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What did Western sanctions on Russia achieve?

Western sanctions haven't ended Russia's war on Ukraine. But they are likely to set back the country's economic development by 30 years

When the war in Ukraine began, for many the course of events already seemed clear. The Russian military would be victorious in a few days, and shortly thereafter the unprecedented Western sanctions would bring the Russian economy to its knees. In fact, the exact opposite happened: the invasion is now in its fifth month and the economic collapse in Russia has failed to materialise. The ruble is as strong as it was before the annexation of Crimea, unemployment is low, state revenues are bubbling up, and the Kremlin is deriding the formal default on its government bonds as amounting to Western propaganda. So are the sanctions ineffective? Has the West miscalculated?

The Russian economy was doing well before the invasion of Ukraine. The recovery from the pandemic was quite solid, with a growth in gross domestic product (GDP) of 3.5 per cent. There has been a significant increase in household incomes and a trough in unemployment; tourism statistics and year-end figures for personal loans jumped upwards. The state budget was balanced and ample, and business was good. Then came the decision to go to war.

Never before has a globalised economy (Russia has the highest ratio of imports to GDP among the BRICS countries) been confronted with such a blockade. The frozen assets of the Russian central bank alone, at $300–400bn, far exceed the total currency reserves of the German Bundesbank. Moscow was actually taken by surprise by this Western instrument: the ruble plummeted. In the first two weeks of the war, Russian banks reported a $30bn outflow from their accounts. A veritable stampede of bank runs followed.

The Kremlin's defence against sanctions

The government and central bank reacted immediately with currency controls, a stock exchange closure, a doubling of the key interest rate to 20 per cent, and new regulations on the mandatory exchange of foreign currency earnings by private companies. The Kremlin has de facto locked liquid capital within the Russian economy, thereby stabilising it. It must be acknowledged that this has worked and is a considerable success for the Russian government.

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The first blow of the sanctions was skilfully staved off by this 'artificial coma'. The downside of this defence strategy, however, is a noticeable slowdown in overall economic activity – the population and businesses took the money they had withdrawn back to the bank, where it now remains. By contrast, foreign investments, which are crucial for Russia, are unlikely to recover.

Russia is facing a severe recession – that much is indisputable. The predicted slump in economic output amounts to 10-15 per cent of GDP. More important, however, is the question of what follows. The analysis of recessions is often illustrated with the letters V, U, W, or K, which depict the course of the crisis in the form of a curve. V represents a rapid, one-time shock and rapid recovery – actually the 'best case' post-shock scenario. U is characterised by a trough, where it takes longer for the economy to get back on track because of lingering crisis effects. W describes the 'double-dip', a prolonged period of massive turbulence followed by a recovery to pre-crisis levels. And in the case of K, the recovery of individual sectors diverges. But the forecast for Russia is different: it is the L. This scenario describes a massive drop in economic output that only ends at a substantially lower level and is not followed by a recovery.

Unemployment and industrial output

Against this background, the successes of initial financial and currency stabilisation are less glamorous. The real challenge is Russia's continental decoupling and detachment from trade and supply relationships on the European continent. In fact, we are witnessing a one-off deindustrialisation that is setting back a fairly advanced capitalist economy by thirty years. Not a collapse, then, but a regression. This can be illustrated by the following four observations.

First, the labour market is reporting the first symptoms of the crisis, with a nominal drop in wages due to company closures and short-time work. In Russia, this is imposed on companies by the state and must be paid for out of company funds to disguise the 'real' unemployment, which ranges between 8 and 25 per cent depending on the industry. Some state-owned companies prepare their staff for self-sufficiency by allocating dacha plots – so that the wage gap that arises can be covered privately, at least if staff feed themselves.

Job portals are recording a falling number of job advertisements and a strong increase in job applications. About 12 per cent of formally employed Russians (around eight million people) are dependent on foreign capital, the corresponding corporate presence, and undisturbed trade relations. The withdrawal or freezing of foreign production facilities – Volkswagen, Peugeot, Volvo, Bosch, and Ikea for example – is also hitting Russian suppliers hard. A rise in unemployment by the end of the year is inevitable. Its effects can already be seen in the retail sector and Russian payment services. Consumer confidence has dramatically dampened.

Secondly, official customs and trade statistics have recently become classified information, so that analysis has to rely on indirect data and export statistics from trading partners. Nevertheless, the trend is clear. Because of import-export sanctions, the closure of European airspace, and the interruption of logistical routes (the EU was crucial, with a 36.5 per cent share of total imports), imports to Russia have plummeted by up to 60 per cent.

China is not a saviour in times of need.

In addition, in the wake of the pandemic, there are catch-up effects of the global logistics and container crisis. What can no longer be imported, however, are not just consumer goods, but above all essential technical solutions for the manufacturing process within Russia. Various industrial sectors are shrinking noticeably – the production of steel has fallen by 25–30 per cent, and wood by up to 80 per cent. By the end of May, the automotive sector recorded a decline of nearly 97 per cent (!) of the previous production volume.

The Russian state is making efforts to fill the industrial gaps left by such companies as Stellantis (Peugeot, Citroën, Opel, Jeep and Fiat) after their withdrawal, by reviving domestic car manufacturing, but at a lower technological level – without airbags, ABS systems, and complex

electronics. Under high pressure, domestic replacements for Tetrapak packaging, kitchen appliances, Coca-Cola, and McDonald's are being organised. Some of this will be successful, but Russia's replacing computer chips, servers, industrial computers, and smartphones on their own is simply not possible.

China doesn't come to the rescue

Thirdly, China is not a saviour in times of need. Imports from the People's Republic account for only half the shortfall. The Chinese credit card organisation Union Pay is not filling the gap left by MasterCard and Visa. Russian planes are not flying to Chinese airports because they fear seizures on behalf of Western leasing companies. Despite the legalisation of so-called parallel imports, the Kremlin's hopes for a rapid reconfiguration of Russian trade relations are by no means being fulfilled. Chinese companies avoid constellations in which they could come into the vicinity Western secondary sanctions.

That's why Chinese spare parts for civilian aircraft are simply not coming. Huawei is closing branches, and Lenovo and Xiaomi are also quietly and gradually withdrawing from Russia. Even as a new customer for energy supplies and thus a remedy for the Western oil embargo and gas decoupling, China is only a partial option. According to Russian estimates, it could take up to ten years to build the necessary pipeline and delivery infrastructure.

Russia is experiencing a technological decline that will be felt by everyone in the country.

Fourth, the strength of the ruble is not a sign of ineffective sanctions, but the real indicator of the extent of Russia's isolation from the world economy and of the massive contraction in domestic demand. Against the background of lost imports, the current account surplus amounts to over $110bn. The slump in demand for rubles is cementing the strong exchange rate of the Russian currency. This in turn is what makes the competitive situation so difficult for the reorientation of Russian industry. 'Exports are poison, imports would be medicine,' said German Gref, the director of Sberbank, Russia's largest financial institution, about the impasse in which the Russian economy finds itself.

Do the sanctions work?

Are the Western sanctions successful or not? That depends to a large extent on expectations. One thing is certain: the sanctions could not stop the war. Russia managed to neutralise the first blow through clever monetary and fiscal policies. Nor are the sanctions likely to bring the war in Ukraine to an end any sooner. In this context it is questionable whether sanctions generally bring about changes in political behaviour.

Nonetheless, Western sanctions are effective and a logical response to war. However, they also mark a dramatic turning point in dealings with Russia. The sanction instruments are no longer 'smart' and selective, but systemic and punitive. The bill is being footed by Russian society, which, in contrast to the oligarchy and authorities that are becoming even stronger, finds no real way out of the looming economic impasse. The war is costing Russia about $500 million a day. The sanctions will additionally strain the narrowing room for manoeuvre of the public budgets. In the incipient economic crisis, it is unclear where the resources to cushion poor Russians will come from.

The sanctions have set in motion a spiral of cumulative effects, thus driving up the price of Russian transgression. Import problems, foreign companies fleeing, and supply shortages of Western technology components are already causing the value chains in the country to break down. Ever larger parts of the manufacturing industry are becoming paralysed. In addition, there are increasingly severe maintenance problems, a lack of software updates, and missing critical components.

Russia is experiencing a technological decline that will be felt by everyone in the country. The competitiveness of the Russian Federation is eroding. An overly strong ruble, expensive supply deliveries, consumers with shrinking wallets who are sceptical about the future, and technological problems are putting an end to Russia's previous growth model. The historic era of prosperity that began with Putin's first presidency 23 years ago is now over.



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