Understanding the Impact of Sanctions on Russia

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Russia's invasion of Ukraine shook the global economic system to its core in February 2022. The international community responded quickly to the initial attacks that occurred on February 24, 2022, by expanding sanctions that had already been in place and cutting off several Russian banks from the SWIFT network of financial transactions, leading to an estimated 30-year economic setback projected for Russia.

The Implications of the Economic Sanctions on Energy

The impacts of the Russo-Ukrainian War have been felt far beyond the borders of the two nations, adversely affecting the global energy market to the extent that more than three-quarters of UK households were in fuel poverty at the beginning of this year. Russia holds enormous influence over natural gas prices, allowing it to limit supply and drive-up prices in response to both the sanctions levied and international aid to Ukraine, which has played a crucial role in slowing and even reversing the advance of Russian forces. The reliance of Germany on Russian natural gas has served as an example of the shortfalls of importing energy from abroad rather than working towards energy independence. In December 2021, for example, Russian piped gas made up 32% of Germany's gas imports. With limited supply, Germany is facing the prospect of short-term blackouts in winter. Geopolitical analysts have suggested that this dependence on Russian gas has limited Germany's response to the invasion.

According to the Council on Foreign Relations, while Germany has increased its military aid to Ukraine since the start of the War, the fear of escalation and domestic economic concerns have led some policymakers to caution against assuming a leadership role among European nations (Fix, 2022). As costs rise and the geopolitical landscape remains unstable, more nations will likely work to achieve greater energy independence, reducing the impact that destabilising international events will have on prices.

On November 29, 2022, the UK government announced its support for the Sizewell C nuclear power station, a £20 billion project forecast to generate electricity for 6 million UK homes. In addition to creating thousands of jobs in the UK, Sizewell C would help to close the energy import-export deficit in the status quo. While the UK's energy consumption fell by 17% between 1998 and 2015, reliance on imported energy has increased to levels we have not seen since 1975. Within Russia, the economic landscape has been reshaped by the sanctions imposed. A tracker from the Yale School of Management has found that over 1000 companies, including Coca-Cola, Uber, and Deloitte, have reduced their presence in the Russian market beyond what current sanctions require.

The Impact of the Economic Sanctions on the International Market

Domestic alternatives were quick to form, including "Vkusno & tochka", a fast-food chain set up by a former McDonald's licensee, which has quickly increased its market share in a less competitive market. The economic sanctions may shift Russian consumers away from international brands and towards local alternatives in the long term, which will face less scrutiny. The extent of this shift will depend on the length of the War and whether market exits are permanent. This could accelerate the Eastern vs Western market divide, where few companies can exist and compete in both due to geopolitical tensions. Huawei, the Chinese telecommunications provider, was banned from providing new 5G technology from wireless networks in 2019 on the basis of national security concerns. Over the next decade, we may continue to see such bans used in conflicts similar to the China-United States trade war, particularly within the TMT (technology, media, and communications) sector.

A major component of the economic sanctions has been the banning of 7 Russian banks from the SWIFT financial network. It has been described as the 'global financial artery that allows the smooth and rapid transfer of money across borders'. By cutting Russia off from the international financial system, the European Commission, and its allies aim to make it more difficult for transactions with other countries to be made, further weakening Vladimir Putin's ability to fund the War. In response, Russia introduced the SPFS (System for Transfer of Financial Messages), although this has received limited traction internationally. This move may push Russia towards reliance on India and Russia for trade, as they have already developed separate financial networks to serve as alternatives. Russia's real estate market has also suffered as a direct result of the economic sanctions imposed, with demand falling by 36-37% in Moscow. This illustrates the declining confidence in Russia's economy, with global and domestic investment both declining. We can conclude that the economic sanctions have made Russia less attractive to investors.

The Human Cost of the Economic Sanctions Imposed against Russia

The long-term standard of living in Russia and Ukraine is likely to decline due to the economic sanctions. According to the Russian ministry of economics, annual inflation is 11.9%. Additionally, Russia is experiencing a 'brain drain', as many of its most educated and capable citizens are leaving to escape the conflict or protest the invasion. According to the Wilson Center, up to 1.5-2 times, the number drafted for military service have fled the country to escape the draft. The depletion of talent in Russia has the potential to set it back for decades.

Additionally, with ~100,000 casualties attributed to the War so far, the productive potential of Russia and Ukraine has been permanently damaged, slowing economic recovery. Russia's fertility rate has fallen to just 1.50, with its population already falling prior to the invasion, making the drop in the available workforce even more concerning.

The Impact of the Economic Sanctions on Russia's Domestic Affairs

The economic sanctions have weakened President Vladimir Putin's standing in Russia. While it is unlikely that there will be a leadership change in the immediate future, despite Prigozhin's short-lived attempt to topple Russian leadership, the worsening economic situation could cause his reputation among the population to decline. Putin's most important audience: the wealthy and powerful oligarchs have been significantly affected by the War. Western governments have sanctioned them, and many have significant portions of their net worth in international holdings and real estate. If, after a cost-benefit analysis, they determine that the War is no longer sustainable and believe that their financial security is at risk, their next move could be to depose Putin.

These figures have often relied on Putin for their influence, which will make it difficult for them to remove him quickly. However, suppose he loses the confidence of the majority of both the country and its most prominent figures. In that case, a viable successor may emerge who could challenge his authority and accelerate his decline in support. Russia has a history of deposing dictators and may do so again if there is no longer an incentive to support the President. Many of its people remember the days of economic isolation and do not wish to return to the status quo of the USSR.

Ukrainian President Volodymyr Zelensky

Source: Getty Images

Conclusion

While it is difficult to separate the impact of the economic sanctions from other outside factors, it is clear that they have harmed the Russian economy and, consequently, Vladimir Putin's ability to finance the War in Ukraine. In the long term, the sanctions will drive a wedge between Russia and the western economic ecosystem, forcing them to adapt and reduce their reliance on imports. While higher energy prices are currently propping up Russia, it cannot rely on them permanently and must change course to prevent collapse. Over time, nations will become less reliant on imported energy, with many using renewable energy to move towards energy independence. Ultimately, these sanctions have accelerated a global split between two contrasting societies: one based on democracy and the other on dictatorship. Each will become more reliant on themselves for trade and cooperation, leading to divisions not seen since the Cold War.

The sanctions have and will continue to contribute to Ukraine's ability to defend itself: with Russia constrained, it has been able to defend from a more powerful aggressor and prevent them from permanently occupying territory. The sanctions have been effective in reducing Russia's ability to attack Ukraine, by destroying its supply chain, reducing living standards, and cutting access to vital technologies. This aggressive, coordinated action will eventually force Russia to withdraw, saving countless lives in the process and liberating a country facing assault. What remains to be seen is the level of economic pain that Russia is willing to tolerate before collapsing under the pressure. Ultimately, it is likely that Vladimir Putin will prioritize his own political survival over his invasion of Ukraine.

Glossary

Sanctions: An official order, such as the stopping of trade, that is taken against a country in order to make it obey international law:

SWIFT: The Society for Worldwide Interbank Financial Telecommunication (Swift), legally S.W.I.F.T. SC, is a Belgian cooperative society providing services related to the execution of financial transactions and payments between certain banks worldwide. Most countries rely on the service for financial services.

Geopolitical: Connected with political activity as influenced by the physical features of a country or area, or with the study of the way a country's size, position, etc. influence its power and its relationships with other countries

Areas of Russian military control in Ukraine

For more information about the Russo-Ukraine War

https://www.statista.com/topics/9087/russia-ukraine-war-2022/
https://www.hrw.org/tag/russia-ukraine-war

Questions to ask yourselves:

How has the Russo-Ukraine War impacted my life?

Do you think that sanctions are an effective way to deal with Putin's aggression?

Do you think Putin will remain President of Russia for long?

Use this area to write down any thoughts or questions that are raised whilst reading this article