemicals; organic or inorganic compounds of precious metals of rare-earth metals	2,339,269	2,511,508	3,584,600	1,073,092	42.7%
'10	Cereals	1,363,252	1,659,902	2,225,869	565,967	34.1%
'85	Electrical machinery and equipment and parts thereof; sound recorders and reproducers, television	185,840	664,605	1,639,590	974,985	146.7%
'84	Nuclear reactors, boilers, machinery and mechanical appliances; parts thereof	317,670	609,035	1,275,762	666,727	109.5%
'25	Salt; sulphur; earths and stone; plastering materials, lime and cement	456,580	743,101	1,169,847	426,746	57.4%
'79	Zinc and articles thereof	620,901	735,418	834,451	99,033	13.5%
'76	Aluminum and articles thereof	522,908	779,960	825,877	45,917	5.9%
'11	Products of the milling industry; malt; starches; inulin; wheat gluten	516,353	492,572	820,776	328,204	66.6%
'71	Natural or cultured pearls, precious or semi-precious stones, precious metals, metals clad	698,895	858,918	788,397	(70,521)	-8.2%
'12	Oil seeds and oleaginous fruits; miscellaneous grains, seeds and fruit; industrial or medicinal	358,360	382,778	639,275	256,497	67.0%
'15	Animal, vegetable or microbial fats and oils and their cleavage products; prepared edible fats	200,166	216,692	531,611	314,919	145.3%
'87	Vehicles other than railway or tramway rolling stock, and parts and accessories thereof	203836	310491	490865	180,374	58.1%

Note: compiled by author

However, there was a significant increase in exports of items under categories such as Electrical machinery and equipment (HS code 85), Nuclear reactors, boilers, machinery (HS code 84), and Vehicles other than tramway (HS code 87). The increase in exports of mineral and agricultural products produced in Kazakhstan is logical due to drastic price hikes amid the war in Ukraine. However, the significant increase in exports of electrical equipment and machinery has already attracted the attention of officials in the EU and the US, as many items in categories with HS codes 84, 85, and 87 are subject to export bans as part of sanctions imposed on Russia (Global Trade Alert, 2023; Implementation of Additional Sanctions Against Russia and Belarus Under the Export Administration Regulations (EAR), and Refinements to Existing Controls, 2023; EU Sanctions, 2023).

Figure 2 shows the categories in Russian imports that exhibited the most notable decrease in 2022.

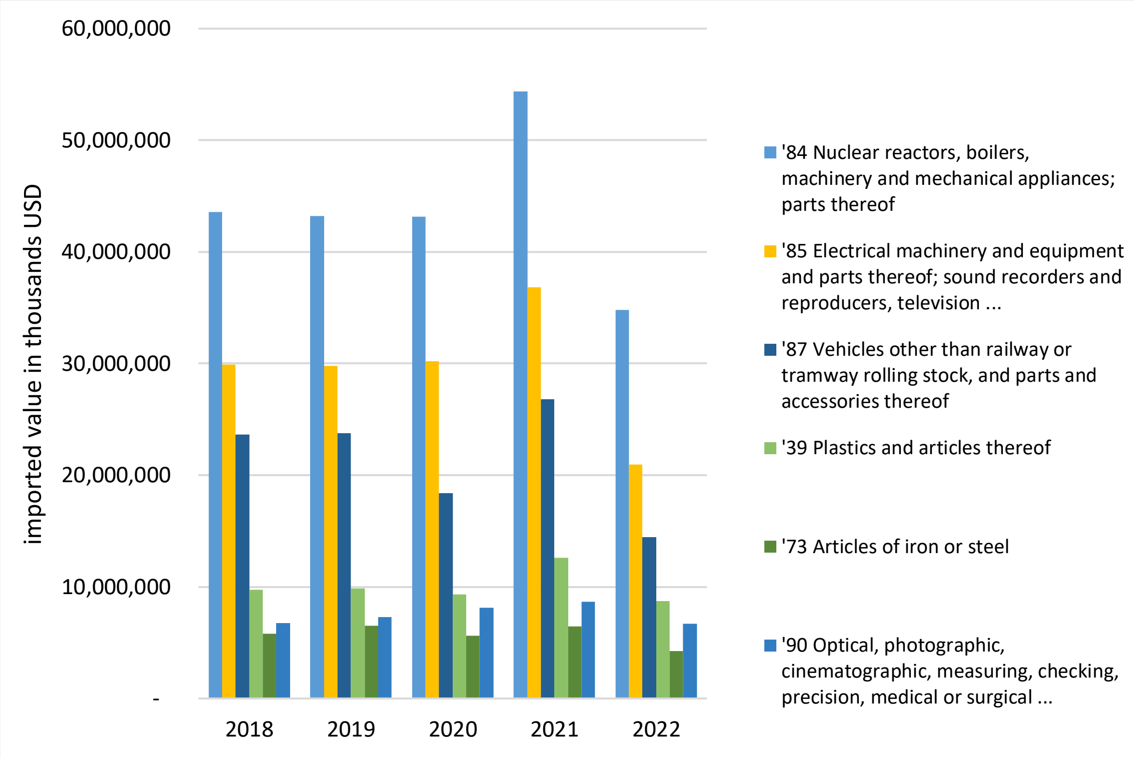

FIGURE 2. Import categories with most significant drop in volume (Russia's imports from World)

Note: compiled by author

The sanctions affected Russia's imports, which decreased from 293.5 billion USD in 2021 to 194.4 billion USD in 2022. When compared to the sanction's lists issued by the EU Commission and the US government, the imports in categories 39, 40, 73, 84, 85, 87, and 90 (HS 2-digit classification) declined by 50.8 billion USD. Although the decline was quite significant, Russia continued importing goods in these categories. Firstly, not all goods in these categories are under sanctions, and some subcategories allow for export (sanction lists are mostly published based on 6-digit HS codes). Secondly, Russia was able to import some sanctioned goods through countries that haven't imposed any sanctions, including trade partners like Kazakhstan.

Given the recent focus of Western countries on monitoring the implementation of sanctions, there is a growing risk of secondary sanctions for countries and individual companies in case of non-compliance. Table 3 shows Kazakhstan's exports to the Russian Federation. We have listed the first ten categories that showed the highest increase in value in 2022 compared to the previous year. These categories correspond to those in Figure 1, and many items within these categories are under sanctions. We used the term 'Risk of sanctioned items' because not all items under the two-digit categories are on the export ban list, and for detailed analysis, six-digit HS codes should be used. Moreover, the sanctions were imposed at different times throughout 2022 and 2023, and some sanctioned goods were exported before the export bans were put in place. For certain goods on the export ban lists, there is a process of certification rather than a complete ban.

Therefore, the data in Table 3 should be treated with caution and should not lead to the conclusion that all of the goods indicated there were in violation of the sanctions regime or part of sanctions busting.

TABLE 3. Kazakhstan exports to Russian Federation (Categories with highest increase in value in 2022)

Code	Product label	Value in 2020	Value in 2021	Value in 2022	Increase in 2022 (value)	Increase (compared to 2021)	Risk of sanctioned items
'84	Nuclear reactors, boilers, machinery and mechanical appliances; parts thereof	108536	128161	837326	709165	553%	Yes
'85	Electrical machinery and equipment and parts thereof; sound recorders and reproducers, television	91715	122867	827400	704533	573%	Yes
'28	Inorganic chemicals; organic or inorganic compounds of precious metals of rare-earth metals	610452	704193	1368440	664247	94%	Yes
'25	Salt; sulphur; earths and stone; plastering materials, lime and cement	102641	169651	285069	115418	68%	Yes
'87	Vehicles other than railway or tramway rolling stock, and parts and accessories thereof	49874	88803	199043	110240	124%	Yes
'79	Zinc and articles thereof	84226	149361	228201	78840	53%	Yes
'90	Optical, photographic, cinematographic, measuring, checking, precision, medical or surgical	6163	19036	92411	73375	385%	Yes
'39	Plastics and articles thereof	72833	112896	182066	69170	61%	Yes
'71	Natural or cultured pearls, precious or semi-precious stones, precious metals, metals clad	932	3426	65047	61621	1799%	Yes
'38	Miscellaneous chemical products	22283	16975	76874	59899	353%	Yes
Note: compiled by author							

More detailed evaluation of exports of sanctioned goods to Russia was done using 6-digit HS codes. It should be noted that some share of values exported to Russia might have taken place before the sanction were imposed. Table 4 displays sanctioned items under category 85 - 'Electrical machinery and equipment and parts thereof...' along with the values of exports from Kazakhstan to Russia in the last three years. Only goods with changes in export values exceeding ten million USD in 2022 are provided, as the list is lengthy. It should be noted that the increase in exports of these goods from Kazakhstan to Russia coincides with an increase in imports of them to Kazakhstan from the rest of the world, which hints at possible re-exports. This data is publicly available and is subject to scrutiny by Western partners of Kazakhstan and other Central Asian nations. Kazakhstan has already taken action to monitor and prevent the re-export of sanctioned goods to Russia. However, more specific measures are yet to be clarified and fine-tuned in order to take effect.

TABLE 4. The exports of items under sanctions in category 85

Product code	Product label	2020	2021	2022	Change in 2022
852872	Reception apparatus for television, colour, whether or not incorporating radio-broadcast receivers	609	7	151591	151584
851713	Smartphones for wireless networks	0	0	142670	142670
851762	Machines for the reception, conversion and transmission or regeneration of voice, images	3068	1933	39501	37568
852852	Monitors capable of directly connecting to and designed for use with an automatic data processing	12	20	29491	29471
850819	Vacuum cleaners, incl. dry cleaners and wet vacuum cleaners, with self-contained electric motor	0	0	24351	24351
852859	Monitors (excl. with TV receiver, CRT and those designed for computer use)	318	309	11249	10940
851650	Microwave ovens	0	0	10928	10928
852869	Projectors (excl. with TV receiver, designed for computer use)	4	20	10620	10600

Note: compiled by author

It is expected that Western countries will prioritize compliance with existing sanctions rather than increasing the number of sanctioned items, as evident in the 11th sanctions package introduced by the EU. This package is more restrictive regarding the transit of goods through Russian territory and provides mechanisms for the implementation of secondary sanctions. The transit of goods is targeted due to the possibility of sanctioned items from the EU to Central Asian countries being unloaded on Russian territory before reaching their final destination, with fake reporting. The secondary sanctions aim to prevent re-exports by targeting specific companies. Overall, companies tend to comply with comprehensive sanctions, as shown in previous research (Crozet et al., 2021). In the case of sanctions on Russia, they are imposed by the major trade partners of Kazakhstan. However, branches or affiliates of Russian companies relying on sanctioned products might continue to circumvent sanctions. This will increase monitoring costs for Kazakhstan and other EAEU member states' governments.

5. CONCLUSIONS

The first months of the conflict resulted in significant logistical issues that were later resolved, albeit with an increase in transportation costs. The fears of tenge devaluation in early 2022 did not materialize due to the growth in exports from Kazakhstan, which increased the supply of foreign currency, and capital controls in Russia prevented a surge in demand for USD and Euro that would have affected the tenge's value. The rise in transportation costs, mass exodus of Russian citizens avoiding mobilization to neighboring countries, including Kazakhstan, and other factors led to a 20.3% inflation rate in 2022. The National Bank of Kazakhstan relied on monetary measures to combat inflation, and the base rate increased from 10.25 in January to 16 by October 2022. Although it had some limited impact on controlling inflation, the high base rate negatively affects economic activity. The effects of the aforementioned factors are yet to be fully identified, and in this article, we focused solely on the trade in goods.

Overall, there were no drastic changes in Kazakhstan's top trade partner portfolio and trade volumes. The total export value increased despite transportation issues, leading to a rise in the positive trade balance. Major changes were observed in trade structure, with booming exports in certain categories, including electrical equipment and machinery. Most of the exports of electrical equipment and machinery went to Russia, and this trend has attracted the attention of Western partners of Kazakhstan, who suspected sanctions busting. Although some firms received short-term benefits from re-exports, overall, the war and subsequent sanctions have created significant challenges for Kazakhstani companies.

Further shifts in Russia towards a wartime economy and a decrease in industrial output for export purposes will diminish Russia's role in Kazakhstan's economy as the main trade partner. Given that most of the investment in Kazakhstan flows from Western countries and most of the oil is exported to EU countries, the Kazakh government will introduce further measures to comply with sanctions against Russia. It is expected that costs related to compliance with the sanctions regime will rise, and companies will need more experts in this field. Several universities in Kazakhstan have already started cooperation with European partners to establish programs or minors related to Strategic Trade Control (STC). The term STC was mainly used for controlling dual-use products and technology related to nuclear, chemical, and biological weapons. However, the war in Ukraine, with the use of drones and high-precision equipment, broadens the definition of dual-use products, as parts of electrical equipment and machinery can be used for military purposes.

Apart from logistics issues and compliance-related costs, there is a problem of uncertainty. It is more difficult for companies to plan and invest in a turbulent environment amid increasing transportation and insurance costs. To adapt, companies and state institutions need to invest in foresight scenario-based planning to navigate the uncertain future in the region. Even if we consider the most optimistic scenario, where Russia withdraws troops from Ukraine, sanctions against Russia, particularly on dual-use products that can be used to develop advanced weapons and military technology, are highly likely to remain in place for decades. Kazakhstan is still subject to trade limitations with the US due to the Jackson-Vanik amendment adopted in 1974, although this amendment no longer applies to Russia. Therefore, policymakers and companies in Kazakhstan should develop long-term strategies to mitigate adverse effects and avoid future risks.

It is recommended to increase awareness about the risk of sanction-busting for local companies through corporate training and business associations. This will help local companies avoid secondary sanctions. Universities can also contribute by offering courses to students, as part of lifelong learning or extension programs, aimed at training specialists in risk management, compliance, and strategic trade control. To prevent country-level sanctions, the government may enhance monitoring of trade in goods on the sanctions list. However, such monitoring should not significantly increase the cost of doing business for firms already struggling with plummeting logistics and compliance costs.

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