# THE STATE OF THE RUSSIA SANCTIONS CAMPAIGN

Ali Ahmadi

WITHIN months of the invasion of Ukraine and the start of the sanctions campaign against Russia, experts predicted a catastrophe for the Russian economy. The sanctioning coalition led by the United States and the European Union was imposing package after package of sanctions on the Russian economy with resolution and purpose. "This is full-on shock and awe," said Juan Zarate, a key Bush administration sanctions architect. "It's about as aggressive an unplugging of the Russian financial and commercial system as you can imagine." The waves of EU sanctions crashing against the Russian economy after the invasion have been hailed as a "revolution."

The White House noted that "Experts predict Russia's GDP will contract up to 15 percent this year, wiping out the last 15 years of economic gains." An March 2022 report by JP Morgan Bank predicted a 12 percent contraction. Russian technocrats envisaged a contraction of up to 30 percent. In a June 2022 paper they published for *The World Economy*, Mahlstein et al projected a total GDP loss of 14.8 percent for Russia in the case of an allied trade embargo being implemented against the country. But that never came to pass.

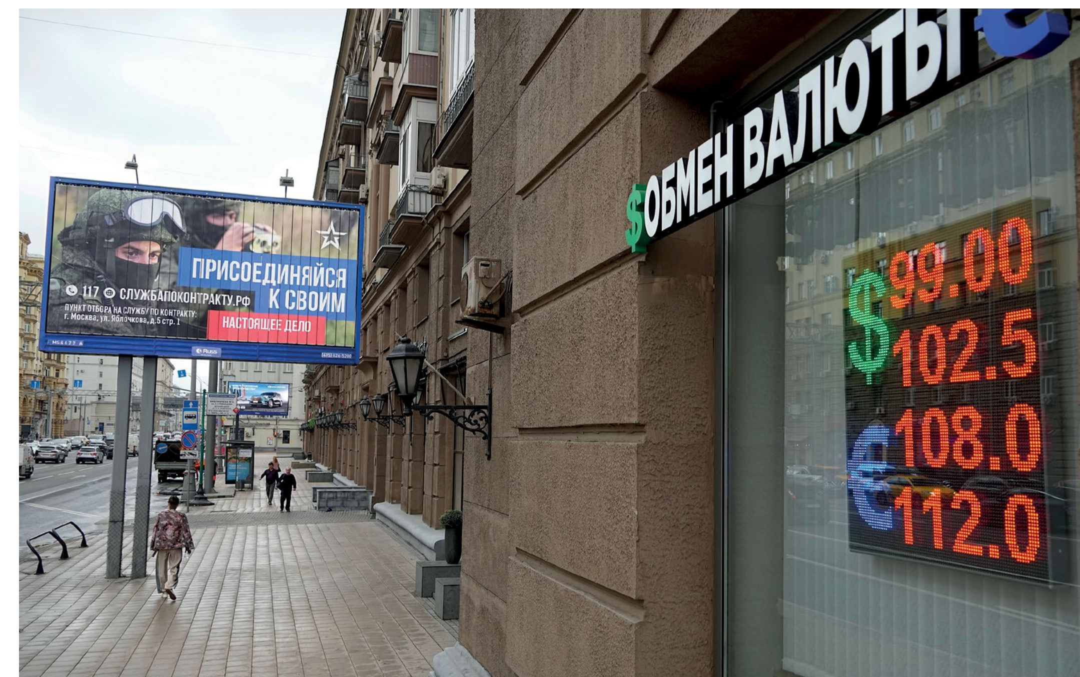
The EU estimates that the Russian economy only contracted by 2.1 percent. The OECD and the World Bank project additional negative growth of 2.5 percent and 0.2 percent respectively for 2023. The IMF projects that the Russian GDP will grow by 0.7 percent in 2023 and 1.7 percent in 2024.

So the topline prediction of doom did not materialize in 2022. The question this analysis seeks to address is why Russia, regularly referred to as the "most sanctioned country in the world," has not experienced the kind of economic folly that would have been expected or did befall many other countries targeted by significant sanctions regimes in the twenty-first century. Countries like Iran, Syria, North Korea, and to a lesser extent Venezuela, were targeted by "maximum pressure" campaigns that did far more damage to their economies than were experienced by Russia.

*Ali Ahmadi* is a scholar of economic statecraft and sanctions policy, an Executive-in-Residence within the Global Fellowship Initiative of the Geneva Centre for Security Policy, and an analyst at the Washington-based Gulf State Analytics. You may follow him on X @AliR_Ahmadi.








Source: Guliver Image

*Cause & Effect: the state of the Russian ruble displayed next to an army recruitment billboard in Moscow*

This study will examine the impact of the sanctions campaign against Russia regarding three key factors. First is the Russian sale of hydrocarbons. Second, the presence of international firms in the Russian market. And third, Russia's ability to import. The analysis will then engage in a discussion about the nature of this sanctions regime and the factors that hold back its potency.

## FIRMS

A key aim of the economic measures imposed against Russia was to halt the involvement of global firms in the Russian economy. Russia sanctions may be targeted at changing the policies of a country, but their primary targets are companies, as Klaus E. Meyer et al argue in a 2023 paper for the *Journal of World Business*. The fact that many major consumer brands departed

Russia immediately after the invasion of Ukraine, including prominent household names like McDonald's and Netflix, gave great hope to the advocates of the sanctions policy.

Since then, there have been a number of projects attempting to estimate the flight of global firms from the Russian economy. The two most prominent are reviewed in this section. The most prominent of the studies evaluating the firm response is the Sonnefeld et al database entitled "The Russian Business Retreat - How the Ratings Measured Up One Year Later" assembled by scholars at Yale University under scholar Jeffrey Sonnenfeld. The study finds that over 1000 firms have either withdrawn or suspended their operations in Russia. An additional 150 have scaled back their activities, close to 180 are buying time and the rest have dug in.

*A key aim of the economic measures imposed against Russia was to halt the involvement of global firms in the Russian economy. Russia sanctions may be targeted at changing the policies of a country, but their primary targets are companies.*

The Kyiv School of Economics (KSE) dataset follows a similar categorization and criteria model as the Sonnenfeld et al dataset, but it includes a far larger sample of 3,213 firms across 88 countries and 57 industries. In their most recent assessment, they conclude that 1,352 firms have stayed in the Russian economy, 519 are waiting to make a decision, 1,191 have either curtailed or suspended their operations (with the vast majority having suspended), and 254 have fully exited the Russian market.

Even if the Sonnenfeld findings were to be taken at face value, it should be concluded that there are still hundreds of international firms that have either dug into the Russian economy or have only limited their operations to a point. And as the Sonnenfeld and other researchers acknowledge, many firms stayed until they can minimize their losses, including by selling their subsidiaries at full valuation or selling them to the local operators, which would in turn minimize the negative impact on the Russian economy.

While this certainly represents a significant blow to Moscow, it is still far more limited than the almost complete exit of all foreign firms from countries like Iran following the initiation of the "maximum pressure" campaign in 2018. The fact that there are so many international firms still operating in Russia also presents an opportunity for significant backfilling, where the abandoned revenue line of a departing firm is instantly taken over by another who stays.

## Imports

Trade agreements are often sold to the public and elites alike for their ability to lift barriers toward a country's exports. This is understandable since many countries rely on exports for jobs and revenue. However, the most important aspect of international trade for any country is actually imports. A country's ability to import parts, technology, and inputs defines its position within global value chains that define the modern international economy. It is that position that defines a nation's economic prosperity and power. Examining Russia's imports is thus critical to understanding how its economy is faring under sanctions.

*There are still hundreds of international firms that have either dug into the Russian economy or have only limited their operations to a point.*

Research from the Bruegel Institute finds that Russian imports dropped from over $17 billion to $8 billion between February and April 2022 and continued at that low level for many months following. However, they began to recover significantly over the summer and averaged roughly $15 billion over the first three months of 2023. These advances are largely the product of import substitution. While imports from the European Union have more than halved since the invasion and remain down though stable at below $4 billion, imports from China have increased from $5 billion to $8 billion despite an initial drop that was likely due to uncertainty about the sanctions that would be imposed.

Analysis from the U.S.-based Silverado Policy Accelerator finds that while Russian imports decreased by 43 percent below medium pre-war levels during March and April of 2022, they quickly rebounded the next fall with September 2023 imports rising above the pre-war levels. They find that while the EU has significantly curtailed its exports to Russia, exports from countries in the Eurasian Economic Zone and China have increased significantly, including the sale of sensitive semiconductors and integrated circuits.

But the Bruegel data also holds important long-term warnings for the Russian economy. Its imports of certain key categories such as semiconductors, telecommunications equipment, and factory inputs have not recovered as quickly. Prior to the conflict these imports were roughly around $2.6 billion and are now stagnating just below $1.5 billion as European exports in this

category have almost entirely evaporated. This is also reflected in an analysis from the Center for Economic and Policy Research that found Russia struggling to substitute the most advanced products, especially semiconductors. This certainly holds an ominous warning for the future of Russian non-oil exports and the future of its involvement in global value chains. Even hydrocarbon exports are threatened by the lack of availability of certain key inputs and technologies.

*A country's ability to import parts, technology, and inputs defines its position within global value chains that define the modern international economy. It is that position that defines a nation's economic prosperity and power.*

But even in this case, the potential long-term outcome remains unclear. European diplomats expressed that Russia is effectively circumventing their bans on the export of semiconductors and integrated circuits by using third-country intermediaries. While this is unlikely to make up for free access to European technology manufacturers for firms in the Russian economy, it will cushion the effect of the sanctions, especially in supplying the Russian defense sector.

## Oil

According to estimates from the Russian government and the International Energy Agency, the Russian government brought in $356 billion from oil and natural gas sales in 2022. According to the aforementioned Bruegel dataset, Russia brought in $317 billion from mineral oils just accounting for 34 countries including 27 European countries, China, India, and several others. Exports to the European countries accounted for almost half, $156 billion, of the total sum though they have dropped precipitously in 2023 and are down to just over $2 billion in March—the last month for which data is available. Russia has shifted exports to non-Western countries and has even overthrown Saudi Arabia as China's largest oil supplier.

The introduction of the G7's so-called "price cap" policy, as well as the phasing in of EU bans on the import of seaborne crude and oil products, brought some hope to the sanctioning coalition that it can finally bring down Russian hydrocarbon revenues (Demertzis et al 2022). The cap calls for the barring of financial and logistics services to be withheld for Russian crude being sold at over $60 a barrel. Japan was given a partial exemption and the rule does not formally apply to countries like China and India, but it does give them substantial bargaining power to negotiate further discounts.

But the outcome of this policy is highly in doubt. Pointing to Russian oil revenue data, the U.S. Treasury Department hailed the program as a success, arguing that Russia is selling just as much crude but is being forced into taking even steeper discounts than they were before, leading to lower revenues. However, these statistics may be misleading. As an analysis by the *Economist* noted—tellingly entitled "Why the West's oil sanctions on Russia are proving to be underwhelming"—claims that Russian revenues are falling are inaccurate and often exaggerated as they struggle to take into account the extent to which this trade is now facilitated through much murkier and less transparent eastern markets, financial institutions, and ports.

*Claims that Russian revenues are falling are inaccurate and often exaggerated as they struggle to take into account the extent to which this trade is now facilitated through much murkier and less transparent eastern markets, financial institutions, and ports.*

An analysis by the Dallas Federal Reserve branch concluded that the impact of the new measures is likely to be "fairly benign" as the price cap was set above per barrel prices and the market for oil products is booming due to recovering demand. The Stanford-based Sanctions Working Group has recommended that the cap be halved to $30 but it's hard to see how economic realities would allow that. The barring of Russian oil products also seems largely unsuccessful as Russia has effectively turned to non-Western markets to make up for the lack of access to Europe. An analysis by the Peterson Institute for International Economics argues that the EU oil ban has been fairly effective, but the effects are still hardly debilitating to the Russian economy.

All of this raises the question as to whether sanctions efforts are merely reshuffling the global hydrocarbon market. Much of Russia's exports are being diverted eastward while the Europeans are buying oil and gas that would otherwise head to Asian markets and fuel products that seem to often be made using Russian oil in Indian refineries. Even Western partners like Saudi Arabia and the United Arab Emirates are importing Russian oil at a discount so they can sell more of their own oil to Europe.

## Making Sense of the Big Picture

Western officials clearly intended for the sanctions campaign to have a crippling effect on the Russian economy and military very quickly. One official from the Treasury Department stated that while previous sanctions campaigns were imposed gradually,

"this time we'll start at the top of the escalation ladder and stay there." But it is difficult to square that with the sanctions campaign in its early months or even today. This sanctions regime is far too gradual and partial to have such a significant and immediate effect. Bruegel's Maria Demertzis et al called this a "strategy of sequencing" in their paper "How have sanctions impacted Russia?," published by the Brussels-based think-tank. According to strategy of sequencing, the EU meets its own needs and only then sanctions. Emily Kilcrease, Jason Bartlett, and Mason Wong of the Center for a New American Security noted that "Under the current waves of sanctions, the allies have made deliberate efforts to insulate current energy production from the impact of sanctions."

*The sanctions campaign against Russia is characterized by a torrent of primary sanctions being imposed by the United States, the EU, and many of their allies in East Asia. Russia is the most designated country in the world, but certainly not the most sanctioned.*

The most important way this obstructed the sender coalition involves hydrocarbons. Europe still needs Russian hydrocarbons and there is a real potential for a radical upward price spiral if the global energy markets were deprived of Russian oil and gas entirely. This effectively removed the kind of global oil and gas embargo effort launched against Iran still currently underway through the intensive use of American secondary sanctions. It also meant that the financial blockade of the Russian banking sector could only go so far. Russia has to be paid for its hydrocarbons and so the Russian financial system cannot be completely cut off from the world.

Many Russian banks remain connected to the global economy, which allows for financial transactions to migrate from one Russian bank to another. While this may include cost and risk, Russia still has significant access to the international financial community. Disconnection from SWIFT was a "nuclear option" with Iran, only because the United States had already spent many years targeting Iranian correspondent banking relationships and other ties with the global banking community.

This is a critical factor undergirding Russia's budgetary stability, its ability to control inflation and the value of the Russian Ruble, and its ability to continue participating in global value chains. The stability of the Russian economy allows for it to retain attractiveness for foreign multinational enterprises. Its currency reserves and access to banking channels have allowed it to recover much of its import and export capacity through trade diversion and facilitated its prolific evasion of technological export controls.

The so-called "maximum pressure" campaigns imposed during the Trump administration were primarily characterized by an aggressive imposition and enforcement of secondary (extraterritorial) sanctions on the part of Washington. By contrast, the sanctions campaign against Russia is characterized by a torrent of primary sanctions being imposed by the United States, the EU, and many of their allies in East Asia. Russia is the most designated country in the world, but certainly not the most sanctioned.

*Despite some claiming that European sanctions enforcement against countries like Iran was a triumphant show of European unity and capacity the truth is that European economies were mostly being policed from across the Atlantic.*

Regarding the maximum pressure campaigns, it was widely acknowledged that many countries, especially those in Asia and Eastern Europe, lack the requisite level of state capacity and sanctions policy to enforce even their own economic restrictions. This is especially important when it comes to Central Asia, the Middle East, and East Asia, where many countries have refused to even impose their own sanctions. The U.S. government instead tracked enforcement of its unilateral secondary sanctions through global financial data, utilizing banking and SWIFT data (panopticon effect), and threatened billion-dollar fines and criminal prosecution. Despite some claiming that European sanctions enforcement against countries like Iran was a triumphant show of European unity and capacity—as Clara Portela does in *Connectivity Wars: The Geo-economic Battlegrounds of the Future (2016)*—the truth is that European economies were mostly being policed from across the Atlantic. This dimension is largely missing in this sanctions campaign.

It is theoretically possible that intensified sanctioning can at some point drive Moscow toward desperation that could cause the Kremlin to either seek a negotiated surrender or deprive Russia of the ability to sustain military operations. This could happen through a severe financial shock to the Russian economy due to depleted foreign reserves or the Russian state exhausting its ability to finance budget deficits. But neither scenario seems likely even over the next few years.

Russia is running very significant deficits, but its sovereign wealth fund is

capable of making up for the shortfall rather easily over the next few years. Moreover, Russia can still borrow domestically. In the previously mentioned Bruegel study, Demertzis et al estimate that Russia's current account surplus for 2023 will be $100 billion. That is a sharp drop from 2022 but still a robust current account dynamic. They also estimate that the Russian banking system was hit with significant losses in the first half of 2022 but that it has since stabilized.

In the long term, sanctions will surely impact the Russian economy in devastating ways. Financial transactions have become more costly and time-consuming, brain drain is intensifying as innovation budgets and resources dwindle, industrial parts and inputs cannot easily be replaced at the same quality and price, Russian hydrocarbon sales have been done through discounts and far more extensive grey market activity in their transport and financial repatriations. Lack of access to high-tech components and direct foreign investment will mean less output down the line. Russia will become increasingly inward-looking and reliant on China.

The U.S. director of OFAC told the media that after months of delicate diplomacy, he will push the countries of the global south more aggressively in cutting trade ties with Moscow by threatening their access to the markets of the sanctioning coalition. The U.S. Treasury announced that, in coordination with the G7, it will redouble its efforts to designate those entities facilitating evasion. Enforcement task forces are being established and sanctions enforcement bodies are on a hiring spree. The EU is building a new unprecedented coordination mechanism to reinforce the sanctions capacity of member states. The Treasury Department's intelligence unit has issued a special alert on various countries being used as third-country circumvention territories. While actions to stop circumvention through arm twisting may be helpful to the goals of the sanctioning coalition, it does include a rather explicit conclusion that widespread adoption of more sanctions to comprehensivize this partial embargo is not in the works.

Additionally, as the G7 and EU's sanctions enforcement tactics become more wide-ranging and advanced, so too do Russia's circumvention tactics and network. And as the sanctions episode goes on, trade diversion will evolve and allow the target to lessen dependencies on the senders.

Clara Portela and Janis Kluge have counseled patience describing sanctions as a "slow-moving tool" in their October 2022 study for the European Union Institute for Security Studies. But while the impact on the Russian economy may become more severe over time, long-term sanctions campaigns have an abysmal record of providing the desired political outcomes. All the maximum pressure campaigns the Trump administration engaged in have failed to produce political results. Saudi Arabia's medieval siege on Yemen failed to achieve adversary capitulation or battlefield advantage despite causing a famine.

*While the impact on the Russian economy may become more severe over time, long-term sanctions campaigns have an abysmal record of providing the desired political outcomes.*

Milov argues that the sanctions have undermined Russia's ability to fund its war effort pointing to the fact that the State Duma only allocated 5 trillion Rubles for defense, up from 3.5 billion in 2022, while Milov himself argues that 10-15 billion would be needed. But it is hard to imagine that the Kremlin ever planned to increase defense spending four-fold from its already high levels.

Sanctions advocates have also been heartened by reports of slowdowns are Russian arms factories and Russian use of older outdated arms stockpiles. While Russia's ability to build its most advanced weapons and guided munitions will undoubtedly be affected by the export control regime of the sanctions campaign, it is too early to make broad conclusions about this matter. It's important to note that even the United States, with likely the most expansive military industrial base in the world, is struggling to keep up defense manufacturing needs associated with the provision of arms to Ukraine. The depletion of U.S. conventional missile stockpiles was even cited by President Biden as a key reason for the provision of cluster munitions to Ukraine.

## Prospects for Containment

Ultimately, the Russia sanctions campaign has been ineffective in dealing a severe blow to the Russian economy because it is merely a partial sanctions campaign rather than a full embargo along the lines of the maximum pressure efforts. The underlying problem is one that will be an ongoing barrier to the effective deployment of economic and financial statecraft in the era of great power competition: when imposing sanctions on larger and more globally integrated economies, the sanctioning countries will struggle to weaponize their much more complex interdependence.

The existing dynamic is acceptable if the sanctioning coalition is looking for long-term "containment" of the Russian Federation but clearly suboptimal and deficient if the goal is to

reestablish full Ukrainian sovereignty or shock Moscow into political or military retreat.

This analysis does not necessarily suggest that the sanctioning coalition moves toward a more fulsome embargo. After all, all the maximum pressure campaigns mentioned above have failed in extracting the political concessions sought by the senders. What the sanctions have produced is leverage that can be deployed strategically to the benefit of Ukraine. This may involve abandoning containment through sanctions and presenting Russia with credible sanctions relief scenarios with a focus on recovering Ukrainian territory at the negotiating table, especially as both American and European leaders doubt that Ukraine can reconquer its territory on its own and through military means.

*When imposing sanctions on larger and more globally integrated economies, the sanctioning countries will struggle to weaponize their much more complex interdependence.*

If when a diplomatic opportunity is presented to advantage Ukraine in a diplomatic negotiation by agreeing to lift sanctions, the West is likely to be best served by placing sanctions on the table and pursuing deterrence toward Russia through other non-sanction means. This could include military support for Russia's Western neighbors and a medium to long-term plan to terminate Russian hydrocarbon imports.

## Association of Young International Criminal Lawyers

The Association of Young International Criminal Lawyers (YICL) is a non-profit organisation open to all those interested in International Criminal Law (ICL), International Human Rights Law (IHRL), International Humanitarian Law (IHL), Public International Law (PIL), and Criminal Law, irrespective of nationality, background or level of experience. YICL is a platform on which academicians, practitioners, and students from all around the world can share their knowledge and experience, evaluate and discuss current developments in the field, and work together toward building a global network.

YICL members have the outstanding opportunity to join an international network: 500 + Members from 86+ Countries in 6+ Continents!

Join us: www.ayicl.com/membership

YICL
Young International Criminal Lawyers