

The Russian Federation within the Global Hierarchy of Great Powers. Consequences of International Sanctions

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Abstract: *The Russian Federation is one of the world's major economic actors and is also an important pole of political and military power. The purpose of this article is to highlight to what extent the international sanctions imposed on this state as a result of the illegal annexation of Crimea (in 2014) had an economic impact on its positioning in the global hierarchy of great powers. Our analysis will focus on two major issues: the impact on trade flows and on FDI from sanctioning countries. The final part of our analysis will highlight the prospects of the Russian economy, especially in terms of maintaining its power in the international arena.*

Key-Words: *Russian economy, international sanctions, bilateral trade, FDI*

JEL Classification: *F, F01, F1, F21*

1. Russian Federation as a global player. Evidence from literature review

It is now widely accepted that after the collapse of the USSR the general belief was that the Russian Federation lost its overwhelming influence in the global arena, especially against the backdrop of the economic chaos of the transition period and as a result of the multiple economic crises faced by this country (these crises erupted during 1992-1996 and 1998). Some analysts (Keating, 2017) even called Russia a "power of the past," but after the accession to power of Vladimir Putin (recently appointed for a third term of office in 2018) it was obvious that a "game changer" factor intervened and induced new valences for the perspective of Russia's position in the global hierarchy of great powers. With the gradual economic recovery, a continuing trend even in the aftermath of the global economic crisis, Russia has had a "comeback" as a world power, rising up as a player whose requirements and capabilities could no longer be ignored.

What caused this "comeback" and what were its consequences? Undoubtedly, Russia's economic power is based on its rich natural resources, and the main source of revenues for the federal budget are the energy exports (in particular oil and natural gas). In fact, the energy exports are not only a source of revenues for the Russian government, but also a formidable geopolitical "weapon." Basically, these exports provide the foundation for Russia's global power, especially in relation to the states that are dependent on Russia's energy imports (notably the EU Member States). According to DG Trade (2018), in 2017, with the exception of peat and coke, the European Union was a net energy importer (imports higher than exports), with Russia being the most important supplier in the field. Both in 2016 and 2017, Russia was the EU's largest supplier of natural gas as well as an important supplier of oil. According to DG Trade, the share of oil imports from Russia rose to 31% of its total oil exports in 2017 (compared to 28% in 2016).

Given the EU's energy dependence on Russia, it is no wonder that the position of the Member States on Russia's geopolitical actions has been hesitant. Although the international sanctions imposed after the annexation of Crimea were prolonged until the end of 2018, it must be said that they only affect marginal bilateral trade, sanctions referring to a category of products (military goods, goods which may be used for military purposes, for oil drilling, and other related technologies), with no significant share in total trade with Russia.

As a source of Russian power and influence in the relationship with the EU, energy exports remain primordial, but they may at the same time be a vulnerability. Some studies (Zubacheva, 2018) show that as the U.S. strives to push the EU away from Russian gas dependence, the future of Russian domination on this market depends on the successful expansion of the necessary infrastructure. Such infrastructure is the Nord Stream 2 pipeline, whose project has already been launched and which, if successful, would allow Russia to reach even

more European consumers. However, the Nord Stream 2 project has its own challenges. A recent analysis in the Financial Times (Toplensky, 2017) indicates that EU officials are looking for ways to delay this process, with a recent refusal to claim that EU energy laws are applicable to Nord Stream 2. According to the official position expressed by Maroš Šefčovič, Vice-President of the European Commission for Energy Union, the success of the Nord Stream 2 project would jeopardize the maintenance of a diversity of EU energy sources, while enhancing the Russian domination of the European gas market. However, given that Russia's natural gas reserves are among the largest in the world (32.3 trillion cubic meters in 2016), it is expected that they will continue to give this country the advantage of maintaining a leading position in gas exports in the next 20 years.

It is perhaps time to point out that many studies in the literature mistakenly consider that Russia's only source of power consists of its energy reserves (the Russian economy was often called "weak", able to export only oil, gas and arms). Such analyses are, however, underestimating this country's huge potential. Aside from the fact that oil, gas and arms are among the most valuable export goods, Russia has shown that it wants to get involved in the race for innovation and for leadership in high technology. According to recent national statistics, public spending on R&D has increased in recent years (from 0.5% in 2012 to over 1.15% in 2016), and 14,792 patent application, 41,529 trademark applications and a total of 3,131 researchers in R&D were registered in Russia in 2016.

But it must be said that the biggest mistake made by those who easily catalogue Russia as "a power of the past" was the lack of vision in understanding the broader geopolitical framework that arose after the collapse of communism. In the decades that have passed since the fall of the USSR, crises, transitions and declines in living standards have occurred, as NATO and the EU continuously expanded towards the East. All those evolutions have reinforced nationalist sentiments and, ultimately, paved the way for Vladimir Putin's accession to power, while at the same time creating, due to the fact that Russia was cornered, its current aggressive foreign policy. In fact, the EU's Neighbourhood Policy and the Eastern Partnership itself (which Russia was not invited to join!) constituted the very seeds of the current tension between Russia and the West, whose actions were perceived as moves to undercut Russian power and stymie its interest. This does not mean that Russia's involvement in the "frozen conflicts" from the former USSR or the annexation of Crimea would be justifiable actions under international law. Every independent state should, of course, be free to decide on its orientation towards economic cooperation with the East or the West, being also able to decide on the military alliances it engages in.

However, the current status quo between Russia and the West could have been avoided if Russia had been invited to the negotiations and to the Eastern Partnership and if the European involvement in the Ukrainian crisis had been less obvious. In the next sections of our paper, we will analyse the context of the imposition of international sanctions on Russia and their consequences on Russia's position in the global arena and on the trade with the states that imposed these sanctions in retaliation for the Russian annexation of Crimea.

2. Sanctions background

The sanctions imposed to the Russian Federation in retaliation for its involvement in the Ukrainian crisis came in successive waves (see Table 1) and are still in force at least until the end of 2018 but, with the current expansion of tensions between Russia and the West, they are very likely to be prolonged even after this timeframe. The imposition of those sanctions was considered by some analysis (Drăgoi, Clichici, 2017) as an act that only tensioned the bilateral relation, triggering mutual economic losses, but they are unlikely to cause a profound change in Russian foreign policy.

The sanctions, consisting in assets freeze, visa travel bans and economic measures have different impact on the various sectors of Russian economy, but the most affected were trade and FDI. Some authors (Gessen, 2018) have pointed out that while, historically, sanctions against Russia have come in several different categories, each wave reflected a different theory of Russia and perhaps even of the world. It must be sad that while the diplomatic expulsions are meant to put pressure on Kremlin's decisions, given the wide influence of the targeted oligarchs, the economic measures, while hurtful for the economy, are proving inefficient in providing a change in the foreign policy field.

Table 1: Sanctions imposed on the Russian Federation - a chronological summary

WAVE 1 <i>MARCH/APRIL 2014</i>	WAVE 2 <i>2014</i>	PRESENT WAVE <i>2015 - PRESENT</i>
6 March 2014	28 April 2014	16 February 2015

<p align="center">WAVE 1 <i>MARCH/APRIL 2014</i></p>	<p align="center">WAVE 2 <i>2014</i></p>	<p align="center">PRESENT WAVE <i>2015 - PRESENT</i></p>
<p>U.S. sanctions: travel bans and the freezing of U.S. assets, against not-yet-specified individuals who had "asserted governmental authority in the Crimean region without the authorization of the Government of Ukraine" and whose actions were found, inter alia, to "undermine democratic processes and institutions in Ukraine".</p> <p>17 March 2014 The U.S., the EU and Canada introduced specifically targeted sanctions the day after the Crimean referendum and a few hours before Russian President Vladimir Putin signed a decree recognizing Crimea as an independent state, laying the groundwork for its annexation of Crimea by Russia.</p> <p>19 March 2014 Australia imposed sanctions against Russia after its annexation of Crimea. These sanctions targeted financial dealings and travel bans on those who had been instrumental in the Russian threat to Ukraine's sovereignty. Australian sanctions were expanded on 21 May 2014.</p>	<p>U.S. ban on business transactions within its territory on 7 Russian officials, including Igor Sechin, executive chairman of the Russian state oil company Rosneft, and 17 other Russian companies.</p> <p>28 April 2014 EU issued travel bans against a further 15 individuals. The aim of EU sanctions was declared not punitive, but designed to bring about a change in policy or activity by the target country, entities or individuals.</p> <p>31 July 2014 The EU introduced the third round of sanctions which included an embargo on arms and related material, and embargo on dual-use goods and technology intended for military use or a military end user, a ban on imports of arms and related material, controls on export of equipment for the oil industry, and a restriction on the issuance of and trade in certain bonds, equity or similar financial instruments with a maturity greater than 90 days.</p> <p>24 July 2014 Canada targeted Russian arms, energy and financial entities.</p> <p>5 August 2014 Japan froze the assets of "individuals and groups supporting the separation of Crimea from Ukraine" and restrict imports from Crimea.</p> <p>12 August 2014 Norway adopted sanctions against Russia: Russian state-owned banks were banned from taking long-term and mid-term loans, arms exports will be banned and supplies of equipment, technology and assistance to the Russian oil sector will be prohibited.</p>	<p>The EU supplemented its sanction list to cover 151 individuals and 37 entities. Australia indicated that it would follow the EU in a new round of sanctions. If the EU sanctioned new Russian and Ukrainian entities, then Australia would keep their sanctions in line with the EU.</p> <p>18 February 2015 Canada added 37 Russian citizens and 17 Russian entities to its sanction list. Rosneft and the deputy minister of defence, Anatoly Antonov, were both sanctioned.</p> <p>June 2015 Canada added three individuals and 14 entities, including Gazprom.</p> <p>April 2018 New U.S. sanctions targeting Russian officials and oligarchs.</p>

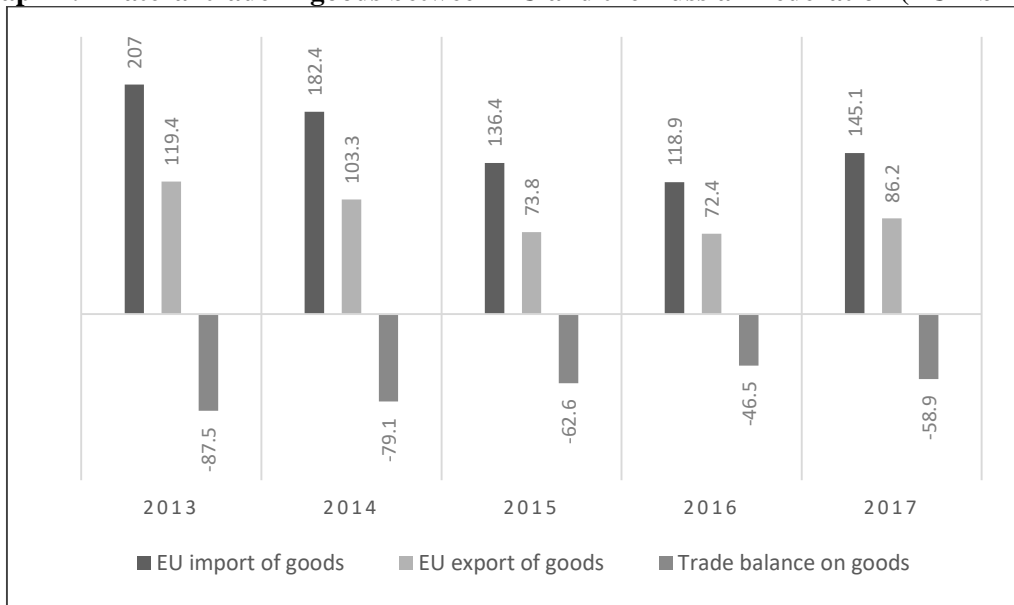
Source: Author, based on studied literature

3. Impact on trade and investment with main sanctioning countries

Four years after the sanctions were imposed, the Russian Federation’s trade with the sanctioning countries, especially with the EU and the U.S. has been severely affected. In the following chapters of our analysis we seek to highlights the vectors of this outcome.

The bilateral trade with the EU was perhaps the most obviously affected by the imposition of sanctions. As shown by the DG Trade data, in the year following the sanctions (2015) a clear decrease of both imports and exports occurred (see Graph 1).

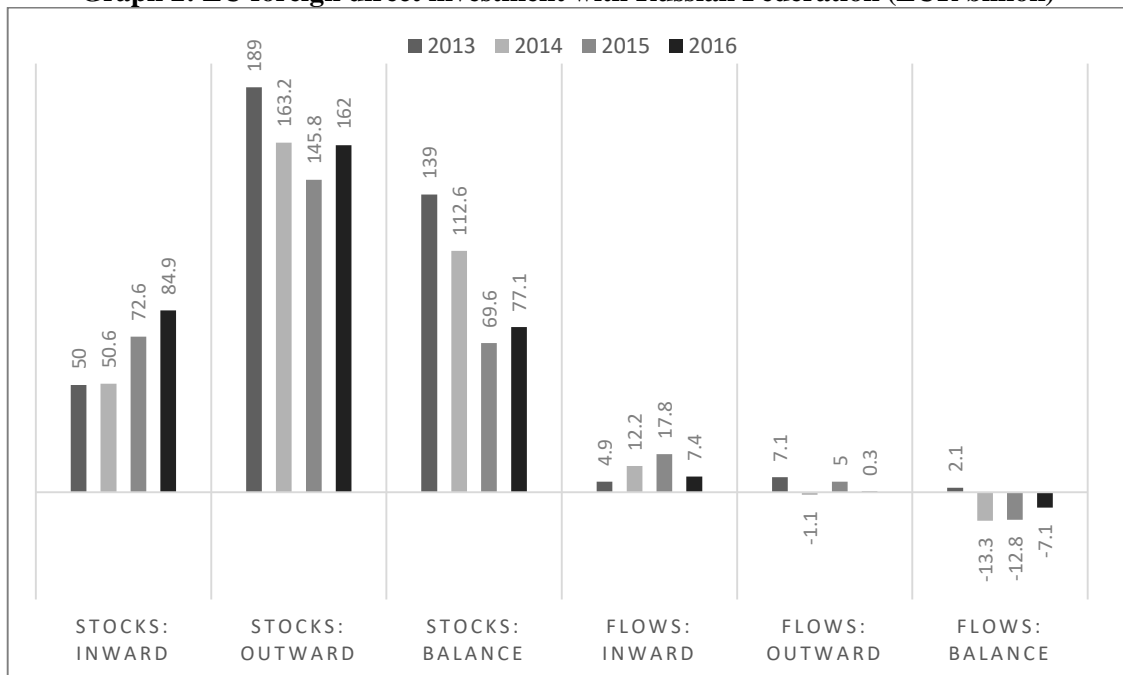
Graph 1: Bilateral trade in goods between EU and the Russian Federation (EUR billion)



Source: Author, based on DG Trade (2018).

Prior to the sanctions, the EU was Russia’s fourth trading partner, but after 2014, the EU-Russia trade has continuously decreased. In terms of FDI, both flows and stocks from the EU to Russia have diminished as a consequence of the “Russian risk” (the investors were driven away by the instability generated by the sanctions along with the depreciation of national currency, risks that were added to the “traditional ones” – red tape and a changing FDI regulatory framework).

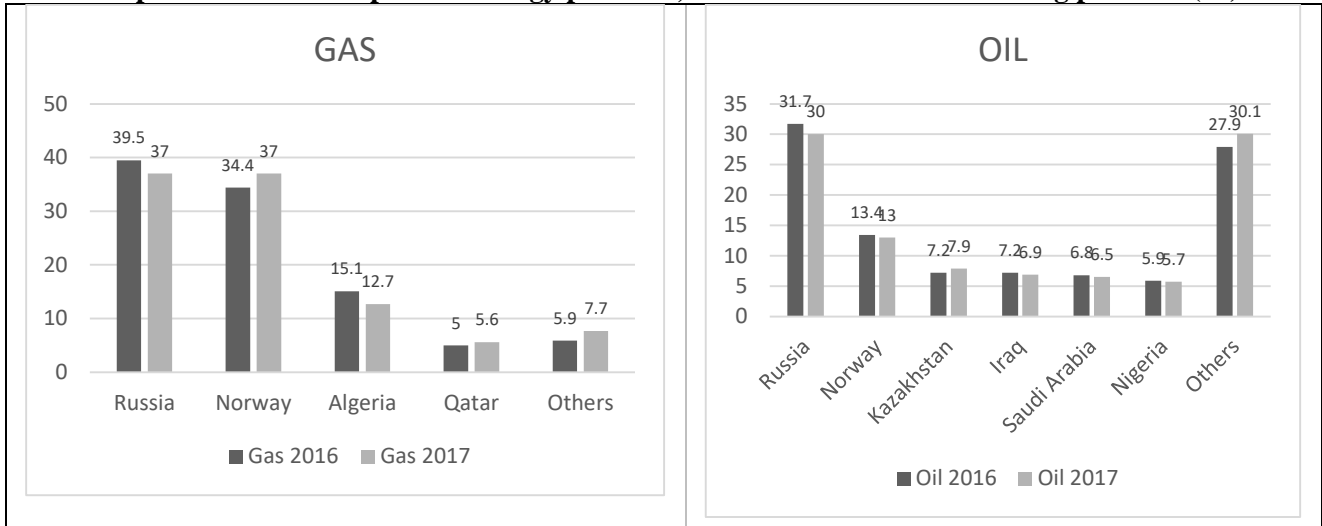
Graph 2: EU foreign direct investment with Russian Federation (EUR billion)



Source: Author, based on DG Trade (2018).

However, it should be noticed that even if the sanctions affected the bilateral trade between EU and Russia, Russia’s main source of “power” over the EU – the energy exports – remains unchanged. Despite the tensions between the two parties, the EU is still largely dependent on Russia for its energy sources (see Graph 3). Russia was the largest supplier of natural gas in the European market both in 2016 and 2017, according to DG Trade data.

Graph 3: Extra-EU imports of energy products, share in value of main trading partners (%)

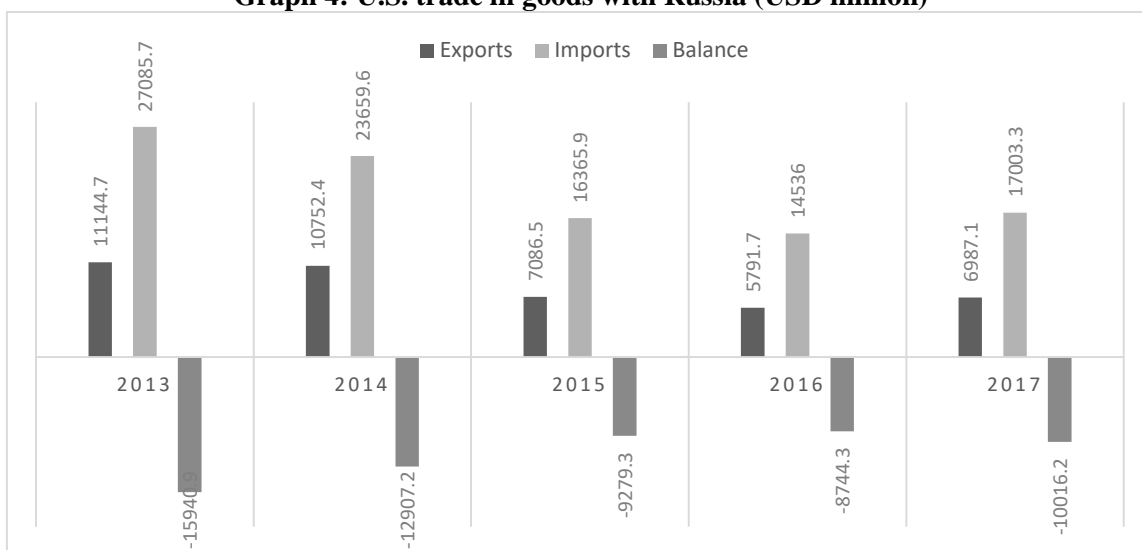


Source: Author, based on DG Trade (2018)

As some studies have pointed out (Saravalle, 2017), “as the world’s second-largest producer of natural gas, Russia actually has leverage over its European customers by threatening to cut off gas supplies, and it’s using this power to foster discord among European countries”. Practically, through its energy exports, notably gas exports, Russia has maintained its power and influence, despite the sanctions regime. However, the relationship with the U.S. is somehow more complicate. While there is a general concern that Russia’s “pipeline policy” poses a direct challenge to the U.S. post-World War II interest in European stability, the latest sanctions imposed by the U.S. are meant to put more pressure on the Russian authorities. The latest punitive measures (on seven oligarchs, 17 top officials and 12 companies) introduced by the U.S. on April 6 have [led to a massive crash](#) of Russia's stock and currency markets, leading to tens of billions of dollars in losses on Russian markets within just a few hours after their impositions.

But was bilateral trade between U.S. and Russia affected? According to the U.S. Foreign Trade, the sanctions impacted both imports and exports, while in 2017, they were significantly reduced compared with 2013 (prior to the imposition of sanctions) as shown by the Graph 4.

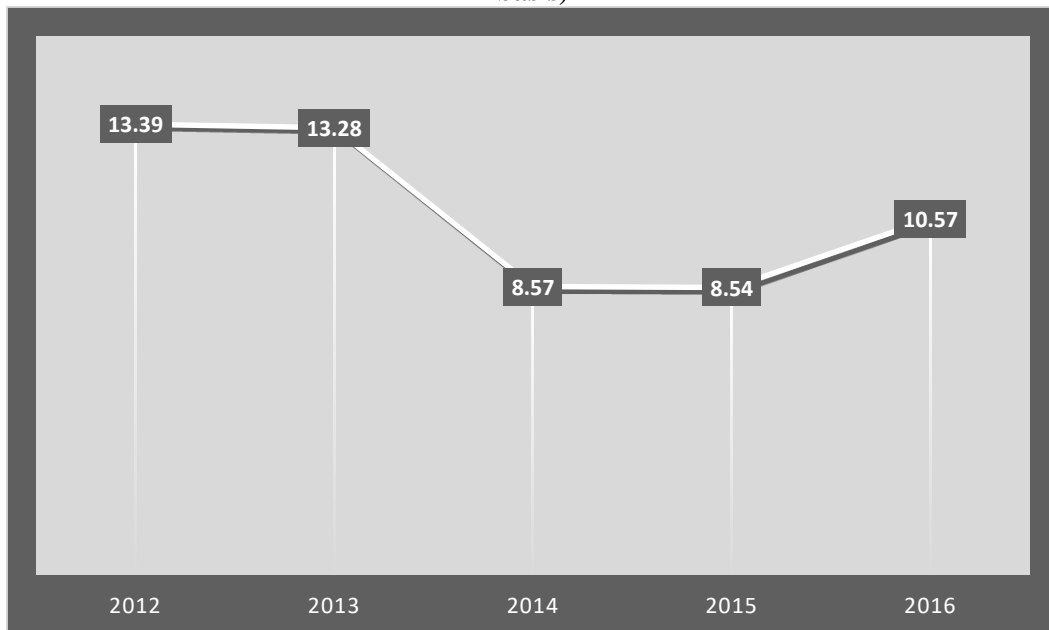
Graph 4: U.S. trade in goods with Russia (USD million)



Source: Author, based on U.S. Foreign Trade (2018).

The U.S. investment with Russian Federation also began to decline after the sanctions were imposed. In the first year after the sanctions, the U.S. direct investment position in Russia declined compared with the year before the sanctions imposition (see Graph 5).

Graph 5: U.S. direct investment position in Russia from 2012 to 2016 (in USD billion, on a historical cost basis)

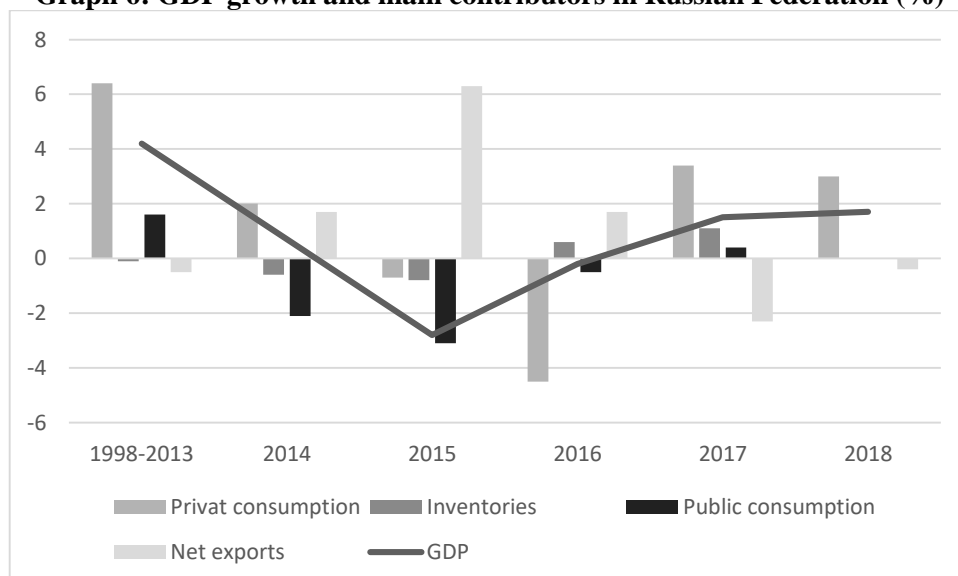


Source: Author, based on Statista (2018).

4. Russia’s global power: future challenges in the post-sanctions era

So, the sanctions had some consequences on bilateral trade, on the national currency and on GDP, but have they really affected Russia’s global power? Some analysts are sceptical about that. While Russia registered a slight recession in the first year after the sanctions (see the Graph 6), “the Kremlin is sticking to its course and Vladimir Putin's power has only grown” (Janjevic, 2018).

Graph 6: GDP growth and main contributors in Russian Federation (%)



Source: Author based on national statistics of Russian Federation.

Note: The data for 2018, are forecast.

The same analysis underlines the fact that even if the Russian economy contracted in 2015 and 2016, it has shown growth in 2017, and better future prospects for 2018, while [most of the previous recession was caused by a drop in oil prices](#). So, from that point of view, the western sanctions appear to be ineffective, but there are

studies (World Bank, 2017) that are highlighting that Russia's return to growth in 2017 (supported by the rise of oil prices) was modest and that the sanctions had negative consequences of FDI flows.

The World Bank analysis points out that the sluggish investment demand and the growth composition of 2017 are similar to the pre-crisis situation, when the country's growth was driven mostly by mineral resource extraction and non-tradable sectors (a structural weakness of Russian economy). However, some analysts are more optimistic about Russia's future as a world super-power. Even if during the first decade after the communist regime fall Russia seemed depleted and defeated, after Vladimir Putin's accession to power a transformation process begun and "step by step, Russia's ruler is restoring his nation to its former grandeur" (Jacques, 2018). The engine of Russia's revival, even after the imposition of sanctions, are the national strategies for rebuilding the country's economic, political and military power.

Undoubtedly, military power is an important "ace" of Russian power in the international arena, along with its huge energy reserves. But are those two enough to form the foundation of lasting influence and power in today's globalised world? Probably not. Because, while Russia is politically and militarily strong, it remains economically vulnerable. With a GDP of the size of Netherland and Belgium combined (USD 1,469 billion in 2017), Russia is "boxing above its economic weight on the international scene" (De Grauwe, 2018), meaning that the country must exert extraordinary efforts to create and maintain a strong military potential. While In 2017, Russian military spending amounted to USD 61 billion (according to national statistics), the U.S. spent nearly 10 times more, namely USD 603 billion, China spent USD 151 billion on defence and yet all those expenses accounted for a much smaller proportion of those countries GDP compared with Russia. However, Russia's power in the world military arena is enforced not necessarily by its military expenses, but by its nuclear arsenal which gives this country a unique position in the world, right next to the U.S. Those outcomes, combined with the fact that Russia is also an important supplier of raw materials, including oil and gas, especially for Europe, are the core foundation of Russia's power today. There are opinions underling that Europe is the main "giver" of Russian influence and that Russia is powerful because Europe grants that power to Russia (De Grauwe, 2018). In our opinion, although many of the mentioned analyses are highlighting important arguments, the source of Russia's power in the world its Russia itself. The country proved resilient and capable of a rebirth crisis after crisis during the post WWII era. With large natural resources, huge territory and a numerous population, Russia remains a geopolitical force in today's world. After the sanctions, the country found ways to move forward and shifted to new partnerships. It is currently building a strong economic partnership with China (during the Far East Initiative) and has become the world's larger wheat exporter (a huge accomplishment given the fact that after the imposition of the ban on the import of European agricultural products, the country was confronted with a shortage on the supply of those products).

5. Conclusion

Undoubtedly the sanctions regime had negative consequences for the Russian economy, and for Russia's position as a geopolitical power in the international arena. However, the sanctions have highlighted that Russia proved resilient and capable of finding solutions to overcome this crisis. For instance, Russia's decision to ban the import of produce, cheese and other products from [the EU](#) in retaliation for sanctions, as well as the subsequent rouble crisis, have stimulated the growth of Russian agriculture and, for the first time in its history, the Russian Federation has started to earn more from food exports than from the arms trade. While China and Russia have deepened their strategic partnership through energy agreements, joint military exercises, and economic development in Central Asia through the Belt and Road Initiative, Russia is gradually building a strategy in order to pierce the "iron circle" of sanctions. As the U.S.- and EU - Russia relationships saw continuing deterioration, China's outbound trade to Russia has grown rapidly, and China's foreign direct investment in areas ranging from infrastructure to real estate have steadily increased. Also, the energy cooperation between China and Russia has deepened, as evidenced by the fact that Russia has become China's top supplier of crude oil. When asked if the sanctions had an effect in diminishing Russia's influence in the global arena, our answer is no. They have economic consequences and effects on trade and investment flows from countries that have imposed sanctions, but Russia's global power has not been diminished. Moreover, Russia's new strategic alliances (including with China) could be the source of a new empowerment and although western countries have criticized Russia as a revisionary power intent on undermining the current world order, China could support the Russian position in the New World Order, while this country has worked to improve its standing within the international system and has benefitted greatly from that approach.

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