

Western Sanctions on Russia and Strategic Stability

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Abstract

Russia's full-scale invasion of Ukraine produced significant economic repercussions as the United States and its allies imposed strict sanctions. The Russian economy suffered a sharp decline in output, and swaths of the economy found themselves isolated from Western parts of the global economy. Despite this, Russia adapted to the new situation, writes Richard Connolly of Eastern Advisory Group. Surprisingly, the economy only contracted by 2 percent in 2022, defying earlier predictions of a steeper decline. This report evaluates the impact of the unprecedented sanctions imposed on Russia 18 months into the war, focusing on how sanctions have affected strategic stability. Sanctions damage strategic stability by encouraging Russia to align with non-Western partners, especially China. Russia's economy has suffered, but it has successfully found alternative markets. While sanctions may weaken Russia's conventional forces by disrupting and raising the cost of production, Moscow's formidable strategic capabilities remain intact.

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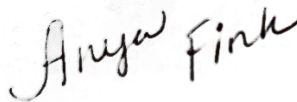
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Introduction

The decision to launch a full-scale invasion of Ukraine in February 2022 and the subsequent imposition of strict sanctions by the United States and its allies shook the Russian economy. Output fell sharply in the months after the invasion. Half of Russia's war chest of international reserves was frozen, and the financial sector wobbled after large swaths of the economy were cut off from the Western financial system. As the year progressed, sanctions on Russia's vital hydrocarbon exports were ratcheted up, but Russia gradually adapted to the new wartime environment. Trade was quickly reoriented to non-Western countries. Most importantly, oil continued to flow to export markets, generating much-needed revenues. In the end, the economy defied the apocalyptic predictions made after the war began and shrank by a mere 2 percent over the course of 2022, a remarkable feat given the scale of the economic disruption caused by sanctions and the war effort. Most observers forecast that output will rise in 2023, prompting some to suggest that the worst is over for Moscow.

This report provides an assessment of the impact of the sanctions imposed by the United States and its allies on Russia—sanctions that were unprecedented in their intensity and scope—18 months into Russia's expanded campaign in Ukraine. In particular, it examines how sanctions have affected strategic stability both in the context of the Russo-Ukrainian War and in general. In the first section, the broad contours of the sanctions regime are outlined. The second section summarizes how the Russians have responded, and the third section highlights where the sanctions have clearly succeeded and failed and where their impact remains uncertain. A final section considers how the sanctions regime has affected strategic stability and the risks that have, or could, emerge if, as is likely, the regime is maintained.

The Allied Sanctions Regime

The United States and its allies introduced a range of sanctions on Russia after February 24, 2022. These sanctions targeted individuals, banks, businesses, and major state-owned enterprises, as well as Russia's ability to export and import certain categories of goods.

Together, these sanctions are intended to perform several functions, ranging from deterring Russia from escalating even further, to punishing Russia for choosing to attack, to reducing the size and sophistication of the Russian economy over the longer term. The last, it is hoped, will reduce Moscow's ability to finance its military and to build the weapons and systems that a modern military requires.

The most important sanctions fall into the following categories:¹

Financial

- International reserves held by the Central Bank of Russia (CBR) were blocked (i.e., effectively frozen). This measure affected more than half of Russia's prewar stock of \$630 billion of international reserves (comprising foreign exchange, gold, and special drawing rights). Russia has also been prevented from making debt payments using the funds that it holds abroad, making it harder for Russia to repay its external debt.
- Several major Russian banks—both state-owned and private—were removed from the SWIFT international financial messaging system.
- The assets of many Russian banks, nonfinancial firms, and individuals linked to the ruling Russian elite were frozen. Targeted individuals and entities have also been restricted from borrowing money from and making deposits in many allied countries.

Trade and energy

- The United States imposed restrictions on imports of Russian oil and gas early in the war.

¹ Further details of the US regime can be found at <https://ofac.treasury.gov/sanctions-programs-and-country-information/ukraine-russia-related-sanctions>, and details of the European Union sanctions regime can be found at https://finance.ec.europa.eu/eu-and-world/sanctions-restrictive-measures/sanctions-adopted-following-russias-military-aggression-against-ukraine_en.

- The European Union (EU) coordinated embargoes on Russian coal and oil and is seeking a further embargo on Russian gas, although this embargo has not been achieved yet and Russia has cut gas supplies in the meantime.² The EU first imposed an import ban on Russian seaborne crude oil and petroleum products followed by corresponding bans by other G7 partners.
- Most notably, the EU with G7 partners (the Price Cap Coalition) put in place a price cap on crude oil and oil products in late 2022 and early 2023. The price cap applies to seaborne crude oil, petroleum oils, and oils obtained from bituminous minerals that originate in or are exported from Russia. The price cap is set as follows:
 - \$60 per barrel for crude oil
 - \$45 per barrel for discounted petroleum products
 - \$100 per barrel for premium petroleum products
- EU countries have established the level of the cap in close cooperation with the Price Cap Coalition. The cap applied from December 5, 2022, for crude oil and from February 5, 2023, for petroleum products. It can be adjusted over time.
- The EU also banned exports of technologies for oil refining to Russia and any investment in Russia's energy sector.
- Allies closed their airspaces, ports, and roads to Russian transport operators.
- The EU has also banned imports of certain exports of value to Russia, including iron, steel, wood, cement, seafood, alcohol, and gold.

Technology

- The US and its allies have imposed an expanded ban on the export of dual-use goods—items with both a civilian and a military purpose, such as vehicle parts. Similar sanctions have been in place since 2014, although the list of prohibited items and targeted entities has grown and the scope for evasion is much reduced.
- A much-enhanced export control regime resembling the Cold War CoCom regime is now in place, significantly restricting the export or transfer of products and technology to Russian end users. With a few exceptions, any item that has an Export Control Classification Number (ECCN) now requires a license for export to Russia. In addition, depending on the end user or potential end use, many goods not assigned an ECCN (so-called Export Administration Regulations (EAR) 99 items) now require a

² Vladislav Gordeyev, "Eksport 'Gazproma' v dalnneye zarubezhe pochti v dva raza" [Gazprom's Exports to Far Abroad Fall Almost by Half], RBK, Jan. 2, 2023, <https://www.rbc.ru/business/02/01/2023/63b2b8079a7947d826022a2b>.

license to be exported to Russia. The new export control rules under the Department of Commerce's EAR have three main effects:

- Expanded export licensing requirements now apply to a much-expanded range of dual-use goods, software, and technologies.
- The expansion of the EAR's "foreign direct product rule" forbids the sale of specified foreign-manufactured goods or components that use US-origin controlled technology or software.
- The expansion of export controls to Russian military or government entity end users and military end uses now covers all US-origin goods with limited exceptions, such as food and medicine destined for nonmilitary and nongovernment end users.

"Spontaneous" sanctions

- In addition to official sanctions drawn up by governments, more than 1,000 multinational companies have either suspended trading in Russia or withdrawn altogether. This exodus included the most important foreign investors in Russia's energy sector, including BP, Shell, and Total, and multinational consumer brands such as Coca-Cola and Starbucks.

Russia's Response to the Allied Sanctions

The allies threatened to impose sanctions in the event of an invasion, so the Russian leadership knew that sanctions were likely. Russia's response began with President Putin stating that the sanctions were illegal and that they deprived Russians of their property rights. The government then approved a list of countries that had committed "unfriendly" actions against the country, its companies, and its citizens, which provided the framework for a series of so-called countersanctions aimed at those nations.

Financial response

Russia's first measures were taken in response to what Putin described as the weaponization of the financial system.³ The government took a series of actions giving primacy to the ruble in international transactions, including, most significantly, a demand that so-called unfriendly countries receiving Russian gas pay only in rubles and that Russians with large debts to unfriendly states pay in rubles. These measures enabled Russian businesses to halt exports or tear up contracts with any individual or entity from an unfriendly country.

Several other related measures were issued, including a ban on Russians issuing ruble loans to unfriendly states, a ban on transfers to unfriendly states from ruble accounts held by non-residents, and a ban on cash exports of more than \$10,000 in non-ruble currency from Russia.

The CBR also banned foreigners from selling Russian securities and banned the payment of dividends by Russian companies to shareholders in unfriendly countries. It halted payments to foreigners holding Russia's locally issued sovereign debt. It has also ordered Russian-listed public companies to delist depositary receipts—an instrument that represents shares—from foreign trading platforms.

Taken together, such measures punished foreigners with financial interests in Russia and Russian companies. Although they are retaliatory responses to Western economic pressure, in

³O. Vyougin et al., "Khuzhe chem krizis. Kak ustroyena i kuda vedyot rossiskaya ekonomicheskaya anomalija—2022" [Worse than a Crisis: the Foundations and Future Directions of the Russian Economic Anomaly—2022], ed. K. Rogov (Re:Russia Expertise, Analysis & Policy Network LMA Foundation, 2022).

practice, they isolated Russian businesses and Russian citizens from financial integration with unfriendly countries.⁴

Tit-for-tat measures

Russia sanctioned Western politicians, including legislators and ministers in the United States, the EU, Britain, Canada, and other countries, as well as other officials and journalists, in response to similar moves by those countries. And in response to a ban on Russian flights in Western allies' airspaces, Russia closed its airspace, forcing some long-haul flights between Europe and Asia to take longer routes.

Further orientation to non-Western export markets

In 2022, Russian trade with the US and its allies contracted sharply, primarily because of sanctions and wider business disengagement but also because of lower demand in Russia caused by falling gross domestic product (GDP). This decline prompted Moscow to accelerate efforts to reorient its trade toward non-Western markets. In value terms, the year-on-year share of imports from the EU fell from 33 percent to 20 percent, and the proportion of imports from China rose from 25 percent to 40 percent.⁵ In value terms, the share of Russia's exports to the EU halved to about 20 percent, whereas the proportions going to China (+20 percent), India (+10 percent), and Turkey (+10 percent) grew.⁶

Economic and political statecraft

Moscow also employed several other measures of political and economic statecraft, including prisoner bargaining, reducing gas exports to Europe, and preventing Ukrainian grain exports

⁴ Taking Western sanctions and Russian responses together, commercial and people-to-people ties are significantly diminished compared to before the war.

⁵ Ivan Tkachev, Anastasia Antipova, and Polina Khimshiashvili, "Chto Kitai znachit dlya ekonomiki Rossii" [What China Means for Russia's Economy], RBK, Mar. 20, 2023, https://www.rbc.ru/economics/20/03/2023/64145bfb9a79477ef586365c?from=from_main_2.

⁶ Mir Landau, "Rossiya voshla v pyaterku krupneishikh torgovykh partnerov Indii" [Russia Becomes One of India's Top Five Trading Partners], RBK, Mar. 11, 2023, <https://www.rbc.ru/economics/11/03/2023/640c3a679a7947e2e34a893b>; Vyacheslav Agapov, "Rossiya stala liderom po eksportu v Turtsiyu" [Russia Becomes Leading Exporter to Turkey], Lenta.ru, Mar. 31, 2023, https://lenta.ru/news/2023/03/31/turkish_export/.

from the Black Sea, which have increased pressure on the world economy. It also claims to have suspended the export of more than 200 goods ranging from timber to pharmaceuticals.

The Kremlin limited or at least obscured information about political and social life in the country. The government increased pressure on nonsystemic opposition figures and independent news media outlets and made it harder for foreigners to access information about the economy from the Federal Tax Service, the CBR, Rosstat, and other official agencies.

The CBR has allowed companies listed on the Moscow Exchange to limit public disclosures, and banks are permitted to stop reporting under Russian accounting standards in order to conceal data about controlling shareholders if it will enable them to avoid sanctions.⁷

Defensive policy measures

Russia has accelerated import substitution with the aim of reducing dependence on Western imports. To this end, Denis Manturov was promoted from trade and industry minister to deputy prime minister with responsibility for both civilian and defense industries, which suggests that efforts will be made to increase cooperation in the two spheres (as China has done with reasonable success, albeit with greater access to Western imports).⁸

Katerina Tikhonova, President Putin's daughter, was also appointed to a role coordinating the import substitution effort at the Russian Union for Industrialists and Entrepreneurs, an organization representing Russia's most significant businesspeople.⁹ This appointment is an unambiguous signal that generating innovation in Russia's private sector has become a top presidential priority, even if the means assigned to achieving it appear insufficient.

The State Duma legalized parallel imports, enabling Russian businesses to import Western goods without the permission of the manufacturer. This extraordinary measure is an implicit acknowledgment that import substitution will not provide immediate compensation to Russian consumers and businesses dependent upon Western goods, components, and equipment. This policy has so far delivered more success than import substitution: Russia's goods trade with Turkey and China, in particular, has increased substantially since the start of the war.

⁷ "Data Blackout," The Bell, May 16, 2022, <https://thebell.io/en/data-blackout/>.

⁸ "Denis Manturov Appointed Deputy Prime Minister – Minister of Industry and Trade," President of Russia, July 15, 2022, <http://en.kremlin.ru/events/president/news/68943>.

⁹ "Katerina Tikhonova zaimetsya importozameshcheniem v RSPP" [Katerina Tikhonova Will Deal with Import Substitution at the RSPP], RBK, July 13, 2022, <https://www.rbc.ru/economics/13/07/2022/62bacf569a79478ceb0a9a39>.

Impact of the Sanctions So Far

Sanctions have delivered successes and failures and have generated further uncertainties. In this respect, sanctions are like any other policy instrument. On one hand, the impact of sanctions will weigh heavily on the Russian economy for some time. The Russian economy's prospects for growth over the next decade—bleak to begin with—are now very different. In quantitative terms, the economy will likely be smaller than it would have been had sanctions not been imposed. In qualitative terms, the range and sophistication of goods and services produced in Russia will also likely be lower. Both these factors will, in turn, shape the prospects for the modernization of the Russian military. On the other hand, Russia's economy has not collapsed, the leadership has not been deterred from military action in Ukraine and remains defiant, and the country is by no means cut off from international trade. Russia is building a new type of economic system that, although economically less efficient than it was before the war, may offer greater resilience in what looks set to be a period of prolonged tensions with the US and its allies. These points are discussed in detail below.

Successes

The allies have been more united in their response to Russian aggression

In 2014, the allies implemented a twin-track approach to Russia, combining targeted sanctions on one hand with maintaining ties in specific areas, particularly trade and investment, on the other. In hindsight, this policy was imprudent. It led Europe toward ever-greater dependence on Russian energy even as Moscow increased its campaign of aggression across the continent. These measures were insufficient to deter Russia from an anti-Western course, and the Russian leadership will have been delighted that Washington could not prevent Berlin from completing the politically contentious Nord Stream 2 gas pipeline. Moscow evidently took the view that Europe lacked resolve, which was undoubtedly a factor in the Kremlin's decision-making as it prepared to invade Ukraine in 2022.

However, the new sanctions represent a significant change of approach. The allies have been more united in their intent to respond to Russian aggression by isolating (rather than engaging) Russia economically. This approach has demonstrated to Moscow that the West has greater shared resolve and unity of purpose.

The scope of the new sanctions is unprecedented against a major economy

The allies have also been more determined than ever to inflict economic pain on Russia. The new sanctions are bold and include steps that were previously dismissed by policy-makers as dangerously escalatory, such as expulsion from SWIFT. The sanctions are also an unprecedented demonstration (and test) of Western economic power, with implications for other adversaries, such as China.

Perhaps more importantly, allied unity is underlined by Europe's willingness, in contradistinction to 2014, to incur economic pain as well by limiting Russian energy imports and incurring greater strategic risk. Enduring the cost of sanctions remains a challenge for Europe: it has been easier to agree on restrictions to oil and coal imports than gas imports, for example, but the overall trajectory of Western economic relations with Russia has fundamentally changed.

Many Western businesses have divested from Russia

Western businesses with a presence in Russia divested en masse, indicating a corporate acceptance of sanctions (and other measures).¹⁰ This exodus was also unprecedented: before the war, many blue-chip companies had profitably endured the tough Russian market for years and lobbied their governments to support trade even as political relations deteriorated after 2014. Even if the war ends quickly, it is very unlikely that Western businesses will return quickly to the Russian market.

Russia will find it harder to access Western goods and technologies

Considering the full package of measures and large-scale divestment of Western businesses, it will be more difficult than before the war for Russia to access Western goods and technologies.

¹⁰ Businesses leaving Russia were likely spurred by the public relations and environment, social, and corporate governance (ESG)-related risks of staying, but the role played by government in withdrawing its support for economic engagement was decisive. Before the war, Western companies operating in Russia lobbied hard to keep trade ties open even as Russian aggression toward the West increased. At that time, their view was that Russia was a risky but potentially profitable emerging market, but that the risks could be managed with government support. This trend can also be seen in China: Western businesses continue to make the case for business there despite, for example, the recent US-China trade war, documented human rights abuses in Xinjiang, elimination of Hong Kong's autonomy, evidence that Western civilian technologies support the development of the Chinese defense economy, and military aggression toward Taiwan. All indications show that, despite the growing ESG risks, these companies will not leave China unless government policy makes it untenable for them to stay.

Concern over supplies has already been reported in major industries.¹¹ Even Russia's most important industry, oil, is not immune, because dependence on Western companies is high at oil fields where the most advanced equipment, such as precision hardware and IT, is required.¹²

Unless Russia can access Western technologies informally or Russian substitutes can be found, the impact on dependent industries will compound over time: industries reliant on Western technology could grind to a halt. Although there is considerable evidence that Russia continues to access prohibited components, sanctions disrupt the production process and, at the very least, raise the cost of production.

Limitations

The new sanctions did not deter Russia from invading Ukraine

The US and its allies threatened new sanctions in the weeks before Russia's invasion, but these sanctions were not sufficient to deter the Kremlin. Rather, when they were imposed, President Putin described them as "akin to a declaration of war."¹³ As a result, sanctions served to reinforce the Russian leadership's narrative that the West seeks to weaken Russia and entrenched the political division with the West.

The Russian economy has not collapsed

The Russian economy has been weakened, but it has not collapsed. A financial crisis was averted. Domestic demand slumped in 2022 as the cost of imports rose, and many industries faced a supply crisis after Western sources were closed off. But imports from China and other non-Western countries have increased, and imports have returned to prewar levels. In some

¹¹ For example, it has been reported that Russian aviation businesses started stripping planes for spare parts. See "Exclusive: Russia Starts Stripping Jetliners for Parts as Sanctions Bite," Reuters, Aug. 9, 2022, <https://www.reuters.com/business/aerospace-defense/exclusive-russia-starts-stripping-jetliners-parts-sanctions-bite-2022-08-08/>. Sanctions will also hit old-fashioned industries. For instance, Russia's gold industry, which has strategic importance for the state and represents the most important precious metal export, has predicted that production will fall by 10 percent this year without access to Western supplies. See Vestnik Zolotopromyshlennika, "Soyuz zolotopromyshlennikov ozhidaet na 30t snizhenie dobychi '22'" [The Union of Gold Producers Expects a 30t Decrease in Production in 2022], Mar. 28, 2022, <https://gold.1prime.ru/news/20220328/448989.html>.

¹² Alex Budris, "Nefteservisniye kompanii prekrashchayut investitsii v Rossii: chto budet s dobychei nefi" [Oil Service Companies Stop Investing in Russia: What Will Happen to Oil Production], Forbes, Mar. 23, 2022, <https://www.forbes.ru/biznes/459711-nefteservisnye-kompanii-prekrasaut-investicii-v-rossii-cto-budet-s-doboyej-nefti?ysclid=l7qbblwmz4167477190>.

¹³ Petr Kvakin, "Putin sravnil sanktsii protiv RF c obyavleniem voyny" [Putin Compared Sanctions Against Russia to a Declaration of War], Gazeta.ru, Mar. 5, 2022, <https://www.gazeta.ru/politics/news/2022/03/05/17385469.shtml>.

instances, Russian entrepreneurs have acquired the assets left by Western businesses, such as McDonald's, and maintained them under different names, softening the blow to Russian consumers.

Russia weathered the effects of international sanctions quite well primarily because of unusually high revenues from energy exports last year, the highest revenues in all of Russia's history, according to a group of eminent Russian economists.¹⁴ According to revised figures published by the Russian State Agency for Statistics (Rosstat) in April 2023, Russia's GDP contracted by 2.1 percent in 2022.¹⁵

Sanctions initially had a severe impact, but it was ameliorated by the authorities' policy response: a strong fiscal stimulus (equal to 3 percent of GDP), the imposition of capital controls, tighter monetary conditions, rapid action to shore up the banking sector, and high ruble revenues driven by the surge in global commodity prices caused by the war.¹⁶

The current account surplus reached a new record high of \$227 billion, compared with \$122 billion in 2021, an increase of more than 86 percent.¹⁷ The trade balance was also in surplus at \$307.9 billion, compared with \$190.34 billion in 2021, an increase of more than 61 percent.¹⁸ By contrast, the federal budget deficit was ₺3.3 trillion, equal to 2.3 percent of GDP at the end of 2022. The Finance Ministry expects the deficit to be smaller in 2023 (₺2.9 trillion), with "normalization" of the budgetary situation by 2025.¹⁹

Looking ahead, the International Monetary Fund expects Russia's economy to return to low levels of growth—0.7 percent in 2023 and 1.7 percent in 2024.²⁰ Similarly, the World Bank expects Russia's economy to stabilize, but believes that long-term growth prospects are poor given the loss of access to Western capital and technology and the consequent impact on

¹⁴ O. Vyougin et al., "Khuzhe chem krizis," p. 2.

¹⁵ "Rosstat predstavlyaet vtoruyu otsenku VVP za 2022 god" [Rosstat Produces Second Assessment of GDP for 2022], Federal Statistics Service of Russia, Apr. 7, 2023, <https://rosstat.gov.ru/folder/313/document/203214#:~:text=%D0%92%D0%92%D0%9F%20%D0%B7%D0%B0%202022%20%D0%B3%D0%BE%D0%B4%20%D0%B2,%D0%B3%D0%BE%D0%B4%D0%B0%20%E2%80%93%20115%2C8%25>.

¹⁶ World Bank, *Social Protection for Recovery: Europe and Central Asia Economic Update, Fall 2022* (2022), accessed Apr. 25, 2023, p. 149, <https://doi.org/10.1596/978-1-4648-1928-5>.

¹⁷ Central Bank of Russia, *Russia's Balance of Payments, No. 4 (13), 2022 Q4*, Jan. 26, 2023, p. 1, https://www.cbr.ru/Collection/Collection/File/43710/Balance_of_Payments_2022-4_13_e.pdf.

¹⁸ "Platzhnyi balans, mezhdunarodnaya Investitsionnaya pozitsiya i vneshnii dolg Rossiiskoi Federatsii v 2022 godu" [Balance of Payments, International Investment Position and Foreign Debt of the Russian Federation in 2022], Central Bank of Russia.

¹⁹ Ivan Tkachev and Anna Galcheva, "Pyataya chast rashhodov byudzheta prishlas v dekabr" [One-Fifth of Budgetary Expenditures Made in December], RBK, Jan. 10, 2023, https://www.rbc.ru/economics/10/01/2023/63bc725f9a79476b85142f34?from=from_main_1.

²⁰ AFP, "Economic 'Momentum' Prompts IMF to Raise Russia's Growth Forecast," *Moscow Times*, Apr. 12, 2023, <https://www.themoscowtimes.com/2023/04/11/economic-momentum-prompts-imf-to-raise-russias-growth-forecast-a80795>.

productivity.²¹ These projections are broadly shared by the CBR, whose medium-term forecast envisages GDP growth of 0.5 to 2 percent (2023), 0.5 to 2.5 percent (2024), and 1.5 to 2.5 percent (2025).²²

Russia has ready-made policies to resist sanctions and Western economic pressure

Since 2014, the Russian state has countered the impact of Western economic pressure through the securitization of economic policy, a concerted effort to bolster import substitution, efforts to cultivate economic ties with Asian countries, and a countersanctions regime that prohibited the import of certain Western goods to improve opportunities for Russian producers.²³ Russia also has an economic team experienced at weathering periodic crises, which introduced measures to support the ruble and the banking system. When new sanctions were introduced, Russia was able to extend these measures further, including by introducing a formal parallel imports scheme extending trade ties with non-Western markets that may support technology transfers.

Russia's private businesses, which are adept at operating between the formal and informal economies, will likely find the means to survive. Using corporations in the service of the state is also a national specialty. It is also reasonable to think that Russia's state companies will be more, not less, active overseas as they seek to access or acquire goods, services, and new markets.

Even though Moscow's efforts to increase self-sufficiency in the production of defense-industrial equipment before the war were only partially successful, Moscow continues to deliver military equipment despite stringent economic sanctions imposed by the Western alliance. It has done so by (1) utilizing large prewar stocks of equipment (i.e., legacy weaponry) and components, (2) introducing new policies to further enhance its "technological sovereignty," and (3) accelerating efforts to import vital components through third parties and other illicit means.

²¹ World Bank, *Social Protection for Recovery*, p. 149.

²² "Srednesrochnyi prognoz Banka Rossii" [Medium-Term Forecast of the Central Bank of Russia], Central Bank of Russia, Apr. 28, 2023, https://www.cbr.ru/Collection/Collection/File/43931/forecast_230428.pdf.

²³ The overall success of Russia's import substitution effort since 2014 is hard to gauge because Russia has historically found innovation challenging. All the same, the minister for industry and trade, Denis Manturov, has stated that this year Russia reduced its dependence on imported equipment and services in its most important sectors—oil and gas—from 60 to 40 percent. See Ekaterina Katkova, "Kak neftegazovaya otrasl' perekhodit na otechestvennye tekhnologii" [How the Oil and Gas Industry Is Moving to Domestic Technologies], *Vedomosti*, Apr. 29, 2022, <https://www.vedomosti.ru/partner/articles/2022/04/29/920343-neftegazovaya-otrasl?ysclid=17qb6pp28x634944814>. Russia also has a few large state-controlled institutions that could, in principle, play a role in the development of Russian-built equipment, machines, and other substitutes. It is reasonable to think that these institutions might receive further investment for this purpose.

Russia's ability to sustain its defense-industrial output raises the likelihood of a prolonged war of attrition in Ukraine, which could potentially affect the long-term commitment of Western support to Ukraine. Although sanctions have undoubtedly increased production costs and caused disruption across various sectors of Russian industry, military production has continued.

Sanctions on Russian oligarchs have had a limited impact

The essential structure of the Russian political economy is not under threat from sanctions. Russia remains a “limited access order” in which figures close to the Kremlin oversee the country’s strategic industries. Russia’s “state oligarchs,” who control its national champions, such as Igor Sechin, and others close to the Kremlin, such as Arkady Rotenberg and Vladimir Potanin, have not been genuinely weakened by sanctions, even if their foreign assets are at further risk.

Sanctions have certainly prompted a reallocation of assets among some oligarchs operating in the private sector. Suleyman Kerimov, for instance, transferred his majority interest in Polyus to the Fund for the Support of Islamic Foundations and Akhmat Palankoev, but these are personal allies, and gold is a strategic industry. In any case, these industries operate with leverage largely provided by state banks, so the fealty of participants is generally assured.

Conversely, it is unlikely that the state, or the Russian public, will much mind the weakening of oligarchs generally resident overseas, such as Roman Abramovich. Sanctions have, in fact, confirmed their relative lack of influence over the Russian leadership, if not their personal or historical links to it. Furthermore, enforcement varies by jurisdiction and can be weak even among implementing countries such as Switzerland.

Uncertainties

What are the conditions for withdrawing sanctions?

In 2014, the allies were clear that sanctions would be withdrawn if Russia returned to its pre-2014 borders, but there has been no such messaging with the new sanctions regime. This lack of clear withdrawal conditions indicates that these sanctions are different—designed more to punish than to coerce or incentivize Russia—and that they will be in place indefinitely. It also indicates that the West is willing to punish the Russian population as it does the Russian leadership. Unavoidable as this approach is in Western eyes, it unfortunately also plays to Moscow’s claim that the US is seeking to weaken Russia and that its “special military operation” is a necessary response to Western pressure. As a result, sanctions could improve the

credibility of the Russian leadership’s messaging with domestic audiences, which is that its actions are essential in a war against the “collective West” led by Washington.²⁴

Is economic isolation an effective measure against Russian militarism?

The narrative of the Russian leadership is based on great power conflict, and the prospect of economic isolation has not deterred it from its course. Rather, Russia’s approach to the conflict appears to be attritional and unbounded by time. Indeed, other cases show that economic isolation is uncorrelated with regime change—sanctions on Cuba, Iran, North Korea, and Venezuela did not weaken those countries’ resolve to confront the United States—while sanctions regimes require sustained effort and policing by the allies. The signs therefore indicate that the Russian leadership is prepared to endure, and indeed embrace, long-term economic isolation. Russia may also retain the idea that Europe will be unable to endure an extended period without access to cheap Russian energy and that the terms of the conflict will turn in its favor over time.

Can Russia continue its military campaign and confrontation with the West if it is denied Western technology?

Historically, Russia has fallen short in its efforts to emulate and outperform the West technologically: its tradition of state-led “innovation on command” has never delivered modernization comparable with its Western competitors outside discrete pockets of activity.²⁵ As a result, Russia (and the USSR) tended to simultaneously covet Western technologies and spurn them for indigenous alternatives. This trend can be discerned in the Putin era: he has welcomed Western goods and equipment (explaining his support for trade) but also emphasized Russia’s technological independence, especially in military technologies. He may believe that Russia should and can do without Western technology because this self-sufficiency is a defining feature of Russian civilization and that Russia has sufficient capabilities of its own to endure a conflict with the West.

Nevertheless, research by the Royal United Services Institute found that the modernization of Russia’s armed forces “depended on the extensive use of microelectronics manufactured abroad.”²⁶ This finding is significant because it indicates that (1) Russia’s import substitution

²⁴ A. Levinson, “If They Fear Us They Respect Us,” Riddle Russia, Aug. 12, 2022, <https://ridl.io/if-nbsp-they-fear-us-they-respect-us/>.

²⁵ For example, see Loren Graham, *Lonely Ideas: Can Russia Compete?* (Cambridge, MA: The MIT Press, 2013).

²⁶ See James Byrne et al., *Silicon Lifeline: Western Electronics at the Heart of Russia’s War Machine*, RUSI, Aug. 2022, https://static.rusi.org/RUSI-Silicon-Lifeline-final-updated-web_0.pdf; James Byrne et al., *The Orlan Complex: Tracking the Supply Chains of Russia’s Most Successful UAV*, RUSI, Dec. 2022, <https://static.rusi.org/SR-Orlan-complex-web-final.pdf>.

effort has not been sufficient to support military modernization effectively, (2) Russia designed its equipment to integrate commercial off-the-shelf components rather than the most advanced technologies, and (3) Russia has been able to acquire those components from a variety of sources worldwide to meet its needs. Together, these findings suggest that Russia's warfighting capabilities would be diminished if those sources were cut off effectively.

These efforts to isolate Russia have proven difficult to achieve in practice. Russia's response to the allied sanctions regime on the defense industrial complex has achieved some success. The increase in the tempo of cruise missile attacks on Ukraine in the spring and summer of 2023, for example, suggests that Russian manufacturers have been able to increase the rate of production well beyond levels observed before the war. The fact that these weapons systems continue to contain Western components shows the success of Russian efforts to source components using alternative trade routes. Indeed, reports in the Russian media indicate that production of several weapons systems has risen sharply over the last year.²⁷ Although these statements should be treated with a degree of skepticism, they do highlight the limits of allied powers in undermining defense production in Russia. Sanctions raise the cost of production, disrupt supply chains, and can result in lower quality weaponry. But because Russia possesses one of the largest defense industries in the world, it is unrealistic to expect that sanctions will prevent it from producing a large quantity of the platforms and munitions required to sustain the war in Ukraine.

Nevertheless, despite Russia's evident weaknesses in microelectronics, it does wield world-class technical know-how in certain other civilian and defense industries. These include the civil nuclear sector under the auspices of Rosatom, which is vertically integrated and does not rely on foreign inputs. In defense, submarine building and missile technologies, for example, are areas of strength. Such industries may receive additional state support to increase their contribution to priority technological challenges, and the brightest students may be encouraged toward these enterprises. Overall, it is too early to declare Russia's technological demise.

²⁷ "Ministr oborony Rossiyskoy Federatsii provel tematicheskoye selekturnoye soveshchaniye s rukovodyashchim sostavom Vooruzhennykh Sil" [The Minister of Defense of the Russian Federation Held a Thematic Conference Call with the Leadership of the Armed Forces], Ministry of Defense of the Russian Federation, May 2, 2023, https://function.mil.ru/news_page/country/more.htm?id=12466014@egNews.

Have the Sanctions Affected Strategic Stability and What Are the Risks?

Considering the foregoing discussion of their impact in the current war, sanctions appear to have a negative bearing on strategic stability. The economic damage is significant for both sides, albeit in different ways, and politically, sanctions have increased tensions. Russia's response has also resulted in it forging closer ties with other countries, such as China, India, and Turkey, in ways inimical to the interests of the US and its allies. This is not to say that sanctions do not have merit or popular support: it was necessary to act in the face of Russian aggression in Europe. However, the following are some points for consideration:

- *Sanctions reinforce, rather than alleviate, conflict.* Sanctions have not, in this conflict or historically, reduced tension between adversaries. They imply that the West is not willing to come to terms or strike a grand bargain. Therefore, the Kremlin was not deterred by the prospect of sanctions, doubled down when they were imposed, and is evidently confident that it can get by in isolation from the West.
- *Implementing sanctions creates further strategic challenges.* Although their purpose in this conflict is to diminish Russia's fighting capabilities, sanctions may, in fact, increase the likelihood that Russia will dig in for the long term. Doing so could be to Russia's advantage, unless the West is willing to maintain strategic pressure indefinitely. However, because the sanctions are so wide-ranging, it is not clear whether the West has further meaningful sanctions to add. The allies have already exceeded previous limits on sanctions and added financial and military transfers to Ukraine. In these respects, it is reasonable to ask whether the new sanctions have revealed the limits of Western economic power.
- *Sanctions damaged Russia's economy but, in so doing, encouraged Russia's orientation to non-Western partners.* Russia has found new export markets and will likely be able to access Western goods through new channels. It could double down on the gray trading and smuggling channels that it has already established around the world to secure Western technologies and other goods, such as gold.
- *Sanctions cannot completely cripple the economies of large diverse exporting economies.* Russia will be able to retain an influence in world markets—and therefore strategic stability—because of the range of essential strategic unsanctioned goods that it exports, particularly aluminum, copper, diamonds, iron, gold, grain, hydrocarbons, nickel potash, and timber. Commodity traders, whose historical role has been to bring

commodities from risky suppliers to the world market, will likely continue to operate in Russia, even if Western governments do not.²⁸

- *Sanctions create their own economic and political pressures among allies and have knock-on effects for third parties.* Despite unprecedented unity on sanctions, the allies have disagreed on the scope of embargoes on Russian energy, and their determination may be tested over time. The allies have also been unable to check Turkey's independent approach to the conflict. Furthermore, nations dependent upon Russian grain, including Egypt, have faced supply crises.
- *Sanctions lead to the development of new trade flows and, potentially, trading blocs and strategic alliances.* Sanctions diminish globalization, politicize supply chains, and reduce the influence of the West on the international trade flows. They may also diminish the West as a reliable international trading partner: states are unlikely to build trading ties or enforce embargos if they are at risk of Western economic pressure.²⁹ The growing risk is that Moscow succeeds in strengthening explicitly anti-Western alliances, especially with China and Iran.
- *Sanctions may diminish Russia's conventional fighting forces over time but are less likely to affect its strategic capabilities.* If Russia's defense industry is less able to produce conventional military equipment—by no means a fair assumption—Ukraine's advantage in the conflict could improve, especially if the West continues to provide military hardware and wider support as well. However, Russia retains independent industrial capacity in the construction of strategic nuclear capabilities and, therefore, the capacity to escalate. Its intent to use these capabilities may increase if it starts to lose control of the war.
- *Sanctions decrease the prospect of cooperation between adversaries.* Since the start of the conflict, Russia has postponed START inspections, has hindered access to the Zaporizhzhia nuclear plant, and intends to withdraw participation in the International Space Station. Such actions are likely to continue as long as the conflict persists. Sanctions provide no incentives to cooperate in, for instance, multilateral forums on Arctic matters or climate goals. This lack of participation is most concerning with respect to matters of international concern, such as responding to an accident at the nuclear plant or distributing grain to the world's poorest.

²⁸ For example, see Javier Blas and Jack Farchy, *The World for Sale: Money, Power, and the Traders Who Barter the Earth's Resources* (Oxford University Press, 2021).

²⁹ "Are Sanctions on Russia Working?" *The Economist*, Aug. 25, 2022, <https://www.economist.com/leaders/2022/08/25/are-sanctions-working>.

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