



Bachelor Thesis

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Abstract

Sanctions have always been a popular tool of foreign policy, capable of bringing about a desirable change in the behaviour of the country accused of violating a treaty or international law. Among all the existing types of sanctions, economic restrictive measures gained in importance in recent years, which led to their frequent use on a global scale. Although quite effective, economic sanctions often fail to achieve their goals, while leaving tremendous costs for both the states engaged into the conflict as well as their allies. These diplomatic and economic costs entail an overall deterioration of long-standing relationships of the involved parties, thus contributing to their isolation. All this leads to negative consequences for international trade, which is considered to be a driver of growth, economic prosperity and development. In its turn, foreign commercial activity is highly dependent on the provision of financial resources necessary for the conduction of trade transactions. Consequently, economic sanctions have tremendous costs for international trade in general and for trade finance operations in particular. This was the case with the Russian Federation, which was targeted by the Western sanctions regimes aimed at changing Russia's attitude towards the Ukrainian crisis. Thus, a rather underdeveloped financial system of the Russian Federation affected by the worsening macroeconomic factors and the decline in Russia's foreign trade was not able to meet a demand for trade finance, which only increased in times of sanctions. Nowadays, historically dominated by Western trade financiers, the Russian market finds itself in the situation, where Western financial institutions are keen on freezing or reducing their exposure to Russia. Given to these tendencies, Russia strives to establish new partnerships, especially with Asian countries, in order to attract sufficient sources of trade and foreign investment. At the same time, in the current geopolitical context, Russian financial institutions get a chance to increase their competitiveness in terms of providing trade finance instruments to the local market, building their strategies on such strengths as existing customer relationships, domestic market knowledge, and tolerance of political risk. This can give an impetus to an overdue development and improvement of trade finance operations in the Russian Federation.

Key words: Sanctions, foreign policy, international trade, trade finance, Russia's economy

JEL classification: F 51, G 21, G 22, P 45

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List of abbreviations

BAFA – Bundesamt für Wirtschaft und Ausfuhrkontrolle (*engl.* Federal Office of Economics and Export Control)

CIS – Commonwealth of Independent States

EBRD – European Bank for Reconstruction and Development

ECA – Export Credit Agency

EXIAR – Export Insurance Agency of Russia

EIB – European Investment Bank

ICC – International Chamber of Commerce

IFI – International Financial Institution

IMF – International Monetary Fund

INCOTERMS – International Commercial Terms

ISIS – Islamic State in Iraq and Syria

L/C – Letter of Credit

MOU – Memorandum of Understanding

OECD – Organisation for Economic Co-operation and Development

S&P – Standard & Poor's

SME – Small and Medium-sized Enterprises

SPV – Special Purpose Vehicle

UCP – Uniform Customs and Practice for Documentary Credits

VEB – Vnesheconombank

VTB – Vneshtorgbank

WTO – World Trade Organisation

1 Introduction

1.1 Research problem

The semantic range of the term “sanction” is very wide and varies from denoting an act of approval up to identification of an act of disagreement. Used in the context of international law, this concept denotes a punitive act taken by one state against another state that has disregarded a treaty or international law, aimed at bringing the latter into compliance with expected rules of conduct. Similarly to the semantic nature of this term, there are different approaches to the study of sanction typology, among which categorisation into diplomatic, financial, trade, and smart sanctions can be frequently found. Economic sanctions became a very popular instrument of foreign policy in recent years, which on the one hand, is capable of bringing about a desired policy change in the behaviour of a renegade state, but on the other hand, leaves tremendous costs for all the parties directly or indirectly involved into the conflict.

International trade, being a driver of economic growth and prosperity on the one hand, and a risky and costly activity on the other hand, is supported by some forms of financing, which can be all combined under the general term of “Trade Finance.” These modes of financing are represented by long-established products, capable of providing exporters and importers with necessary financial resources and contributing to the reduction of risks, which both parties can face while being engaged in commercial activities. Traditionally, all the existing modes of financing trade transactions can be subdivided into three principal groups: short-term, medium-term and long-term financing. The general principles and regulations of conducting these transactions were laid down by the International Chamber of Commerce and since then are subject to periodic revision. Wide acceptance and common use of these rules guarantee high effectiveness of trade finance instruments, which contribute to the effective conduction of international trade in their turn.

Recent events in Ukraine triggered an imposition of sanctions regimes against Russia on the part of Western countries and a subsequent implementation of a counter-sanction strategy on the part of the Russian Federation, leading to the situation, in which all the engaged states suffer under the negative consequences of these policies. Under these circumstances, heavy costs were imposed on Russia’s foreign trade with an ultimate adverse impact on its trade finance operations.

This research paper aims to analyse how Western sanctions against Russia have influenced trade finance operations in the Russian Federation. Therefore, the focus will lie on the investigation of fundamentals of a sanction theory as well as on the analysis of sanctions and counter-sanctions regimes imposed by the West and Russia. Furthermore, an overview of trade finance practices and instruments used for assistance of international trade will be made. Finally, costs of the imposed sanctions and their impact on trade finance operations in the Russian Federation will be highlighted.

1.2 Course of investigation

This research paper gives an overview of the events preceding and following the introduction of Western sanctions against Russia and a brief account of existing trade finance practices as well as an analysis of the impact of the former on the latter in the Russian Federation. Since an investigation of the correlation between these concepts was required, the research methods of descriptive, historical and correlation analysis were applied for this purpose.

Based upon the research question that has been postulated in chapter 1.1 an overall review of background information in respect to the imposition of Western sanctions and Russia's counter-actions will be provided in chapter 2. A general understanding of sanctions within the context of recent trends in world politics will be given in chapter 2.1. The sanctions policies and events preceding the imposition of sanctions regimes will be depicted in chapter 2.2. Special importance will be brought to the political background of the conflict between Russia and the West in chapter 2.2.1 with an emphasis on the sanctioners' actions against Russia in chapter 2.2.2 as well as a focus on the sanctioned party's counter-actions in chapter 2.2.3. The prospects of Western sanctions success in the form of a SWOT analysis will be highlighted in chapter 2.3.

Thereafter, trade finance and its characteristics in the context of international trade will be addressed in chapter 3. While theoretical fundamentals of trade finance will be summarised in chapter 3.1, typical practices and products of trade finance will be presented in chapter 3.2. Special attention will be paid to providers of trade finance in chapter 3.3, emphasising the role of such trade financiers as commercial banks in chapter 3.3.1 and export credit agencies in chapter 3.3.2.

Furthermore, an overview of the impact of Western sanctions on trade finance in Russia will be given in chapter 4. Initially, trends and challenges in the pre-sanctions era in this area of business will be touched upon in chapter 4.1. Post-sanctions state of affairs and prospects for the future will be addressed later in chapter 4.2. Finally, interviews with two experts in Trade Finance and Export Credit Insurance will be provided in chapter 4.3, revealing a state of mind of the Global Trade Finance Senior Manager at HSH Nordbank AG in chapter 4.3.1 and a stance of the Head of Unit Russia/CIS at Euler Hermes AG in chapter 4.3.2.

2 Western sanctions against Russia and Russia's counter-actions

2.1 Definition of sanctions

Sanction is a broad term that possesses various meanings, when used in different contexts. Thus, the semantic range of this word is wide and the range of its meanings vary from denoting a tacit or an explicit approval up to describing an act of disagreement or condemnation. (West's Encyclopedia of American Law, edition 2, 2008) When this term is used in the context of international law, it means "a punitive act taken by one nation against another nation that has violated a treaty or international law... International sanctions are measures that are designed to bring a delinquent or renegade state into compliance with expected rules of conduct." (ibid.)

As with the absence of consensus about the definition of the term "sanction", there is no unanimous approach to the study of sanction typology. Nevertheless, the following broad categorisation can be found in the literature devoted to this topic:

- *Diplomatic sanctions*: revoking an ambassador as well as suspension of international negotiations
- *Financial sanctions*: investment restrictions, lending freeze on the part of international organizations (World Bank, IMF) and freezing of assets as well as termination of development assistance
- *Trade restrictions*: trade embargoes and import/export bans
- *Smart sanctions*: restrictions on travel against concrete people, groups of people or organisations as well as freezing of their assets. (Kholodilin, et al., 2014, p. 3)

Of all the foreign policy instruments, economic sanction regimes have become most popular and therefore they have been used on a frequent basis in recent years. Since the end of the Cold War, a number of numerous economic sanction strategies has emerged in large part due to the decisions made by the United Nations. The Security Council has acted under Chapter Seven nine times since the fall of the Berlin Wall to call mandatory economic sanction programs into existence. (Reisman, 2009, p. 12) Among all the countries in the world, the United States of America is a leader of using economic sanctions as a policy instrument. (Early, 2015, p. 5)

The following sanctions terminology is used for identifying key concepts in the theory of economic sanctions:

- *Sender* – an initiator of sanctions placed on the target. Any country, any uncoordinated group of states or any coordinated group of countries, any international organisation or a mixture of all these parties can act as a sender.
- *Target* – an entity, against which sanctions are imposed.
- *Economic sanctions* – restrictions that policy makers place on commercial relations with foreign countries, firms or individuals in order to force a change in their behaviour.
- *Targeted sanctions* – ones that focus on certain individuals, groups or economic sectors (in contrast to broad or comprehensive sanctions).
- *Sanctions success* – an observed improvement in the policy behaviour of a target, which was desired by a sender, who imposed a sanctions regime against the targeted entity.
- *Sanction costs* – burdens accrued by the target as a negative effect of imposed sanctions. (Oxenstierna & Olsson, 2015, pp. 22-23)

The information provided by academic and policy circles has an evidence of a poor performance of economic sanctions. Thus, a statistical analysis conducted to measure a sanctions success has a relatively insufficient record of a favourable outcome: just 23% – 34% of all the cases of imposing economic sanctions achieved their goals. Very often economic sanctions are treated as a low-cost alternative to the military force. At the same time, recent findings have shown that governments targeted by the sanctions are inclined to an increased repressiveness and the citizens, living in the states against which sanctions are imposed, suffer more misery and impoverishment. Therefore,

human costs of sanctioning efforts are tremendous and a record of human rights can worsen even though sanctioning efforts fail to achieve the intended goals. Moreover, negative effects of economic sanctions can spill over to the third-party countries, thus having disruptive impacts on senders and targets as well as on the targets` trading partners. Consequently, finding ways of mitigating the harms caused by economic sanctions should be a common goal for all the involved parties. (Early, 2015, pp. 5-8)

2.2 The sanctions policies and their background

2.2.1 The political background of the conflict between Russia and the West

„The Ukraine crisis has caused the biggest rift between Russia and the West since the end of the Cold War.” (Sanberk, 2015) As is well known, the last straw that started a social unrest in Ukraine and triggered a still ongoing crisis in this country was the decision of Ukraine's ex-President Viktor Yanukovich not to sign an agreement with the European Union in November 2013. Instead, he signed an agreement with Russia for a bail-out loan of 15 billion US dollars in December 2013. (Oxenstierna & Olsson, 2015, p. 14)The climax in the political crisis in Ukraine, which at the same time was a tipping point in the conflict between the West and Russia over Ukraine, was a massacre of almost 50 Maidan protesters on February 20, 2014. This mass killing of the protesters resulted in the abolition of the pro-Russian government of Viktor Yanukovich and provoked a civil war in Eastern Ukraine, triggered Russia’s military intervention in Crimea and Donbas, and escalated the international conflict between the West and Russia over Ukraine, which led to the imposition of sanctions on the Russian Federation. (Katchanovski, 2015, p. 2) The overall results of the Ukraine crisis are as follows: thousands of deaths, billions of dollars of devastation, an enhanced risk of military conflict between NATO and Russia, increased geopolitical and geo-economic divisions, and a ruined international partnership against common threats such as ISIS in the Middle East. (Sanberk, 2015)

There is a number of events that are regarded as official reasons for imposing sanctions against Russia. Among them is an opinion that Crimean referendum was not legitimate, a view that Russia’s annexation of Crimea was illegal as well as a vision that Russia continued to disregard Ukrainian sovereignty and assist the pro-Russian separatists. Although these events were the main triggers for the decision of the West

to employ sanctions regimes against Russia, there is also an issue of a deep disagreement over the post-Cold War security order in Europe, which lies beyond the scope of this work. (Oxenstierna & Olsson, 2015, p. 15)

Despite all the negotiations and diplomatic efforts that Russia and the West have held and undertook in order to resolve the Ukraine crisis and make sure that it does not convert into a larger and more dangerous war, two sides are still far from any serious resolution. It worth noting that there are important economic links between Russia and the West, which make a diplomatic resolution to the crisis possible and desirable. However, this implies certain levels of understanding and compromise from the West and Russia and neither side has been willing to show them yet. Currently, both Russia and the West continue to increase military posturing and weapons buildups, which only contributes to the further isolation. (Stratfor Global Intelligence, 2015)

2.2.2 Western sanctions against Russia

Sanctions regimes employed by the West in respect to Russia can be differentiated into the EU and the USA sanctions policies. Both regimes will be subjects for further investigation in the current chapter.

In response to Russia's military intervention in Crimea and annexation of the Crimean peninsula as a result in March 2014, the EU, which did not and still does not recognize this absorption, has imposed sanctions against the Russian Federation in three subsequent stages, which have been revised in the course of time. (Dolidze, 2015, p. 1) Thus, the European Council introduced the first diplomatic measures as a reaction to Russian operations in Ukraine and started to elaborate on further restrictive measures, which were to come in force, providing that Russia would not succeed in employing de-escalatory steps towards conflict resolution and so would further contribute to the destabilisation of the situation in Ukraine. This package of new restraints, which included the first travel bans and asset freezes against persons involved in supporting the absorption of the Crimean peninsula, came into force on 17 March 2014. Then, regarding Russia's actions as contributing to the escalation of the conflict in Eastern Ukraine, the EU introduced economic sanctions in July 2014, which were reinforced later on in September 2014. The European Council linked the prolongation of these economic sanctions to the issue of a full-scale implementation of

the Minsk agreements in March 2015. Given that these Minsk agreements were not completely implemented by 31 December 2015, the European Council has extended the duration of all sanctions until 31 January 2016. (European Union Newsroom, 2015)

The EU sanctions regime against Russia was enhanced by moving from the individual level to the sectoral one and at present has the following targets:

- persons and private entities, who contributed to the escalation of the Ukrainian crisis by applying visa bans and freezing of their assets;
- capital markets via prohibiting long-term EU loans for five major state-owned Russian banks (Sberbank, Vneshtorgbank (VTB), Gazprombank, Vnesheconombank (VEB) and Rosselkhozbank);
- the energy sector represented by three major Russian energy companies (Rosneft, Transneft and Gazprom Neft) through imposing bans on buying from or selling to them new bonds, equity or similar financial instruments with a maturity exceeding 30 days as well as by applying some restrictions on exports of certain energy-related equipment and technology to Russia;
- the defence sector via prohibiting long-term EU loans for three major Russian defence companies as well as by imposing embargo on the import/export of arms and related material from/to Russia and by banning exports of dual-use goods and technology for military use in Russia or to Russian military end-users and nine mixed technology manufacturers. (Cf. Dolidze, 2015, p. 1; European Union Newsroom, 2015; Germany Trade & Invest, 06/2015)

Although, sanctions have become a common instrument of the EU foreign policy in recent years, the sanctions regime against Russia can be regarded as an unprecedented case in respect to the sanctions targets and their scope. (Fischer, 2015, p. 1)

The US sanctions regime against Russia is based on the implementation of three subsequent presidential executive orders. The first round of sanctions, Executive Order 13660, was signed by President Barack Obama on 6 March 2014 and was aimed at targeting pro-Russian separatists. The second round of sanctions, Executive Order 13661, was announced on 17 March 2014 in response to Russia's annexation of Crimea and as a reaction to the beginning civil war in Eastern Ukraine. These sanctions were directed at seven Russian officials for their engagement in setting Russia's policy

in Ukraine. This wave of sanctions gave rise to broader restrictive measures, which led to the freezing of assets of Russian defence companies as well as of close business partners of Russian President Vladimir Putin. Three days after that, 16 Russian government officials, four prominent pro-Kremlin Russian oligarchs as well as Bank Rossiya also became targets of asset freezing process. In the meanwhile, the US administration started to elaborate more aggressive measures aimed at Russia's key economic sectors. Consequently, Executive Order 13662, directed at sanctioning Russian energy, banking, mining, and other sectors, was issued on 20 March 2014. (Cf. Harrell, 2015, p. 2; Oxenstierna & Olsson, 2015, p. 18)

The US sanctions regime against Russia is very similar to that of the EU and it includes such restrictive measures as:

- asset freezing of certain persons and prohibiting USA individuals and entities to conduct any financial transactions with these individuals;
- asset freezing of certain entities, such as state-owned banks, energy companies as well as weapons manufacturers;
- restraints on conducting financial transactions with entities, relating to key Russian sectors: energy, defence and finance;
- export restraints on oil- and dual-use technologies.

In April 2014, a number of new export restrictions were placed on technologies and services regulated under the US Munitions List, which contributed to the worsening of Russia's military capabilities. Later on, the list of sanctioned financial institutions and energy companies was extended, which considerably limited their access to the capital markets in the USA. Moreover, the US administration prohibited any transactions with eight Russian arms companies and blocked the assets of other five Russian state-owned defence technology firms. Thereafter, export bans were imposed on goods, services and technology used for exploration or production purposes of Russian deepwater, Arctic offshore and shale projects, possessing potential to produce oil. (Oxenstierna & Olsson, 2015, pp. 18-19) Downgrading of Russia's sovereign credit rating to junk status and to just above junk status by three most influential rating agencies (S&P, Moody's and Fitch) was another art of non-official economic sanctions, which made it more difficult for large corporates and banks to refinance themselves, thus pushing up their borrowing costs. This trend also stimulated capital outflow from

Russia. (Katasonov, 2015, pp. 117-120) Anticipating the escalation of the Ukrainian crisis, President Barack Obama signed the Ukraine Freedom Support Act in December 2014, which made the imposition of further sanctions against Russia possible.

An overall goal of the restrictive measures against the Russian Federation was an intention to increase its diplomatic and economic costs, thus contributing to the political isolation of Russia. These actions, in close coordination with EU and other international partners, were to convey a strong message to the Russian government, aimed at changing Russia’s policy in Ukraine. (U.S. Department of the Treasury, 2014)

2.2.3 Russia’s counter-sanctions

As an immediate reaction to the sanctions policies employed by the EU, the USA and their partners, on 6 August 2014 the Russian Federation decided to place import bans on meat, fish, cheese, fruit, vegetables and dairy products from the EU, the US, Australia, Canada and Norway (see Figure 1). The relevant document was signed by the Head of the Russian government, Dmitry Medvedev, on 7 August 2014 and was to be applied by the Federal Customs Service of Russia immediately. The latter was also authorized to control the commodities, coming from Belorussia in order to prevent the import of banned goods across the Belorussian border. (Deutsch-Russische Auslandshandelskammer, 2014)

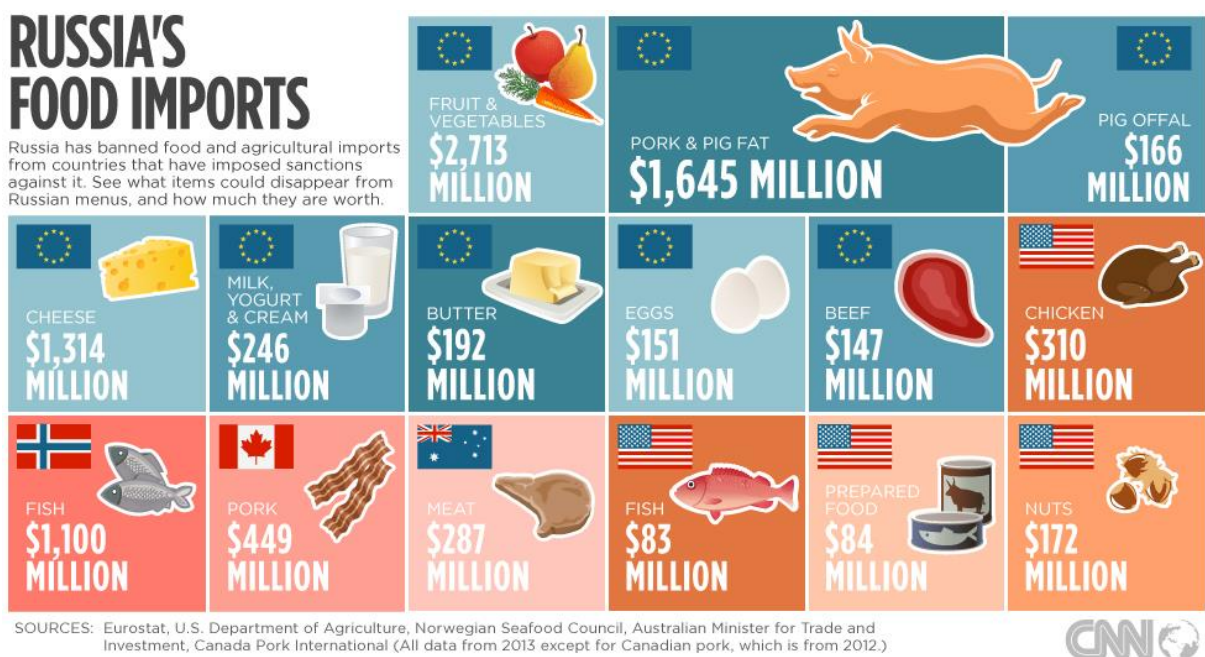


Figure 1: Russia’s food imports (Dolidze, 2015, p. 3)

At first, it was decided upon an imposition of a one-year embargo, which was prolonged until 5 August 2016 by the Russian President on 24 June 2015 in response to the decision upon the extension of Western sanctions against Russia. It was emphasized that imports of baby food were not addressed by these restrictive measures. (ibid.) As for the portion of the EU agricultural food exports to Russia before these prohibitive measures, it was about 10% of all EU exports of agricultural goods worldwide. (Dolidze, 2015, p. 2) On 13 August 2014, the list of sanctioned counties was extended by adding to it such states as Albania, Montenegro, Iceland and Liechtenstein. (Germany Trade & Invest, 06/2015)

Due to the worsening economic conditions in the agricultural sector across the EU countries provoked by the Russian counter-sanctions, the European Council announced its financial assistance to producers of certain fruit and vegetables in the framework of the support programme until 30 June 2015, which was prolonged after several adaptations until 30 June 2016. In line with the updated variant of these supportive measures, producers were advised to reduce the amount of their goods on the market and thus stabilize prices for these products. The principal difference between the original of the support programme and its revised version was the right of the member states to disregard this amendment. (Bundesministerium für Ernährung und Landwirtschaft, 2015)

The next counter-sanctions step that Russia undertook in response to Western sanctions was an introduction of visa bans against 89 EU individuals, who were involved in decision-making processes in the sphere of politics as well as in the defence and military sector. (Germany Trade & Invest, 06/2015)

To sum it up, these counter-sanctions on the part of the Russian Federation were of a more political nature and represented a non-military reaction to Western sanctions. Their primary targets were producers of agricultural goods and the transport sector in those countries, which trade in these products and services. Within this context, it is worthwhile noting that Western companies, which regard Russia as an important market, are aware of ways how to bypass the imposed import bans. One of the widespread strategies is to engage a third country into the trade transactions. At the same time, those trading partners, who were chagrined at Russia's counter-actions, started to redirect their exports to other countries. (Oxenstierna & Olsson, 2015, pp. 49-50)

As for the Russian government, it sees great potential in current developments and regards import bans as a useful tool for achieving improvements in the Russian agrarian sector. Thus, new programs, which support various areas of businesses in Russia, should act as a catalyst for the expansion of the domestic production. In line with this policy, it is also planned to raise the competitiveness of Russian products through the promotion of science and technology. Nevertheless, there are two essential factors, which are responsible for the feasibility of these objectives: the question of time and the issue of financial resources available. (Bundesministerium für Ernährung und Landwirtschaft, 2014, p. 15)

2.3 The prospects of Western sanctions success: SWOT analysis

The effectiveness of sanctions success is a frequent topic of discussion and, as it was already highlighted in the chapter 2.1, the statistical data points to the certain bounds of achieving desired outcome by applying sanctions regimes. Whereas some findings indicate a high level of sanctions' effectiveness, others argue that only very tough measures can have a significant impact on the targeted entity. Furthermore, a sanctions regime is believed to be successful only when it contributes to the achievement of the desired policy change. Thus, the measurement of an economic damage, induced by the imposition of restrictive measures, is not suitable for the assessment of the sanctions success and is of minor importance in this context. At the same time, there are certain factors, which, according to the opinion of some researchers, can either increase or decrease the probability of achieving goals traced by the imposed sanctions. These factors are:

- *The size of the targeted country:* the theory of a negative correlation between the size of the state and the sanctions' effectiveness. Therefore, the bigger the targeted economy is, the less negative consequences, left by the imposed sanctions, it will have.
- *Political and economic relations between the sender and the target in the pre-sanctions period:* a view that restrictive measures will have more impact on the sanctioned party, if a sanctioner has been its major trading and/or political partner before the introduction of sanctions.

- *The use of unilateral or multilateral sanctions:* an empirical evidence supports the idea that multilateral sanctions have a higher economic impact on the target than unilateral, since the choice of available trading partners is limited. (Kholodilin, et al., 2014, pp. 3-4)

It goes without saying that the sanctions regimes imposed by the EU and USA against the Russian Federation have already impacted its economy in a negative way and that the full effect of these sanctions is still to be seen. Nevertheless, a key issue is whether and if so, to which extent these restrictive measures have contributed to the achievement of their political goal – a change in Russia’s behaviour towards the crisis in Ukraine. In order to answer this question, a so-called SWOT analysis (see Figure 2) can be used for the identification of the strengths, weaknesses, opportunities and threats of Western sanctions regimes, aimed at the policy adjustment towards the Ukrainian crisis on the part of the Russian Federation.

Strengths	Weaknesses
<ul style="list-style-type: none"> • wide-ranging sectoral nature of Western sanctions • high importance of the conflict in Ukraine 	<ul style="list-style-type: none"> • lack of unity within the EU over the usefulness of sanctions • wide popularity of Vladimir Putin and his policies in Russia
Opportunities	Threats
<ul style="list-style-type: none"> • manageable dependency of the EU on agri-food exports to Russia • Russia’s hazardous policy of import substitution 	<ul style="list-style-type: none"> • energy dependency of the EU on exports from Russia • Russia's reorientation towards Asia

Figure 2: SWOT analysis of Western sanctions regimes (own illustration)

As far as **strengths** are concerned, the following ones are of prime importance:

- *A wide range of sectors that are targeted by sophisticated sanctions, which still can be strengthened in their turn.* In comparison to the individually-targeted sanctions introduced previously, these broad restrictive measures took a heavy toll on the Russian economy, driving it into the recession phase. Some sectors have already experienced harsh consequences of the Western sanctions regimes and the financial sector with its capital flight, falling stock prices, investors and trading partners, leaving the country, and a heavy depreciation of the rouble is a vivid example of this trend. (Cf. Fischer, 2015, p.4; Dolidze, 2015, pp. 3-4)

- *A high relevance of the conflict, which contributes to the determination of the West.* Thus, the escalation of the Ukrainian crisis as well as high attention of the mass media to the events in Ukraine triggered the introduction of restrictive measures in three successive stages, which have been periodically revised and reinforced by both the EU and the USA. (Oxenstierna & Olsson, 2015, p. 58)

The most significant **weaknesses** of the Western project are as follows:

- *“A lack of unity within and a lack of solidarity from the outside”.* (Dolidze, 2015, p. 9) On the one hand, there is no unanimity within the EU member states over the usefulness of the sanctions placed on Russia. Thus, some EU states have disapproved of these restrictive measures and have been even engaged in “Russia-lobbying” activities. Hungary, Slovakia, the Czech Republic, Finland, Serbia and some others, who showed milder attitude towards Russian policy, were observed in these practices. On the other hand, there are “smuggling” attempts on the part of some EU companies, which try to bypass Russian import bans by involving transit countries and EU “smugglers” in their activities. Belorussia, Kazakhstan, Montenegro and Bosnia are among those countries accused by Russia of “grey” trade. (ibid., pp. 7-9)
- *An increased popularity of Russian President Vladimir Putin and his policies.* The results of the polls conducted by the independent Yuri Levada Analytical Centre in August 2014 have shown, that 58% of Russians asked about the reasons behind the Western harsh response to Crimea’s accession, said that it was a demonstration of the hostile attitude towards Russia and a desire to put pressure on the Russian government. At the same time, only 12% of the respondents were of the opinion, that it was an act of condemnation regarding Russia’s annexation of a foreign territory. (Cf. Fischer, 2015, p. 5; Yuri Levada Analytical Centre, 2014) According to the last survey, conducted by the same centre, 85% of Russians approve Putin’s actions as a President of Russia. (Yuri Levada Analytical Center, 2015) Consequently, a wide popularity of Vladimir Putin and his policies among the Russian population represents another difficulty in achieving goals, set by the imposed sanctions of the West.

As for the chances for achieving the desired outcome, a number of **opportunities** can be identified:

- *A manageable dependency of the EU countries on agri-food exports to Russia.* While the portion of the banned products in total EU exports to Russia is rather low, contracts signed before the introduction of the counter-measures are exempted from these restraints. Therefore, import bans to Russia are likely to cause limited harms to the economies within the EU. At the same time, the Russian embargo can be used by the EU as an opportunity for entering new markets, thus redirecting agri-food exports to alternative third countries. The same concerns the energy sector, where the ways of reducing dependency on Russian supplies are still to be found. (Cf. Christen, et al., 2015, p. 2; Dolidze, 2015, pp. 10-11) Consequently, this reorientation of the EU member states towards other countries and thus deterioration of trade relations with Russia can provoke a desirable change in the target's behaviour.
- *Import substitution as a central plank of Russia's policy.* Diversification of the Russian economy is per se a right decision for the country, which economic system is very dependent on the exports of natural resources and therefore is sensitive to the volatile prices for these resources. However, as it was already mentioned in the chapter 2.2.3, there are two prerequisites for the successful realisation of this plan: sufficient time and financial resources. As it is rather impossible to substitute imports from the EU in a short-term perspective as well as to get additional financial resources for the execution of this program in times of recession, cooperation with the West in these issues becomes essential for the Russian Federation. (Cf. Bundesministerium für Ernährung und Landwirtschaft, 2014, p. 15; Oxenstierna & Olsson, 2015, 2015, p. 60) Hence, there is a possibility of compromises, initiated by the Russian government in questions over its policy change in Ukraine.

At the same time, there are certain **threats**, which can undermine the successful realisation of the sanctions policy, employed by the West against Russia:

- *Energy dependency of the EU on the exports from Russia.* It is not a secret that the EU is one of the main importers of the Russian gas. Thus, one-third of its natural gas demand is satisfied by Russia. This makes the EU vulnerable to possible decisions of the Russian government to cut off its energy supplies. Therefore, "the

energy security threat is imminent and real, while alternative sources are still a future prospect.” (Dolidze, 2015, p. 11) This testifies to the fact that the Russian Federation has its own lever of pressure over the EU.

- *Russia's reorientation towards Asia.* Russia's decision to rebalance its orientation towards Asia and build new strategic alliances was an immediate reaction to Western sanctions. Thus, multiple letters of intent as well as various MOUs have been signed since the beginning of the conflict over the events in Ukraine. This redirection of the Russian economy can entail a power shift in the world, which will have negative consequences for well-established cooperation between the former trading partners. Thus, this will contribute to further cooling of relations, making former allies less dependent on each other. (Cf. Deutsch-Russische Auslandshandelskammer, 09/2015, pp. 4-5; Wätzel, 2015, p. 25)

To sum it up, while the strengths and the opportunities emphasized in the SWOT analysis for the most part are economic factors, the weaknesses and the threats are rather political by nature. Therefore, sanctions regimes imposed by the West have achieved certain results in contributing to Russia's deteriorating economic situation. Nevertheless, these costs have not been enough to induce Russia to change its policy towards Ukraine despite the fact that the EU and the USA have demonstrated great determination in the imposition and prolongation of their sanctions regimes and that Russia has not managed to „disunite the common front of struggle”. (Oxenstierna & Olsson, 2015, pp. 57-62)

3 Trade Finance

3.1 Theoretical fundamentals of Trade Finance

“International trade has been a driver of growth, economic prosperity and development since the dawn of business and commercial activity.” (Malaket, 2014, p. 1) Trade has always been an effective means of involving different countries into the cooperation, thus preventing them from possible violations of international peace and security. Moreover, trade is capable of contributing to the overall development across the world, improving the standard of living in developing countries by supporting a fair distribution of revenues to the producers. In times following the global financial and economic crisis,

which broke in 2007, trade got additional significance in the political, academic and business circles as it proved to be the most effective engine for recovery and growth. At the same time, as in any complex system, the mechanisms of international trade are far from being perfect in all the respects. Consequently, this highly valuable system, capable of enriching nations and benefiting business circles as well as lives of ordinary people, has the potential for improvement, which can be achieved by applying better understanding of business, trade and investment. (ibid., p.1-6)

International trade with its long distances and time frames is a risky and costly activity. Therefore, most trade transactions are supported by some forms of financing, capable of providing exporters with necessary working capital and contributing to the reduction of risks, which exporters and importers can face while being engaged in commercial activity. (Cf. Auboin, 2014, p. 12; Demir, 2014, p. 34) These forms of financing are represented by traditional and long-established products, which can be all combined under the general term – “Trade Finance”. There are plenty of different interpretations of trade finance, which convey various nuances and emphasise certain aspects. The following interpretation of this term was chosen as it captures the essence of this complex concept. “*Trade finance* is an expression generally reserved for what practitioners define as “short-term” financing of trade transactions, typically involving durations (terms or tenors) of up to 18 or 24 months, though some will limit this category to 360 days or less. Transactions that involve financing over longer periods, up to seven years or so, are often referred to as medium-term trade finance, or in some cases, “structured trade finance”, and those with longer exposures, perhaps 15 or 20 years or longer, commonly involve large-scale capital projects, and therefore referred to as project finance.” (Malaket, 2014, pp. 11-12)

Trade finance serves as a bridge between an exporter and an importer, covering a time gap between the moments at which exporters wish to be paid and importers are able to pay. It is worth mentioning that such transactions entail certain risks for both parties. Thus, importers face the risk that exporters will not be able to deliver goods under all the product requirements, which were agreed upon in the contract. At the same time, exporters have the risk of not being paid for the goods they delivered to the importers. Moreover, the international aspect of these transactions, which presupposes dealings with different countries and their jurisdictions, only increases the variety of possible threats and probability of facing multiple risks. Nevertheless, trade

finance instruments are considered to be relatively safe as these transactions are underwritten by strong collateral and documented credit operations. (Cf. Auboin, 2014, p. 12; Demir, 2014, p. 34)

As it was already highlighted, parties involved into the international trade, namely exporters and importers, have in essence divergent interests. Thus, a seller would not welcome an idea of sending goods to the importer prior to being paid for them, and a buyer would not be eager to pay for the products prior to the inspection of their quality and further specifications set out in the contract. (Palmer, 1999, p. 21) Therefore, the main aim of trade finance providers, who will be a subject of further investigation in chapter 3.3, is to align interests of both parties via meeting a broad range of business requirements.

Trade finance offers various instruments and practices, proposing solutions aimed at single-shipment transactions as well as at more complex undertakings, capable of assisting established trade relationships. Whatever nature of the transaction is, there are four elements (*payment, financing, risk mitigation* and *information*), which constitute any trade finance transaction and which have different degrees of emphasis that depends on the particular type of a relationship and/or a transaction in its turn. (Malaket, 2014, pp. 27-28) Partnerships, which refer to long-standing trade relations and therefore most likely operate in lower-risk markets, use those trade finance instruments focused on cost-effective financing modes and timely arrangements. Alternatively, those trade relationships, which are relatively new or which involve operations in high-risk markets, tend to employ effective and therefore often more expensive solutions for the successful mitigation of risks. (ibid., p.78) The following illustration provides additional information on the constituent parts of any trade finance transaction as well as their main characteristics.

Payment	Financing	Information	Risk Mitigation
<ul style="list-style-type: none"> • secure • timely & prompt • global • low-cost • all leading currencies 	<ul style="list-style-type: none"> • available to importer or exporter • several stages in the transaction • no impact in operating line for exporters 	<ul style="list-style-type: none"> • financial flows • shipment status • quality of shipment • L/C systems include web & desktop solutions 	<ul style="list-style-type: none"> • risk transfer • country, bank and commercial risk • transport insurance • export credit insurance

Figure 3: Four elements of Trade Finance (own illustration based on Malaket, 2014, p. 28)

Regarding the first element, *payment*, it should be emphasised that an aspect of receiving a secure payment on time is of prime importance for any seller. Therefore, an exporter will search for the best solutions offered by trade finance in order to guarantee a safe and timely payment for the goods sent to the importer. In respect to *financing*, an attention brought to the aspect of providing both exporters and importers with the most favourable terms, thus offering them a variety of options in terms of sourcing financial resources for short, medium, and long terms. (Cf. TradePort, 2010; Malaket, 2014, pp. 28-32) The next element of any trade finance transaction, *information*, is also very important for all the parties involved into international commerce. Thus, a timely exchange of relevant information via sophisticated technology plays a significant role in facilitating trade. (Malaket, 2014, pp. 40-41) As noted above, *risk mitigation* is an urgent issue in the framework of international trade. Generally, risks can be subdivided into two categories: political and economic. Whereas political risks can be split into manufacturing and payment risks, economic risks range from manufacturing and payment risks to exchange rate, interest rate and cost risks. (Backhaus, et al., 2011, pp. 10-11) Due to the various mechanisms and practices applied by trade finance for risk reduction and elimination, businesses can optimize their risks against the cost of mitigation, improve the level of risk tolerance of their firms as well as increase the target returns associated with the opportunity proposed by the trade transaction. (Malaket, 2014, p. 35)

To sum it up, trade finance assists the execution of a payment across frontiers on time and in a secure way, provides financial resources needed for the transaction, executes adequate mitigation of possible risks and facilitates information flows between all the parties involved into the transaction. (ibid., p. 12)

3.2 Typical practices and products of Trade Finance

Wide acceptance and common use of certain practices, particular techniques, and a special language guarantee high effectiveness of trade finance instruments and mechanisms. These general principles and regulations were collected into the set of rules, which serves as a Bible for countries, organizations and businesses engaged in international trade. This set of rules came into existence due to the activities of the International Chamber of Commerce (ICC) based in Paris. Since 1933, the ICC has been publishing the “Uniform Customs and Practice for Documentary Credits” (UCP), which are in active use of most countries involved in foreign commercial activities. The UCP outlines the roles and duties of all the parties, who use documentary letters of credit. The revision of this set of rules, which demands vast knowledge as well as wide-ranging and in-depth experience in financial and legal issues, is performed by the specialist of the ICC every 10 years. The current version, called the UCP 600, formally commenced on 1 July 2007, following a drafting process that started in 2003. It is worth mentioning that the UCP is not the only set of rules published by the ICC. The organisation is engaged in publishing of further rules relevant for trade finance instruments, which play significant role in international trade. Among them can be found such sets of rules as the Uniform Rules for Collections or the Uniform Rules for Demand Guarantees. (Malaket, 2014, pp. 80-81)

Another important contribution of the ICC, which provides a solid basis for sustainable trade transactions, is a series of pre-defined commercial terms, known as International Commercial Terms (INCOTERMS). These terms play an indispensable role in international trade since they define the points at which the ownership of the goods together with the associated risks are shifted from the exporter to the importer as well as points to which the cargo must be delivered. INCOTERMS are periodically revised by the ICC, which published its latest version in 2010. (ibid., p. 85)

As highlighted in chapter 3.1, there are multiple instruments and practices of trade finance, which constitute a most frequently occurring topic in literature on international trade and which provide a number of solutions in respect to payment, settlement and financing patterns for all the parties involved. A highly globalized world with its intensive competition for export markets brought special attention to the aspect of providing flexible payment terms, which became a binding clause of any sales contract. (TradePort, 2010)

The following figure gives a common overview of settlement options with varying degree of risk for sellers and buyers, illustrating which of them are more favourable for exporters and which of them are more preferred by importers.

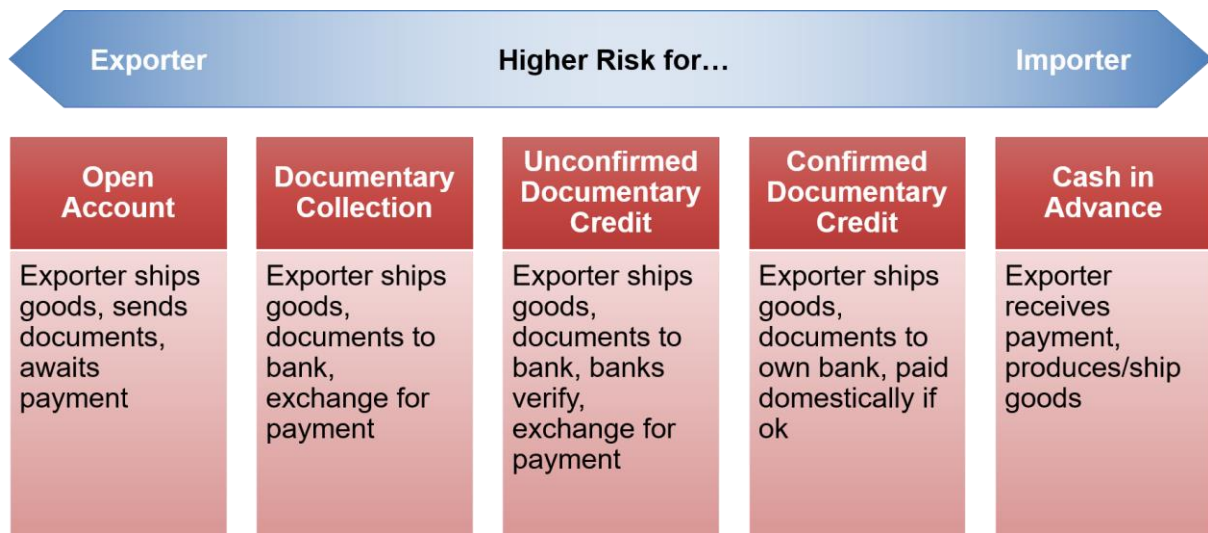


Figure 4: Settlement options (own illustration based on Malaket, 2014, p. 85)

Selling on *open account* imposes all the risks on the exporter, leaving him zero-protection in case of non-payment. The seller ships the goods and thus the ownership of the cargo on the buyer’s pledge to make a payment. Despite all the possible threats for exporters, a shift in trading patterns to open account terms with extended dating has been a growing trend in recent years. (TradePort, 2010)

Another alternative, referred to as *documentary collections*, provides both parties with a better balance of security via involving their banks as intermediaries. Nevertheless, it is worth noting that the sole responsibility of involved banks it to support an exchange of shipping documents, which limits their role in this type of settlement options.

Documentary credits, also known as *documentary letters of credit or letters of credit or L/C*, offer a balance of protection to both exporters and importers. The principle difference between *an unconfirmed* and *a confirmed documentary credit* lies in the fact that the latter provides additional security to exporters. Both types of instruments will be a subject to further investigation later in this chapter. (Malaket, 2014, pp. 86-88)

Another extreme option, called *cash in advance* is the most favourable option for the exporter and therefore the most risky alternative for the importer. According to the terms of this settlement, the buyer makes the payment to the seller for the goods prior to their shipping or even producing. (TradePort, 2010)

Definition given to trade finance in chapter 3.1 makes emphasis on the duration of financing, which plays a major role in the categorisation of numerous instruments used for trade finance. Hence, all the existing modes could be subdivided into three principal groups: *short-term*, *medium-term* and *long-term financing*. (Backhaus, et al., 2011, pp. 6-7)

As it was already made explicit in the provided definition of trade finance, *short-term trade financing* refers to payment terms of up to one year. As a Letter of Credit is the most common form of short-term trade financing, together with its main types it will be a subject of a more thorough investigation.

According to the existing interpretations of this concept, a *Letter of Credit* could be defined as a document issued by a financial institution (issuing bank) at the request of an importer (applicant) and given to the exporter (beneficiary), confirming a stated sum of money in the corresponding currency to be paid at sight or credited to the beneficiary's account within a prescribed time limit and against stipulated documents as well as provided that the terms and conditions of the credit are complied with. (Cf. Handelskammer Hamburg, 2008, p. 52; Malaket, 2014, p. 262; Palmer, 1999, p. 41)

As already highlighted, there are various approaches to the categorisation of a L/C, which are based on different criteria of this instrument. Nevertheless, there are two major types of a L/C, which are of prime importance: a *Commercial L/C* and a *Standby L/C*. The main difference between them consists in the fact that a Commercial L/C serves as a means of payment in the underlying transaction, while a Standby L/C acts like a guarantee of a payment by the applicant to the beneficiary. Therefore, a Standby L/C is not generally drawn, if there is no default in the underlying transaction. On the contrary, if there is certain evidence that the applicant has failed to meet the terms of the contract, an issuing bank has to step in and pay to the beneficiary. Due to its hybrid nature, a Standby L/C has been regarded as a difficult instrument to comprehend for a long period until the ICC has officially recognised it as a L/C under the ICC Publication No. 500. (Cf. Handelskammer Hamburg, 2008, p. 54; Malaket, 2014, p. 265; Palmer, 1999, p. 55)

Both main types of a L/C can be further split into two subtypes: a *Confirmed* and a *“Silently” Confirmed L/C*. As already highlighted previously in this chapter, a Confirmed L/C is more advantageous for the beneficiary as it provides him with additional comfort.

Thus, an issuing bank requests another bank (confirming bank, usually situated in the country of export) to add its undertaking (in case of using a Standby L/C) and commitment to pay (in case of using a Commercial L/C) to the L/C in addition to that of the issuing bank. Hence, the beneficiary has two parties involved in the transaction, which helps him to mitigate the country and banks risks of the issuing bank. A “Silently” Confirmed Standby L/C is usually initiated by the beneficiary (not the issuing bank), who asks a confirming bank to undertake honouring or negotiating compliant documents (in case of using a Commercial L/C) and honouring a complaint claim made under the Standby L/C (in case of using a Standby L/C). (Cf. American Bankers Association, 2011, p. 3; Handelskammer Hamburg, 2008, p. 53; Malaket, 2014, p. 263-265) It is worth mentioning that “the “Silent” Confirming Bank’s obligation is evidenced by a separate undertaking document which is outside the terms of the letter of credit and this distinct bilateral arrangement is not covered by the ICC rules. By contrast to an “open” confirmation, the silently confirming bank is not a participant in the LC according to UCP.” (American Bankers Association, 2011, p. 3) In addition, there is one more subtype of a Commercial L/C, an *Unconfirmed L/C*, which does not include any payment obligation on the part of any bank other than an issuing bank. (ibid., p.3)

As noted above, there are further types of a L/C, which differentiation is based on various criteria, such as the criterion of security for the exporter or the criterion of terms of payment and use. Moreover, there is a great variety of other financial instruments commonly used as short-term trade finance instruments. Among them, the following modes can be mentioned as most frequently used: *advance on current account*, *discount credit*, *acceptance credit*, *documentary acceptance credit* as well as *export factoring*. (Cf. Fairway Search Partners, 2015, p. 7; Handelskammer Hamburg, 2008, p. 5) Therefore, due to vast amount of respective information as well as certain limitations in respect to the volume of the Bachelor Thesis, a more detailed analysis of all existing practices used as alternatives for short-term trade finance can not be done in the current work.

As far as the instruments of *medium-term* and *long-term financing* are concerned, the next illustration provides an overview of widely used products of these types of trade finance.

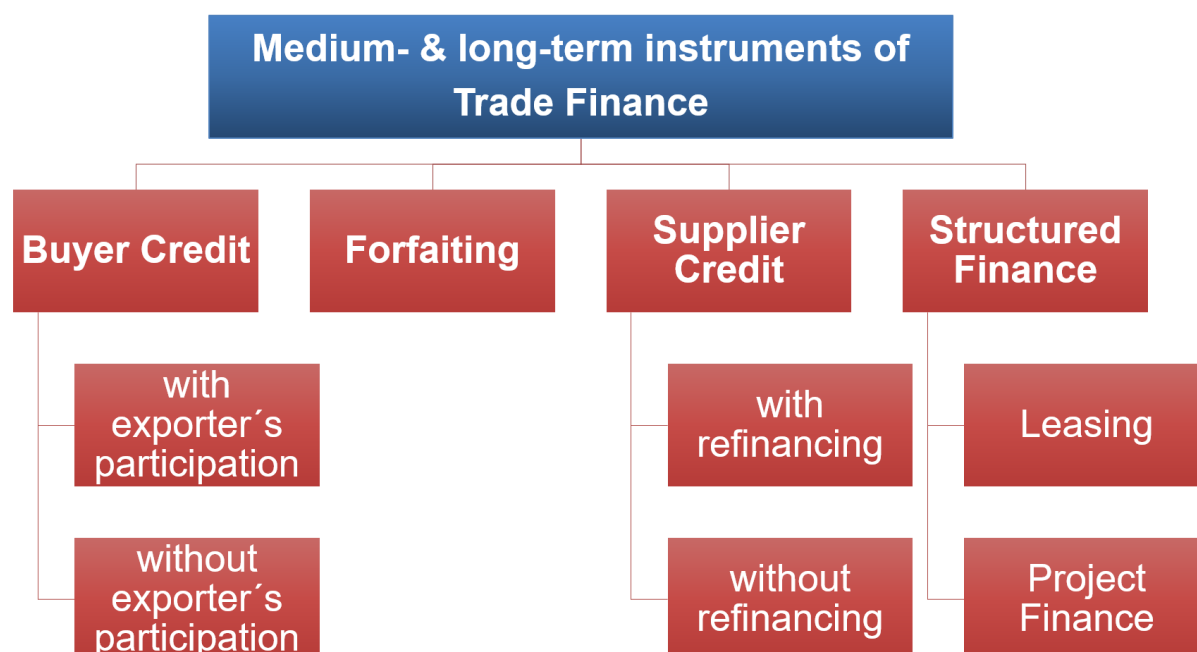


Figure 5: Medium & long-term instruments of Trade Finance (own illustration based on Backhaus, et al., 2011, p. 7)

Buyer Credit can be defined as a loan facility aimed at financing an export transaction, which is extended to the importer and paid out by a financial institution directly to the importer or to the importer's bank or alternatively to the exporter. Generally, this financial institution is a bank in the exporting country. Besides the financing bank, a buyer credit facility can also involve an export credit agency (ECA) based in the exporter's country that guarantees the loan, or alternatively the importer's bank that issues a payment guarantee. Thus, this instrument substantially limits exporter's exposure, reducing his liability to losses totalling the amount retained by an ECA or to payment of the risk premium and similar risks. (Cf. Handelskammer Hamburg, 2008, p. 56; Backhaus, et al., 2011, p. 8)

The next specialized technique, *Forfaiting*, can be defined as a medium-term form of financing, which presupposes non-recourse sale of long-term export receivables to the forfeiter (a financial service provider) for an immediate payment at a discount. Thus, all the risks associated with the export transaction are transferred from the exporter to the forfeiter without recourse to a previous holder of an obligation. (Cf. Backhaus, et al., 2011, p. 8; Handelskammer Hamburg, 2008, p. 56; Malaket, 2014, p. 269; Palmer, 1999, p.99)

The next instrument, *Supplier Credit*, is a certain payment term (usually 30/60/90 or 180 days), which is granted by the seller to a foreign buyer. Under these conditions, a supplier acts as a financial institution and thus bears all the risks associated with the transaction. It is worth mentioning that an exporter can refinance these receivables by selling them to the financial institution, thus avoiding possible liquidity squeeze. (Cf. Backhaus, et al., 2011, p. 7; Handelskammer Hamburg, 2008, p. 55)

Besides the above-mentioned classic instruments of medium-term and long-term financing, such products as *Leasing* and *Project Finance*, being subtypes of *Structured Trade Finance*, are also of interest in the context of international trade. International leasing arrangements enable exporters to use these mechanisms as modes of financing in those markets, where the purchase and explicit ownership of foreign machinery, equipment, vehicles and similar products are not allowed. The scheme is as follows: a leasing company takes over the exporter's product and leases it as a "finance lease" to the importer. With regard to project finance, which represents a cash-flow related lending secured by the project assets, a so-called special purpose vehicle (SPV) is established, which serves as a means of project settlement and as a source of financial resources. Due to its great complexity and high transaction costs, project finance is especially suitable for big projects. (Cf. Backhaus, et al., 2011, p. 9; Malaket, 2014, p. 105)

To sum it up, a great variety of all existing practices and instruments, used in trade finance transactions, provide importers and exporters with different levels of risk mitigation and/or financing. (Malaket, 2014, p. 261)

3.3 Providers of Trade Finance

"Engaging effectively with trade financiers is as much about knowing a market and transaction, and communicating sufficient detail about it to assist a financier in being responsive, as it is about knowing the capabilities and capacities of various financiers, and where possible, selecting a provider that is well-matched to the financing needs under consideration". (Malaket, 2014, p. 139) According to this definition, a provider of trade finance is to have profound knowledge in all the existing tools and practices as well as in every facet of trade finance and subjects allied thereto. (Palmer, 1999, p. 26) Hence, these financial intermediaries are

essential in such matters as improvement of the risk profile of a transaction, risk transference between the parties involved as well as balanced security of their interests. (Malaket, 2014, p. 8)

There are multiple financiers focused on providing solutions to both exporters and importers. Banks, ECAs, international financial institutions (IFIs) and boutique financing firms are considered to be the most popular among them. The next two chapters will be devoted to a more detailed investigation of two widely recognised trade finance providers, namely commercial banks and ECAs.

3.3.1 Commercial banks

There is no doubt that banks play a critical role in international trade, providing trade finance services and traditional trade finance products for centuries. According to some estimates, over 80% of all trade finance across the world is supplied by banks. It is worth noting that the market of trade finance is highly concentrated and that the vast majority of all trade finance products are offered by large multinational banks. (Cf. Malaket, 2014, p. 18; Niepmann & Schmidt-Eisenlohr, 2014, p. 6) Hence, it is widely thought that these international and global banks are experts with broad experience in trade finance. While well-established companies generally have no problems in getting access to the trade finance services of these banks, SMEs do due to smaller deal size and volumes accompanied by greater risk. (TradePort, 2010) Nevertheless, an enforcement to grant more lending to SMEs by large financial institutions has been a recent trend, aimed at supporting small businesses in receiving necessary levels of trade finance, thus stimulating recovery and growth through commerce. (Malaket, 2014, pp. 19-20)

Though international trade with a strong emphasis on trade finance is considered to be a main engine of global recovery and growth, until recently the concept of trade finance has been poorly understood within financial institutions. Thus, an overall shift of the global financial system to quality in response to disruptive consequences left by the global financial and economic crisis of 2007, forced banks to undergo a process of downsizing and rationalization, which led to their engagement in more conventional core activities around deposit taking and lending, also often referred to as *Transaction Banking*. As a result, nowadays most

internationally active banks run large trade finance programs, which have been essentially improved in the post-crisis era. (Cf. Malaket, 2014, pp. 124-125; Niepmann & Schmidt-Eisenlohr, 2014, p. 7)

Increased competition for financial resources across the globe, political enforcement to lend on a larger scale as well as strict oversight and regulatory measures push banks to reshape their approaches to financing, especially in respect to trade finance solutions. Thus, banks appreciate value transparency and are eager to finance those trade transactions, which are thoroughly thought out, documented in a proper way and suggest an effective risk mitigation. Those transactions that do not correspond to these requirements can be financed alternatively by other non-bank providers such as boutique financing firms. (Malaket, 2014, p. 20)

3.3.2 Export credit agencies

Although the first ECA named “Export Credits Guarantee Department” (ECGD) was founded in Great Britain in 1919, ECAs-boom across the world occurred later. Being created as public sector entities aimed at supporting export trade via financing, insurance and different forms of guarantee programs, ECAs were originally established to reconstruct post-war Europe and thus facilitate economic recovery. (Cf. Malaket, 2014, p. 21; Gavrilov & Belyakov, 2007, p. 111) In the course of time, ECAs started to lose their significance, as it was widely believed that private export insurers would be able to cover all the risks distributed in different markets. This mentality changed after the financial crisis of 2007, when “ECAs suddenly experienced renaissance... and thus played a crucial role in keeping export finance viable”. (Hunke, 2014, p. 17)

Initially, ECAs served as means of supporting national interests of their corresponding jurisdictions, thus promoting national exports by providing insurance coverage to both exporting companies and their financing banks. Hence, an overall aim of all official ECAs was to expand national benefits, having better employment situation on the domestic market as a frequent result of this policy. Nowadays, a range of ECAs’ mandates allows them to offer trade finance and risk mitigation support to those transactions, which are of a commercial nature and thus may even disregard national interests. (Cf. Malaket, 2014, p. 135; Bischoff, 2014, p. 23; Drysdale, 2014, p. 5) This trend triggered an appearance of various forms, under which ECAs can operate,

ranging from fully privatized entities up to public/private partnerships and hybrid models. (Malaket, 2014, p. 156) Nowadays all the institutional forms of ECAs can be combined into three major groups. According to this classification, ECAs can be organized as:

- *State government departments or services provided by the State.* Among the OECD member states, this type of the organisational structure can be found in Great Britain and Switzerland. In some developing countries, the services of providing export finance are realised through export credit programs of central banks and ministries of finance or industry.
- *Corporations or agencies that are owned by the State.* This institutional model is characterised by a great variety of institutional variants of entities, which can be organised for providing both export finance and insurance services or just financing/risk mitigation programs. Such ECAs can be found in Asian countries, where organisations offer either credit facilities or only insurance services.
- *Private companies acting as agents.* In some countries, governments conclude agreements with private companies, which conduct risk analysis and offer authorities certain strategies. Special about this institutional model is the fact that all the associated risks are accepted by the respective governments. ECAs of this type could be found in Germany (Euler Hermes), France (Coface), and the Netherlands (Atradius). (Gavrilov & Belyakov, 2007, p. 111)

Abundance in institutional and business models provoked the situation, in which modern ECAs provide financing and insurance solutions even to foreign-based buyers. This led to a heavy competition between these national agencies. Nevertheless, bound to a set of rules recognised by the OECD countries and therefore called the OECD-consensus, ECAs with their complementary programs and value propositions have to cooperate in order to guarantee appropriate solutions to various types of trade transactions. (Cf. Bischoff, 2014, p. 23; Gavrilov & Belyakov, 2007, p. 112; Malaket, 2014, pp. 21, 165)

4 Impact of Western sanctions on Trade Finance in Russia

4.1 Trends and challenges in the pre-sanctions era

It is well known that the financial sector in Russia, which as any other in the world consists of such elements as a bank system, equity market, money market and market of derived financial instruments, is rather underdeveloped. Historically, with the introduction of the two-level bank system in the late 1980s in the Soviet Union, which was accompanied by the issuance of two acts “About State Bank” and “About Banks and Bank operations”, the first steps towards reformation of the USSR bank system were made. Thus, the basis for foundation of business banks was laid, leading to the rapid development of the bank system until 1994, followed by the downward trend after 1995. The same trend accompanied three other elements of the Russian financial system, thus leading to the overall formation of the financial market in Russia in the beginning of the 1990s.

In subsequent years, the Russian financial system was characterised by the following features:

- low public savings as a result of low income and distrust in banks;
 - insufficient level of financing for industries;
 - liquidity squeeze of business banks;
 - interference of the State in the process of capital flow distribution;
 - lack of competition in the banking sector and
 - underdevelopment of the security market, resulting in its vulnerability to global speculative attacks as well as low capitalisation and lack of long-term investment.
- (Gavrilenkov, et al., 2004, pp. 234-240)

All this together with the crisis, which happened on 17 August 1998, only contributed to the further deterioration of the Russian financial system. Nevertheless, a number of factors such as high oil prices as well as restructuring and political stability triggered a decade of high and uninterrupted economic progress between 1999 and 2008, during which annual real GDP growth averaged 6,9%. Thus, Russia grew into a dynamic transition economy, whose growth was heavily dependent on its natural resources sector. (Cf. Gavrilenkov, et al., 2004, p. 1; Black Sea Trade and Development Bank, 2015, p. 3)

The next global economic and financial crisis of 2007 was another challenge for the Russian economy. It had immediate negative effects for the financial system of the Russian Federation, among which were contraction of the real GDP by -7,8% in 2009, lack of an access to external financing for private firms, increase in capital outflows as well as fall in domestic consumer demand and decline in export receipts. Although measures, undertaken by the Russian government and accompanied by the recovery of the global economy with an associated increase in demand and price for energy resources, contributed to the reconstruction of the Russian economy in the second half of 2009, core problems remained as structural issues of the Russian financial system were not addressed in a proper way. Hence, in a short-term perspective an economic growth was assured, while an adequate support for the real sectors of economy was not provided. Consequently, this short-sighted policy of the Russian government provoked further challenges for the financial system of the Russian Federation. (Cf. Black Sea Trade and Development Bank, 2015, pp. 3-4; Tolstolesova, 2014, p. 60)

To sum it up, Russian economy with its high dependence on the natural resources sector and a rather underdeveloped financial sector is more exposed to global turbulences. In comparison to the economies of the West, the financial system of the Russian Federation is especially characterized by a high concentration of capital resources around most influential banks, immaturity of other participants of the financial system (insurance and leasing companies, stock exchanges, etc.) as well as imperfections of the regulatory norms with their inherent conservative and therefore inflexible approaches. (Tolstolesova, 2014, pp. 22-23)

As highlighted above, export of natural resources and commodities is a main factor of economic growth in Russia. Thus, between 2002 and 2004 the growth rate of exports exceeded the GDP growth rate by approximately 10%, while in 2013 the exports of natural resources and commodities accounted for half a trillion dollars or 93% of all export revenues. Under these circumstances, it seems logical that a corresponding development of supporting practices and instruments of trade finance with an emphasis on export finance in Russia should have been of prime importance. However, the post-Soviet banking system was not able to satisfy an ever-growing demand for trade finance. While just few of Russian banks were involved in financing commercial trade, international financiers took advantage of the opportunity and offered Russian exporters a wide range of their trade finance services. (Cf. Gavrilov & Belyakov, 2007,

p. 108; Kharlamov, 2015) Moreover, according to the estimations of the Ministry of Economic Development of the Russian Federation, Russia lags behind the developed countries in providing support to trade finance at the governmental level. Thus, while in other countries expenditures on export finance amount to approximately 0,35% of GDP, only 0,15% of GDP was provided by the Russian budget in 2006. It is worthwhile noting that even this financial support was not realised in full. At the same time, imports to the Russian Federation are to a large extent financed by the ECAs of Russia's trading partners. Thus, Russia ranked first in 2004 as a country with the highest accumulation of export credit financing, which OECD member states grant to their trading partners. (Gavrilov & Belyakov, 2007, p. 112)

In times of the global economic and financial crisis of 2007, it became clear that the establishment of Russia's own ECA was needed. While in the period before the autumn of 2008 Russian commercial banks accepted the risks associated with untimely payments, in times of crisis it was obvious that only the State could provide support to Russian exporters via establishing a special entity for this purpose. Under this special entity was meant an ECA that could assume those risks (including country and political ones) with those tenors, which other commercial organisations could not accept. (Volovik, et al., 2012, pp. 99-100) Therefore, Export Insurance Agency of Russia (EXIAR), with Vnesheconombank acting as the sole shareholder and the charter capital amounting to 30 billion roubles, was founded in October 2011. The main task of this credit agency was to facilitate export via offering insurance to short-, medium- (up to 2 years) and long-term (up to 20 years) export credits against commercial and political risks and through providing Russian investments abroad with insurance coverage against political risks. (Ministry for Economic Development of the Russian Federation, 2011) EXIAR's objective for the years beginning with 2013 was to grant insurance coverage of no less than 30% of all exports of the Russian machinery, equipment, vehicles, building and engineer services. (Volovik, et al., 2012, p. 109) While the first year of EXIAR's operations was largely devoted to the introduction of export-friendly initiatives to the Russian legislation and to the establishment of relationships with banks, corporates and other ECAs, it has managed to assist Russian exporters in closing approximately 20 transactions by the end of February 2013. (Bermingham, 2013, p. 102) According to Mikhail Kuznetsov, Adviser to the Chairman of the Managing Board of Gazprombank, due to EXIAR's services,

which provide Russian businesses with coverage against supply risks in countries with increased political, economic and currency risks, Gazprombank began to consider deals and even develop trade relationships with these countries. (Ageev, 2014, p. 39) It is worth mentioning that there is no unanimity among trade financiers concerning the establishment of EXIAR as well as its activities. While some of them suppose that EXIAR's foundation was overdue, others are sure that the operation of the Russian credit agency will contribute to the consolidation of national banks in issues around export finance and will enhance their competitiveness among major Western banks. (Cf. Bermingham, 2013, p. 102; Ageev, 2014, p. 41)

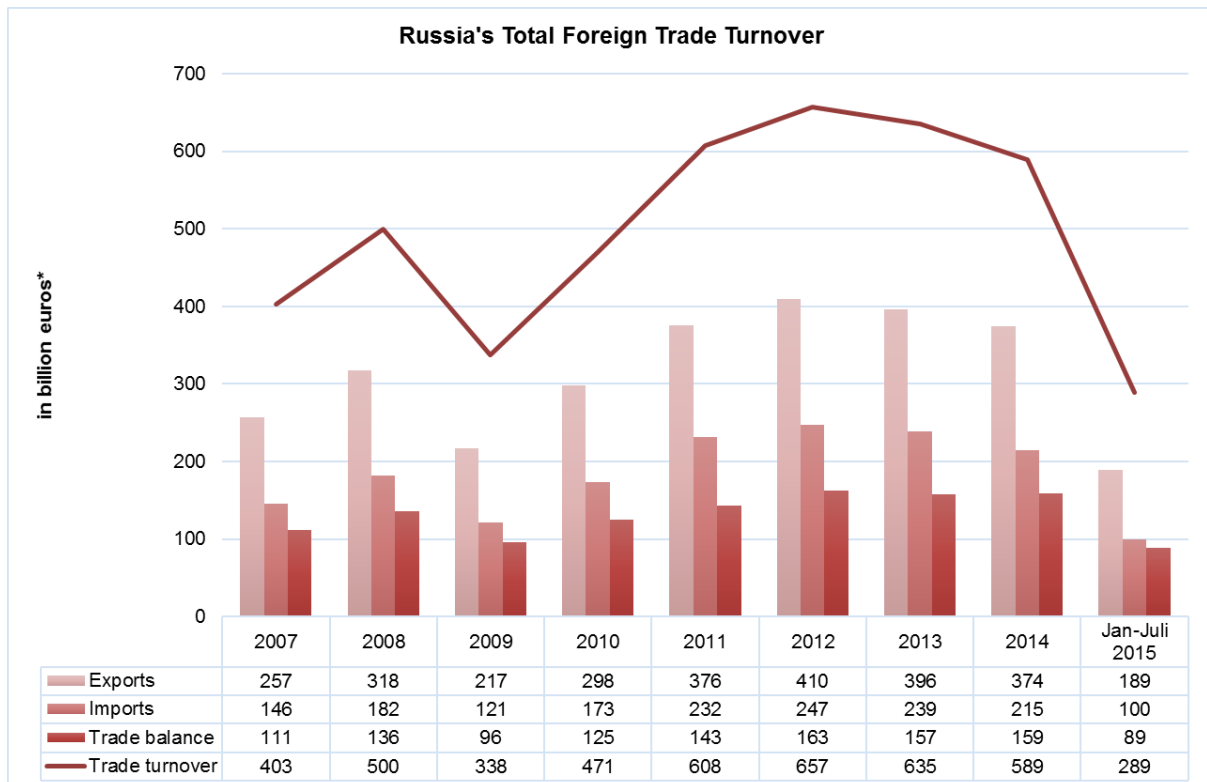
Russia's accession to the World Trade Organisation (WTO) and its impact on the development of an export sector as well as export finance in Russia had been a frequent topic of numerous discussions before Russia finally joined the WTO in August 2012. The opinions on this topic divided: while some politicians advocated this accession and attributed positive developments for both export sector and corresponding export finance in Russia, others were rather sceptical and brought arguments against this entry and the rest saw this joining as a significant event, but not "an all-curing panacea for an export sector so heavily dominated by oil and gas". (Bermingham, 2013, p. 100) Among the arguments for Russia's accession was a view that an overall inflow of investments into the financial system of the Russian Federation would supply the Russian economy with "cheap" and long-term loans, low interest rates and investors' trust. (Tolstolesova, 2014, p. 34) Moreover, it was believed that, in terms of export support, entry into the WTO would allow the Russian government to provide assistance to an export sector more systematically. At the same time, export support was seen as a stimulus for domestic competition, stimulating an expansion and diversification of the Russian export sector. (Ageev, 2014, p. 43) Thus, it was believed that these tendencies in the export sector would generate additional impetus for further development and improvement of export finance operations. (Euromoney Seminars Ltd., 2013, p. 3) The strongest argument against Russia's accession was an opinion that the overall inflow of investments into the Russian Federation, accompanied by the arrival of foreign banks, would represent a serious threat to the existing national banks, leading to further domination of international banks in providing trade finance services to the Russian market to the disadvantage of Russian banks. (Tolstolesova, 2014, p. 34) Those, who, on the one hand, saw certain potential in

Russia's accession to the WTO, but, on the other hand, were not too optimistic about this event, stated that WTO would affect Russia and Russia's trade only marginally in a short-term perspective. However, in a long-term perspective they saw opportunities for economic growth and trade boom in Russia as a consequence of the expected standardization of internal regulations with those of WTO and liberalization of foreign investment in business services. (Euromoney Seminars Ltd., 2013, p. 2) Consequently, it can be stated that Russia's accession to the WTO brought along new opportunities for the improvement of Russia's trade partnerships as well as for the development of the financial system in general and banking sector in particular. Nevertheless, this joining was not enough for making Russian exports and export finance operations more competitive on a global scale. Under these circumstances, a consolidated work on the part of the Russian government and corporates took on a new meaning and became essential in this context. (Cf. Ageev, 2014, p. 43; Bermingham, 2013, p. 102)

To sum it up, an immature and therefore a rather underdeveloped financial system of the Russian Federation with its heavy legacy left by the reforms of the 1990s, was unable to meet an ever-growing demand for trade finance, which led to the inflow of Western banks willing to provide these services to the Russian market. (Kharlamov, 2015) Accordingly, while Russian banks financed only 10% of all Russian exports, the remaining 90% were backed by Western financial institutions. (Ageev, 2014, p. 41) On the one hand, this can be attributed to the fact that in Russia a bank should be large enough in order to attract trade financing. This leads to a high concentration of banks involved into the trade finance operations in Russia, leaving small banks outside this area of business and therefore limiting the supply of respective services offered to the domestic market. (ibid., p.38-39) On the other hand, while SMEs, especially greenfield projects with small cash flows, struggle to raise export finance, well-established companies with a long history and a good reputation have no problems in attracting required financing. All this testifies to the inflexibility of trade financiers, who operate in Russia. (Bermingham, 2013, p. 101) Nevertheless, such events as the establishment of the Russian ECA in 2011 as well as Russia's accession to the WTO in 2012 together with an overall stabilization of the economic growth in Russia in the post-2008 period suggested good opportunities for the expansion of the Russian foreign trade. with a respective positive impact on further development of trade finance instruments and practices in the Russian Federation. (Euromoney Seminars Ltd., 2013, pp. 2-3)

4.2 Status quo and prospects for the future

Decreasing economic activity, heavy depreciation of the rouble, low oil prices and imposed sanctions with their negative impact especially on the financial sector have contributed to the reduction in Russia's total foreign trade turnover. While Figure 6 illustrates the shrinking volume of total foreign trade in Russia, Figure 7 depicts decline in trade turnover with the EU countries. (Deutsch-Russische Auslandshandelskammer, 08/2015, p. 4)



* Converted on the basis of the Euro reference rate of the European Central Bank

Figure 6: Russia's total foreign trade turnover (own illustration based on *Botschaft der Bundesrepublik Deutschland, Deutsch-Russische Auslandshandelskammer, Germany Trade and Invest, 2015, p. 6*)

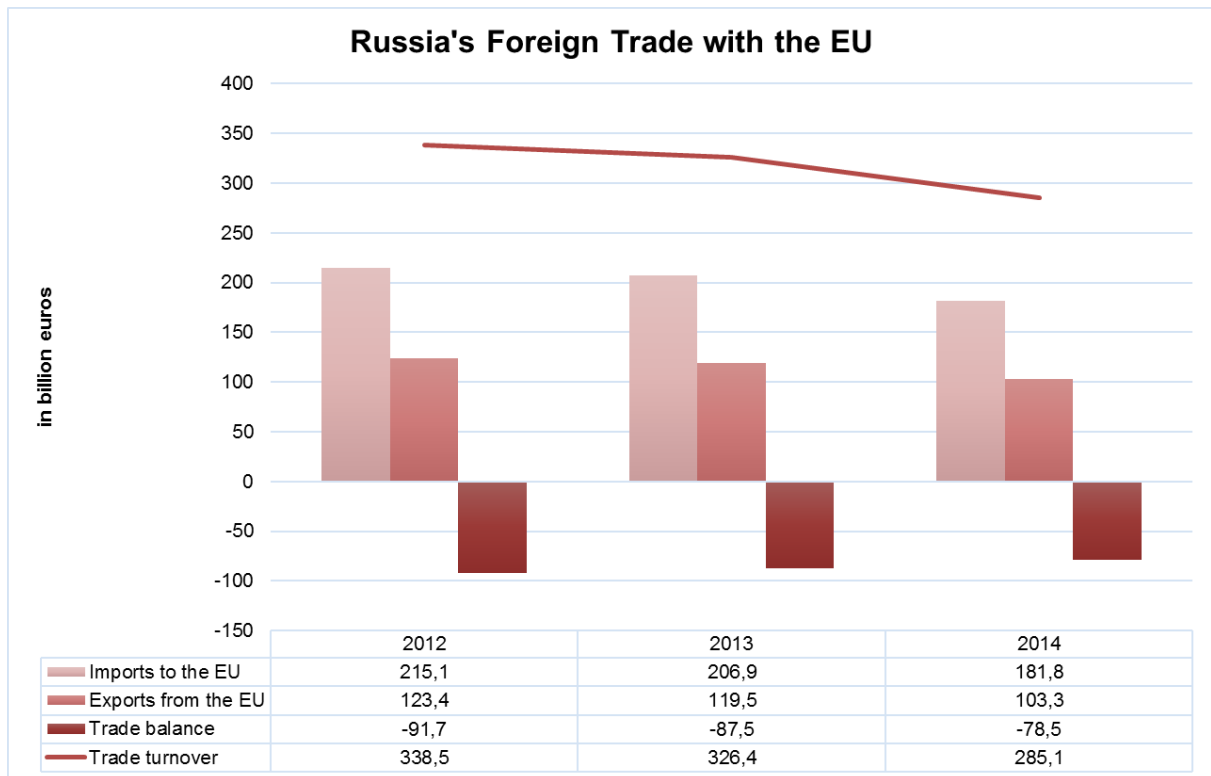


Figure 7: Russia's foreign trade with the EU (own illustration based on German Trade & Invest, 11/2015, p. 4)

As it can be seen in Figure 7, the trade relationships between Russia and the EU were affected by the economic downturn in the Russian Federation already in 2013, namely before the introduction of sanctions against Russia. Nevertheless, the implementation of the restrictive measures on the part of the EU member states catalysed the deterioration of the commercial relationships with the Russian Federation even stronger, leading to a significant drop in EU-exports to Russia. Thus, Russia slipped back to the 13th place on the list of major recipient countries for goods manufactured in the EU in 2014, while it took 11th place in the previous year. This trend became more pronounced in the last quarter of 2014, intensifying further in the first quarter of 2015. (Christen, et al., 2015, p. 2) Amid declining Russian foreign trade with practically all countries, it is worth mentioning that China was a main trade partner of Russia in 2014, having 11,2% in the Russian total foreign trade turnover, while Germany and the Netherlands with the share of each country amounting to 8,7% took the second place. (Cf. Deutsch-Russische Auslandshandelskammer, 08/2015, p. 4; Botschaft der Bundesrepublik Deutschland, Germany Trade and Invest, Deutsch-Russische Auslandshandelskammer, 2015, p. 7) In respect to trade relations between Russia and Germany, there are some remarkable facts that are worth mentioning. Thus, according

to the estimations made by the German-Russian Chamber of Commerce, the vast majority of trade transactions between Russia and Germany are not targets of the imposed sanctions and counter-sanctions regimes. Thus, roughly speaking only 20% of all commercial transactions are targeted by the sanctions and counter-sanctions. In this context, it is worth noting that due to multiple long-term investments made by the German companies into the Russian economy, Germany still considers Russia as its strategic partner. Moreover, an intention of the German firms to invest further 900 million euros into the Russian Federation in the timeframe between 2015 and 2016 only emphasizes the importance of this strategic partnership for the German economy. (Deutsch-Russische Auslandshandelskammer, 09/2015, pp. 1-2) Although, broadly speaking German companies are satisfied with a payment behaviour of their Russian counterparts, a heavy depreciation of the rouble makes it difficult for the Russian firms to hold the terms of the contacts concluded before these developments. Therefore, practically all the German businesses with long-standing trade relationships to the Russian enterprises try to negotiate new conditions, applicable to their trading partners. Nevertheless, data provided by the German ECA, Euler Hermes, can not be regarded as promising information. Thus, according to the estimations made by this export credit agency, a number of payment defaults on the part of the Russian companies increased by 200% in 2014. According to the forecast made for the following year, a number of loan defaults and company insolvencies in Russia would increase by 10%, a second highest figure worldwide. Under these circumstances, a more thorough supervision of creditworthiness of Russia's trading partners took on new significance for the German companies. (Germany Trade & Invest, 02/2015, pp. 2-3)

As already highlighted, the financial sector of the Russian Federation is a main "victim" of the sanctions policy, employed by the West against Russia. Thus, restrictive measures imposed on five major Russian banks (Sberbank, Vneshtorgbank, Vneshekonombank, Gazprombank, und Rosselchosbank), which also act as main trade financiers in the Russian Federation, limited their long-term refinancing capabilities and made these services expensive for the sanctioned banks. Under these circumstances worsened even more by a heavy devaluation of the rouble, these banks as well as other Russian financial institutions have worked to reduce their foreign obligations. This led to the situation, where Russian importers have difficulties in getting financial resources as trade loans became expensive and hardly accessible. In

addition, for the time being the European Investment Bank (EIB) and the European Bank for Reconstruction and Development (EBRD) refused to finance new projects in Russia, which only made things worse. Moreover, being on the downside of the current economic cycle, many Russian companies are not able to service their debts. Therefore, Russian banks have experienced increases in non-performing loans as well as impaired/restructured loans. At the same time, an increase in capital outflows from Russia triggered by the growing uncertainty represents another problem and a threat to the deposit base over time. All these developments contributed to the further destabilisation and deterioration of the Russian financial system in general and banking sector in particular. (Cf. Black Sea Trade and Development Bank, 2015, p. 5-6; Germany Trade & Invest, 2014, pp. 2-3)

Given to these negative tendencies in the Russian foreign trade and financial system, such instruments of trade finance as L/C, bank or export credit guarantees gain in importance, as they offer solutions for conducting international trade in times of crisis, when adequate mitigation of risks is of prime importance. (Cf. Germany Trade & Invest, 02/2015, p. 1; Deutsch-Russische Auslandshandelskammer, OWC-Verlag für Außenwirtschaft GmbH, 2015, p. 51) Thus, a privately-owned RosBank acknowledged by the Trade & Forfeiting Review as the second best bank in trade finance in Russia and the CIS in 2014, reported an increase in its portfolio of trade finance documentary obligations by 47% in 2014. RosBank Deputy Director of Transactional Banking Services and Head of Trade Finance, Marianne Kuzanov, expected an increase in the size of the corresponding portfolio by 25% by the end of 2015. (Cf. Fairway Search Partners, 2015, pp. 8-9; Rosbank, 2015, p. 12) Alternatively, during the St. Petersburg International Economic Forum held in June 2015, Sberbank of Russia and Italia export credit agency Sace signed a MOU aimed at developing a long-term cooperation, concerning export credit, in order to facilitate foreign trade operations between the Russian Federation and Italy. This testifies to the fact that despite sanctions, Russia remains an important partner for Italy. (Fairway Search Partners, 2015, p. 15) The same is true for the German-Russian trade partnership. As mentioned above, although German exporters face certain difficulties in conducting trade with Russian importers, the Russian market is still of high importance for them. Aware of possible risks, German exporters are inclined to use exports credit guarantees, provided by the German ECA. According to the estimations of this export credit agency, in 2013 and 2014 Russia

ranked second among those countries, which accounted for the vast majority of Hermes-covered exports. (Cf. Euler Hermes Aktiengesellschaft, 2014, p. 12; Euler Hermes Aktiengesellschaft, 2015, p. 12) More detailed information on the activities of this ECA with respect to Russia will be provided later in the chapter 4.3.2.

Currently, it can be stated that while “frozen trade and investment flows with Europe show little sign of thawing, high-growth Asian markets and south-south trade corridors offer an attractive source of trade and foreign investment”. (Global Trade Review, 2015) This redirection of the Russian economy towards Asian markets was an immediate reaction to the imposition of Western sanctions. In line with this policy, Russia has announced a strategic alliance with China followed by a number of signed MOUs and letters of intent. (Deutsch-Russische Auslandshandelskammer, 09/2015, p. 4) Among these cooperation agreements was a currency swap arrangement, signed on 29 December 2014 for an initial sum of 25 billion US dollars and aimed at increasing trade in roubles and yuans and reducing worldwide demand for the petrodollar. (Katasonov, 2015, pp. 179-180)

Under these circumstances, when Western financial institutions are keen on freezing or reducing exposure to Russia and when Russia strives for reorientation towards alternative business partners from Asia in general and China in particular, Russian banks get a chance to increase their competitiveness in terms of providing trade finance instruments to the domestic market. In other words, the current geopolitical situation may catalyse the overdue development of trade finance in Russia. In order to succeed, local banks should build their strategies on such strengths as existing customer relationships, domestic market knowledge, and tolerance of political risk. Consequently, those prerequisites for the development and improvement of trade finance operations in Russia that appeared just before the introduction of Western sanctions, can be used to the full in the current geopolitical context. (Cf. Ageev, 2014, pp. 40, 43; Global Trade Review, 2015; Kharlamov, 2015)

4.3 Interviews with two experts in Trade Finance and Export Credit Insurance

Pursuing an aim of getting first-hand data on the topic under discussion, an inquiry for respective information was made to three German experts in Trade Finance and Export Credit Insurance, who have large experience of working with the Russian

market. Two of them, namely Victoria Jarosch-Dohmen from HSH Nordbank AG and Stefan Schmidt from Euler Hermes AG, gave their consent for conducting an interview about consequences for trade finance operations, left by Western sanctions against Russia.

4.3.1 Interview with Victoria Jarosch-Dohmen, Global Trade Finance Senior Manager at HSH Nordbank AG

How can you characterize the developments in Russia's trade finance operations in the pre-sanctions era and after the introduction of Western sanctions?

It is worth noting that starting with the year 2000 a boom in the development of Russian foreign trade with a corresponding increase in trade finance operations was observed. Thus, a peak in these developments was reached in 2006, followed by a downturn trend in the post-crisis period. Nowadays, the situation even worsened due to the imposition of Western sanctions regimes against Russia. As far as I know, there are just few German banks that are still engaged in financing trade with Russia. The main player in this area is Commerzbank, which still provides a number of products to the Russian market. As far as HSH Nordbank is concerned, it stopped any trade finance operations with Russian importers and their financing banks in 2014.

In this context, which instruments were widely used for financing trade transactions with Russia before the imposition of Western sanctions as well as after their introduction?

Syndicated loans were a very common product for the Russian banks, as well as Letters of Credit. However, these products became uncommon in terms of trade finance in Russia. We rarely see any Buyer Credits covered by the German export credit agency Euler Hermes and given by German banks.

It is well known that the market of trade financiers in the Russian Federation is highly concentrated among five most influential banks. Have you noticed any changes in this respect in recent years? Was this market enlarged by inclusion of small and private banks?

I think smallish banks rather stopped their operations in Russia. I do not see any increase in the number of market participants. On the contrary, most of them stopped their operations in Russia.

What threats for the further development of trade finance operations in Russia can you identify?

On the one hand, a strained political situation in Russia with its current conflicts in Ukraine and Turkey will contribute to the further deterioration of trade partnerships not only between these countries, but also with their allies. On the other hand, massive capital outflows from Russia represent another problem of the financial system and a threat of its total destruction with corresponding negative impacts for banking system in general and for trade finance operations in particular. By the way, it is not a secret, but practically nobody knows that large amounts of Russian capital are accumulated by the banks located in the Baltic States.

Speaking about the current situation, do you see any positive developments in the sphere of trade finance operations in Russia? Are there any opportunities for the further development and improvement of these services in the near future?

Of course, there are certain progresses in this field. Thus, advances in the Russian education, which could be observed in the last five years, have contributed to a better understanding of practices in the sphere of finance. In my opinion, the main objective of the Russian financial system, which will open new opportunities for Russia's economy, is to get rid of the US-dollar dependence and to strengthen the national currency – the rouble. Under these circumstances, Russia will be able to introduce its own financial products, including solutions in trade finance, while being reoriented towards Asian financial institutions, which is already a reality. (Jarosch-Dohmen, 2015)

4.3.2 Interview with Stefan Schmidt, Head of Unit Russia/CIS at Euler Hermes AG

What was the total volume of Hermes Cover issued in 2014 and 2015 and what was the share of Hermes-covered exports to Russia in corresponding years?

The total volume of export credit guarantees issued by the Federal Government in 2014 amounted to 24,8 billion euros. Russia with the share worth 2,22 billion euros ranked second in the list of those states, which account for the vast majority of Hermes-

covered exports. Although the figures for the last year have not been published yet, I can tell you, that until November 2015 the total cover volume amounted to 22,9 billion euros, while Russia's share totalled 3,4 billion euros, making it the top country for Hermes-covered exports in the corresponding year so far.

Which changes in the cover policy were made in respect to providing export credit guarantees to German exporters, who have trade relationships with Russian companies?

Despite a quite complicated geopolitical situation, there are no formal restrictions on cover for exports to Russia. Nevertheless, German exporters as well as their financing banks should hand out a declaration of compliance with the EU restrictive measures imposed on Russia, when they apply for an export credit guarantee. Moreover, each transaction is checked on a case-by-case basis. In this context, it is worth noting that a certain exception was made in respect to five sanctioned Russian banks: Sberbank, Vneshtorgbank, Gazprombank, Vnesheconombank and Rosselkhozbank. Thus, these banks can further act as guarantors or borrowers of short-term as well as medium- and long-term trade transactions. As far as premium rate for export credit guarantees is concerned, it depends primarily on the country risk category, into which the buyer country is classified. This country risk category is an indicator of a country's political and economic development and is determined in binding form for all the OECD member states. There are eight country risk categories, of which seven (1-lowest risk, 7-highest risk) are used as basis for the calculation of the premium. Therefore, the decision to shift Russia from 3rd category into the 4th one contributed to a corresponding increase in the premium rate, thus making export credit guarantees, granted to German exporters engaged in trade with Russian companies, more expensive.

How did the behaviour of German exporters and their financing banks change since the introduction of sanctions against Russia?

As for the demand for Hermes Cover for exports to Russia, it was moderate in recent years. Especially SMEs made use of export credit guarantees to hedge and finance their businesses. Nevertheless, it can be said that a rather reserved attitude on the part of German exporters and their financing banks in respect to the Russian market can be observed. However, this is more a result of the deteriorating macroeconomic factors, such as falling oil prices and devaluation of the rouble, rather than an impact

of the imposed sanctions. All this led to a significant increase in demand for consultancy services, especially among those companies with little or even no experience in Hermes Cover for exports to Russia. Those, who are not confident of whether their exports to Russia are not targeted by the imposed sanctions and therefore are afraid of being punished by a fine, can apply to the Federal Office of Economics and Export Control (BAFA) for a so-called “zero-notice”. This document provides an exporter with a legally binding statement, that his exports are neither targets of the sanctions nor subjects to approval. As far as export-financing banks are concerned, a slight reduction in their number could be observed in two last years.

How did the payment behaviour of Russian importers change with the imposition of Western sanctions?

It goes without saying that the number of payment defaults has considerably increased. The reasons for these developments are not new in respect to Russia: company insolvencies, liquidity constraints, increase in non-performing loans and impaired/restructured loans. Historically, the root of this problem lies with Russia's weak macroeconomic environment, which only deteriorated further in times of sanctions.

What is your forecast in respect to Hermes Cover for exports to Russia for this year?

So, it is a difficult question as this business will depend on a number of different factors, such as trends in oil prices or rouble's exchange rate. Although, traditionally Germany and Russia have been good trading partners, current attempts towards localization and import substitution in Russia prevent German companies from getting access to respective orders. I would suggest that big projects are hardly to be expected, while a number of small and medium-sized ones will be carried out. All in all, I have more pessimistic expectations. (Schmidt, 2016)

5 Conclusion

5.1 Summary and Outlook

A research paper at hand revealed that sanctions, especially economic ones, gained popularity in recent years as effective instruments of foreign policy. Therefore, states are seduced to use this tool against delinquent countries in order to bring them into compliance with expected rules of conduct. In the second chapter sanctions within the

context of modern trends in world politics were investigated. The provided information denotes certain boundaries of sanctions' effectiveness and sheds light on their costs. Thereafter, events preceding and following the introduction of Western sanctions regimes against Russia were analysed and presented. An overall goal of the restrictive measures against the Russian Federation was an intention to change Russia's policy in Ukraine. Counter-sanctions strategy employed by the Russian government, only contributed to the further deterioration of long-standing relationships with Western partners and to the political isolation of Russia. To date, sanctions regimes imposed by the EU and the USA have achieved certain results in increasing Russia's diplomatic and economic costs, but these negative effects have not been enough to induce Russia to change its policy towards Ukraine.

The presentation of trade finance in the context of international commerce was the focus of the third chapter. Initially, characteristics of trade finance were displayed, revealing that trade finance serves as a bridge between an exporter and an importer, enabling both parties of financing trade transactions, aligning their divergent interests and minimising the associated risks at the same time. Further, general practices and rules of conducting trade finance transactions as well as typical instruments of trade finance were investigated. It was revealed that while being governed by certain sets of rules worked out by the International Chamber of Commerce, trade financiers have a wide choice in offering various instruments for short-, medium-, and long-term trade transactions. In their turn, different entities can act as providers of trade finance, among which commercial banks and export credit agencies enjoy widespread recognition.

Trade finance operations in the Russian Federation, which are closely interrelated with the overall developments in Russia's financial system and foreign trade, were analysed in the fourth chapter. The conducted research indicated that a rather immature Russian financial system with its heavy heritage left by the reforms of the 1990s was unable to meet an ever-growing demand for trade finance operations, which led to the inflow of Western trade financiers to the Russian market. Nevertheless, an overall stabilization of the economic growth in Russia in the post-2008 period accompanied by the establishment of the Russian credit agency in 2011 and Russia's accession to the WTO in 2012, suggested good opportunities for the expansion of Russian foreign trade with a corresponding positive impact on its trade finance operations. However, the imposition of Western sanctions with their heavy costs for

the Russian financial sector and foreign trade made these plans rather utopian, at least in the short-term perspective. Therefore, Western sanctions regimes can be treated as a cause for the worsened state of affairs in the sphere of trade finance operations in the Russian Federation with a potential for improvements in the long-term perspective.

Traditionally, in times of crisis, such instruments of trade finance as Letters of Credit, bank or export credit guarantees gain in importance, but in relation to Russia an increased uncertainty as well as deteriorating macroeconomic factors, such as falling oil prices and devaluation of the rouble, make Western financial institutions willing to freeze or reduce their exposure to Russia. On the one hand, this drives Russia's reorientation towards alternative business partners from Asia, but on the other hand, under these circumstances Russian financial institutions get a chance to increase their competitiveness in terms of providing trade finance solutions to the domestic market. In other words, the current geopolitical situation may catalyse the overdue development of trade finance in Russia. Consequently, those prerequisites for improvements in trade finance operations that appeared just before the introduction of Western sanctions can be used to the full in the current geopolitical context.

5.2 Critical acclaim

The main focus of this research paper lied on the impact of Western sanctions on trade finance operations in Russia. Regarding the available literature, it can be concluded that Western sanctions against Russia and their impact on trade finance is a modern and quite unexplored issue. For this reason, the main difficulty in writing this paper was to find sources of information, capable of covering the topic. Therefore, literature on three languages (English, German and Russian) was used for the preparation of this work, which contributed to further difficulties connected with different and very often contradictory interpretations of relevant events in these sources of information. Furthermore, due to certain time and volume limits of a Bachelor thesis, some topics were solely touched lightly and are worth of further investigation.

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Declaration of originality

I hereby declare that this Bachelor Thesis and the work reported herein was composed by and originated entirely from me. Information derived from the published and unpublished work of others has been acknowledged in the text and references are given in the list of sources.

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