

The Effect of Economic Sanctions on the Russian Economy¹

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Today I would like to make a small presentation about the influence of economic sanctions on the Russian economy at this time. During the years since the collapse of the Soviet Union, the Russian economy has faced several highs and lows. These highs and lows were due to a variety of factors, both internal and external. Several crises such as the Russian crisis, the world economic crisis of 2007-2008, and the European debt crisis have shaped the Russian economy to what it is now. Of course, there was a positive influence: one of the most beneficial factors was the high price of oil and natural gas starting in 2000. Now we can say that we are witnesses to a new threshold or bifurcation point.

Sanctions are not new to the world economy. Sanctions have been used by different countries over time. Here some examples². What we can say from these examples is that there are always two sides of influence. Sanctions can be imposed for political or economic reasons and under the process of globalization at times we can't draw a clear line between them. Sanctions became an important instrument of influence for countries besides military intervention. From the start most sanctions were focused on a trade segment – almost $\frac{3}{4}$ of them. But this instrument is not static. From the beginning sanctions were developing and countries looked for ways to make sanctions more efficient, to increase their economic impact and to influence countries on specific questions. Under the process of globalization it became clear that one of the most vulnerable points of every economy in the world nowadays is finance. With different degrees of dependence of each country on foreign finance, cutting out this line would have influence on trade, real economy, firms and consumers. And of course we can use a mixture of trade or financial sanctions.

It's not the first time sanctions have been imposed on the Russian economy. Of course, the Soviet Union was under the pressure of sanctions. But I would like to highlight a recent example. For the past few years there were three main points. The first one occurred in 2000 when some Russian companies cooperating with Iran in the field of

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² Examples of imposing sanctions: Soviet Union, China, Iraq, Iran, Libya, Belorussia .

nuclear energy were subject to sanctions. The second case occurred in the summer of 2008. At that time, the US government thought about the possibility of imposing sanctions, accusing Russia of military aggression against Georgia. The last one of the three happened in 2013. The United States was ready to impose sanctions against the largest Russian banks in cooperation with the government of Assad in Syria. In my opinion all these three cases made the Russian economy to see what could happen as a consequence of sanctions and whether or not the Russian economy is ready for that. And the Russian economy could see a consequence not so long ago.

So what is going on and what does it mean for the Russian economy? To answer this I would like to set aside some political questions and focus mainly on what has happened during the past year. The trigger for imposing sanction was in March 2014, when Russia recognized the results of a referendum in the Crimea. At that point in time sanctions were mostly soft. Sanctions on Russia were by more than 20 countries and world organizations (For example, the EU, NATO, the G8, the European Organization for the Safety of Air Navigation). These soft measures include lists of “persona non grata”, which differ by each country. At the further escalation of this situation the lists were extended. The last round was not so long ago, this summer. Also some countries, in addition to the list, added restrictions to companies’ finance or activities. It was like a trial period for sanctions supposedly on a one year basis. For now this period has been extended. Two main events led to the increasing economic confrontation. The first was in April-May, 2014 when the situation in the east of Ukraine deteriorated. The second one, the 17th of July 2014, was the crash of the Boeing 777 in the Donetsk region. More countries were now involved in this conflict. It was clear that from that moment that it would be hard to find a turning point. Step by step economic sanctions have influenced different key sectors of the Russian economy. Of the most crucial were the energy sector, defense and finance. During that time some key projects were frozen or canceled. At some point in time it became Russia’s turn to find a way to secure the situation or defend against the negative influence of imposed sanctions. As a result, the Russian list of ‘persona non grata’ was created. If we look at projects, abandoning the "South Stream" gas pipeline was a great blow. Still, a solution was found by creating the project of a gas pipeline to Turkey. And one of the most recent steps was the Russian embargo on food and goods from countries which had imposed the sanctions. The main products in the embargo are meat, fish, fruits, nuts, vegetables and dairy products. For me I would call it a “Cheese shortage moment.” In people’s minds there are two responses to the embargo. The first is negative: the table will be without the usual products. The second is positive: now there is more space for producers from another countries or even domestic companies. Actually many countries were ready to cooperate and export their products to Russia (Latin America, Serbia, Turkey, Egypt, Belorussia, and Iceland) and

some domestic companies were ready to expand their business. Still the main problem is that Russian market is vast, and it will take some time to fill that gap. Sanctions will continue to have an effect.

We can call what is happening right now the Russian Financial crisis 2014-2015 but sanctions are not the only reason. If we try to summarize all the consequences, they are the structural crisis; geopolitical crisis and changes in oil prices and exchange rates. All these problems together can be called, as was said by Minister of Economic Development, Mr. Ulyukaev: “a perfect storm.” These three crises share a strong mutual influence and interdependence. Some of these problems can be seen right after the EU debt crises of 2009. Some steps were made to improve the situation but there hasn't been enough time. The geopolitical crises concerning the situation in Ukraine and sanctions which are imposed on Russia accelerated crises. Structural crises are connected to internal problems in the Russia economy: a high dependence on natural resources, ineffectiveness in other sectors, an aging population. The problems that could be seen years before became more urgent and time became a crucial factor. The decrease in the oil price has hit the most crucial part of economy which combined with exchange rate volatility has had a great impact on both companies and the population. And in that sense the actions of the government and the central bank were crucial. Still, some of these actions were insufficient or mistimed. In my opinion, one of the most fragile sectors in Russia is the banking sector. There are people who remember the Russian crisis of 1998 which is why there is uncertainty in people's minds. So if the situation is unclear people prefer to cut their deposits to a minimum. That is why managing people's expectations is crucial. It would be hard to move on if we don't improve them or if we make them worse. What is more interesting for researchers is to divide all three factors and find the degree of impact on the Russian economy. As I said earlier they all have a strong mutual influence and interdependence, so dividing them is not such an easy task.

There are two sides to this situation. First we can see it as a dangerous case that is threatening the Russian economy. But there is a second side. We can see it as an opportunity: an opportunity to improve the Russian economy as a whole and increase its effectiveness. It is an opportunity to find all the pitfalls and drawbacks discussed years ago. I hope it will be so.