What are the most likely implications of the economic sanctions imposed on Russia?

One of the defining geopolitical events of 2022 was the reigniting of the Russia-Ukraine conflict sparked by Putin's launching of a military operation into Ukraine. This triggered a dramatic series of economic events, most notably a comprehensive set of sanctions by the West on Russia. This essay will explore the implications of these sanctions both in the short and long-term. It will ultimately be concluded that the sanctions will presently have limited impact on the Russian economy relative to expectations but will be more damaging over a longer timeframe. Conversely, the sanctions have been more pronounced on the West than expected in the short-term but will be less severe in the long-term.

Numerous sanctions have been placed on Russia since the escalation of the Ukrainian war on the 24th of February 2022. The earliest sanctions, led by the West, Japan and Taiwan included export controls on software, equipment, and technology to Russia. These were closely followed by the US and UK freezing assets of large Russian banks (VTB, Sberbank ect.) and banning them from the SWIFT financial system as well as imposing restrictions on the Central Bank of Russia (Martin, 2022). On March 8th, the US introduced the first bans on imports of Russian oil, gas and other energy (Martin, 2022). Since then, most other sanctions involve further escalation of these import restrictions, with the UK pledging to end all dependence on Russian oil and coal by the end of 2022 (Department for Businessm Energy & Industrial Strategy, 2022) and the West imposing a $60 per barrel price cap on crude oil from Russia (Martin, 2022). Along with these official sanctions from various governments worldwide, many multinational businesses have either ceased their operations within Russia, stopped collaborating with Russian partners or pulled out of investment projects in the country (Sonnenfeld, et al., 2022).

In the short term, many of the sanctions seem to have limited effects on the Russian economy. In the first quarter of 2022, Russia's federal budget revenues were up by 34% as compared to the same period of 2021 (CEPR, 2022). This is due to the global price of oil and gas increasing due to reduced supply. The over-reliance the West has on Russian energy prevents them from imposing sanctions in a manner that dramatically affects Russia's revenues. When the EU introduced price cap of $60 per barrel (Martin, 2022) on Russian crude oil (the country's largest single export accounting for 18% of the total (Harvard, 2020)**,** the market price of Russia's Urals oil blend was at $57.49 per barrel (Trading Economics, 2022)with the costs of production at $20 to $40 per barrel (Economist, 2022). Thus, Russia is still able to generate a healthy profit from its oil and gas exports, generating a trade surplus of around 15% (CEPR, 2022)**.** Whilst the withdrawal of more than $15 billion in foreign direct investment is one of the largest on record (Economist, 2022), it has also failed to have much impact on either increasing unemployment or in creating a liquidity crisis that would have rendered Russia unable to finance the war. This is because Russia has already been relatively isolated from the West. In 2019, foreign direct investment in Russia was worth 30% of its GDP whilst the global average was 49% (Economist, 2022). Similarly, only 0.3% of working Russians had jobs with American firms as compared to 2% in most European countries (Economist, 2022). As of January 2023, Russia currently has an unemployment rate of 3.9 (Economist, 2023). This means that, at least in the short term, Russia can sustain their internal finances using government reserves of around $300 billion and the additional revenues from gas and oil in 2022. Overall, the Russian economy is set to contract by 3% in 2022 (Congressional Research Service, 2022). This is still a significant recession but relatively speaking the drop is smaller than that experienced after the 2008 Financial Crisis (Statista, 2022). Hence, in the short-term it appears the sanctions have had some negative impact but have fallen short of causing the crippling effects they were intended to.

The West on the other hand is struggling economically more than expected from the sanctions. In fact, the EU and UK economies would appear to have suffered more from the sanctions than Russia. The restriction of cheap Russian gas has increased energy prices, thereby exacerbating the broader issue of rapid cost-push inflation (Turak, 2022) (Associated Press, 2022). Inflation has already been rising since the start of 2022 due to increasing aggregate demand following the recovery from the

COVID lockdowns. The impact of rising fuel prices following Russian retaliation to sanctions by cutting off Nord Stream 1 (Associated Press, 2022)has exacerbated this issue. Across Europe, the CPI increased by more than 15% in 2022: other countries who chose not to engage in transactions have only seen a 10% increase in the CPI indicating the specific role sanctions have played in this issue (Economist, 2022). Similarly, despite the EU's attempt to stockpile gas, gas and electricity costs are still 144% and 78% more expensive as compared to 2019 causing a meaningful reduction in consumer welfare as well as real income decreases of 0.7 to 1.7% (CEPR, 2022) (Associated Press, 2022) (Economist, 2022). This is reflected in studies suggesting high mortality rates are associated with higher energy costs as people may become unable to heat their homes, leading to more diseases and deaths (Economist, 2022). Some experts have even predicted that, in case of a harsh winter, the rise in energy prices in Europe due to the sanctions could cost 335,000 more lives than the average during the winter period (Economist, 2022). For comparison, this is triple the Russian death toll from direct military conflict of 112,700 (Ukrinform, 2023).

In the long run, the sanctions have the potential to be far more damaging to the Russian economy. Firstly, restrictions on software, equipment and technology exports to Russia will start substantially reducing productivity in the economy. Russia has presently been trying to substitute Western goods with Chinese or Turkish ones, with China's exports to Russia growing by more than 20% (Reuters, 2022). However, these substitutes cannot meet all of Russia's news for sophisticated high-tech products such as advanced semiconductors**.** This issue will start to manifest over the next few years

as Russia runs out of replacements and so cannot support the technological advancement required for long-term economic growth. A second challenge for the Russian economy will come from the brain drain as skilled workers opt to leave the country. An estimate from the BBC suggests some 200,000 Russians have fled the country within two months of the start of the war, with the majority being educated, high-income workers (Turak, 2022; Demytrie, 2022). This means that Russia will have a large gap in the workforce which cannot easily be substituted as the specialist training required to replace skilled workers would take many years. This will also further exacerbate the problem of decreasing productivity in Russia. Together, these factors will result in significantly reduced economic growth with the IMF forecasting that Russia's economy will shrink by 20% by 2030 (Blanchard, 2022).

In contrast, the West is set to be more resilient to the effects of the sanctions over the long-term. Given a longer time period, the West will be able to greatly reduce their reliance on Russian energy and stabilise cost-pull inflation. This can be achieved by expanding the output of alternative energy sources such as nuclear energy. Nuclear energy currently makes up around 26% of the EU's electricity production (Szazadveg, 2023) and is one of the cheapest methods of producing electricity at $32/MWh (LTO) with gas costing $91/MWh(without accounting for price shocks) (iea, 2020). Other sources of renewable energy (offshore wind) are also becoming cheaper and more readily available as governments funded development projects (Department for Business, Energy & Industrial Strategy, 2022). Forecasts estimate that more than 40% of the West's energy needs will be met by renewable sources by 2030 (Euopean Council, 2022). Consequently, the West will be able to lessen their dependence on Russian exports in the long term and limit the economic damage from the sanctions. The West also has the advantage of being less isolated from other countries than Russia. The trends towards globalisation in the recent decades means that the EU has numerous trading partners to distribute goods to. Whilst Russia would struggle to find new markets for gas and crude oil without a big discount in price (Sonnenfeld, et al., 2022); as the West decouples from Russian energy, the West will be able to boost their economy by selling technological equipment to foreign countries much easier, especially following the reopening of China, which will bring a high demand for numerous goods and services and provide a boost to slowing economies (Reuters, 2023). All in all, although the Western economies is expected to head into recession, there is much hope in the markets and some are predicting stock prices to rise to up to 17% by the end of 2023, much better than Russia's impending decline (Economist, 2023).

In conclusion, the sanctions that have been placed on Russia will have less of a negative impact than intended in the short-term. Conversely, in the coming decade they will have severe implications on its economic health, as will be demonstrated by a lack of technological progress and reduced economic growth. The West will experience the opposite, with sanctions having a surprisingly large immediate negative effect through inflation and a cost-of-living crisis. Over the long-term, however, it will be able to withstand the economic fallout and ultimately be much better off than Russia.

If the results of this analysis hold true, then they justify reconsidering the West's approach in how economic tools are used to apply political pressure to Russia. This is because the limited short-term negative impact of current sanctions means they are unlikely to deter Russia from their military expansion. Equally, the significant long-term damage will hurt future generations of Russia and potentially lead to further resentment which makes international reconciliations and cooperation more challenging. Further economic research should attempt to provide policymakers with an alternative set of economic tools to current sanctions which can be leveraged to better bring about peace.

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