

# SANCTIONS

## The economic sanctions against Russia

Impact and prospects of success

Susanne Oxenstierna and Per Olsson



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## Sammanfattning

Syftet med denna rapport är att kvalitativt utvärdera effekterna av de ekonomiska sanktionerna som EU och USA har infört mot Ryssland efter annekteringen av Krim. Den centrala frågeställningen är i vilken grad sanktionerna har uppnått sina mål: att skapa kostnader för den ryska ekonomin och bidra till att förändra den ryska politiken gentemot Ukraina. Huvudslutsatsen är att de riktade ekonomiska sanktionerna från EU och USA tillsammans med andra faktorer har skapat kostnader för den ryska ekonomin, men att de hittills inte har lyckats övertyga Ryssland om att ändra sin politik gentemot Ukraina. Faktorer som har förstärkt sanktionernas effekter på ekonomin är det fallande oljepriset, rubelns depreciering och försvagade handelsförhållanden samt det politiserade ekonomiska systemet som fördelar resurser till fördel för olönsamma och statssubventionerade företag framför konkurrenskraftiga. Politiska faktorer däremot utgör ett hot mot sanktionernas målsättningar. Regimens auktoritära natur och dess anti-västliga propaganda som styr den allmänna opinionen i frågor om konflikten gör den mindre utsatt för den fulla effekten av den ekonomiska nedgången. Västs politiska åtgärder som kompletterar sanktionerna måste möta dessa hot och hantera riskerna detta utgör mot Västs syften. Konflikten om Ukraina är viktig för både Ryssland och Väst. För att kunna lösa den behövs strategier som minimerar risken att förlora ansikte för båda sidor.

Nyckelord: *ekonomiska sanktioner, EU, USA, Ryssland, Ukraina, rysk ekonomi, sanktionsteori, importsubstitution, propaganda, opinion.*

## Summary

The objective of the report is to qualitatively assess the effects of the economic sanctions imposed by the EU and US against Russia following the annexation of Crimea and further activities in eastern Ukraine. This entails investigating how they have performed vis-à-vis the goals of the sanctions: imposing a cost on the Russian economy and contributing to changing Russia's policies towards Ukraine. The main conclusion of the report is that the targeted economic sanctions of the EU and the US have contributed to imposing a cost on the Russian economy in combination with other factors, but have so far not persuaded Russia to change its behaviour towards Ukraine. Factors that have reinforced the effects of the sanctions are the falling oil price, depreciation of the rouble and weakened terms of trade. The politicised economic system gives advantage to rent-addicted loss-making producers who are loyal to the regime over competitive companies in resource allocation, which is damaging to the country's economic performance. At the same time the political resource allocation and rent distribution system warrant the survival of the regime and represent threats to the success of the sanctions. The authoritarian nature of the regime and its anti-Western propaganda, which manipulates public perceptions of the conflict issue, make the regime less exposed to the full effects of the economic decline. The West's political measures that complement the sanction regimes need to address this threat and manage the risks it poses to the Western objectives. The conflict over Ukraine is important for both Russia and the West. In order to resolve it, exit strategies need to minimise the risk of loss of face for both sides.

Keywords: *economic sanctions, EU, US, Russia, Ukraine, sanction theory, Russian economic system, import substitution, propaganda, public perceptions.*

## Foreword

The Russia Programme (RUFS) at FOI studies developments in Russia in a broad perspective and its experts come from different academic fields. The present report focuses on Russia's economic development in light of the sanctions regime introduced against the country by the US and the European Union. In doing this, the report picks up some of the unanswered questions in a previous study from the FOI, *A Rude Awakening* (FOI-R--3892--SE), which was published in June 2014. At the time, sanctions had only just been introduced and it was too early to draw conclusions about their effect.

In this report, the authors draw on previous research on sanctions and apply it to the Russian case. In doing so, the authors address topical questions such as what impact the sanctions have had so far on the Russian economy and how internal and international factors have interacted with the sanctions. The authors discuss whether the sanctions will compel Russia to change its behaviour and note that politics as well as economics will decide the outcome.

The research topic will not disappear from the agenda and will demand more interdisciplinary research. This report adds to our knowledge about Russia but also represents a contribution to the literature on sanctions by adding a case study to the research field.

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*Carolina Vendil Pallin*

Head of the Russia programme

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## Acronyms and abbreviations

bbl	barrels
bcm	billion cubic metres
BRICS	Brazil, Russia, India, China, South Africa
CIS	Commonwealth of Independent States
CPI	Consumer price index
D	Council Decision
EACU	Eurasian Customs Union
EEC	European Economic Community
ESPO	East Siberia-Pacific Ocean Oil Pipeline
EU	European Union
FATF	Financial Action Task Force
FDI	Foreign direct investment
FZ	Federal Law of the Russian Federation ( <i>Federalnyi zakon RF</i> )
GDP	Gross domestic product
HSEO	Hufbauer, Schott, Elliott and Oegg sanction data set
IMF	International Monetary Fund
LNG	Liquefied natural gas
OECD	Organisation for Economic Co-operation and Development
OPEC	Organization of Petroleum Exporting Countries
OSCE	Organization for Security and Co-operation in Europe
R	Council Resolution
RBH	Russia Behind the Headlines
RF	Russian Federation
RUB	Russian rouble
SWOT	strengths, weaknesses, opportunities, threats
ToT	Terms of trade
TIES	Threat and Imposition of Economic Sanctions data set
UK	United Kingdom
UN	United Nations
US	United States of America
USD	US dollar
WGI	Worldwide Governance Indicators
WMD	Weapon(s) of Mass Destruction

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# 1 Introduction

The invasion of Crimea came as a shock to the world as well as to many Russians, although the Kremlin had been openly signalling dissatisfaction with the security order in Europe for quite some time. Moreover, it was obvious the “Putin.3” regime had been moving in an increasingly authoritarian direction with increasing military capability, and its doctrines and policy documents clearly signalled Russia’s intention to reclaim its position as a great power in the world. However, few could have imagined that a political leader who one day hosted the most expensive Olympic Games of our times, on the next would invade another country, thereby losing all goodwill from this event so carefully orchestrated by the Kremlin propaganda machine. It has been said countless times that Russia cannot and should not be assessed by Western standards, but the mistake is repeated over and over again. The exact Russian logic or lack of logic that would apply in this particular case is hard to know.

Nevertheless, the West quickly and unanimously condemned Russia’s illegal actions in Ukraine and retaliated with sanctions, the foreign policy instrument commonly used by the 21st-century West to signal disapproval of countries breaking international law. At first sanctions were targeted at individuals and entities involved in the invasion and annexation of Crimea, and subsequently restrictions on trade with Crimea were introduced. In July 2014 both the US and the EU considerably increased the pressure on Russia by imposing economic sanctions on Russia itself. These sanctions restrict the ability of the banks and companies listed to raise credit on EU and US capital markets. On top of these financial sanctions, the EU and the US have imposed targeted sectorial sanctions that prohibit the export of arms and dual-use goods to Russia as well as advanced equipment for oil exploration.

In parallel to these events the performance of the Russian economy has deteriorated. The decline started in 2011 despite high oil prices and is largely caused by the politicised economic system that hinders institutional reform and productivity growth (see Oxenstierna 2015). The crisis of confidence spurred by the invasion of Ukraine has led to increased capital flight and depreciation of the currency, which has further deepened the crisis. Finally, the fall of the oil price led to almost zero growth in 2014 and a significant contraction of the economy is expected in 2015.

All the sanctions regimes against Russia signal that the US and EU do not accept Russia's policy towards Ukraine. The economic sanctions are aimed at contributing to a change of Russia's political behaviour by targeting essential functions and sectors in the Russian economy. The idea is that by imposing a considerable cost on Russia, the country would become more inclined to stop hostilities. Three questions have guided the research for this report:

- Are the sanctions effective in terms of the economy being affected?
- How do they interact with other factors contributing to the economic decline?
- Will this strategy work and compel Russia to change its behaviour?

### *Objectives*

The main purpose of this report is to assess the effectiveness of the economic sanctions imposed by the EU and the US against Russia with respect to their goals: making Russia's behaviour in Ukraine expensive by imposing costs on the Russian economy and thereby persuading Russia to change its behaviour. Economic sanctions are an instrument commonly used in security policy and their design and effects have been thoroughly researched in the academic literature. This report analyses the sanctions against Russia in a framework developed from the international sanctions literature. In the analysis of how the sanctions are hitting the Russian economy the focus lies on how the specific systemic features of the Russian economy influence the impact of sanctions and how the Russian government's responses to the sanctions and the economic decline in general have affected the outcome. In addition, the report aims to provide an overview of the sanctions process that could be used as a baseline in further research of these matters.

### *Research approach and methods*

Sanctions are not unique to the conflict between the West and Russia, but are widely used to inflict costs on countries behaving in a way that is unacceptable to the international community.<sup>1</sup> For that reason it seemed crucial to link the analysis of the Russian situation to the international literature on sanctions and their results. A library search of the sanctions literature was made at the beginning of the project and a theoretical model for discussion of the effects of

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<sup>1</sup> The EU alone had restrictive measures in force against 36 countries as of 19 March 2015 (European Commission 2015). It may be remembered that the USSR was severely sanctioned by the US and Western countries during the Cold War.

sanctions was developed based on Blanchard and Ripsman (2013). Pioneering empirical work on the effects of sanctions was done by Hufbauer et al. (2007) and we have subsequently tried to identify relevant research in the sanctions literature for the analytical framework. Official documents have been used to investigate the sanctions process. Annex 2 lists these documents with web addresses to facilitate further research. The analysis of the Russian economy is based on results from the literature on transition economies and comparative economic studies, particularly the model on the rent-addicted economy developed by Gaddy and Ickes (2010) and developed to cover three sectors by Oxenstierna (2014, 2015). Russian primary sources and international statistics are used. In our final assessment of whether the sanctions can make a significant contribution to reaching the political goal we borrow a simplifying tool from the business management area – a so-called SWOT (strengths, weaknesses, opportunities, threats) matrix. This is a tool for sorting factors when assessing the prospects of a venture and makes it easier to get an overview of the prospects of the Western sanctions. Work on the study started at the end of February and was finalised in July 2015.

### *Limitations*

The report only discusses the effects of economic sanctions on Russia. It neither analyses the effects of targeted restrictions, later embargoes, on investment and other economic activities on Crimea (which is Ukrainian territory illegally annexed by Russia), nor the effects of asset freezes and travel restrictions imposed on individuals. These are listed together with the economic sanctions in Annex 2 since they are important parts of the sanctions process but their possible effects on the economy are not analysed in particular.

The report does not aim to quantify the effects of sanctions or separate their effects on the Russian economy from those of other factors. The report is limited to a qualitative analysis of how sanctions are impacting the Russian economy together with other factors. A proper quantitative analysis requires a more complex approach and the availability of data before and after sanctions were imposed. However, it is uncertain whether an econometric analysis would be able to isolate the effects of sanctions at this early stage and serious studies of the impact of sanctions will probably appear only after some time has elapsed.

The report focuses on the sanctions actually imposed and does not analyse the impact of “threats of sanctions” and incentives, two instruments widely used in combination with imposing sanctions. Threats of sanctions were used by the West before sanctions were imposed and they probably continue to be used – together with incentives – before a sanction is imposed and extended, but the progress of such discussions is not available in the public domain. Another

implication of working with open sources is that what may appear to be a link between certain events on the ground (Annex 1) and the time at which a sanction was imposed (Annex 2) in the narrative (in Chapter 2) may in fact be circumstantial.

It is unknown what price Russia is willing to pay for keeping Ukraine in its “sphere of influence” or for achieving more drastic changes of the security order in Europe. On 22 June the EU prolonged its sanctions until 31 January 2016. The sanctions are conditioned on the complete implementation of the Minsk agreements which is foreseen be concluded by 31 December 2015. The discussion of the sanctions’ potential success in changing political behaviour is therefore tentative.

### *Outline*

The outline supports the objectives of the report. Data and partial analysis of different aspects of the effects of sanctions and the prospect of sanction success are provided in chapters 2, 3 and 4. The final analysis that takes account of all findings is presented in Chapter 5. The second chapter gives a brief historical background to the conflict between Russia and the West and describes the process of sanctions imposed by the EU and US. Chapter 3 presents an analytical framework for the study of sanctions that includes a theoretical model and the identification of factors in the empirical sanctions literature that are relevant to the impact of sanctions. Additionally, this chapter presents some lessons learnt from previous sanctions regimes against other countries. Chapter 4 contains an analysis of the situation in the Russian economy and of the responses that the Russian government is implementing to moderate the general economic decline and the impact of the sanctions. In this chapter we identify factors specific to the Russian case that affect the effectiveness of the sanctions in reaching their goals. Using the analytical framework developed in Chapter 3 and the findings of chapters 2 and 4, Chapter 5 provides the concluding analysis of the effects of the economic sanctions on the Russian economy. The prospect of the political goal of the sanctions being achieved is made with the help of a SWOT analysis, which highlights the risks to the outcome generated by political factors. Finally, in Chapter 6, the conclusions of the whole study are drawn.

## 2 The sanctions process and its background

This chapter gives a brief account of the political background to the conflict and provides an overview of the sanctions process based on the official sanctions documents. All documents cited are listed in Annex 2.

### 2.1 The political background to the conflict between Russia and the West

The official reasons behind the sanctions imposed by the EU and the US against Russia are the view that the Crimean referendum was illegitimate, Russia's illegal annexation of Crimea and Russia's continued violation of Ukrainian sovereignty and support for the pro-Russian separatists. However, under these immediate issues lies a deep disagreement over the post-Cold War security order in Europe. In brief, Russia has become dissatisfied with the arrangements that developed after the collapse of the Soviet Union in 1991 and wants to preserve at least what is left of the former Soviet "sphere of influence", which includes the remaining former Soviet republics in Europe (Ukraine, Belarus, Georgia, Moldova, Armenia and Azerbaijan) and Central Asia.<sup>2</sup> Meanwhile the West regards these countries as sovereign states that are free to engage in any international cooperation they choose and form the alliances they want. Russia's former satellites in Europe and the three Baltic republics joined NATO in 1999 and 2004<sup>3</sup> and they acquired full membership in the EU in 2004 and 2007.<sup>4</sup> In 2008, Georgia and Ukraine pursued attempts to join NATO, which Moscow found too provocative and unacceptable. In the resulting military conflict in 2008 with Georgia over South Ossetia and North Abkhazia, Western countries were

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<sup>2</sup> This section draws on Freedman (2014).

<sup>3</sup> Poland, Hungary and the Czech Republic joined in 1999, and Estonia, Latvia, Lithuania, Slovenia, Slovakia, Bulgaria and Romania joined in March 2004. Additional new members are Albania and Croatia which joined in April 2009.

<sup>4</sup> The Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland and Slovakia entered the EU in 2004 and Bulgaria and Romania in 2007.

not inclined to intervene. Russia won the conflict and as a result two breakaway republics, South Ossetia and Abkhazia, were created on Georgian territory, recognised only by Russia and Nicaragua, Venezuela and Nauru.<sup>5</sup>

After the Georgian war the EU launched the Eastern Partnership which was to include Armenia, Azerbaijan, Belarus, Georgia, Moldova and Ukraine. This was mainly an economic initiative and it offers opportunity for economic reforms through increasing interaction and exchange with the EU. However, in addition it included goals of building a “common area” of democracy, prosperity and stability. The idea was thus to create stronger economic cooperation with the EU and strengthen the market economy, growth and prosperity in the Eastern Partnership countries and to transfer Western values of democracy, rule of law and fighting corruption. Russia disliked this initiative because it found that the EU was trespassing on its “sphere of influence”.

In response, Russia announced that it intended to form the Eurasian Customs Union (EACU) by 2015. Belarus and Kazakhstan signed the agreement to establish the EACU in 2011, but the union would be too small if it consisted of just Russia and these two countries. Russia first opted to include Armenia, Moldova and Ukraine. Of these countries Ukraine mattered most to Russia because of its size and strong economic, historical and cultural ties with Russia. If Ukraine signed the Association Agreement covering trade with the EU, which was planned to happen in November 2013, it could not join the EACU because the whole idea of a customs union is that you have common tariffs with the outside world.<sup>6</sup> For Russia it was vital to prevent any further expansion of “the EU’s sphere of influence” and especially to block Ukraine joining the Eastern Partnership. As is now known, then President Viktor Yanukovych did not sign the Agreement with the EU in November 2013; instead he signed an agreement with Russia for a bail-out loan of USD 15 billion in December 2013. This was the last straw that triggered the still ongoing crisis in Ukraine.

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<sup>5</sup> Countries that initially recognised at least one of the breakaway republic but later withdrew their recognition are Tuvalu and Vanuatu. Non-UN territories that have recognised them are Nagorno-Karabakh, Transnistria, the Luhansk People’s Republic and the Donetsk People’s Republic.

<sup>6</sup> Neither the Association Agreement nor the EACU is only about border tariffs. Under the EU Agreement Ukraine has had to apply a certain number of EU laws that apply to the EU’s single market. The EU Agreement implied that Ukraine had to apply EU competition rules and intellectual property rights, certain service sectors had to be liberalised, the country was to be opened up to foreign direct investment and industrial product standards needed to be changed. The Agreement required Ukraine to phase out its Soviet-era state standards. All this would be incompatible with parallel membership in the EACU (Borderlex 2014).

People's protests, on the Maidan in Kiev,<sup>7</sup> started in November 2013. After the failure to sign an agreement with EU the tension increased and the government tried to fight the uprising by force, which resulted in many casualties. On 22 February 2014, protesters ousted President Yanukovich, who fled to Russia, and an interim government was formed in Kiev. In response to the overthrow of Yanukovich, on 27 February Russia's "little green men"<sup>8</sup> took the airport in Sevastopol and occupied the Supreme Council of Crimea, and a pro-Russian government could be installed. By 18 March Russia's annexation of Crimea was a fact.<sup>9</sup>

## 2.2 The EU's sanctions against Russia

The EU has imposed three different sanctions regimes in connection with Russia's aggression against Ukraine.<sup>10</sup> These regimes target the following.

- a. Individuals and legal entities that have been involved in actions undermining or threatening the territorial integrity, sovereignty and independence of Ukraine may be listed and have their assets in the EU area frozen. *This regime is linked to the annexation of Crimea and Russia's actions in eastern Ukraine.*
- b. Restrictions and later a total ban on the import into the EU of goods originating in Crimea or Sevastopol, in response to the illegal

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<sup>7</sup> Literally "Maidan" means square. *Maidan Nezalezhnosti* means *Independence Square* in Kiev. The protest movement is also referred to as "Euromaidan".

<sup>8</sup> The term refers to the masked soldiers in green army uniforms without insignia wielding Russian military weapons and equipment within Ukraine. A retired Russian admiral revealed that the little green men belonged to the army Spetsnaz and said that according to his information the Russian troop deployment in Crimea included six helicopter landings and three landings of IL-76s with 500 people (Sputnik 2015).

<sup>9</sup> Several dates for the annexation circulate in the media literature. The correct dating of the events according to Law (2015) is available in Annex 1.

<sup>10</sup> This section is based on the sanctions documents listed in Annex 2. Additionally, we have used Swedish Ministry of Foreign Affairs (2015) and EU sanctions (2015). It should be noted that assumed links between events on the ground and the imposition of a sanction may be purely circumstantial since sanctions take time to prepare and in the EU they need to be agreed between 28 countries. This point was made by Per Saland, Sanction Coordinator at the Swedish Ministry of Foreign Affairs, in a discussion with us on 6 May 2015. However, since we are restricted to working with open sources only, we use the public timeline (Annex 2) in the narrative.

annexation of Crimea and Sevastopol. *This regime is linked to Russia's illegal annexation of Crimea and Sevastopol.*

- c. Economic sanctions against Russia restricting the use of EU financial markets, and prohibiting the export of armaments and dual-use goods and of equipment and services to the oil industry. *This regime is linked to Russia's actions in eastern Ukraine.*

On 18 March 2014, the day of the Russian annexation of Crimea, the EU imposed the first sanctions regime (a) targeting individuals and legal entities that have been involved in actions undermining or threatening the territorial integrity, sovereignty and independence of Ukraine (Council Regulation 269/2014). Assets in the EU countries were frozen and individuals were banned from travel into the EU. These sanctions were later extended to Russian decision makers and persons or companies who have dealings with the separatists in eastern Ukraine. The two People's Republics, Luhansk and Donetsk, were listed as well. These sanctions were originally valid until 15 March 2015 but were extended until 15 September 2015. In all 132 individuals (both Russian and Ukrainian) and 29 legal entities had been listed by March 2015.

On 27 March 2014, the General Assembly of the UN adopted Resolution 68/262 (see Annex 2) on Ukraine's territorial integrity. The resolution stressed that the 16 March referendum organised on Crimea was not valid and the international community was requested not to acknowledge the annexation. The 23 June the EU adopted a regulation (b) against the import of goods from Crimea and Sevastopol and against technical and financial assistance and insurance in connection with such imports (Council Regulation 692/2014). These sanctions were extended on 30 July to incorporate sectorial investment and export bans (Council Regulation 825/2014). This implies that equipment and technology for transport, telecommunications and energy must not be exported to Crimea and Sevastopol. Restrictions correspondingly apply to accompanying technical and financial services. These sanctions were valid until 23 June 2015. On 18 December 2014 they were reinforced to create a general investment ban and restrictions on tourism services were added (Council Regulation 1351/2014).

Following the escalation of military action in eastern Ukraine and after the Malaysia Airlines flight MH-17 was shot down on 17 July 2014 over a separatist-controlled area, the EU decided to extend sanctions on Russia and on 31 July it introduced economic sanctions (c) which restricted the opportunity of Russian state-owned banks to seek financing on European capital markets and trade with certain sectors (Council Regulation 833/2014). This regulation made it prohibited to invest or trade in Russian state securities with a state share of over 50 per cent and a maturity of over 90 days. Five state-owned Russian banks –

Sberbank, VTB, VEB, Vneshekonombank, and Rosselkhozbank – and financial institutions and their subsidiaries were targeted by the sanctions. In addition, the EU imposed an embargo on the export and import of arms from Russia and connected services. The export embargo includes dual-use products and advanced technologies used by the oil industry. The latter sanctions mainly impact advanced technologies for exploration on the Arctic shelf and thus Russia's opportunities for future oil incomes. The arms embargo and the other trade restrictions are only valid for new contracts.

The economic sanctions were reinforced and broadened on 8 September (Council Regulation 960/2014) for the same sectors as in Council Regulation 833/2014. According to this latter regulation the duration of credits was cut to 30 days for the state-owned banks listed and this restriction was extended to three state-owned defence companies – Oboronprom, United Aircraft Corporation and Uralvagonzavod – and three state energy companies – Rosneft, Transneft and Gazpromneft. The restrictions imply that no new loans can be given to the companies listed with a duration longer than 30 days; however, trade credits are allowed, but services connected to trade in prohibited areas are included in the export bans on oil exploration equipment needed on the Arctic shelf.

The restrictions on the export of dual-use goods to the Russian military sector were extended to nine companies with both military and civilian production. On 18 December these sanctions were further extended (Council Regulation 1351/2014). The original duration of these sanctions was until 15 July 2015. On 19 March 2015, the European Council (2015a) discussed the situation in Ukraine. It was agreed “that the duration of the restrictive measures against the Russian Federation, adopted on 31 July 2014 and enhanced on 8 September 2014, should be clearly linked to the complete implementation of the Minsk agreements, bearing in mind that this is only foreseen by 31 December 2015” (ibid.). On 22 June 2015 the European Council (2015b) decided to prolong all sanctions until 31 January 2016.

## 2.3 The US sanctions against Russia

The basis for the US sanctions is three presidential executive orders.<sup>11</sup> The first, Executive Order 13660, was signed by President Barack Obama on 6 March 2014 and the following two – 13661 and 13662 – on 17 March and 20 March 2014 respectively. Utilising these executive orders the US has steadily increased the diplomatic and financial costs of Russia's aggressive actions towards Ukraine. The aims of the US sanctions are to increase Russia's political isolation as well as the economic costs to Russia, especially in areas of importance to President Putin and those close to him (Nelson 2015: 5). In December 2014, the President signed the Ukraine Freedom Support Act which gives support for the imposition of further sanctions (ibid.). The US sanctions include:

- Asset freezes for specific individuals. Assets of individuals close to Vladimir Putin have been frozen. US individuals and entities are prohibited from conducting financial transactions with them.
- Asset freezes for specific entities, particularly state-owned banks, energy companies and arms producers.
- Restrictions on financial transactions with Russian firms in finance, energy and defence.
- Restrictions on exports of oil-related technology.
- Restrictions on exports of dual-use technology.

On 28 April 2014, in response to Russia's continued actions in southern and eastern Ukraine, the Department of State expanded its export restrictions on technologies and services regulated under the US Munitions List. Thereby pending applications for export or re-export to Russia or occupied Crimea of any high-technology defence articles or services regulated under the US Munitions List that contribute to Russia's military capabilities would be denied. In addition, the Department could revoke any existing export licences which meet these conditions.

On 16 July 2015 the US Treasury imposed several economic sanctions. Two major Russian financial institutions, Gazprombank and VEB, were included. Two Russian energy firms, Novatek and Rosneft, were sanctioned and their access to US capital markets was limited. On 29 July the list of sanctioned

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<sup>11</sup> The US sanctions are listed in chronological order with web links in Annex 2.

financial institutions was extended with by adding Bank of Moscow, Rosselkhozbank and VTB Bank. In addition, the Treasury designated eight Russian arms firms. They include Almaz-Antey, Federal State Unitary Enterprise State Research and Production Enterprise Bazalt, JSC Concern Sozvezdie, JSC MIC NPO Mashinostroeniya, Kalashnikov Concern, KBP Instrument Design Bureau, Radio-Electronic Technologies, and Uralvagonzavod. All these companies produce a range of materiel that includes small arms, mortar shells, and tanks. Assets in the US of these entities were frozen and transactions involving these companies were generally prohibited. On 29 July this list was extended with the addition of United Shipbuilding Corporation, which designs and constructs ships for the Russian Navy.

The US Treasury designated the “Luhansk People’s Republic” and the “Donetsk People’s Republic”, which have asserted governmental authority over parts of Ukraine without the authorisation of the government of Ukraine, and Aleksandr Borodai, the self-declared “prime minister” of the Donetsk People’s Republic, for threatening the peace, security, stability, sovereignty, and territorial integrity of Ukraine. Furthermore, the Treasury designated Feodosiya Enterprises, a key shipping facility on the Crimean Peninsula, because it is complicit in the misappropriation of state assets of Ukraine.

On 9 December 2014 the US Treasury extended the economic sanctions. Russia’s largest bank – Sberbank – was included in the list of sanctioned financial institutions. The maturity of Russian debt involved in transactions with US individuals or entities was reduced from 90 to 30 days for all the six banks on the list. In addition, the Treasury blocked the assets of five more Russian state-owned defence technology firms – Dolgoprudny Research Production Enterprise, Mytishchinski Mashinostroitelny Zavod, Kalinin Machine Plant JSC, Almaz-Antey GSKB, and JSC NIIP.

Sanctions were imposed that prohibit the export of goods, services (not including financial services) and technology in support of exploration or production for Russian deepwater, Arctic offshore and shale projects that have the potential to produce oil. An additional five Russian energy companies – Gazprom, Gazprom Neft, Lukoil, Surgutneftegas, and Rosneft – involved in these types of projects were listed. The Treasury imposed sanctions that prohibit transactions in, the provision of financing for, or other dealings in new debt of greater than 90 days maturity issued by two additional Russian energy companies – Gazprom Neft and Transneft.

## 2.4 Concluding remarks

Finally, some features of the sanctions deserve to be highlighted:

- The sanctions are a signal that the West regards Russia as part in the military conflict in Ukraine, but Russia denies being involved.
- The sanctions in combination with diplomatic efforts are the non-military responses to the Russian military aggression in Ukraine. Neither the US nor the EU has so far seen a military response as an option.
- The EU has managed to keep together in the sanctions process and the Commission has enhanced facilitation and cohesion of different members' needs and views. This in itself is a great achievement for the EU as a union.
- The EU and US sanctions have been carefully designed and are "targeted" to have as much impact as possible on the regime and minimise the impact on the population. The targeted sanctions focus on well-defined core sectors and companies in the Russian economy, in contrast to overall trade embargoes that have broad effects that are difficult to control and are difficult to maintain and control over longer periods. Table 2.1 lists the companies named in the sanctions documents.
- The financial sanctions entail that five state banks cannot raise loans with a duration of over 30 days on EU and US capital markets. Some state companies in the oil sector, among which is the oil giant Rosneft, and companies in the defence sector could not raise credits with a duration longer than 90 days, later in many cases shortened to 30 days.
- The energy sanctions are aimed at the oil sector which is the main export earner. This means that oil companies or the oil divisions of oil and gas companies have been targeted. Gas production and delivery are not directly restricted by the EU sanctions, but Gazprom is targeted by the US. This reflects the EU's dependence on Russian gas. Oil is a homogeneous good available on the world market at a market price and can easily be replaced. Yet countries that are still highly dependent on Russian pipeline oil have problems as well as those that are highly dependent on pipeline gas, with or without LNG terminals, and cannot change gas supplier in the short and medium run as easily.

**Table 2.1 Companies targeted by US and/or EU sanctions\* (March 2015)**

<b>Banks</b>		<b>Defence industry</b>	
Rossiia	US	OAo Almaz-Antey	US/EU
Sberbank	US/EU	OAo NPO Bazalt	US/EU
Vneshekonombank (VEB)	US/EU	JSC Concern Sozvezdie	US
VTB Bank	US/EU	JSC MIC NPO Mashinostroeniya	US
Gazprombank	US/EU	Kalashnikov Concern	US/EU
Bank of Moscow	US	KBP Instrument Design Bureau	US
Rosselkhozbank	US/EU	Radio-Electronic Technologies	US
		JSC NIIP	US
<b>Energy companies</b>		United Shipbuilding Corporation	US
Novatek	US	Uralvagonzavod	US/EU
Rosneft	US/EU	OPK Oboronprom	EU
Gazprom	US	United Aircraft Corporation	EU
Gazprom Neft	US/EU	Dolgoprudny Research Production Enterprise	US
Lukoil	US	Mytishchinski Mashinostroitelny Zavod	US
Surgutneftegas	US	Kalinin Machine Plant	US
Transneft	US/EU	JSC Sirius	EU
		OJSC Stankoinstrument	EU
		OAo JSC Chemcomposite	EU
		JSC Tula Arms Plant	EU
		NPK Tekhnologii Mashinostroeniya	EU
		OAo Vysokototschnye Kompleksi	EU

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Source: Annex 2.

\*Not including legal entities on Crimea

### 3 Analytical framework

In the aftermath of the Cold War the use of economic sanctions as instruments of statecraft increased significantly. Western countries have implemented economic sanctions within the UN Security Council six times more often since 1990 than they did before. The volume of research on sanctions has expanded simultaneously (Drezner 2011). Proponents of economic sanctions have presented them as a milder and less costly alternative to military intervention. Opponents regard them as being generally inefficient. The empirical literature gives support to both these views. Later research has shifted focus away from efficiency towards a discussion of when and under what circumstances sanctions are effective in contributing to concessions by the targeted state. This chapter develops an analytical framework with a basic theoretical model showing that sanctions are filtered through a number of factors or circumstances that determine their impact. Then we look at factors identified in the empirical sanctions literature that have been found to strengthen or weaken the impact of sanctions. To complement this model lessons learnt from three brief case studies of previous sanctions regimes are presented and discussed.

#### 3.1 Definition of key concepts

Before developing an analytical framework some key concepts need to be defined:

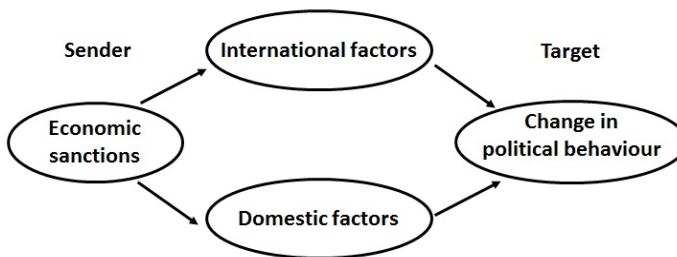
- Sender – the party that imposes the sanctions. The sender can be a single country, a multilateral uncoordinated group of countries, or a union of (coordinated) countries, like the EU, an international organisation, or a combination of these.
- Target – the state against which the sanctions are aimed.
- Economic sanctions – government-sponsored disruptions of economic relations by one or several senders in order to achieve a change in the policy behaviour of the target.
- Targeted sanctions – focused on specific individuals or sectors, as opposed to broad or comprehensive sanctions. All the economic sanctions against Russia target specific sectors or goods.
- Sanction success – an outcome where economic sanctions have made a significant contribution to a change in the policy behaviour of the target in line with the objectives of the sender.

- Sanction costs – costs experienced by the target in connection with sanctions.

## 3.2 A basic theoretical model

The objective of economic sanctions is usually to change the political behaviour of the target country in some specific area, e.g. persuading Russia to leave Ukraine. Economic sanctions are used by the sender to create costs for the target. Through these costs the sender hopes to coerce the target into changing a policy which is undesirable to the sender. However, the impact is usually not direct in the sense that economic sanctions have a direct impact on political behaviour. Instead the effects of economic sanctions are diminished or amplified by different intermediate circumstances or factors. Some of these factors are found in the international arena (e.g. the oil price) while others belong within the domestic confines of the target state (e.g. its economic system). Another possible way to categorise factors of influence is that they are external or internal to the target. Figure 3.1 shows a simplified version of a model developed by Blanchard and Ripsman (2013: 16–36).

**Figure 3.1 Theoretical model for analysing the effects of sanctions**



Source: The authors based on Blanchard and Ripsman (2015: 16–24)

The model in Figure 3.1 depicts the sender and target within a sanctions regime. The arrows show how the impact of economic sanctions is filtered through different kinds of factors, here represented by international and domestic factors, to produce a change in political behaviour. The box *international factors* represents international factors that strengthen or weaken the costs of sanctions for the target. The box *domestic factors* represents factors internal to the target

that strengthen or weaken sanction costs. It could for instance be the target's ability to defuse the effects of sanctions by diverting costs away from key supporters.<sup>12</sup>

The theoretical model thus posits that economic sanctions filter through different factors, which increase or decrease pressure for political change, and that the combination of the sanctions and these factors will determine the impact of economic sanctions. In the following discussion, identifying factors in general within the existing sanctions literature, we do not sort them into categories of "international" or "domestic"; however, when the concrete factors affecting the Russian case are summarised in Chapter 4, it has proved useful to group the factors into these categories (see Table 4.4).

### **3.3 Factors affecting the success of economic sanctions**

Recent research on economic sanctions has focused on identifying which factors impact the probability of sanction success. These empirical studies build on two main data sets; both of these include successful and failed sanctions as well as series of potential explanatory variables. The most widely cited, the HSEO<sup>13</sup> data set, has been created and updated by Hufbauer et al. (2007). It contains cases from 1915 to 2000 of which the majority were imposed by the US. The later Threat and Imposition of Economic Sanctions (TIES) data set was constructed by Morgan et al. (2009) and contains cases of threatened and imposed sanctions during the period 1971–2000, and is used by Bapat et al. (2013) as well. The factors we have identified as most important within the literature are presented below. Annex 3 summarises the results of different studies regarding the expected impact of different factors on a target country's political behaviour.

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<sup>12</sup> A possible extension of the model would be to take account of the fact that international and domestic factors do not work in isolation from each other. The sender may take the domestic development of the target into account throughout the sanctions process. Similarly, domestic actors within the target state will position themselves in reaction to international responses to economic sanctions. These secondary or indirect effects are not used in the analysis in this report but are suggested as a subject for further research.

<sup>13</sup> HSEO – acronym of the surnames of the researchers who developed the data set – Gary Hufbauer, Jeffrey Schott, Kimberly Elliott and Barbara Oegg (Hufbauer et al. 2007).

### *Sanction costs*

There is widespread support within the empirical literature for the importance of sanction costs of the target for sanction success (see Annex 3). The higher the cost of sanctions, the more likely it is that the target will change its political behaviour in accordance with the sender's demands (Bapat et al. 2013: 89). However, high costs do not guarantee success. For instance, the extremely high costs associated with the sanctions against Iraq were not sufficient to oust Saddam Hussein and the political concessions came at enormous human costs (see further Section 3.4).

### *Trade dependency*

The costs of sanctions imposed on the target are linked to the level of trade dependency between target and sender prior to sanctions. Mutual trade dependence can make sanctions more efficient, but it can simultaneously have the effect of deterring the sender from imposing sanctions. Empirical studies show different signs, but both Major (2012) and Bapat et al. (2013: 90) find that trade dependency is positively associated with sanction success.

### *Duration of sanctions*

The duration of sanctions might be just as important as the initial level of costs. The longer sanctions stay in place the higher the accumulated costs. On the other hand, the longer the duration the more time the target has to adapt to the sanctions. In general, the empirical literature indicates a decreasing chance of sanction success with the passing of time (Hufbauer et al. 2007: 171). However, some costs for the target take a long time to have an impact and, for instance, in the case of Libya, the long duration of the targeted sanctions against the oil sector was crucial (see further Section 3.4).

### *Sanction costs for the sender*

Sanctions may incur costs for the sender too. If the sender's economy is severely hurt by the sanctions, costs may prevent the sender sustaining or escalating sanctions, which reduces the chance of sanctions succeeding. On the other hand, a willingness to accept substantial costs on the part of the sender can demonstrate a high level of commitment which could put further pressure on the target. There is no conclusive support for the idea that the cost for the sender has an impact in either direction (Hufbauer et al. 2007: 177).

*Multiple senders*

Intuitively the overall sanction costs for the target should increase with the number of international actors involved on the sender side. Multiple senders provide fewer export markets for the target and increase the international legitimacy of sanctions. However, empirical studies reject a positive relationship between multilateral cooperation between individual countries and the effectiveness of sanctions (e.g. Bapat et al. 2013: 88–89). In fact, multiple senders seem to have a general negative impact on sanction success (Nooruddin 2002: 64–65). The most apparent reason behind this relationship is that the diverse agendas of different senders may create confusion and competition, which can be used by the target state. Multilateral sanctions issued by individual states may also divide the senders, thereby decreasing the pressure on the target for change in political behaviour.

So far the EU member states have acted in unity. However, the unequal impact on different EU members of Russia's economic decline could threaten the consistency of the EU's sanctions. Likewise, the difference between the EU and US with regard to their geographical location and economic involvement with Russia could become a problem in the long term.

*International institutions*

International institutions can play an important role in coordinating multilateral efforts, thereby mitigating some of the negative effects associated with multilateral sanctions. International organisations, such as the UN, can serve as a point of reference for multiple senders. This significantly limits the number of additional negotiations and compromises which the senders otherwise would have to engage in (Miers and Morgan 2002: 130). The involvement of international institutions is found to increase the chances of sanction success (Bapat et al. 2013: 88-89). In the case of Russia the EU has so far acted as a coherent union thanks to its ability to facilitate the interests of various member states.

*Third-party countries*

Third-party countries ("black knights") may moderate the cost of sanctions for the target (Kaempfer and Lowenberg 2007: 894). Third-party countries may act as alternative markets for exports and sources of finance, either because they sympathise with the target or because sanctions provide them with favourable business opportunities. This may undermine the legitimacy of the sanctions. In

the case of Russia, BRICS<sup>14</sup> and CIS members may act as such third-party countries.

#### *Authoritarian regime*

Compared to democracies, authoritarian regimes usually face little organised opposition and have the tools to repress domestic discontent. An important instrument is the regime's control over media and resource distribution. Several empirical studies support the notion that authoritarian regimes are generally more resilient to sanctions than democracies (Cortright and Lopez 2000, Nooruddin 2002, Brooks 2002, Allen 2005). However, authoritarian regimes are not immune to economic sanctions. Major (2012) shows that they are in fact sensitive to certain events such as domestic protests, strikes and elections. Elections in authoritarian states pose other than mere symbolic dangers when the regime is simultaneously faced with sanctions (ibid.).

#### *State capacity*

The state capacity of the targeted state determines the damaging effects of sanctions, as well as which segments of the population get hurt (Burlone 2002). The political infrastructure and the economic system of the target are important for its resilience against sanctions, both in reducing the overall impact of costs and in particular in distributing these costs where the targeted state's government desires.

#### *The importance of a conflict*

The above-mentioned factors may raise or reduce sanction costs for the target state. However, the overall cost of sanctions must be weighed against the importance of the original conflict issue which led to sanctions being imposed in the first place. It is intuitive to assume that the greater the importance of the conflict issue the less likely it is that neither target nor sender will be willing to concede in the face of sanctions, as they risk losing face both internationally and domestically. There is some evidence that the importance of a conflict reduces the chance of sanctions succeeding (Bapat et al. 2013: 89–90).

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<sup>14</sup> Brazil, Russia, India, China, South Africa.

### 3.4 Lessons learnt: short case studies of previous sanctions regimes

To illustrate the impact of economic sanctions under different circumstances we have chosen to examine three cases of previous sanctions regimes. Economic sanctions regimes against South Africa, Libya and Iraq were chosen because they were imposed against authoritarian regimes with resource-abundant economies that are dependent on the export of commodities, which to some degree makes their situation comparable to that of Russia. They all achieved some partial success in changing the political behaviour of the target, but in various ways and at various costs.

#### *Case 1: Sanctions against South Africa 1948–1994*

The economic sanctions against apartheid<sup>15</sup> in South Africa were in effect for almost 50 years, but eventually contributed to the fall of the regime. They were first imposed in 1948 as a response to the institution of apartheid, but it was the brutal killing of 69 protesters at Sharpeville in 1960 which sparked wider international sanctions (Blanchard and Ripsman 2013: 113–114). In 1964 the US banned Export-Import Bank loans to South Africa and blocked the IMF purchasing gold from South Africa, and in 1973 the Organization of Petroleum Exporting Countries (OPEC) initiated an oil embargo. The US later expanded sanctions to computer and nuclear technology, iron and steel, and the EEC<sup>16</sup> and Japan imposed similar sanctions. In 1986 the US prohibited imports of agricultural and mining products from South Africa as well as exports of arms and petroleum. Estimates of the costs imposed by sanctions vary.<sup>17</sup> Eventually, the economic sanctions against South Africa succeeded in contributing to regime change. However, it is disputed how important sanctions were in relation to other contributing factors, such as the loss of domestic and international legitimacy of the regime.

<sup>15</sup> Apartheid meant the separation of people according to race, favouring whites and discriminating against blacks. Political restrictions and censorship were enforced by the police and even by the armed forces.

<sup>16</sup> The European Economic Community (EEC) was a regional European organisation created by the Treaty of Rome in 1957. With the creation of the EU in 1993 it was renamed the European Community, which in 2009 was absorbed into the EU framework.

<sup>17</sup> For instances, coal and oil export losses were significant and sanctions implied billions in higher prices of coal conversion and import substitution costs (ibid.).

Lessons learnt from the sanctions imposed against South Africa are:

- Support by international institutions, such as the EEC, the IMF and OPEC, isolated the apartheid regime and gave the sanctions legitimacy.
- The long duration of sanctions and their subsequent extensions to new products put constant pressure on the South African government. However, it is disputed how important sanctions were in relation to other contributing factors, such as the loss of domestic and international legitimacy of the regime.

*Case 2: Sanctions against Libya 1969–2003*

The economic sanctions against Libya were targeted at specific sectors and eventually proved successful. Already back in 1969, the US imposed diplomatic and partial economic sanctions, following Moammar Qaddafi's seizure of power. However, international sanctions began after Libyan involvement in the destruction of Pan Am flight 103 by a terrorist bomb over Lockerbie in 1988. The consequent UN sanctions included a ban on arms sales and oil equipment, and asset freezes. Qaddafi's human rights violations and anti-Western rhetoric remained, but by the late 1990s Libya had begun to rethink its support for terrorism and the pursuit of weapons of mass destruction (WMD). In 1998 persons suspected of the Lockerbie bombings were put on trial and the UN sanctions were lifted quickly afterwards. In December 2003, Libya announced that it would end its pursuit of WMD (Jentleson and Whytock 2006: 67–73).

The costs of sanctions were high for Libya, but not crippling. Libyan oil revenue was hit by sanctions and low oil prices, but it recovered by 2003. Furthermore, the country was not denied access to OECD-based banks and maintained at least some investment inflow from Europe (Oskarsson 2012: 95–97). But the targeted sanctions on the oil industry and its infrastructure had a serious impact. Libya was forced to acquire equipment on the black market, sometimes at four times the market price (ibid.). By the late 1990s it was clear that the US sanctions were depriving Libya of necessary technology.

A crucial factor behind the concessions made by Libya was the US move away from an *implicit demand for regime change* towards an *explicit demand for policy change*. Furthermore, the US and UK made sure that the Libyan regime understood this shift of goals prior to the signing of the WMD agreement (Jentleson and Whytock 2006: 79–85).

Lessons learnt from the sanctions imposed against Libya are:

- The involvement of the UN and the long duration of the sanctions made

the Qaddafi regime consider concessions by the late 1990s regarding its support for terrorism and pursuit of WMD. The UN sanctions could be lifted when the Lockerbie bomber was put on trial. Nevertheless, it was only in 2003 that Libya refrained from developing WMD.

- The targeted sanctions prohibiting exports of modern oil production equipment to Libya were central to sanction success, but it took a long time before they had sufficient impact to attain this goal.
- In the later stages, the senders were clear in communicating the goal of the sanctions to the target, regime change, which helped resolve the conflicts over the Lockerbie bombings and Libya's pursuit of WMD.

*Case 3: Sanctions against Iraq 1990–2003*

The economic sanctions against Iraq had mixed results. While several of the UN goals were met, the US goal of regime change did not materialise. Moreover, the economic and humanitarian costs of the comprehensive sanctions against Iraq were catastrophic. Sanctions began in August 1990 as a direct response to Saddam Hussein's invasion of Kuwait. While the US launched Operation Desert Storm, the UN called for general comprehensive sanctions including a freeze of government assets, an arms embargo, the suspension of international air travel, a financial transactions ban, an oil embargo, and a ban on all trade (Alnasrawi 2001: 208). During the sanctions regime Iraq's GDP declined by half and inflation rose by 5 000 per cent. It has been estimated that sanctions caused up to 227 000 deaths among children (Oskarsson 2012: 92). While the oil-for-food programme offered some relief, it did not change Iraq's deteriorating economic situation (Alnasrawi 2001: 212–213).

Sanctions did not destabilise Saddam Hussein, who easily managed to shift the blame for Iraq's hardships on to the West. Under food rationing people became increasingly dependent on the government. Full control over the economy allowed Saddam Hussein to keep his inner circle and the military establishment sufficiently satisfied (Oskarsson 2012: 94). Iraq did comply partially or fully with seven of eight conditions identified in UN Resolution 687 (United Nations 1991), most importantly those regarding the sovereignty of Kuwait as well as the monitoring and dismantling of WMD. However, these efforts were not reciprocated with an easing of sanctions, which reduced the sanctions' bargaining power. Hostilities continued and in 1997 it became increasingly clear that the US would seek *regime change* rather than *policy change* (Cortright and Lopez 2000: 55–57). The consequence was stalemate. Sanctions did not end until the US ousted Saddam Hussein by military force in 2003.

Lessons learnt from the broad sanctions against Iraq are:

- The broad economic sanctions, including the freezing of government

assets, oil and arms embargoes, and bans on trade and financial transactions, contributed to a human catastrophe. However, these high costs did not result in the overthrow of the regime of Saddam Hussein.

- The authoritarian regime's control over media and the distribution of resources and incomes made it easy for the Iraqi regime to ascribe the deterioration of the economy to the West, while the inner circle and military establishment could largely be protected from the economic hardship and sustained its support for the regime. Thus, despite the extremely high sanction costs borne by the Iraqi people, Saddam Hussein managed to maintain power.
- Different goals among the senders caused confusion and ineffectiveness. Iraq did comply with most of the UN conditions regarding Kuwait and WMD, but the US insistence on regime change created a stalemate. In the end, without the support of the UN Security Council, the US used military force to attain its goal.

### 3.5 The analytical framework – conclusions

According to the analytical framework presented in this chapter, economic sanctions are imposed by the sender in order to impose costs on the target with the aim of changing its political behaviour with regard to the relevant conflict issue. According to the theoretical model (Figure 3.1), the costs incurred by the target country and the prospects of success of the sanctions are filtered through different factors that increase or decrease the effects of sanctions on the target. These factors contribute to the success or failure of sanctions and form the basis of our analytical framework.

The empirical sanctions literature highlight different factors:

- Costs for the target: higher sanction costs for the target have a positive impact on the chance of sanction success.
- Trade dependence: high trade dependence may imply high costs for both sender and target. In the literature, the impact of trade dependence is far from conclusive, but some studies indicate a positive impact on sanction success.

- Duration of sanctions: the findings within the literature are inconclusive. On the one hand, the longer sanctions are in place, the higher the accumulated sanction costs, but on the other hand this gives the target time to adapt to the restrictions and find ways around them. Some of the empirical literature points to a negative relationship, while in our cases duration was important for sanction success.
- Costs for the sender: intuitively, high costs for the sender should lead to its being dissuaded from imposing and escalating sanctions. However, there is no support in the empirical literature for this being the case.
- Multiple senders: multiple senders can have a negative effect on the efficiency of sanctions since different senders have different goals and there may be confusion that can be exploited by the target. Empirical research indicates that the existence of multiple senders has a negative impact on the success of sanctions.
- International institutions: the participation of international institutions is found to have a positive effect as they coordinate multiple senders and create legitimacy for the sanctions regime.
- Third-party countries: can offer alternative trade opportunities and reduce the costs and efficiency of sanctions, which works against sanction success.
- Authoritarian regimes: sanctions against authoritarian regimes are less effective than sanctions against democracies. The main reasons for this are that these regimes have control over public opinion and can put the blame for economic hardship on the senders, and that they control the distribution of economic resources which means they can protect elites and groups vital for staying in power from economic hardship. This makes them more resilient.
- State capacity: the better the target state can manage the effect of sanctions, the less efficient sanctions will be.
- The importance of the conflict: the costs have to be weighed against the importance of the conflict issue that originally caused the disagreement. If the issue is of great importance it becomes more difficult for sanctions to change political behaviour.

The three case studies presented supplement the results of the empirical literature with examples of how concrete sanctions regimes and factors have interacted and produced good, mixed or bad results. Some lessons learnt are:

- Sanction costs for the target: while the empirical literature indicates that high costs are important for success, the case of Iraq shows that imposing high costs on the target country is no guarantee for success.
- Participation of international institutions: gives strong legitimacy to sanctions and were important in all three case studies.
- Duration of sanctions: while empirical studies indicate that time is a negative factor for sanction success, the long duration of sanctions was important in the cases of Libya and South Africa. Costs accumulated over time and some costs only materialised once economic and technological problems became acute, e.g. in the Libyan oil industry.
- Especially when sanctions are imposed over longer periods it is difficult to assess how important they were in relation to other contributing factors to changing political behaviour. The loss of domestic and international legitimacy of the apartheid regime in South Africa over time was not only the result of sanctions.

## 4 The economic situation in Russia

The aim of this chapter is to give a picture of the Russian economic situation in 2014–2015 and the policies adopted by the Russian government to alleviate the effects of the country's economic decline. In addition, the chapter identifies a range of domestic and international factors that interact with the sanctions (together with the more general factors identified in Chapter 3) and affect the prospects of sanction success.

### 4.1 Declining growth due to weak institutions

In 2013, Russian growth plummeted to 1.3 per cent a year instead of the 2–3 per cent forecast. The confidence crisis following Russia's annexation of Crimea and its continuing aggression against Ukraine lowered growth expectations, and in October the IMF (2014) revised its forecast to 0.2 per cent growth for 2014, 0.5 per cent for 2015 and a recovery to 1.5 per cent only in 2016. In January 2015, however, the preliminary result for 2014 was 0.6 per cent growth and the IMF (2015) now projected a contraction of –3 per cent for 2015 and –1 per cent for 2016. Western sanctions, Russian counter-sanctions and the dramatic fall in the oil price had added to the negative trend. In April 2015, the World Bank (2015b) presented three scenarios with growth rates between –2.9 and –4.6 for 2015 and 0.1 to –1.0 for 2016. The baseline scenario is described in Table 4.1 and indicates –3.8 per cent for 2015 and –0.3 for 2016 (Table 4.1).

Russia's current economic situation stems from multiple accumulating problems and is not just the consequence of Western sanctions or of President Putin's authoritarian domestic policies during his third presidency. Despite discussions over the years and a serious modernisation proposal by then President Dmitry Medvedev in 2009,<sup>18</sup> Russia has not managed to cast off its dependence on the

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<sup>18</sup> The "Russia, forward!" modernisation programme was launched in September 2009 (Medvedev 2009, discussed in Oxenstierna 2009: 43–45). This programme saw the whole energy industry, nuclear energy, the pharmaceutical industry and IT as the core areas. Generally the programme aimed at improving the conditions for development – better institutions, more investment, developed infrastructure, innovation and support for intellectual achievements. Medvedev's analysis of the situation in 2009 was in many respects a strong criticism of the results of Putin's

export of hydrocarbons and there do not seem to be any new innovative products “made in Russia” in prospect or a policy that would improve the chances of a change.

**Table 4.1 Macroeconomic development in Russia, 2012–2015**  
(*World Bank baseline scenario 2015*)

	2012	2013	2014	2015	2016
Oil price, USD/bbl	105	104	97.6	53.2	56.9
GDP growth, %	3.4	1.3	0.6	−3.8	−0.3
Consumption growth, %	6.4	3.9	1.5	−5.3	−1.9
Gross capital formation growth, %	3.0	−6.6	−5.7	−15.3	1.1
General government balance, % GDP	0.4	−1.3	−1.2	−3.6	−3.1
Current account, USD billion	71.3	34.1	56.7	73.7	62.9
Current account, % GDP	3.6	1.6	3.0	6.0	4.4
Capital and financial account, USD billion	−32.3	−56.2	−143.2	−122.1	−60
Capital and financial account, % GDP	−1.6	−3	−7.7	−10	−4.2
CPI, average, %	5.1	6.8	7.7	16.5	8.0

Source: World Bank (2015b: 24).

A big difficulty for any modernisation programme in Russia is that the economic system that has developed since the reforms in the 1990s still bears features of the Soviet command system. Despite the change of system from a command economy to a market economy, the institutions that normally support market allocation are weak and in many ways they are overruled by informal institutions surviving from the Soviet era and by new variants of personal management that have evolved during Putin’s reign. That Russia’s market institutions are deficient is reflected in the Worldwide Governance Indicators (WGI 2014). The WGI project constructs aggregate indicators of six broad dimensions of governance: political stability and absence of violence/terrorism; voice and accountability; government effectiveness; regulatory quality; rule of law; and control of

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previous two terms as President: the economic structure was backward, corruption was out of control and society was too paternalistic (ibid.).

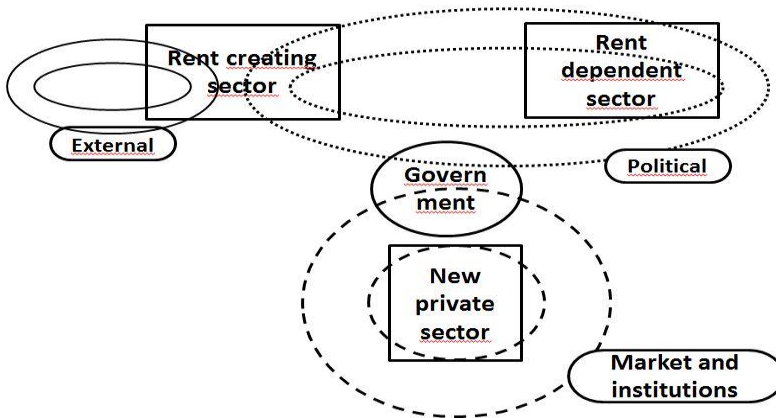
corruption. When these indicators are studied over time it is found that in Russia they have generally been low but that they improved up to the early 2000s. However, since 2004 there has been a marked deterioration in vital institutions like “rule of law” and “control over corruption” (Oxenstierna 2014: 32–36). “Voice and accountability” shows a downward trend over the whole period of Putin’s leadership since 2000 (ibid.). Weak institutions create scope for personal management of economic matters by the political sphere which is one reason why institutions in Russia need to be kept weak. With weak institutions and personal management, political rather than economic goals can be pursued.

## 4.2 The rent-dependent economy

The present Russian economic system may be characterised as a hybrid of the old Soviet heritage with inefficient state-owned or state-controlled subsidised enterprises and state intervention, on the one hand, and a market economy consisting mainly of the small and medium-sized business sector that evolved after the change of systems, on the other. In Putin’s power balancing system, the loss-making “Soviet-type enterprises” are subsidised to ensure continuing support for the regime. Rents from high oil prices have been distributed in what Gaddy and Ickes (2010, 2015) call a “rent management system” and economic behaviour has been labelled “rent addiction” (ibid.), alluding to the fact that when rents from natural resources are invested in inefficient production by loss-making firms, so-called “addicts”, these will continue to demand resources in order to save jobs and capital already installed. Oxenstierna (2014, 2015) argues that this preservation of the old industrial structure and the politically-driven system for distributing rents are inhibiting the growth of the private market-oriented sector. The rent-addicted sector operates under different rules and boundaries and uses political ties to obtain resources and factors of production.

Figure 4.1 depicts an economy with government and three sectors – the rent-creating sector (basically the oil and gas industry in the case of Russia), the rent-dependent sector (Soviet-type enterprises in need of subsidies, such as the lion’s share of the defence industry) and a private sector (first and foremost companies that were started during the transition that are operating under market rule). The circles around the sectors represent the different forms of boundaries that set the rules for the economic actors in each sector.

**Figure 4.1 Types of boundaries and control in a rent-dependent economy**



Source: Oxenstierna (2015: 101).

The three types of boundaries are: external markets; political rules and incentives; and markets and institutions supporting the market. The behaviour of the rent-creating sector is in some respects restricted by the rules of the external markets where it sells a large share of its products and by the demands of the political establishment that controls its assets and distributes the rents. The rent-dependent sector is controlled only by the political sphere. The behaviour of the new private sector is governed basically by market rules and institutions but is influenced by the rent management system since it deprives small and medium-sized enterprises of factors and inputs. Lack of credit and of qualified workers has been a constant complaint by these businesses.

This model of the economic system under Putin provides an explanation of the weak institutional framework and poor business climate in today's Russia.<sup>19</sup> It explains why attempts to reform the economy and build stronger institutions

<sup>19</sup> Russia was at place 120 in the World Bank's Doing Business Index in 2012 (World Bank 2015a) and did improve its rating to 62 in 2015, which is partly due to St. Petersburg being included in the index. See further Oxenstierna 2014: 27–28, 2015: 105–107).

constantly fail: only the new private sector would gain from a more genuine market allocation with rule of law and strong institutions. Competition on equal terms would benefit its companies and the sector would expand. The rent-addicted part of the industrial sector, however, is not interested in institutional reform and more competition; more market and competition would just entail serious risks to its survival (Oxenstierna 2014, 2015). The uncompetitive “addicts” are much better off with the political rent distribution system where their skills in showing loyal support for the government and playing the political game to get subsidies and resources could pay off. The government is not interested in institutional reform since it would deprive it of or weaken its major tool for controlling resource allocation – personal control over the rent management system. The actors in the rent-creating sector could survive in a market environment, and have adapted to the rules of the external markets, but they have chosen to support the regime in their domestic activities in order to survive under Putin.<sup>20</sup> This means accepting the rent sharing expected by the government and buying overpriced goods and services from the addicts (Gaddy and Ickes 2015: 25).

When rents decline, which is presently the case, the “addicts” supporting the regime still need to be satisfied. In the present situation of falling oil incomes and Western sanctions the politicised and administratively managed resource allocation system will still ensure that the rent-dependent sector gets the lion’s share of the diminishing financial and real resources. State support for them will continue because reducing rent flows to established claimants is too risky.<sup>21</sup> The import substitution strategy (see further Section 4.6) launched by the government is a splendid example of how to give the “addicts” what they crave while the rest of the economy will suffer from goods of lower quality at higher prices than similar imported products. The economic decline thus reduces the efficiency of the economy since more competitive players outside the rent distribution system will get less. A similar point is made by Connolly (2015: 20–21) who emphasises the emerging features of a more dirigiste system of political economy that emphasises self-sufficiency.

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<sup>20</sup> This has been their consistent strategy since the imprisonment of former oil oligarch Mikael Khodorkovsky who served 10 years in prison for opposing Putin.

<sup>21</sup> It could lead to strikes and open protests as happened in the 1990s, which Putin may have difficulty controlling (Gaddy and Ickes 2015: 29).

## 4.3 Fiscal policy

The federal budget reflects the priorities of different public spending areas.<sup>22</sup> Since 2007 the budget has taken a three-year format but the budgets for the two later years are preliminary. Each year the budgetary process coordinated by the Ministry of Finance takes place between July and September and the Duma approves the federal budget in November. It is then signed into law by the President (Cooper 2013: 15).

The budget for 2015–2017 (FZ-384) was adopted by the Duma in November 2014 (tables 4.2 and 4.3). The Ministry of Finance had opted for a minimal budget deficit of less than 1 per cent and fierce discussions had accompanied the budget process within the government on where the cuts should be made, and not the least on how far defence spending could be preserved at high levels when other public spending had to be reduced.

The budget law implied a defence budget of 4.2 per cent of GDP in 2015 (Table 4.2) although Minister of Finance Anton Siluanov had already signalled that a new defence programme needed to be developed that took into account the changed economic situation (Reuters 2014).<sup>23</sup> However, not only defence spending had to be cut. As it became increasingly obvious that the oil price would not be around USD 100/bbl but rather around USD 50/bbl in 2015 and that GDP would contract, the Ministry of Finance prepared amendments to the whole budget that were discussed during the first months of 2015. The new amended budget for 2015 was adopted by the Duma on 7 April 2015 and embodied a much lower estimate for GDP in 2015.

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<sup>22</sup> As an example, the priority being given to defence is reflected in the increasing GDP share of national defence in the federal budget. It rose to 2.9 per cent in 2012, to 3.1 per cent in 2013, to 3.5 per cent in 2014 and 4.3 per cent in the revised budget for 2015 (Table 4.2).

<sup>23</sup> This was an echo of Siluanov's veteran predecessor, Alexei Kudrin, who quit in protest when the rise in military spending was initially proposed under President Medvedev in September 2011. At that time, however, the funding of the military reform and the rearmament programme was based on the assumption that Russia would maintain its unprecedented high growth rate of 6 per cent per year throughout the decade.

**Table 4.2 Federal budget items as shares of GDP in Russia, 2012–2015; percentage of GDP**

	<b>2012 Actual</b>	<b>2013 Actual</b>	<b>2014 Actual</b>	<b>2015 FZ-384</b>	<b>2015 New budget</b>
<i>Federal budget as % of GDP</i>	20.6	19.8	20.9	20.0	20.8
General state issues	1.3	1.4	1.3	1.4	1.5
National defence	2.9	3.1	3.5	4.2	4.3
National security and legal	2.9	3.0	2.9	2.8	2.8
Support to the economy	3.1	2.7	4.3	3.0	2.9
Housing and utilities	0.4	0.2	0.2	0.2	0.2
Environmental protection	0.0	0.0	0.1	0.1	0.1
Education	1.0	1.0	0.9	0.8	0.8
Culture	0.1	0.1	0.1	0.1	0.1
Health	1.0	0.8	0.8	0.5	0.5
Social policy	6.2	5.7	4.9	5.2	5.8
Physical culture and sport	0.1	0.1	0.1	0.1	0.1
Media	0.1	0.1	0.1	0.1	0.1
Debt service (state and municipal)	0.5	0.1	0.6	0.6	0.8
Inter-budgetary transfers	1.0	0.6	1.1	0.9	0.8
Deficit/surplus	–0.1	–0.8	0.5	–0.6	–3.7
<i>GDP billion RUB</i>	62 599	67 519	70 976	77 499	73 119

Sources: Federal Treasury (2013)—data for 2102 and 2013;  
Ministry of Finance RF (2015a: 2015b)—data for 2014 and 2015.

As seen in Table 4.3, forecast GDP is almost 6 per cent under that in the original budget law. The new law applies to 2015 only and the Ministry of Finance will introduce changes related to 2016 and 2017 in September 2015. The new law is based on the assumption of an oil price of USD 50/bbl and a 3 per cent contraction in GDP. Budget revenues are projected to decrease by 3.3 per cent of GDP while expenditure decreases only marginally, from 20.9 in 2014 to 20.8 per cent of GDP in 2015. The deficit rises to 3.7 per cent of GDP and the Reserve Fund will be the main source of deficit financing (World Bank 2015: 26). This means that in total RUB 3.2 trillion (about USD 50 billion) will be drawn from the Reserve Fund, which corresponds to about 60 per cent of the whole fund (USD 85 billion) (Reuters 2015a). This reduces Russia's room to manoeuvre in the future unless the economy recovers or Western financial markets open up for Russian state banks.

**Table 4.3 Russian Federal budgets 2014 and 2015 and new budget 2015; million RUB and per cent**

	2014	2015	2015	2015	Change %
	Actual	Budget law FZ-384	Proposed change	New budget April 2015	from FZ-384 to new budget
Total spending	14 830 601	15 513 079	-298 035	15 215 045	-1.9
State administration	934 741	1 113 735	-33 669	1 080 066	-3.0
National defence	2 479 074	3 273 991	-157 218	3 116 774	-4.8
National security and legal system	2 086 165	2 148 072	-80 423	2 067 649	-3.7
National economy	3 062 915	2 338 749	-205 897	2 132 852	-8.8
Housing and municipal services	119 609	144 606	-15 603	129 003	-10.8
Environmental protection	46 366	54 947	-8 868	46 079	-16.1
Education	638 265	632 976	-30 867	602 108	-4.9
Culture	97 832	99 008	-7 115	91 893	-7.2
Health	535 564	420 940	-34 730	386 210	-8.3
Social policy	3 452 374	4 010 082	203 639	4 213 721	5.1
Physical culture and sports	71 164	73 662	-1 818	71 844	-2.5
Media	74 832	69 971	2 152	72 124	3.1
Debt service	415 612	449 304	135 996	585 299	30.3
Transfers between budgets	816 090	683 037	-63 614	619 423	-9.3
Deficit		-431	-2 245	-2 673	
GDP billion RUB	70 976	77 499	-4 380	73 119	-5.7

Source: Ministry of Finance RF (2015a: 8, 2015b).

As shown in Table 4.3, the defence budget has been cut by almost 5 per cent (in nominal terms) compared to the original budget FZ-384. Its share of GDP remains high, 4.3 per cent. National security – much less discussed but an item that has had high priority and grown during the Putin era – similarly sees reductions. Support for the national economy is cut by 8.8 per cent, which is quite courageous of the government considering the difficulties Russian companies are experiencing under present circumstances. Furthermore, spending on many of the items that affect the population most, such as the health sector, protection of the environment, education and culture, has been reduced and it will be interesting to see if this has any effect on public opinion. Nevertheless,

social policy sees increased funding, which will be devoted to pensions and social provisions for the households most hit by the economic decline (World Bank 2015b: 26).

## 4.4 Economic policy

So what is the government doing to mitigate the poor economic prospects? It has initiated an anti-crisis programme worth USD 35 billion (about 1.5 per cent of GDP) (Government 2015; Reuter 2015b). The plan was rather vague as to what was to be cut in public spending in order to afford this programme since it was presented after the original budget was adopted in November 2014 and before the new budget that was adopted only in April 2015. Most of the spending goes to the banking sector to smooth the credit crunch that is the result of limited access to Western capital markets and is inhibiting investment. It follows that major state investment programmes are being delayed, with the important exception of those on Crimea.<sup>24</sup>

### *Government bail-outs of company debts*

The financial sanctions are causing the most trouble in the short run since they create serious difficulties for sanctioned state banks and large state companies which need to refinance their debt. Therefore there is strong pressure on government reserves, which has resulted in a large part of planned infrastructural investments and other long-term government programmes having to be put on hold in favour of more immediate payments. As early as August 2014 Rosneft, the big state oil company, applied for state support of over USD 40 billion to refinance its debt (Kragh 2014: 60).

### *Amnesty on repatriated capital*

Moreover, the financial restrictions have enhanced a sharp rise in capital flight from Russia. In 2014 capital flight amounted to USD 152 billion compared to USD 61 billion in 2013, that is an increase by a factor of 2.5 (IMF 2015). For 2015 an outflow of USD 115 billion is expected (ibid.). In response to these tendencies and the difficulties of accessing Western financial markets, Putin announced an amnesty for capital returned to Russia in his annual statement to the Federation Council on 4 December 2014 (Poslanie 2014). In March 2015 a

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<sup>24</sup> According to Kragh (2014: 60) in July 2014 the Russian government allocated USD 21 billion for infrastructure and welfare programmes in Crimea up to 2020.

draft law was sent to the Duma but the topic of the law is now not a capital “amnesty” but “simplification of the declaration of assets” (Vedomosti 2015a). The main reason for this change of wording appears to be second thoughts about the possibility not only that a full amnesty could be used by tax-evading citizens and firms but also that it could become an instrument for laundering money originating in organised crime and terrorism, concerns that were raised by critics. The law will not require the return of assets to Russian territory, demanding only their registration in a “transparent” jurisdiction that is not blacklisted by the Financial Action Task Force (FATF). Under the proposed legislation, the declared assets will not be subject to a one-time tax and will not be used for criminal investigations (Blomberg 2015). The law was to be adopted around 1 July 2015.

#### *National payment system*

In response to the financial sanctions, which imply that five state banks cannot be served by Western counterparts, and probably to earlier threats that it would be banned from the SWIFT international bank communication system, Russia has taken serious steps to develop its national payment system.<sup>25</sup> On 1 April 2015 a national card payment system was introduced. The large credit card companies MasterCard and Visa are now forced to clear their transactions in Russia through this system since the alternative would have been to deposit sums exceeding their turnover in Russia in the Central Bank.<sup>26</sup> The next stage should be the Russian national payment system’s issuance of plastic cards, which is scheduled for December 2015 (RBH 2015b).

## 4.5 Import substitution

However, the main new direction and new paradigm in Russian economic policies is “import substitution”. Hereby the Russian economy should take advantage of the current situation and advance domestic industry and production

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<sup>25</sup> Payment systems are used in lieu of tendering cash in domestic and international transactions and are a major service provided by financial institutions. A large number of electronic payment systems have emerged. These include debit cards, credit cards, electronic funds transfers, direct credits, direct debits, internet banking and e-commerce payment systems. Standardisation has allowed some of these systems to grow to a global scale, e.g. credit cards, ATM networks and the SWIFT network that is used to transfer money internationally.

<sup>26</sup> Morgan Stanley has estimated the figure at USD 950 million for Visa and USD 500 million for MasterCard (RBH 2015b).

that should replace foreign products on the Russian market. In April 2015 the Ministry of Industry and Trade presented a plan for how Russia should become more self-sufficient by implementing 2 059 projects in 19 branches of the economy up to 2020 (Novoe Vremya 2015: 19). The cost is estimated at RUB 1.5 trillion, of which only RUB 235 billion will come from the federal budget (ibid.).

Many Russian observers point out the difficulty of this scheme given the relatively high import dependence of the Russian economy after almost 25 years as an open market economy and that the funds available for necessary investments are too small. Berezinskaya and Vedev (2015) highlight the fact that the general dependence on imports in production almost doubled between 2006 and 2013, from 8.5 to 14.7 per cent (Figure 4.2). In machine construction the figure has risen from 13.4 to 36.5 per cent. High shares may likewise be noted in communications and transport (Figure 4.2).<sup>27</sup>

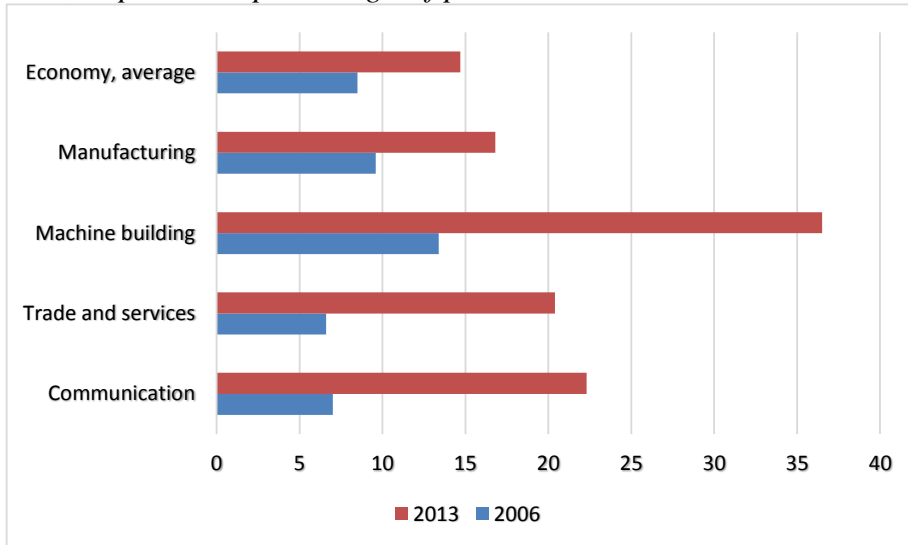
The main criticism from liberal economists, however, is directed towards the whole scheme. Vladimir Mau, Rector of the Presidential Academy of the National Economy, states that if the import substitution were geared to producing goods for export it might do some good, but currently it is only a way to provide domestic consumers with goods of lesser quality at higher prices (Vedomosti 2015b). Former Minister of Finance, now head of the Civil Initiatives Committee, Alexei Kudrin states that the economy is not up to modern challenges and foresees that Russian companies will take advantage of rising prices of imported goods to hike prices for their not-yet-competitive goods. Eventually they may invest in new production and only in five or 10 years' time will they start producing goods that are close to those made in the West (RHB 2015a).

The economic rationale behind the import substitution policy is primarily the depreciation of the rouble: imported goods have become expensive. The political rationale behind the scheme, however, is to use the weak currency and counter-sanctions to give the advantage to Russian domestic producers that are not competitive. Under the policy of import substitution they can gain market shares although their products are of inferior quality to imported goods. Thus, this is a way of transferring money to the rent-dependent sector and draining the rest of the economy of scarce resources.

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<sup>27</sup> These figures are calculated in current prices. In fixed 2005 prices the average import dependence in the Russian economy is assessed at 21 per cent (Berezinskaya and Vedev 2015: 106).

**Figure 4.2 Import dependence in the Russian economy 2006 and 2013; imports as a percentage of producers' total costs**



Source: Berezinskaya and Vedev (2015: 104).

### *Counter-sanctions*

The idea of import substitution likewise permeates the Russian one-year ban on the import of certain foods from the EU, the US, Australia, Canada and Norway imposed on 7 August 2014 (Government 2014). The list of products that should not be imported includes meat in all forms, fish, dairy products, fruit and vegetables. The idea is that by banning these imports domestic production of food should increase. However, there is a significant dependence on imports even in Russian food production<sup>28</sup> as well as capacity constraints. At the moment opportunities for getting necessary investment and acquiring the needed technology are small due to the weakness of the rouble and the lack of equipment on the Russian market. Thus, in the short run the most evident effect of the counter-sanctions is increased food prices and higher inflation.

<sup>28</sup> Apparently in meat there is a dependence of 20 per cent, in fish and seafood the corresponding figure is 28 per cent, and in the production of vegetables and fruits it is 33 per cent (Berezinskaya and Vedev 2015: 108). In more advanced production there is a need for more advanced technology if Russia is to become more self-sufficient, e.g. in the production of food enzymes import dependence is presently 68 per cent (ibid.).

*Gosplan revisited?*

On 29 April 2015 the draft law on import substitution passed the Duma at the first of three readings. The proposed law entails that a “coordination centre” will be established that will control public procurement, all projects with support from the government and the exploration of natural resources. The coordination centre should be led by Prime Minister Dmitry Medvedev. The idea behind this scheme is to verify that projects funded by the government apply import substitution and to ensure that Russian companies are given the advantage in procurement (Kommersant 2015). However, all the large oil companies have protested against the proposed law and argued that making their purchasing public would make them more vulnerable and open to new targeted sanctions, the more so since the inputs they need are not available on the Russian market (ibid.). This “mini-Gosplan/coordination centre” reinforces the impression that the government is using the situation to increase its administrative control over resource allocation in order to ensure that the rent-dependent sector’s claims are satisfied.

## 4.6 Reorientation of trade?

The EU has been Russia’s most important trade partner since Russia introduced a market economy in the 1990s. In 2013 53 per cent of Russia’s exports of goods went to the EU and 46 per cent of imported goods came from the EU (Nelson 2015: 7). European banks hold 75 per cent of foreign bank loans to Russia and substantial stocks of FDIs (ibid.). It follows that it will take time for Russia to change its trade orientation if it wants to replace part of the forgone exports and imports to and from Europe with trade with Asia, BRICS, Latin America or the CIS. In the 2010s, about 80 per cent of its energy exports went to the West<sup>29</sup> and 10 per cent to Asia (Oxenstierna 2012: 96). According to Mau (2015: 14) cooperation with BRICS cannot resolve the major challenges of attracting investment and technology. Expanding the cooperation with the countries in the Eurasian Customs Union (EACU) is a plausible option but it would imply embarking on a “special route” going backwards rather than forwards (ibid.).

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<sup>29</sup> In 2011, 90 per cent of oil, 70 per cent of gas and 50 per cent of coal from Russia went to the EU. This represented about 30 per cent of the EU’s imports of each of these fuels (Oxenstierna and Tynkynen 2014: 6).

Nevertheless, some steps have been taken to increase cooperation with China. Oil and nuclear power have long been areas of cooperation with the ESPO oil pipeline and Russia building nuclear reactors for China's ambitious nuclear energy programme. In 2013 Rosneft won a deal to double its supplies to China and in May 2014 a gas deal was finally struck implying that Russia and China will build the "Power of Siberia" gas pipeline from eastern Siberia to China and Russia will export 38 bcm of gas to China from 2018 for 30 years. This is a great achievement for Russia but the deal corresponds to only 23 per cent of Russia's yearly gas exports to Europe (Carlsson et al. 2015: 52–53). In addition, China and Russia have discussed a gas project from western Siberia into China's western provinces, the so-called "western route" or Altai project, since 2006. During President Putin's visit to Beijing in November 2014 a new memorandum of understanding concerning the export of gas to China via the Russian republic of Altai was signed. The Altai pipeline would allow Russia to optimise sales from Gazprom's vast west Siberian resource base and to provide an arbitrage opportunity for switching sales between Europe and Asia (Henderson 2015).

In addition, in May 2015 Gazprom reached a deal with Turkey to build a "Turkish Stream" pipeline across the Black Sea. This project replaces the stalled "South Stream" project that met with objections from the EU and was cancelled by Putin in December 2014. The first Turkish Stream pipeline would deliver 16 bcm gas a year for the domestic Turkish market from 2016. Gazprom plans to extend the network so that additional pipelines would deliver another 47 bcm – almost equivalent to the volume transited through Ukraine – to the Greek-Turkish border (Financial Times 2015). Thus, Russia is seriously trying to develop its gas exports to new customers and find new routes to existing clients; but there are question marks regarding the viability of these projects. Who would take on further pipeline building from Greece further into Europe? Gazprom can hardly develop both the Altai project and the Power of Siberia at the same time, and how will plans with China finally develop?

Western sanctions have closed Russia's access to Western defence and dual-use technologies and Russia has lost the quite extensive arms cooperation with Ukraine (see Section 5.2). This could open up scope for new Russian-Chinese defence industry cooperation. Russia's dependence on the West in electronics needs to be neutralised. China has developed its indigenous production, and Russia could use Chinese electronics in its arms development (Carlsson et al. 2015: 56).

## 4.7 Perceptions of the sanctions in Russia

In the Russian narrative the sanctions are interpreted as but one component of a broader-based Western strategy seeking to weaken Russia. Ultimately, according to the propaganda, the goal would be to bring about regime change in Moscow and “the American and European sanctions originate from an aggressive, illegitimate and counterproductive policy where Russia finds itself in a purely defensive position” (Fisher 2015: 3). It is further claimed that the sanctions are the product of American unilateralism whereby Washington has forced the EU member states to pursue a policy that contradicts their interests (ibid.). Thus, the propaganda blames all economic hardship on the West and by claiming that the goal is to bring about regime change and not only policy change the nationalistic “rallying around the flag” and anti-Western sentiments are fuelled. The West has so far not managed to counteract the misconceptions of the goals of the sanctions among the Russian population.

The Russian narrative of the events in Ukraine has strengthened support for the regime at home on the basis of loyalty, nationalistic and anti-Western attitudes. It is not only the economic sanctions that are used to “prove” that the West is hostile. Individuals who have been publicly targeted by asset freezes and travel restrictions in the sanctions targeting individuals proudly declare their appearance on Western sanctions lists as a sign of their patriotic solidarity with the fatherland and the political leadership (ibid.: 4). In a Levada<sup>30</sup> public opinion survey in December 2014 only 12 per cent of the population associated the West’s actions with the fact that Russia had annexed foreign territory and violated international law, while almost 70 per cent saw it as the result of the West’s hostile attitudes and wish to exert pressure on Russia (ibid.).

The Russian propaganda directed at Russian-speakers abroad is part of a broader soft power strategy<sup>31</sup> (Persson 2015: 22) and the authorities are using both Russian-speaking and English-speaking media and internet sites to spread Russian views as part of the strategy to increase Russia’s influence and interfere in other countries’ internal affairs (Winnerstig 2015: 142).

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<sup>30</sup> The Levada Center is a Russian independent, non-governmental polling and sociological research organisation.

<sup>31</sup> A basic law regulating the policy regarding compatriots is the Law on state policy on compatriots abroad, which was adopted in 1999.

## 4.8 Concluding remarks

It is clear that the Russian government has chosen a strategy of more state intervention and more political control over resource allocation and rents. From the outside this looks suboptimal, but given the fact that rent addiction is a major characteristic of the economic system under Putin it is a logical strategy. Putin must ensure that the rent-dependent economic actors are taken care of in managing the political risk. The result will be further decline or at best stagnation of the economy, but saving the “addicts” is probably the best bet for maintaining political power and stability in the short run. In the medium and long run, however, suffocating the oil producers that “lay the golden eggs” and depriving the new private sector of its potential for growth will push the economy back. Many of the tremendous achievements of the transition in terms of true system change will come undone and will need to be re-enacted after an indispensable political reform which is a necessary condition for reviving the Russian economy.

Table 4.4 summarises the factors specific for Russia that are increasing/decreasing the effects of Western sanctions on the Russian economy and the prospects of sanction success.

### *Comments on the counter-sanctions*

The effects of the counter-sanctions on Russia’s trade partners are beyond the scope of this report, but some comments can be made.<sup>32</sup> The counter-sanctions appear primarily to be a political gesture: some non-military response to the economic sanctions had to be presented. They hurt mainly agricultural producers and the transport sector in the countries trading in these products and services. Yet the weakness of the rouble has affected trade more. Moreover, the efficiency of counter-sanctions is significantly undermined by the fact that this kind of

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<sup>32</sup> It should be stressed that these comments are not based on findings from an investigation, but represent a view that has been formed in informal discussions in April–May 2015 with some Stockholm-based official representatives of some EU countries that have relatively high trade dependence on Russia and the presentations and discussion at the seminar “Economic development in the East and the West and their effects on Baltic countries” arranged by the Lithuanian Business and Professional Club, the Investment and Development Agency of Latvia and the Estonian-Swedish Chamber of Commerce in Stockholm on 18 May 2015.

retaliation measure has been used quite often in the past by Russia vis-à-vis individual countries. Western companies active on the Russian market know how to circumvent these administrative restrictions (e.g. by engaging a third country in the transactions). Moreover the counter-sanctions give strong incentives for countries that have earlier devoted great effort to penetrating the Russian market to look elsewhere for more reliable trade partners.

**Table 4.4 Specific factors affecting the effects of sanctions on the performance of the Russian economy**

<b>Strengthening the effects of sanctions</b>	<b>Weakening the effects of sanctions</b>
<i>International</i>	<i>International</i>
Low oil price, depreciation of the rouble, deterioration of ToT, capital flight	Third-party countries (BRICS, CIS, Turkey, Latin America) may potentially replace part of the trade with the EU
<i>Domestic</i>	<i>Domestic</i>
Rent addiction and a politicised economic system where control over rent distribution is crucial for staying in power. Preference for rent-addicted sector lowers efficiency	The authoritarian political system that is less sensitive to falling living standards of the population than a democracy and can protect supporting elites from economic hardship
Weak institutions	An effective propaganda machine that controls public opinion and manipulates perceptions about the sanctions among the Russian population
Fiscal deficit	
Maintained high priority for defence spending	
Import substitution and more administrative control over resource allocation that increases inefficiency	
Counter-sanctions that lead to higher prices and inferior goods	

Source: The authors.

## 5 Effects of the sanctions and the prospects of sanction success

In this chapter, the analytical framework presented in Chapter 3 is applied to assess the effects of the sanctions on the Russian economy and the prospect of the West reaching the goals of the sanctions: to impose a significant cost on Russia for its behaviour towards Ukraine and to produce a change in Russia's foreign policy. The theoretical model (Figure 3.1) entails that the effects of sanctions and sanction success depend on the sanctions imposed (see Chapter 2) and on other factors that amplify or weaken the effects of the sanctions. Relevant factors that increase or decrease the effects of sanctions in general were identified in the empirical sanctions literature (Chapter 3, summarised in Section 3.5) and those specific to Russia are identified in Chapter 4 (summarised in Table 4.4).

### 5.1 Effects of the financial sanctions

There is still no comprehensive analysis of how the sanctions are hitting the Russian economy and even less of the magnitude of the effects because the sanctions interact with other factors and it is difficult to isolate the sanctions from these. Nevertheless, the World Bank (2015b: 38–39) argues that Western sanctions have hit the Russian economy through three distinct channels. First, they have caused volatility on the foreign exchange market and a significant depreciation of the rouble (*ibid.*). This has led to capital flight and the deterioration of Russia's international reserves. Second, the restriction on access to international financial markets has tightened domestic and external credit conditions and this had a negative effect on investment and consumption. These are the sanctions that have impacted the economy most in the short run since they inhibit investment and refinancing of major state banks and other financial institutes which affects the whole economy. In addition, the key income-earning state oil company Rosneft is directly targeted by these sanctions as well as companies in the defence sector. This adds to the general credit crunch.

The third channel cited by the World Bank is the crisis of confidence that has developed as a consequence of the geopolitical tension and sanctions. It has resulted in great uncertainty regarding policy and economic development. Consumption growth slackened in 2014 and fixed investment contracted. Foreign

direct investment was halved in the first three quarters of 2014 compared with the same periods in the three years 2011–2013. In addition trade flows have been impacted and imports have decreased mainly due to the weakening of the rouble and the Russian counter-sanctions banning certain food imports, which have spurred inflation (*ibid.*).

The analysis of the Russian economic situation shows that the effects of the financial sanctions have been strengthened first and foremost by the dramatic fall in the oil price. This external factor has affected the federal budget negatively and led to expenditure being cut, which will contribute to a contraction of GDP in 2015 and 2016. The budget is no longer balanced and to finance the deficit over half of the Reserve Fund will be used in 2015 alone, which puts further pressure on the quite undeveloped domestic financial system. This has contributed to the further deterioration of the rouble which in turn has weakened Russia's terms of trade<sup>33</sup> and increased inflation.

The politicized economic system increases the losses of the economy. When rents are scarce subsidising rent-addicted producers becomes relatively more expensive. Yet, as argued in Chapter 4, the addicts' claims need to be met in order to maintain power and avoid political unrest. In addition, the fact that companies both in the rent-creating sector, e.g. Rosneft, and in the rent-dependent sector, e.g. Uralvagonzavod, are directly targeted by the financial sanctions puts enormous pressure on the state for financial support, while because of falling budget revenues there is a deficit which needs financing too. All this means that there is extremely limited room for productive investment for small and medium-sized enterprises. The new private sector will not expand in this environment where financial resources become even scarcer for this sector than they were before.

The responses of the Russian government to the difficult economic situation in the form of counter-sanctions and import substitution further emphasise the dirigiste features of the Russian political economy. The attempt at self-sufficiency supports uncompetitive producers but will lead to higher prices and

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<sup>33</sup> Terms of trade (ToT) is defined as the ratio of export prices to import prices. ToT describes the amount of import goods an economy can purchase per unit of export goods. A fall in a nation's terms of trade means that it can buy less imports for any given level of exports.

lower quality in the short and medium run. In the long run the Russian government appears to be opting for a Putinist version of “back to the USSR”. In this context a reminder seems to be appropriate: the big “advantage” of the Soviet command economy model was that the military sector could be protected from all demands for economic efficiency and it had absolute priority in resource allocation.

## 5.2 Effects of sanctions targeting the energy and defence sectors

The effects on Russia’s oil and gas export volumes have not been too evident yet. This is due to the fact that oil and gas contracts are usually set for a longer period and that the sectorial sanctions target future oil and gas production. Yet the EU and US bans on the export of advanced equipment for oil and gas exploration cover 68 per cent of all Russia’s imports for this sector (Faltsman 2015: 118). The Ministry of Industry and Trade cannot see how these components can be replaced by Russian analogues in the near future. China could provide some products, but not at the same quality. Most of the oil rigs are imported from South Korea, but half of the hydraulic pumps for oil come from Germany, Ukraine, Italy and the US and only 15 per cent from China (ibid.).

The embargo on advanced equipment for oil and gas exploration is mainly hitting the new exploration projects on the Arctic shelf. Although some offshore equipment comes from South Korea, Russia can hardly manage without Western technology. The American energy giant ExxonMobil had to suspend its huge cooperation with Rosneft in the Sakhalin-1 project (Gazeta.ru 2014) and the Kara Sea due to the sanctions, and although the Rosneft says they will continue on their own, it is uncertain whether they can proceed (Reuter 2015d). In any case the present low oil price makes the costly Arctic exploration risky in terms of profitability and it may be postponed for economic reasons.<sup>34</sup>

The full impact of the advanced equipment sanctions will emerge in the long run. Probably they will negatively affect Russia’s domestic technological

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<sup>34</sup> The Shtokman gas exploration project was cancelled in 2012 for this reason.

development in the oil and gas area as well as the capacity to explore on the Arctic shelf. For the time being, however, the energy sector is more affected by the low oil price and the West's financial sanctions which have created great difficulty for refinancing debt on the Russian market due to the restrictions on state oil companies for raising funds for refinancing and investments on EU and US capital markets.

### *Defence industry*

The defence industry does not import very much from the West, but electronics is a tight spot. In rockets and space equipment imported components comprise 65–79 per cent of Russia's requirements (Faltsman 2015: 119). Russia is completely import-dependent when it comes to unmanned vehicles. Regarding civil aircraft, 90 per cent of aircraft are imported (ibid.). Western assessments suggest that as much as 90 per cent of electronic components in Russian armaments are of Western origin and that it would take at least six years for Russia to become self-sufficient in this area (Malmlöf 2015). Furthermore, it should not be forgotten that technology transfer has been an important part of the limited imports from the West. The cancellation of the delivery of the spectacular order for French Mistral-class amphibious assault ships is hurting the technological innovation process in the defence industry as well as future military capability at sea (Reuters 2015c). The reason for purchasing French helicopter carriers in the first place was that Russia cannot construct such ships by itself and there was a considerable technology transfer element to the project. Two of the ships were to be built in Russia according to the original plans.

The big set-back for the Russian defence industry, however, is the loss of the partnership with Ukraine. Between 2009 and 2013 Ukraine's share in Russia's imports of major conventional arms systems, components and subsystems amounted to 87 per cent (Malmlöf 2015). Thus, the dependence has been substantial and works both ways.<sup>35</sup> Many Russian companies are dependent on

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<sup>35</sup> During the Soviet period Ukraine specialised in the production of liquid-fuel heavy intercontinental and space rockets, aircraft carriers, heavy military transport aircraft and helicopter engines. Ukraine maintained a monopolistic position in these areas in the post-Soviet space in the 1990s and was then a crucial subcontractor to Russia's defence industry. Unlike Russia, Ukraine has not mastered the whole technological cycle for many of its products and has remained dependent on Russia, its main client. In the late 1990s Russia decided to shift to domestic

Ukrainian exports of components, but it should be borne in mind that there are many Ukrainian subcontractors that are dependent on contracts with Russian companies as well. It has been estimated that to replace this cooperation the Russian defence industry needs to be modernised, which would demand investment of around USD 20 billion over at least four years. Machine construction will be the most serious challenge for the defence sector (Faltsman 2015).

### 5.3 Effects of the sanctions on the political sphere

When it comes to the political effects of the sanctions the prospects are less clear. The short case studies of sanctions against South Africa, Libya and Iraq presented in Chapter 3 show that it takes a long time for the political goals of sanctions to be reached when the target state is an authoritarian regime. That it is more difficult to influence an authoritarian regime than a democratic one is a consistent result in the empirical sanctions literature. Russia today fulfils many of the criteria of an authoritarian regime and it follows that this factor weakens the prospects of achieving the political goal of the sanctions: Russia accepting Ukraine as an independent sovereign state and respecting its territorial borders.

The economic reason why authoritarian regimes are less sensitive to sanctions than democracies is that these regimes have relatively more control over resources and rents, which means that they can protect loyal elites from economic hardship and distribute resources as they decide in order to stay in power. In Russia, it is Putin's rent management system that fulfils this function. Furthermore, politically authoritarian regimes are not accountable to the population for their actions and they can manipulate public opinion by controlling the media and the internet and suppress and eliminate any opposition. Russia has used its propaganda machine to effectively disseminate disinformation about the conflict in Ukraine both at home and abroad, as well as giving its own version of why sanctions have been imposed: America wants to see regime change in Russia and has manipulated its European allies to take part

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production of many items previously produced by Ukraine. In connection with privatisations in the 2000s Russia has acquired shares in several Ukrainian defence companies (Malmlöf 2015).

in this scheme. Perceptions in Russia are manipulated and the Russian population do not understand the real aims behind the sanctions: The West wants Russia to leave Ukraine and respect it as a sovereign state. The regime's misinformation that is disseminated abroad mainly aims at creating uncertainty regarding what is false and what is true but is at the same time a tool for gaining understanding for the Russian position that Ukraine is part of Russia's "sphere of interest" and that Russia is saving Russians abroad from "fascist aggression".

The authoritarian nature of the Russian regime is thus a factor that on the one hand supports the sanctions by leading to slower growth due to the suboptimal resource allocation favouring the rent-dependent sector, but on the other counteracts the sanctions by protecting loyal elites and unopposed blaming the West for all economic hardship and Russia's isolation. The regime has shown strong state capacity in controlling public opinion, thus manipulating the perceptions of the population and creating inimical feelings towards the US and the EU.

Finally, the conflict is very important for both Russia and the West, which makes it challenging to find a resolution. The sanctions are costly for Russia but Russia is "defending" what it considers to be its "sphere of influence" and so far it finds it worth the expense. For the West it is important to show consistently that Russia's breaking of international law is unacceptable and that countries in its neighbourhood are independent and sovereign, even though the sanctions imply losses for their own businesses on the Russian market. Without a clear red line there is anticipation at least among some countries that Russia might pursue further territorial campaigns in its neighbourhood. Regrettably, results cited in the sanctions literature indicate that the greater the importance of the conflict issue the less likely it is that either target or sender will be willing to give up as they risk losing face both internationally and domestically.

## 5.4 The prospects of sanction success – a SWOT analysis

Will sanctions make a significant contribution to achieving the political goal? In order to answer this question we have arranged our findings in a so-called SWOT matrix that gives an overview of the strengths, weaknesses, opportunities and threats of the Western project.<sup>36</sup> We arrange our factors in a matrix under the headings strengths, weaknesses, opportunities and threats (Table 5.1) and divide them into two groups: factors that are internal to the EU and the US and factors that are external. The objective against which the assessment should be made is the prospect of changing Russia's behaviour towards Ukraine.

As may be seen in Table 5.1, all the strengths and almost all the opportunities identified in this report are economic while the majority of the weaknesses and threats are political factors. In combination with other factors, the sanctions have been successful in imposing costs on the Russian economy. They are well designed by the senders, targeting the financial sector and key actors and thereby not indiscriminately affecting great parts of the population. The support from external factors has been favourable and the macroeconomic situation in Russia has deteriorated. The systemic nature of the Russian economy which favours rent-addicted producers over competitive ones in resource allocation and rent distribution is adding to the economic decline. The Russian government's isolationist and protectionist policy responses are adding to the economic decline, but at the same time the regime's rent management system is a vital tool to protect the elites that represent the political base for its political survival from economic hardship and ensure continuing support for the regime staying in power. The weaknesses and threats challenging the continuing impact of the economic sanctions are mainly political in their nature and need to be addressed by political means.

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<sup>36</sup> SWOT stands for strengths, weaknesses, opportunities and threats. A SWOT analysis is a method used to evaluate projects and business ventures. The objectives of the project are specified and then internal and external factors that are favourable and unfavourable to achieve the objectives are identified.

**Table 5.1 The prospects of economic sanctions reaching the political goal. A SWOT analysis**

Type of factor	Strengths	Weaknesses
<b>Internal to the EU and US</b>	<ul style="list-style-type: none"> <li>-Sanctions have a sophisticated design and are targeted at core sectors of the economy</li> <li>-The importance of the conflict sustains the decisiveness of the West</li> </ul>	<ul style="list-style-type: none"> <li>-Costs for some EU senders due to the high trade dependence on Russia may affect the sustainability of the sanctions</li> <li>-Neither the EU nor the US is considering putting a military threat behind the sanctions</li> <li>-Prolongation and extension of sanctions have been made conditional on implementation of the Minsk 2 agreement. How do parties agree on what has been implemented or not implemented?</li> <li>-The importance of the conflict can make it hard to exit on a compromise with Russia</li> </ul>
	<b>Opportunities</b>	<b>Threats</b>
<b>External to the EU and US</b>	<ul style="list-style-type: none"> <li>-Low oil price. (An increasing oil price would be a threat)</li> <li>Weak rouble</li> <li>Deterioration of the terms of trade for Russia</li> <li>-A fiscal deficit that puts further stress on the Russian financial system</li> <li>-Russia's economic system which reinforces the economic decline</li> <li>-Despite the authoritarian nature of Putin's regime, it is sensitive to public opinion ratings. A fall in Putin's ratings is an opportunity</li> </ul>	<ul style="list-style-type: none"> <li>-Russia is an authoritarian regime that controls public opinion and suppresses the opposition. It is not sensitive to the falling living standards of the population as a democratically elected government would be</li> <li>-Russian propaganda at home and abroad manipulates perceptions.</li> <li>-Russia is trying to split the EU which could lead to a situation resembling "multiple senders" problems</li> <li>-Third countries can replace part of Russia's trade with the West</li> <li>-The importance of the conflict makes it hard for Russia to exit not only because of its interests in Ukraine but also due to the risk of "losing face"</li> </ul>

Source: The authors. SWOT – strengths, weaknesses, opportunities, threats.

## 6 Conclusions

This report has investigated the effects of the economic sanctions on the Russian economy and assessed the prospects of the sanctions reaching their aim of contributing to changing Russia's political behaviour towards Ukraine. The report uses a theoretical approach and empirical findings from the literature on economic sanctions. Previous research shows that for economic sanctions to affect the political behaviour of a target country they need to interact with different factors that translate the sanctions into certain effects that could impact the political establishment. These factors increase or decrease the effects of economic sanctions and can be of different kinds.

Three central questions guided our research of these matters. Are the sanctions effective in terms of the Russian economy being affected? How do the sanctions interact with other factors to the economic decline in reaching the goal of changing Russia's political behaviour towards Ukraine? And will the West's strategy succeed in compelling Russia to change its behaviour?

*Have the sanctions affect the Russian economy?*

Together with other factors the economic sanctions have impacted the Russian economy negatively. The geopolitical tension, threats of sanctions and the imposing of sanctions have produced a crisis of confidence that has hurt the willingness of both domestic and foreign actors to embark on business ventures in Russia and to invest. The financial sanctions have targeted Russia's main state banks and key companies, which has contributed to a strained financial situation in the whole economy and led to difficulties in refinancing debt in the short run and in financing investment, which affects Russia's economic development in the medium and long run. In addition, the EU and US export bans on specific products that are crucial for the energy and defence sectors will affect technological development in both these areas. The full effect of these sanctions is still to be seen.

*How do sanctions interact with other factors?*

The results of our analysis show that the sanctions have been amply reinforced by the fall in the oil price, the depreciation of the rouble and other variables, leading to a deterioration of the macroeconomic situation in Russia and contributing to the confidence crisis already triggered by the geopolitical tension.

Fascinating, but not surprising, are the effects caused by the rent-dependent economic system. Because of Putin's rent management system the economically non-viable actors supporting Putin's regime – the rent-addicted enterprises – will be served first when it comes to scarce financial resources. In addition, because parts of the rent-creating oil sector have been directly targeted by financial sanctions, these companies are now adding to the pressure on the internal financial system and the government for refinancing loans. When the big actors need to use the domestic financial system, the smaller actors are crowded out. It follows that the situation for the small-scale sector of entrepreneurs and medium-sized enterprises that hold the potential of Russia's future growth is deteriorating further. The state has suddenly become a lender of last resort for otherwise viable large companies instead of them helping the state in different projects. This adds to the burden of all the non-viable companies that the state already supports besides other public spending. Today financial resources are short in Russia and the government has gone as far as calling an amnesty for capital that is repatriated. The postponement of both private and public investment due to the credit crunch will have long-term effects on the economy.

The main policy response to the economic crisis is the policy of import substitution. This policy strengthens the sanctions since it is just another way of ensuring that domestic non-competitive producers get resources and makes the economy less competitive. Russia's counter-sanctions, enacted in April 2014, concern the import of foods and give a flavour of what import substitution brings at least in the short run: higher prices. There are no resources to modernise production technology and no competition so the scheme implies that the quality of products will be inferior to that of imported goods.

Economic factors that could weaken the effects of the sanctions are linked to the high trade dependency between the EU and Russia, perceived high costs for some sender countries, and Russia's attempts to split the EU and undermine its decisiveness. Nevertheless, the EU has managed to keep together on sustaining the sanctions and 22 June 2015 the sanctions were prolonged until 31 January 2016. Russia has taken steps to modify its trade dependence on the EU particularly when it comes to new gas pipeline projects, but these changes require time and money for investment before they materialise. Meanwhile, Russia's European trade partners are also looking towards other markets that are more secure in terms of political risk and currency stability.

*Will economic sanctions contribute to Russia changing its political behaviour?*

The political effects of the sanctions are less clear than the economic. The discussion indicates that while economic factors act in favour of sanctions succeeding, the political factors identified have ambiguous and negative effects on the probability of sanction success:

- The authoritarian political system makes the regime less sensitive to the sanctions and their economic consequences since it can protect loyal elites, control public opinion and blame economic hardship on the West.
- As a result of the propaganda, perceptions in Russia are that the West wants to hurt Russia for no particular reason and the impression has been spread that the West wants to see regime change in Russia which has fuelled anti-Western feelings. The state dominates the media scene and popularity ratings are high, which decreases the regime's need and motivation to change its political behaviour toward Ukraine which is the true goal of the West.
- Russia has tried to split the EU countries by using threats and incentives, but with the prolongation of sanctions until January 2016 this is no longer an immediate threat. Yet further attempts may be pursued if the Minsk agreements are not met by then and sanctions are not lifted.
- The importance of the conflict for both sides. Exit strategies must include minimising the risk of loss of face for both parties.

The main conclusion is that economic sanctions have achieved results in contributing to Russia's economic decline but significant economic costs alone have not been enough to persuade the regime to back off and change its policy towards Ukraine in the year that has elapsed since sanctions were first imposed. Pressure on the economy can be kept up with economic sanctions but the mainly political threats and weaknesses in the Western project need to be addressed by political means.

So far the EU and the US have shown great decisiveness in keeping up the sanctions and Russia has not managed to split the senders. However, less attention appears to have been given to the political problems hindering the success of sanctions. As long as Russia's propaganda dominates the domestic scene and promotes misperceptions of the West's intentions among the Russian population there will be no pressure from within Russia to resolve the conflict. As time goes by, economic hardship will grow and people may become more

open to listening to voices other than the Kremlin's. This may open an opportunity for the West to be heard.

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# Annex 1 – Timeline for events in Ukraine 2013–2015

## 2013

### November

21 – President Viktor Yanukovych decides to abandon plans to sign an association agreement with the EU.

### December

1 – About 300 000 people protest in Kiev’s Independence Square. The City Hall is seized by activists.

17 – Russian President Vladimir Putin announces plans to buy USD 15bn in Ukrainian government bonds and a cut in the cost of Russia’s natural gas for Ukraine.

## 2014

### January

16 – Anti-protest laws are passed in Ukraine and quickly condemned as “draconian” by the West.

### February

18–20 – Security forces kill about one hundred protesters in Kiev.

22–23 – President Yanukovych flees to Russia, opposition takes control under interim President Olexander Turchynov and acting Prime Minister Arseny Yatseniuk. Russia refuses to recognise the takeover.

### March

3 – The EU introduces restrictive measures against 18 individuals (mainly Ukrainian state officials) associated with embezzlement and the infringement of human rights (Council Resolution 208/2014).<sup>37</sup>

16 – Crimea votes to leave Ukraine in a referendum; the result is condemned as illegal by the international community, while Russia recognises it.

17 – Crimea asks to join the Russian Federation. The EU and US open up a new sanctions regime, including travel bans and asset freezes, targeting individuals and entities involved in undermining Ukraine ((Annex 2 D 2014/145/CFSP).

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<sup>37</sup> <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=OJ:L:2014:066:FULL&from=EN>

18 – Russia approves the annexation of Crimea which prompts the most serious showdown with the West since the Cold War.

20 – The annexation of Crimea is adopted by the Russian Duma.

21 – The annexation of Crimea is ratified by the Russian Federal Council.

27 – The UN General Assembly adopts Resolution 68/262 on Ukraine's territorial integrity.

#### **April**

Throughout the month – Pro-Russian separatists seize parts of the eastern Donetsk and Luhansk regions on the Russian border. The Ukrainian government launches a military operation in response.

28 – The US expands its export restrictions on technology and services associated with the Russian defence industry.

#### **May**

11 – Pro-Russian separatists in Donetsk and Luhansk declare independence after unrecognised referendums.

25 – Leading businessman Petro Poroshenko wins the presidential election on a pro-Western platform. Signs delayed EU association accord in July.

#### **June**

23 – The EU adopts regulations against imports from Crimea and Sevastopol, including technical assistance and insurance.

#### **July**

16 – The US Treasury imposes sanctions which target financial institutions and energy firms.

17 – Malaysian Airlines Flight 17 comes down in separatist-held territory, killing all 298 people on board, with all the evidence suggesting that it was shot down.

29 – The US Treasury expands the list of financial institutions under sanctions and includes several arms suppliers.

31 – The EU announces new sanctions, banning trade with certain Russian state securities and preventing Russian state-owned banks from borrowing and trade with some sectors. The US expands previous economic sanctions.

#### **August**

6 – Russia introduces counter-sanctions, including on agricultural products.

22 – Russia sends the first of several unauthorised convoys allegedly carrying aid to Donetsk and Luhansk. NATO claims Russian forces are directly involved in military operations inside Ukraine.

25 - The President of Ukraine, Petro Poroshenko, announced the date of the election to the Verkhovna Rada, 26 October.

#### **September**

5 – **Minsk 1** The government signs the Minsk peace plan ceasefire with pro-Russian leaders in eastern Ukraine. The two separatist regions agree to hold local elections under Ukrainian law in December.

8 – EU sanctions are reinforced and broadened to include state-owned banks and defence companies as well as banning the export of oil exploration equipment.

#### **October**

5 – Ukraine accuses the separatists of violating the peace treaty.

26 – Parliamentary elections in Ukraine produce a convincing majority for pro-Western parties.

#### **November**

2–3 – Donetsk and Luhansk separatists hold elections not provided for by the Minsk plan. Ukraine rescinds its pledge for regional autonomy in response.

12 – NATO accuses Russia of sending forces into Ukraine.

#### **December**

4 – The EU sanctions are broadened to include oil exploration on the continental shelf.

9 – The US Treasury expands sanctions to include Sberbank and cuts maturity rates for all financial institutions targeted by sanctions.

18 – The US Congress passes the Ukraine Freedom Support Act into law.

### **2015**

#### **January**

15 – Separatists capture the remains of Donetsk airport in a renewed offensive.

#### **February**

12 – **Minsk 2** Germany and France broker a new ceasefire deal at talks in Belarus.

17 – Separatists drive Ukrainian troops out of the transport hub of Debaltseve.

#### **March–May**

Fighting continues, but with lower intensity. The Minsk 2 agreement is violated repeatedly.

#### **June**

22 – The EU extends sanctions against Russia to 31 January 2016.

Sources: Al-Jazeera (2014a-b), BBC (2014, 2015), CSIC (2015), The Guardian (2015a-b), OSCE (2014, 2015), European Council (2015a-b).

## Annex 2 – List of sanctions documents

### Sanctions imposed in connection with Russia's aggression towards Ukraine 2014-2015

Legend:[a. Sanctions on individuals and entities] [b. Sanctions on import/export to Crimea and Sevastopol]

[c. Economic sanctions]

EU SANCTIONS			
Date	Council Regulations (R) Council Decisions (D)	Content	Web page
2014-03-17	<b>D 2014/145/CFSP</b>	Original list of persons/entities undermining or threatening the territorial integrity, sovereignty and independence of Ukraine	<a href="http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2014:078:0016:0021:EN:PDF">http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2014:078:0016:0021:EN:PDF</a>
2014-03-17	<b>R 269/2014</b> concerning restrictive measures in respect of actions undermining or threatening the territorial integrity, sovereignty and independence of Ukraine	Confirming the 21 persons/entities listed in D 2014/145/CFSP. These are subject to travel restrictions and asset freezes	<a href="http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2014:078:0006:0015:EN:PDF">http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2014:078:0006:0015:EN:PDF</a>

2014-05-12	<b>R 476/2014</b> amending Council Regulation No 269/2014 concerning restrictive measures in respect of actions undermining or threatening the territorial integrity, sovereignty and independence of Ukraine	Stricter rules for persons and companies on Crimea. Asset freezes of listed in R 269/2014.	<a href="http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014R0476&amp;from=EN">http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014R0476&amp;from=EN</a>
2014-05-12	<b>D 2014/265/CFSP</b>	Amending criteria for listing in D 2014/145/CFSP	<a href="http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014D0265&amp;from=EN">http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014D0265&amp;from=EN</a>
2014-05-28	<b>D 2014/308/CFSP</b>	Amending information on listed persons/entities in D 2014/145/CFSP	<a href="http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014D0308&amp;from=EN">http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014D0308&amp;from=EN</a>
2014-06-23	<b>D 2014/386/CFSP</b>	Restricting imports originating from Crimea or Sevastopol, in response to the illegal annexation of Crimea and Sevastopol	<a href="http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014D0386&amp;from=EN">http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014D0386&amp;from=EN</a>
2014-06-23	<b>R 692/2014</b> concerning restrictions on the import into the Union of goods originating in Crimea or Sevastopol,	Restricting imports originating from Crimea or Sevastopol, with the exception of goods having been granted a certificate of origin by the government of Ukraine	<a href="http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014R0692&amp;from=SV">http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014R0692&amp;from=SV</a>

	in response to the illegal annexation of Crimea and Sevastopol		
2014-07-11	<b>D 2014/455/CFSP</b>	Amending 2014/145/CFSP	<a href="http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014D0455">http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014D0455</a>
2014-07-18	<b>D 2014/475/CFSP</b>	Amending 2014/145/CFSP	<a href="http://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:32014D0475&amp;from=EN">http://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:32014D0475&amp;from=EN</a>
2014-07-18	<b>R 783/2014</b> amending R 269/2014 concerning restrictive measures in respect of actions undermining or threatening the territorial integrity, sovereignty and independence of Ukraine	Amending criteria in D 2014/145/CFSP and R 269/2014	<a href="http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014R0783&amp;from=EN">http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014R0783&amp;from=EN</a>
2014-07-25	<b>D 2014/499/CFSP</b>	Amending D 2014/145/CFSP	<a href="http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014D0499&amp;from=EN">http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014D0499&amp;from=EN</a>
2014-07-25	<b>R 811/2014</b> amending Regulation (EU) No 269/2014 concerning restrictive measures in respect of actions undermining or threatening the territorial integrity, sovereignty and independence of Ukraine	Amending criteria for D 2014/145/CFSP and R 269/2014	<a href="http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014R0811&amp;from=EN">http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014R0811&amp;from=EN</a>

2014-07-30	<b>D 2014/508/CFSP</b>	Amending D 2014/145/CFSP	<a href="http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014D0508&amp;from=EN">http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014D0508&amp;from=EN</a>
2014-07-30	<b>D 2014/507/CFSP</b>	Amending D 2014/386/CFSP	<a href="http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014D0507&amp;from=EN">http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014D0507&amp;from=EN</a>
2014-07-30	<b>R 825/2014</b> amending Regulation (EU) No 692/2014 concerning restrictions on the import into the Union of goods originating in Crimea or Sevastopol, in response to the illegal annexation of Crimea and Sevastopol	Restricting financial transactions. Prohibition of loans and credits intended for development of Crimea or Sevastopol. Prohibited to export technology or to create joint ventures	<a href="http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014R0825&amp;from=SV">http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014R0825&amp;from=SV</a>
2014-07-30	<b>R 826/2014</b>	Adding entities and persons to list in R 269/2014. 8 physical and 3 legal persons added	<a href="http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014R0826&amp;from=EN">http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014R0826&amp;from=EN</a>
2014-07-31	<b>D 2014/512/CFSP</b>	Restricting credits to Russia ( <b>over 90 days</b> ), financing, export of military and dual-use technology	<a href="http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014D0512&amp;from=EN">http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014D0512&amp;from=EN</a>
2014-07-31	<b>R 833/2014</b> concerning restrictive measures in view of Russia's actions destabilising the situation in Ukraine	Restricting credits to Russia ( <b>over 90 days</b> ), financing, export of military and dual-use technology	<a href="http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014R0833&amp;from=EN">http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014R0833&amp;from=EN</a>

2014-09-08	<b>D 2014/659/CFSP</b>	Amending D 2014/512/CFSP	<a href="http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014D0659&amp;from=SV">http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014D0659&amp;from=SV</a>
2014-09-08	<b>R 960/2014</b> amending Regulation 833/2014 concerning restrictive measures	Extending restrictions in R 833/2014	<a href="http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014R0960&amp;from=EN">http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014R0960&amp;from=EN</a>
2014-09-08	<b>R 959/2014</b> amending R 269/2014 concerning restrictive measures in respect of actions undermining or threatening the territorial integrity, sovereignty and independence of Ukraine	Extending R 269/2014 to encompass persons and legal entities in Donbas region of Ukraine	<a href="http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014R0959&amp;from=EN">http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014R0959&amp;from=EN</a>
2014-09-08	<b>D 2014/658/CFSP</b>	Amending D 2014/145/CFSP	<a href="http://hb.betterregulation.com/external/Council%20Decision%202014_658_CFSP.pdf">http://hb.betterregulation.com/external/Council%20Decision%202014_658_CFSP.pdf</a>
2014-11-17	<b>D 2014/801/CFSP</b>	Amending D 2014/145/CFSP	<a href="http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014D0801&amp;from=EN">http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014D0801&amp;from=EN</a>
2014-11-28	<b>D 2014/855/CFSP</b>	Amending D 2014/145/CFSP	<a href="http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014D0855&amp;from=EN">http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014D0855&amp;from=EN</a>

2014-12-04	<b>D 2014/872/CFSP</b>	Amending D 2014/512/ CFSP and D 2014/659/CFSP. Restriction on credits <b>(over 30 days)</b>	<a href="http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014D0872&amp;from=EN">http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014D0872&amp;from=EN</a>
2014-12-04	<b>R 1290/2014</b> amending R 833/2014 concerning restrictive measures in view of Russia's actions in destabilising the situation in Ukraine, and amending R 960/2014.	Extending export sanctions to include oil exploration in economic zones and on the continental shelf	<a href="http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014R1290&amp;from=EN">http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014R1290&amp;from=EN</a>
2014-12-18	<b>R 1351/2014</b> amending R 692/2014 concerning restrictive measures in response to the illegal annexation of Crimea and Sevastopol	Details on sectorial sanctions. Ban on all foreign investment in Crimea or Sevastopol. Prohibition on services directly related to the investment ban, as well as services related to tourism activities, including in the maritime sector, and in the sectors of transport, telecommunications, energy and exploitation of oil, gas and minerals in Crimea or Sevastopol. The former export prohibition on goods and technology in the sectors of transport, telecommunications, energy and exploitation of oil, gas and minerals is broadened	<a href="http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014R1351&amp;from=EN">http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014R1351&amp;from=EN</a>

2015-02-09	<b>D 2015/241/CFSP</b>	Amending list of persons in D 2014/145/CFSP	<a href="http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32015D0241&amp;from=EN">http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32015D0241&amp;from=EN</a>
2015-02-09	<b>R 2015/240</b>	Amending list of persons R 269/2014	<a href="http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32015R0240&amp;from=EN">http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32015R0240&amp;from=EN</a>
2015-03-13	<b>R 2015/427</b>	Amending list of persons in R 269/2014	<a href="http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32015R0427&amp;from=EN">http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32015R0427&amp;from=EN</a>
2015-03-13	<b>D 2015/432</b>	Amending list of persons in D 2014/145/CFSP	<a href="http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32015D0432&amp;from=EN">http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32015D0432&amp;from=EN</a>
<b>US SANCTIONS</b>			
<b>Date</b>	<b>Executive order (EO) /Treasury sanctions</b>	<b>Content</b>	<b>Web page</b>
2014-03-06	<b>EO 13660</b> blocking property of certain persons contributing to the situation in Ukraine	Sanctions on entities and individuals responsible for violating Ukraine's territorial integrity	<a href="http://www.gpo.gov/fdsys/pkg/FR-2014-03-10/pdf/2014-05323.pdf">http://www.gpo.gov/fdsys/pkg/FR-2014-03-10/pdf/2014-05323.pdf</a>
2014-03-16	<b>EO 13661</b>	Sanctions on entities and individuals responsible for violating Ukraine's territorial integrity	<a href="http://www.gpo.gov/fdsys/pkg/FR-2014-03-19/pdf/2014-06141.pdf">http://www.gpo.gov/fdsys/pkg/FR-2014-03-19/pdf/2014-06141.pdf</a>

	blocking property of additional persons contributing to the situation in Ukraine		
2014-03-20	<b>EO 13662</b> blocking property and additional persons contributing to the situation in Ukraine	Additions to 13660 and 13661	<a href="http://www.treasury.gov/resource-center/sanctions/Programs/Documents/ukraine_eo3.pdf">http://www.treasury.gov/resource-center/sanctions/Programs/Documents/ukraine_eo3.pdf</a>
2014-03-20	<b>Treasury sanctions</b> on Russian officials, members of the Russian leadership's inner circle, and 1 entity for involvement in the situation in Ukraine	Sanctions target Russian government officials, the inner circle that supports them, and Bank Rossiya, the personal bank for officials of the Russian Federation	<a href="http://www.treasury.gov/press-center/press-releases/Pages/jl23331.aspx">http://www.treasury.gov/press-center/press-releases/Pages/jl23331.aspx</a>
2014-04-28	<b>Treasury sanctions</b> on Russian government officials and entities	Additional sanctions target 7 Russian government officials, including members of the Russian leadership's inner circle, and 17 entities	<a href="http://www.treasury.gov/press-center/press-releases/Pages/jl2369.aspx">http://www.treasury.gov/press-center/press-releases/Pages/jl2369.aspx</a>
2014-04-28	<b>State Department</b> expanding export restrictions on Russia	Additional restrictive measures on defence exports to Russia	<a href="http://www.state.gov/r/pa/prs/ps/2014/04/225241.htm">http://www.state.gov/r/pa/prs/ps/2014/04/225241.htm</a>
2014-06-20	<b>Treasury sanctions</b>	Sanctions target 7 separatists in Ukraine	<a href="http://www.treasury.gov/press-center/press-releases/Pages/jl2438.aspx">http://www.treasury.gov/press-center/press-releases/Pages/jl2438.aspx</a>

	on additional individuals for threatening the territorial integrity of Ukraine		
2014-07-16	<b>Treasury sanctions</b> on entities within the financial services and energy sectors of Russia, against arms or related materiel entities, and those undermining Ukraine's sovereignty	Actions implement Executive Order 13662 against two Russian financial institutions and two energy firms. Actions also target 8 defence technology entities, 3 separatists, 1 entity complicit in the misappropriation of Ukrainian state assets, and 4 Russian government officials	<a href="http://www.treasury.gov/press-center/press-releases/Pages/jl2572.aspx">http://www.treasury.gov/press-center/press-releases/Pages/jl2572.aspx</a>
2014-07-29	<b>Treasury sanctions</b> on Russian financial institutions and on a defence technology entity	Additional sanctions target 3 Russian state-owned banks, and one Russian state-owned defence technology entity	<a href="http://www.treasury.gov/press-center/press-releases/Pages/jl2590.aspx">http://www.treasury.gov/press-center/press-releases/Pages/jl2590.aspx</a>
2014-11-04	<b>Treasury sanctions</b> on 7 individuals and 1 entity contributing to the situation in Ukraine	Sanctions target Crimean separatists, a former Ukrainian official, and a Crimea-based gas company	<a href="http://www.treasury.gov/press-center/press-releases/Pages/jl2355.aspx">http://www.treasury.gov/press-center/press-releases/Pages/jl2355.aspx</a>

2014-12-09	<b>Treasury sanctions</b> within the Russian financial services, energy and defence or related materiel sectors	Actions target largest Russian bank. Deepens existing sanctions on Russian financial institutions. Expands sanctions in Russia's energy sector, and targets additional energy- and defence-related Russian entities	<a href="http://www.treasury.gov/press-center/press-releases/Pages/jl2629.aspx">http://www.treasury.gov/press-center/press-releases/Pages/jl2629.aspx</a>
2014-12-18	<b>Ukraine Freedom Support Act (H.R. 5859)</b> provides for further sanctions against Russia as well as supporting measures to Ukraine	States that it is US policy to assist the government of Ukraine in restoring its sovereignty and territorial integrity in order to deter the government of the Russian Federation from further destabilising and invading Ukraine and other independent countries in Eastern Europe and Central Asia	<a href="https://www.congress.gov/bill/113th-congress/house-bill/5859/">https://www.congress.gov/bill/113th-congress/house-bill/5859/</a>
2014-12-19	<b>EO 13685</b> blocking property of certain persons and prohibiting certain transactions with respect to the Crimea region in Ukraine	Sanctions on entities and individuals and transactions	<a href="http://www.treasury.gov/resource-center/sanctions/Programs/Documents/ukraine_eo4.pdf">http://www.treasury.gov/resource-center/sanctions/Programs/Documents/ukraine_eo4.pdf</a>

RUSSIAN SANCTIONS			
2014-08-06	<b>Ukaz Prezidenta No 560</b> “O primeneni otdelnykh spetsialnykh ekonomicheskikh mer v tselyakh obespecheniya bezopasnosti RF”	Restrictions on imports of certain food products, e.g. dairy products and vegetables, from the US, the EU, Switzerland, Norway, Japan, Canada	<a href="http://www.garant.ru/hotlaw/federal/558039/">http://www.garant.ru/hotlaw/federal/558039/</a>
UN RESOLUTION			
2014-03-27	<b>Resolution 68/262</b> on the territorial integrity of Ukraine	Affirming commitment to the sovereignty, political independence, unity and territorial integrity of Ukraine within its internationally recognised borders, underscoring the invalidity of the referendum held in Crimea on 16 March, and calling upon all states not to recognise any alterations to the status of Crimea and Sevastopol	<a href="http://www.un.org/en/ga/search/view_doc.asp?symbol=A/RES/68/262">http://www.un.org/en/ga/search/view_doc.asp?symbol=A/RES/68/262</a>

MINSK AGREEMENTS			
2014-09-05	<b>Minsk 1</b> A 12-point protocol calling for ceasefire in eastern Ukraine. A follow-up memorandum included a withdrawal of heavy weapons and an end to offensive actions.	Calling for an immediate ceasefire in eastern Ukraine. Monitoring should be conducted by the OSCE. The Ukraine-Russian border must be secure. Release of hostages and amnesty for certain events. A decentralisation of power and improvement of the humanitarian situation in the Donbas region.	<a href="http://www.osce.org/ru/home/123258?download=true">http://www.osce.org/ru/home/123258?download=true</a>
2015-02-12	<b>Minsk 2</b> A 13-point protocol calling for a ceasefire and withdrawal of heavy weapons in eastern Ukraine. Very similar to Minsk I, but the conditions are more specific and detailed.	Calling for ceasefire from 00.00 on 15 February in eastern Ukraine. Monitoring should be conducted by the OSCE. The Ukraine-Russian border must be secure. Release of hostages and amnesty for certain events. A decentralisation of power and improvement of the humanitarian situation in the Donbas region.	<a href="http://www.osce.org/ru/cio/140221?download=true">http://www.osce.org/ru/cio/140221?download=true</a>

Sources:

EU sanctions: <http://europeansanctions.com/eu-sanctions-in-force/russia/>

<http://www.regeringen.se/sb/d/18725> ; <http://eur-lex.europa.eu/>;  
\_US sanctions: <http://www.archives.gov/federal-register/executive-orders/2014.html>  
<http://www.treasury.gov/resource-center/sanctions/programs/pages/ukraine.aspx>  
Russian sanctions: <http://www.garant.ru>  
UN resolution: <http://www.un.org>  
Minsk agreements: <http://www.osce.org>

## Annex 3 –Factors affecting sanction success

The Annex 3 table summarises findings within the sanctions literature regarding the expected impact of various factors on the political behaviour of the target, in other words the factors' expected contribution to sanction success. An expected *positive impact* is coded (+), a *negative impact* is coded (-). If the expected impact has been found to be *inconclusive*, it is coded (i).

	Bapat et al. (2013)	Major (2012)	Drezner (2011)	Hufbauer et al. (2007)	Kaempfer and Lowenberg (2007)	Miers and Morgan (2002)	Nooruddin (2002)	Burlone (2002)
Costs for the target	+			+			+	
Trade dependency	+	+	i		i			
Duration of sanctions				-				
Cost for sender	i			i				
Multiple senders	-	-		-		i <sup>a</sup>		
International institutions	+				+	+		
Third-party countries				-			i	
Authoritarian regime		- <sup>b</sup>					-	
State capacity								-
Importance of conflict	- <sup>c</sup>							

Notes:

<sup>a</sup> Multiple senders are less successful than single senders when dealing with multiple issues but more effective than when dealing with just one issue.

<sup>b</sup> Generally less effective against authoritarian regimes; these are however still vulnerable to crisis.

<sup>c</sup> The importance of the conflict makes the sanctions less likely to succeed. This variable has limited statistical significance.

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The objective of the report is to qualitatively assess the effects of the economic sanctions imposed by the EU and US against Russia following the annexation of Crimea and Russia's further activities in eastern Ukraine. The report investigates how sanctions have performed vis-à-vis their goals: imposing a cost on the Russian economy and contributing to changing Russia's policies towards Ukraine. The main conclusion is that the targeted economic sanctions of the EU and the US have contributed to imposing a cost on the Russian economy in combination with other factors, but they have so far not persuaded Russia to change its policies towards Ukraine. Factors that have reinforced the effects of the sanctions are the falling oil price, depreciation of the rouble and weakened terms of trade, and the politicised economic system. The political resource allocation and rent distribution system warrant the survival of the regime and represent threats to the success of the sanctions. The authoritarian nature of the regime and its anti-Western propaganda, which manipulates public perceptions of the conflict issue, make the regime less exposed to the full effects of the economic decline. The conflict over Ukraine is important for both Russia and the West. In order to resolve it, exit strategies need to minimise the risk of loss of face for both sides.