

Sanctions on Russia: A New Chapter

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DOI: 10.31278/1810-6374-2022-20-4-103-119

Abstract

Russia's special military operation in Ukraine has fueled an unprecedentedly wide range of restrictions imposed by the Western states against Russia. The sanctions hit all key sectors of the Russian economy, but does this mean that they will work? This article's key idea is that the imposed restrictions are unlikely to be effective enough to let the countries that initiated them attain their political goals. The sanctions have not changed Russia's policy towards Ukraine and there are no signs they ever will. At the same time, they have proven to be relatively effective in terms of the damage inflicted on the economy. Although the Russian economy has avoided an immediate collapse and is adapting to the imposed restrictions, the sanctions may affect the behavior of Russia's foreign contractors. For fear of secondary

sanctions and coercive measures they may suspend or curtail transactions with Russian partners. Not only contractors in the Western countries but also numerous partners in friendly states tend to opt for this strategy. Their governments will not formally join the Western restrictive measures, but businesses will have to watch their step or abandon partnership with Russia altogether.

Keywords: sanctions, effectiveness of sanctions, Russia, Ukraine.

Soon after launching the special military operation in Ukraine Russia faced an unprecedented sanctions pressure from the Western countries. The restrictive measures affected key sectors of the Russian economy, including finance, energy, ferrous metallurgy, mining, electronics, engineering, and transport. Almost all possible sanctions instruments were employed, including blocking financial sanctions, investment bans, export and import controls, transport blockades, visa restrictions, etc. Official government sanctions go hand in hand with corporate boycotts by many foreign companies, or at least with the suspension of their operations in Russia. The imposed restrictions are also incredible in pace and scale. In just a few weeks Russia saw a set of sanctions almost as significant as that Iran had to put up with over four decades. Since the end of the Cold War the world has not seen such drastic restrictive measures imposed on a major world power. In Russia's own past only the blockade during the Civil War of 1918-1920 was a close enough precedent. Also, the countries that initiated the sanctions displayed unique political consolidation. Whereas before February 2022 it was still possible to speculate about multi-speed sanctions policies against Russia, with the U.S. clearly leading the way and the EU lagging behind (Timofeev, 2020a), now their efforts are highly synchronized.

At the same time, the question arises: How effective are the imposed sanctions? Is it possible to talk about their success or failure in terms of the goals set by the initiating countries? In what respect exactly did the initiators succeed, and in what areas did their efforts fall flat? Why can sanctions against Russia after February 24, 2022 be considered

effective or ineffective? These questions describe the problems explored in this article.

The key postulate is that the sanctions proved ineffective in terms of the immediate impact of the restrictive measures used as a foreign policy instrument: they have not changed Russia's political course. They have not shattered Moscow's determination to push ahead with the military operation and they are unlikely to do so in the foreseeable future. At the same time, the sanctions can be considered relatively effective regarding the damage they cause. True, the U.S., the EU and other initiators have not ruined the Russian economy overnight. However, the damage from the sanctions is going to be significant. In addition, the sanctions are likely to influence the behavior of Russia's foreign contractors as they will have to take into account the new sanctions regimes for fear of secondary sanctions and administrative or even criminal prosecution. Similar risks are relevant for companies in countries friendly to Russia: at the political level, their governments may not join the Western sanctions, but some companies may be forced to act with caution or even curtail their partnership with Russia.

And still, Moscow has some room for maneuver. The Russian government has managed to maintain financial stability, including by taking steps in advance to create a sovereign financial infrastructure. The process of redirecting exports to new markets is bound to be painful and long, but at least Russia has the time for such a maneuver. Import substitution will be a great challenge for a wide range of high-tech industries. But in other sectors it is likely to gain momentum. The key condition for reducing the costs of new sanctions will be the creation of alternative channels for financial transactions with other countries. The role of the Chinese yuan can become crucial. For China itself, sanctions against Moscow are a chance to gain a firmer foothold as an alternative global financial center.

VIEWS OF SANCTIONS' EFFECTIVENESS: ONE OR SEVERAL?

Sanctions are various economic restrictive measures aimed at achieving political gains. "Classic" studies (for example, Hufbauer et al., 2009) emphasize influence on the target country's policies as the key goal.

At that, both local minor political problems (for example, the release of political prisoners), and more ambitious goals can be the end gains sought. The latter may include a change in the political regime, coercion to cease hostilities or to revise borders, etc. The list of the key goals also includes restriction of the rivals' potential, prevention of their access to certain weapons, technologies, or equipment necessary for military programs, dual-use projects, etc. It is natural that the main yardstick to measure the effectiveness of sanctions was the achievement of the formulated political objectives. If the target country has changed its course partially or completely or abandoned its plans as a result of the sanctions, then they are certainly effective. If such a change has not occurred, then the effectiveness can be considered low or even zero.

Such interpretation of sanctions produced the disappointing conclusion that most of the sanctions in the 20th century were ineffective (Pape, 1997). Research has been carried out into the factors of sanctions' success or failure. For example, the scale of damage to the target country's economy and the nature of the sanctions coalition, including its reliance on decisions of international institutions, were listed as factors of success (Bapat et al., 2013). There emerged a concept of the sanctions paradox: sanctions against allies lead to a change in the political course much more often than sanctions against opponents (Drezner, 1999). In most successful cases, sanctions worked even before they were applied (Drezner, 2003). In such instances the signaling function of sanctions produced the desired effect.

The effectiveness of sanctions in terms of the influence on the behavior of the target country has become more difficult to assess in the 21st century with the spread of "smart" sanctions. Such sanctions targeted individuals or selected legal entities involved in certain political problems—terrorism, support for a particular political regime, the production of weapons of mass destruction, etc. (Drezner 2015). The methodological problem was that it is more difficult to assess a change in the behavior of an individual than a change in the political course of a country. At the very least, different criteria of "behavior" are required, because individuals, companies and organizations differ in nature from states. However, "smart" sanctions are mostly tied to the policy

towards a particular country, such as Iran, North Korea, China, or Russia. Therefore, the change of tools still left a chance to use the same basic criterion of effectiveness, such as a change in the target country's political course. The sanctions against Iran showed the fundamental ability of "smart" restrictions to promote political concessions (Nephew, 2018), although such effectiveness could hardly be considered absolute, given the ability of the target countries to adapt to them.

The effectiveness of sanctions can also be viewed in terms of damage to the target country. For example, restrictive measures can lead to a reduction in trade relations (Hinz, 2017), a crisis in the banking system (Hatipoglu and Peksen, 2018), shrinking investment, thriving corruption, public administration problems (Rosenberg et al., 2016), and a decline in the performance of companies in strategic industries (Ahn and Ludema, 2019). In other words, they inflate the costs of the policy being pursued and make sanctions reasonable for the initiating countries even if the target country does not change its policy. The latter simply becomes more costly.

Furthermore, sanctions can be used to address domestic political problems in the initiating countries. For example, sanctions have become a handy tool for the U.S. Congress in strengthening its role in the U.S. foreign policy process (Vickery, 2019) or for bolstering the incumbent's ratings (Whang, 2011). Evaluation of their effectiveness in this case will depend on the aims that individual players set for themselves inside their own country.

Restrictive measures can leave the political course of the target country unshattered. However, they may fundamentally influence the behavior of business partnerships with such countries. The threat of secondary sanctions, that is, the freezing of assets in retaliation to transactions with previously blacklisted individuals and organizations, as well as the risks of administrative and even criminal prosecution force businesses to shy away from contacts with sanctioned individuals and jurisdictions. A significant share of companies that were once fined by the U.S. Department of the Treasury prefers to avoid repeating violations in the future and to cooperate with the U.S. authorities (Timofeev, 2019a). Banks are especially vulnerable because they perform many transactions

and face higher risks of violations of the sanctions regime (Timofeev, 2020b). Researchers have discovered strong damage to fined banks but a very insignificant impact on the behavior of other financial companies (Hundt and Horsch, 2018). However, one study showed that the impact on banks that avoided fines still exists—they change their operation in the same way as penalized companies (Caiazza et al., 2018). Earlier probes produced similar results (Gabbi et al., 2018).

The fear of secondary sanctions leads to overcompliance with sanctions by businesses. This is especially true of companies engaged in international activities, use the U.S. dollar or the currencies of the initiating countries in their settlements, or rely in their operations on their technologies, software or patents. In the final count, businesses themselves assume supervisory functions, avoiding even those transactions with sanctioned jurisdictions that may not fall under the restrictive measures.

SANCTIONS AGAINST RUSSIA: THE “VEGETARIAN STAGE”

The current stage of sanctions against Russia began with the adoption of the 2012 Magnitsky Act by the U.S. Congress, which gave the U.S. administration the power to impose blocking financial and visa sanctions against Russian individuals and organizations involved in human rights violations and corruption (U.S. Congress, 2012). That act did not entail any noticeable consequences for the Russian economy: the market simply left unnoticed the sanctions against a group of officials. Moreover, its effectiveness in terms of promoting democracy and human rights the U.S. style can be considered negative. It caused Moscow’s sharp reaction and brought about opposite consequences. Moscow responded with the Dima Yakovlev Law. Its later versions included, among other things, “foreign agents”-related rules (Federal Law, 2012).

The question of sanctions’ effectiveness emerged in the limelight in 2014, when Russia faced a more serious set of restrictions. The sectoral sanctions imposed by the U.S. (U.S. Department of Treasury, 2014), the EU (EU Council, 2014a) and some of their allies posed a notable problem. They prohibited long-term lending to several leading Russian banks, energy and defense companies. Financing and the provision of

goods, technologies and services for Russian oil production projects in the Arctic were limited. Export controls were introduced for a number of categories of dual-use goods. Blocking sanctions were used against some Russian individuals and entities (U.S. President, 2014; EU Council, 2014b). In 2014, large businesses remained practically unaffected. At the same time, in 2014, the introduction of sanctions coincided with a slump in energy prices. It is not easy to identify the role of sanctions in the damage to the Russian economy during that period, but, apparently, they increased the negative impact on the situation on the commodity markets at that time (Gurvich and Prilepskiy, 2016). In subsequent years, the sanctions hit Russia's trade with the EU (Fritsz et al., 2017) and the U.S. (Moret et al., 2017).

The infoglut around sanctions grew significantly against the background of Russia's alleged interference in the U.S. elections. The U.S. Congress codified the previously imposed restrictions against Russia in the CAATSA (a set of laws on sanctions against Russia over the Ukrainian issue had been introduced even earlier) (U.S. Congress, 2017). The administration was obliged to coordinate with Congress even the exclusion of certain Russian individuals and companies from the sanction lists. New mechanisms were also introduced, for example, secondary sanctions against persons from third countries for the purchase of Russian weapons. As for election interference, the administration also created a set of legal mechanisms making it possible to expand sanctions, although they have not been widely applied (U.S. President, 2018).

The Skripal case, and then the Navalny case, made a big splash when the British, EU and U.S. authorities accused Russia of using nerve agents and imposed sanctions in response. Those by the EU and Britain could be considered token. The United States took the most resolute steps, introducing, among other things, some restrictions on the purchase of Russian foreign currency denominated debt securities in the primary market (U.S. President, 2019). But even such restrictions were paltry. Starting from 2017, the markets were repeatedly disturbed by news from the U.S. Congress, which proposed bills for "draconian sanctions" against Russia, such as DASKA or DETER. However, they never developed into

anything serious. DASKA was generally criticized by the administration for being redundant and difficult to enforce (Timofeev, 2019b). At the same time, the U.S. Congress and administration declared almost a crusade against pipeline projects involving Russia. The new legislation (U.S. Congress, 2019; 2021) made it possible to slow down Nord Stream 2, but in the end Moscow was very close to its completion. For businesses, the April 6, 2018, blocking U.S. sanctions against some Russian tycoons and their assets became most acute (U.S. Department of Treasury, 2018). Eventually, the sanctions were lifted from some assets, though. Besides, such measures were not employed on a wide scale until 2022.

The history of sanctions against Russia in 2014-2021 can be considered a “vegetarian stage,” for the damage to the economy was relatively small. In 2019, their contribution to the economic growth slowdown was estimated at around 0.2 percent per year (International Monetary Fund, 2019). The sanctions created information noise, especially after 2017, but it was disproportionate to the real strength of the measures applied. Moreover, 2019-2021 saw a stabilization of the sanctions pressure on Russia (Timofeev, 2021).

The “vegetarian” sanctions in no way influenced Moscow’s political course but they did have an impact on businesses. Corporate compliance on the Russian track noticeably revived following a number of cases, such as the criminal prosecution in the United States of Oleg Nikitin and his foreign partners for attempting to circumvent U.S. sanctions to export a U.S. turbine to Russia, the Siemens turbine case, a number of fines the U.S. and British authorities imposed for violating financial sanctions, and the criminal prosecution of two citizens in Germany for exporting machine tools to Russia in violation of export controls. Russia has become a sanctions risk area for businesses. This was perhaps the only achievement of the sanctions policy during the “vegetarian” stage. By the beginning of February 2022, the impact of sanctions on Russia’s economic development and trade could be considered negligible.

SANCTIONS TSUNAMI

Warnings of a large-scale sanctions response to Russia’s hostile moves against Ukraine began to be heard even before February 2022.

On the eve of the special military operation, a whole series of bills appeared in the U.S. Congress, threatening a significant expansion of restrictive measures (U.S. Congress, 2022). Britain fired its “warning shot” by introducing the first amendments to the Russia Sanctions Regulations (UK Government, 2022a). Rhetorical warnings came from the European Union. However, the real sanctions that followed the beginning of hostilities surpassed even the most radical forecasts. Almost the entire set of sanctions instruments was used against Russia.

The U.S., the EU, Britain, Canada, Switzerland, and some other initiators significantly expanded the lists of blocked Russian persons to change them quantitatively and qualitatively. For example, whereas before 2022 there were around 250 Russian individuals on the U.S. list of blocked persons, by June 2022 their number exceeded 1,000 (U.S. Department of the Treasury, 2022a). Similar trends can be seen in the EU (EU Council, 2022a), the United Kingdom (UK Government, 2022b), and others jurisdictions. Taking into account the “50-percent rule,” which extends blocking sanctions to subsidiaries and controlled entities, the actual number of blocked persons may be even greater.

The qualitative changes are significant, too. In 2014-2021, the Western countries avoided blocking backbone Russian companies. After February 24, a significant blow to them followed. The U.S. and Britain blocked a vast majority of large Russian banks. The EU is still lagging behind them, however, given the threat of U.S. secondary sanctions and coercive measures, but EU businesses comply with U.S. requirements. In other words, Brussels’ lagging behind in this case is insignificant. A number of banks have been disconnected from the SWIFT financial messaging system. Russian sovereign debt transactions are prohibited. Operations with the Bank of Russia, the Ministry of Finance, and the National Welfare Fund are limited. Sectoral financial sanctions prohibiting long-term lending have been expanded. Bans on investments in Russia have been introduced. The U.S. has blocked them completely (U.S. Department of Treasury, 2022b; EU Council, 2022b; UK Government, 2022b). In some jurisdictions, Russian reserves are frozen. Mechanisms for the confiscation of the blocked Russian persons’ property are being considered (Timofeev, 2022).

Russia is facing massive transport restrictions. Access to the seaports and airspace of most initiators of Western sanctions is prohibited. Sanctions have been imposed on aircraft, and their maintenance has been restricted. The EU has limited Russian road transport on its territory (EU Council, 2022b). Trade restrictions were another blow. The Western initiators have almost completely banned the supply of high-tech goods and dual-use products, including electronics (except for consumer electronics), navigation equipment, lasers, etc. (U.S. Department of Commerce, 2022a; EU Council, 2022b; UK Government, 2022b). Export bans are being expanded gradually to encompass less technologically advanced manufactures—ball bearings, refrigerators, machine tools, engines, etc. (U.S. Department of Commerce, 2022c; EU Council, 2022b). Less sensitive measures include restrictions on the supply of “luxuries” (U.S. Department of Commerce, 2022b) and consulting services (U.S. Department of the Treasury, 2022b; EU Council, 2022b; UK Government, 2022b). Import restrictions are mainly aimed at ousting key Russian exports: oil and oil products, gas, coal, gold, iron and steel products, etc. from the Western markets. The United States has completely banned the import of Russian fossil fuels (U.S. President, 2022). The EU, along with the restrictions mentioned above, has blocked the import of Russian coal, iron and steel products, oil and oil products—with some exceptions, and also banned the supply of goods, services and technologies to the Russian oil refining industry (EU Council, 2022b). Britain has joined these export controls by and large and introduced a number of import restrictions (UK Government, 2022b). Canada, Australia, Japan, Switzerland and a number of other countries have joined the mentioned financial, transport and trade measures to varying degrees.

Thus, a marked change in the current policy of sanctions has occurred. Its key features are the increased volume of measures introduced, the variety of instruments used, the scope of various sectors of the economy entailed, the speed of restrictions imposed, and the level of consolidation of Western initiators (albeit not absolute, but clearly greater than in 2014-2021). Besides formal government bans,

the current realities are distinguished by unprecedented corporate boycotts—the suspension or curtailment of foreign companies’ operations in Russia, even in those areas that are not subject to sanctions. There is a temptation to compare sanctions on Russia with those imposed against Iran and North Korea. Perhaps the only similarity is their volume in relation to the scale of the economy of the target countries. Among the distinctions are the pace of imposing sanctions and, most importantly, the specifics of Russia as a state: for the first time over a long period such a high level of restrictions has been applied to a leading world military power and a large economy.

AN EFFECTIVE PARADIGM?

From the standpoint of influence on Russia’s policy towards Ukraine, the “sanctions tsunami” has proven to be ineffective. Moreover, Moscow’s intentions now stretch well beyond the original demands. Already, the integration of Ukraine’s territories, which are under the control of Russian troops, into the Russian information, economic and political space is underway. In case of a further advance of the Russian troops, the same will happen to other territories. Sanctions may expand further. But since Moscow has not backed down from its policy after the “carpet bombardment” with sanctions, it is unlikely to be impressed by more restrictions.

Economists are yet to assess the damage to the Russian economy based on new statistics. However, it can be assumed that such damage will be colossal both in quantitative and qualitative terms. The World Bank predicts that Russia’s GDP will shrink by 8.9 percent in 2022 and by 2 percent in 2023. A 2.2-percent correction is expected in 2024 (A World Bank Group, 2022). The fall in GDP will certainly affect the labor market, the real incomes of citizens, the prices for goods and services, and so on. Sanctions will have a direct impact on the amount of investment in Russia, given the bans on such activities. Direct restrictions on the supply of certain goods, as well as the disruption of financial and logistical channels will lead to the shortage of imports from the initiating countries, as well as from third countries that manufacture products under licenses from the United States and

other countries exercising export control. In some areas, the missing imports can be replaced fairly quickly both with the help of domestic production forces and supplies from friendly countries, although even in this case sanctions will play their role, as financial transactions will be vulnerable to disruptions. In other areas, such as electronics, it will be extremely difficult, if not impossible, to replace Western supplies. Russia has for thirty years existed amid the global economic realities, with its high level of international division of labor, close involvement in international supply chains and dependence on imports. The process of embarking on a new path is going to be painful.

However, Moscow has managed to avoid an economic catastrophe. Long before 2022, the Russian financial authorities managed to build a national payment system that is technically independent of external players. In combination with emergency measures by the Bank of Russia, the Ministry of Finance and other organizations and agencies following February 24, 2022, the authorities managed to maintain financial stability. Skyrocketing energy prices also played a role. The price hikes supported the exchange rate of the national currency, and partly compensated (at least temporarily) for the loss of Western markets. Reorientation to new markets will take time and require significant effort. But as long as the prices of raw materials keep rising and the sanctions' initiators are unable to stop using Russian goods overnight without sustaining unacceptable damage, Moscow will have time to implement emergency measures. Their success is not guaranteed. On the Asian markets, Russia will encounter the expectations of discounts and the very same problems with logistics and financial transactions. And yet, Russia has a chance to handle the incoming economic problems step by step, avoiding their simultaneous and cumulative impact.

The Western sanctions show high effectiveness in terms of influencing business behavior. A paradox arises when the governments of such countries refuse to join the sanctions, but businesses are forced to comply with the requirements and laws of the United States and other initiating countries for fear of the loss of markets, secondary sanctions, fines and criminal prosecution. It is not easy to estimate the real impact of this factor on Russian trade, but it is obvious that

the caution of businesses in friendly countries will slow down the reorientation to Asian markets.

The most important mechanism for solving the problem will be to build reliable financial transaction instruments that do not use the services of correspondent banks from unfriendly countries, their currencies, as well as the financial messaging systems they control. The creation of such mechanisms for trade with China appears to be the highest priority. The Chinese market is the most diversified and attractive for Russia. Yuan and ruble transactions and the use of Chinese and Russian financial messaging systems will significantly reduce the impact of Western financial sanctions. The growth in demand for the Chinese currency from Russian exporters is a very telling sign (Russian Central Bank, 2022, p. 4). With regard to export controls in the United States and other countries, they are limited to goods containing U.S. components or manufactured with U.S. technologies. Meanwhile, China can provide a wide range of its own goods. In the future, Russia may also use the Chinese yuan for transactions with third countries, which would be a serious step towards turning China into a world financial center and an alternative to the United States. It is also expedient for Russia to promote its own settlement systems with other countries. For example, one can expect that the Russian ruble may begin to be used widely in a number of segments of economic relations with Turkey.

The Western economic blockade, with all its costs, turns a new page in the history of the Russian economy. Apparently, the Kremlin is determined to preserve the market system, which in itself is a very unusual policy in Russia in extreme conditions. The role of individual entrepreneurs, their energy and adaptability to new conditions will play a no smaller role, and possibly even a greater one, in comparison with government regulation. Russia is moving away from the Western-centric global economy. It may be replaced by closer integration with the Chinese market, as well as the markets of other friendly countries. Such a transition will be painful, but without alternatives, given the high probability that the political breakup with the collective West will last.

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The “sanctions tsunami” against Russia provides a colossal amount of material for the researchers of restrictive measures to study. For now, the current trend confirms the ineffectiveness of sanctions as a tool to change the political course of the target country, especially if it is a major power determined to achieve its goals. On the other hand, it is difficult to ignore the huge economic price that Russia will have to pay as a result of the imposition of large-scale economic sanctions. The question is about the safety margin of the Russian economy’s stability and the Russian leadership’s readiness to sustain economic losses. The sanctions have failed to ruin the Russian economy and they make it possible to handle many economic problems over time one by one, which is a reason enough to postulate that the economic damage factor is unlikely to affect Russia’s policy on the Ukrainian track, at least in the short term. Western financial sanctions and business compliance remain a big problem for the reorientation of Russian trade towards friendly countries. The emergence of alternative financial transaction channels may not only mitigate this risk, but is also likely to lead to more serious consequences for the U.S. unipolarity in global finance.

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