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How to get away with sanctions, Russian-style

There are nearly 15,000 sanctions on Russia. And yet, it manages to bypass the toughest of them

The 2022 invasion of Ukraine was met with nearly universal condemnation as countries in the West and beyond unleashed an unprecedented array of sanctions against Russia. The aim of the sanctions has been to constrain Russia's war-making capacity by draining its revenues and blocking its access to imports of high-tech military equipment.

While the sanctions did weaken Russia's economy, they have fallen short of their ambitious objectives – mostly because Russia has found pathways for bypassing many of them. For this, the Kremlin has used international corruption mechanisms, relied on third-country intermediaries and exploited loopholes in trade restrictions.

Global corruption helps Russia

Russia is barred from purchasing Western chips and arms. But the Kremlin has found a simple way around this. If Russian entities cannot buy military tech directly, then someone else can do it for them – shady companies with connections to the Kremlin.

The scheme is simple. Russian-linked companies set up subsidiaries across the world, often registering new entities in offshore havens or in countries where regulations are relatively lax or non-existent. To obfuscate the arrangements, the daughter companies spawn offspring in the form of subsidiaries, as the chain of concealment stretches on and on. The result is like a giant *Matryoshka* doll, except here, the smaller models often have no obvious resemblance to the mother company. Tracking the connections between the end beneficiary and the purchasing company is extremely difficult.

Through a long chain of entities, sanctioned goods such as microchips, drones and other high-tech tools end up on Russian battlefields.

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A recent investigation found that two-thirds of the components recovered from Russian weapons on the frontline contain chips and microprocessors produced by American and other Western companies. Subproducts from 1,000 foreign companies were found in Russian military equipment, all presumably purchased illegally.

Another example is the supply of Chinese DJI drones. While China did not join in sanctioning Russia, it promised it wouldn't sell drones to any party in the Russo-Ukrainian war. However, the flow of Chinese drones into Russia never stopped – while Ukraine can no longer purchase them. The drones come through sales to third parties linked to Russia which, through shady entities in the US, Hong Kong and elsewhere, buy sanctioned technology.

Creating intermediaries allows Russia to buy more freely from countries which did not sanction it – but which are afraid of potential Western restrictions if they sell tech and other dual-use goods to the Kremlin openly. This allows companies in China, Hong Kong and beyond to sell their goods to Russia without fearing repercussions from the US or the EU.

Third countries and ghost items

Russia's intermediary schemes also rely on the complicity of third-country governments.

The most obvious case is Kazakhstan. Although the country's government claimed neutrality on the Russo-Ukrainian war, its trade with Russia shows otherwise. Kazakhstan has become a principal conduit for the supply of technology exports to Russia and for the evasion of Western sanctions. In the last year, Kazakhstan's imports from the EU grew by 89 per cent, reaching €10.4 bn. This increase includes a significant volume of tech and machinery purchases (valued at roughly €4 bn). About €2.6 bn worth of goods have gone missing, thus turning into 'ghost items' – products which were officially purchased by Kazakhstan from the EU but which never reached the consumers in Central Asia.

At the same time, Kazakh exports to Russia increased by 25 per cent in 2022 and reached €8 bn. Nearly 1 bn of this amount went to tech and machinery goods – although Kazakhstan does not produce most of these items. Kazakh Deputy Prime Minister Serik Zhumangharin confirmed that among these items were at least 104 sanctioned goods, including

many dual-use products. Kazakhstan sold €3.3 million worth of semiconductor components to Russia last year, although, in 2021, the volume of that trade was only €11,000.

Kyrgyzstan and Armenia play a similar role. Together with Kazakhstan, the countries 'lost' nearly €1 bn worth of sanctions-affected goods from the EU, becoming 'ghost items' too – likely resold to Russia at a later date. Turkey and other supposedly neutral countries in Asia have followed a similar practice of allowing substantial imports of technology products that are then exported to Russia.

The US has already warned Kazakhstan and other countries mentioned above by imposing secondary sanctions – for example it sanctioned several entities based in Kyrgyzstan for their role in breaking the sanctions.

Loopholes

Another significant loophole regarding the sanctions is the uneven enforcement of the price cap on Russian crude oil exports. The price cap was introduced as an alternative to a Russian energy embargo, as the latter was hiking up the energy prices. If effectively enforced and then progressively lowered, the price cap could steadily decrease the vital income Russia derives from oil sales and diminish Russia's ability to finance the war, as originally intended.

With the price cap, Russian seaborne crude oil has to be sold for under $60 a barrel if it is transported using G7 tankers. Russians have to show a contract that proves this price – but there are no requirements on the buyer's side.

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Russia has been notorious in faking its documentation and spreading false information, so falsifying a contract to match the price cap is relatively easy for the Kremlin. Investigators and journalists highlight that Russia could be bypassing the price cap through illegal deals with its oil buyers (such as India and China) – on paper, it would be selling its oil below the price cap while in reality, the price would be higher. The buyers would benefit, too as they could resell the same oil at a higher price to more countries including those which sanctioned Russian energy. After all, current sanctions only target oil sold directly by Russia,

but after it changes hands, the next buyer (and owner) can resell the oil as its own, thus driving the price up and benefitting from illegal dealings with Russians.

For sanctions to work, Western governments need to get serious about preventing Russia from exploiting these and other loopholes. It is important to go after the entities which facilitate illegal trade and apply restrictions on intermediaries and international companies that sell goods to Russia. They can be denied access to Western markets as a punishment for their role in sanctions violations – and more restrictions should be proposed for the countries which facilitate and enable these illegal practices. More documentation should be required of companies that buy Russian oil to make sure that the contracts fall under the price cap – and the price cap needs to be lowered, too.

European countries and the US need to expand their investigative and sanctions-tracking teams to improve the monitoring of sanctions compliance and to introduce new measures against systematic rulebreakers. The sanctioning states have the resources and capacity for this. They need to act.



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