

### Sanctions against Russia: No Blitzkrieg, but a Devastating Effect Nonetheless

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## ANALYSIS

## Sanctions against Russia: No Blitzkrieg, but a Devastating Effect Nonetheless

By Ilya Matveev (Public Sociology Laboratory)

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### Abstract

In response to the Russian invasion of Ukraine, over 40 countries have introduced sanctions against Russia. The new restrictions concern finance, trade, logistics, and personal sanctions against businessmen and officials. In addition, more than 1,000 companies have ceased or limited their activities in Russia. In this article, I argue that the sanctions, despite their unprecedented scale, have not led to the collapse of the Russian economy, yet their effect is dramatic, multi-faceted, and will increase over time.

### Introduction

Much has already been said about the unprecedented nature of the current economic sanctions against Russia. Never before has an economy of this size been subjected to such a sweeping blockade. The frozen Russian Central Bank reserves alone (according to various estimates, \$300–400 billion) are comparable to all the reserves of Brazil (\$350 billion) and three times the reserves of the United Arab Emirates (\$120 billion).

With the start of the Russian invasion of Ukraine, Western countries switched from a policy of “smart” sanctions (which are selective and aimed at minimizing harm to ordinary citizens) to a policy of total embargo, limited only by the capacity of their own economies to cut off ties with Russia, primarily in terms of energy imports. Both the countries imposing the sanctions and their target, Russia, see the sanctions as “economic warfare”—war by other means. In this article, I argue that the West has not achieved a blitzkrieg-style victory in this war. Nevertheless, the effect of sanctions on the Russian economy is devastating. Under the present sanctions regime, the goal of national development is simply unrealizable.

### Russia's Vulnerability to De-Globalization

Russia is an extremely globalized economy. Its share of imports as a percentage of GDP (20.6%) exceeds that of the other BRIC countries (19.2% in India, 16% in China, and 15.5% in Brazil) (World Bank 2022a). At the same time, as is well known, Russia exports mainly raw materials and imports mainly high-tech goods (OEC 2022). The EU accounted for 36.5% of Russia's imports in 2020, with another 2.6% coming from the US. However, the list of countries that have introduced sanctions against Russia goes beyond the EU and the US to include Japan, South Korea, and Taiwan, among others. In March 2022, the Russian government composed a list of 48 “unfriendly countries;” together, these account for more than half of Russia's imports.

Russia is also dependent on foreign investment. On average, the ratio of foreign direct investment to GDP between 2000 and 2020 was 2.1%, lower than in Brazil (3.2%) and China (3%), but higher than in India (1.7%) (World Bank 2022b). As of 2020, 2.8 million workers in Russia were employed by foreign-owned or mixed-ownership enterprises. If we take into account Russian suppliers connected to these companies, the number of workers dependent on foreign capital could be as high as 5 million—about 12% of all those employed in the formal sector.

Beyond the sheer numbers, Russia's integration into the global economy is complex and multi-faceted. Like any other modern economy, Russia is dependent on geographically distributed supply chains and “just-in-time” delivery systems. The full effect of a logistical blockade on this scale is thus impossible to predict.

### Directions of Attack

Economic sanctions against Russia, both public and private, can be divided into five categories: finance, logistics, export and import restrictions, foreign businesses pulling out of the country, and, finally, personal sanctions against businessmen and officials.

The hardest blow was dealt by the freezing of Russia's reserves. Sanctions against the Central Bank and a number of commercial banks—including the cutting-off of some banks from SWIFT, as well as a ban on the import of hard currency (dollars and euros)—also belong to this category. Some countries have banned all investment in Russia. Visa, Mastercard, PayPal, and other financial companies have blocked transactions with Russian clients.

As regards logistics, European countries have closed the skies to Russian aviation, while foreign leasing companies have withdrawn their aircraft from Russia. European ports are shut to Russian-flagged ships. Most major container lines, such as Maersk, have suspended operations in Russia. Delivery by road and rail is made as difficult as possible.

Sanctions have also hit hard trade between the EU and Russia. EU countries have banned imports of Russian steel, significantly reduced oil imports, and will gradually give up imports of coal. In the private sector, a huge number of Western companies have stopped exporting goods and services to Russia. Moreover, to date, more than 1,000 companies have stopped or limited their activities in Russia (Yale School of Management 2022). Finally, unprecedented personal sanctions (asset freezes, entry bans, etc.) have affected more than 1,000 Russian businessmen and officials.

### The Impact of Sanctions So Far

Western hopes of a blitzkrieg-style victory in the economic war against Russia hinged on the shock of the unprecedented financial sanctions introduced early in Russia's invasion of Ukraine. However, the Russian financial system weathered the storm.

Western countries froze Russian dollar and euro assets in order to take away the Central Bank's ability to maintain the ruble exchange rate through currency interventions, i.e., the sale of foreign currency on the domestic market. However, capital controls, the forced sale of Russian exporters' foreign-exchange earnings, and the sale of gas exports for rubles saturated the Russian market with foreign currencies and helped keep the ruble from plunging in the short term. After the initial shock in March, the ruble quickly recovered its value.

Nevertheless, just like on the battlefields of Ukraine, the blitzkrieg phase of the economic war has given way to a long war of attrition. In this war, the reduction of exports to Russia plays a central role. Rosstat, Russia's statistical agency, no longer publishes trade statistics (which in itself says a lot), but various indirect assessments indicate that Russian imports from "unfriendly countries" have fallen by at least 60–70%.

Elvira Nabiullina, the head of the Central Bank, noted in her report to the State Duma in April: "The main problems will be associated not so much with the sanctions against financial institutions, but rather with the restrictions on imports and logistics in foreign trade and, further on, with possible restrictions on Russian exports. You certainly know that manufacturing in the modern world is organised so that almost any product has a greater or lesser portion of imported components. This is the way of manufacturing of a large number of products. Even if such portion is small in total output, an enterprise may be critically dependent on a certain part or component. [...] Currently, this problem might be not as acute because the economy still has inventories, but we can see that the sanctions are being tightened almost every day, including the restrictions on Russian goods transportation and the operation of Russian carriers. However, the period when the economy can get along with stocks is limited." (Nabiullina 2022).

As she pointed out, the main problems will be associated not so much with the sanctions against financial institutions, but with the restrictions on imports and logistics in foreign trade and, down the road, with potential restrictions on Russian exports. Manufacturing in the modern world is organized so that almost any product has a portion of imported components. Even if this portion is small compared to the total output, an enterprise may be critically dependent on a certain part or component. Currently, this problem might be less acute because the economy still has inventory, but we can see that the sanctions are being tightened almost every day, including restrictions on Russian goods transportation and the operation of Russian carriers. The economy will be able to make do with existing inventory only temporarily (Nabiullina 2022).

Indeed, a huge number of factories—including, for example, almost all car plants—have already stopped operating. Nabiullina's speech is illustrated well by the situation at the Tikhvin Freight Car Building Plant, the largest of its kind in Russia and the post-Soviet region as a whole. Even though the plant itself is owned by a Russian company, it is critically dependent on foreign-made components for bearing units. These components are no longer supplied and production at the factory has stopped, with no clear date for its resumption. Tikhvin is a small city in the St. Petersburg area. Out of its population of 50,000, 7,000 people are employed by the freight car plant and several thousand more work at an IKEA factory, which is also currently closed due to IKEA's exit from Russia. If both factories are unable to reopen, Tikhvin will become a ghost town.

Apart from factory closures and cascading unemployment, the dramatic fall in imports has produced macroeconomic distortions. Since its initial collapse in March, the ruble has been steadily recovering its value, eventually surpassing its pre-war exchange rate to become "the best-performing currency in the world" (Ivanova 2022). This simply reflects the balance of supply and demand: while soaring energy prices ensure the supply of foreign currency to Russia, falling imports result in a lack of demand for dollars and euros. However, the overvalued ruble puts pressure on the Russian budget (which is dependent on the ruble value of energy exports) and reduces the profitability of non-energy exports (most notably, metals such as steel). As German Gref, the head of Sberbank, noted during the St. Petersburg Economic Forum, "Export is now becoming poison for the economy. Import... becomes the main medicine" (RT International 2022).

While macroeconomic imbalances and most supply chain bottlenecks can eventually be overcome, the biggest problem created by sanctions is long-term. In the context of the economic blockade, the technological

gap between Russia and the advanced economies will widen over time. In the absence of global cooperation and with hundreds of thousands of skilled professionals having left the country, innovative and technological advancement in Russia is simply impossible. The sanctions regime (or, rather, the war that has triggered it) robs the country of its future. Even if most sanctions are lifted, the damage already done will set Russia back by years, if not decades.

And yet, even though the long-term impact of sanctions will be devastating, they are not critically reducing Russia's ability to wage war in Ukraine. High energy prices ensure that the Kremlin can still finance this war. While the economic blockade most likely had a negative impact on the military-industrial complex, which is still dependent on foreign-made components, Russia will probably be able to smuggle many of them into the country, including by contraband. Nor, as I argue below, have sanctions created significant problems for the regime.

### The Politics of Sanctions

Sanctions have failed to achieve a significant impact on Russian politics. Among the elite groups, the oligarchs are the most hurt by Russia's economic isolation. However, there is not much they can do to express their frustration within the system established by Putin many years ago. Furthermore, for the business leaders, there is a silver lining: Western companies are leaving behind assets that can be acquired at discounted rates or even for free. With the elimination of foreign competition, oligarchs automatically increase their share of the domestic market. As in any monopolistic environment, this gives them the ability to sell lower-quality goods at inflated prices. Consequently, the economic impact of sanctions is shifted from the business elites to the population at large. And in terms of their luxury lifestyle, the oligarchs still have safe havens such as Dubai, where they are reportedly acquiring new properties at a rapid pace (Fernández 2022).

For the ordinary people, sanctions are a heavy burden. There are indirect signs that the economic situ-

ation impacts the perception of the war: for example, people with lower incomes tend to be less supportive of the "special military operation" than the middle class. At the same time, surveys that measure attitudes toward sanctions directly do not show any significant changes since the start of the war. The share of those who were "concerned" or "very concerned" about the sanctions did increase from 32% in December 2021 to 46% in March 2022, yet it declined to 38% in May 2022. Furthermore, 75% of respondents believe that Russia should "continue its policy regardless of the sanctions," while only 19% claim that Russia should "seek compromise, make concessions in order to withdraw from sanctions" (Levada 2022). It should be noted that any survey results coming from Russia since the start of the war are highly problematic due to the issue of preference falsification, which is amplified by the new repressive laws. However, even bearing this in mind, it is clear that sanctions have not created widespread dissatisfaction with the regime. Rather, they continue to act as a "rally around the flag" mechanism, especially in the context of the regime's near-total control of the media space. Mass layoffs in the coming months may create pockets of protest activity, but such protests are likely to face the full power of the repressive state.

### Conclusion

Sanctions against Russia represent an unprecedented weaponization of economic ties. In their scale and significance, they are comparable to the Russo-Ukrainian war itself, which is the biggest military conflict in Europe since the Second World War. The long-term impact of sanctions on the Russian economy will be devastating, even though they have not—and probably cannot—end the war or trigger regime change in Russia. While the imposition of sanctions on this scale was perhaps inevitable, as they correspond to the threat that the Kremlin's aggression poses to the international order, the ultimate consequences of sanctions for global economic and political relations are yet to be seen.

#### About the Author

Ilya Matveev is a political scientist who focuses on Russian political economy. He is a member of the Public Sociology Laboratory (St. Petersburg, Russia). His academic work has appeared in *Europe-Asia Studies*, *East European Politics*, *Demokratizatsiya: The Journal of Post-Soviet Democratization*, *Socialist Register*, *South Atlantic Quarterly*, and other journals.

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## ANALYSIS

## Fighting the Pandemic and Fighting Sanctions: Can the Russian Economy Now Benefit from Its Experience with Anti-Crisis Measures?

By Andrei Yakovlev (Freie Universität Berlin)

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### Abstract

Faced with tough international sanctions in reaction to its war against Ukraine, the Russian government has resorted to measures developed during the COVID-19 pandemic in order to stabilize the economy. This short analysis discusses the rationale behind this approach and demonstrates its limits.

### Introduction

Against the background of the harsh international sanctions imposed since late February, the Russian government began to make active use of the set of anti-crisis measures that had been applied in 2020, during the Covid-19 pandemic. These measures included tax deferrals, subsidies for small enterprises, preferential loans to help small and medium firms continue their operations, and specific measures for individual industries. On the whole, these measures have proven quite effective at counteracting the pandemic-induced recession: contrary to very pessimistic initial expectations, the decline in Russian GDP as of the end of 2020 was 2.5%, compared to 3.4% in the US and 6.5% in the Eurozone.

The reason for resorting to these measures in the current situation may be that, like the 2020 shock, the 2022 one is external for Russia. The large-scale restrictions on exports from and imports to Russia imposed since late February by the United States, the EU, and other developed countries—combined with the shutdown of

hundreds of international companies—have affected the activities of Russian firms in much the same way as the quarantine restrictions in the early months of the COVID-19 pandemic. In both cases, we could observe an abrupt break in established supply chains—and this may be why the Russian government is again trying to use the tools that it tested with such success two years ago.

### Factors Promoting Economic Stability during the Pandemic

However, in order to accurately assess the possible effects of these measures, it is worth looking at the whole range of factors that made it possible to mitigate the effects of the coronavirus pandemic on the Russian economy in 2020. Based on the results of a project of the Higher School of Economics and the Russian Union of Industrialists and Entrepreneurs about business' reaction to the COVID-19 pandemic and its evaluation of the government's anti-crisis measures, we can highlight the following factors: