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Anders Åslund Western Economic Sanctions on Russia over Ukraine, 2014–2019



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In comparison with other countries, the United States is particularly keen on economic sanctions, and it is becoming ever more so. In the US foreign policy debate, the point is often made that sanctions are not a foreign policy, only one of many tools. In practice, however, sanctions have become a major feature of US foreign policy. For many years, the United States has been reluctant to expand foreign aid, which has been highly unpopular with the electorate. Diplomacy does not have a high standing in the United States. Under George W. Bush, military force dominated foreign policy, resulting in the long and costly wars in Afghanistan and Iraq. After these traditional forms of foreign policy have been found wanting, economic sanctions have gained prominence under Presidents Barack Obama and Donald Trump.

For policymakers, economic sanctions have many attractions. No Americans have to be sent abroad and no troops are being killed. Nor do they involve any budget allocations. For a big country with limited foreign trade such as the United States, the cost of sanctions appears small. Thus, sanctions have become the US foreign policy tool of choice. The United States has imposed sanctions on dozens of countries, most severely so against Cuba, North Korea, Iran, Syria, and Venezuela.

As sanctions have proliferated, they have become more specific with regard to aim and means. The purpose of this paper is to investigate the Western sanctions on Russia related to Ukraine. First, why were they imposed and what was their aim? Second, what effects have they had? Which sanctions have been most effective? What problems have arisen? Third, what has Russia's effect been? Finally, what lessons can be drawn for the future?

SANCTIONS ON RUSSIA OVER UKRAINE

On 18 March 2014 Russia annexed Crimea, swiftly integrating it into Russia. This came as a complete surprise to the West. Military support for Ukraine was never considered an option, but the West felt it had to do something, so it imposed sanctions. Russia offered a special challenge. With an economy roughly three times as large as Iran's, Russia was the biggest economy the West had sanctioned.

In March 2014, the European Union and the United States announced Crimea-related sanctions with visa bans and assets freezes on individuals and companies accused of undermining democracy, misappropriating Ukrainian property, and violating human rights. Gradually both the US and the EU have expanded their sanctions to people responsible for Russian policy on Crimea and enterprises operating there. Ukraine has cut off almost everything – electricity, water, trade, and transportation – isolating Crimea from the outside world.¹

A novelty was that the United States sanctioned four of Putin's cronies, namely Yuri Kovalchuk, Arkady and Boris Rotenberg, and Gennady Timchenko, as well as their Bank Rossiya. The EU sanctioned Kovalchuk and Arkady Rotenberg as well, and a fifth crony Nikolai Shamalov, but it has not sanctioned Boris Rotenberg or Gennady Timchenko because they are Finnish citizens. These sanctions were based on the insight that Russia was a kleptocracy. Similarly, sanctions were imposed on enterprises owned by the state or cronies, and only exceptionally on private enterprises.

The aim of the Crimea-related sanctions was primarily to isolate and stalemate Crimea economically, but also to punish the culprits, to stop Russia's aggression, and to deter Russia from further aggression. Crimea remains utterly isolated, although the common view is that nothing will happen until the Putin regime ends in Moscow. The standard parallel is with the Baltic countries after the Soviet occupation of them in 1940, which the United States never recognized, and in 1991 they restored their independence. Major trade sanctions on commodities such as oil and gas were out of the question, because their effects would be too great on the Western economies.

The Crimea-related sanctions did not deter the Kremlin from proceeding with further aggression in Ukraine. In April 2014, anonymous Russian special forces tried to repeat their success in eastern and southern Ukraine, but unrest took root only in parts of Ukraine's two easternmost regions of Donetsk and Luhansk. As the Ukrainian military advanced against the Russian-backed forces, Russia sent in regular troops in August.

In response the United States imposed more substantial sectoral sanctions on Russia on 16 July, and the EU did so on 31 July. Most other Western allies – Japan, Canada, Australia, New Zealand, Switzerland and Australia – joined the US-EU sanctions but no developing country did. The July 2014 sanctions went much further than the Crimea sanctions. They covered three sectors: finance, oil, and defense technology, focusing on large state companies. Also, individuals responsible for Russian policy in the occupied territories and enterprises involved

¹ Aleksashenko (2016) offers an excellent and detailed analysis and CRS (2019) provides all the relevant details.

were sanctioned. The financial sanctions prohibited lending to the sanctioned state banks and companies for 30 days or more, and the European Bank for Reconstruction and Development was blocked from offering new financing in Russia. The energy sanctions were limited to three kinds of oil development: deep offshore drilling, arctic offshore, and tight oil. They did not harm production in the short term, but in the long term. The EU insisted that gas must not be subject to any sanctions because of its great dependence on Russian gas (CRS 2019).

The United States coordinated the sanctions over Crimea and Eastern Ukraine with the EU and other allies, reinforcing their impact. After the floodgates had been opened, the US has imposed one sanction after the other on Russia. In December 2012, the US adopted the Sergey Magnitsky Act for human rights sanctions. It proceeded with sanctions related to Syria and North Korea, and in December 2016 sanctions because of cyber and election interference were imposed. In response to Russia's use of nerve gas in the United Kingdom, the US imposed new sanctions based on the 1991 Chemical and Biological Weapons Control Act (Fried 2018).

President Barack Obama imposed the Ukraine-related US sanctions through presidential executive orders, which meant that they could be modified at any time. During the election campaign in 2016, Donald Trump repeatedly criticized the US sanctions on Russia, arousing fear that he would actually abolish them. Therefore, the US Congress codified these sanctions into law in the Combating America's Adversaries through Sanctions Act (CAATSA), which President Trump signed into law on 2 August, so that the president no longer could alter the Russia sanctions without the consent of Congress.

In April 2018, the US Treasury issued its first Ukraine-related sanctions based on CAATSA. They were so severe that they caused a shock. The Treasury sanctioned 24 people and 14 enterprises. Most of the people sanctioned were quite close to Putin, including his former son-in-law Kirill Shamalov. Several big oligarchs were sanctioned, notably Oleg Deripaska. These were designations, meaning that no US person was allowed to do any business with these people or enterprises. Finally, these sanctions hit some very big enterprises, notably Deripaska's company Rusal, which was a listed company and accounted for 6 percent of global aluminum production.

The sanctions on Russia have not been severe in comparison with those on Cuba, Iran, North Korea, and Venezuela, but they are becoming increasingly more severe. In the summer of 2019, even Russian sovereign debt was sanctioned, though Russia can still use the international bank clearing system SWIFT (Åslund 2019).

None of the Western sanctions is directed against trade. Russia's dominant exports are oil

and gas, accounting for two-thirds of all Russian exports. If Russian oil had been sanctioned, oil prices would have skyrocketed to the benefit of the Kremlin. Moreover, the Europeans opposed any sanction on Gazprom. Similarly, Russia's substantial metal exports were too important to be sanctioned.

EFFECTS ON RUSSIAN POLICY AND ECONOMY

The effects of sanctions are multiple. Did they change Kremlin behavior? What was the economic effect of the sanctions? The Western sanctions were imposed in parallel with the oil price collapse in 2014, which makes it difficult to separate the two impacts.

The Crimea sanctions aimed to isolate Crimea for the foreseeable future, which seems to have been attained. Even big Russian state companies such as Sberbank and VTB refuse to do business in Crimea because of the particularly severe Western sanctions on Crimea. Instead, already sanctioned Russian banks and state banks designed for occupied territories have moved in, showing that these sanctions are a severe deterrent (Åslund 2018).

The sanctions related to eastern Ukraine had several goals. First and foremost, they were supposed to incite the Kremlin to stop the Russian military offensive, aiming at taking 'Novorossiya', the southern and eastern Ukraine, about which Putin spoke so eloquently on 17 April 2014 (Putin 2014). Putin did drop Novorossiya from his speeches, while it was always less probable that the Kremlin would evacuate eastern Ukraine.

Economically, the most important sanctions have been the financial sanctions connected to Russian aggression in eastern Ukraine. Western banks were afraid of being trapped. Even the four big Chinese state banks obeyed the US financial sanctions, because they have activities in the United States and all dollars pass through New York, thus being subject to US jurisdiction, allowing the US authorities to impose sizable fines.

The most obvious effect of the financial sanctions is the development of the size of Russian total foreign debt. It declined from USD 732 billion in June 2014 to USD 482 billion in June 2019 – that is a reduction of USD 250 billion or 16 percent of GDP (Central Bank of Russia 2019). Russian corporations had no choice but to pay off their debt service as it fell due, and they had hardly any possibilities of refinancing. Without sanctions, Russian foreign debt would probably have increased by a similar amount, as was the case in most of the world (Pestova and Mamonov 2019). Thus, the sanctions might have forced Russian entities to forgo investments of up to 32 percent of GDP in the course of five years, or 6.4 percent of GDP a year in investment, which is a lot. The sanctions have also aggravated Russia's already low credit rating, rendering foreign capital not only scarcer but also more expensive.

In 2015, the IMF assessed the impact: “model-based estimates suggest that sanctions and countersanctions could initially reduce real GDP by 1 to 1.5 percent. Prolonged sanctions could lead to a cumulative output loss over the medium term of up to 9 percent of GDP, as lower capital accumulation and technological transfers weakens already declining productivity growth” (IMF 2015, 5). In 2019, the IMF returned to this issue, but with a rather different question and methodology. It noted that Russia’s economic growth decelerated sharply after the global financial crisis, and then even more starting in 2014. The IMF took the low growth rate expected in 2013 and asked why it was even lower. Its analytical work based on economic models found that sanctions accounted for lower growth to the tune of 0.2 percent of GDP, oil prices were responsible for 0.6 percent of GDP, and fiscal, financial, and monetary factors for another 0.4 percent of GDP (IMF 2019). A discussion paper from the Bank of Finland Institute for Economies in Transition comes to a similar result but does not quantify it (Pestova and Mamonov 2019).

These studies pose different questions. Originally the IMF had expected higher growth in the future, while in its analysis in 2019, it asked why the prior low growth rate had become even lower. The impact of the lower oil price is not in doubt, but most of the adjustments of fiscal and monetary policy should be seen as the impact of sanctions, forcing the Kremlin to save hard currency at the expense of investments. Therefore, the IMF assessment of 2015 appears more relevant.

By contrast, the cost to the West of the Western sanctions and the Russian countersanctions has been minimal. Russian imports fell sharply in 2014 and 2015, but because of the falling oil price, and the EU has maintained its large market share in Russia of about 45 percent. Plausibly, Gros and Di Salvo (2017) have concluded that the position of European exporters in the Russian market has not been infringed because of the EU sanctions. The impact of the Russian countersanctions on agro-food imports from the EU has been minimal. Russian imports of these goods have fallen by about EUR 400 million, which is less than 0.3 percent of EU GDP, while overall EU exports of these goods have increased because of increased sales to other markets.

The sanctions on Russian oil development focus on long-term developments of Arctic and deep offshore drilling and tight oil and have no immediate or even medium-term impact. The sanctions on defense technology are difficult to evaluate, but neither have a direct economic impact.

The systemic impact is all the more obvious. Sanctions are the opposite of economic integration, making Russia and the West grow apart. Each sanction provokes maintenance sanctions and countermeasures. Both sides protect themselves through

increasing isolation. Businessmen have to calculate with sanction risks, credit risks, and eventually with reputational risks. Although Putin’s cronies and state corporations have been singled out for Western sanctions, the sanctions seem to have reinforced the role of both the state and the cronies in the economy, while many *bona fide* private businessmen flee abroad.

In 2013, before the Western sanctions were initiated, Putin started isolating Russia with ‘deoffshorization’ and import substitution. Big Russian businessmen face the choice of staying in Russia and reducing their links to the West or selling their assets in Russia and moving to the West. By and large, the elite from the 1990s makes the latter choice, which is reflected in even larger capital flight than before 2014 and minimal foreign direct investment in Russia.

OFFICIAL RUSSIAN REACTIONS

Through his many public statements, Putin has made clear what he thinks of sanctions. He reacted the most against the Magnitsky Act and the Western March 2014 sanctions against his close friends, which blocked them from visas, cut them out from the Western financial system, and potentially froze their assets in the West. By contrast, he played down the impact of the sectoral sanctions, and he imposed the countersanctions on food for the Russian people himself.

What really upset Putin was transparency, the release of the Panama Papers on 3 April 2016, which revealed his apparent offshore holdings of at least USD 2 billion through his cellist friend Sergei Roldugin. The eminent Russian journalists Andrei Soldatov and Irina Borogan have recorded the Kremlin response. On 7 April, Putin attacked the journalists who had released the Panama Papers: “what did they do? They manufactured an information product. They found some of my friends and acquaintances. [...] There are many, many people in the background – it is impossible to understand who they are, and there is a close-up photo of your humble servant in the foreground. [...] Besides, we now know from Wikileaks that officials and state agencies in the US are behind all this!” (Borogan and Soldatov 2017, 314–319).

When it came to his close friends (Kovalchuk, the Rotenbergs, Timchenko), Putin took it extremely personally. He defended them repeatedly and passionately in public. On 17 April 2014, in his annual phone-in program with the people, Putin took this obviously planted question: “these sanctions hit several major businessmen such as Yury Kovalchuk, Gennady Timchenko, and the Rotenberg brothers. They are rumored to be your personal friends and part of your inner circle and that their fortunes were made thanks to that friendship. [...] Don’t you

get the feeling that the main target of the EU sanctions is you, personally?” (Putin 2014). Putin stood up for his friends: “it looks as if they are trying to make me the object of these sanctions. As for the people you mentioned, they are indeed my good acquaintances, my friends. But for the most part they had made their fortunes before we even met. [...] Mr. Timchenko’s wife had serious surgery and was unable to pay for it because her bank account and credit cards were frozen. This is a flagrant violation of human rights” (Putin 2014).

As a consequence of the European sanctions against Rotenberg, Italy froze luxury properties belonging to Arkady Rotenberg in September 2014. These assets included the Berg Luxury hotel in Rome and properties in Sardinia, which together were valued at USD 36 million (Rudnitsky and Sirletti 2014). The Russian Duma responded by authorizing the Kremlin to seize foreign assets in Russia and use them as compensation for individuals and businesses being hurt by Western sanctions over the Ukraine crisis. This bill was called the ‘Rotenberg Law’ (Kramer 2014). In 2017, Putin signed an alternative Rotenberg Law. The Russian state itself would offer compensation out of the state coffers to Russian individuals who had suffered from Western sanctions. Because of the sanctions Arkady Rotenberg transferred much of his ownership to his son Igor (Chellanova et al. 2014).

Since the Russian economy is so much smaller than the Western economy, Russia cannot respond effectively without hurting itself more. It sanctioned some Western officials, which was of little consequence. Russia has imposed one group of serious sanctions, but on its own people. In August 2014, the Kremlin introduced ‘countersanctions’ against food imports from the countries that had imposed sanctions on Russia.² Many other kinds of sanctions were discussed, such as prohibition of flights over Russian territory, but they were never adopted (Kramer 2014). The Kremlin realized that Russia was the underdog.

For years, Putin denied that the Western sanctions cost Russia anything, but on 20 June 2019, in his big annual phone-in program with the Russian people, Putin changed tone and admitted that the Western sanctions were costly to Russia. But he did so in a very strange statement: “Russia fell short by about USD 50 billion as a result of these restrictions during these years, starting in 2014. The European Union lost USD 240 billion, the US USD 17 billion [...] and Japan USD 27 billion” (Putin 2019). His vague statement does not clarify what he refers to or for what period, and the numbers make no sense. The only important point is that he agreed that the sanctions are costly to Russia.

CONCLUSION

Many lessons can be drawn from the Western sanctions on Russia. The most obvious conclusion is that these sanctions were feasible and have had great tenacity, while many argued that the European Union would break them. However, sanctions tend to be inert. As Russia has not withdrawn from eastern Ukraine, there was no logical ground to end the sanctions (Fried 2019). Although the EU had to renew the sanctions initially every half year and later every year, this has been done ever more easily. Western trade with Russia has declined, mainly because of lower oil prices and thus less Russian exports since 2014, and Russia is so insignificant for Western exporters that the pro-Russian enterprise lobby is not very significant. Russia was not too large to be sanctioned. Nor has Western trade with Russia declined disproportionately.

The general lessons about sanctions are that the more limited and targeted the aim, the more likely the success (Hufbauer et al. 2009). The Crimean sanctions were designed to hold in the long run and to keep Crimea isolated, which remains true. The sanctions related to Russia’s aggression in eastern Ukraine stopped the Russian offensive in July 2014, but they have not persuaded the Kremlin to withdraw from that territory.

Another general lesson is that the broader the alliance behind the sanctions, the more likely they are to succeed (Hufbauer et al. 2009). The US administration under President Barack Obama was crucially aware of this. Its strong office of sanctions in the State Department pursued high-level coordination of the Russia sanctions with the EU and other allies. Without providing any public explanation, President Donald Trump abolished the State Department office of sanctions. As a consequence, coordination of sanctions both within the US government and with allies was weakened, as sanctions policy was effectively transferred to the Treasury Department (Mortlock and O’Toole 2018). The US Congress distrusts President Trump and has seized more initiative, in particular by adopting the CAATSA in July 2017. The Trump administration has reduced the coordination with allies and the number of unilateral US sanctions on Russia has increased. So far this has not broken the sanctions regime, but Trump remains the greatest threat.

After the US sanctioned Rusal in April 2018, the US Treasury appears to have realized that the company was too big to sanction because it caused havoc on the global aluminum and alumina markets. After prolonged negotiations and numerous extensions, the US Treasury finally declared victory and delisted Rusal. The real explanation was that the undesired effects were too great (US Treasury 2019).

For the rest, the design of the sanctions appears to have worked well. As President Putin himself has

² “Putin Extends Russia’s Countersanctions on Western Food”, *Radio Free Europe/Radio Liberty*, 30 June 2017.

emphasized, he is most concerned about his friends and top officials being personally sanctioned. The financial sanctions have obvious and significant effects on Russia's economic growth. The Kremlin has successfully increased its international currency reserves, but it has done so with considerable cost to the standard of living that has fallen for each of the last five years. The capital outflows from Russia have not slowed down but rather accelerated with the sanctions.

A serious shortcoming of the Russia sanctions, however, is that few assets of sanctioned businessmen have actually been frozen. To some extent, this is negligence of national authorities, but the dominant reason is the prevalence of completely anonymous companies. In the UK, the government does not know the owner of 100,000 buildings, and in the United States there are at least two million anonymous companies. In 2018, the EU adopted its Fifth Anti-Money Laundering Directive, which demands that all member countries establish registries with the ultimate beneficiary owners of all companies. In the US, legislation on similar registries to be established with the Financial Crimes Enforcement Network of the US Treasury is currently being considered.

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