

May 29, 2023

The War in Ukraine and Western Sanctions on Russia: Their Effects and Challenges

By **TANAKA Soko**

Russia's invasion of Ukraine was a violation of the values of international law and democracy, and the G7 nations, the EU, and several other developed countries have joined forces to impose sanctions on Russia. Let us look at the events thus far.

●Financial and trade sanctions

Wide-ranging sanctions have been imposed against Russia.

[1] Financial sanctions: (1) In principle, dollar payments by the Russian central bank and other major banks have been prohibited. (2) Major Russian banks have been excluded from the international payment network, SWIFT.

[2] Asset freezes: (1) The assets of the Russian central bank and other major banks have been frozen. (2) The assets of Putin and other politicians and oligarchs have been frozen, they have been banned from entering the sanctioning countries, and deposit blockades have been imposed for Russia's wealthiest in London and other financial markets.

[3] Exports of advanced technology products to Russia (semiconductors, semiconductor products, machine tools, automobiles, airplanes, etc.) have been prohibited. The US is also imposing secondary sanctions (prohibiting the export of US products and technologies to companies that have supported Russian military operations).

[4] Imports of Russian products, such as fossil fuels, have been banned.

[5] Russia's most-favored-nation status has been revoked (tariff increase). Additionally, Russian aircraft have been banned from entering the EU / G7 airspace.

●Problems faced by the EU

A ban on fossil fuel imports was easy for resource-rich countries, such as the United States, Canada, and Australia, but the EU, which has been highly dependent on Russia, needed time to prepare. The ban on coal was decided in April and implemented in August. The ban on oil was decided in June and implemented in December for crude oil and in February 2023 for petroleum

products. However, oil imports via pipelines for some Eastern European countries were approved so that this sanction would apply only to sea transport (about 90% of imports). The dependence on natural gas was too high for any decision on sanctions to be made, but Russia stopped supplying it (see below).

EU sanctions on Russia are based on the Common Foreign and Security Policy. The 27 member states were unanimous, but they struggled to deal with pro-Russian Hungary ("unilateral abstention," which does not obstruct the decision, was applied). EU institutions (separate from member states) are second only to the United States in terms of aid to Ukraine. They will also provide military assistance through the "European Peace Facility" established in 2021. In March 2023, a decision was made to provide one million rounds of ammunition to Ukraine by the end of the year. Ukraine cannot continue the war without the EU.

●Purpose of the economic sanctions

The purpose of economic sanctions is to reduce the ability to continue waging war. If Russia's dollar acquisition (import capacity) is reduced and its acquisition of semiconductors and advanced technologies is restricted, thus causing shortages of components and a decline in production capacity, arms production will become difficult. A lowering of the living standard and inflation may also encourage the Russian people to oppose the war.

●Effects of the sanctions

The war in Ukraine caused oil and gas prices to soar over the summer, and Russia's trade surplus in 2022 was the largest in history. The sanctions have also caused various problems.

(1) Financial sanctions, including exclusion from SWIFT, have been disappointing. Russian small and medium-sized banks and the Russian branches of large Western banks have been exempted from sanctions, and since the EU pays for imports, some major Russian banks have been removed from sanctions. Russian companies have been able to continue importing using dollars and euros.

(2) The ban on exports to Russia covers high-tech products, while exports of products other than prohibited items are still possible. Exports to Russia declined sharply until March and April but then recovered. Western exports to Russia declined, while Chinese exports of semiconductors and other products increased. Detour exports are another big problem, with Russian companies entering Turkey and exporting to Russia via them, causing Turkey's exports to Russia to increase by 60% in the previous year. Exports of home appliances (washing machines and refrigerators) from the EU to former Soviet republics, such as Kazakhstan and Armenia, have soared. After they are exported to these former Soviet republics, they are re-exported to Russia (allegedly, semiconductors are removed and inserted into missiles).

(3) Western imports from Russia decreased year-on-year in 2022. However, Chinese imports increased by 43%, and Indian imports were 4.6 times higher than the previous year's, as they imported and refined Russian crude oil that had become cheap owing to sanctions, also selling it in the West.

(4) Damage to the Russian economy. In the automobile sector, Western companies have withdrawn from Russia or reduced their production, with the production value in July falling to about 10% of the pre-war level. Companies from China and Kazakhstan are expanding, while Russian companies are also showing signs of recovery. Air transportation has also been affected significantly. However, Russia's GDP growth rate in 2022 was -2.2%, which is very small compared with the -8 to -10% that was predicted at the time of the invasion (-7.8% in 2009 during the Lehman crisis). Inflation also approached 20% at one point, but it decreased subsequently.

(5) The budget deficit of the Russian Federation. The budget depends on a balance between export tax revenues in the oil and gas sector, which accounts for approximately 40% of the total revenue, and defense spending. The budget deficit was 3.3 trillion rubles (about 6 trillion yen) in 2022 and 2.4 trillion rubles in January–March 2023 alone. In December, the West announced a policy of barring ships transporting Russian crude oil for more than \$60 a barrel from insurance, after which the price of Russian Ural crude oil fell to nearly half that of North Sea Brent Crude. The Russian government will likely respond to the budget deficit by raising taxes and issuing government bonds. The Saudi-led OPEC Plus has repeatedly cut production in its oil cartels, which in turn supports Russian revenues.

●Russia's counterattack

Nord Stream 1 (a pipeline directly connecting Russia and Germany) supplies natural gas from Germany to many EU countries. Russia cut off the supply at the end of August, causing the EU to panic temporarily and leading to global inflation due to rising fuel prices. In the EU, business shutdowns and social unrest increased in the winter, which the Russian government believed would cause the EU's support for Ukraine to collapse. However, EU countries increased imports of liquefied natural gas (LNG) to secure stockpiles, and by the end of the year, both oil and gas prices had reduced to pre-war levels. They were saved by an unprecedentedly warm winter, US LNG exports to Europe, and a decline in LNG demand in low-growth China. The EU will increase gas imports from the Middle East, the Caucasus, North Africa, Central Asia, and other countries for future stockpiling. And the EU will also accelerate the greening of energy.

●Challenges with sanctions against Russia

Western sanctions and support for Ukraine have strengthened the unity of the "democratic camp." The EU has survived the counterattack of the suspension of NS1, but henceforth, solutions must

be implemented. EU imports of Russian fossil fuels will likely be curbed to the extreme in 2023, deepening Russia's predicament. However, the Chinese-led "dictatorship and authoritarian camp" supports Russia. The "Global South" comprising India, Turkey, Saudi Arabia, and others pursues national interests amid the rivalry between the two others, thereby supporting Russia. With this three-way split of the world, the West will need a strategy to increase the effectiveness of sanctions against Russia. I hope that the Hiroshima Summit, chaired by Japan, will be the first step toward this goal.

(This is an original article written by TANAKA Soko, Professor Emeritus, Tohoku University.)