"Dimitrie Cantemir" Christian University
Knowledge Horizons - Economics
Volume 8, No. 1, pp. 63–67
P-ISSN: 2069-0932, E-ISSN: 2066-1061

www.orizonturi.ucdc.ro

ECONOMIC SANCTIONS AGAINST RUSSIA. A CRITICAL EVALUATION

Andreea-Emanuela DRAGOI[1], Ana-Cristina BALGAR[2]

[1,2]*"Institute for World Economy", Romanian Academy, Bucharest, Romania, E-mail: andre.emanuela@gmail.com, anacristinabalgar@gmail.com*

Abstract *The main goal of the present paper is to quantitatively and qualitatively assess the effects of the economic sanctions imposed to Russia by the international community following the annexation of Crimea. Based on the literature review and most relevant international statistics our methodological approach will emphasize if the targeted economic sanctions of the EU have contributed to imposing a cost on the Russian economy, simultaneously with a change in its behavior towards Ukraine. Our analysis will take into considerations factors such: the decline in oil price, depreciation of the ruble and weakened terms of trade. Considering the international economic climate, our research will highlight to what extent, the Western sanctions may be considerate a success, scrutinizing if the involved parties need to consider some exit strategies, in order to minimize the risk of loss of face for all them.*

Keywords
Economic sanctions, EU, Russia, Ukraine, theory of economic sanctions, Russian economy, FDI, trade flows

1. Standpoints about the economic sanctions effectiveness

Economic sanctions are an increasingly common tool of coercion in international disputes. Considering the fact that many studies related to sanction theory underlie that economic measures are not often successful in achieving a change of the targeted country's foreign policy, our research aims to critical assess the effectiveness of sanctions imposed to Russia after the Crimean crisis.

The Crimean crisis[1] has been considered by some studies (Poladian *et al*., 2014) a very concluding case on "how political decisions would quickly lead to negative economic effects on regional and international level between all power poles involved". After the Crimea's annexation, Russia has been submitted to a series of political and economic sanctions[2] aimed to change its behavior towards Ukraine. When considering the effectiveness of such sanctions, our analysis will take into consideration the main approaches of the literature review (the sanctions theory), also assessing the direct economic impact on Russian economy and on its foreign policy.

Firstly, it should be mentioned that while Crimea's annexation lead to a "cooling effect" in the relationship between Russia and its Western partners (EU, U.S. and Canada), it was followed by a series of mutual economic sanctions[3] that reflected badly on the Russian economy.

In the literature in the field (Hufbauer *et al*., 2007; Caruso, 2003); Kaempfer and Lowenberg, 2007) there is a consensus about three main types of sanctions against a political regime: diplomatic sanctions, financial sanctions and trade restrictions (see Figure 1).

Some authors (Larn, 1990) consider that a distinct category of sanctions may be imposed to a political regime: the so-called "smart sanctions" involving especially travel bans against certain individuals, companies or groups of people.

In the mainstreamed approaches related to the *sanctions theory* (Hufbauer *et al.* 2007[4]; Jentleson,

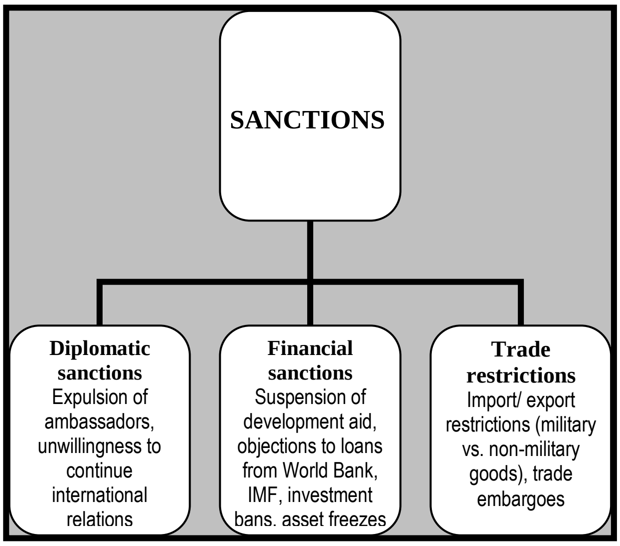
[1] The Crimean crisis (See Appendix 1) has induced severe tensions between Russia and Western European countries and the United States. The conflict peaked when Russian troops were committed to Crimea after a referendum about the incorporation into the Russian Federation was held at a short notice.

[2] In July 2014 the European Union adopted a series of economic sanctions against Russia: the ban of accession on the European financial markets and the ban on the sale of energy technologies, weapons and goods that may be used both for civilian or military purposes.

[3] In response to the EU's sanctions, Russia banned the imports of agricultural and food products from all the Member States. This embargo significantly affected the European agricultural market, the hardest-hit sectors being the fruit and vegetables, the dairy and the meat sector.

[4] Hufbauer *et al*. 2007 is one of the most known studies on economic sanctions and examines 204 sanctions episodes (the reasons behind the sanctions, the type of sanctions deployed and their duration and also an assessment of the effectiveness of sanctions).

2000; Morgan, Krusta and Bapat[5]), there is largely accepted the idea that such political and economic measures are not likely to produce immediate changes on the foreign policy of the targeted country.



Source: Author's representation, based on the studied literature

Figure 1. Main types of international sanctions

Hufbauer (2007) has stated that while "economic sanctions are considered an important tool for government withdrawal, or threat of withdrawal, of customary trade or financial relations" they remain "a controversial foreign policy tool that policymakers invoke to respond to perceived misdeeds of foreign governments".

For instance the case of Iran[6] indicate that while economic sanctions may affect negatively an economy, to the point of catastrophe, the political regime may remain inflexible in its choices.

Considering this indisputable truth, some analyses (Kholodilin, 2014) have stated that the imposed sanctions against Russia, which consist of travel bans and asset freezes (against a limited group of individuals and firms) and of some trade restrictions are unlikely to trigger a profound change in Russian foreign policy.

2. Some geopolitical considerations

In the case of the current political crisis between the West and Russia, we encounter a combination between all types of international sanctions mentioned before in our analysis: certain politicians, businessmen and journalists from Russia and Crimea are not allowed to travel in the EU and U.S. and their assets along with those of some Russian companies (mainly banks and energy companies) are frozen. In addition to that, the U.S. has prohibited any commercial relations between U.S. citizens and the sanctioned Russian companies, the most important ones being Bank Rossiya, SMP Bank and the investment firm Volga. Both U.S. and EU have banned the export of certain goods and technologies that can be used for military purposes. It should be noted that the relations between the West and Russia have been affected, prior to the Crimean crisis, by some tensions related to the respect for human rights (the death of the businessman Sergei Magnitsky in a Moscow prison, in 2009, has led to tensions between Western countries and Russia)[7].

The Vilnius summit (in November 2013) and the Ukraine decision to start accession negotiation with the EU refusing in the same time the integration into the Eurasian Union have been the triggering factor for the Crimean crisis.

However, some analysis (Moldoveanu, 2012) have stated that Vladimir Putin's expansionist approach in the foreign policy field has "paved the way" to this geopolitical crisis. Although in the geopolitical area the tension has reached a peak, we remain skeptical about the sanction regime effectiveness in respect to foreign policy choices, given the fact that the sanctions do not include general restrictions to the trade, but only a limited ban for the military goods and technologies. As for the economic effectiveness of sanctions (the impact on Russian economy), the success may not be disputed. The Russian case illustrates some empirical evidences from the literature in the field [(Hufbauer et al. (1985), Bonetti (1998) and Jing et al., (2003)]: it is more likely that the imposed sanctions to have a powerful economic impact if the targeted country represents an important trading partner.

In this respect, it should be noted that some types of sanctions such as restrictions on trade and finance will have more effect if there is a lot of economic activity in place compared to a situation where there is a poor connection between countries. Because prior the crisis EU was an important trading partner for Russia, Russian economy was vulnerable to EU sanctions more than to those of U.S.

[5] They have developed the *Threat and Imposition of Sanctions (TIES) Data Page* that collected data related to sanctions imposed in the international affairs.

[6] Iran sanctions have been imposed to determine Mahmud Ahmadinejad's regime to give up its nuclear program. The sanctions aimed at blocking access to capital markets and prohibit the sale of petroleum on external markets, have negatively affected the Iranian economy. The sanctions were stopped in 2016 but are likely to be reversed by the US and EU after new ballistic test was conducted by Iran.

[7] These tensions ultimately led to travel bans to the United States and the exclusion of involved Russian officials from the US-American banking system.

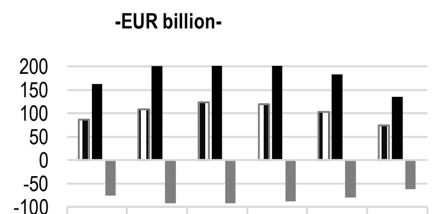
3. Sanctions impact on bilateral trade and inward FDI

As the Western sanctions covered mainly trade and finance, this subchapter will focus on how these restrictions have disrupted bilateral trade and on how investors have responded to their home-states' coercive measures imposed against Russia, by adjusting their investment policies and seeking for other sources of profit. Consequently, we will evaluate the distorting impact of the imposed set of sanctions which connected with two other major shocks[8] that negatively affected Russian economy in the last years having a severe direct impact on trade and investment.

Appraising the effects of international sanctions in addressing the annexation of Crimea must include a cost-benefit analysis of the costs paid by the imposing countries, in relation to the benefits reached (Galbert, 2015) and should also take into consideration Russia's countermeasures related to the import of agricultural products, raw materials and food from the countries that have imposed sanctions.

As in terms of trade, in 2014 Russia ranked the EU's third largest partner (after the U.S. and China) with 8.4% share in total trade (European Commission, 2015) hence the mentioned sanctions have severely disturbed Russian economy but have also significantly impacted European economies. Therefore, the total two-way annual volume of trade declined by almost 36% in 2015, reaching about EUR 209.6 billion, by comparison with EUR 285 billion in 2014 and EUR 326 billion in 2013 (as Shown in Graph 1). Consequently, EU-Russia trade shrank by about EUR 75 billion and cost the Union about EUR 30 billion in lost exports to Russia.

Graph 1. EU trade with Russia 2010-2015



	2010	2011	2012	2013	2014	2015 (est.)
Exports	86	108.6	123.4	119.5	103.2	73.9
Imports	162	201.3	215.1	207	182.4	135.7
Trade balance	-76	-92.7	-91.7	-87.5	-79.2	-61.8

Exports ■ Imports ■ Trade balance

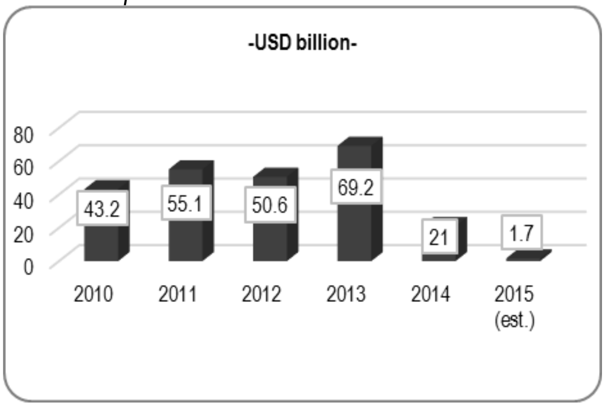
Source: Drawn up by the authors based on statistical data published by Eurostat (2016).

As the shares of EU in Russian imports have changed significantly due to the ban on food imports and to the already weakening exchange rate, we may state that sanctions (plus counter-sanctions measures) have played an important role in weaken trade flows between EU and Russia, also having further consequences for value added and employment that are more difficult to evaluate at present.

Taking into consideration the ongoing weakness in Russian economy, the sanctions seem to contribute to a worsening of the already depreciate economic climate, having also an adverse effect on investment, considering that, prior the crisis, up to 75% of FDI came from EU (European Parliament, 2015). Hence, after the major downgrading[9] of Russia's economy the foreign investors have become more hesitant about doing business in Russia and have started to switch to new markets and to withdraw the capital of the country. Accordingly, net private capital outflow from Russia totaled USD 152 billion in 2014, compared to a net outflow of USD 61 billion in 2013 and USD 54 billion in 2012 (Nelson, 2015).

The reduced market confidence and the ongoing geopolitical tensions correlated with the country's economic recession impacted heavily on the FDI inflows, which declined by 30% in 2014 and by 92% in 2015 (UNCTAD, 2016a) – see Graph 2. Thus, according to the most recent estimates elaborated by UNCTAD, FDI into Russia amounted to approximately USD 1.7 billion in 2015, after a plunge of USD 21 billion, recorded in 2014 (against USD 69.2 billion, attracted in 2013). FDI inflows are not expected to recover soon, due to uncertainties for businesses climate caused by geopolitical pressures and the lasting issues of the national government.

Graph 2. FDI inflow in Russia 2010-2015



Source: Drawn up by the authors based on statistical data published by UNCTAD (2016).

[8] The main events were the sharp drop in international oil and commodity prices and the abrupt decline of the national currency, the rouble.

[9] After the sanctions, all the major Rating Agencies (Moody, Standard&Poor's, etc.) have downgraded the Russian economy to the "junk status" not recommended for investment.

Besides the negative impact of economic sanctions imposed by Western countries reflected in the FDI decline, another factor undermining the business confidence in Russia was related to a reduced profitability of the corporate sector over the past five years (Connolly, 2015) caused by a boost in share of wages at the expense of profits. All in all, it seems that EU's sanctions against Russia had a powerful impact on Russian's economy contributing to slowing growth by reducing trade flows, limiting foreign investment and contributing as well to a depreciation of the national currency.

4. Conclusions

In the past, many sanctions (like for instance those imposed to Iran, North Korea or Cuba) were linked mainly with trade embargoes that tended to be harmful for all the involved parties. Hence, in the beginning of the 20th century, the concept of "targeted sanctions" emerged in the international arena. The targeted sanctions covered mainly trade restrictions in order to prevent the receiving country to fully benefit from its economic potential. This type of sanctions could also include financial measures (asset freezes and other prohibitions on financial transactions) and travel bans denying the access of individuals in the imposing countries.

The sanctions imposed to Russia get together a complex mix of measures involving "smart sanctions", but also investment bans, asset freezes and trade embargoes. As a result the Russian economy was hit hard, but its foreign policy towards Ukraine remained unchanged (Russia still retains Crimea and the Eastern part of Ukraine). However, in our opinion further expansionist tendencies in Russian foreign policy are unlikely to happen due to the strong reaction of international arena and the negative output for the Russian economy. Taking into consideration the Russian case (in respect to the effectiveness of economic sanctions) we may conclude that while economic sanctions tend to be more effective when foreign policy goal is relatively modest, their success is more likely to happen when the targeted country is economically weak and politically unstable (not the case of Russia).

Moreover, some analysis (Rumer, 2016) have stated that the image of Russia as weak and withdrawn from the international arena as a consequence of imposed sanctions is not an accurate one, while this country has great resources, and the political force necessary to find solutions to the current economic challenges. While it can not be denied that national economy is shrinking and the population's poverty is increasing, Russia may not be forced to retreat from Ukraine, as long as the country owns some redoubtable policy toolkit that may undermine the international alliance's cohesion: cyber operations, economic boycotts, monopolistic position on the energy markets in Europe.

However, Russia cannot afford to freeze all cooperation with U.S. and EU because its "Achilles heel" remains the high risk of a liquidity crisis since financial sanctions already affected not only state owned companies but, through a domino effect, the private sector as well. Some analysis (Galbert, 2015) pointed out that sanctions had a severe impact on Russian currency due to the restricted access to the international financial markets, also determining a decline in investors' confidence.

So far, the international sanctions toward Russia are only partially effective, because while all the involved parts register economic costs, their foreign policy choices remain inflexible.

References

1. Bonetti, S. (1998), *Distinguishing characteristics of degrees of success and failure in economic sanctions episodes*, Applied Economics, Volume 30, Issue 6, p.3
2. Caruso, R. (2003), *The Impact of International Economic Sanctions on Trade - An Empirical Analysis*, Catholic University of the Sacred Heart of Milan, p.3
3. Connolly, R. (2015), *Troubled Times – Stagnation, Sanctions and the Prospects for Economic Reform in Russia,* Chatman House, Russia and Eurasia Programme, The Royal Institute of International Affairs, February 2015, London
4. European Commission (2015), Directorate General for Trade, *European Union, Trade with Russia*, p.9, 20.10.2015, Brussels
5. European Parliament (2015), *Economic Impact on the EU of Sanctions over Ukraine Conflict*, October 2015, Brussels
6. Eurostat Database (2016), available online at: http://ec.europa.eu/eurostat/data/database
7. Galbert, S. (2015), *Sanctions against Russia – Now What?,* A European Assessment of the Outcome and Future of Russia Sanctions, Center for Strategic & International Studies (CSIS), a Report of the CSIS Europe Program, October 2015
8. Jing, C., Kaempfer, William K., Lownberg, Anton D., (2003), *Instrument Choice and Effectiveness of International Sanctions: A Simultaneous Equations Approach*, Journal of Peace Reasearch, Vol. 40, No. 5, p. 519-535
9. Jentleson, B.W. (2000), *Economic Sanctions and Post-Cold War Conflicts: Challenges for Theory and Policy, in International Conflict Resolution after the Cold War*, edited by Paul C. Stern and Daniel Druckman, Washington, DC: National Academy Press, p. 123-177.

10. Hufbauer, G.C., (1990), *Economic Sanctions Reconsidered: History and Current Policy*, Institute for International Economics, Washington DC, p. 181
11. Hufbauer, G.C., J.J. Schott, K.A. Elliott, Oegg, B. (2007), *Economic Sanctions Reconsidered*. 3d ed. Washington, DC: Peterson Institute for International Economics, (2007), p.14
12. Kaempfer, W., K., Lowenberg, A., D., (2007), *The political economy of economic sanctions,* Handbook of Defense Economics, Vol.2, Edited by Todd Sandler and Keith Hartley, Elsevier, p.2
13. Kholodilin, K.A, (2014). *Are the Economic Sanctions against Russia Effective?*, DIW Roundup Politik im Fokus, (2014)
14. Larn, S.L., (1990). *Economic sanctions and the success of foreign policy goals: a critical evaluation*, in Japan and the World Economy, vol. II, p. 240
15. Moldoveanu, A., (2012), *Social Consequences of the New Russian imperialism – The Underdevelopment of the center and the periphery*, PhD Thesis, Department of Sociology, University of Bucharest, p.3
16. Nelson, R.M. (2015), U.S. Sanctions on Russia: Economic Implications, Congressional Research Service (CRS), CRS Report February 4, available online at: https://www.fas.org/sgp/crs/row/R43895.pdf
17. Poladian M.,S., Drăgoi, A.-E., (2015), *Crimean Crisis Impact on International Economy: Risks and Global Threats,* Procedia Economics and Finance 22 Elsevier, p.453
18. Rumer, E., (2016), *A World Order Reshaped by Vladimir Putin's Ambition,* Financial Times, April 6.
19. UNCTAD (2016a), *Global Investment Trends Monitor* No.22, 20 January 2016, New York and Geneva, p. 6
20. UNCTAD Database (2016), available online at: http://unctad.org/en/Pages/Statistics.aspx

Appendix 1. The Ukrainian crisis: chronology of key-events

21/11/2013	Ukraine suspended preparations for EU trade agreement
22/02/2014	President Yanukovych left the country, Parliament set elections for 25 May
27/02/2014	Pro-Russian government seized key buildings in the Crimean capital, Sevastopol
01/03/2014	Russia's Parliament approved Vladimir Putin's request to use force in Ukraine to protect Russian interests
06/03/2014	U.S. announced sanctions against Russia and EU's leaders held the Energy Summit in order to find solutions to pressure Russia
17/03/2014	Both U.S. and EU imposed travel bans and assets freezes on several officials from Russia
20/03/2014	EU extended the list of individuals targeted for sanctions
28/04/2014	EU extended list of sanctioned individuals and firms
11/05/2014	Pro-Russian separatists in Donetsk and Luhansk declared the independence after a referendum not recognized by Ukraine
6/08/2014	Russia banned import of agricultural products from EU, USA and Canada
25/06/2015	Russia extended ban on Western food imports
21/12/2015	EU prolonged economic sanctions by six months

Source: Authors synthesis based on the official available information.