CHAPTER 14

Sanctions and Forces Driving to Autarky

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Highlights

- Economic sanctions introduced in 2014 by the United States (US), the European Union (EU), and other advanced economies, in response to the annexation of Crimea and the conflict in Donbas, together with Russia's domestic and international countermeasures, started the process of decoupling the Russian economy from global markets, reversing the earlier trend of global integration.
- Additional and much stronger sanctions came in response to Russia's invasion of Ukraine in February 2022. Similar to 2014, these sanctions were followed by retaliatory measures from Russia against 'unfriendly' countries, which also deepened the sanctions' negative effects on the Russian economy.

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- As a result of the sanctions and countersanctions, the Russian economy has become partly closed to the external world, less competitive, less innovative, and more autarkic. Quality of life will suffer and the costs of production will increase. Even if the Russian economy overcomes the sanction-related recession, its long-term growth trend will be slower as compared to a non-sanction scenario.
- Other effects of the sanctions and countersanctions will include the increasing role of the government in economic management, more state ownership, further deterioration of the business and investment climate, and more macroeconomic fragility.

14.1 Introduction

Since the second half of the 2000s, political relations between Russia and its Western[1] partners, in the first instance, the United States and the EU, have gradually deteriorated. Both caused by the Russian authorities' military and foreign policy decisions, two turning points dramatically accelerated this deterioration. First, in March 2014, Russia annexed Crimea, a part of the Ukrainian territory. It shortly after began to actively support the separatist movement in Donbas, which led to Ukrainian authorities losing control over approximately half of this region as well as the formation of two unrecognised territorial entities—the Donetsk and Luhansk People's Republics. Despite an international effort to end the conflict in eastern Ukraine (the two Minsk agreements signed on 5 September 2014 and 11 February 2015), it was never resolved. Second, on 24 February 2022, Russia started a military invasion of the Ukrainian territory (called in official Russian terminology a 'special military operation') that led to a full-scale war, which continues at the time of writing this chapter (May 2022).

The analysis of the geopolitical causes and dynamics of the conflict between Russia and its Western partners is beyond the thematic remit of this chapter. However, we will analyse its negative impact on economic relations between Russia and its major trade and investment partners, the functioning of the Russian economy, and, consequently, Russia's economic performance in the short, medium, and long run. Below, we present and analyse the first (2014) and second (2018) rounds of Western sanctions against Russia (Sect. 14.2), Russia's countersanctions and other policy response measures (Sect. 14.3), and estimates of their negative impact on the Russian economy (Sect. 14.4).[2] Then we move to the new, much more comprehensive and robust packages of sanctions following the invasion of Ukraine in February 2022 (Sect. 14.5) and Russia's response measures to these sanctions (Sect. 14.6). Finally, Sect. 14.7

[1] In this chapter, we use the adjective 'Western' in a broad geopolitical (membership in US- and EU-initiated alliances) rather than precise geographical sense (for example, Japan, Australia, and South Korea are not located west of Russia).

[2] The content of Sects. 15.2 and 15.4 partly draws from Dabrowski (2019).

attempts to assess the potential economic impact of the war and sanction/countersanction regime on the Russian economy from a short-, medium- and long-term perspective.

14.2 The 2014 and 2018 Rounds of Western Sanctions

The annexation of Crimea and Russia's engagement in the conflict in the Donbas region of Ukraine in 2014 triggered a series of international sanctions against Russia initiated by the US and the EU. To various degrees, Canada, Australia, Norway, Iceland, Switzerland, Japan, some EU candidate countries, and international organisations such as the European Bank for Reconstruction and Development (EBRD) joined the anti-Russian measures. Sanctions were put in place in 2014 and are still in force, subject to regular renewal (in the case of the EU) and updates (concerning the list of sanctioned individuals and companies).

The 2014 US and EU sanctions had a multipronged character,[3] involving four groups of measures (Russell, 2016): political/diplomatic (Tier 1), sanctions against individuals and entities (Tier 2), economic sanctions (Tier 3), and those related to Crimea.

The Tier 1 sanctions excluded Russia from the Group of Eight (G8). They suspended negotiations on Russia's accession to the Organisation for Economic Co-operation and Development and the International Energy Agency, a new EU-Russia treaty (which could include a free trade agreement), and EU-Russia visa liberalisation. They also stopped the semi-annual EU-Russia summits, the NATO-Russia cooperation, and the voting rights of the Russian delegation to the Parliamentary Assembly of the Council of Europe (this sanction was terminated in 2019).

The Tier 2 sanctions have been targeted against named individuals and companies, for example, those engaged in doing business in Crimea. Measures include visa bans and asset freezes. Russian public money has supported some affected companies to compensate for sanction-related losses.

In the economic sphere (Tier 3), sanctions have concentrated on three areas:

- A ban on medium- and long-term financing for the largest state-owned banks and companies;
- A ban on trade in military and dual-use equipment and some oil exploration and production equipment and services;

[3] See https://www.state.gov/ukraine-and-russia-sanctions/ for the list and content of US sanctions and https://www.consilium.europa.eu/en/policies/sanctions/restrictive-measures-against-russia-over-ukraine/history-restrictive-measures-against-russia-over-ukraine/ for the list and content of EU sanctions.

- A ban on trade, including tourism, travel, and communication services, with the annexed Crimea, and prohibition on the use of Crimean ports and involvement in investment activity in this territory.

In April 2018, the US adopted the Countering America's Adversaries Through Sanctions Act (CAATSA), which partly codified the existing sanctions and introduced new ones against selected Russian businesspeople and companies in response to Russia's alleged interference in the US 2016 presidential election. Another wave of US sanctions followed in August 2018 in response to the attempted assassination in the United Kingdom (UK) of a former Russian intelligence officer.

14.3 Russia's Policy Response in 2014 and the Following Years

In August 2014, the Government of the Russian Federation responded to the Western sanctions (see Sect. 14.2) with a ban on imports of most food products from countries that adopted sanctions against Russia. Imports of meat, milk products (especially cheese), fruits, and vegetables became the most affected. Geographically, food imports from European and especially Eastern European and Baltic states declined dramatically. Domestic consumers became the main losers (see Sect. 14.4), while domestic agricultural and food producers were the leading gainers. The food imports embargo meant the implementation of much earlier proposals of an agriculture lobby for more robust protection against imports, justified on the grounds of the country's food security (Korhonen et al., 2018).

Since 2014, Russia has also started to introduce a series of economic sanctions against Ukraine, the most significant being revoking the bilateral free trade agreement (FTA) on 1 January 2016 (in response to the entry into force of the EU-Ukraine FTA). To have a complete picture, one should also mention Ukraine's sanctions against Russia, such as banning direct passenger flights between Russia and Ukraine in October 2015 (Rainfords, 2015) and the energy and transport blockade of Crimea in November 2015 (Olearchyk & Farchy, 2015).

The Russian government also has extended restrictions on non-resident ownership in some sectors, for example, the media and industries that may be important for national defence and security. These restrictions came on top of those before 2014 and related to investment in natural resources and the financial sector, gas supply, and transportation via pipelines, medical equipment, and telecommunication, among others (European Commission, 2020). The government also tightened entry rules for incoming foreign investment (see Chapter 13) and several other regulations, such as public procurement (European Commission, 2020), international cooperation of non-government research institutions, and civil society organisations.

The reaction to Western sanctions and the increasing geopolitical confrontation with the West also led to a substantial reorientation of the entire economic policy. Earlier measures aimed at achieving competitiveness in global markets were replaced by initiatives to reduce dependence on foreign partners and international institutions, financed by the rents generated by traditional export markets. This strategy was implemented via an increasing interference of the government into business activity.

The postponement (or explicit refusal) of liberal economic reform became the most prominent feature of economic policy after 2014. No further liberalisation of regulated markets, no liberalisation of electricity prices, no reform of the financial and banking system, and no profound changes in the administrative regime or administrative control were undertaken.

Economic policy goals were shifted from diversification of economic structure, improvement of investment climate, and integration in the global economy to support for disintegration, the continuing promotion of traditional mineral export, and import substitution. It tried to support domestic producers in manufacturing and resource industries through tax incentives, government subsidies, investment support, export taxes and quotas (to decrease the domestic prices of many critical inputs), and preferences for domestic suppliers in public procurement, including purchases by state-owned and regulated companies (European Commission, 2020). An import-substitution policy and the associated economic, financial, and legal support to domestic producers contributed to building and strengthening various sectoral and industrial lobbies and helped them to capture government policies (Connolly & Hanson, 2016). Import-substitution programmes have also led to additional fiscal and quasi-fiscal costs and trade distortions, and often they have contradicted Russia's commitments to the World Trade Organization (WTO).

Several policy measures aimed to avoid, or at least reduce, the Russian economy's critical dependence on decisions taken abroad and potential new sanctions, increasing Russia's self-sufficiency.

One of the key actions to increase the country's 'economic security' focused on reforming the cashless payment system. In 2015, a national payment card system under the control of the Central Bank of the Russian Federation (CBRF) began to process all cashless transactions in Russia. The payment card 'MIR' (*peace* or *world* in the Russian language) was introduced and quickly expanded its scale of operations, among others, due to its use for payments from public funds. At the end of 2021, the share of the MIR payment system expanded to more than 25% of cashless payments in Russia, and its centralised national processing diminished the threats of the interruption of global payment systems.

The government has also tried to achieve digital independence by supporting Russian-born digital platforms in domestic markets. From 2014 to 2021, several remedies on Google were imposed to support Russian Yandex to promote digital services. From 2021, a rule on the compulsory pre-instalment of Russian applications to all devices sold in Russia is in force. In 2019, the Federal Assembly adopted a law to create a separate 'Russian Internet' (*Runet*).

Import-substitution policies and associated protectionist measures (usually having a non-tariff character) led to a response from Russia's trade partners. For example, the European Commission applied several anti-dumping procedures against Russian exporters of chemical and ferrous metal products (European Commission, 2020; see Chapter 12). As a result, non-tariff measures increased from both sides: Russia and its trade partners (European Commission, 2020).

Since 2014, Russia has refrained from re-establishing or promoting international trade with European countries, announcing a strategy to increase economic cooperation and exchange with Asia. However, the actual geography and structure of commodity exports and imports have changed very slowly, and the share of oil and natural gas in total exports further increased. In 2020, the EU remained the largest trade partner. The only destination with increasing Russian exports is China, but overall export volume in 2021 was still one-third lower than exports to Europe (USD 140 billion against USD 218 billion).

The Government of Russia also announced changes in the priorities for budget expenditures and the management of public programmes. Twelve government programmes along three priorities named 'Quality of Economic Environment', 'Economic Growth', and 'Human Capital Development', accounting for about 12% of annual budget expenditure, were initiated. Among these 12 priority programmes launched in 2019, nearly half of the expenses are allocated for infrastructure: roads, railroads, and energy. Substantial funds were spent on the social benefit programmes within the Human Capital Development programme. This spending increased during the COVID-19 pandemic in 2020–2021, exceeding the pre-2014 level.

14.4 Economic Impact of the First Two Rounds of Sanctions and Countersanctions

Assessing the impact on the Russian economy of the first two rounds (2014 and 2018) of sanctions and countersanctions is not an easy task because of the difficulty of disentangling their effects from other factors, such as the collapse of the oil price and other commodity prices in mid-2014 (Korhonen et al., 2018). Furthermore, most of the quantitative assessments were done during the early stage of sanctions implementation (2014–2016), and some of them were based on *ex-ante* forecasting rather than *ex-post* analysis.

Some early estimates (for example, Kholodilin & Netsunajev, 2016) found an annual negative impact ranging from 1 to 2% of gross domestic product (GDP). Gurvich and Prilepskiy (2015) estimated the cumulative loss of

Russian GDP from Western financial sanctions at 6% of GDP for 2014–2017. Bloomberg Economics obtained a similar result (cumulative 6%) for 2014–2018 (Doff, 2018).

The International Monetary Fund (IMF, 2015, p. 5) estimated the initial negative impact of sanctions between 1.0% and 1.5% of Russian GDP, with a long-term cumulative effect of up to 9% of GDP. However, in its later report (IMF, 2019, p. 58), it gave a much lower estimate: sanctions were to be responsible for 0.2 percentage points (pp) of GDP lower annual growth in comparison with the IMF 2013 World Economic Outlook (WEO) projection. This is in line with Pestova and Mamonov's (2019) estimates.

The World Bank (2016, p. 40) estimated that removing sanctions would increase forecasted GDP growth in 2017 by 0.9 pp (from 1.1 to 2%) because of the boost to investment and consumer confidence. However, the forecasted growth rate would remain unchanged in subsequent years because of other factors unrelated to sanctions, limiting Russia's growth potential.

Overall, the latest estimates based on actual data series gave lower estimates of growth losses (due to sanctions) than earlier estimates based on forecasting models.

Regarding the Russian countersanctions, Volchkova et al. (2018) estimated that they were responsible for an average annual loss of RUB 2,000 (about USD 30) per Russian consumer, or 0.00036% of Russian GDP per capita in 2014. Russian producers captured 63% of this amount, and non-sanctioned exporters, in particular from Belarus, took 26%. The remaining 10% constituted a deadweight loss.

None of the available studies measured the potential impact of the 2018 US CAATSA sanctions.

Overall, the sanctions and countersanctions aggravated the 2014–2016 currency crisis and recession (see Chapters 15 and 16). In 2014–2015, financial sanctions were particularly painful. By suddenly closing off the international financial market to large state-controlled companies such as Rosneft, Novatek, and Gazprom, the sanctions forced the Russian authorities, including the CBRF, to rescue them. This caused an additional diminution of the CBRF's international reserves and a depletion of National Wealth Fund (NWF) assets. Financial sanctions also triggered large-scale capital outflows from Russia in 2014–2015 (see Chapters 13 and 16). Therefore, they added to the market panic and the collapse of the rouble exchange rate in December 2014 and early 2015.

Beyond the effects of the sanctions, the Ukrainian conflict involved other direct and indirect costs for Russia, such as higher military spending, human losses, the social costs of refugee flows, and aid of various kinds to rebel-controlled territories, among others. Increased military expenditure crowds out expenditure on other public services, in particular education and health care, negatively contributing to potential economic growth, an argument frequently raised in Russian economic debates (Kudrin & Knobel, 2018; Kudrin & Sokolov, 2017).

The termination of the free trade regime with Ukraine and the various restrictions initiated by both sides of the conflict (see Sect. 14.2) hurt economic growth in both countries—more significant in Ukraine, more minor but still considerable in Russia (given the different sizes of both economies).

In addition, there have been substantial costs of integrating Crimea into the Russian economy. The costliest investment project was the construction of the Crimea Bridge over the Strait of Kerch, between the Kerch Peninsula (part of the Crimean Peninsula) and the Taman Peninsula in Krasnodarsky Krai (part of the Russian mainland), which was opened in May 2018. Its length is over 18 kms, and the total construction cost was in the region of USD 4 billion.

Aslund (2018) estimated the cost of integrating Crimea and providing support to occupied Donbas at USD 4 billion or 0.3% of Russia's GDP, not including the construction costs of the Crimea Bridge.

14.5 The 2022 Round of Western Sanctions

The military invasion of Ukraine launched on 24 February 2022 triggered an unprecedented wave of sanctions against Russia initiated by the US, EU, the UK, Canada, Japan, Australia, and several other countries. When writing this chapter, the war in Ukraine continues, and new sanctions are added to those introduced earlier. Below, we present a summary of the adopted and planned sanctions as of 15 May 2022.[4]

As in the case of the 2014 sanctions, they address various sectors and areas of relations with Russia and target different subjects (individuals, institutions of the Russian state, businesses, and banks, among others). However, they have much broader coverage and are more robust than those adopted eight years earlier.

14.5.1 Individual Sanctions

The US, EU, the UK, and other countries have sanctioned more than 1,000 Russian individuals and businesses, including top government officials and their families, members of the State Duma and National Security Council, military and security commanders involved in atrocities in Ukraine, key businesspeople close to the Kremlin (the 'oligarchs'), and others. For example, the sixth package of EU sanctions discussed in the first half of May 2022 includes a list of 58 individuals.

Individual sanctions involve visa bans and personal asset freezes in most cases.

[4] See https://www.bbc.com/news/world-europe-60125659, https://www.consilium.europa.eu/en/policies/sanctions/restrictive-measures-against-russia-over-ukraine/sanctions-against-russia-explained/, https://home.treasury.gov/policy-issues/financial-sanctions/sanctions-programs-and-country-information/ukraine-russia-related-sanctions.

14.5.2 Financial Sanctions

Financial sanctions involve a ban on transactions with the CBRF and the freezing of its assets (this affected approximately one-half of Russia's international reserves). They cut seven Russian banks off the Society for Worldwide Interbank Financial Telecommunication (SWIFT). They also banned the supply of euro-denominated banknotes to Russia and deposits to crypto-wallets. They restrict the access of Russian banks, enterprises, and individuals to the capital and financial markets of the US, EU, and the UK. The US government also barred Russian entities from using their assets held in US banks to repay their debts.

The EU restricted financial and non-financial support to Russian publicly owned or controlled entities under the EU, Euratom, and Member States programmes.

In its sixth sanctions package, the EU plans to disconnect an additional three Russian banks from the SWIFT system.

14.5.3 Energy Sanctions

The US banned all oil and natural gas imports from Russia, and the UK will stop oil imports from Russia by the end of 2022. The EU is discussing the same measure. In August 2022, the EU will also stop coal imports from Russia. There is a broad debate within the EU about a substantial reduction of its natural gas imports from Russia.

Germany has finally suspended the opening of the Nord Stream 2 gas pipeline from Russia. This investment project raised a lot of political controversy within the EU and its relations with the US.

New sanctions also involve a ban on exports to Russia of goods and technologies in the oil refining sector and new investments in the Russian energy sector.

14.5.4 Trade Sanctions

Apart from sanctions related to energy trade (see Section 14.5.3), the EU imposed an embargo on importing iron, steel, wood, cement, rubber products, seafood, spirits, and liquor from Russia. The UK has imposed a 35% duty on some imports from Russia.

On the export side, the US, EU, and the UK have banned selling dual-use goods (which may serve both civilian and military purposes) to Russia. The respective list includes, among others, drones and software for drones, software for encryption devices, semiconductors, and advanced electronics. The EU and UK have also prohibited exporting some luxury goods to Russia.

The EU prohibited all Russian nationals and entities from participating in procurement contracts.

On 15 March 2022, the EU, in cooperation with other G7 partners, stopped treating Russia as a Most Favoured Nation according to WTO rules. In this way, Russia lost a substantial part of its membership rights and privileges in this organisation.

14.5.5 Transportation Sanctions

Transportation sanctions include the closure of EU, US, UK, and Canadian airspace to all Russian-owned, registered, or controlled aircraft. The airspace closure accompanies the ban on exports, sales, supply, or transfer of all aircraft, aircraft parts, and equipment to Russia and the provision of all related repair, maintenance, or financial services. Similar bans concern goods, technology, and services exports in the maritime and space sectors.

The countries mentioned above also closed their seaports to Russian vessels. The EU banned Russian road transport operators.

14.5.6 Media Sanctions

The first round of media sanctions included a ban on all forms of broadcasting of Russia Today and Sputnik. In its sixth sanctions package, the EU considers adding three main Russian television channels to this list.

14.5.7 Diplomatic Sanctions

Diplomatic sanctions included suspension of the EU-Russia visa facilitation agreement concerning Russian diplomats and other Russian officials and businesspeople and a reduction in the number of diplomatic staff in Russian embassies and consulates. Russia has also been suspended from the United Nations Human Rights Council and excluded from the Council of Europe.

14.5.8 Withdrawal from Russia and Spontaneous Boycott

Besides official sanctions, Russia as a country and Russian residents have become the subject of spontaneous international boycotts in various spheres, including sport, culture, scientific cooperation, and various forms of business activity. For example, by mid-May 2022, more than 1,000 international companies had either suspended or completely stopped their activities in Russia. This list includes, among others, 3 M, Acer, Adidas, Amazon, Apple, Asus, AXA, BMW, British Petroleum, Canon, Chevron, Daimler Truck, Decathlon, DHL, Deloitte, Deutsche Telekom, Dr. Oetker, Equinor, Exxon, Ernst & Young, FedEx, Fitch, Ford, Heineken, Henkel, Honda, Hyundai, Ikea, JYSK, KONE, KPMG, Maersk, McDonald's, McKinsey, Michelin, Mitsubishi, Moody's, Netflix, Nokia, OBI, Oracle, Panasonic, PwC, Renault, Samsung, Schneider Electric, Shell, Siemens, Skoda, Spotify, Starbucks, TikTok, Uber, UPS, Volkswagen, and Volvo.[5]

Various considerations justified the decisions of individual companies: difficulties in continuing business in the environment of sanctions, countersanctions, partial inconvertibility of the rouble, the expected economic downturn in Russia, political arguments, and public relations motives, among others.

14.6 Russia's Response Measures to the 2022 Sanctions

Initiating a war in Ukraine, Russian authorities had to expect tough sanctions from the US and EU as Ukrainian allies. However, no one could perfectly predict what would be the exact content of the sanction measures and how tough, deep, and effective they would be. Consequently, most of the response measures (except those taken earlier to increase self-reliance in such areas as the payment system and digital sphere—see Sect. 14.3) were taken in reaction to the concrete sanction decisions presented in Sect. 14.5. These measures can be divided into four groups: (i) short-term stabilisation tools; (ii) support for aggregate demand and supply; (iii) retaliation (countersanctions) measures; and (iv) sectoral measures to compensate cuts in imports and the withdrawal of foreign direct investment.

14.6.1 Short-Term Stabilisation Measures

In the first month of the war, the Russian authorities' primary and most visible attempts were concentrated on preventing a banking and currency crisis. From the end of February, by mid-March, Russia introduced highly restrictive monetary policy instruments and restrictions on rouble convertibility. The CBRF increased its policy rate more than twice—from 9.5 to 20%. Exporters had to convert 80% of their export revenues into roubles (surrender requirements).

According to the new regulations, Russian residents were restricted from getting credit contracts with non-residents (special approval was necessary for new contracts). They also became obliged to register accounts in banks outside Russia. Russian debtors became obliged to repay debt obligations above RUB 10 million monthly (according to the current CBRF exchange rate) in roubles, irrespective of the currency of the contracts (exceptions could be allowed by the Ministry of Finance). In retail banking, withdrawals from individual currency deposits and transfers abroad were restricted to USD 10 thousand. In April and May 2022, some of the above restrictions (timing of conversion of export revenues and rules of buying currency in cash, among others) were partly relaxed, and the key CBRF policy rate was cut to 14%.

[5] https://som.yale.edu/story/2022/almost-1000-companies-have-curtailed-operations-russia-some-remain?company=Coca+Cola&country=.

These regulations are considered Russian retaliation to Western sanctions, but they hurt every foreign investor in Russia on a non-discriminatory basis, being an instrument of capital control. Until the end of 2022, Russian residents are prohibited from buying shares in any non-resident company or making payments to any non-resident under joint venture agreements unless they obtain a special permit from the CBRF. For specific contracts with non-residents, Russian residents are prohibited from making advance payments exceeding 30% of the sum of their obligations under the contract. Professional brokers in Russia are prohibited from selling securities on behalf of non-Russian companies or individuals. The issuance and trading outside of Russia of depositary receipts representing shares of Russian companies are not permitted (this means automatic de-listing from foreign stock exchanges). Russian corporations are obliged to terminate their respective agreements so that the depositary receipts are converted into underlying shares that can be traded only in Russia.

All these measures have mitigated capital flight from Russia. Capital outflow from Russia during the first quarter of 2022 amounted to USD 64 billion, which is slightly less than during the entire 2021 (USD 72 billion). When writing this chapter, annual capital outflows in 2022 are expected to be comparable with the outflows of 2008 and 2015.

14.6.2 Support for Aggregate Demand and Supply

The partial inconvertibility of the rouble will further deteriorate the business and investment climate (see Chapter 6) and, therefore, contribute to the deterioration of economic performance. Still, it provides more room for manoeuvring domestic fiscal and monetary policies in the short term. This allowed, among others, the weakening of the budgetary discipline rules (see Chapter 16). The fiscal rule on accumulating extra revenues from oil exports (above the threshold oil price) in the NWF was suspended. The government obtained the right to spend these additional revenues (if they occur) with high discretion. This allows the implementation of expansionary fiscal policies and applying demand-targeted and supply-targeted measures.

Demand-targeted measures include subsidising mortgages, applying negative effective interest rates to particular groups of domestic debtors, and the further extension of social expenditures.

Supply-targeted measures include easing administrative burdens and deferred tax payments. In monitoring and control, the government introduced a moratorium on regular inspections (except those related to health and safety), automatically renews most permissions, and simplifies and speeds up certification and compliance procedures.

The relaxation of the prudential regulation of Russian banks complemented the expansionary fiscal measures. This includes a moratorium on the capital adequacy requirements determined by the Basel-3 rules. The amount of credit provided to small and medium-sized enterprises without specific financial audits increased five times.

Among two groups of measures, demand-oriented ones prevail, desired to compensate for money outflow from Russian markets and to mitigate the expected decline in nominal GDP.

14.6.3 Retaliation (Countersanction) Measures

The reaction of the Russian government to Western sanctions adopted in February 2022 (see Sect. 14.5) was similar to that in 2014. It followed the tradition of symmetric response by adopting retaliatory measures against 'unfriendly' states, that is, countries that joined anti-Russian sanctions (despite their damaging impact on the Russian economy).

The most important and potentially influential countermeasure is the decision which obliges purchasers of Russian natural gas from 'unfriendly' countries to pay in roubles. The 'rouble payment rule' makes it mandatory for buyers to register a special account in Gazprombank and deposit the payment in the contract currency (euro or dollar) which would be converted into roubles by this bank. The proclaimed reason for this rule is the desire to evade sanctions technically. The purchase of roubles is expected to support the exchange rate and provide funds for the additional budget expenditure due to changes in fiscal rules (see Section 14.6.2). However, payments in roubles as a strategic instrument of Russian trade policies were discussed and designed long before 2022. One of the objectives was to discourage using US dollars in trade transactions. However, it was never achieved because residents and non-residents lacked interest in using the rouble as a transaction currency. Last but not the least, payments in roubles are expected to promote market segmentation for gas supply and potentially for other commodities.

Another retaliation instrument is the refusal to protect intellectual property rights (IPR) owned by residents of 'unfriendly' states. Inventions, utility models, or industrial designs are to be used for zero compensation without the consent of the rights holders.

The Government of the Russian Federation has also introduced an export ban on more than 200 products until the end of 2022, including telecoms; medical, vehicle, agricultural, and electrical equipment; and timber.[6]

It blocked interest payments to foreign investors who hold government bonds and banned Russian firms from paying dividends to foreign shareholders. It also prohibited foreign owners of Russian stocks and bonds from selling them.

Reciprocity measures were also adopted in the transportation sector. Russia closed its airspace and seaports to carriers and vessels from 'unfriendly' countries.

[6] See https://www.bbc.com/news/business-60689279.

The few Western and independent domestic media, including social networks and Internet outlets, that still operated in Russia at the beginning of 2022 were prohibited and cut off from broadcasting once the war started. Heavy criminal penalties were introduced for spreading supposedly false information—that is, information contradicting official government information and its interpretation of events.

Several drafts of legal documents that allow the direct confiscation of property of foreign owners are under consideration, including a draft bill on the 'external' administration of companies closing their business in Russia and the right to confiscate the property of 'unfriendly' countries and the persons associated with them. According to another draft bill, Russian banks are to be prohibited from providing information on clients and their transactions upon the request of any non-Russian authorities without the prior consent of Russian authorities. However, it remains unclear which of these drafts will be adopted, when, and in which form.

14.6.4 Sectoral Measures to Compensate for the Withdrawal of Imports and FDI

The exit of several foreign companies from Russia (see Section 14.5.8) will destroy technological ties and, therefore, put the functioning of the Russian economy under threat. Two types of measures were undertaken to mitigate the danger of technological unbundling. First, for particular import groups, import tariffs were reduced to zero. In addition, parallel imports (imports without the prior consent of the IPR-holder) were allowed for technological equipment for selected industries (including mining, energy, railroads and shipping, and agriculture), auto components and car engines, computers and smartphones, pharmaceuticals, and cosmetics. The intention is to evade sanctions for the producers of branded goods.

The second group of measures focuses on import substitution. The NWF is expected to be used for these purposes, for example, through subsidised credit programmes.

The policy to stop a brain drain from Russia is another form of policy response. In particular, a support programme was offered to companies and professionals in the information technologies (IT) sector. Until 2025, Russian IT companies are exempted from the profit tax and all forms of foreign exchange control, and they could obtain subsidised credits. There is a programme for IT professionals working in Russia, offering them mortgage credits with a near-zero interest rate (negative in real terms) and exempting them from mandatory military service.

There is a substantial overlap between the measures addressing different targets. Restrictions on capital outflows (i) hurt companies from 'unfriendly states' (iii) and every foreign investor in Russia. The 'gas for roubles' scheme was considered the most painful retaliatory measure (iii), but it also helped to stabilise the domestic financial market (i), which is necessary to stimulate aggregate demand (ii). By allowing parallel imports and removing the protection of IPR of 'unfriendly' state residents, the government tries to prevent shortages of critical goods and services in the domestic market (iv). However, it also penalises the companies which left Russia (iii).

14.7 Impact of Sanctions and Geopolitical Confrontation on Russia's Economic Development

When writing this chapter, it is impossible to forecast how extensive the economic damage would be to the Russian economy coming from the war in Ukraine, sanctions, countersanctions introduced in 2022, and other policy measures adopted by the Russian authorities in response to the new situation. In its April 2022 WEO, the IMF (2022) forecasts Russia's negative growth of real GDP at -8.5% in 2022 and -2.3% in 2023, inflation jumping to 24% at the end of 2022, and a deep contraction in imports and exports.

Going beyond quantitative forecasts, which are speculative and uncertain by their nature, qualitative changes in the Russian economic system and policies seem even more critical. Many of them will likely remain in force for a long time, even if the reasons for their introduction disappear. Below, we try to outline the most important of them:

- The disintegration of the Russian economy from the global economy. This may lead to the loss of a substantial part of the productivity gains obtained from trade, investment, and financial liberalisation since the 1990s (see Chapters 12, 13, and 15). The Russian economy will become partly closed to the external world, less competitive, less innovative, and more autarkic. Quality of life will suffer and the costs of production will increase. China, India, Turkey, South Africa, and some other developing economies that have not joined anti-Russian sanctions cannot substitute the US, EU, and other advanced economies as technology suppliers critical to continuing Russia's economic modernisation. Nor can Russia's domestic research and innovation sector fill the knowledge and technology gap.
- An increasing role of the government in managing the economy and a weakening of the role of the market mechanism. Sectoral import-substitution programmes with accompanying financial incentives and administrative support measures will inevitably lead to more structural, microeconomic, and social distortions.
- The increasing role of the government in economic management and Russia's decoupling from the global economy will further deteriorate the already poor business and investment climate (see Chapter 6). Geopolitical confrontation with the West and the atmosphere of war will also further increase the role of security and law enforcement agencies, reducing areas of economic and civil freedom.

- Although, until May 2022, the government refrained from the large-scale expropriation of foreign owners, the share of state-owned enterprises in the Russian economy (see Chapter 7) will inevitably increase due to the exit of foreign shareholders. The government may use the resources of the NWF for these purposes, including buying back the shares of foreign owners.
- The fragile macroeconomic stability (see Chapter 16) may deteriorate due to higher budget expenditures for supporting business activity and import substitution, military and security purposes, social programmes, and lower revenue (due to the recession and energy sector-related sanctions). Although a currency crisis in March 2022 (the depreciation of the domestic currency by more than 20% against the USD) was partly mitigated, thanks to capital controls and a dramatic hike in the CBRF policy rate (see Subsection 14.6.1), the rouble will remain vulnerable to new potential shocks. They may originate, for example, from lower international energy prices or new economic and financial sanctions.

Questions for students

1. What were the causes of the Western sanctions against Russia introduced in 2014, 2018, and 2022?
2. Please characterise the content of the sanction packages in 2014, 2018, and 2022.
3. How has Russia responded to the sanctions (in terms of retaliation measures against the countries which introduced sanctions and domestic policy adjustment)?
4. Please assess the negative impact of the 2014 sanctions on the Russian economy.
5. What will be the most likely economic consequences of the 2022 sanctions in the short, medium, and long terms?

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