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## ARE WESTERN SANCTIONS ON RUSSIA EFFECTIVE?

EKA JAVAKHISHVILI

169

EXPERT OPINION





საქართველოს სტრატეგიისა და საერთაშორისო ურთიერთობათა კვლევის ფონდი  
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## Introduction

“A nation that is boycotted is a nation that is in sight of surrender. Apply this economic, peaceful, silent, deadly remedy and there will be no need for force,” said US President Woodrow Wilson in 1919 who considered economic sanctions as an alternative to war. History remembers numerous examples of both successful and unsuccessful practices of sanctions between rival states. After World War II, the United States frequently imposed embargoes/trade restrictions and expanded its mechanisms of economic influence around the world, although this mechanism did not always work. Sanctions on countries that were relatively confident and well-armed were less effective. Cuba, North Korea and Iran, which have lived under sanctions for decades, are proof of this estimation. In the modern world, the effectiveness of sanctions often raises questions about Russia which has come under the pressure of complex sanctions imposed by the United States and the European Union over the past decade.

A wide range of economic sanctions have been imposed with regard to Moscow’s interactions with North Korea, Cuba, Venezuela and Iran; multiple human rights abuses and political repressions, its intervention in Syria, the destabilization of Ukraine and the annexation of Crimea, cyber-attacks and interference in foreign elections, poisoning of people, etc. The sanctions include wide financial and visa restrictions on both individuals and legal entities.

Some of the sanctions against Russia were introduced in 2005-2006 when Russia became actively involved in a confrontation with the West during Vladimir Putin’s first term of presidency. The policy of sanctions entered an active phase in 2012 with the adoption of the Magnitsky Act (Sergei Magnitsky Rule of Law Accountability Act of 2012) which was originally directed against those involved in the death of Sergei Magnitsky, a lawyer of the Hermitage Capital Foundation. Under the Magnitsky Act, sanctions are imposed on more than 50 individuals and entities who have been denied visas and whose assets have been frozen in the United States. In December 2016, the US Congress generalized the Magnitsky Act and it now applies globally, authorizing the US government to sanction those it sees as human rights offenders, not only in Russia but around the world.

In 2014, when Russia launched its military aggression in eastern Ukraine and occupied the Crimean peninsula, a large-scale and coordinated portion of sanctions was imposed on Moscow by the United States and the European Union. These sanctions are periodically renewable until Russia returns Crimea under Ukraine's control and stops supporting the separatist forces in eastern Ukraine.

In 2015, Russia received an additional package of sanctions for its aggressive actions in cyberspace. On August 2, 2017, US President Donald Trump signed the US federal law, entitled Countering America's Adversaries Through Sanctions Act (CAATSA), which imposed sanctions on Iran, North Korea and Russia.

In 2018, sanctions were imposed against people involved in the poisoning of Sergei Skripal, a former Russian Foreign Intelligence Officer (GRU) officer, and his daughter, Yulia Skripal, in the city of Salisbury, the United Kingdom. They were poisoned using a Novichok nerve agent. In 2021, the United States and the United Kingdom imposed additional sanctions on the Kremlin over the poisoning and arrest of a Russian opposition politician, Alexei Navalny. The same year, due to cyber attacks and interference in the US 2020 presidential election, the US responded to Russia with additional economic sanctions.

This is an incomplete list of sanctions. The US alone has about fifteen different sanctions packages targeting Russia.<sup>1</sup> To increase pressure on official Moscow, initiatives to develop additional mechanisms and tighten existing sanctions are often heard. From 2014 to September 2021, US and EU sanctions on Russia covered over 457 individuals and 561 legal entities.<sup>2</sup> In addition, "black lists" have been developed (Kremlin List) which include those individuals and companies against whom restrictions may soon be imposed.<sup>3</sup> Despite consolidated efforts, the Kremlin has not yet made any concessions and sanctions have been extended from year to year. Russia's resistance to economic pressure has proven more resilient than initially thought.



It should be noted that the effect of sanctions is not always immediately noticeable. It is a slower-acting tool that has the effect of instant psychological impact while causing strong cumulative results in the long run.

Achieving the desired results through sanctions requires significant patience. On this difficult road, periodically, there is some frustration about the effectiveness of sanctions against Russia. Some EU countries, which have suffered from the limitation of economic interaction with Russia themselves, are trying to find ways to reset relations with the Kremlin which casts some shadow over the joint effort. Increasingly, proposals are being made to ease sanctions against Moscow and look for alternative ways. Consequently, the effectiveness of sanctions will depend on whether the initiators of the sanctions will be able to maintain unanimity for a long time.

### Assessment of the Effectiveness of Sanctions

Today, economic pressure is a key tool in the foreign policy of the United States and the European Union in response to the Kremlin's expansionist actions but its effectiveness is hotly debated. Proponents of the sanctions believe economic restrictions have helped to deter Moscow's aggression in eastern Ukraine while opponents think that sanctions as a whole have

failed to change Russia's foreign policy. Thus, questions are being raised about the effectiveness of sanctions as leverage to be used against authoritarian regimes.

Some experts who believe that sanctions are ineffective point out that Russia has already overcome the initial shock from sanctions and has managed to adapt to them, making the existing restrictions less effective every year. They suggest that the policy of sanctions indicates a reduction of Washington's political weight in the international arena.

As Daniel W. Drezner, a professor at Tufts University argues, the sanctions have long been declarative but the US government refuses to acknowledge this because lifting the sanctions is a sign of the recognition of their weakness and a loss of prestige in the international arena.<sup>4</sup>

Numerous international studies and reports prove the opposite where figures and concrete calculations confirm that the imposed sanctions have a significant impact on the Russian economy. Over the years, Russia's economic growth has slowed, the investment climate has deteriorated, Russian production has fallen behind in technology, etc., which has ultimately contributed to weakening Russia's aggressive military rhetoric.<sup>5</sup> The very fact that Russian officials are constantly complaining about sanctions and demanding their lifting is an indication of the positive effect of they have.

Gary Clyde Hufbauer, an American researcher who has thoroughly studied 174 cases of major sanctions in the 20th century and compiled a database, says that economic weapons are not always successful in changing the behavior of target countries. However, according to the study, the sanctions were at least partially successful in 34% of the episodes studied. Consequently, the popular notion that "sanctions never work" is clearly wrong.<sup>6</sup>

Along with Hufbauer's research, significant knowledge has been accumulated about circumstances in which economic sanctions have tangible results and the factors that hinder their successful implementation. The effectiveness of sanctions varies considerably depending on the target country, the purpose of the sanctions and the number of parties imposing them. Narrow, targeted and well-defined sanctions are usually more effective than broader sanctions. However, the more countries participating in the joint sanctions process, the more effective the sanctions are. Finally, sanctions must be strictly enforced to be effective and make sense.

According to Hufbauer, sanctions should deter, punish or change the “bad behavior” of the target country. In the case of Russia, sanctions have had a deterrent effect. Although Western collective sanctions have failed to force the Kremlin to completely alter its aggressive actions and withdraw from Ukraine, they have played an important role in weakening the economy of the target country and halting wider military aggression. In the summer of 2014, Vladimir Putin, President of the Russian Federation, spoke about the possibility of invading Ukraine but after the sanctions were imposed, he refrained from greater military aggression. It should be noted that due to the decline in economic growth, the Kremlin became more cautious about waging real wars and replaced them with so-called “hybrid wars” which require relatively less financial resources.

### **What Damage has the Russian Economy Experienced?**

During the period of imposing sanctions on Russia, the price of oil fell in the global market which had a critical impact on the Russian economy. In the given situation, it is quite difficult to separate the impact of low oil prices from the effects of Western financial sanctions but experts are trying to distinguish the key parameters that have had a visible impact on Russia’s economic situation because of the pressure of sanctions.

First, it was to restrict access to the Western capital market for large Russian banks and companies and limit foreign direct investment which was not related to the price of oil.<sup>7</sup> As a result, the Russian government was forced to pursue a tough fiscal and monetary policy which significantly reduced Russia’s economic growth. Analysts estimate that sanctions on Moscow cost an average of USD 50 billion annually.

#### ***Reducing foreign debt***

The decline in access to Western financial resources has had a direct impact on the reduction of Russia’s foreign debt. It sounds good that the country has reduced its foreign debt but it also means that the country can no longer receive additional financial resources that will contribute to its economic development and, at the same time, the reduction of foreign debt by Russia was not voluntary. Russia’s total foreign debt shrunk from USD 729 billion at the end of 2013 to USD 470 billion at the end of 2020 (a reduction of USD 259 billion). According to experts, Russia would have increased its foreign debt to USD 949 billion if it had followed the average



emerging economy trend. The Western sanctions have forced Russia to forego international credits of USD 479 billion which potentially could have gone toward investment and, thus, economic growth.

The Kremlin has been unsuccessful in seeking foreign loans in China and the Persian Gulf in order to bypass the Western sanctions. None of the four big Chinese state-owned banks were prepared to offer Russia any credits as they all had operations in the United States and were aware of the risk of being sanctioned. The same was true of the banks in the Gulf and elsewhere.

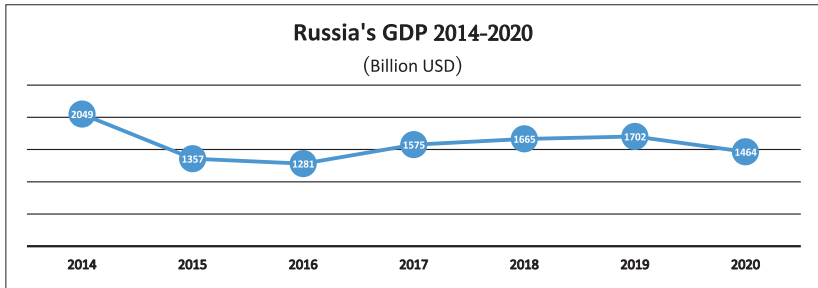
### ***Decrease of investment***

The inflow of foreign direct investment in Russia has always been relatively limited due to corruption in the country and a less attractive investment environment. Foreign investors outside the oil sector were not targeted by the Western sanctions but fears of investing in Russia have intensified. In a sanctioned country, they faced credit and reputation risks.

In 2010-2013, Russia's fixed investments increased by an average of 6.2% a year but the rate declined annually in 2014-2020. In 2014-2019, the annual net inflows of foreign direct investment in Russia averaged 1.39% of the country's GDP which is considerably less than in the previous six years when it averaged 3% of the GDP. This means that Russia lost about USD 169 billion in potential foreign direct investment in 2014-2020. If we add the amount of potential loss on the above-mentioned foreign loans (USD 479 billion) to this sum, we get a total of USD 648 billion lost - this is 34% of Russia's GDP in 2019.

### ***GDP change***

With the reduction of foreign loans and direct investment, Russia's economic growth has declined significantly. Since 2014, the Russian economy has shown an average growth of 0.3% per year while globally the average rate was 2.3% per year. For comparison, Russia had an average growth of 0.7% a year over five years while its Western neighbors had an average annual growth of 4-5% per year. Russia's GDP in 2013 amounted to USD 2.3 trillion which fell by 35% to USD 1.5 trillion in 2020.<sup>8</sup> According to the International Finance Institute (IIF), the country's GDP growth has been delayed for many years because of sanctions.



**Capital outflow**

Western sanctions have divided the Russian business community into two groups. A limited number of Vladimir Putin’s inner circle, state-owned enterprises and oligarchs particularly close to the Kremlin have sold foreign assets and focused on economic activity in Russia. Others, on the contrary, sold their Russian assets (sold them to the state or Putin’s friends), transferred the capital to offshore havens and moved to their families who already live abroad. It turned out that a larger part of the capital left the country than returned to Russia. It is noteworthy that not many Russian oligarchs are under Western sanctions while many of them are still expected to be sanctioned.

**Technological backwardness**

The most viable of the sanctions imposed against Russia turned out to be those prohibiting Russian companies access to vital Western technologies, especially in the oil and gas sector, rocket engineering, the petrochemical industry and so on. These types of sanctions effectively disrupt the Russian supply chains and hampered the country’s development in science and technology, weakening its capacity for modernization. It is assumed that in the next ten-15 years, the scientific and technological gap between Russia and the developed world will broaden.<sup>9</sup>

Restrictions on access to modern electrical equipment and components manufactured in the United States and Europe have severely affected the State Corporation for Space Activities (Roscosmos) which the head of the corporation spoke about.<sup>10</sup> After blocking access to Western technologies, the corporation found it difficult to replace them with its own production which, in turn, was related to a lack of technology, human capital, industrial equipment and financial resources.

## How Have the Assets of Russian Billionaires Changed Over Sanctions?

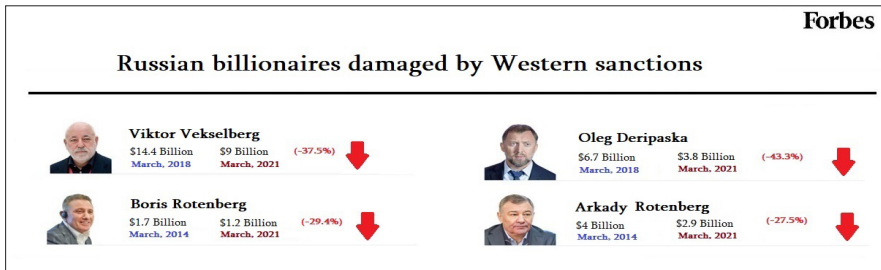
Russian businessmen have been subjected to Western sanctions due to the annexation of Crimea and the events taking place in eastern Ukraine. Their assets had been affected by economic restrictions, although in most cases not dramatically.

Maria Snegovaya, a visiting scholar with the Institute for European, Russian and Eurasian Studies at the George Washington University (IERES), explains that individual sanctions have been the least painful for the Kremlin and its allies as the oligarchs close to the Kremlin cultivated psychological stability towards sanctions in recent years. Besides, in order to reduce the impact of sanctions, the Kremlin developed a system of compensation with a scheme by transferring state tenders to them.<sup>11</sup>

Some members of Vladimir Putin's inner circle were particularly affected by the sanctions (see infographic #3). The biggest financial damage was inflicted on Russian oligarch Oleg Deripaska (Rusal, En+ Group). In 2018, Deripaska and his companies were subject to US sanctions. Although the US Treasury Department had to lift restrictions on some of his companies, the personal sanctions on Deripaska remained in place. Between 2018 and 2021, Deripaska's net worth has declined by 43%.

The sanctions also affected Victor Vekselberg, the owner of the Renova group of companies, and a close friend of Putin whose assets amounted to USD 14.4 billion in 2014 and declined to USD 9 billion in 2021. Since Vekselberg was added to the Treasury Department's sanctions list in 2018, he reduced his stake in Swiss companies by 50% whereas his USD 1.5 billion on bank accounts in the US and Switzerland were frozen.

Businessmen brothers, Boris and Arkady Rotenberg, who are especially close to Vladimir Putin, were also subject to US and European sanctions in 2014. Sanctions reduced their assets by almost 30%. For reference, the Arkady Rothenberg-owned company Stroygazmontazh (Стройгазмонтаж) built a 19-km bridge worth USD 3.7 billion connecting the Russian-occupied Crimean peninsula to Russia.



If we take a look at the Forbes 2021 ranking of the richest Russian businessmen, the net worth of the top ten billionaires has increased compared to 2011 (see infographic #4).<sup>12</sup> Some of the top businessmen have been sanctioned while others are on the “Kremlin List” against which sanctions have not yet been imposed, although economic restrictions may apply soon.

Western sanctions have not harmed the assets of the richest people in metallurgy. According to Forbes, the top three richest Russian businessmen work in metallurgy and, at the same time, their assets show an annual growth trend:<sup>13</sup>

- The richest Russian businessman of 2021 is **Alexey Mordashov**, chairman of the board of directors of the company Severstal (Северсталь). His assets have been growing since 2014. In 2018, the US imposed sanctions against his company Power Machines (Силовые машины) for supplying Siemens turbines in annexed Crimea. However, his assets continued to grow. Although in 2020 Mordashov’s assets decreased by USD 3.7 billion (USD 16.8 billion), they set a record in 2021 (USD 29.1 billion).
- **Vladimir Potanin**, the president of Nornickel (Норильский никель) whose assets are worth USD 27 billion, took second place in the ranking. In 2018, the company Rusal (Русал) of his partner Oleg Deripaska (Rusal owns 27.8% of Nornickel shares) was subject to US sanctions which were later lifted but caused some financial loss for Potanin. Nevertheless, Potanin’s capital is steadily growing;
- **Vladimir Lisin**, the chairman and majority shareholder of Novolipetsk Steel (NLMK) (Группа НЛМК) holds the third position with USD 26.2 billion in assets. His assets declined in 2014-2016 but started to increase in 2017 and set a record in 2021.



## Challenges of Sanction Policy

Western sanctions against Russia have several significant drawbacks which are due to various complexities. All of these reasons are related to the nature of the sanctions, the motivations of the parties imposing them and the peculiarities of the sanctions mechanisms in the EU and the United States.

***Incorrectly targeted sectors*** – Due to Russia’s strong integration in the world market, it turned out that the full implementation of all of the sanctions imposed on Russia was not possible for Western countries. For example, sanctions imposed on three companies of Oleg Deripaska, engaged in the production of aluminum (Rusal, EN+ Group, and EuroSibEnergO), caused damaging consequences not only for Russia but for the global economy. Sanctions on Rusal, which produces 6% of the world’s aluminum, led to a 20% rise in the price of aluminum. In 2019, after ten months of negotiations, the US Treasury Department had to lift imposed sanctions.

Oleg Deripaska's automobile company GAZ (ГАЗ) in Russia was also fully sanctioned. It had a joint venture with German Volkswagen which was not allowed to operate with the sanctioned company. The Russian side offered Volkswagen the opportunity to buy the second half of the GAZ shares but Volkswagen did not want to invest more in Russia nor did it want to abandon its assets because of the US sanctioning. Finally, as a result of the US-German negotiations, sanctions from GAZ were lifted.

***Old and ineffective sanctions*** – Several sanctions became ineffective over the years. Some sanction packages have not been changed or renewed over time. The Russian government, meanwhile, has already found many ways to avoid sanctions.

***Non-complex nature of the sanctions*** – Sanctions do not cover the entire target sectors and, therefore, their impact is partial.

***The EU-US unanimity*** – The political aspect of sanctions, especially its European dimension, creates additional obstacles to preserve the sanctions regime. EU sanctions were imposed after a series of multi-layered negotiations in which 28 EU member states were involved. In some European countries, the enthusiasm for sanctions was not felt from the beginning and it is difficult to maintain unanimity on sanctions within the EU as a result of active pressure from the business-political lobby.

Moreover, recent statements in Brussel, Paris and Berlin indicate that a significant part of the European establishment considers the Ukrainian conflict as a hindrance towards realizing their long-term interests. They want to return to active trade relations and cooperation with Russia. In this respect, German policy vis-à-vis Russia has always been pragmatic. According to German Chancellor Angela Merkel: "The EU cannot isolate Russia because Russia is a reality that the EU cannot escape." She also said the EU should seek direct contact with Russia and force Moscow to refrain from aggressive actions.

It should be noted the great contribution of Germany in the lifting of the restrictions from the Nord Stream 2 pipeline. On July 23, 2021, Angela Merkel and US President Joe Biden reached an agreement to lift sanctions on the construction of the pipeline, although some mechanisms remained to re-enact the sanctions. With this move, another example of easing sanctions imposed on Russia has emerged which may become a risky trend in the future.

To summarize, from an economic point of view, Western sanctions are working at this stage; however, additional efforts are needed to increase their effectiveness. According to experts, the Western approach needs to be reconsidered, the diplomatic factor strengthened, sanctions optimized and priorities set in order to strengthen and expand anti-Russian sanctions.

## **Georgia and Sanctioned Russia**

To stop Vladimir Putin's aggressive expansionist policy, the West has taken active steps following the destabilization of Ukraine and the annexation of Crimea. However, six years before the events in Ukraine in August 2008, Russia occupied territories of Georgia but imposing sanctions on Moscow was not on the agenda of the US and the EU at that time. If Putin's regime had received as severe sanctions in response to the occupation of Georgian territories as it does because of Ukraine, Russia's policy towards occupied Abkhazia and the Tskhinvali region might have taken a completely different direction. It is also possible that the events in Ukraine were prevented and Moscow could not even dare to annex the Crimean Peninsula.

Although the West has not imposed sanctions on Russia for the occupation of Georgian territories, the United States and the European Union have repeatedly called on Russia to fulfill its obligations under the August 12, 2008 agreement, immediately withdraw its military and security forces, and abolish the recognition of the so-called independence of the territories of Georgia - Abkhazia and the Tskhinvali region. However, many years of calls and resolutions adopted so far have not forced the Kremlin to step back.

Russia's expansionist policy towards Georgia has not changed but is gradually becoming more aggressive: the perimeter of Georgian land occupied by the Russian occupation forces is constantly expanding and the creeping occupation does not stop. The daily lives of those living along the conflict line become even more unbearable as they live in constant fear of illegal detentions and kidnappings, restrictions on freedom of movement or other forms of discrimination.

The fact is that the Kremlin is not giving up its position on Ukraine even under the pressure of almost eight years of sanctions and it is also unlikely that it will do so in the case of Georgia. Russia will step back only on the basis of declarative calls. If it is possible to persuade Russia to make

concessions to Ukraine thanks to sanctions, it may be possible for Georgia to find a way out of the situation as well.

However, the existing sanctions lack the intensity that would have altered the Kremlin's behavior. Supposedly, many more years and even tougher sanctions will be needed against Putin's regime in order for the sanction policy to achieve the desired result. Strategic patience will be the key to the effectiveness of sanctions.

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