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Research Report

Sanctions, counter-sanctions and Russia: Effects on economy, trade and finance

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Abstract

This note briefly reviews the history and current impacts of sanctions on Russian entities imposed by the EU, US and others, as well as Russia's counter-sanctions imposed on Western countries. A large drop in price of oil in 2014 and 2015 coincided with these measures, complicating our efforts to tease out the specific economic effects of sanctions on the Russian economy. While it is clear that the decline in oil prices had a substantially larger impact on Russian GDP in 2014−2016 than sanctions, the sanctions regime proved effective in restricting access of Russian banks to capital. Looking specifically the impacts on EU countries, we note that the declines in trade with Russia and the EU's reduced market share in Russia are to some extent continuations of long-term trends. Russia's counter-sanctions have targeted, among other things, EU food exports to Russia. While the macroeconomic effects Russia's counter-sanctions on the EU have been marginal, food sector in some EU countries has been affected. Russia's counter-sanctions have also directly lowered consumption of affected goods in Russia.

Keywords: Russia, economy, sanctions, international trade, capital flows

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1. Introduction

The economic fallout from sanctions and counter-sanctions regimes imposed by the US, EU, Russia and other countries following Russia's illegal annexation of Crimea and Sevastopol, along with Russia's actions in destabilizing the situation in eastern Ukraine, is widely documented. It is also generally accepted that the restrictive measures of the various parties in the conflict have been highly asymmetrical. The US and EU have mostly limited access of select Russian entities to market finance and technology exports, while Russia has concentrated on banning specific imports, including a wide range of agricultural goods from different countries. One can also see import bans to be part of an "import substitution" policy aimed at increasing self-sufficiency and supporting domestic producers.

While it is difficult to isolate the impact of sanctions, it can be said with some confidence that their role in the recent downturn of Russian economy has been substantially smaller than that of the oil price decline. Moreover, the impact of sanctions has been relatively limited on the aggregate level, but pronounced for companies and individuals directly affected. This is reflected, for example, in the difficulties of Russian banks and companies in access to foreign financing. From the EU's point of view, the aggregate impact of mutual sanctions also seems to be limited, with certain sectors and companies hit harder than most. The food sector clearly suffered in 2014 and 2015 from the effects Russia's sanctions, even if most subsectors have since managed to reorient their exports outside the EU to other markets.

It should be noted, however, that our conclusions are not evaluations of the effectiveness of the sanctions imposed on Russia e.g. by the EU. The goal of the economic sanctions imposed by the EU is not to make Russian economy collapse or to impoverish the Russian people, which is also reflected in the relatively narrow targeting of the sanctions. They are meant to influence policy, e.g. implementation of the Minsk agreements (and also tied to this). While it is beyond the scope of this paper to assess the extent of the policy effects, we would like to emphasize that Russia's policies without sanctions might have been quite different today – and not in a good way.

This note is structured as follows. In the second section, we describe sanctions imposed by various countries. The third section attempts an assessment of the macroeconomic effects of sanctions on Russia. In the fourth section, we offer evidence of the impacts of various sanction on international trade and capital movements. The fifth section concludes.

2. Sanctions and counter-sanctions

2.1. The rationale and design of sanctions

Since the annexation of Crimea and commencement of military operations in East Ukraine, specific Russian entities and natural persons have been subject to various economic and financial sanctions by the European Union, the US, Canada, Australia and others.[1]

The initial round of sanctions was relatively mild. It included restrictions on travel, asset freezes and proscribing of business dealings with certain individuals and enterprises, including entities based in Crimea and Sevastopol.[2] Persons or institutions involved in political and economic actions deemed to "undermine Ukraine's territorial integrity" were the most likely to find themselves on the sanctions

[1] This section draws heavily on Korhonen (2018). For an insightful assessment of various criteria on designing sanctions against Russian entities, see Christie (2016).
[2] For a comprehensive, up-to-date listing of EU's restrictive actions, see https://europa.eu/newsroom/highlights/special-coverage/eu-sanctions-against-russia-over-ukraine-crisis_en.

list. Only one financial institution made the first sanctions list – Russian National Commercial Bank. The bank was established in Crimea to handle banking business in the annexed peninsula and was wholly owned by the regional government of Crimea. Even today, the sanctions related to annexation of Crimea are legally separate from later sanctions.

The downing of Malaysian Airlines flight MH-17A caused a distinct tightening of the sanctions regime. The timing of EU and US measures were coordinated with only minor timing differences.[3] G7 members, Norway, Iceland, Australia, Switzerland and others also joined in enforcing most of these restrictions. Numerous institutions and individuals were added to the EU sanctions list on July 30, 2014.

The sanctions affected many sectors. Export and import of arms was forbidden, as was export of dual-use goods for military use. Export of certain types of goods related to oil exploration and production was also banned.

Most significant perhaps was the curtailing of long-term financing of Russian companies that had no direct involvement with the fighting in Donetsk and Luhansk regions. Investors in the EU were forbidden to provide long-term financing to Sberbank, VTB, Gazprombank, Rosselkhozbank (Russian Agricultural Bank) and VEB (Russia's state-owned development bank). Initially, the financing ban only applied to loans with maturities longer than 90 days or equity financing. On September 12, 2014, the maturity threshold was lowered to 30 days.[4] The long-term financing ban was also extended to oil giant Rosneft, oil pipeline company Transneft, oil exploration and refiner Gazpromneft, as well as several companies operating in the military sector.

Economic sanctions, travel bans and asset freezes imposed by the EU are regularly reviewed every six months and their continuation requires renewed support from all 28 EU members. Annual reviews of sanctions related to entities in the Crimean Peninsula have also been established.

2.2. Russia's sanctions ("anti-sanctions") and import substitution policies

In this subsection, we assess the links between Russia's ban on imports of certain foodstuffs and its long-term policy of trying to support domestic production by the way of "import substitution." Substituting imports with domestic production is a goal in and of itself, not just a reaction to the sanctions imposed by the US and the EU in 2014. Indeed, import substitution and promotion of domestic production in key sectors is a familiar theme in Russian politics; replacing imports with domestic production integral to policies aiming at economic sovereignty and securing security of supply of crucial products has been emphasized since the early 2000s. The National Priority Programs established at the beginning of Putin's second presidency in 2005 enshrined the notion of increasing self-sufficiency in agriculture.

The groundwork for anti-sanctions was also laid well before events in 2014. The food security doctrine, a framework policy paper outlining Russia's goals in agricultural policies, was signed in January 2010. The doctrine establishes minimum targets for domestic production in basic foodstuffs such as potatoes, dairy products, grains, meat and meat products. The minimum targets were defined

[3] On April 6, 2018, the US introduced additional sanctions on various Russian individuals and corporations "in response to worldwide malign activity," https://home.treasury.gov/news/press-releases/sm0338. The move provoked sharp market reactions over the following days. Share price of one of the targeted companies, aluminium producer, Rusal, dropped 50% immediately. The ruble depreciated approximately 10% despite rising oil prices. We do not take up the possible further effects of these newest sanctions as they are so recent, but note that uncertainty concerning Russian economy has clearly increased.

[4] Such rule changes may be difficult to interpret before they are enforced. Furthermore, Sberbank's subsidiary banks in the EU were exempt from the ruling. The EU now tries to ensure these subsidiary banks are not used to circumvent the financing ban.

in terms of shares of domestic production in total consumption. A target of 90 % was set for milk and dairy products and 85 % for meat and meat products (Vassilieva and Smith, 2010).

Russia's food security policy reflects a worldview in which dependence on imports is considered dangerous. This differs from most countries, where food security tends to be defined in terms of access to adequate and affordable food supplies for the population (Wegren and Nikulin, 2016). The general guidelines for Russia's food security doctrine were articulated in an action plan under the Development Program for Agriculture 2013–2020, approved in 2012. The development program put strong emphasis on increasing production volumes, raising quality in agriculture and food industry and replacing imports with domestic production.[5]

Import-substitution is not confined to agriculture and the food industry. The government approved in April 2014 a wide-ranging policy document "Government Program on Industries and Competitiveness" with detailed plans for almost all industries. It called for increasing domestic production and R&D with the help of e.g. budget money and localization requirements.[6] The program is even referred from time to time as the "import-substitution program" of the Russian government.

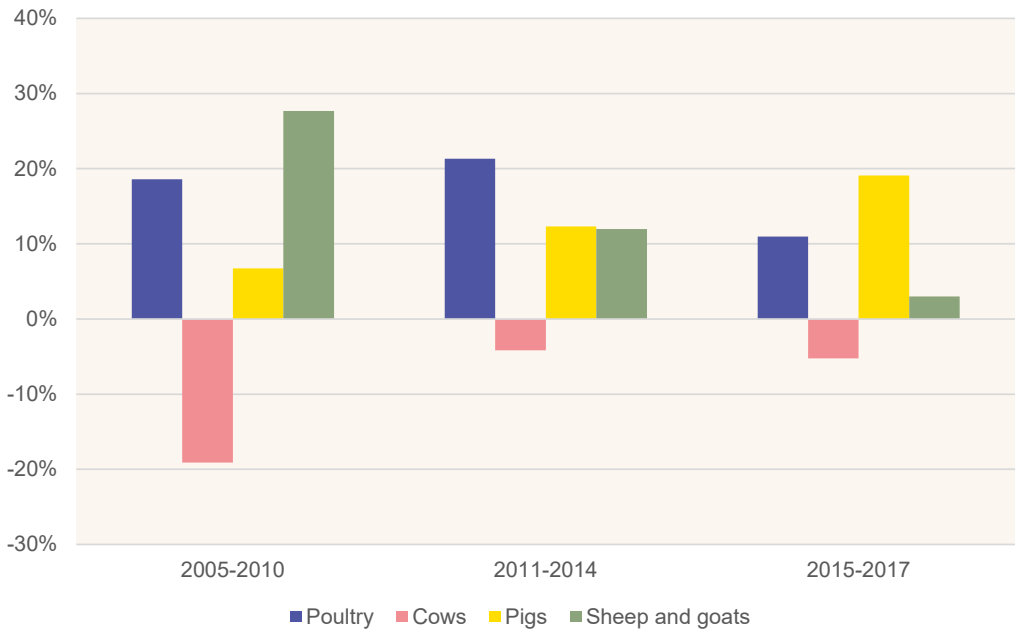
All these policy programs were approved following relatively broad discussions within administration, so we feel comfortable arguing that they reflect a broadly held view on the importance of import substitution in fostering economic growth. Russia reacted to the sanctions imposed by the US and EU in July 2014 by restricting imports of selected food products, including fish, fresh milk and dairy products, fruits and vegetables (Simola, 2014). The import ban was announced within days of the US/EU sectoral sanctions, leading many to wonder whether the lists of banned products had not been prepared beforehand with the aim of supporting domestic production.

The worsening geopolitical situation redoubled Russia's determination to push forward with policies aimed at replacing imports in all sectors of the economy. Despite discussion about costs and benefits of import substitution in the Russian academia, however, little criticism of the policy has been voiced at the political level. While consumers would surely benefit from lower prices and larger product selections from the removal of import bans, the overall impact of such a ban-lifting on consumer welfare is small. Even so, restrictions are framed in the official narrative as an extremely positive basis for economic development.[7]

Counter-sanctions, import restrictions from Turkey,[8] ruble devaluation and various state support programs have indeed helped in boosting domestic production in agriculture.[9] Notably, these positive trends long predate most counter-sanctions. For example, production of poultry meat increased significantly before 2014. Growth in pork production begun to ramp up at the beginning of this decade. The continuous decline in number of dairy cows and the resulting decline in fresh milk production is stunning given that imports of fresh milk and milk products were severely restricted in 2014 (Figure 1). Favorable weather conditions partly explain the exceptional grain harvests in 2016 and 2017, but fruit and vegetable crop yields have increased steadily since 2010 (Figure 2). Notably, agricultural land use has not increased markedly in recent years. The area of land under cultivation for grain crops in 2016 was still slightly below the 2009 peak.

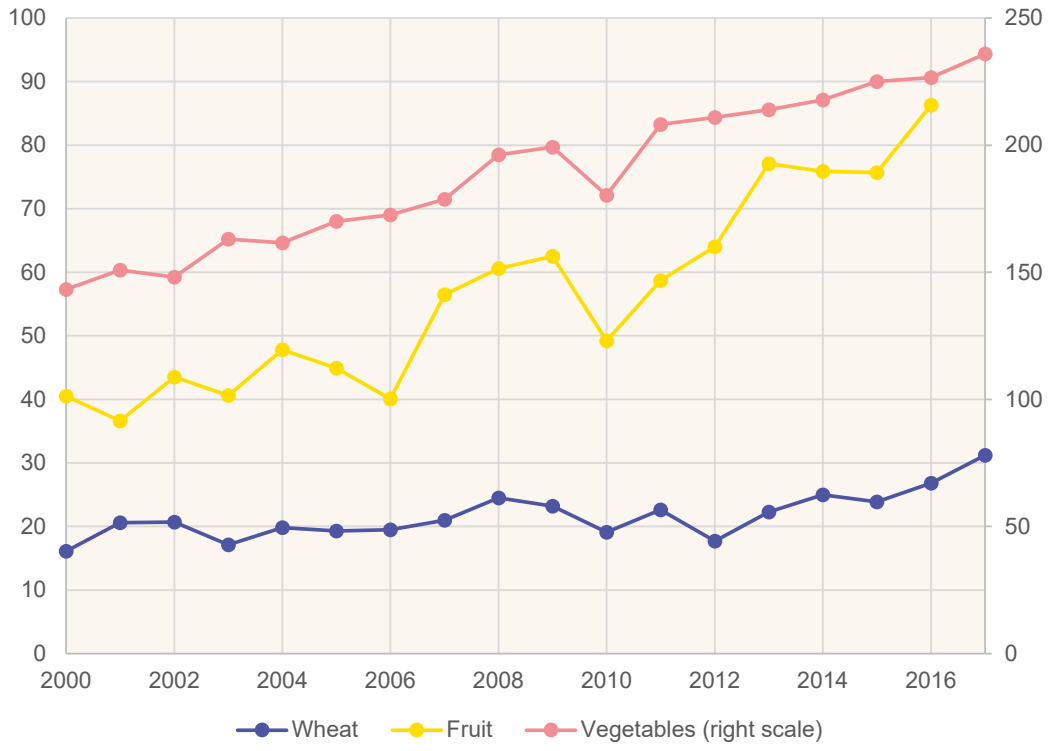
[5] http://government.ru/programs/208/events/
[6] http://government.ru/docs/11912/
[7] See interview with Ministry of Economy department head Alexander Maslennikov for an example http://economy.gov.ru/minec/about/structure/depSectorEconom/2017180802
[8] Russia banned imports of several food items from Turkey in December 2015 as part of the sanctions imposed on Turkey after the downing of a Russian fighter jet.
[9] New investment in the greenhouses amounted to 200 billion rubles in 2014–2017 (https://ria.ru/economy/20180117/1512779188.html).

Figure 1. Change in livestock animals, %.



Source: Rosstat.

Figure 2. Crop yields, centners per hectare.



Source: Rosstat.

Lack of foreign competition and subsidized credits have attracted many new players to the agricultural markets. This unavoidably gives certain businessmen a newly established interest in protecting domestic agriculture. Sometimes these businessmen can be well-connected. As an example, Agrokompleks, a company owned by the family of the Minister for Agriculture Alexander Tkachov, has grown rapidly since 2013. Agrokompleks today controls over 640,000 hectares of agricultural land, making it one of the largest landowners in the country.

One can imagine Russia lifting some import restrictions if political tensions ease, but probably not at the expense of domestic producers. Easing of import restrictions would most likely happen in products where domestic companies already have established dominance (e.g. cucumbers). Moreover, even if bans were lifted, Russia can easily impose non-tariff barriers to complicate imports (e.g. phytosanitary inspections). In early 2014, for example, Russia banned imports of pigs and pork products citing a few cases of African swine fever in some parts of the EU.[10] Non-tariff barriers are frequently used in relations with non-EU countries. In spite of sharing a customs union with Russia, Belarus is regularly targeted by threats of import restrictions. For example, Russia briefly threatened in spring 2018 to impose restrictions on import of milk products from Belarus.[11]

3. Macroeconomic and trade effects of sanctions

3.1. Effects on Russia

In this subsection, we review evidence on the macroeconomic effects of sanctions on Russia. At the outset, it should be noted that trying to estimate effects of sanctions is fraught with difficulty – especially in a situation where oil prices first collapse and then rebound (Figure 3). Russian GDP growth began to decelerate sharply in late 2012. By 2013, annual GDP growth had slowed to 1.8 %. 2014 quarterly growth rates were negative. Russian GDP overall contracted approximately 3 % between 2014 and 2016. Growth resumed in 2017, but only reached 1.5 % (Figure 4).

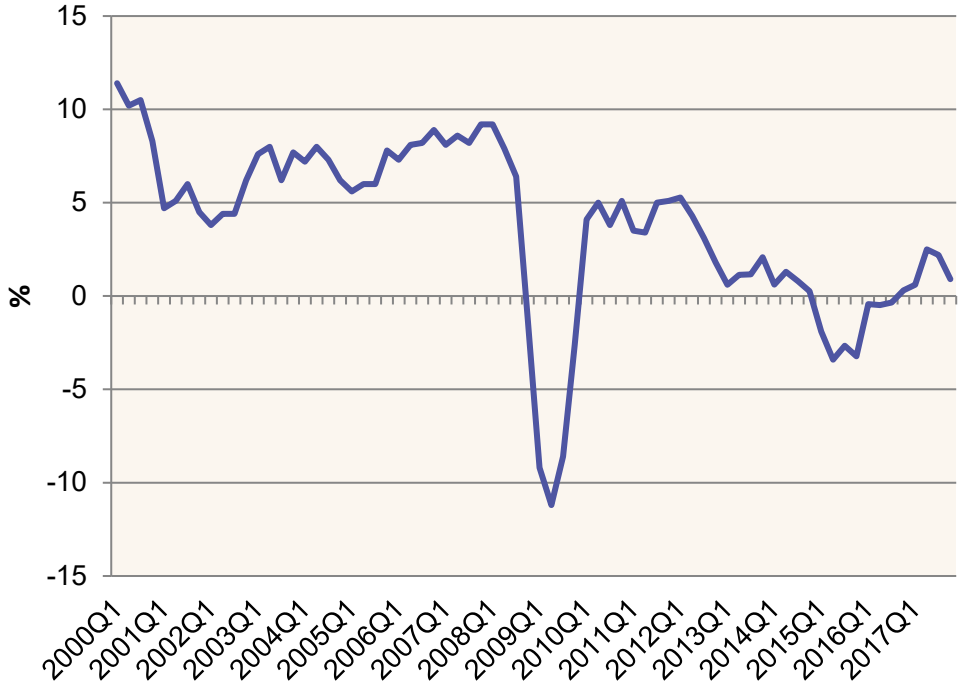
[10] The EU took the matter to the WTO and won. However, as soon as Russia lifted the import bans in question, it immediately added the same products to its list of counter-sanctions. See "Russian Federation — Measures on the Importation of Live Pigs, Pork and Other Pig Products from the European Union," https://www.wto.org/english/tratop_e/dispu_e/cases_e/ds475_e.htm.

[11] https://rg.ru/2018/02/26/rossiia-s-26-fevralia-ogranichila-vvoz-belorusskoj-molochnoj-produkcii.html

Figure 3. Price of Urals crude oil, USD/bbl.

Source: Reuters.

Figure 4. Russia's quarterly GDP growth, year-on-year.



Source: Rosstat.

Despite the difficulties, researchers have attempted to separate the effects of sanctions from all other factors of Russian GDP growth. The International Monetary Fund (2015) reported that Western

sanctions and Russia's counter-sanctions likely reduced Russian real GDP initially by 1–1.5 %. Over the medium-term, the IMF suggested that Russia's cumulative output loss might be as high as 9 %. This large loss in GDP, however, presupposes a lower level of investment and lower level of productivity growth (as Russia's own inward-looking policies lead to lower level of competition). Taking the IMF assumptions at face value, it might be better to say that the IMF's estimates imply that Russia's GDP in 2015 would have declined by 1.5 % without sanctions, instead of the 2.5 % actual decline.

Citibank (2015) attempted to estimate the effects of sanctions on Russia's economic performance using a simple macroeconomic model of Russia. Their analysts found that about 90 % of the observed decline in GDP could be explained by falling oil prices. Thus, only 10 % of the output decline in 2014–2015 was explained by sanctions (and everything else happening in and around Russia during that period).

Gurvich and Prilepskiy (2015) gauge the effects of financial sanctions on the availability of finance for Russian companies. They find that financial sanctions reduced the amount of finance available. However, this effect was mitigated by the fact that Russian companies have been able to dip into their own foreign assets. Looking forward, Gurvich and Prilepskiy formulate four scenarios for various combinations of sanctions regimes and oil price. They find that cumulative effect of sanctions on Russian GDP during 2014–2017 was 2.4 percentage points, i.e. without sanctions the level of GDP would have been 2.4 % higher at the end of 2017. However, the negative effects of low oil prices in the period were three times greater than the sanctions effect, reinforcing the preeminent role played by oil prices in the Russian economy.

As for effects of Russia's food embargo on Russians themselves, Volchkova (2018) reports that average Russian has had to decrease his or her consumption of embargoed foodstuffs by 2,000 rubles ($34 at the average 2017 exchange rate) per year. The average monthly wage in 2017 was 39,150 rubles.

Dreger et al. (2016) look at effects of sanctions on Russian financial markets, including exchange rate. They find that the price of oil is by far the main driver of developments in Russian financial markets, but sanctions explain some of the volatility. Ahn and Ludema (2017) examine effects of sanctions at the level of Russian companies, noting that sanctioned companies lose half of their market value and a quarter of their operating revenue in comparison to Russian companies not sanctioned. They conclude that sanctions have worked as intended, i.e. they have not caused collateral damage for other Russian companies and other parts of the Russian economy.

3.2. Effects on Russia's foreign trade

Effects of sanctions and anti-sanctions on trade are difficult to estimate for the same reasons as macroeconomic effects. However, thanks to greater variety in the available data (country pairs, some products banned, some not), more can be said about them.

Fritz et al. (2017) look at Russia's imports from different countries and find that all sanctions (both Russian and Western) have reduced the EU exports to Russia by 11 %. Each EU country is affected differently, with Germany bearing the largest absolute loss of exports. Relative losses were also large in Poland, Hungary, the United Kingdom and Greece. From these trade loss estimates, they calculate that the EU has lost less than 0.2 % of its value-added and employment because of the sanctions.

Crozet and Hinz (2017) estimate global trade losses stemming from EU and Russian sanctions introduced in 2014. They find that global trade decreases $4.8 billion per month,[12] with $1.8 billion

[12] Notably, their dataset does not include Russian imports from China or Korea.

of that borne by the sanctioning Western countries (mostly EU countries). The drop has consisted mostly of goods not directly embargoed.

4. Effects on goods and services trade, capital flows

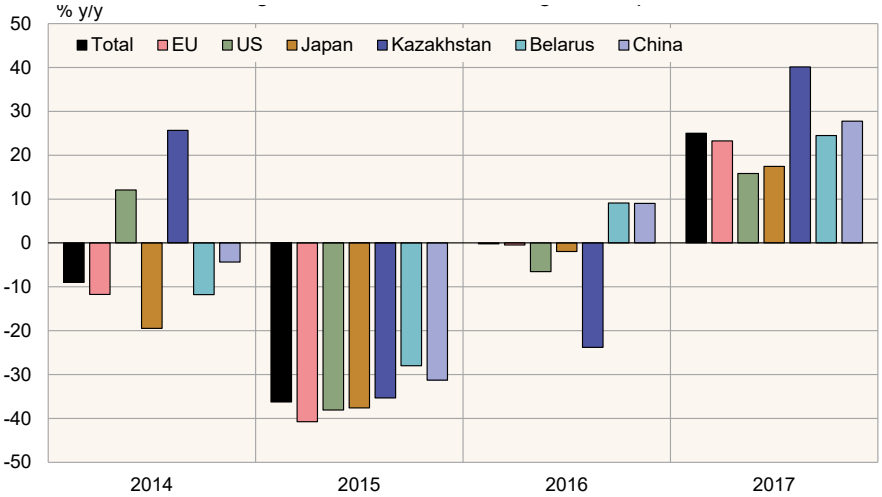
4.1. Goods trade: sanctions vs. general economic downturn

Russian imports from the EU have declined substantially in recent years. The main factor behind this is the weak Russian economy. The role of sanctions has been much more modest. We illustrate this observation first by comparing the development of Russian imports from countries that have engaged in sanctions with Russia and those that have not to show the across-the-board decline. Second, we compare trends in EU exports to Russia with the trends of certain other countries, particularly those reliant on oil export earnings. Finally, we compare the goods trade impacts from EU and Russian sanctions.

4.1.1. Russian imports declined generally in the first three years of sanctions

Russian import trends are mainly defined by corporate and household demand and the ruble's exchange rate. In recent crisis, fixed investment in Russia fell by 13 % in real terms from peak to trough; household consumption dropped by 12 %. The ruble's average annual exchange rate in 2014–2016 against the euro depreciated by over 40 % and by over 50 % against the US dollar. Due to declining demand and sharp ruble depreciation, Russian imports declined notably from all countries, irrespective of their sanctions involvement (Figure 5). Similarly, as the Russian economy started to recover in 2017 and the ruble strengthened, Russian imports from all countries increased, including countries that maintained sanctions.

Figure 5. Change in the (USD) value of Russian goods imports by country in 2014–2017, %.[13]

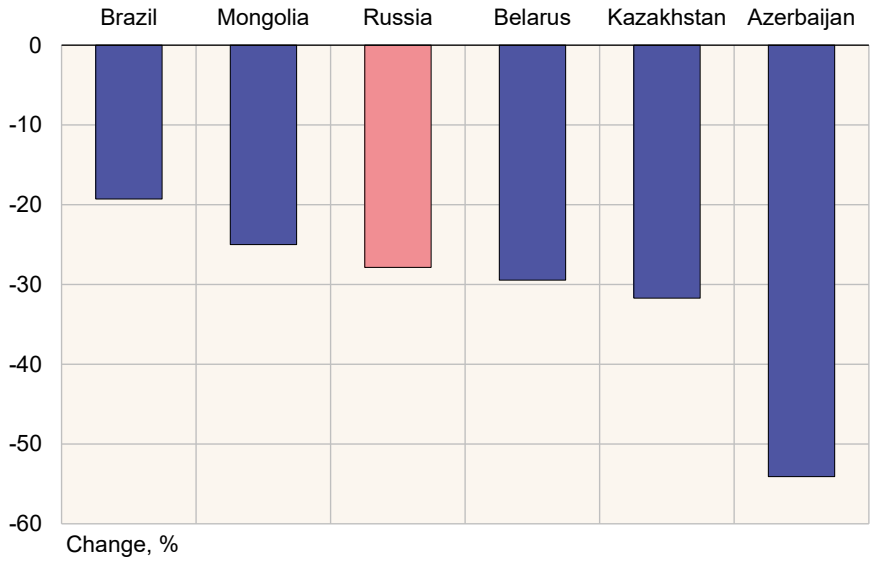


Sources: CEIC and Russian Customs.

[13] US export data for 2014 show that the value of US exports to Russia declined 3.5 %, while Russian import figures show an increase of 12 %. In 2015 and 2016, the shifts in both sets of statistics are more similar.

Also EU exports have declined to many countries in recent years, not just Russia. The decline generally concerns countries relatively reliant on income from oil or other commodity exports, illustrating the important role played by the oil price drop. For example, EU exports to oil exporter Azerbaijan declined much more than exports to Russia during 2013–2017 (Figure 6). Similar development was seen in the case of Belarus, although its poor economic performance was related more to factors other than directly to the oil price decline.

Figure 6. Change in the (EUR) value of EU28 goods exports to certain countries in 2013-2017, %.

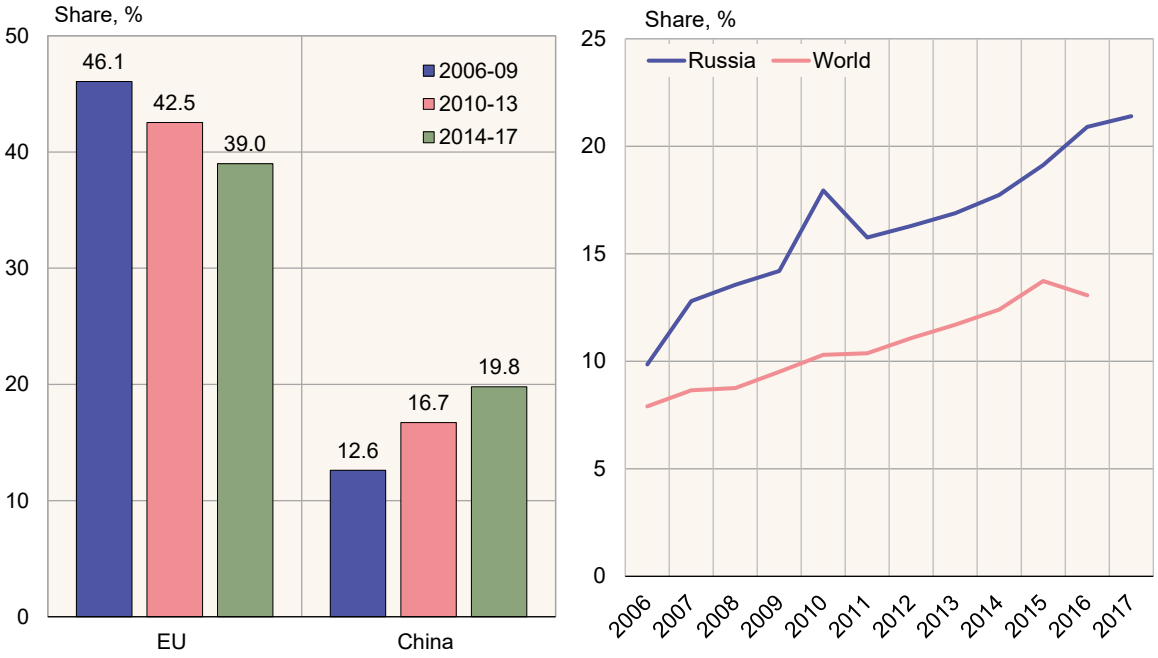


Source: Eurostat.

4.1.2. Sanctions are not the main cause of the EU's declining market share in Russia

The EU has lost market share in Russia in recent years, losing out especially to China. The shift, however, is part of longer and geographically wider trend (Figure 7). Actually growth of China's market share in Russia has slowed in recent years from larger gains earlier. Boosted by enhanced competitiveness, China has become the world's largest goods exporter in recent decades. Part of China's huge success, however, is a statistical artefact related to its increasing integration into global value chains. As China has specialized on the labor-intensive final production stages such as assembly, the final products are recorded as part of Chinese exports although the actual contribution or value-added created in China is actually much lower.

Figure 7. Comparison of market share trends of the EU and China in Russia (left) and the market share of China in Russian and world imports (right).



Sources: CEIC, ITC.

4.1.3. EU export restrictions focus on just a few products

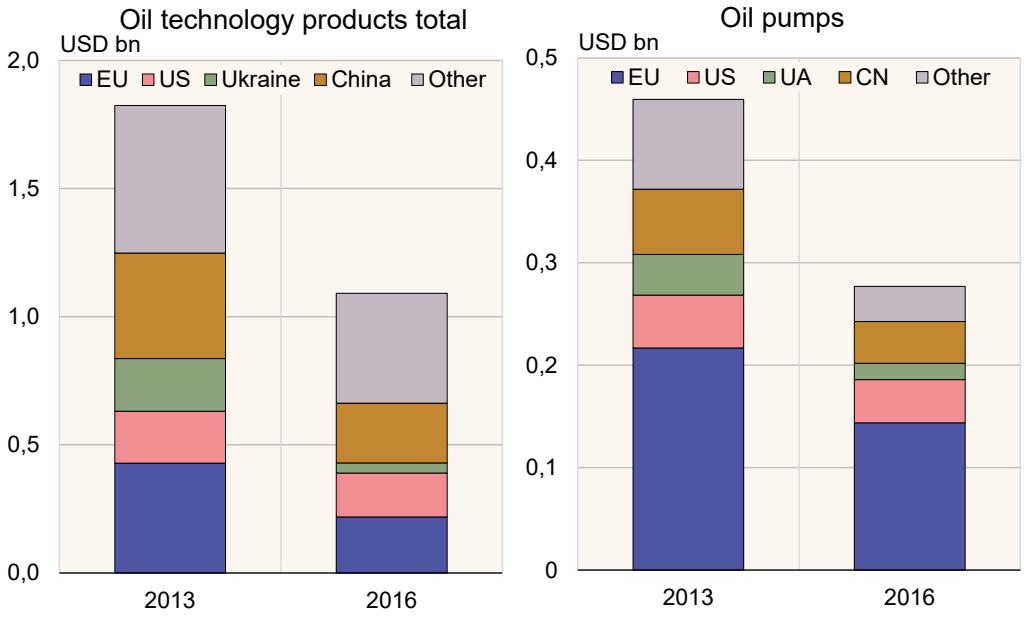
As explained in section 2.1, the export restrictions imposed by the EU intentionally target a narrow assortment of products, so their impact on total EU exports is limited in most cases. The EU has banned exports to Russia of arms, dual-use products for military clients and certain products related to exploration or production for deep-water, Arctic offshore and shale oil projects.

The total value of exports of the EU28 to Russia of the oil exploration and production technologies subject to restrictions was about 350 million euros in 2013, accounting for 0.3 % of total exports of the EU28 to Russia and for 0.02 % of total extra-EU exports. Russia's share in the EU28 exports of these products was about 3 % in 2013. As the exports of these products are banned only for use deep-water, Arctic offshore and shale oil projects, only a fraction of this amount is actually banned. We cannot distinguish the exact amount from the trade statistics, but obviously it is quite limited. The US sanctions related to oil exploration and production technology are further narrowed as they apply only to certain Russian companies as buyers.

For Russia, these sanctions may have a much larger impact (as indeed intended by the countries imposing sanctions), at least in longer term when Russia will probably need new production from the more complicated reserves targeted by the sanctions to compensate for the declining production in traditional fields. Russia imports most of this advanced technology and expertise. It cannot substitute them with domestic products – at least in short or medium term. Moreover, Russia has traditionally imported most of this technology from the EU and US and it seems that there are no straightforward substitutes available elsewhere. The value of Russian imports of these products declined by 40 % in 2014–2016 (Figure 8). This could partly also reflect the fact that some oil projects in Russia were frozen in recent years during the period of low oil prices. The share of the EU in Russian imports of these products overall has declined slightly during past years, but so has e.g. China's share. This trend in aggregate imports masks significant variation at the detailed product level. In some products, the

share of EU has actually increased in recent years which is possible as the export ban only concerns supplies to certain projects as noted above.

Figure 8. The value of Russian imports in 2013 and 2016 of the products related to oil exploration and production in oil technology exports to Russia; EU total and oil pumps in particular.



Source: UN Comtrade.

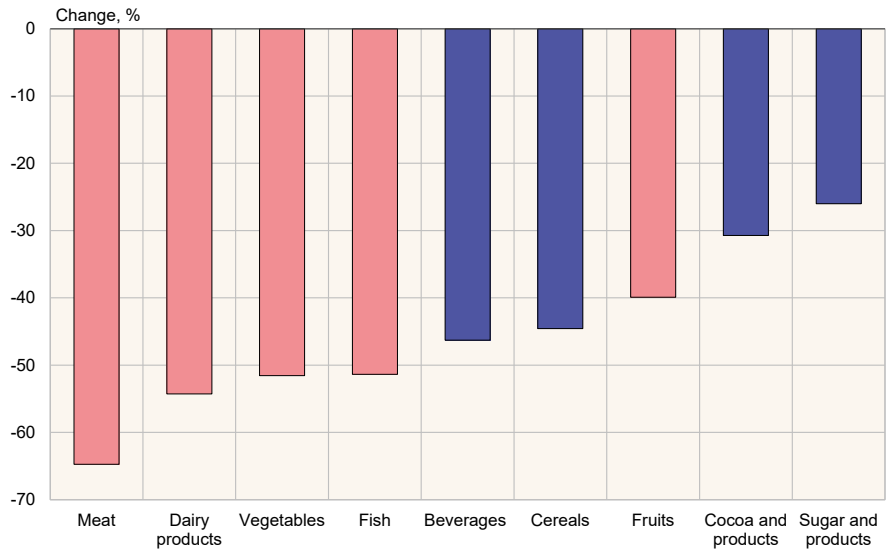
***Note**: The oil technology products aggregate is slightly wider than the products that exports are restricted by the EU as the Comtrade database provides data only on HS6-digit level. The export restrictions imposed by the EU apply only to products supplied for exploration or production in deep-sea, Arctic offshore and shale oil projects.*

It is difficult to make quantitative estimates related to the arms export ban, because trade statistics on the value of arms trade between the EU and Russia are available only to a limited degree. According to the figures published by the EU, the combined value of arms exports to Russia of the 12 countries reporting such data was about 90 million euros in 2013. Therefore the impact of the export ban at least for these reporting countries should be modest. Of course, there could also be considerable variation by country and year. For example, France had a contract to sell Russia Mistral warships. The deal did not fall under the export ban, since the EU sanctions apply only to new contracts. Ultimately, France decided to scrap the deal. The total value of EU exports of dual-use goods was about 25 billion euros in 2013, but the export ban applies only to exports for military end-users. These figures cannot be separated from trade statistics, but it is estimated to be much smaller.

4.1.4. Russian restrictions on food imports have had an effect, but so has the weak ruble

In August 2014, Russia banned imports of certain foods from certain countries that had imposed sanctions on Russia, including the EU. The import ban essentially halted Russian imports of food products from these countries. On the other hand, imports of all foodstuffs were hit hard by declining demand and ruble depreciation. Food imports overall contracted substantially during 2013–2016 (Figure 9).

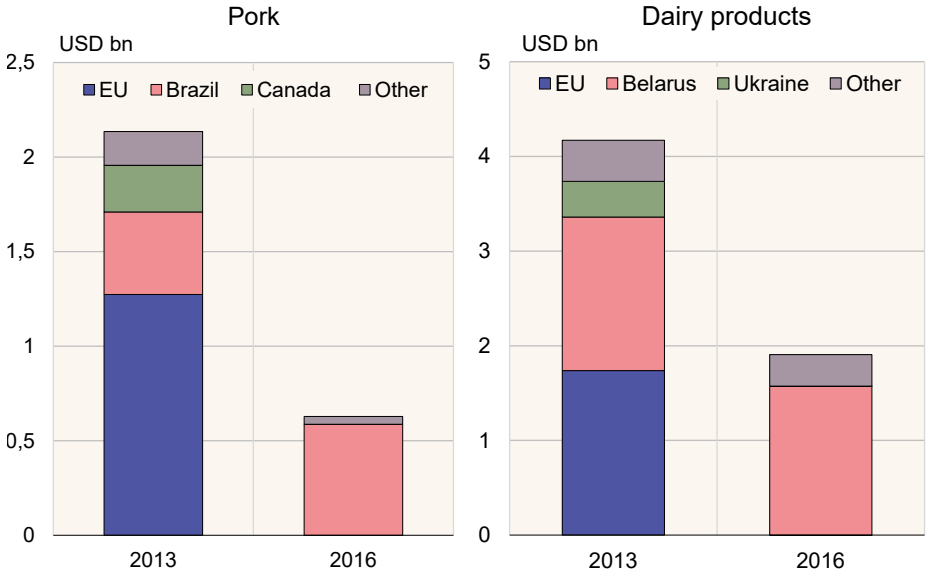
Figure 9. Change in the value of Russian imports of certain foodstuffs in 2013–2016, % (pink bars depict products where import restrictions were applied, blue bars are products not subject to restrictions).



Source: UN Comtrade.

Import bans and ruble depreciation supported to some extent domestic production, which replaced some imports that were banned or became too expensive. Part of the banned imports were substituted for imports from other countries resulting in heavy geographical concentration of Russian imports in many of the products falling under import restrictions (Figure 10). In some cases, like pork and dairy products, the imports from the main markets (Brazil and Belarus, respectively) have even increased slightly in absolute terms with growing market shares. This might have partly motivated some of the recent cases, when Russia has either restricted or threatened to restrict imports of dairy products also from Belarus.

Figure 10. Geographical distribution of Russian imports of pork and dairy products subject to import restrictions in 2013 and 2016.



Source: UN Comtrade.

As the share of banned food products in total EU exports was relatively small even before restrictions, the overall economic impact of the import bans has been limited from the EU's standpoint. In 2013, the year before the bans were imposed, the total value of EU28 exports of the banned food products to Russia was 5.2 billion euros, or 0.3 % of the total external exports of the EU28. Cessation of the exports of food products banned by Russia accounted for about a third of the loss in the EU's market share in Russia between 2013–2016, a loss of just over 1 percentage point.

The significance of the banned exports varied considerably across countries. Lithuania and Poland were most affected in national terms (Table 1).[14] However, the negative impact on individual sectors and companies where Russia provides an important export market has been substantial in some countries. For the Baltic countries and Finland, the share of Russia in the extra-EU exports of the banned products was 60–80 % before the bans were imposed.

Table 1. EU exports in 2013 of the products banned by Russia.

	Exports of banned foodstuffs, EUR million	**Share of banned products in total extra-EU exports, %**	**Russian share of banned extra-EU exports, %**
Lithuania	927.0	8.5	81.3
Poland	839.7	2.2	38.7
Germany	583.3	0.1	17.9
Netherlands	528.4	0.4	9.7
Denmark	377.0	1.2	13.2
Spain	338.4	0.4	11.8
Finland	283.4	1.1	62.7
Belgium	281.2	0.3	20.9
France	244.2	0.1	6.1
Italy	162.4	0.1	8.0
Greece	124.4	0.9	28.1
Austria	103.5	0.3	22.6
Ireland	90.3	0.2	12.8
Hungary	78.1	0.4	22.4
Estonia	76.2	2.1	58.2
Latvia	70.4	1.9	65.1
United Kingdom	39.9	0.0	2.7
Portugal	14.7	0.1	3.4
Sweden	13.3	0.0	3.3
Cyprus	13.0	2.0	23.3
Czech Republic	11.5	0.0	9.0
Bulgaria	10.1	0.1	12.9
Slovenia	9.9	0.2	6.9
Croatia	6.7	0.2	4.3
Slovakia	6.2	0.1	21.3
Luxembourg	4.5	0.2	57.3
Romania	1.3	0.0	2.7
Malta	n.a.	n.a.	n.a.
EU28	**5,239.1**	**0.3**	**17.0**

Source: Eurostat.

[14] A large part of Lithuanian exports are actually re-exports.

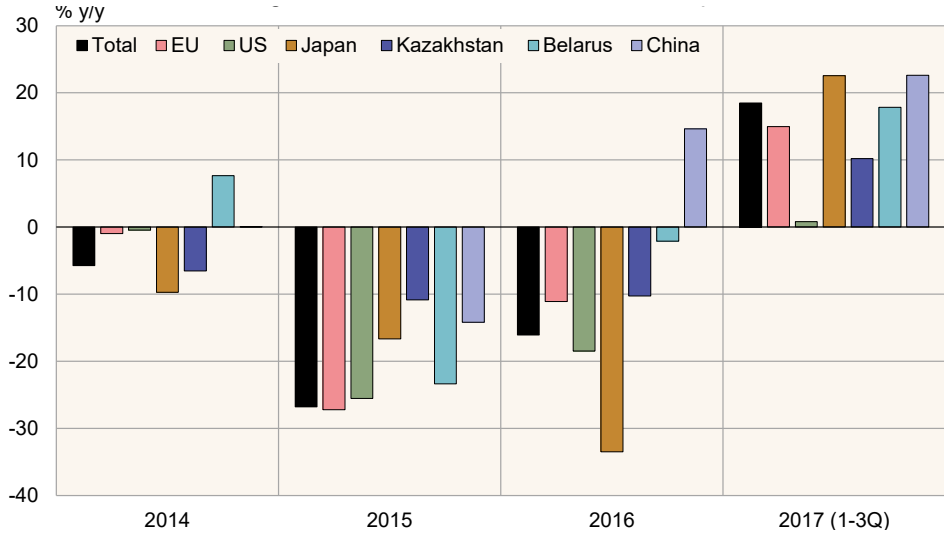
Despite some media reports, legal and illegal circumvention of the Russian import bans by exporting the goods through Belarus seems not to be a major issue for EU exports.[15] EU28 exports to Belarus of the food products that Russia banned increased by 10 % in 2015 compared to 2013. In value terms, the increase was only 70 million euros, however. This is marginal compared to the estimated value of banned EU exports to Russia of 5.2 billion euros. Moreover, in 2016-17 the value of exports of these products from the EU to Belarus has actually declined and even fallen below the 2013 level.

The EU countries have to some extent been able to replace the Russian markets with other extra-EU markets in their food exports during past years. For the total EU28, the value of extra-EU exports had in 2017 exceeded the 2013 level for most of the products. Variations between individual products and countries are, however, quite large.

4.2. Services trade: an even smaller role for sanctions

Practically the only sanctions imposed on trade in services between EU and Russia are the restrictions imposed by the EU on the exports of certain services related to offshore and shale oil exploration. These particular services cannot be separated from official statistics, but it is obvious that the direct impact of sanctions on trade in services is very limited. This is further reflected in the fact that Russian imports of services have contracted in comparable amounts across most countries, irrespective of sanctions (Figure 11).

Figure 11. Change in the (USD) value of Russian services imports by country in 2014–2017, %.



Source: Central Bank of Russia.

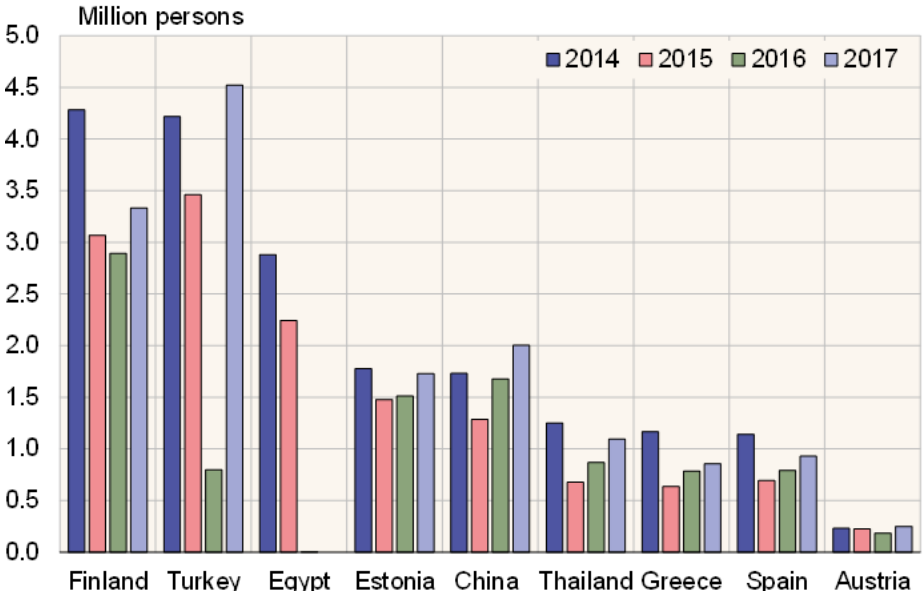
Within trade in services, tourism is an important category. There are almost no sanctions on mutual trade in tourist services of the EU or Russia, [16] so any direct effects from sanctions on tourist service exports from EU countries to Russia are impossible. However, Russia in recent years has placed travel

[15] *Legal circumvention* refers to exporting raw materials from the EU for further processing in Belarus and then exporting the finished products to Russia. Russian officials accepted this procedure. Mere re-exporting of finished products through Belarus, however, is considered *illegal circumvention* by the Russian officials. Officials are required to seize and destroy such products.

[16] The exceptions are travel bans imposed by the EU on specific Russian individuals and restrictions on tourism services located on the Crimean Peninsula.

restrictions on Turkey and Egypt.[17] This has had a pronounced effect on Russian tourism to these destinations, nearly stopping Russian tourist flows to these countries altogether temporarily (Figure 12).

Figure 12. Russian tourist flows to select countries.

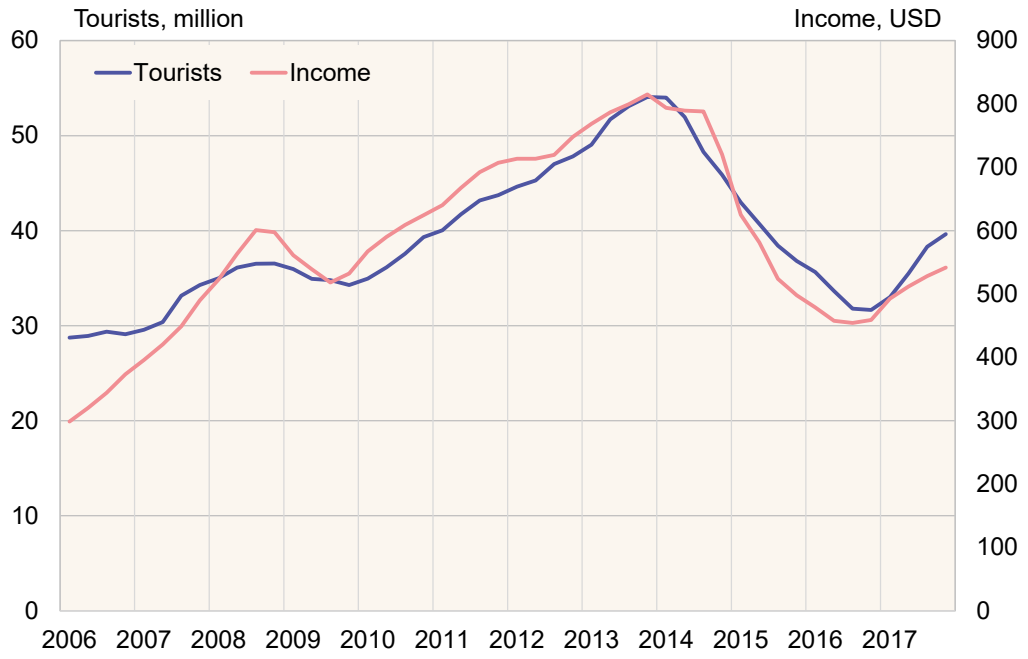


Source: CEIC.

Development of Russian tourism abroad is mainly defined by the income trends of Russian households and the ruble exchange rate. With declining income and a sharp depreciation of the ruble, the average monthly income of Russian households was nearly halved in dollar terms during 2014–2016. This nose-dive in household revenues weighed heavily on tourist flows abroad (Figure 13).

[17] Russia banned charter flights to Turkey at the start of December 2015 as part of the sanctions imposed on Turkey after its air force downed a Russian fighter jet. The ban was lifted in autumn 2016. Flights to Egypt were suspended after a plane transporting Russian tourists suffered a mid-air explosion and crashed in the Egyptian Sinai in late October 2015 due to a terrorist plot. Flights to Egyptian tourist destinations are expected to resume in autumn 2018.

Figure 13. Russian tourism and average monthly income of Russians in USD (4Q moving average).



Source: CEIC.

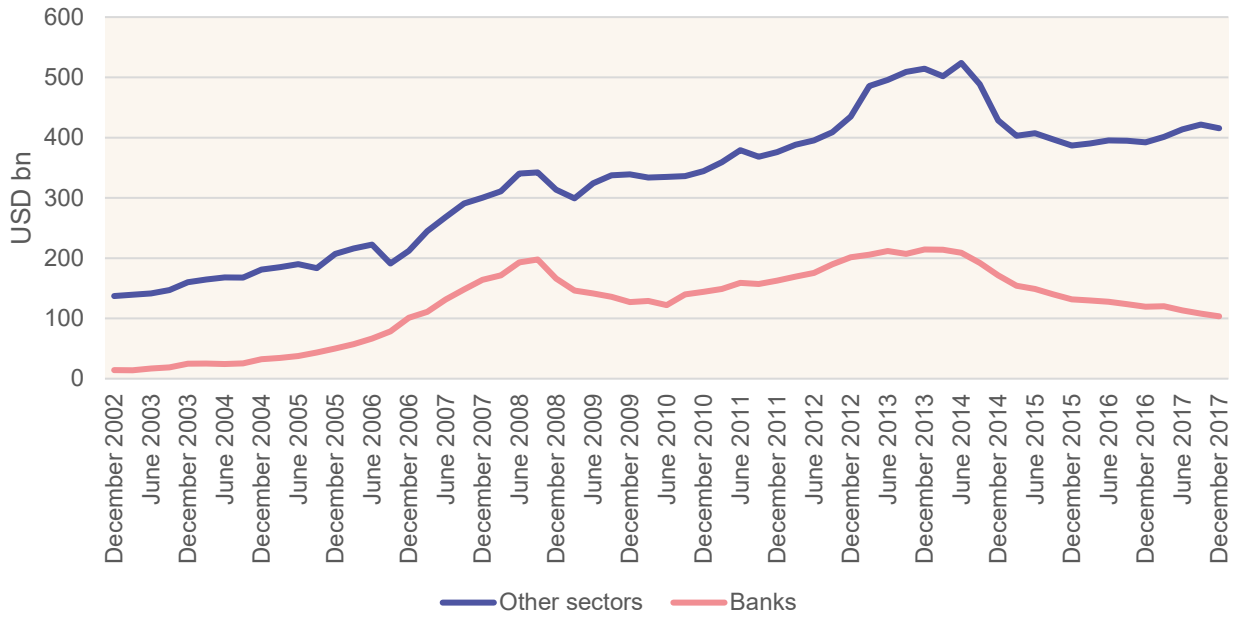
4.3. Capital flows and sanctions

As was noted in Section 2.1, access of many Russian companies to external finance from the US and EU has been limited since third quarter of 2014.[18] However, and similarly to the macroeconomic effects of the sanctions, it can be difficult to disentangle effects of the sanctions from those emanating from general uncertainty and drop in energy prices. Whatever the cause, the private sector net capital outflow nearly tripled in 2014 to a record level of $152 billion. Most of the outflow was recorded in 4Q14. The annual net outflow has continued negative ever since, although moderating substantially in following years.

Many Russian companies and especially banks found it difficult to refinance their foreign loans falling due in 2014 and 2015. Figure 14 shows foreign debt of Russian commercial banks and other sectors aggregated. We can see that gross foreign debt decreased some $210 billion from end of 2013 to the end of 2017. Especially banks' foreign debt has decreased, and here sanctions must play a role, as the largest Russian banks are under financial sanctions. In fact, foreign debt of banks is at the same level as in 2006.

[18] In addition, Russian entities have received no new financing from the European Bank for Reconstruction and Development or from European Investment Bank since 2014.

Figure 14. Foreign debt of Russia's corporate sector, USD billion.



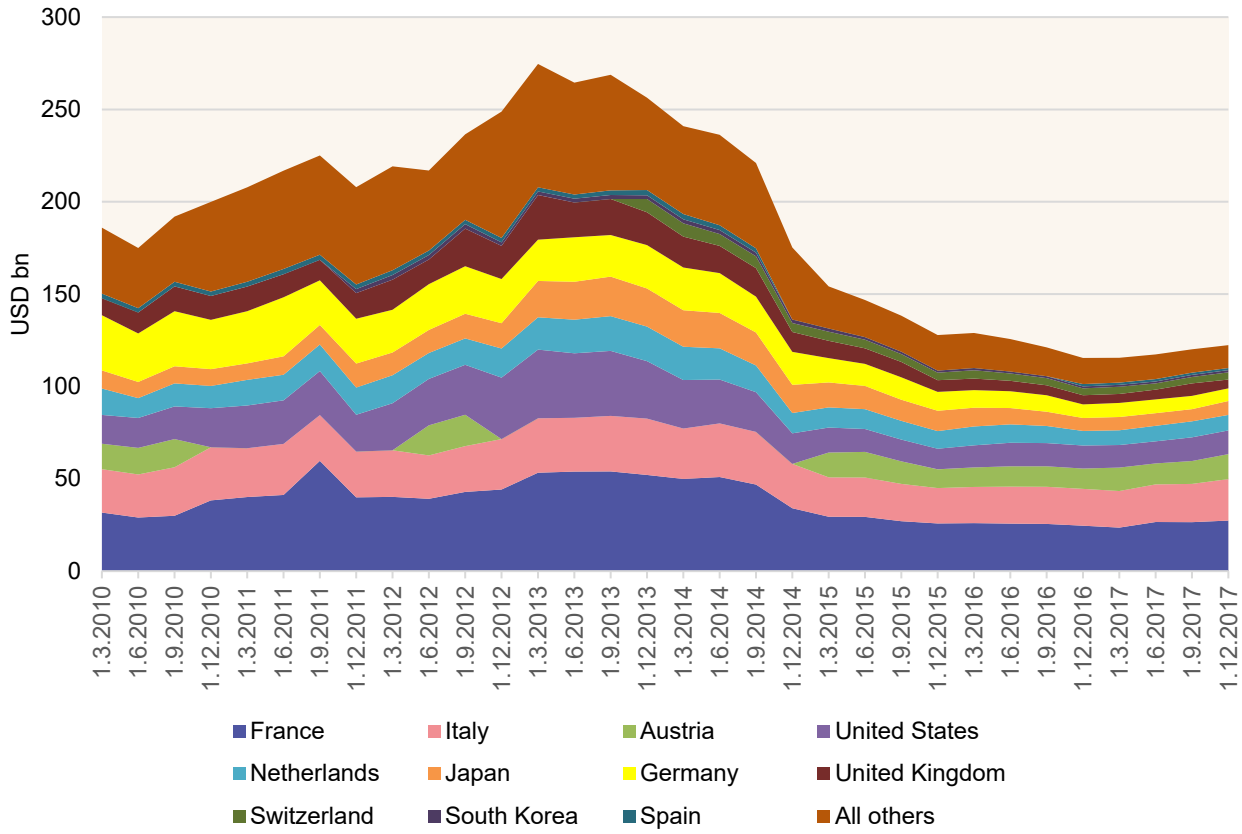
Source: Central Bank of Russia.

BIS data on cross-border bank lending show that the claims of foreign banks on Russian entities at the end of 2017 was $122.4 billion, [19] down just over 50 % from $256.4 billion at the end of 2013. The figures not only reveal how drastically foreign banks have decreased their exposure to Russia, but also show that much of Russia's foreign debt is held by creditors other than banks. On consolidated basis, largest creditors to Russia were French ($27.4 billion) and Italian ($22.4 billion) banks (Figure 15). Lending from all major countries to Russia has declined, in many cases radically.

Compared to other emerging market countries, the drop in international bank lending to Russia has been exceptionally large. From the end of 2013 to the end of 2017, the total lending of banks decreased for e.g. China (down 6 %) and Poland (down 16 %), while bank lending increased for e.g. Indonesia (up 18 %) and India (up 17 %).

[19] "On a consolidated basis" means that a loan to Russia from, say, a German bank's London branch is recorded as a German loan, https://www.bis.org/statistics/rppb1804.htm .

Figure 15. BIS reporting claims of banks on Russia (consolidated basis).



Source: BIS.

From 2014 to 2016, inward foreign direct investment to Russia declined. Again, it is difficult to specify exactly the direct effect of sanctions. Oil prices were falling and Russia fell into recession, making it generally less attractive as an investment destination. Between 2010 and 2013, the average FDI net inflow was $54.5 billion per year. It declined to $22 billion in 2014 and to just $7 billion in 2015. FDI inflows thereafter began to recover, although FDI net inflows are still far below their pre-crisis and pre-sanctions levels.[20] After the initial shock, financial sanctions seem ineffective at scaring off foreign direct investment.

[20] Interpreting inward foreign direct investment into Russia is challenging. The largest provider of FDI to Russia by far is Cyprus. Some 32 % of total inward FDI stock ($499.7 billion) flowed into Russia from Cyprus at the end of September 2017. It is generally agreed that this is mostly Russian money round-tripping via the Cypriot financial sector. Other large offshore financial centers and tax havens sending FDI to Russia include Luxembourg (10.3 % of total), the Bahamas (6.5 %), Bermuda (4.3 %), the British Virgin Islands (2.7 %) and Jersey (2.2 %). For comparison, Germany accounts for 3.8 % of Russia's inward FDI stock, the UK 3.7 %, France 3.1 %, Austria 0.9 % and Finland 0.8 %.

5. Concluding remarks

In this note, we reviewed the sanctions and counter-sanctions regime imposed by the EU, US and Russia in the aftermath of Russia's illegal annexation of Crimea and military presence in eastern Ukraine. The existing literature on economic effects suggests that sanctions have had a negative effect on Russian economy. Notably, the available evidence consistently suggests that between 2014 and 2016 the decline in the price of oil had a much larger negative effect on the Russian economy than sanctions. On the other hand, it is possible that if sanctions on both sides remain in place for an extended period, especially if Russia intensifies its import-substitution policy, Russia's long-term growth potential will be diminished (International Monetary Fund, 2015).

Exports to Russia from the EU, the US and other countries participating in sanctions have declined in recent years. We show that the direct effect from sanctions on export decline was limited, however. The main factors behind this development were the contraction in demand in Russia and substantial depreciation of the ruble. In Russia's banking sector, large state-owned banks such as Sberbank and VTB dominate. As they have been targeted by the ban on long-term financing, it is no wonder that the foreign debt of Russian banks has decreased dramatically.

Many EU sanctions are explicitly linked to the Minsk peace process and its implementation, which currently seems quite distant. At the same time, Russia's food import bans seem to have become parts of its overall import substitution policy. These two facts in themselves are sufficient to imply that various sanctions on bilateral economic activities between the EU, US and other countries, as well as Russia on the other side, will be in place for a good while. The latest round of US sanctions in April, 2018, illustrates how further sanctions can add to the uncertainty concerning Russian economy.

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