

## **Economics: What are the most likely implications of the economic sanctions imposed on Russia?**

Since February 2022, the United States (US), the European Union (EU), the United Kingdom (UK) and many other countries have imposed economic sanctions on Russia to restrict its financial and technological capacity for continued warfare against Ukraine. The likely implications of these sanctions will be complex, difficult to measure, and their effectiveness will depend on the sectors at which they are targeted. Primarily, these are: the oil and gas sector, finance and banking, the manufacturing and technological segments of the economy, and social and business sectors. The impact of the war on global food and fertiliser prices has also been immense but this sector is not under sanctions and therefore falls outside of the scope of this analysis. This essay will examine the likely ramifications in each category. It will also draw some conclusions on the implications for conflict in the world, for trade patterns, for markets and for environmental and political issues.

The first and most significant category of sanctions targets Russia's oil and gas exports, which comprised over 40% of Russia's state revenues prior to the introduction of sanctions.<sup>1</sup> The US is a net exporter of oil and gas – imports from Russia only accounted for 2% of its supply.<sup>2</sup> The UK imported only 9% of oil and 4% of its gas needs from Russia before the invasion so any impact to its supply has also been minimal.<sup>3</sup> However, the situation is very different in Europe. In 2020, the EU imported over half of its oil and gas from Russia (see Figure 1).<sup>4</sup> The initial impact of sanctions was immense, firing the major European benchmark TTF gas future price to as high as \$367 per megawatt hour in March 2022 and

<sup>1</sup> Palmer, Ian. 2022. As Russian Oil Exports Are Capped – What You Need To Know About The Mother Of All Sanctions. Forbes. <https://www.forbes.com/sites/ianpalmer/2022/12/04/russian-oil-exports-are-capped--things-to-know-about-the-mother-of-all-sanctions/?sh=44f72d234841> [Accessed 10.12.2022] <sup>2</sup> U.S. Energy Information Administration. 2022. Oil and Petroleum products explained. EIA. <https://www.eia.gov/energyexplained/oil-and-petroleum-products/imports-and-exports.php> [Accessed 10.12.2022]

<sup>3</sup> Bolton, Paul. 2022. Imports of fossil fuels from Russia. House of Commons Library.

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contributing to soaring European inflation levels of up to 11.5% in 2022, up from 5% in 2021.<sup>5</sup> Sanctions have led to both price and production caps.



(Figure 1 above, showing natural gas pipeline flows from Russia to the EU since January 2022)<sup>6</sup>

The loss of Russian imports will be remedied by the expansion of trading relations; Europe has already started importing more oil from the United States, West Africa and the Middle East,<sup>7</sup> evidence of the implicated shift in the global oil and gas market. Russia has had to sell more volumes to other countries, particularly those in Asia (see Figure 2), but at a substantial discount to the market price.<sup>8</sup>

<sup>5</sup> Author unknown. 2022. Annual inflation up to 10.6% in the euro area, up to 11.5% in the EU. Eurostat. <https://ec.europa.eu/eurostat/documents/2995521/15265521/2-17112022-AP-EN.pdf/b6953137-786e-ed9c5ee2-6812c0f8f07f> [Accessed 15.12.2022]

<sup>6</sup> Author unknown. 2022. World Energy Outlook 2022. IEA. <https://iea.blob.core.windows.net/assets/c282400e-00b0-4edf-9a8e6f2ca6536ec8/WorldEnergyOutlook2022.pdf> [Accessed 20.12.2022]

<sup>7</sup> Cahill, Ben. 2022. European Union Imposes Partial Ban on Russian Oil. Centre for strategic and international studies. <https://www.csis.org/analysis/european-union-imposes-partial-ban-russian-oil> [Accessed 23.12.2022] <sup>8</sup> Tan, Florence. Verma, Nidhi. 2023. Russia sends more Arctic oil to China, India after sanctions.

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(Figure 2 above, showing change in spending (in billion USD) on Russian oil in India and China in March to May 2021 and March to May 2022)<sup>9</sup>

Crude imports from Russia to India hit a record-high of 6.67 million barrels in November 2022.<sup>10</sup> Russian exports to Turkey and China have also risen substantially – together now making up 70% of total Russian crude flows by sea.<sup>11</sup> The current issue for Russia is that contracts are now mostly sold at a substantial discount, averaging 50% below the global benchmark prices for both oil and gas (see Figure 3).<sup>12</sup> In March 2022, Urals crude sold for \$111/bbl. By January 2023, this had declined by approximately half to \$56/bbl and has also

<sup>9</sup> China Customs/India Trade Ministry via Bloomberg

<sup>10</sup> As above

<sup>11</sup> Horton, Jake. Palumbo, Daniele. 2022. Russia sanctions: How can the world cope without its oil and gas? BBC News. <https://www.bbc.co.uk/news/58888451> [Accessed 20.12.2022]

<sup>12</sup> Watkins, Simon. 2023. Predicting Russia's Next Move Against The Oil Price Cap. <https://oilprice.com/Energy/General/Predicting-Russias-Next-Move-Against-The-Oil-Price-Cap.html> [Accessed 10.01.2023]

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led to an accelerated reduction in reserves.<sup>13</sup> This will undoubtedly add to the woes of the Russian economy which forecasters predict will contract by about 3% – 6% in 2023.<sup>14</sup>



(Figure 3 above, showing trading price of Russian Urals crude oil before and after the invasion)<sup>15</sup>

In parallel, the EU has been successful in seeking alternative energy supplies from elsewhere in the world in order to reduce reliance on Russian gas imports in 2023 and beyond. More recently, this has helped reduce and stabilise the market price of oil and gas and therefore the impact of any sanctions. In the near and mid-term term, the EU has set

<sup>13</sup> As 12

<sup>14</sup> Marrow, Alexander. 2022. Russia's more gradual economic contraction to extend into 2023. Reuters. <https://www.reuters.com/markets/russias-more-gradual-economic-contraction-extend-into-2023-2022-12-02/> [Accessed 17.12.2022]

<sup>15</sup> Author unknown. 2023. Urals Oil. Trading Economics.  
<https://tradingeconomics.com/commodity/urals-oil> [Accessed 14.01.2023]

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levels for gas storage of up to 90% for future years.<sup>16</sup> Investment in European-wide regasification plants and the execution of new liquified natural gas (LNG) contracts with the United States and South East Asia is already underway. New pipeline import agreements with the owners of the giant gas fields of the eastern Mediterranean, Azerbaijan, Norway and Algeria have also recently been signed.

For longer-term needs, the EU has 'rebranded' nuclear power as a new energy - and investments in nuclear, wind and hydrogen production are commonplace. The EU contracted 15 gigawatts of capacity from new wind farms in 2022, a third more than the previous year, in an attempt at strengthening Europe's energy security.<sup>17</sup> In summary, the EU is now well-placed to wean itself away from Russian oil and gas, therefore mitigating the initial effect of sanctions. Additionally, the sanctions could even be seen as a catalyst to cleaner energy transition in western societies although the cheaper availability of fossil fuels to countries such as China and India may undermine this benefit.

Sanctions have also been imposed on the financial and banking sector. The Russian banks have been denied access to the SWIFT settlement system,<sup>18</sup> affecting Russia's ability to access foreign exchange to pay for imports from overseas. Additionally, these asset freezes, (originally worth \$280 billion in March 2022, see Figure 4) were then extended to individuals to capture \$330 billion by December 2022.<sup>19</sup>

<sup>16</sup> Abnett, Kate. 2022. EU to require countries to fill gas storage 90% before winter. Reuters.  
<https://www.reuters.com/business/energy/eu-require-countries-fill-gas-storage-90-before-winter-draft-2022-03-22/> [Accessed 18.12.2022]

<sup>17</sup> Belliard, Rue. 2023. EU wind installations up by a third despite challenging year for supply chain. Wind Europe. <https://windeurope.org/newsroom/press-releases/eu-wind-installations-up-by-a-third-despite-challenging-year-for-supply-chain/> [Accessed 12.01.2023]

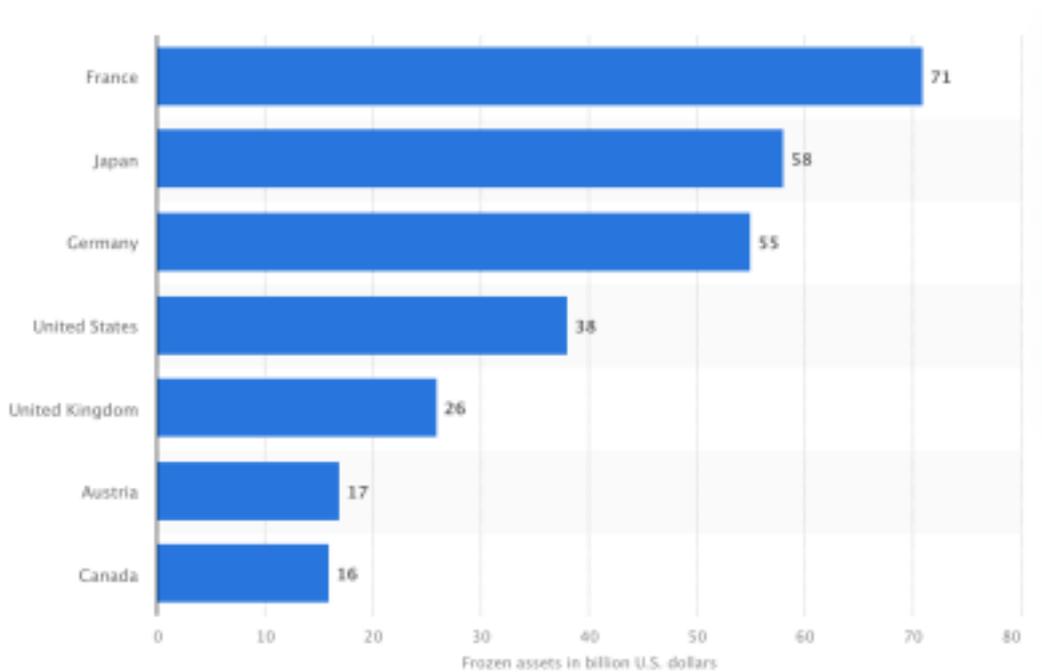
<sup>18</sup> Hotten, Russel. 2022. Ukraine conflict: what is Swift and why is banning Russia so significant? BBC News.

<https://www.bbc.co.uk/news/business-60521822> [Accessed 12.12.2022]

<sup>19</sup> Tan, Huileng. 2022. A US-backed global task force says it has frozen more than \$330 billion of assets from Russian oligarchs and the country's central bank in 100 days. Insider. <https://www.businessinsider.com/repo-global-task-force-freeze-330-billion-russia-oligarch-assets-2022-6?r=US&IR=T> [Accessed 13.12.2022]

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(Figure 4 above, showing Russian asset freezes as of March 2022, by country)<sup>20</sup>

This has forced Russia to act promptly to expand its use of alternative banking systems. For example, SPFS (The Financial Messaging System of the Bank of Russia) is becoming increasingly popular.<sup>21</sup> Fifty new entities joined Russia's alternative system in 2022, taking the total number to 440 – with 100 of these being non-residential.<sup>22</sup> Another alternative is China's own messaging network, CIPS (Cross-Border Interbank Payment System). As of 2021, eighty financial institutions were counted as users of the system, including 23 Russian banks.<sup>23</sup> There has been no news from China about removing these Russian banks from CIPS as their reluctance to reprimand Russia for its military actions in Ukraine continues.

<sup>20</sup> Author unknown. 2022. Value of assets of the Bank of Russia frozen due to sanctions due to the war in Ukraine as of March 2022, by country. Statista. <https://www.statista.com/statistics/1298593/frozen-assets-of-bank-of-russia-by-country/> [Accessed 11.12.2022]

<sup>21</sup> Marrow, Alexander. 2022. Russia's SWIFT alternative expanding quickly this year, central bank says. Reuters. <https://www.reuters.com/business/finance/russias-swift-alternative-expanding-quickly-this-year-says-cbank>

<sup>22</sup> As above

<sup>23</sup> Author unknown. 2022. Are there alternatives to SWIFT? Yes and No. Finlync.

<https://www.finlync.com/blog/alternatives-to-swift-russian-sanctions/> [Accessed 17.12.2022]

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Evidently, Russia's ban from SWIFT has cushioned its tightening relations with other Eastern countries, such as China, and its move away from European markets and communications.

The third distinct category where the sanctions are proving effective are those concerned with the manufacturing and technological sectors. Sanctions have been imposed on cutting edge technologies, transportation equipment, oil refining, energy, space and aviation industries, and maritime navigation. Due to these, Russia has been compelled to rely on items such as drones from Iran because of the Russian inability to access spare parts and micrographs for its own manufacturing capabilities - since the invasion of Ukraine, Iran has become Russia's top military supporter.<sup>24</sup> Conversely, the Foreign Direct Product Rule has reduced American chip exports to Russia by 90% from 2021.<sup>25</sup> Russia has therefore strengthened ties with 'rogue' nations such as Iran, Syria and North Korea - all of whom supply armaments to Russia.

Other sanctions aimed at the business sector also contribute to the widening gap between Russia and the West. Companies such as Shell, BP, British Aerospace and McDonalds have now withdrawn from Russia. Mercedes is the third automobile manufacturer with a factory in Russia to leave the country since February, along with Renault and Nissan.<sup>26</sup> Evidently, the removal of these Western companies will have a notable impact on the Russian economy if Russian attempts to incorporate and emulate these brands fail and employment is lost. Another more irreparable loss is the 'brain drain' of many thousands of

<sup>24</sup> Kube, Courtney. Carol E., Lee. 2022. Russia is providing 'unprecedented' military support to Iran in exchange for drones, officials say. NBC News. <https://www.nbcnews.com/politics/russia-providing-unprecedented-military-support-iran-exchange-drones-o-rcna60921> [Accessed 17.12.2022]

<sup>25</sup> Author unknown. 2022. Chip exports to Russia plunged by 90% after curbs-U.S. official. Reuters. <https://www.reuters.com/technology/chip-exports-russia-plunged-by-90-after-curbs-us-official-2022-06-29/> [Accessed 18.12.2022]

<sup>26</sup> Hordiichuk, Dana. 2022. Mercedes-Benz leaves Russia and sells assets. Ukrainska Pravda. <https://www.pravda.com.ua/eng/news/2022/10/26/7373568/> [Accessed 20.12.2022]

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talented Russians either being called to the front line or emigrating to escape it and the bad conditions at home.

In conclusion, there are profound implications to be considered in the future arising from these economic sanctions. It has to be remembered that Russian support for the war in Ukraine is at over 85% of the population. Their support is based on the belief that the sanctions are a deliberate attempt by the West to impoverish 'Mother Russia' - a belief reinforced by the failure of the sanctions to deliver the knockout blow originally expected. Indeed, the IMF estimated in October 2022, that Russia's economy would only contract by 3% (less than half that took place during the financial recession of 2008-2010) although other estimates are as high as 6%.<sup>27</sup> If the war continues and the sentiment remains the same, the risk of conflict proliferation will increase. There is also a dramatic shift in trade patterns between the East and West as China, India and the Middle East become closer trading partners with Russia whilst the EU, the UK and the US are effectively shut out.

Finally, it must be acknowledged that the sanctions to-date have not succeeded in bringing the war in Ukraine any closer to an end and it seems unlikely that this will happen in the near future – although the capacity of Russia to finance the war from fuel reserves is limited. If, in the future, a perceived risk develops that sanctions could ultimately destroy the Russian economy and Russia is losing the war, Putin might be tempted to deploy nuclear weapons to achieve ultimate military success in spite of the hostility from the rest of the world including China. On the other hand, there is also a scenario that sanctions will do such damage to the economies of the sanctioning countries, largely in the EU, that patience will be exhausted and sanctions will be reversed. As recently stated by the Hungarian Prime minister, Viktor

Orban: "We can safely say that as a result of the sanctions, European people have become

<sup>27</sup>As 11

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poorer, while Russia has not fallen to its knees,...This weapon has backfired, with the sanctions Europe has shot itself in the foot."<sup>28</sup>

Word count: 1,584

<sup>28</sup> Than, Krisztina. Komuves, Anita. 2022. Hungary PM Orban says EU sanctions on Russia have “backfired”. Reuters. <https://www.reuters.com/world/europe/hungary-pm-orban-says-eu-sanctions-russia-have-backfired-2022-09-26/> [Accessed 13.01.2023]