

# Sanctions on Russia

A Study of Economic Coercion  
in the Contemporary World



Rajneesh Singh

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# SANCTIONS ON RUSSIA: A STUDY OF ECONOMIC COERCION IN THE CONTEMPORARY WORLD

RAJNEESH SINGH



MANOHAR PARRIKAR INSTITUTE FOR  
DEFENCE STUDIES AND ANALYSES

मनोहर पर्रिकर रक्षा अध्ययन एवं विश्लेषण संस्थान

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*For Rhea*

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## *PREFACE*

On 24 February 2022, the Russian President Vladimir Putin announced a ‘special military operation’ in Ukraine. The operation, he said, was, ‘aimed at protecting civilians and countering the encroaching threat of the North Atlantic Treaty Organization.’<sup>1</sup> Following his televised address, Russian forces advanced along four main fronts: from Belarus towards Kyiv; westwards, from Russia towards Kyiv and Kharkiv; from Crimea towards Odesa in the west, and Zaporizhzhia in the north; and towards Mariupol in the east.<sup>2</sup> The Ukrainian forces put up stronger than expected resistance, and any hope of a quick Russian victory was lost.

Russia’s special military operation triggered a series of sanctions by the USA, the EU, and others. These countries immediately imposed restrictions on Russia’s financial industry, its central bank and energy export, and export control measures. Many foreign companies have withdrawn voluntarily, anticipating adverse public opinion. All these measures have had a profound impact on the Russian economy.

Three months before Russia’s 2022 special operations in Ukraine, CIA Director, William Burns, and the US Ambassador to Russia, John Sullivan, met with Nikolai Patrushev, Adviser to Russian President Vladimir Putin, in Moscow. The visiting Americans warned Patrushev that the West would impose severe consequences on Russia should it proceed with its plans to invade Ukraine. Soon after, the USA publicly

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<sup>1</sup> Ann M. Simmons, ‘Putin Announces Special Military Operation in Eastern Ukraine’, *The Wall Street Journal*, 23 February 2022, at <https://www.wsj.com/livecoverage/russia-ukraine-latest-news/card/putin-announces-special-military-operation-in-eastern-ukraine-BBbiFSHMKssPMTur01Vh>, accessed 11 March 2022.

<sup>2</sup> ‘Six months on, the Russia-Ukraine war mapped out’, Al Jazeera, 23 August 2022, at <https://www.aljazeera.com/news/longform/2022/8/23/russia-ukraine-war-after-six-months-explained-in-maps>, accessed 24 Aug 22.



repeated its threat. Almost three months ahead of the military operations, Russia was aware that the USA and its allies would attempt to destabilise both the Russian economy and its war efforts. These three months of advance warning gave the Russians and the Western allies time to prepare, if Russia were to indeed go ahead with its planned operations in Ukraine.

One year after the war, the West, led by the USA, continues to impose newer sanctions and export control measures on Russia. By the end of January 2023, the USA had imposed trade restriction on close to 380 entities. The West appreciates that the unprecedented sanctions and export control measures that it has imposed are having a debilitating impact on the Russian economy, and its war efforts. One of the greatest areas of impact on the Russian defence industry is the embargo on critical technology equipment and parts. This is hampering efforts to sustain, repair, and resupply the Russian armed forces. On the other hand, notwithstanding the Western claims, there are Russian announcements and assessments which suggest that it is going to be a prolonged war.

## **AIM**

The first anniversary of the war is an appropriate time to assess the impact of Western sanctions on the Russian economy and war resolution efforts, and assess its usage as a tool of coercive diplomacy. The aim of this monograph is to study the impact of Western sanctions on Russia in the contemporary global environment, and to assess the scope and limits of this tool of coercive diplomacy on the Russian economy and war resolution efforts.

## **SCOPE**

The scope of the study is limited to the period February 2022 to February 2023 — that is, during one year of fighting and the imposition of sanctions. The study will focus on actions taken by Western nations, including those restricting the access to weapons and technology as well as the sale of Russian energy. The study will also analyse Russian reactions to the sanctions, and the efforts made to mitigate their impact on the country as well as on the war effort. The actions of countries, such as China and India, will also be examined. In doing so, an attempt

will be made to assess the efficacy of Western actions and their impact on the Russian economy, war prosecution efforts, and war-termination.

Chapter One studies sanctions and export control measures imposed by the West. Of particular interest is the manner in which the sanctions were planned and implemented. The West paid special attention to Russian energy, and took measures to reduce their own dependence on it. Controls were also imposed on weapon systems and technology. These issues will be addressed in the chapter. Chapter Two focuses on Russian measures to mitigate the impact of sanctions, both before and after the commencement of the war. The chapter also attempts to study the sanction evasion schemes employed by Russia. Chapter Three will analyse the fact that China and India have not condemned Russian actions, and have continued to maintain trade relations with Russia. The chapter will attempt to explore the rationale for their actions, and the impact on Western sanctions. Chapter Four will critically analyse the efficacy of sanctions on Russia, and prognosticate the impact of sanctions on conflict termination.

## ANALYTICAL FRAMEWORK

Defining the analytical framework of the monograph before examining the sanctions imposed by the West and their impact on Russia is prudent here. According to Sir Harold Nicolson, diplomacy is ‘the management of international relations by negotiation’.<sup>3</sup> This course of action may be appropriate in a harmonious international environment. However, the reality of the contemporary world is far from harmonious. On the other hand, the application of kinetic power has extreme implications. Coercive diplomacy lies between these two extremes, and can be construed as diplomatic strategy with a limited amount of coercion. It aims to apply pressure in a manner and magnitude that

seeks to persuade an opponent to cease aggression rather than bludgeon him into stopping ... just enough force of an appropriate

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<sup>3</sup> Bruce Jentleson, *Coercive Diplomacy: Scope and Limits in the Contemporary World*, The Stanley Foundation Policy Analysis Brief, 2006, pp. 6–7.

kind to demonstrate resolution and to give credibility to the threat that greater force will be used if necessary.<sup>4</sup>

Thomas Schelling's exposition of coercion as the 'power to hurt' — which best succeeds when it is 'held in reserve' rather than when it is used as 'brute force' — is pertinent for policy makers. The full-scale use of force (war-fighting) should not be interpreted as the most extreme execution of a purposeful threat: rather, it should translate into the failure of coercion.<sup>5</sup>

Sanctions are a tool of coercive diplomacy, and may be defined as measures taken by one country to disrupt economic exchange with another.<sup>6</sup> They are categorised into primary sanctions and secondary sanctions. Primary sanctions, such as asset freezes and trade embargoes, prohibit citizens and companies of the sanctioning country from engaging in certain activities with their counterparts from the sanctioned country.<sup>7</sup> Secondary sanctions put pressure on third parties to stop their activities with the sanctioned country by threatening to cut-off the third party's access to the sanctioning country.<sup>8,9</sup>

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<sup>4</sup> Alexander L. George and William E. Simons (eds.), *The Limits of Coercive Diplomacy*, 2nd ed., Boulder, Col.: Westview, 1994, p. 9. Also See Note 3

<sup>5</sup> Maria Sperandei, 'Bridging Deterrence and Compellence: An Alternative Approach to the Study of Coercive Diplomacy', *International Studies Review*, Vol. 8, No. 2, June 2006, pp. 253–280, see p. 258.

<sup>6</sup> Daniel W. Drezner, 'The United States of Sanctions The Use and Abuse of Economic Coercion', *Foreign Affairs*, September/October 2021, at [https://www.foreignaffairs.com/articles/united-states/2021-08-24/united-states-sanctions?utm\\_medium=social](https://www.foreignaffairs.com/articles/united-states/2021-08-24/united-states-sanctions?utm_medium=social), accessed 15 September 2021.

<sup>7</sup> For example, following Russia's annexation of Crimea, the US government prohibited, among other things, new investment in Crimea by US persons.

<sup>8</sup> For example, in order to halt Iran's nuclear programme, US secondary sanctions give financial institutions around the world a choice to either halt transactions with Iranian banks or lose access to the US financial system.

<sup>9</sup> Ole Moehr, 'The United States of Sanctions The Use and Abuse of Economic Coercion', *Atlantic Council, EconoGraphics*, 6 February 2018, at <https://www.atlanticcouncil.org/blogs/econographics/ole-moehr-3/>, accessed 3 January 2023.

Export control is an entirely separate category tool of coercion, and works differently from sanctions. It is aimed at curbing the target's access to commodities and technologies. Many tend to group sanctions and export control together, despite the difference in their method of operation. The sanctions halt trade and banking relations from the date of their implementation, while the export control gradually curtails the target's access to commodities and technologies. In reality, it has been seen that export controls have rarely been foolproof since the target country has often been able to get access to restricted items via a third country, or through domestic production.<sup>10</sup>

Some important terms associated with these measures are given below.

- Sanctions refer to the measures taken by one country or a group of countries to restrict trade, financial transactions, and diplomatic relations with another country. Sanctions are used as a diplomatic tool to pressure a country to change its behaviour or policies.<sup>11</sup>
- Export controls are measures taken by a country to regulate the export of certain goods, technologies, and services to other countries. These controls are designed to prevent the spread of sensitive materials, technologies, or knowledge that could be used for military purposes, or to support terrorist activities.<sup>12</sup>

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<sup>10</sup> Maria Shagina, 'Technology Controls Can Strangle Russia—Just Like the Soviet Union', *Foreign Policy*, 22 August 2022, at <https://foreignpolicy.com/2022/08/22/russia-ukraine-war-sanctions-export-controls-technology-transfer-semiconductors-defense-industry-military-espionage/>, accessed 19 November 2022.

<sup>11</sup> United Nations Security Council 47th year (31 March 1992). Resolution 748 (1992) / adopted by the Security Council at its 3063rd meeting, on 31 March 1992, United Nations Digital Library, at <https://digitallibrary.un.org/record/196976?ln=en>, accessed 17 April 2023.

<sup>12</sup> 'Wassenaar Arrangement on Export Controls for Conventional Arms and Dual-Use Goods and Technologies', Founding Documents, Volume I, Wassenaar Arrangement Secretariat in Wassenaar Arrangement (WA-DOC (17) PUB 001), February 2017, at <https://www.wassenaar.org/app/uploads/2015/06/WA-DOC-17-PUB-001-Public-Docs-Vol-I-Founding-Documents.pdf#page=7>, accessed 17 April 23.

- Dual-use items are goods, technologies, or software that can have both civilian and military applications. While these items can be used for peaceful purposes, they can also be used to develop weapons of mass destruction, missiles, or other military equipment.<sup>13</sup>
- Sectoral sanctions are targeted sanctions that restrict specific sectors of a country's economy, such as finance, energy, or defense. These sanctions are designed to minimize the impact on the general population while exerting pressure on the targeted regime.<sup>14</sup>
- The Entity List is a list of foreign entities maintained by the US Department of Commerce. It restricts these entities from receiving certain US-origin goods, technologies, or services.<sup>15</sup>
- The Magnitsky Act is a US law that imposes sanctions on individuals and entities responsible for human rights abuses or corruption. The law is named after Sergei Magnitsky, a Russian lawyer who died in police custody after uncovering a large-scale corruption scheme.<sup>16</sup>

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<sup>13</sup> Council Regulation (EC) No 428/2009 of 5 May 2009, setting up a Community regime for the control of exports, transfer, brokering, and transit of dual-use items (Recast), 29 May 2009, in The Council of The European Union (L 134/1), at <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32009R0428&from=EN>, accessed 18 April 2023.

<sup>14</sup> 'Blocking Property of Additional Persons Contributing to the Situation in Ukraine', Executive Office of the President of the United States, 2014, in Executive Order 13662 (No. 2014-06612), Federal Register: The Daily Journal of the United States Government, at <https://www.federalregister.gov/documents/2014/03/24/2014-06612/blocking-property-of-additional-persons-contributing-to-the-situation-in-ukraine>, accessed 18 April 2023.

<sup>15</sup> Control Policy: End-User and End-Use Based: Supplement No. 4 to Part 744 – ENTITY LIST, 2023, Export Administration Regulations (EAR) Part 744, in Bureau of Industry and Security. U.S. Department of Commerce, at <https://www.bis.doc.gov/index.php/policy-guidance/lists-of-parties-of-concern/entity-list>, accessed 18 April 2023.

<sup>16</sup> 'Russia and Moldova Jackson-Vanik Repeal the Sergei Magnitsky Rule of Law Accountability Act of 2012', PUBLIC LAW 112-208-DEC. 14, 2012, 14 December 2012, U.S. Government Publishing Office, at <https://www.govinfo.gov/content/pkg/PLAW-112publ208/pdf/PLAW-112publ208.pdf>, accessed 18 April 2023.

## ECONOMIC COERCION: A CHEQUERED HISTORY

Economic statecraft has been a vital component of US diplomacy since the early days of the republic. President Thomas Jefferson passed the Embargo Act of 1807 to punish the UK and Napoleonic France for harassing US ships.<sup>17</sup> That effort at sanctions was a disaster. In the early years of the nineteenth century, the USA needed European markets far more than the UK and France needed the US market. The Embargo Act cost the USA far more than it did the European great powers. Despite losses, the USA continued to use economic coercion as a main tool of foreign policy.<sup>18</sup> At the end of World War I, the USA renewed its enthusiasm for trade sanctions as a means of regulating world politics. President Woodrow Wilson urged Americans to support the League of Nations by arguing that its power to sanction would act as a substitute for war. ‘A nation boycotted is a nation that is in sight of surrender,’ he said in 1919. ‘Apply this economic, peaceful, silent, deadly remedy, and there will be no need for force. It is a terrible remedy.’ However, the Americans remained unconvinced, and the USA never joined the League of Nations.

In the end, the sanctions imposed by the League failed to deter Italy from invading Ethiopia in 1935, or stop any other act of belligerence that eventually led to the outbreak of World War II. In fact, the US embargo on fuel, and other war materials going to Japan, helped precipitate the attack on Pearl Harbor.<sup>19</sup> There is evidence to suggest

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<sup>17</sup> US President Thomas Jefferson’s nonviolent resistance to British and French molestation of US merchant ships carrying, or suspected of carrying, war materials and other cargoes to European belligerents during the Napoleonic Wars. See, Britannica, <https://www.britannica.com/topic/Embargo-Act>. Thucydides accounts suggest what may have been the first use of sanctions, when Athens instituted a commercial ban against merchants from the city of Megara in 432 BC. See also, Joshua Keating, ‘Economic sanctions were designed as a severe threat. Now they’re a default policy option’, *The Washington Post*, 25 February 2022, at <https://www.washingtonpost.com/outlook/2022/02/25/economic-weapon-review-sanctions-history-mulder/>, accessed 30 May 2023.

<sup>18</sup> Daniel W. Drezner, no. 6.

<sup>19</sup> Ibid.

that the Japanese attack on Pearl Harbour was a consequence of US policy of freezing Japanese assets and the embargo on oil sales to oppose the Japanese war in China.<sup>20</sup>

In 1990, after Iraq invaded Kuwait, the Security Council imposed a comprehensive trade embargo on Iraq. Iraq's GDP reduced by half; however, economic pressure could not force Saddam Hussain to withdraw from Kuwait. A Western coalition had to launch a war to force Saddam Hussain to withdraw.<sup>21</sup>

Since 2006, the UN Security Council has passed nearly a dozen resolutions sanctioning North Korea for developing nuclear weapons and related activities. The USA and other countries have also imposed unilateral sanctions banning the trade of weapons and military equipment, freezing the assets of people involved in the nuclear program, and restricting scientific cooperation, among other actions. Despite the crippling sanctions, North Korea continues to arm and test missiles and nuclear weapons.<sup>22</sup> Similar is the case with Iran. The sanctions have not pressurised the Iran regime to surrender its nuclear ambitions. In February 2022, the International Atomic Energy Agency (IAEA) reported that it had found uranium enriched to 84% in Iran — which is very close to weapons grade.<sup>23</sup>

It is not as if there are no success stories. During the Cold War era, the USA provided a significant amount of multilateral and bilateral foreign

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<sup>20</sup> Erik Sand and Suzanne Freeman, 'The Russian Sanctions Regime and the Risk of Catastrophic Success', *War on the Rocks*, 8 March 20 22, at <https://warontherocks.com/2022/03/the-russian-sanctions-regime-and-the-risk-of-catastrophic-success/>, accessed 10 March 2022.

<sup>21</sup> Daniel W. Drezner, no. 6.

<sup>22</sup> 'What to Know About Sanctions on North Korea', Council on Foreign Relations, 27 July 2022, at <https://www.cfr.org/background/north-korea-sanctions-un-nuclear-weapons>, accessed 27 January 2023.

<sup>23</sup> Francois Murphy, 'IAEA says it is in discussions with Iran after report of enrichment', Reuters, 20 February 2023, at <https://www.reuters.com/world/middle-east/iaea-says-discussions-with-iran-after-report-enrichment-2023-02-19/>, accessed 22 February 2023

aid to allies and partners. This provided the USA with substantial influence over the recipient country, and any move by the USA at economic coercion had a significant impact on the target country. During the Suez Crisis of 1956, the USA forced the UK to withdraw its troops from the area.<sup>24</sup>

After renouncing its weapons of mass destruction (WMD) programmes, Libya is presented as another success story of economic coercion. On 19 December 2003, the Libyan President, Muammar Gaddafi, renounced Tripoli's WMD programmes and invited inspectors to verify his claims. The Bush Administration claimed that the USA led 2003 invasion of Iraq as well as the October 2003 interdiction of a ship containing nuclear-related components destined for Libya, as being key factors in Tripoli's decision; however, outside experts argue that years of sanctions and diplomatic efforts were more important.<sup>25</sup>

The chequered history of sanctions is indicative of its limited efficacy. There are studies to suggest that the USA, in many cases, is unable to impose its will by using economic means alone. A 2014 study relying on a data set maintained by the University of North Carolina found that, at best, sanctions lead to concessions between one-third and one-half of the time. A 2019 US Government Accountability Office study concluded that not even the federal government was necessarily aware when sanctions were working. The report noted that Officials at the Treasury, State, and Commerce Departments 'stated they do not conduct agency assessments of the effectiveness of sanctions in achieving broader US policy goals.'<sup>26</sup>

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<sup>24</sup> The United States' most successful use of economic sanctions in this period was during the 1956 Suez Crisis. Outraged by the British-French-Israeli invasion of Egypt, Washington prevented the UK from drawing down its International Monetary Fund reserves to defend its currency. The subsequent run on the Pound forced London to withdraw its troops. See, Daniel W. Drezner, no. 6.

<sup>25</sup> 'Chronology of Libya's Disarmament and Relations with the United States', Arms Control Association, March 2021, at <https://www.armscontrol.org/factsheets/LibyaChronology>, accessed 22 February 2023.

<sup>26</sup> Daniel W. Drezner, 2021, no. 6.



## ECONOMIC COERCION AGAINST RUSSIA

In retaliation to Russian ‘special military operation’, the USA laid out a two-pronged strategy of economic coercion. The first prong of the strategy was to deny the Kremlin the ability to use its money to procure war like stores; the second prong was to reduce the revenues that President Putin could use to fund the war, and prop up Russia’s economy.<sup>27</sup> The EU also adopted a number of sanctions designed to weaken Russia’s economic base, depriving it of critical technologies and markets with the aim to significantly curtail its ability to wage war.<sup>28</sup>

The USA, its allies, and partners announced a series of unprecedented sanctions<sup>29</sup> against Russia even before its forces entered Ukraine.<sup>30</sup> On 21 February 2022, the USA announced the first tranche of sanctions. These followed the moving in of Russian ‘peacekeepers’ in the Donbas

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<sup>27</sup> ‘Remarks by Deputy Secretary of the Treasury Wally Adeyemo on International Sanctions Against Russia’, US Department of Treasury, 21 February 2023, at <https://home.treasury.gov/news/press-releases/jy1286>, accessed 23 February 2023.

<sup>28</sup> Council of the European Union, ‘Timeline: EU restrictive measures against Russia over Ukraine’, 2022, at <https://www.consilium.europa.eu/en/policies/sanctions/restrictive-measures-against-russia-over-ukraine/history-restrictive-measures-against-russia-over-ukraine/>, accessed 17 January 2023.

<sup>29</sup> Sanctions are penalties imposed by one country on another to stop them acting aggressively, or breaking international law. They are among the toughest actions nations can take, short of going to war. See, ‘What are the sanctions on Russia and are they hurting its economy?’, BBC News, 30 September 2022, at <https://www.bbc.com/news/world-europe-60125659>, accessed 27 January 2023.

<sup>30</sup> Moscow has been dealing with sanctions since 2012, when the US and EU imposed punitive measures against Russian individuals and organizations in connection with the Magnitsky case. More sanctions were imposed following Russia’s annexation of Crimea in 2014. See, ‘The Impact of Sanctions on Russia’, *Geopolitical Futures*, 4 April 2022, at <https://geopoliticalfutures.com/the-impact-of-sanctions-on-russia/>, accessed 27 January 2023.

region, and the announcement of the independence of the two republics, Donetsk People's Republic and the Luhansk People's Republic. On 24 February 2022, the USA announced a second, stronger package of sanctions in response to Russia's full-scale invasion of Ukraine. These sanctions were implemented in tandem with those announced by other Western allies and partners. The EU, UK, Canada, Australia, Japan, South Korea, and Taiwan announced their own sanctions and export controls.

The second tranche of sanctions included the expansion of the Foreign Direct Product Rule (FDPR), which targeted high-ranking Russian officials and their families, state-owned enterprises, and Russia's financial sector — including its two largest commercial banks. The third tranche of sanctions barred some Russian banks from SWIFT (the financial messaging system), sanctioned the Russian central bank, and announced the establishment of a multilateral task force to identify and freeze the assets of high-ranking Kremlin officials, including Putin. These were announced on 26–27 February 2022.<sup>31</sup>

The EU has progressively imposed sanctions on Russia since 2014, following the annexation of Crimea. It massively expanded the sanctions in 2022, following Russia's decision to recognise the areas of the Donetsk and Luhansk oblasts as independent entities, and the launch of 'military operations' against Ukraine. By the end of December 2022, the EU had adopted nine packages of sanctions.<sup>32</sup>

The West has been unified in its response to implement punitive actions against Russia. However, some emerging market economies are notable in their hesitation to condemn Russia. These include Turkey, Brazil,

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<sup>31</sup> Gerard Dipippo and Matthew Reynolds, 'EU response to Russia's invasion of Ukraine', *CSIS*, 2 March 2022, at <https://www.csis.org/analysis/sanctions-response-russias-invasion-ukraine>. accessed 17 January 2023.

<sup>32</sup> Council of the European Union, 'EU response to Russia's invasion of Ukraine', 2022, at <https://www.consilium.europa.eu/en/policies/eu-response-ukraine-invasion/>, accessed 17 January 2023.

Israel, and India. With its long-standing ties with Russia, India has sought to carve out a neutral position. Importantly, China has emphasized the importance of ‘respecting ... territorial integrity’, but also recognizing ‘Russia’s legitimate security concerns.’ Although Brazil voted (25 February) for the UN resolution ‘deploring’ the Russian invasion, President Bolsanaro has said that Brazil will stay neutral in the conflict. The Israeli government has been circumspect in its criticism of Moscow, fearing it could jeopardize Russia-Israel defence coordination in Syria.<sup>33</sup>

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<sup>33</sup> Ibid.

# THE PLANNING AND IMPLEMENTATION OF SANCTIONS AGAINST RUSSIA, INCLUDING ENERGY SANCTIONS

‘Sprinkle it Salt Bae style with a few drops of someone else’s diesel, it’s no longer Russian’.<sup>34</sup>

— Viktor Katona, Kpler

Sanctions have been used by US as a tool of foreign policy for over a century. They are an effective tool of coercive diplomacy when imposed multilaterally, and sustained over time. In recent years, one high-profile use of sanctions is the case of Russia, which has been suffering them since 2012. Following Russia’s annexation of Crimea in 2014, additional sanctions were imposed. This chapter will explore the planning and implementation of these sanctions, including those on Russian energy.

In the recent years, whenever there is a requirement of action ‘without deploying the military or risking broader conflict’,<sup>35</sup> sanctions have been a favoured policy tool of US policy makers. Since February 2022, the USA and its allies and partners as well as other major powers, such as Japan, have pursued economic sanctions as one of their principal

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<sup>34</sup> Sean Mathews, ‘Middle East primed to pounce when EU bans Russian diesel’, *Middle East Eye*, 18 January 2023, at URL <https://www.middleeasteye.net/news/middle-east-sweet-spot-ahead-russian-import-ban>, accessed 23 January 2023.

<sup>35</sup> Kenneth I. Juster (2021), ‘Remove a Sanctions Cloud From US-Indian Relations’, *War on the Rocks*, 27 April 21, at <https://warontherocks.com/2021/04/remove-a-sanctions-cloud-from-u-s-indian-relations/>, accessed 28 April 2021.

responses to thwart Russian plans for Ukraine.<sup>36</sup> They have imposed the most comprehensive package of financial and technological sanctions ever applied to a nuclear-armed great power. The USA and its allies and partners have implemented measures that have imposed immediate and long-term costs on Russia's financial system and economy, cutting off Russia's access to global financial markets and critical trade, degrading Russia's access to vital technology and inputs, and denying Russia access to his finances which can fund the war in Ukraine.<sup>37</sup>

The decision to impose sanctions against Russia was the result of a coordinated plan by the Western alliance, and was aimed at punishing Russia for its actions in Ukraine, including the annexation of Crimea and its support for separatist rebels in eastern Ukraine. The decision to impose sanctions was also driven by a desire to deter Russia from further aggression, and to signal to other countries that such actions would not be tolerated.<sup>38</sup> In doing so, the West is hoping to severely weaken Russian economy and political elite.<sup>39</sup>

The planning and implementation of sanctions against Russia has involved a wide range of actors, including governments, international organizations, and private companies. While the USA and the EU were at the forefront of the effort to impose sanctions, other countries, aligned with USA, also played a role. The measures included cutting

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<sup>36</sup> By August 2022, 37 countries had joined USA to sanction Russia.

<sup>37</sup> FPC Briefing, 'U.S. Sanctions on Russia', US Department of State, 18 March 2022, at <https://www.state.gov/briefings-foreign-press-centers/%e2%80%afu.s.-sanctions-on-russia>, accessed 1 March 2023.

<sup>38</sup> Some are of the opinion that the USA and its allies imposed sanctions because there was a 'reputational cost' associated with not doing anything, especially after having announced their support to Ukraine; they also believe that the 'specific strategic goals of these sanctions remain unclear.' See, Daniel W. Drezner, 'What is the plan behind sanctioning Russia?' *The Washington Post*, 1 Mar 22, at <https://www.washingtonpost.com/outlook/2022/03/01/what-is-plan-behind-sanctioning-russia/> accessed 6 January 23.

<sup>39</sup> 'Sanctions against Russia', Federal Ministry of Finance, Germany, 18 March 2022, at <https://www.bundesfinanzministerium.de/Web/EN/Issues/Europe/War-in-Ukraine/war-in-ukraine.html> accessed 20 January 2023.

off Russian banks from the financial markets of the West, restrictions on trade, investment, and travel, as well as targeted measures against individuals and companies that were seen as supporting the Russian government.

One most significant aspect of the sanctions was directed against the Russian energy sector. Russia is one of the world's largest producers of oil and gas, and its energy exports are a critical source of revenue for the country. The impact of the sanctions against Russia and its energy sector was felt not just in Russia but also in the global energy market. The restrictions on Russian energy exports led to a tightening of the market which, in turn, led to higher oil and gas prices. This had implications for countries around the world, particularly those that are heavily reliant on imported energy.

This chapter will analyse the sanctions imposed by the West and their implications in detail. It will specifically deliberate on the sanctions imposed on Russian energy as well as control on weapon systems and technology.

## **HOW SANCTIONS WERE PLANNED AND IMPLEMENTED BY EU IN CONJUNCTION WITH THE USA<sup>40</sup>**

In its 1 July 2022 edition, the Spiegel International has a report on the manner in which the sanctions were planned and implemented by the EU in conjunction with the USA. The idea to impose coordinated sanctions originated in November 2021, during the visit of CIA Director, Bill Burns, to Brussels. The US intelligence chief had just returned from Russia, and was convinced that President Putin was planning a large-scale invasion of Ukraine. Since a large-scale military response by the North Atlantic Treaty Organisation (NATO) was not being contemplated, it was decided that a coordinated and substantial economic penalty would be imposed on Russia.

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<sup>40</sup> For details of how the sanctions were planned and implemented, see Michael Sauga, 'How Well Are Sanctions Against Russia Working?' Spiegel International, 1 July 2022, at <https://www.spiegel.de/international/europe/how-well-are-european-sanctions-against-russia-working-a-2c83502d-e64f-43a7-98c8-a8076e5746fc>, accessed 5 July 2022.

The USA had imposed economic sanctions following the Russian occupation of Crimea in 2014. It was decided that Europe should also join in to increase the severity of these actions. The chief interlocutors of the programme included Björn Seibert<sup>41</sup> of the EU, and the Deputy Secretary of State, Wendy Sherman, and the Deputy National Security Adviser Daleep Singh, a former Goldman Sachs banker in the USA. By the end of January 2022 — weeks before Russia's 'special military operation' began — broad outlines of sanctions regime, catering for five different war scenarios, had been planned. The planning for various scenarios was wide-ranging as very few diplomats expected Russia to launch a full-scale operation. It was anticipated Russian military operations would be restricted to Eastern Ukraine, and milder sanctions were planned for such a scenario.

In order to plan for all encompassing sanctions, Seibert consulted with the senior officials of the Directorates General for trade, finance, and energy. These officials went into the granular details of the manner in which various items were produced, and how they could be replaced by Russia, if sanctioned. Thereafter, decisions were taken regarding how to 'impose high costs on Russia', and 'minimize undesirable consequences for its own citizens and businesses.' Similar planning was done in the USA by the team led by Wendy Sherman and Daleep Singh. The USA had undertaken a similar exercise against Iran as well as Russia (since 2014), and against the Chinese company, Huawei.

The West has been pragmatic in implementing sanctions. They were mainly imposed against oligarchs; more importantly, some of them were even spared. As per *Forbes*, 45 oligarchs escaped Western sanctions as on 8 April 2022. The reasons for this are complicated, and vary from case to case. However, many of them promote publicly held companies with Western shareholders, and supply commodity

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<sup>41</sup> Björn Seibert is Ursula von der Leyen's Chief of Cabinet who has gained a reputation as a talented tactician and organizer. He previously taught Security Studies at Harvard. See, Hans von der Burchard, 'The EU's most powerful Germans', *Politico*, 30 June 2020, at <https://www.politico.eu/article/eu-most-powerful-germans-rotating-council-presidency/>, accessed 28 February 2023.

requirements to Western industries. One example is Vagit Alekperov who is the founder of Lukoil, which produces 2% of the world's oil. Seen as comparatively independent, Alekperov remains unsanctioned. Most likely this is because he is viewed by the West as a counterweight to the state-owned Rosneft's sanctioned boss, Igor Sechin.<sup>42</sup> Alexander Abramov is Russia's largest steel producer. Igor Altushkin is the founder and largest shareholder of the Russian Copper Company, the country's third-largest copper producer.<sup>43</sup>

During the planning, it emerged that Russia had been preparing for such an eventuality for a long time. It soon became apparent to Western diplomats that Russian energy companies had reduced the supply of natural gas to Europe and, as a result, the reserves would not suffice for the winter of 2022. At the same time, Russian profits from energy sales were held in western and central banks. These banks held more than US\$ 300 billion of Russian money.

On 24 February 2022, when the Russian troops entered Ukraine, the USA and EU responded by announcing the most extensive and severe sanctions known to history.

Among the measures that were immediately adopted by the USA and EU included disconnecting seven major Russian banks from the SWIFT messaging system; prohibiting transactions with the Russian central bank; making it more difficult for Russia to use its foreign reserves to evade sanctions and cushion the blow of these economic measures; and imposing restrictions on major Russian financial institutions, including various other restrictions on the largest Russian financial institutions.

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<sup>42</sup> 'The Russian Oligarch Billionaires Who Haven't Been Sanctioned', *Forbes*, 7 April 2022, at <https://www.forbes.com/sites/johnhyatt/2022/04/07/these-50-russian-oligarch-billionaires-havent-been-sanctioned/?sh=276a03617d64>, accessed 5 June 2023.

<sup>43</sup> 'The Forbes Ultimate Guide To Russian Oligarchs', *Forbes*, 7 April 2022, at <https://www.forbes.com/sites/giacomotognini/2022/04/07/the-forbes-ultimate-guide-to-russian-oligarchs/?sh=25dbd09c276d>, accessed 5 June 2023.



These measures were followed by measures targeting individuals, including President Vladimir Putin, the Minister of Foreign Affairs, Sergey Lavrov, and Russia's two top defence officials: Sergei Shoigu and General Valery Gerasimov.<sup>44</sup>

## **DIFFERENCES AMONG ALLIES AND PARTNERS**

The implementation of the sanctions faced glitches that reflected the political constraints of its leaders. Soon after announcing the initial sanctions, differences cropped up among allies and partners. Canadian Prime Minister, Justin Trudeau, announced a national oil embargo, largely motivated to placate his Ukrainian constituency. He was supported by the USA in this move. The EU Commission President, Ursula von der Leyen, was in favour of the move. However, there were many European countries which were reliant on Russian energy — such as Slovakia, the Czech Republic and Hungary — thus opposed the move. This delayed the sixth package by many weeks.

The sanction on Russian Central Bank, however, was better coordinated. On 28 February 2022 — two hours before the banks opened — necessary instructions were passed to freeze Russian assets. The seizure of assets of the Russian Central Bank was one of the most effective measures: it forced the Russian Foreign Minister, Sergei Lavrov, to concede that 'Nobody saw that coming,' and that 'it was just theft.'<sup>45</sup>

## **THE IMPLEMENTATION OF THE SANCTIONS**

On 21 February 2022, Russian 'peacekeeping forces' entered into two breakaway regions in eastern Ukraine, after recognising them as independent.<sup>46</sup> The USA announced the first tranche of sanctions, similar

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<sup>44</sup> FPC Briefing, US Department of State, no. 37.

<sup>45</sup> Michael Sauga, no. 40.

<sup>46</sup> 'Timeline: The events leading up to Russia's invasion of Ukraine', Reuters, 1 March 22, at <https://www.reuters.com/world/europe/events-leading-up-russias-invasion-ukraine-2022-02-28/>, accessed 1 March 2023.

to those implemented after Russia's annexation of Crimea in 2014.<sup>47</sup> On 24 February 2022, following launch of Russian 'special military operations' in Ukraine, the USA announced the second tranche, and implemented them 'in tandem with partners and allies.' The third tranche was announced over the 26–27 February 2022 weekend. These barred some Russian banks from the Society for Worldwide Interbank Financial Telecommunications (SWIFT) financial messaging system,<sup>48</sup> sanctioned the Russian Central Bank, and announced the establishment of a multilateral task force to identify and freeze the assets of high-ranking Kremlin officials, including President Putin. The G7 Finance Ministers and Central Bank governors reaffirmed the commitment of the member countries for a coordinated response to ensure that they deliver

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<sup>47</sup> 'FACT SHEET: Joined by Allies and Partners, the United States Imposes Devastating Costs on Russia', Press Statement, The White House, 24 February 2022, at <https://www.whitehouse.gov/briefing-room/statements-releases/2022/02/24/fact-sheet-joined-by-allies-and-partners-the-united-states-imposes-devastating-costs-on-russia/>, accessed 16 January 2023.

<sup>48</sup> SWIFT is a Belgian cooperative company, and is 'owned and controlled by its shareholders [financial institutions] representing approximately 3,500 firms from across the world'. The system is overseen by the G10 central banks, as well as the European Central Bank, with its lead overseer being the National Bank of Belgium. SWIFT network is used by banks to send secure messages about transfers of money and other transactions. More than 11,000 financial institutions around the world use SWIFT, making it the backbone of the international financial transfer system. Russia has the second-largest number of users after the USA, with some 300 Russian financial institutions in the system — which is more than half of Russia's financial institutions. As an alternative to SWIFT, Russia has set up its own network: the SPFS (System for Transfer of Financial Messages). It sent about 2 million messages in 2020, or about a fifth of Russian internal traffic, says the central bank, which aims to up this share to 30 percent in 2023. The Chief Economist for the Asia Pacific at Natixis in Hong Kong, Alicia Garcia Herrero, said that banning Russia from SWIFT would be a serious blow to the country. See, 'What is SWIFT and why were some Russian banks excluded from it?' Aljazeera, 27 February 2022, at <https://www.aljazeera.com/news/2022/2/25/what-is-swift-could-be-used-punish-putin>, accessed 5 January 2023.

the full impact of the sanctions, and curb the conflict.<sup>49</sup> The West was near unanimous in their response. However, notable exceptions were Israel, Turkey, Brazil, China, and India.<sup>50</sup>

The severity of the sanctions was such that the Russian Finance Minister, Anton Siluanov announced (during an interview with state TV, aired on 13 March 2022) that foreign sanctions have frozen around US\$ 300 billion out of US\$ 640 billion that Russia had in its gold and forex reserves. However, he assured viewers that Russia would fulfil its state debt obligations, and would pay roubles to its debt holders until the state reserves were unfrozen.<sup>51</sup>

In an unprecedented move, the USA announced imposing sanctions on President Putin as well as three members of Russia's Security Council directly responsible for 'special military operations'. These were the Minister of Foreign Affairs, Sergei Lavrov; the Minister of Defence, Sergei Shoigu; and First Deputy Minister of Defence and Chief of the General Staff of the Armed Forces of the Russian Federation, Valery Gerasimov. This was in addition to eleven members of the Russian Security Council who were already designated by the US Treasury.<sup>52</sup>

On 28 February 2022, the USA announced that it had, along with its allies and partners, frozen Russian assets worth hundreds of billions

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<sup>49</sup> 'G7 reaffirms its decisive course of action and calls for resolute implementation of sanctions', Federal Ministry of Finance, Germany, 1 March 2022, at <https://www.bundesfinanzministerium.de/Content/EN/Standardartikel/Topics/world/G7-G20/G7-Presidency/2022-03-01-g7-meeting.html>, accessed 20 January 2023.

<sup>50</sup> Gerard Dipippo and Matthew Reynolds, no. 31.

<sup>51</sup> 'Sanctions have frozen around \$300 bn of Russian reserves, FinMin says', Reuters, 13 March 2022, at <https://www.reuters.com/article/ukraine-crisis-russia-reserves/sanctions-have-frozen-around-300-bln-of-russian-reserves-finmin-says-idUSL5N2VG0BU>, accessed 16 January 2023.

<sup>52</sup> 'Imposing Sanctions on President Putin and Three Other Senior Russian Officials', Press Statement, US Department of State, 25 February 2022, at <https://www.state.gov/imposing-sanctions-on-president-putin-and-three-other-senior-russian-officials/>, accessed 16 January 2023.

of dollars,<sup>53</sup> and prohibited any US person from conducting any transaction involving the Central Bank of the Russian Federation; the National Wealth Fund of the Russian Federation; or the Ministry of Finance of the Russian Federation. The US Department of the Treasury's Office of Foreign Assets Control (OFAC) imposed blocking sanctions on the Russian Direct Investment Fund — a known slush fund for President Putin and his inner circle — as well as two of its subsidiaries, and CEO Kirill Dmitriev. These measures were primarily directed to weaken Russia's ability to use its international reserves in ways that could undermine the impact of Western sanctions, as well as to prevent Russia from accessing its wealth fund for use in its ongoing war against Ukraine.<sup>54</sup>

In the first week of the war, in addition to the USA and EU, Western allies and partners too reacted proactively. By 28 February 2022, Japan had sanctioned Russian financial institutions and individuals, and halted the exports of military-use goods such as semiconductors. The UK unveiled its largest-ever package of sanctions against Russia, targeting banks, members of President Putin's closest circle, and wealthy Russians who enjoy high-rolling London lifestyles. It also banned Russia's flagship airline Aeroflot from landing in the UK, suspended dual export licences to Russia, and banned the exports of some high-tech items and parts of the extractive industry. Australia also imposed more sanctions on Russia, targeting several of its elite citizens and lawmakers. Australia sanctioned 'oligarchs whose economic weight is of strategic significance to Moscow' as well as more than 300 members of the Russian parliament who voted to authorise sending Russian troops into Ukraine. The country also worked with the USA to align sanctions on key Belarusian individuals and entities who helped Russia.<sup>55</sup>

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<sup>53</sup> Michael Sauga, no. 40.

<sup>54</sup> 'Additional Measures Against the Russian Financial System', Press Statement, US Department of State, 28 February 2022, at <https://www.state.gov/additional-measures-against-the-russian-financial-system/>, accessed 16 January 2023.

<sup>55</sup> 'List of sanctions against Russia after it invaded Ukraine', Aljazeera, 27 February 2022, at <https://www.aljazeera.com/news/2022/2/25/list-of-sanctions-on-russia-after-invasion>, accessed 27 February 2022.

## EXPORT CONTROL MEASURES

Export control measures were imposed by the USA and its allies from day one of the war. By the third week of August 2022, the USA and 37 other countries had imposed a novel and complex regime of export controls against Russia — very similar to one used to isolate, contain, and ultimately defeat the Soviet Union.<sup>56</sup> These measures were aimed at cutting off more than half of Russia's high-tech imports, restricting access to vital technological inputs, weaken its industrial base, and undercut Russia's strategic ambitions of exerting influence on the world stage. The Russian defence sector was subjected to sweeping restrictions by the denial of sensitive technology, including that produced in foreign countries using US-origin software, technology, or equipment. These measures were aimed to deny Russia semiconductors, telecommunication, encryption security, lasers, sensors, navigation, avionics, and maritime technologies.<sup>57</sup>

Don Graves, Deputy Secretary US Department of Commerce, has this to say about Export Controls.

Export controls are one of the most powerful national security tools that you've probably never heard of. They are trade restrictions that help keep us safe by preventing adversaries from acquiring American products and using American innovation against the United States, our allies, and our values. Export controls are a policy tool that the U.S. government has developed over decades. But in 2022, export controls took on new strategic importance. The U.S. government deployed more export controls with greater speed, precision, and multilateral coordination than ever before. These controls are playing an essential role in ensuring the national security of the United States and our partners around the globe.<sup>58</sup>

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<sup>56</sup> Maria Shagina, no. 10.

<sup>57</sup> Press Statement, The White House, 24 February 2022, no. 47.

<sup>58</sup> See Don Graves, 'America's Hidden Tool is Hobbling Russia's War Machine with Multilateral Impact', *War on the Rocks*, 1 February 2023, at <https://warontherocks.com/2023/02/americas-hidden-tool-is-hobbling-russias-war-machine-with-multilateral-impact/>, accessed 2 February 2023.

The export control measures imposed by the West were, perhaps, the most stringent applied against a single country since the Cold War. Earlier, these measures were applicable only to a few advanced military equipment, and dual use technology. For the first time, the West has expanded the scope of controls far beyond current multilateral export control regimes — such as the Wassenaar Arrangement, the Australia Group, the Missile Technology Control Regime, and the Nuclear Suppliers Group — all of which are narrowly focused on weapons of mass destruction, non-proliferation, or specific arms embargos.

Four types of restrictions have been imposed on Russia.<sup>59</sup>

- Ban on the export, reexport, and transfer of any commodity, software, or technology. This includes all that is essential for Russia's defence, aerospace, and maritime sectors.
- The Application of foreign direct product rule. This restriction severely limits Russia's access to foreign-made products using US software and technology.
- Embargo prohibiting the export of items of US origin to the Russian military.
- Increase of numbers in the Entity List compiled by the Bureau of Industry and Security of the US Department of Commerce. More than 100 entities were added to the list, including Rostec and Sukhoi Aviation.

## **THE APPLICATION OF SANCTIONS AND EXPORT CONTROL MEASURES BY THE USA**

Between 3 March and 15 December 2022, the USA announced the following 21 packages which have wide ramifications on the Russian defence establishment.

- Targeting Russian Elites and Defence Enterprises of Russian Federation — March 3.

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<sup>59</sup> Maria Shagina, 2022, no. 10.

- Commerce Restricts the Export of Luxury Goods to Russia and Belarus — March 11
- Targeting Elites of the Russian Federation — March 11.
- Sanctions against officials responsible for human rights abuses and violations — March 15.
- Sanctioning Additional Members of Russia's Duma, Russian Elites, Bank Board Members, and Defence Entities — March 24.
- Additional Sanctions on Russia's Technology Companies and Cyber Actors — March 31.
- — Targeting Additional Russian Financial Institutions, Officials, and Other Individuals – April 6.
- Further Targeting Russian State-Owned Enterprises — April 7.
- Targeting Russia's Financial, Defence, and Marine Sectors, and Promoting Accountability for Russian and Belarusian Military Officials – May 8.
- Targeting Russia's Oligarchs and Vessels — June 2.
- Promoting Accountability and Imposing Costs on the Russian Federation and Its Enablers for Putin's Aggression Against Ukraine — June 2.
- Targeting Russia's War Machine, Sanctions Evaders, Military Units Credibly Implicated in Human Rights Abuses, and Russian Federation Officials Involved in the Suppression of Dissent — June 28.
- Targeting Russia's Global Malign Influence Operations and Election Interference Activities — July 29.
- Imposing Additional Costs on Russia for Its Continued War Against Ukraine — August 2.
- Designating Iranian Proliferators of Shipping Unmanned Aerial Vehicle Technology to Russia for Use in Ukraine — September 8.

- Targeting Russia's Senior Officials, Defence Industrial Base, Financial Infrastructure Leaders, and Human Rights Abusers — September 15.
- Imposing Swift and Severe Costs in Response to Russia's Violations of Ukraine's Sovereignty — September 30.
- Targeting Russia's Global Military Procurement Network and Kremlin-Linked Networks — November 14.
- Imposing Sanctions on Entities and Individuals in Response to Iran's Transfer of Military UAVs to Russia — November 15.
- Further Constraints by the Treasury on Russia's Financial Services Sector — December 15.

## **APPLICATION OF SANCTIONS AND EXPORT CONTROL MEASURES BY THE EU**

Between 23 February 2022 and 25 February 2023, the EU announced 10 packages of sanctions and export control measures. The details are given below.<sup>60</sup>

### **The First Package of Sanctions against Russia**

The first package announced on 23 February 2022 included

- Targeted sanctions against the 351 members of the Russian State Duma, and an additional 27 individuals.
- Restrictions on economic relations with the non-government controlled areas of Donetsk and Luhansk oblasts.
- Restrictions on Russia's access to the EU's capital and financial markets and services.

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<sup>60</sup> Council of the European Union, 'Timeline: EU restrictive measures against Russia over Ukraine', 2022, at <https://www.consilium.europa.eu/en/policies/sanctions/restrictive-measures-against-russia-over-ukraine/history-restrictive-measures-against-russia-over-ukraine/>, accessed 2 March 2023.



## **The Second Package of Sanctions against Russia**

The second package, announced on 24 February 2022, froze the assets of President Putin, and of the Minister for Foreign Affairs, Sergey Lavrov. In addition, it has imposed restrictive measures on the members of the National Security Council of the Russian Federation, and on the remaining members of the Russian State Duma who supported Russia's immediate recognition of the self-proclaimed Donetsk and Luhansk' republics.'

## **The Third Package of Sanctions against Russia**

The third package announced on 28 February 2022 includes the following.

- A ban on transactions with the Russian Central Bank.
- • 500 million support package to finance equipment and supplies to the Ukrainian armed forces.
- A ban on the overflight of EU airspace, and on access to EU airports by Russian carriers.
- New sanctions on additional 26 persons, and one entity.

As a part of the third package, some additional measures were announced on 2 March 2022. These included the SWIFT ban for seven Russian banks. The seven banks are Bank Otkritie; Novikombank; Promsvyazbank; Rossiya Bank; Sovcombank; Vnesheconombank (VEB); and VTB Bank.

The EU has also introduced a ban on

- Investing, participating or otherwise contributing to future projects co-financed by the Russian Direct Investment Fund.
- Selling, supplying, transferring or exporting euro banknotes to Russia or to any natural or legal person or entity in Russia.

The EU also approved the suspension of the broadcasting activities of the outlets Sputnik and Russia Today in the EU accusing it of

conducting disinformation and information manipulation against the EU and its member states.

### **The Fourth Package of Sanctions against Russia**

The fourth package of economic and individual sanctions was announced on 15 March 2022, and includes bans on

- All transactions with certain state-owned enterprises
- The provision of credit rating services to any Russian person or entity
- New investments in the Russian energy sector

The Council expanded the list of persons connected to Russia's defence and industrial base, on whom tighter export restrictions were imposed regarding dual-use goods, and other goods and technology which might contribute to Russia's technological enhancement of its defence and security sector.

The EU also introduced

- Trade restrictions for iron, steel and luxury goods.
- Sanctions on an additional 15 individuals and 9 entities.

### **The Fifth Package of Sanctions against Russia**

The Council adopted a fifth package of sanctions against Russia on 8 April 2022. The package includes a ban on the following.

- Imports from Russia of coal, and other solid fossil fuels.
- All Russian vessels from accessing EU ports.
- Russian and Belarusian road transport operators from entering the EU.
- Imports of other goods such as wood, cement, seafood, and liquor.

- Exports to Russia of jet fuel and other goods.
- Deposits in crypto-wallets.

### **The Sixth Package of Sanctions against Russia**

The Council adopted a sixth package of sanctions against Russia on 3 June 2022. The package includes the following.

- A ban on imports from Russia of crude oil and refined petroleum products, with limited exceptions
- A SWIFT ban for an additional three Russian bank and one Belarusian bank Suspension of broadcasting in the EU for three more Russian state-owned outlets
- The EU also adopted sanctions against an additional 65 individuals and 18 entities. These include individuals responsible for the atrocities committed in Bucha and Mariupol.

### **The Seventh Package of Sanctions against Russia**

The Council adopted a seventh package of sanctions against Russia on 21 July 2022. The package

- Introduces a new prohibition to purchase, import or transfer Russian-origin gold, including jewellery.
- Reinforces export controls of dual use goods.
- Extends the existing port access ban to locks.
- Clarifies existing measures, for instance in the field of public procurement, aviation and justice.
- Sanctions an additional 54 individuals and 10 entities, including the mayor of Moscow and Sberbank, a major financial institution.

### **The Eighth Package of Sanctions against Russia**

The Council adopted an eighth package of sanctions against Russia on 6 October 2022. The package includes, amongst others,

A price cap related to the maritime transport of Russian oil for third countries.

- Additions to the list of restricted items which may contribute to Russia's military and technological enhancement.
- Additional restrictions on trade and services with Russia.
- An additional 30 individuals and 7 entities.

### **The Ninth Package of Sanctions against Russia**

The Council adopted a ninth package of sanctions against Russia on 16 December 2022. The new measures include bans on the following.

- Exports of drone engines.
- Exports of dual-use goods and technology.
- Investments in the mining sector.
- Transactions with the Russian Regional Development Bank.
- The provision of advertising, market research and public opinion polling services.

The EU has also suspended the broadcasting licenses of four additional Russian outlets, and has sanctioned an additional 141 individuals and 49 entities.

### **The Tenth Package of Sanctions against Russia**

The Council adopted a tenth package of sanctions against Russia on 25 February 2023. The agreed package includes a ban on the following.

- Exports of critical technology and industrial goods
- Imports of asphalt and synthetic rubber
- Provision of gas storage capacity to Russians
- Transit through Russia of EU exported dual use goods and technology.

The EU has also

- Suspended the broadcasting licenses of RT Arabic and Sputnik Arabic.
- Restricted the possibility for Russian nationals to hold any position in the governing bodies of EU critical infrastructures and entities.
- Introduced new reporting obligations to ensure the effectiveness of the asset freeze prohibitions.
- Imposed additional sanctions against 87 individuals and 34 entities, including key decision makers, military leaders, military commanders of the Wagner group and drone manufacturers.

The sanctions and the economic control measures implemented by the EU had some unintended consequences. The EU, which was envisaged as an economic community, seemed to transform itself into a security alliance, with an increasing influence over the member states.<sup>61</sup>

## **SANCTIONS ON RUSSIAN ENERGY**

The West has a varying degree of dependence on Russian energy. The response to the call for sanctions by the USA, the EU and other allies and partners has been dictated by their respective dependency on Russian energy. Canada and the USA were amongst the first to ban all imports of Russian oil, while the UK announced a phase-down to zero at the end of 2022.<sup>62</sup> This was possible largely due to the limited reliance of

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<sup>61</sup> Maria Shagina, 2022, no. 10.

<sup>62</sup> 'EU nations have ended imports of Russian oil brought in by sea, and a ban on refined oil products will come in from 5 February. The United States said last March that it would stop importing Russian oil, and the UK said it was banning Russian crude oil and refined products with effect from 5 December. European countries have sought to reduce their dependence on Russian gas. An oil price cap approved by Western allies in December also aims to prevent Russia getting more than US\$ 60 (£48) for a barrel of crude oil.' See Jake Horton & Daniele Palumbo, 'Russia sanctions: What impact have they had on its oil and gas exports?' BBC News, 26 January 2023, at <https://www.bbc.com/news/58888451>, accessed 6 March 2023.

these countries on Russian export. The EU, which is far more reliant on Russian energy, agreed in May 2022 to stop seaborne imports of Russian oil by the end of the year.<sup>63</sup> It was expected that, by the start of 2023, more than 90 percent of Russia's previous oil exports to the EU would be banned.<sup>64</sup> The move to sanction Russian energy will have a significant impact not only on Russia in the long term, but also on the EU and the rest of the world in the short to medium term.

The leaders of the Group of Seven (G7) met in Elmau, Germany, on 26–28 June 2022, where they were joined by the leaders of Argentina, India, Indonesia, Senegal, and South Africa as well as Ukraine. The leaders of the G7 countries committed to 'tak[ing] immediate action to secure energy supply and reduce price surges driven by extraordinary market conditions, including by exploring additional measures such as price caps.'<sup>65</sup> Thereafter, the G7 Finance Ministers met on 2 September 2022 where, in pursuance of the decision taken at Elmau in June 2022, the G7 committed to 'permit[ting] only those service providers to continue to do business related to Russian seaborne oil and petroleum products sold at or below the price cap.' This measure was announced to 'build on and amplify the reach of existing sanctions, notably the

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<sup>63</sup> In order to allow EU and its partners to secure alternative supplies, and minimise the impact on global oil prices, it was decided to allow a certain transition period to enable the sector and global markets to adapt. It was also decided that a temporary exemption for pipeline crude oil be put in place to ensure that Russian oil is phased out in an orderly fashion. See, Press Release, 'Russia's war on Ukraine: EU adopts sixth package of sanctions against Russia', European Commission, 3 June 2022, at [https://ec.europa.eu/commission/presscorner/detail/en/IP\\_22\\_2802](https://ec.europa.eu/commission/presscorner/detail/en/IP_22_2802), accessed 6 March 2023.

<sup>64</sup> Maria Demertzis, Benjamin Hilgenstock, Ben McWilliams, Elina Ribakova, Simone Tagliapietra, 'How have sanctions impacted Russia?', *Bruegel Policy Brief*, 26 October 2022, at [https://www.bruegel.org/sites/default/files/2022-10/PC%2018%202022\\_1.pdf](https://www.bruegel.org/sites/default/files/2022-10/PC%2018%202022_1.pdf), accessed 27 January 2023, pp. 14–15.

<sup>65</sup> 'G7 Leaders' Communiqué: Executive Summary', Council of European Union, 28 June 2022, at <https://www.consilium.europa.eu/en/press/press-releases/2022/06/28/g7-leaders-communicue/>, accessed 6 March 2023.

EU's sixth package of sanctions, ensuring coherence through a strong global framework.<sup>66</sup>

One of the significant ways to undermine Russian oil exports is to deny insurance cover to ships carrying Russian oil and gas. Over 90 percent of the world's oil tankers are insured via the International Group of P&I Clubs, a London-based association of insurers (S&P Global 2022). In agreement with the UK, the EU also introduced in its sixth package of sanctions against Russia, a ban on insurance for ships carrying Russian oil from the beginning of 2023.<sup>67</sup> On 12 October 2022, Australia also joined the price cap coalition.<sup>68</sup> EU insurance companies were prohibited from insuring and financing the transport of Russian oil to third countries. The USA intervened, due to the likely repercussion on the global energy prices, resulting in the EU modifying its previous oil sanction scheme, and introduced — with its eighth sanctions package — the option for EU companies to insure oil tankers transporting Russian oil to third countries, trading below the agreed price cap.<sup>69</sup> The aim of the price cap is to stabilize global oil prices, yet ensuring Russia does not get a windfall to finance its war in Ukraine.

Ensuring the security of gas supply and sanctioning Russian gas was a much more difficult proposition. EU's dependence on Russian gas was much greater. On 27 June 2022, the Council adopted a new

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<sup>66</sup> 'G7 Finance Ministers' Statement on the united response to Russia's war of aggression against Ukraine', Federal Ministry of Finance, Germany, 2 September 2022, at [https://www.bundesfinanzministerium.de/Content/EN/Downloads/G7-G20/2022-09-02-g7-ministers-statement.pdf?\\_\\_blob=publicationFile&v=13](https://www.bundesfinanzministerium.de/Content/EN/Downloads/G7-G20/2022-09-02-g7-ministers-statement.pdf?__blob=publicationFile&v=13), accessed 20 January 2023.

<sup>67</sup> Press Release, European Commission, 3 June 2022, no. 63.

<sup>68</sup> 'G7 Finance Ministers and Central Bank Governors' Statement on the global economic impact of Russia's war of aggression against Ukraine, and G7 support to Ukraine', Federal Ministry of Finance, Germany, 12 October 2022, at [https://www.bundesfinanzministerium.de/Content/EN/Downloads/G7-G20/2022-10-12-g7-statement-ukraine.pdf?\\_\\_blob=publicationFile&v=8](https://www.bundesfinanzministerium.de/Content/EN/Downloads/G7-G20/2022-10-12-g7-statement-ukraine.pdf?__blob=publicationFile&v=8) accessed 20 January 2023.

<sup>69</sup> Maria Demertzis, et al., no. 64.

regulation on gas storage. The rule was aimed at ensuring that the EU member states' gas storage facilities are filled before the winter season, and can be shared with those member states not owning storage facilities. The member countries deliberated sanctions on Russian gas, and a consensus was reached on 5 August 2022 to voluntarily reduce natural gas demand by 15% by the winter. Member states agreed to reduce their gas demand between 1 August 2022 and 31 March 2023 by 15%, compared to their average consumption in the past five years, with measures of their own choice.<sup>70</sup> The European Commission was flexible enough to give leeway to member countries to tide over the vagaries of harsh winters.<sup>71</sup>

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<sup>70</sup> 'Impact of Russia's invasion of Ukraine on the markets: EU response', Council of the European Union, 2022, at <https://www.consilium.europa.eu/en/policies/eu-response-ukraine-invasion/impact-of-russia-s-invasion-of-ukraine-on-the-markets-eu-response/>, accessed 7 March 2023.

<sup>71</sup> The Council agreed that member states which are not interconnected to other member states' gas networks are exempted from mandatory gas reductions as they would not be able to free up significant volumes of gas to the benefit of other member states. Member states whose electricity grids are not synchronised with the European electricity system, and are more reliant on gas for electricity production, will also be exempted in case they are desynchronised from a third country's grid, in order to avoid the risk of an electricity supply crisis. Member states were also permitted to limit their reduction target to adapt their demand reduction obligations if they have limited interconnections to other member states, and can show that their export capacities and their domestic LNG infrastructure are being used to re-direct gas to other member states to the fullest. Member states were also allowed to limit their reduction target if they overshot their gas storage filling targets, or if they are heavily dependent on gas as a feedstock for critical industries, or they can use a different calculation method if their gas consumption has increased by at least 8% in the past year compared to the average of the past five years. See, Press Release, 'Council adopts regulation on reducing gas demand by 15% this winter', Council of European Union, 5 August 2022, at <https://www.consilium.europa.eu/en/press/press-releases/2022/08/05/council-adopts-regulation-on-reducing-gas-demand-by-15-this-winter/>, accessed 7 March 2023.



In retaliation to Western sanctions, Russia also took punitive measure to punish European countries by implementing export cuts on Russian gas. It progressively cut Russian energy export down to around 20 percent of their 2021 levels by October 2022. The move expectedly caused political tensions in Europe, and is expected to cause hardship to European countries during the winters of 2022/2023 and 2023/2024. In the medium run, substantial consequences are expected for Russia's gas-export business.

Meanwhile, OPEC+ — which includes Saudi Arabia and Russia — announced (in October 2022) that it will slash oil production by 2 million barrels per day. This is the biggest cut since the start of the Corona pandemic. It was a move that had the potential to push gasoline prices higher just weeks before the US midterm elections. The group of major oil producers announced the production cut following its first meeting in person since March 2020. The reduction was equivalent to about 2% of global oil demand. The price of Brent crude oil rose 1.5% to more than \$93 a barrel. US oil was up 1.7%, at US\$ 88.<sup>72</sup> The announcement came approximately three months after President Biden's visit to Riyadh to convince it to support Western sanctions.

The prices of energy in EU reached record levels in 2022. The rise, linked to the increase of wholesale energy prices globally, started back in 2021 in the wake of the COVID-19 pandemic, and growing international demand. The Russian special operations have had an aggravating effect. The import price for energy in EU more than doubled between December 2020 and December 2021.<sup>73</sup> In 2022, the Russian decision to suspend deliveries of gas to some EU member states pushed up the price of gas, which was instrumental for record high prices for electricity in the EU. Heatwaves during summer 2022

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<sup>72</sup> Hanna Ziady, 'OPEC announces the biggest cut to oil production since the start of the pandemic', CNN News, 5 October 2022, at <https://edition.cnn.com/2022/10/05/energy/opec-production-cuts/index.html>, accessed 7 March 2023.

<sup>73</sup> This rise was quite unprecedented as energy import prices, while rather volatile, do not generally change by more than around 30% in the course of a year.

put additional pressure on energy markets: causing increased demand of energy for cooling on the one hand, and on the other, decreased energy supply due to drought, and the consequent reduction in the supply of hydropower.<sup>74</sup>

The move by OPEC+ to slash oil production by 2 million barrels per day in October 2022 did have a stabilising impact on crude prices. The price of Brent crude — which saw the high of more than US\$ 130 a barrel last year — has since retreated. On 19 January 2023, it stood at US\$ 86.30 a barrel, putting the international crude benchmark well below its historic highs of 2022. The Liquefied Natural Gas (LNG) prices have also been extremely volatile over the past year, even as Europe sought other suppliers. Asian LNG spot prices in January 2023 fell down about 67 percent from record highs, but are still twice as high as they were in mid-2021.<sup>75</sup>

The West was a house in disarray during 2022, especially regarding the implementation of the various provisions of sanctions on Russian energy. The EU announced a worldwide ban (May 2022) on the provision of maritime insurance to vessels carrying Russian oil, expecting coordinated action with the British government. However, the UK did not introduce similar restrictions, causing uncertainty in the energy market.<sup>76</sup> The USA had certain reservations regarding the European

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<sup>74</sup> 'Energy price rise since 2021', Council of the European Union, 2022, at <https://www.consilium.europa.eu/en/infographics/energy-prices-2021/>, accessed 17 January 2023.

<sup>75</sup> 'Energy price rise since 2021', *Middle East Eye*, 19 January 2023, at <https://www.middleeasteye.net/news/saudi-arabia-engaging-moscow-stable-oil-prices#:~:text=Saudi%20Arabia%20will%20continue%20to,Saud%20told%20Bloomberg%20on%20Thursday>, accessed 23 January 2023.

<sup>76</sup> 'Sanctions lawyers said the EU appeared to be soft-peddalling its efforts to stem the global flow of Russian oil, and that there was new uncertainty among traders over the UK's commitment to a global insurance ban. Sarah Hunt, a partner at the HFW law firm, said trading houses were inquiring whether it was now legal to buy Rosneft oil to ship to countries outside the EU. She said, 'The new EU sanctions effectively permit the lifting of Russian crude by European companies. We were surprised by this.' Leigh Hansson,

Commission's proposal, and Brussels (in late July 2022) amended some curbs on dealing with state-owned Russian companies, citing concerns over global energy security.<sup>77</sup> In July 2022, the British parliament approved sanctions against Russia which prohibited providing insurance to vessels carrying Russian oil to the UK, and only after 31 December 2022. The legislation was introduced after the government promised to outlaw the import of Russian oil from the end of the year, but did not ban the provision of services to shipments from Russia to other countries. The USA had domestic political compulsions to implement the price cap mechanism. US President Joe Biden was keen to reduce gasoline prices before midterm elections in November 2022.

## EXPLOSIONS IN NORD STREAMS 1 AND 2

On 26 September 2022, seismologists recorded explosions before gas began pouring out of two Russia-to-Germany pipelines under the Baltic Sea, Nord Streams 1, thus adding an additional dimension to an already complex matrix. Two leaks were discovered in Nord Stream 1, which Moscow had shut down earlier that month in retaliation for Western sanctions over Russia's war in Ukraine. Another leak was discovered on Nord Stream 2, which was frozen following Russia's invasion of Ukraine, and has never been operational since. Both were

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partner at Reed Smith, another law firm, said the EU's sanctions amendment was a 'big retreat', adding that lawyers had also been expecting 'more robust' measures by now from the UK. Additional reporting by Alice Hancock and David Sheppard.' See also, Tom Wilson, Harry Dempsey and Oliver Ralph, 'West eases efforts to restrict Russian oil trading as inflation and energy risks mount', *Financial Times*, 31 July 2022, at <https://www.ft.com/content/333f7447-aed8-40d2-87e9-f8d289162707>, accessed 1 August 22.

<sup>77</sup> The EU's insurance ban was introduced on 4 June 2022. It prevents companies in the bloc from writing new insurance for any vessel carrying Russian oil anywhere. Existing contracts remained valid until 5 December 2022 when all such business were banned. However, the EU later amended part of its own sanctions to permit European companies to deal with some Russian state-owned entities, such as Rosneft, for the purpose of transporting oil to countries outside the bloc.

in proximity to the Danish Island of Bornholm.<sup>78</sup> The damage to both the pipelines was considerable.

Coincidentally, 27 September 2022 was the date on which Baltic pipeline was inaugurated in a ceremony in Goleniów, Poland, which is expected to become a key route to carry gas from Norway through Denmark to Poland as well as neighbouring countries. The pipeline will make it possible to import up to 10 billion cubic metres (bcm) of gas annually from Norway to Poland, and to transport 3 bcm of gas from Poland to Denmark.<sup>79</sup>

At 1,200 km in length, Nord Stream 1 has the capacity to carry up to 170 million cubic metres of gas per day (or 55 billion cubic metres per year). Russia has been accused of manipulating supplies after being hit with six tranches of EU sanctions in the aftermath of the Ukraine war. Flows reached 20% of maximum capacity in the summer before the pipeline was shut down. Nord Stream 2, which was built in parallel to the original conduit, was supposed to double its total capacity to an annual 110 billion cubic metres. However, the project drew harsh criticism from Poland, the Baltic states, and Ukraine, and so never received authorisation.<sup>80</sup> The cause behind the leaks is not clear till date, though a number of theories have been propounded.

Since the 1960s, US intelligence agencies have been on the look out to prevent cheap Russian energy export to Europe. Even though

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<sup>78</sup> 'Images and videos released by the Danish military showed a huge area of gas bubbling on the surface of the Baltic Sea. The largest disturbance has a diameter of more than one kilometre, the military said, and the smallest covers around 200 metres. The Swedish National Seismic Network said two 'probable explosions' had been recorded in the area of the gas leaks. The first was at 2:03 on Monday, before a second one at 19:03.' See, Jorge Liboreiro, 'Nord Stream: Explosions recorded prior to discovery of major gas leaks', *Euro News*, 27 September 2022, at <https://www.euronews.com/my-europe/2022/09/27/denmark-and-sweden-issue-navigation-warnings-over-nord-stream-gas-leaks>, accessed 28 September 2022.

<sup>79</sup> 'Launch of the Baltic Pipe', *European Commission*, 27 September 2022, at [https://commission.europa.eu/news/launch-baltic-pipe-2022-09-27\\_en](https://commission.europa.eu/news/launch-baltic-pipe-2022-09-27_en), accessed 9 March 2023.

<sup>80</sup> Jorge Liboreiro, 2022, no. 78.

unsuccessful, the USA did its utmost to halt the export of Russian energy.<sup>81</sup> In the recent times, the USA has attempted to prevent the operationalization of the Nord Stream pipelines. There is even a video clip of President Joe Biden saying that, in the event of Russian invasion, the Nord streams would end — a sentiment echoed by Undersecretary Victoria Nuland.<sup>82</sup>

The Nord Streams have been constructed with the latest technology, and have a very low probability of a failure or a leak. Any successful sabotage attempt would require extremely high military competence and intelligence, which very few countries possess. The USA is the foremost among them. President Biden had proclaimed (in 2021) that Nord Stream 2 was a ‘bad deal’ for Europe, which the US would continue to oppose because Russia would have more leverage over the EU politically, thus reducing US influence over Europe, and a reducing its demand for its fracked gas.<sup>83</sup>

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<sup>81</sup> ‘In the 1960s, Washington succeeded in passing a resolution within NATO to embargo exports of large diameter pipes intended for use in the first ambitious Soviet pipeline Druzba (Friendship); this was lifted only in 1966. Other pipelines — like the Urengoy pipeline which controversially brings gas to both sides of Germany — agitated the Reagan administration enough to first offer financial incentives against the pipeline, and then applied unprecedented extraterritorial sanctions on components being supplied by European companies, which were of American origin. This created a political crisis of no mean order. Eventually, after severe disputes, the US lifted the sanctions and the Urengoy pipeline(s) went ahead anyway, ironically with more Soviet equipment than originally intended.’ See, Tara Kartha, ‘The Curious Case of Nord Stream Blasts and a Twist in the Ukraine War Tale’, *News 18*, 4 October 2022, at <https://www.news18.com/news/opinion/opinion-the-curious-case-of-nord-stream-blasts-and-a-twist-in-the-ukraine-war-tale-6096301.html>, accessed 6 October 2022.

<sup>82</sup> See, Tweet by ABC News, 8 February 2022. at <https://twitter.com/i/status/1490792461979078662>.

<sup>83</sup> ‘EU countries imported as much as 36% of American natural gas in 2019 — an increase of around 5 billion cubic metres from the previous year — a considerable amount given that Russia is just on its doorstep, and also bearing in mind the EU’s environmental pledges (fracking produces heavy amounts of methane gas, responsible for global warming).’ See, Johanna Ross, ‘Why Joe Biden will continue the US war on Nord Stream 2 till the bitter end’, BRICS Information Portal, 26 February 2021, at <https://infobrics.org/post/32870/>, accessed 2 October 2022.

Seymour Hersh, an American investigative journalist and political writer, has reported that the USA and Norway were responsible for the sabotage of the Nord Stream pipelines.<sup>84</sup> Even though there are reports to counter Hersh's claims and debunk his report,<sup>85</sup> given the limited amount of information available in the open domain, suspicions of US involvement in the blast persist. *The New York Times* (7 March 2022) reported that new intelligence reviewed by US officials suggest that a pro-Ukrainian group had carried out the attack on the Nord Stream pipelines.<sup>86</sup> Citing anonymous US officials, the report said there was no evidence that Ukrainian President Volodymyr Zelensky, or his top lieutenants, were involved in the operation. The US newspaper reported that the officials declined to disclose the nature of the intelligence, how it was obtained, or 'any details of the strength of the evidence it contains'. It added, 'Officials who have reviewed the intelligence said they believed the saboteurs were most likely Ukrainian or Russian nationals, or some combination of the two.'<sup>87</sup> Ukraine has denied any involvement in the blast.

Till today, it is unclear as to who was responsible for the blasts, as also the rationale for the same. The resultant implications on the sanctions are also uncertain for the moment. In the 'fog of war', where multiple players are involved, each pursuing their respective agendas —some at

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<sup>84</sup> Seymour Hersh, 'How America Took Out The Nord Stream Pipeline', *Blogpost*, 8 February 2023, at [https://seymourhersh.substack.com/p/how-america-took-out-the-nord-stream?r=5mz1&utm\\_campaign=post&utm\\_medium=web](https://seymourhersh.substack.com/p/how-america-took-out-the-nord-stream?r=5mz1&utm_campaign=post&utm_medium=web), accessed 9 February 2023.

<sup>85</sup> Oliver Alexander, 'Blowing Holes in Seymour Hersh's Pipe Dream', *Blogpost*, 10 February 2023, at <https://oalexanderdk.substack.com/p/blowing-holes-in-seymour-hersh-pipe>, accessed 23 February 2023.

<sup>86</sup> Adam Entous, Julian E. Barnes, and Adam Goldman, 'Intelligence Suggests Pro-Ukrainian Group Sabotaged Pipelines, U.S. Officials Say', *The New York Times*, 7 March 2023, at <https://www.nytimes.com/2023/03/07/us/politics/nord-stream-pipeline-sabotage-ukraine.html>, accessed 9 March 2023.

<sup>87</sup> Malu Cursino and Emily McGarvey, 'Ukraine denies involvement in Nord Stream pipeline blasts', BBC News, 8 March 2023, at <https://www.bbc.com/news/world-europe-64877979>, accessed 9 March 2023.

cross purposes to each other despite being on the same side of the alliance — it is likely to take some time before the truth is revealed.

Weaning away the West's dependence on Russian energy was not easy. Based on the data maintained by Vortexa, as late as November 2022, Europe continued to be the biggest buyer of Russian diesel, with nearly half of the EU and the UK seaborne diesel imports coming from Russia. The high dependence of Europe on Russian diesel can become a major problem, considering the total embargo on imports of Russian oil products by sea which entered into force on 5 February 2023.<sup>88</sup> Europe is attempting to diversify its sources of procuring diesel and other petroleum products. However, just before the 5 February 2023 ban, its demand of Russian diesel picked up again. As per the study of International Energy Agency (IEA) of November 2022, 'the competition for non-Russian diesel barrels will be fierce, with EU countries having to bid for cargoes from the USA, the Middle East, and India away from their traditional buyers.'<sup>89</sup>

On its part, Russia has announced a ban on oil exports to countries implementing price caps. On 27 December 2022, Russia issued a decree to ban oil sales to countries and companies complying with price caps agreed upon by Western nations. The decree will come into effect from 1 February 2023. However, the ban can be lifted in individual cases, based on a 'special decision[s]' by the Russian President, Vladimir Putin. Meanwhile, Gazprom's gas exports to Europe dropped by almost 50% in 2022. Russia has been able to compensate for Europe's import cuts through higher energy prices, which have resulted in a 30% budget revenue growth from oil and gas sales from January to October 2022, and tapping new markets in Asia. Russia has inaugurated

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<sup>88</sup> The EU and the UK imported an average of 1.34 million barrels per day (bpd) of diesel-type fuel between November 1 and 24, of which 45% — or 600,000 bpd — came from Russia. See, Tsvetana Paraskova, 'Europe Remains Russia's Biggest Diesel Buyer', OILPRICE.com, 29 November 2022, at <https://oilprice.com/Energy/General/Europe-Remains-Russias-Biggest-Diesel-Buyer.html>, accessed 8 Mar 20.

<sup>89</sup> Ibid.

the Kovykta natural gas field in eastern Siberia which will allow it to increase its gas exports to China.

Overall, there is a ‘global rewiring’ of energy trade taking place. The Gulf states have taken the place of Russia, while Russia has moved in to supply energy to their traditional customers in Asia. The impact and efficacy of sanctions will be analysed in detail in chapter 2 and 3.

## **CONTROL ON WEAPON SYSTEMS AND TECHNOLOGY**

The US imposed sanctions following the Russian occupation of Crimea in 2014. However, it is the export control measures which have been imposed following the Russian ‘special military operations’ of 2022, that have the maximum potential to undermine Russia’s defence industry, and erode its military capabilities to wage war.

Russia inherited a robust and mature defence industry, capable of manufacturing conventional weapon systems and platforms, from the erstwhile Soviet Union. However, it remained behind the West in the field of strategic materials and technology — such as semiconductors, micro-chips, electronics, among others, required for modern weapon systems. Following the sanctions of 2014, Russia introduced measures — such as the import substitution plan — to reduce its dependence on foreign sources. Notwithstanding the government’s thrust, Russia’s reliance on foreign manufacturers, especially for high tech equipment, continues to remain high.<sup>90</sup>

Sanctions and export control measures are two diverse tools of coercive diplomacy, and differ in the manner in which they are implemented.

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<sup>90</sup> A Royal United Services Institute (RUSI) study looked at 27 of Russia’s most up-to-date military systems — including communications systems, cruise missiles, and electronic warfare equipment — and found them to contain at least 80 different types of components subject to US export controls. See, James Byrne, Gary Somerville, Joe Byrne, Jack Watling, Nick Reynolds, and Jane Baker, ‘Silicon Lifeline: Western Electronics at the Heart of Russia’s War Machine’, *RUSI*, 8 August 2022, at <https://rusi.org/explore-our-research/publications/special-resources/silicon-lifeline-western-electronics-heart-russias-war-machine>, accessed 9 March 2023.



Sanctions are directed towards financial institutions, banks and trade. Their impact on the target country is almost instantaneous. Export control measures, on the other hand, are slower to take effect, and deny the target country technology and commodities. By their very nature, export control measures have a long-term crippling impact on the target country's domestic industry. However, unlike sanctions, export controls are difficult to impose, and the target country can always circumvent these measures by importing technology and goods via a third country. The measure of success of this tool is dictated by the efficacy of administrative controls, such as licensing and permit systems, and penalties for noncompliance. The West, both through allurements and punitive actions, is attempting to choke Russia and its defence industrial base.<sup>91</sup>

US export control measures are being led by Don Graves of the Department of Commerce. The department is working with the objective of ensuring US made goods and technologies as well as certain foreign-made items that incorporate US content, or are produced from US software, technology, or equipment, do not reach the Russians. The department protects 'dual-use' products (items with both a commercial and military use) as well as certain items with only military uses. Graves, in his 1 February 2023 article, (in War on the Rocks) has explained the procedure.<sup>92</sup>

Once an export control rule is announced, exporters must assess whether their products or transactions are subject to the new restrictions and whether authorizations are required from the US government. That assessment might include reviewing their products' technical specifications and customer lists. There are more details to the process,<sup>93</sup> such as reviewing compliance procedures for the new controls, but that is the basic idea.

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<sup>91</sup> Maria Shagina, no. 10.

<sup>92</sup> Don Graves, no. 58.

<sup>93</sup> For updated information on export control measures, see <https://www.bis.doc.gov/index.php/policy-guidance/country-guidance/russia-belarus>.

The Commerce Department, in conjunction with other departments and international partners, is working to ensure a robust mechanism to prevent Russia from accessing US technology and products.

The Commerce Department undertook a massive outreach effort to help the public understand, and thus comply with, the new rules. Where necessary, the Commerce Department has followed up with enforcement action to address potential violations of the controls. We have our own enforcement arm that works closely with other branches of the US government, including the Department of Homeland Security, the Federal Bureau of Investigation, the State Department, the Treasury Department, US embassies abroad, the Defense Department, and the intelligence community. In addition, we collaborate and coordinate with international partners.<sup>94</sup>

As analysed earlier in the chapter, the West has imposed several types of restrictions on Russia. A ban on export, re-export, and the transfer of any commodity, software, or technology that is essential for Russia's defence, aerospace, and maritime sectors has been imposed. An attempt is also being made to severely limit Russia's access to foreign-made products using US software and technology. The USA has also increased the entity list compiled by the Bureau of Industry and the Security of the US Department of Commerce. More than 100 entities have been added to the list compiled by the bureau.

The implications of the export control measures on Russia are likely to be significant. It will severely limit country's access to advanced goods and technologies that are critical to its war waging potential. These measures are also likely to lead to increased costs, reduced competitiveness, and other negative consequences.

Sanctions and export control regimes are not always easy to implement. Despite claims (by the US Department of Commerce) on the effectiveness of the combined effort of 38 nations that, 'since the start

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<sup>94</sup> Don Graves, no. 58.

of the invasion, Russia's access to semiconductors from all sources has been slashed by nearly 70 percent', an independent study by Reuters using data from Russian customs records indicate that 'since the invasion, the declared value of semiconductor imports by Russia has, in fact, risen sharply.'<sup>95</sup> The study has further revealed that many of the shipments of Western computer parts to Russia have arrived from China, and other countries that have not joined the USA and the EU in restricting exports to Russia. There are, however, some notable exceptions, and some of the sanctioned items have come directly from EU.<sup>96</sup>

## **DRONE STRIKE ON IRAN FACTORY: 28/29 JANUARY 2023**

Russia is known to have employed sanction evasion methods to overcome shortages of critical items required for the war effort. One such item that is being sourced from abroad are drones. There are reports to suggest that Russia is employing Iranian drones extensively to strike Ukrainian targets. On the night of 28/29 January 2023, there was a drone attack on military industry target near the Iranian central city of Isfahan. A Reuters report suggests an Israeli role in the attack. In Ukraine, which accuses Iran of supplying hundreds of drones to Russia to attack civilian targets in Ukrainian cities, a senior aide to President Volodymyr Zelenskiy linked the incident directly to the war there. 'Explosive night in Iran,' Mykhailo Podolyak tweeted. 'Did warn you.'<sup>97</sup>

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<sup>95</sup> Steve Stecklow, David Gauthier-Villars, and Maurice Tamman, 'The supply chain that keeps tech flowing to Russia', Reuters, 13 December 2022, at <https://www.reuters.com/investigates/special-report/ukraine-crisis-russia-tech-middlemen/>, accessed 10 March 2023.

<sup>96</sup> 'Elmec Trade Oü, an electronic-components wholesaler based in the Estonian capital Tallinn, shipped at least US\$ 17 million worth of goods to Russia between 1 April and 31 October, according to Russian customs records. These included chips made by Analog Devices and other US manufacturers.'

<sup>97</sup> Parisa Hafezi and Phil Stewart, 'List of sanctions against Russia after it invaded Ukraine', Reuters, 30 January 2023, at <https://www.reuters.com/world/middle-east/blast-heard-military-plant-irans-central-city-isfahan-state-media-2023-01-28/>, accessed 30 January 2023.

Neither Israel, nor any other country, has claimed responsibility for the attack, even though unknown US military officials claim Israel's complicity. This action, like the earlier blasts in Nord Stream 1&2 has a direct bearing on the implementation of sanctions and export control regimes on Russia.

## **SANCTIONS ON RUSSIAN COMMODITIES**

Russia is a global store house of many natural resources. In 2021, Russia provided 17.5 percent of oil sold on the world market, 47 percent of palladium, 16.7 percent of nickel, 13 percent of aluminium, and almost a quarter of potash fertilisers.<sup>98</sup> This creates a paradoxical situation for the West. Sanctioning Russia's commodities have the potential to cause global price hikes and, perhaps, recession in many parts of the world.<sup>99</sup> That is why, in 2022, the West was careful in imposing sanctions, and did so on Russian export sectors, such as steel, coal, and processed wood, where the global economy has spare capacity. In the energy sector, the West has targeted revenues rather than production. As a result, Russian oil production increased by 2 percent in 2022.<sup>100</sup>

## **CONCLUSION**

A study of the planning and implementation of sanctions on Russia by the West, especially Russian energy, underscores the complexity of the exercise, besides highlighting the influence of various factors, not least domestic political compulsions that affect the whole process.

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<sup>98</sup> Sergey Aleksashenko, 'The Dust Has Settled. The Russian Economy And Sanctions: Who's Who?', Free Russia Foundation, 4 November 2022, at <https://www.4freerussia.org/the-dust-has-settled-the-russian-economy-and-sanctions-whos-who/>, accessed 13 March 2023.

<sup>99</sup> The USA's attempt to close the access of Russian aluminium to the world market in 2018 led to an instant jump in the price of this metal by 20 percent, which forced the White House to abandon the announced plans. See, Sergey Aleksashenko, 'Russia after a year of sanctions', Aljazeera, 28 February 2023, at <https://www.aljazeera.com/opinions/2023/2/28/russia-after-a-year-of-sanctions>, accessed 4 March 2023.

<sup>100</sup> Ibid.

As far as the export control mechanisms are concerned, they are well suited for imposing higher hurdles for the target to acquire any given technology. Even if they work slowly, they can be one of the most powerful tools in the West's toolbox of economic statecraft. However, their impacts on Russia's ability to wage war will not be automatic — they require constant monitoring, stringent enforcement, and adjusting to Moscow's evolving adaptation tactics.<sup>101</sup>

An attempt has been made to shed light on various measures that have been implemented to isolate Russia from the global financial system, banks, trade, and technology. These measures are in continuation to those which were imposed following Russia's annexation of Crimea in 2014. However, following the 'special military operations' of February 2022, this is probably the first time when a coordinated action involving so many countries has been undertaken. Some of the most severe economic measures ever undertaken in history have been imposed on Russia. These sanctions have been designed to impose severe economic costs, and diminish Russia's war waging potential.

The implementation of sanctions has not been without challenges, as Russia has sought to circumvent them through alternative means, including the creation of partnerships with countries that are not part of the sanctions regime. Additionally, some countries have been hesitant to fully enforce the sanctions due to their economic ties with Russia. This aspect will be deliberated upon in greater detail in subsequent chapters.

Despite these challenges, the sanctions have had a significant impact on Russia's economy. The restrictions on access to the global financial system has made it difficult for Russian businesses to obtain loans and conduct business, while the export control measures have limited Russia's access to advanced technology. These restrictions, as will be seen later, have contributed to a decline in Russia's GDP growth, and resulted in the rise of inflation.

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<sup>101</sup> Maria Shagina, no. 10.

The sanctions have also had political implications as Russia has responded with countermeasures, and accused Western countries of interference in its internal affairs. The sanctions have further strained the relationship between Russia and Western countries, and their impact on the global economy remains a concern.

Moving forward, it will be important to continue monitoring the effectiveness of the sanctions and adjusting them as necessary. It will also be important to consider the unintended consequences of sanctions, including their impact on innocent civilians and the potential for negative economic effects on other countries.

## **A CHESS GAME OF SANCTIONS: RUSSIA'S MITIGATION STRATEGIES AND EVASION SCHEMES**

There are a range of foreign policy tools available to a super power in pursuance of its national interest: diplomacy, military power, intelligence, public diplomacy, economic tools such as aid and sanctions, and so on. Sanctions as a tool of coercive diplomacy have become the go-to solution for many foreign policy problems in the West, and more specifically in the USA.<sup>102</sup> Russia has been subjected to multiple rounds of sanctions since the annexation of Crimea in 2014.

Ever since the start of its 'special military operations', the USA, the EU, and their allies and partners have imposed some unprecedented trade restrictions and export control measures to harm Russia's economy as well as war waging potential, and including the defence industry. These actions have had a significant impact on the Russian economy, leading the government to take various measures to mitigate their effects. Russia, in fact had been bracing itself to face Western sanctions even before the start of the operations. This chapter aims to examine the measures taken by Russia to reduce the impact of sanctions, both before

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<sup>102</sup> During President Barack Obama's first term, the USA designated an average of 500 entities for sanctions per year, for reasons ranging from human rights abuses to nuclear proliferation to violations of territorial sovereignty. That figure nearly doubled over the course of Donald Trump's presidency. President Joe Biden, in his first few months in office, imposed new sanctions against Myanmar (for its coup), Nicaragua (for its crackdown), and Russia (for its hacking). He has not fundamentally altered any of the Trump administration's sanctions programmes, beyond lifting those against the International Criminal Court. See, Daniel W. Drezner, no. 6.

and after the commencement of the war. Additionally, it explores the sanctions evasion schemes employed by the country.

In 2014, the West imposed sectoral sanctions that targeted Russia's oil, defence, and financial sectors. These sanctions caused some initial disruption. However, their impact on targeted sectors quickly subsided. Russian authorities utilized a range of tools and resources to cushion the targeted sectors from the worst effects of sanctions. The Russian response resulted in a clear shift towards a greater reliance on domestic resources — or 'Russification' — on the one hand, and towards a more multidirectional foreign economic policy that emphasizes closer relations with non-Western countries, on the other.<sup>103</sup> The sanctions which followed the February 2022 special military operations are especially severe, and it remains to be seen how effective they are.

The Russian government had anticipated Western sanctions, and was preparing for them for a long time. The 'Fortress Russia'<sup>104</sup> strategy, and the Bank of Russia's skilful response, prevented the 'serious blow' to the Russian economy — quite unlike what was anticipated by the West. Other key measures included strengthening economic ties with China and other non-Western countries. After the imposition of sanctions, the Russian government implemented a series of measures to reduce their impact, including sanction evasion schemes. One of the most significant schemes is the use of front companies to bypass sanctions. These companies are set up in third countries to facilitate trade in those critical items which have been denied. Other methods used by Russia to evade sanctions include the use of cryptocurrencies and barter trade.

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<sup>103</sup> Richard Connolly, 'Russia's Response to Sanctions: How Western Sanctions Reshaped Political Economy in Russia', *Russia in Global Affairs*, 4 December 2018, at <https://eng.globalaffairs.ru/articles/russias-response-to-sanctions-how-western-sanctions-reshaped-political-economy-in-russia/>, accessed 13 March 2023.

<sup>104</sup> The 'Fortress Russia' strategy describes efforts by Russian authorities implemented since sanctions were first imposed after Russia's annexation of Crimea in 2014. The aim was to insulate the country's economy from potential additional measures. See, Maria Demertzis, et. al. 2022, no. 64.



This chapter explores the measures taken by Russia to mitigate the impact of sanctions, both before and after the commencement of the war. It also examines the sanctions evasion schemes employed by the country, which have allowed it to circumvent the restrictions imposed by the international community. The chapter provides insights into the strategies employed by Russia to manage the economic impact of sanctions, and highlights the challenges faced by the country in the current geopolitical climate. In addition to understanding the measures taken by Russia, the chapter attempts to analyse the complex relationship between sanctions, geopolitics, and the global economy.

### **MITIGATING THE IMPACT OF SANCTIONS BEFORE THE COMMENCEMENT OF WAR: THE ‘FORTRESS’ STRATEGY**

The ‘Fortress’ strategy was conceived after several major financial crises, which had resulted in the balkanisation of the Soviet Union in 1989, negatively impacted the value of the rouble twice in the 1990s and, thereafter, again after the financial crisis of 2008. In 2014, Russia suffered the twin shocks of falling oil prices and Western sanctions after the invasion of Crimea.<sup>105</sup> The Russian government’s comprehension of the need for cushioning the economy from further shocks led to the development of the ‘Fortress’ strategy.

The strategy is supported by two pillars: a prudent fiscal policy, and credible inflation targeting, which resulted in strong public finances and foreign reserve accumulation just before the start of the war in February 2022. The introduction of inflation targeting has been successful in bringing inflation down from the high levels of 2014. This has allowed Russia to build resilience against external shocks, including sanctions. Russia has been a target of sanctions since 2012 for a variety of reasons. However, the ‘Fortress’ strategy ensured protection — even though it occasionally inflicted pressure on the rouble and on

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<sup>105</sup> The 2014 crisis caused a 55% depreciation of the rouble vis-à-vis the US\$ in 2014–2015. Between Q1 of 2014 and Q1 of 2015, the Central Bank used US\$ 130 billion in international reserves to try to stabilize the rouble.

economic growth. At no point did the sanctions threaten to cripple the Russian economy.

Since 2017, the Russian government has been operating under the fiscal rule which stipulates that federal budget spending (excluding government debt interest payments) cannot exceed estimated budget revenues. The estimated budget revenues will be based on revenues from oil and gas, calculated at the benchmark oil price and a projected rouble-dollar exchange rate. Non-oil and gas revenues will be estimated in a ‘normal’ fashion. The benchmark oil price in August 2021 was US\$ 42 per barrel Ural blend, while the then market price of oil was around US\$ 70 per barrel. Excess revenue generated when the oil price exceeded the benchmark — as was the case in August 2021 — was transferred to the National Wealth Fund (NWF), and invested in foreign assets. If the price fell below the benchmark, the government supplemented the oil revenue shortfall by withdrawing from the NWF. This fiscal rule, arguably, has helped to diminish the pro-cyclical effect of oil prices on the Russian economy.<sup>106</sup>

The other important pillar of the ‘Fortress’ Russia strategy is that the Central Bank of Russia (CBR) acts as a credible, independent institution. The monetary policy of the Central Bank is centred on an inflation target of 4%. The CBR moved to a free-floating rouble in 2014, from a managed floating exchange rate regime it operated before. It used to operate a dual-currency trading band with the US dollar and euro. Even though, since 2014, the Central Bank does not officially follow exchange rate targets, it can still conduct FX interventions during episodes of high exchange rate volatility.

Because of prudent macroeconomic policy — both fiscal and monetary — Russia was able to rebuild its international reserves, and reduce external debt. External debt in Russia has fallen considerably over the

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<sup>106</sup> ‘Russia imposes entry ban on EU officials in response to 9th package of sanctions’, TASS, 17 January 2023, at <https://tass.com/society/1563479>, accessed 14 March 23.

years. Gross external debt declined from 41% of GDP in 2016, to an expected 27% in 2021. All these measures ensured macroeconomic figures were healthy just before the start of the war.

## **WEANING AWAY FROM THE DOLLAR<sup>107</sup>**

One of the strategies followed by the Russian Central Bank to limit the effect of sanctions is by reducing its reliance on the US dollar. Over time, the Russian government has reduced the amount of assets held in dollars as well as the number of transactions that use the dollar. This strategy is aimed at reducing Russia's risk of being cut off from the global financial system dominated by the US dollar.

In June 2021, Russia's Finance Ministry announced that the country's National Wealth Fund would decrease the share of assets held in dollars from 35 percent to 0.<sup>108</sup> The fund accumulates Russia's oil revenues, and is intended to support the country's pension system. By altering the composition of the fund to favour currencies other than the US dollar, sanctions restricting the use of the US dollar would not impede domestic spending from the fund.

The Russian Central Bank has worked to diversify its foreign exchange reserves, weighting the euro, Japanese yen, and Chinese renminbi more heavily than before. Following the spring 2018 sanctions, the Russian Central Bank halved its total dollar reserves to 22 percent, and increased the share of the renminbi to 15 percent of the nearly US\$ 550 billion total.<sup>109</sup> Further reductions in dollar holdings followed in 2020. By the

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<sup>107</sup> Caileigh Glenn, 'Lessons in Sanctions-Proofing from Russia', *The Washington Quarterly*, 4 April 2023, at <https://www.tandfonline.com/doi/full/10.1080/0163660X.2023.2188829>, accessed 8 April 2023.

<sup>108</sup> Georgie Kantchev, 'Russia's Wealth Fund to Ditch Dollar Amid Sanctions Threat.' *The Wall Street Journal*, 3 June 2021, at <https://www.wsj.com/articles/russias-wealth-fund-to-ditch-dollar-amid-u-s-sanctions-threat-11622730123>, accessed 15 April 2023.

<sup>109</sup> Max Seddon, 'Russia to cut dollar share of its \$125bn sovereign wealth fund,' *Financial Times*, 13 November 2019, at <https://www.ft.com/content/c196fe1c-0622-11ea-a984-fbbacad9e7dd>, accessed 15 April 2023.

end of 2021, the Japanese yen comprised 6 percent of Russia's foreign exchange reserves, totalling around US\$ 33 billion,<sup>110</sup> up from a near negligible amount in 2014.<sup>111</sup> The Central Bank focused on diversifying away from the dollar, requiring exposure to the EU and Japanese sanctions risk by denominating reserves in euros and yen, and locating reserves in European and Japanese banks.

This diversification strategy included a prioritization of gold. The Russian government is holding reserves in gold to retain some access to a relatively stable store of value. It enabled Russia to engage in sanctions evasion by using gold to conduct transactions without exposing those transactions to dollar clearinghouses. De-dollarization in this way is an attempt to reduce the exposure of the government's assets to Western sanctions.

## **MEASURES TAKEN TO AVOID TRADE DISRUPTION BY BLOCKAGE FROM THE SWIFT SYSTEM**

SWIFT is considered the backbone of the international financial transfer system. Russia has the second-largest number of users after the USA, with some 300 Russian financial institutions in the system — which is more than half of Russia's financial institutions. The sanctions imposed by the West bar Russian banks from using SWIFT to facilitate cross-border payments, prohibit banks from doing most forms of business with Russian entities, and freeze assets held abroad by the Central Bank of Russia in the form of treasury securities and bank deposits.

### **WHAT IS SWIFT?**

SWIFT was founded as a cooperative in 1973 by 239 banks from 15 countries. It is headquartered outside Brussels, and incorporated under

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<sup>110</sup> Reuters, 'Japan to Freeze Russia's foreign exchange reserves, report says,' in *Japan Times*, 28 February 2022, at <https://www.japantimes.co.jp/news/2022/02/28/national/japan-russia-central-bank-sanctions/>, accessed 15 April 2023.

<sup>111</sup> Bank of Russia, 'Bank of Russia Annual Report for 2014,' 30 April 2015, at [https://www.cbr.ru/Collection/Collection/File/8316/ar\\_2014\\_e.pdf](https://www.cbr.ru/Collection/Collection/File/8316/ar_2014_e.pdf), p. 57, accessed 15 April 2023.

Belgian law. The system instructs participating banks via messages to debit and credit customer accounts not just in dollars but also in other currencies. As of April 2022, the dollar accounted (by value) for 41.8 percent of payment instructions transmitted by SWIFT, the euro for 34.7 percent, the British pound for 6.3 percent, the Japanese yen for 3.1 percent, and the Chinese renminbi for 2.1 percent. Despite being a cooperative, the US government has tremendous control over the system. It enables the US government to monitor third-party compliance with sanctions. SWIFT initially resisted sharing its proprietary data with US authorities, but came around after 9/11 terror attacks, when Congress threatened to sanction the society itself.

The US government has an overarching control over SWIFT as it operates a pair of data centres in Virginia, exposing it to the reach of US authorities. The US Department of the Treasury has stated that financial data gleaned from SWIFT messages are useful for tracing financial flows, and combating illicit finance. Any country's banks can be excluded from SWIFT by a vote of its shareholders. Although US banks are only minority shareholders in the organization, other banks, fearing secondary sanctions, normally give in to US demands. In addition, the USA can pressure Belgium, where SWIFT is incorporated, to enforce sanctions. The US government can also make SWIFT's compliance with its sanctions a condition for its continued dealings with US banks, or even sanction SWIFT directly—though a threat to isolate the organization might not be credible, given the very considerable financial disruptions that would ensue.<sup>112</sup>

Ever since 2014, there have been attempts to ban Russia from SWIFT. As an alternative to SWIFT, Russia has set up its own network: the System for Transfer of Financial Messages (SPFS). It sent about 2 million messages in 2020, or about a fifth of Russian internal traffic, says the Central Bank, which aims to up this share to 30 percent in

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<sup>112</sup> See Barry Eichengreen, 'Sanctions, SWIFT, and China's Cross-Border Interbank Payments System', *Centre for International & Strategic Studies*, 20 May 22, at <https://www.csis.org/analysis/sanctions-swift-and-chinas-cross-border-interbank-payments-system>, accessed 14 March 2023,.

2023.<sup>113</sup> Besides SPFS, there is a Chinese system — Chinese Cross-Border Interbank Payment System (CIPS) — which can serve as an alternative. CIPS is already being termed as a regional alternative to SWIFT, especially in Eurasia.

As on date neither the Russian SPFS nor the Chinese CIPS constitute a serious challenge to Western clearinghouses. For comparison, as of May 2022, US Clearing House Interbank Payments System (CHIPS) had nearly 10 times as many participants. CHIPS was used by around 11,000 financial firms worldwide while CIPS by just over 1,300. CHIPS processed 40 times as many transactions. In March 2022, the daily volume on CIPS was 385 billion yuan (\$45.6 billion), compared to \$1.8 trillion on CHIPS. However, transactions using CIPS are growing. As per available information, the transaction value of CIPS has increased by 75 percent in 2021, and transaction volume by 50 percent. More banks around the world could plausibly join CIPS as a part of contingency plans. Even if they have little use for it for the moment, participation would provide a limited alternative in the event that CHIPS and SWIFT restrict access.<sup>114</sup>

Russia has initiated a process to set up an alternative to SWIFT, besides having the fall back option of the Chinese system. For the moment, both these systems are not robust enough to support existing trade volumes; yet they are an alternative which will increasingly find support from countries who fear Western hegemony, and their propensity to target the economy as a means of coercive diplomacy.

## **CREATION OF A STOCKPILE OF ELECTRONICS BEFORE THE WAR**

In his address (25 October 2022) to the Government Coordination Council regarding ‘meeting the needs of the Russian Federation Armed

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<sup>113</sup> Lara Jakes and Marc Santora, ‘How Was Russia Able to Launch Its Biggest Aerial Attack on Ukraine?’, *The New York Times*, 18 November 2022, at <https://www.nytimes.com/2022/11/18/us/politics/ukraine-russia-missiles.html>, accessed 14 March 2023.

<sup>114</sup> Barry Eichengreen, 2022, no. 112.

Forces, other troops, military formations and bodies', President Putin announced domestic efforts to ramp up production of equipment and systems 'associated with providing support for the special military operation' in Ukraine.<sup>115</sup> It is quite likely that Russia has been preparing for this war from before. Quoting Janes, a defence intelligence firm, *The New York Times* said, Russia has very likely stockpiled microchips and other technology necessary to build precision missiles before invading Ukraine in February. It is possible that this was started years ago, given Moscow's deteriorating relations with the West after its illegal annexation of Crimea in 2014.<sup>116</sup> Quoting Janes' analysis, *The New York Times* noted that many of the microelectronics used in missiles and other military equipment are also used for civilian purposes, and Russia may have obtained them from third parties willing to risk US ire. It is quite likely Russia may have produced large number of missiles, including Iskanders, Kalibrs, and cruise missiles before the invasion.<sup>117</sup>

## **FORESTALLING THE IMPACT OF SANCTIONS: MILITARY-CIVIL FUSION**

'Military-civil fusion' is a term used by US defence analysts to refer to China's national strategy to bolster military capabilities by systematically eliminating the barriers between the defence industry and ostensibly civilian research institutions.<sup>118</sup> During Cold War, the West and the Soviet Union actively engaged in espionage activities. The Soviet Union is known to have targeted leading Western electronics and computer companies, particularly in the USA and Japan, as part of an illicit procurement campaign. As per a Western study, Russian research

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<sup>115</sup> 'Meeting with members of the Government Coordination Council on the needs of the Russian Armed Forces', President of Russia, 25 October 2022, at <http://www.en.kremlin.ru/events/president/news/69676>, accessed 14 March 2023.

<sup>116</sup> Lara Jakes and Marc Santora, 2022, no. 113.

<sup>117</sup> Ibid.

<sup>118</sup> Maria Shagina, no. 10.

institutes have continued to be actively involved in industrial espionage by redirecting critical items to the defence sector.<sup>119</sup>

The Royal United Services Institute (RUSI) study of August 2022 analysed 27 of Russia's latest military systems, which included communications systems, cruise missiles, and electronic warfare equipment. The results of the study suggest these systems contain at least 80 different types of components, which are subject to US export controls.<sup>120</sup> These studies suggest that the sanctions and export control measures implemented by the West may not be very effective, and Russia has found ways and means to access some of the technology and equipment denied to it.

## **MITIGATING THE IMPACT OF SANCTIONS AFTER THE COMMENCEMENT OF WAR**

Russia has been able to evade the impact of Western sanctions to some extent by implementing a range of measures for the past several years. In addition to the measures discussed above, which were implemented before the commencement of war, Russia has been proactive in countering the West's more recent economic measures. Attempts to insulate Russia from sanctions have been made by launching a number of sanction evasion schemes. A large quantity of banned computers and electronics have continued to flow in from third countries. To curb financial sanctions, Russia's Central Bank hiked up interest rates,

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<sup>119</sup> In April 2022, a Russian scientist working at the University of Augsburg in Germany was convicted of spying — he had passed information on European rocket propulsion technology to Russian intelligence. In the latest batch of sanctions, the USA, therefore, targeted a number of nominally civilian high-technology entities, including the Moscow Institute of Physics and Technology, and the Skolkovo Foundation. The research institutes actively collaborated with numerous Russian defence entities such as Uralvagonzavod, Russia's largest tank producer; Almaz-Antey, the country's largest arms producer; and the United Aircraft Corporation, an aerospace and defence corporation.

<sup>120</sup> James Byrne, et. al., 2022, no. 90.



and required citizens and corporations to exchange most of their foreign exchange earnings for roubles. As the European Commission recently noted, this has even pushed the currency's exchange rate 'above its level at the beginning of the year.'<sup>121</sup>

## **INSULATION STRATEGIES OF PUTIN'S TECHNOCRAT TEAM**

Western analysts had assessed that, as a result of sanctions, Russian GDP would be hit in the order of 3.5–5.5 per cent in 2022. However, even though Russia has been largely cut out of the global banking and payments systems, its economy has not been hit as hard as the West expected. This has been largely due to a team of Russian technocrats, consisting of Herman Gref, the chief executive of state-owned lender Sberbank, and Elvira Nabiullina, the Central Bank governor, besides others. Nabiullina has been credited with steering Russia out of an economic crisis after Russia's annexation of Crimea in 2014. She took concerted measures to tame inflation through an aggressive monetary policy, and some strong actions against vested interests in the notoriously corrupt banking sector. Nabiullina was also instrumental in creating SPFS<sup>122</sup> which helped insulate Russia from the 2014 sanctions, and amassing over US\$ 600 billion dollars.

President Putin's technocrats were surprised by his decision to launch a 'special military operation', and were caught off guard when the West immediately imposed sanctions and export control measures. Despite some forward thinking and deft economic measures on the part of Russian team, the West was successful in freezing about half of Russia's foreign currency reserves, leaving Nabiullina unable to use a resource that was supposed to protect the economy from turbulence. The Central Bank governor was now forced to implement measures which were unthinkable earlier. She was, by the turn of circumstance, required to introduce currency control measures. The measure taken by the technocrats stabilised the situation and, by April/May 2022, the panic in Russia had largely subsided.

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<sup>121</sup> Michael Sauga, no. 40.

<sup>122</sup> See footnote 111.

Even though Russia was banned from the SWIFT system, the SPFS allowed uninterrupted transactions within the country. High energy prices permitted Russia to grow its budget revenue — half of which comes from oil and gas — by 34 per cent year on year from January to April, and helped the rouble recover from its fall against the dollar. Even though Russia's dollar income from energy sales grew, the sanctions made it much more difficult for Russia to buy imports, leading to a substantial trade surplus. That eased pressure on the rouble, allowing Nabiullina to relax currency controls, and begin cutting interest rates.

The technocrats have limitations in handling the way sanctions are being imposed. The team may hold out in short to medium term; but the sanctions may hit Russia in the long term. In addition, Russia has been banned from importing microchips and servers. This move is likely to hit the planned banking reforms.

## **RUSSIAN SANCTIONS AGAINST THE WEST**

In retaliation to Western sanctions, Russia also promulgated a 'blacklist' of Western officials who have been barred from entering Russia. The blacklist also includes several European Parliament members. This list was further expanded after the EU announced the ninth package of sanctions. The Russian list covers the chiefs of EU law enforcement agencies which are involved in training Ukrainian troops within the framework of the EU mission to provide military assistance to Kiev. Additionally, sanctions were imposed against European state and commercial structures manufacturing weapons and military hardware and supplying them to Kiev, as well as against EU nationals indulging in anti-Russian rhetoric in public.<sup>123</sup>

## **SANCTION EVASION SCHEMES**

Export control regimes, highlighted elsewhere in the paper, are effective tools to deny Russia critical items of equipment and technology. However, they are difficult to implement and extremely slow to become

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<sup>123</sup> 'Russia's Fortress strategy is not for free', *Atradius*, 14 September 2021, at <https://group.atradius.com/publications/economic-research/russia-fortress-strategy-is-not-for-free.html>, accessed 14 March 2023.

effective. Part of the difficulty lies in monitoring transshipment from third party suppliers. Russia has reportedly used companies located in Hong Kong and Vietnam to hide the final destination of products. The re-export of non-controlled goods is difficult to monitor and control, especially in the jurisdiction of a third country. Technically, items not destined for military use can be exported to Russia and Belarus. A RUSI study has compiled a long list of low-technology consumer goods repurposed for Russian weapons.

The past success of export controls illustrates that they are well suited for imposing higher hurdles for the target to acquire niche technology. Even if they work slowly, they can be one of the most powerful tools in the West's toolbox of economic statecraft. However, the impacts on Russia's ability to wage war won't be automatic — they require constant monitoring, stringent enforcement, and adjusting to Moscow's evolving adaptation tactics.<sup>124</sup>

### **POSSIBLE USE OF 'BLACK SEA INITIATIVE' TO OVERCOME SANCTIONS**

On 22 July 2022, Russia, Ukraine, Türkiye, and the United Nations (UN) signed the Black Sea Initiative in Istanbul, to alleviate human suffering worldwide from unprecedented food and fuel prices.<sup>125</sup> There are two versions of the pact which are, apparently identical. One was signed by the Russian Defence Minister, Sergei Shoigu; the Turkish Defence Minister Hulusi Akar; and the UN Secretary-General, António Guterres as a witnesses. The other version was signed by Oleksandr Kubrakov, Ukraine's infrastructure minister, Hulusi Akar, and Guterres.

The initiative was signed with the aim to ship out 'significant volumes of commercial food from three key Ukrainian ports in the Black Sea — Odesa, Chernomorsk and Yuzhny' which have been stuck in Ukraine's ports since the war began on 24 February 2022. Reportedly,

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<sup>124</sup> Maria Shagina, no. 10.

<sup>125</sup> For details, see Damilola Banjo, 'Trending UN News: Week Ending July 22', PassBlue, 22 July 22, at <https://www.passblue.com/2022/07/22/trending-un-news-week-ending-july-22/>, accessed 16 March 2023.

22 million tons of grains have been stuck due to Russian naval blockade, and dangers posed by Ukrainian undersea mines planted in the area.

In addition, a separate agreement between Russia and the UN was signed to ensure that Russian fertilizer and foodstuffs also get to international markets. The export of these goods has been stymied by concerns of companies doing business with Russia amid European and American sanctions imposed on the country. As the UN pointed out, the agreement is based on the principle ‘that measures imposed on the Russian federation do not apply to those products.’<sup>126</sup> The side deal will be carried out by the UN Conference on Trade and Development (UNCTAD), directed by Rebeca Grynspan, in liaison with the Russian mission to the UN. PassBlue reports that some of the provisions have the potential to be misused by Russia to circumvent sanctions and export control regimes.<sup>127</sup>

For Russia, the deal could be a huge gain because it aims to remove all barriers, imagined or otherwise, that companies in finance, logistics, and insurance circles may face when doing business with Russia, as they fear they will be fined and incur other black marks. These industries have also been hit the hardest in Russia by Western sanctions.

The Russian foreign ministry commented on the deal, saying ‘the signing of the Russia-UN memorandum reiterated the absolutely artificial nature of the West’s attempts to shift the blame for the problems in supplying grain to international markets on Russia.’ It also implies that the UN will act on Russia’s behalf: ‘The Russian Federation will inform the Secretariat of the impediments to access of food and fertilizers, including the raw materials required to produce fertilizers (including ammonia), originating from the Russian Federation to the world markets.’ And, the UN secretariat ‘will endeavour to engage relevant authorities and the private sector to effectively exempt food and fertilizers’ originating in Russia from measures imposed on the country,

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<sup>126</sup> Ibid.

<sup>127</sup> Dulcie Leimbach, ‘The Curious UN-Russian Side Deal to Get Russian Food and Fertilizers to World Markets’, PassBlue, 24 July 2022, at accessed 16 March 2023, <https://www.passblue.com/2022/07/24/the-curious-un-russian-side-deal-to-get-russian-food-and-fertilizers-to-world-markets/>.

‘based on the principle that those measures do not apply to food and fertilizers.’

However, the word ‘access’ is not defined in the document, possibly on purpose. Additionally, Western sanctions deliberately exempt Russian food and fertilizers. The USA has also said it will provide ‘comfort letters’ to companies that want to do business with Russia legally in these products. The emphasis in the UN plan on overcoming commercial barriers may be an attempt by Russia (as told to PassBlue) to have the ban on Russia’s participation in the all-important Swift financial system dropped.

The section in the agreement on the UN advising Russian companies on ‘how to do business with the UN, and the procedure and requirements for becoming a registered vendor’ is another confounding aspect of the plan. It seems intentionally written to include any Russian vendor — rather than only food- and fertilizer-related — into the UN procurement system, thus trying to pre-empt further requests by Ukraine and its allies to stop buying Russian goods and services. In 2021, these totalled more than \$282 million.

## **USE OF DIGITAL ASSETS BY STATE INSTITUTIONS AND OLIGARCHS**

In a report released in 2021, The US Treasury Department identified digital assets as a major threat to the sanctions programmes. The report has flagged the urgency for the federal authorities to build up institutional knowledge of digital assets and associated services. Tokens such as Monero and others, which provide anonymity, were especially noted for the leverage they provide to move large amounts of money without disclosing identity. The report gains further credence from the fact that other sanctioned regimes of North Korea and Iran have netted hundreds of millions of dollars, some of which were laundered through peer-to-peer decentralized finance platforms. There are studies to suggest that Iran’s bitcoin mining industry helps the country evade sanctions.<sup>128</sup>

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<sup>128</sup> Tom Robinson, ‘How Iran Uses Bitcoin Mining to Evade Sanctions and ‘Export’ Millions of Barrels of Oil’, *Elliptic*, 21 May 21, at <https://www.elliptic.co/blog/how-iran-uses-bitcoin-mining-to-evade-sanctions>, accessed 16 March 2023.

The US Treasury Department report notwithstanding, there are officials who are not overly concerned regarding the use of digital assets, either by wealthy Russians or state-backed institutions, to subvert the international financial system. These officials are confident of identifying signatures of laundering large amounts of money through digital wallets and exchanges since the process of money laundering is expensive and time-consuming. Moreover, any such effort, in their opinion, is likely to be visible in the broader crypto market, given the massive investment portfolios of individuals and institutions named in the sanctions.

Despite the confidence of officials in detecting Russian sanction evasion actions, missteps cannot be discounted. Russia is home to several crypto businesses whose services help generate hundreds of millions of dollars for cybercriminals.<sup>129</sup> Prior to the invasion of Ukraine, the US Treasury sanctioned two Russian crypto exchanges that were found to have processed transactions that had been tied to ransomware attacks and other illegal activities. The exchanges, Suex and Chatex, were both tied to Russian investor Egor Petukhovsky.<sup>130</sup>

Till date, there has been no known effort, either by the Russian elites or state institutions, to subvert Western sanctions by using digital assets. This is not to suggest that such efforts are not being attempted. The onus is on the USA and its allies and partners to produce evidence of Russian complicity in breaching the sanctions regime. Similarly, no evidence has come to light of Russia using the Black Sea Initiative, or the side agreement between Russia and the UN to export Russian fertilizers and foodstuff to the international market.

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<sup>129</sup> 'Russian Cybercriminals Drive Significant Ransomware and Cryptocurrency-based Money Laundering Activity', *Chainalysis*, 14 February 22, at <https://blog.chainalysis.com/reports/2022-crypto-crime-report-preview-russia-ransomware-money-laundering/>, accessed 16 March 2023.

<sup>130</sup> Sam Sutton, 'Russia's hidden tool to undermine sanctions', *Politico*, 25 February 2022, at [https://www.politico.com/news/2022/02/25/russia-crypto-sanctions-00011886?mc\\_cid=e8c082a371&mc\\_eid=70e0953026](https://www.politico.com/news/2022/02/25/russia-crypto-sanctions-00011886?mc_cid=e8c082a371&mc_eid=70e0953026), accessed 3 January 2023.

## TRADE IN CURRENCY OTHER THAN DOLLARS

The dollar dominates world trade, giving the USA coercive powers over countries deemed hostile to its interests. This dominance has been an issue of concern with many countries, including Russia, having suffered sanctions imposed by the USA. In order to reduce the dominance of the dollar, some countries have been working to increase the use of local currencies in international trade. The use of local currencies has multiple benefits.

- Countries reduce the risks associated with fluctuations in foreign currencies
- These countries can economize by reducing the conversion costs associated with dollar trade
- By trading in local currencies, the economic ties between countries is likely to improve, leading to greater volumes of trade between them.
- Countries become less susceptible to US sanctions if they trade in local currencies.

Despite the benefits associated with trading in local currency, the US dollar is preferred for financial transactions and global trade because it enjoys stability, liquidity, and widespread acceptance. Like most other countries, Russia faces several challenges in conducting trade in its local currency instead of dollars.

- The Russian rouble is relatively more volatile than major reserve currencies such as the dollar and the euro. This makes it harder to predict and manage trade related costs and profits.
- The sanctions imposed by the West has limited Russia's access to global financial institutions thereby impeding the use of rouble in international trade.
- Under the current situation, the convertibility of the Russian rouble is a challenge, especially while promoting its use in international trade. Countries are normally hesitant to trade in local currency, fearing difficulties in converting it into other currencies of choice.

Russia and China have been working for a long time to reduce dependence on the dollar for trade. China has already established currency swap agreements with several countries, allowing it to trade in currencies other than the dollar. Russia has also been working to promote trade in roubles. One such attempt to reduce dependence on the US dollar was a proposal to create a new reserve currency based on a basket of currencies from BRICS countries. The challenges faced in implementing this proposal is reflective of the difficulties that lie ahead in reducing dependence on the US dollar.<sup>131</sup>

After the sanctions were imposed by the West, Russia has been promoting trade in currencies other than dollar with renewed vigour, though with limited success. Quoting Reuters, *Dawn*, a leading Pakistani newspaper, had published a news item suggesting Pakistan will pay for Russian energy purchases in the 'currency of friendly countries'.<sup>132</sup> Russia has also been working with China and India to increase trade in local currency. After the Indian government had given permission for such trade, nine special vostro accounts have been opened with two Indian banks.<sup>133</sup> Despite the announcements, India's rupee trade plan with Russia has not taken off.<sup>134</sup>

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<sup>131</sup> The proposal to have a basket of currencies for the BRICS countries is not new, and was initially formulated by the Valdai Club in 2018. The reserve currency was proposed to be called R5 or R5+ based on the first letter of the BRICS currencies, each of which begins with the letter R (Real, Rouble, Rupee, Renminbi, Rand).

<sup>132</sup> Tahir Sherani, 'Pakistan to pay for Russian energy purchases in 'currency of friendly countries': Russian official', *Dawn*, 20 January 2203, at <https://www.dawn.com/news/1732677>, accessed 17 March 2023.

<sup>133</sup> 'Nine Russian banks open special vostro accounts for trade in rupee', PTI, 2022, *The Times of India*, 15 November 2023, at <https://timesofindia.indiatimes.com/nine-russian-banks-open-special-vostro-accounts-for-trade-in-rupee/articleshow/95535843.cms>, accessed 17 March 2023.

<sup>134</sup> 'India's Rupee trade plans with Russia has likely run into trouble', Bloomberg, *The Economic Times*, 14 February 2023, at <https://economictimes.indiatimes.com/news/economy/foreign-trade/indias-rupee-trade-plans-with-russia-has-likely-run-into-trouble/articleshow/97901787.cms?from=mdr>, accessed 17 March 2023.



Notwithstanding the setbacks, Russia is still persisting with the idea which will help reduce the dominance of the dollar and the coercive influence of the West, in the hope of improving its position in the future. To overcome these challenges, Russia would need to develop a comprehensive strategy that includes promoting the rouble's stability, improving financial infrastructure, expanding trade partnerships with countries willing to adopt the local currency, and addressing any concerns related to convertibility and risk management.

## **TRADE IN SANCTIONED ITEMS THROUGH THIRD COUNTRIES**

Trade in sanctioned items through a third country is a popular way of undermining sanction regimes. It involves procuring goods from a third country rather than directly from an authorised supplier. In order to ensure the constant flow of sanctioned goods, Russian traders need to develop a diversified pool of suppliers from more than one country, besides stockpiling products. They also need to take cognizance of issues regarding shipping, such as choice of ports, handling time of the cargo, port rates, etc. In addition, the need to be discreet, and obliterate any tell-tale signs to avoid punitive actions by the West cannot be overemphasized.

The paragraphs below attempt to analyse how global supply chains continues to feed Russia with items sanctioned by the West, including computer components, electronic goods, weapons and drones, and other warlike stores.

### **Case Study: Azu International Ltd. Sti**

A joint study by Reuters and the Royal United Services Institute (RUSI), a London-based defence think tank, has attempted to highlight the global supply chain that feeds Russia with Western computer components and other electronics. Azu International Ltd Sti is part of the supply chain, and its methodology is representative of how the system functions.

In March 2022, Azu International Ltd Sti was registered as a new firm in Turkey's corporate registry and, a week later, it began trading in electronics and computer parts with Russia. According to Russian

customs records, in the first seven months of the company's existence, it exported goods worth at least US\$ 20 million, including chips made by US manufacturers.

As per the records available, the company was co-founded by Gokturk Agvaz, a Turkish businessman, and Huma Gulum Ulucan. Before the West imposed sanctions, Agvaz was involved in exporting IT products through a German company named Smart Impex GmbH. Smart Impex stopped trading with Russia after the sanctions were announced in February 2022, to comply with EU trade restrictions. However, it started selling to Turkey — a non-EU country that does not enforce most of the West's sanctions against Russia.

Trading by Azu International is an example of how supply channels to Russia have remained open despite Western export restrictions and manufacturer bans. At least US\$ 2.6 billion of computer and other electronic components flowed into Russia in the first seven months of the war. At least US\$ 777 million of these products were made by Western firms whose chips have been found in Russian weapons systems: America's Intel Corp, Advanced Micro Devices Inc (AMD), Texas Instruments Inc, and Analog Devices Inc. as well as Germany's Infineon AG.<sup>135</sup>

### **Case Study: Pixel Devices**

Pixel Devices Ltd. is a Hong Kong registered company, incorporated in 2017 by a Hong Kong firm called Bigfish Investments Ltd. Reuters has published an investigative report concerning trade in sanctioned items by the firm in December 2022. The investigation reveals the firm is controlled by Kirill Nosov, a Hong Kong resident holding a

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<sup>135</sup> Steve Stecklow, et. al. 2022, no. 95. Also, the report flags the role of Russian importer, OOO Fortap. This company, based in St. Petersburg, was set up by a Russian businessman in April 2022 and has, since then, imported at least US\$ 138 million worth of electronics, including US computer parts, according to Russian customs records. They show that one of Fortap's biggest suppliers is a Turkish company, Bion Group Ltd Sti, a former textile trader that expanded into wholesale electronics post the March 2022 sanctions.

Russian passport, and is involved in shipping Western technology to Russia.

The investigation reveals Pixel Devices' current owner is a Singapore company, Asia Global Neolink Pte Ltd, which in turn is owned by a Seychelles company called White Wings Ltd., according to Hong Kong and Singapore company records. Pixel Devices' sole director is Pere Roura Cano, a Spaniard, who is also listed as a director of Asia Global Neolink, and runs an aviation club in Catalonia. Roura Cano has confirmed that Pixel Devices has been shipping semiconductors and other products to Russia.<sup>136</sup>

The firm has tried to circumvent sanctions regimes by using the plea that export restrictions are not universal, and do not involve a complete ban on the export of IT equipment to Russia. The company claims it does not sell to entities controlled by sanctioned individuals.

## **SANCTIONED COMPANIES ARE CHANGING NAMES TO CIRCUMVENT SANCTIONS**

### **Case Study: AO GK Radiant**

AO GK Radiant is a Moscow-based 30 years old distributor of computer chips and other electronic parts. The company provides Russian clients with 'the best solutions from global manufacturers.' In July 2021, the US Department of Commerce added the company to its trade restrictions list, alleging that it was 'involved in the procurement of US-origin electronic components likely in furtherance of Russian military programs.'

Even after the sanction by the USA, the company's head office continues to remain on the eleventh floor of a building at 65 Profsoyuznaya Street in Moscow. On the same floor of the building there is another company, Titan-Micro, which is also involved in the import of Western computer components. The Reuters investigative report suggests that

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<sup>136</sup> Ibid.

AO GK Radiant and Titan-Micro are one and the same firm, and details the *modus operandi* of the company.<sup>137</sup>

Russian customs records show that Titan-Micro began importing Analog Devices and other electronic components in November 2021, nine months after it was established. Titan-Micro has since imported at least US\$ 12.7 million in parts, including US\$ 9.9 million worth since April 2022. It has used some of the same suppliers as GK Radiant, including Sinno Electronics Co. Ltd., a Chinese company that was placed under export restrictions by the US Department of Commerce in June, for allegedly providing support to Russia's defence sector.

The address for Titan-Micro listed in Russian corporate records leads to a wooden house, deep inside a birch forest in northern Moscow, with no apparent sign of business activity.

The company's general manager, Nadejda Shevchenko, hung up when Reuters reached her by phone. However, a Titan-Micro employee, who declined to give his name, later said that the employees were not working in the wooden house, but on the 11th floor of the business centre at 65 Profsoyuznaya Street. That is where GK Radiant also operates.

## RUSSIA RECEIVING IRANIAN DRONES

In July 2022, the USA claimed that Iran was planning to supply Russia with military hardware. Later, the Ukrainian government accused Russia of using around 400 Iranian UAVs to strike Ukraine's civilian infrastructure.<sup>138</sup>

In its report dated 9 November 2022, *Middle East Monitor* has claimed that Russia has secretly provided western weapons seized in Ukraine,

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<sup>137</sup> Ibid.

<sup>138</sup> 'Iran to supply Russia with drones for war in Ukraine, US claims', *Middle East Monitor*, 13 July 22, at <https://www.middleeastmonitor.com/20220713-iran-to-supply-russia-with-drones-for-war-in-ukraine-us-claims/>, accessed 22 March 2023.

and hundreds of millions of dollars to Iran in return for over 160 Iranian drones. The report claims that two Russian military cargo planes landed in Tehran airport on August 20, carrying a US Javelin anti-tank missile, a Stinger anti-aircraft missile, and a British NLAW anti-tank missile as well as US\$ 141 million (£123.4 million) in cash. The missiles were reportedly intended for Ukraine and its armed forces, but ‘fell into Russian hands’, and ‘will probably be reverse-engineered and used in future wars’ by the Iranians and their allies. In return, Iran has provided 160 drones, including 100 Shahed-136 drones, 60 smaller Shahed-131 drones, and six Mohajer-6 drones, to Russia. The report also claims a second drone deal was also signed between Russia and Iran worth \$200 million (£175 million).<sup>139</sup>

The USA has taken action against Iran for the alleged violation of the sanctions regime. Seven Iranian entities are now subject to additional trade restrictions, including through the use of Foreign Direct Product Rule which imposes controls on foreign-made items produced with the use of certain US equipment. The Foreign Direct Product Rule impacts Iran’s ability to obtain many foreign-made electronic components that could be used in drones.<sup>140</sup>

On March 21, the US Department of the Treasury revealed its latest round of sanctions against Iranian drone and missile production. The Department said that the targeted ‘procurement network’ operates on behalf of Iran’s Ministry of Defence and Armed Forces Logistics, which oversees firms involved in developing unmanned aerial vehicles (UAVs) and ballistic missiles. The latest sanctions come as US officials continue to accuse Iran of supplying Russia with drones for use in Ukraine.<sup>141</sup>

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<sup>139</sup> ‘Russia flew \$141m, western weapons to Iran in return for UAVs’, *Middle East Monitor*, 9 November 2022, at <https://www.middleeastmonitor.com/20221109-russia-flew-141m-western-weapons-to-iran-in-return-for-uavs/>, accessed 22 March 2023.

<sup>140</sup> Don Graves, no. 58.

<sup>141</sup> ‘US targets Iranian drone industry in latest round of sanctions’, *Aljazeera*, 21 March 22, at <https://www.aljazeera.com/news/2023/3/21/us-targets-iranian-drones-in-latest-round-of-sanctions>, accessed 22 March 2023.

## RUSSIAN ENERGY

Europe has been one of the largest consumers of Russian energy before the sanctions were imposed by the West. In early December 2022, Europe introduced an embargo against the maritime shipments of Russia's Urals crude oil, and placed a price cap of US\$ 60 per barrel on oil purchases, which was agreed to by the G7 and Australia. The price cap required the mostly Western-based shipping insurers to only service the purchases of Russian oil below the set price level. Prior to that, the European Union also introduced an embargo on Russian coal. In February 2023, this was followed by a ban on refined Russian oil products, including jet fuel and diesel.<sup>142</sup>

While Europe largely managed to wean itself off raw Russian oil ahead of the ban, it has continued to rely on it for refined products, like diesel. The sanction regime has created a situation where Russian energy is being exported to Europe via third countries.

The sanctions have allowed Russia to displace the Middle East in its traditional markets of Asia, while the Middle East is substituting Russia in the European markets. The situation becomes even more irrational since the Middle East is importing Russian energy and re-exporting it to countries in Europe, thereby profiting in the bargain. Among the countries which are known to be involved in such trading practices include, Saudi Arabia, Egypt, UAE, Tunisia, among others.

According to EU rules, Russian crude must be 'substantially transformed' in order to be exempt from sanctions. Technically, blending Russian diesel with another batch may not skirt the ban; however, analysts say the rules are opaque and, in practice, it is difficult to trace the diesel's origin.

When the sanctions were imposed, it was appreciated that the transportation of Russian energy worldwide would be a challenging

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<sup>142</sup> Maria Snegovaya, Tina Dolbaia, Nick Fenton, and Max Bergmann, 'Russia Sanctions at One Year', CSIS, 23 February 2023 at <https://www.csis.org/analysis/russia-sanctions-one-year>, accessed 9 April 2023.

task. The USA, however, was keen to ensure that Russian oil keeps flowing to keep its domestic oil prices in check. The price cap of US\$ 60 per barrel was set high for this purpose. Western insurance companies, the International Group of Protection and Indemnity Clubs in London, and the American Club in New York, among others, were allowed to provide necessary support to the oil trade. As a result, the sanctions have had a very limited impact on Russian energy trade. In a report, *The Economic Times* (18 March 2023) has exposed the manner in which Russian energy is being transported around the world.<sup>143</sup> The report highlights the manner in which Russian oil is being transported by Gatik Ship Management, Mumbai, and Fractal Shipping, Dubai.<sup>144</sup>

The report asserts the two firms are running US\$ 2 billion in tanker assets between them. Gatik's fleet can haul about 30 million barrels of oil and fuels, and Fractal's has a transportation capacity closer to 15 million barrels. Almost all Fractal and Gatik tankers made calls to Russian ports this year, or took Russian cargoes by ship-to-ship transfer. India and the UAE did not sign up to the price cap, nor do they have other sanctions on Russian oil. They can legally use western services too, providing they give an attestation the cargoes were bought at, or below the price cap.

Neither Gatik nor Fractal is listed as the beneficial owner of the tankers in their fleets — meaning that they are probably operating the ships for others, whose identity is often not made public. They are described as the 'registered owners' of their vessels on the American Club's website.

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<sup>143</sup> Elizabeth Low, 'Tanker giants sprout from nowhere to keep Russian oil moving', *The Economic Times*, 18 March 2023, at [https://economictimes.indiatimes.com/industry/energy/oil-gas/tanker-giants-sprout-from-nowhere-to-keep-russian-oil-moving/articleshow/98754257.cms?utm\\_source=twitter\\_web&utm\\_medium=social&utm\\_campaign=socialsharebuttons](https://economictimes.indiatimes.com/industry/energy/oil-gas/tanker-giants-sprout-from-nowhere-to-keep-russian-oil-moving/articleshow/98754257.cms?utm_source=twitter_web&utm_medium=social&utm_campaign=socialsharebuttons) accessed 23 March 2023.

<sup>144</sup> 'It is this new breed of tanker market players who have helped Russian oil to continue to flow around the world,' said Rebecca Galanopoulos Jones, Senior Content Analyst at Vessels Value, a firm that tracks the prices of thousands of merchant ships. 'The sanctions on Russian oil seem to have had very little impact on overall export levels.' Ibid.

This is a common form of vessel ownership in the shipping industry, but does not denote the ship's true owner. According to information from IHS, which maintains a shipping database for the International Maritime Organization, beneficial ownership is a more important detail for understanding who really owns the assets.

## CONCLUSION

The measures taken by Russia in response to the imposition of sanctions by the USA and its allies have been both varied and complex. Despite the challenges posed by these sanctions, Russia has been able to adapt, and find ways to reduce the severity of the sanctions through the use of third countries, by establishing new companies, and replacing designated entities.

One key strategy employed by Russia has been to engage in trade with third countries, thereby bypassing the sanctions altogether. By conducting transactions through intermediaries, Russia has been able to continue importing western products critical for its defence industry and domestic consumption, thereby offsetting the impact of the sanctions to some extent. However, this approach comes with its own set of risks, including the possibility of being caught by international authorities and the potential for trade disruptions. Russian entities have to be extremely vigilant and prepared with alternatives, lest the war efforts are jeopardized.

In February 2022, there was an expectation that the sanctions and export control regimes will have serious repercussions on the Russian economy, and severely limit the progress of Russian operations. However, for the reasons discussed in the chapter,

this did not happen. Russia had prepared well to cushion the economy by accumulating substantial financial reserves, and diversifying its trade. Since 2021, in order to create political dissonance among the Western partners, it had even restricted the flow of natural gas to Europe, leaving storage facilities only fractionally full. It was assumed that the reserves would not suffice in the event of a cold winter. What Russia did not anticipate was over US\$ 300 billion of its surplus accrued from profitable energy trade and parked in Western banks would be frozen by the West.



Russia's response to the imposition of sanctions by the USA and its allies has been multifaceted, reflecting the country's determination to protect its national interests and maintain its economic stability. While there are risks associated with the evasion of sanctions, Russia has shown itself to be adept at finding ways around them, using a range of strategies, including trade through third countries, establishing new companies, and replacing designated entities. It remains to be seen how effective these measures will be in the long term. But for now, Russia appears to be weathering the storm of sanctions with resilience and determination.

## **CHINA AND INDIA'S APPROACH TO WESTERN SANCTIONS: BALANCING ECONOMIC INTERESTS AND GEOPOLITICS**

The relationship between Russia and the West has been fraught with tension for several years, with disagreements over issues such as Ukraine, Syria, and interference in the US presidential elections. In response, Western countries have imposed a series of economic sanctions on Russia, targeting its energy, banking, and defence sectors. However, two of the world's largest economies, China and India, have not followed suit and have, instead, maintained strong economic ties with Russia.

China and India's stance on Russia has been the subject of much debate in recent times, with questions being raised regarding their commitment to Western sanctions. There are also leaders who have praised the pragmatic approach of the two countries to international relations, and the manner in which the two countries have attempted to safeguard their respective national interests. While China and India have expressed concern over certain Russian actions, such as the continued 'special military operations' of February 2022, they have stopped short of condemning Russia, or joining in Western sanctions.

China and India have had a long history of trade relations with Russia. Russia is the biggest supplier of defence equipment to India. Even though India is attempting to diversify its defence imports in the recent years, yet Russia continues to remain the largest supplier of arms.<sup>145</sup>

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<sup>145</sup> India remained the world's largest arms importer for the five-year period between 2018–22 even though its arms imports dropped by 11% between 2013–17 and 2018–22, according to the Swedish Think Tank, Stockholm International Peace Research Institute (SIPRI). Russia was the largest supplier

Russia has also provided China with defence equipment involving niche technology.<sup>146</sup> Consequent to the Russian ‘special military operations’, both countries have become major importers of Russian oil and gas, and any disruption to these supplies would have a significant impact on their respective economies. In addition, China and India are also investors in Russia’s energy and infrastructure sectors, with several joint ventures and projects in the pipeline.

Moreover, China’s stance on Russia can also be seen in the context of its geopolitical ambitions. China regards itself as a major world power, and has been expanding its influence in Asia and beyond. By maintaining ties with Russia, it is signalling its independence from the Western-dominated world order, and asserting its strategic interests. India, on the other hand, since the 1950s, has followed the policy of non-alignment in its various *avatars*. India has zealously guarded its strategic autonomy, and would loathe to align with any of the major powers, to the detriment of its national interest.

The impact of China and India’s stance on Western sanctions on Russia has been a topic of much speculation. Some argue that their continued trade ties with Russia undermine the effectiveness of Western sanctions, while others point out that China and India are not the only countries that have not joined in the sanctions regime.

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of arms to India in both 2013–17 and 2018–22, but its share of total Indian arms imports fell from 64% to 45%, while France emerged as the second largest supplier between 2018–22. See, Dinakar Peri, ‘India remains biggest arms importer between 2018–22 despite drop in overall imports’, *The Hindu*, 13 March 2023, at <https://www.thehindu.com/news/national/india-remains-biggest-arms-importer-between-2018-22-despite-drop-in-overall-imports/article66614120.ece> accessed 14 March 2023.

<sup>146</sup> China has relied heavily on Russian military hardware to modernise its armed forces, made increasingly necessary by the imposition of US and European arms embargoes in the wake of the 1989 Tiananmen Square crackdown. See, Kai Wang and Wanyuan Song, ‘What support is China offering Russia?’, BBC News, 14 April 2022, at <https://www.bbc.com/news/60571253>, accessed 20 February 2023.

Against this backdrop, this chapter aims to explore the manner in which China and India have circumvented Western sanctions, the rationale behind their stance, and their actions on Western sanctions. Overall, this chapter seeks to contribute to the ongoing debate on the role of China and India in the global arena, and their relations with Russia and the West.

## SINO-RUSSIAN RELATIONS

The genesis of strong Sino-Russian relations lies in the deep admiration President Xi has for Soviet values, history, and culture. President Xi was born in 1953, the year Mao Zedong launched a campaign to study the Soviet Union as a model for China's political, economic and military systems. President Mr. Xi's father, Xi Zhongxun, was an associate of Mao who had fought alongside the Chinese leader. Zhongxun went to the Soviet Union in the late 1950s to study its heavy industry. President Xi's initial exposure to the Soviet system left a deep imprint on him, and transformed him into an ardent admirer of the Soviet system.<sup>147</sup>

In 2013, on his first trip abroad as President, President Xi travelled to Russia to meet President Putin. Since then, the two leaders have developed a strong bond.<sup>148</sup> Economic ties between China and Russia have been deepening since Moscow's seizure of Crimea from Ukraine in 2014. China refused to join Western sanctions, and the trade between the two countries has risen to US\$ 146.9 billion in 2021, from US\$ 95.3 billion in 2014, according to Chinese customs data. Crude oil makes up half of China's total Russian imports, and Russia has become increasingly reliant on its southern neighbour for electronics, such as broadcasting equipment and computers.

In late 2021, the West further alienated China because of its alleged human rights records. This drove President Xi to make a bold statement

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<sup>147</sup> Lingling Wei and Marcus Walker, 'Xi Jinping Doubles Down on His Putin Bet. 'I Have a Similar Personality to Yours'', *The Wall Street Journal*, 14 December 2022, at <https://www.wsj.com/articles/xi-jinping-putin-china-russia-relations-11671030896>, accessed 29 March 2023.

<sup>148</sup> During the visit to Moscow, the two leaders shared similar visions of restoring their countries to past glory. 'I have a similar personality to yours,' President Xi told Mr. Putin during his visit. *Ibid.*

about China's relations with Russia, declaring the partnership had 'no limits.' As per some reports, China was not privy to Russia's plans for the 'special military operations', and neither was the announcement intended to declare allegiance with Russia in the case of war.<sup>149</sup> The message was a show of solidarity against the perceived American threat.

As soon as the Russian troops started amassing at the Ukrainian border, the USA presented the Chinese with intelligence regarding the Russian plan. President Xi dismissed the reports. Since February 2022, President Xi has sought to distance China from Russia's war without condemning it.

Russia's special military operations in Ukraine have not progressed as per plans. The fighting has been on for more than a year, and some of the severest sanctions have been imposed on Russia. As a result, Russia's reliance on China has grown manifold.

## **CHINA'S TRADE RELATIONS WITH RUSSIA**

The trade between China and Russia has been growing over the years. China accounted for around 18% of Russia's overall trade in 2021—almost \$147bn (£110bn)—despite the challenges posed by the COVID-19 pandemic.<sup>150</sup> Energy and raw materials have been the main areas of cooperation between the two countries. Russia is one of the world's largest producers of oil and gas, while China is the world's largest energy consumer. China has been importing large quantities of oil and gas from Russia, and the two countries have also cooperated in building new pipelines to transport energy resources.

China is one of the biggest markets for Russian oil, gas, and coal. Just a week before the Ukraine invasion, the two countries agreed on a new Russian coal deal worth more than US\$ 20bn. President Putin also unveiled new Russian oil and gas deals with China worth an estimated US\$ 117.5 billion. The two countries aim to build a new gas pipeline (the Power of Siberia 2). The existing one began operation in 2019, under a 30-year contract worth more than US\$ 400 billion.

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<sup>149</sup> Ibid.

<sup>150</sup> Kai Wang and Wanyuan Song, 2022, no. 146.

China is also a major importer of grains, such as wheat and barley, and one of its most important sources is Russia. Until very recently, China had placed restrictions on the import of wheat and barley from Russia because of disease concerns. However, these were all lifted on the day the Russian assault on Ukraine began. In addition to energy and grain, China and Russia have also increased their cooperation in other sectors, including high-tech industries and tourism. Both countries have also been actively promoting the use of their respective currencies in bilateral trade to reduce their reliance on the US dollar.

Overall, the trade relationship between China and Russia is on the upswing, and the two countries are committed to deepening their economic ties through various initiatives and agreements.<sup>151</sup> Present day trade is not restricted to just domestic consumables. China is also providing technology that Moscow's military needs to execute Russia's 'special military operations'. Customs records show that Chinese state-owned defence companies are shipping navigation equipment, jamming technology, and jet-fighter parts to sanctioned Russian government-owned defence companies.<sup>152</sup>

## CHINA'S NON-LETHAL HELP TO RUSSIA

Recently released Chinese customs data illustrates that there has been a considerable increase in China-Russia trade, a pattern already seen in 2022.<sup>153</sup> Freshly released Chinese customs data points to a steady growth

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<sup>151</sup> During President Putin's visit to Beijing in February 2022 for the Winter Olympics, the two countries said they would boost trade to US\$ 250bn by 2024. Ibid.

<sup>152</sup> Ian Talley Follow and Anthony DeBarros, 'China Aids Russia's War in Ukraine, Trade Data Shows', *The Wall Street Journal*, 4 February 2023, at <https://www.wsj.com/articles/china-aids-russias-war-in-ukraine-trade-data-shows-11675466360?st=z6hd5o0q4zouu0f>, accessed 9 February 23.

<sup>153</sup> Bilateral trade between the two countries reached a record US\$ 190bn in 2022. See, Max Seddon and Joe Leahy, 'Xi Jinping-Vladimir Putin talks highlight Russia's role as 'junior partner' to China', *Financial Times*, 21 March 2023, at <https://www.ft.com/content/73d50de6-53c8-4bf6-adf9-8cf108f82ca1>, accessed 22 March 2023.

in trade, both exports and imports, in January and February 2023. This has been so despite the impact of the oil price cap and other trade restricting measures implemented by the West. During January and February 2023, the total volume of trade increased by 25.9%, or to US\$ 36.7 billion. Of this, Russia's export to China increased by 31.3%, or to US\$ 18.65 billion. During the same period, China's export to Russia increased by 19.8%, or to US\$ 15.04 billion. Interestingly, China's trade over the same period has dropped by 8.3%: the decline in trade with the USA is 17.4%, and with EU it is 10%. However, here one must consider that the volumes of trade are much higher than with Russia. The data is reflective of Russia's growing economic exposure to, and dependence on China.<sup>154</sup>

Russian energy trade has been discussed elsewhere in this monograph. China's imports of Russian energy — which make up more than 40 per cent of its budget revenue — grew from US\$ 52.8 billion to US\$ 81.3 billion. Russia was China's second-largest supplier of crude oil and coal, according to Columbia University's Centre on Global Energy Policy (CGEP). In January 2023, Russia overtook Qatar, Turkmenistan, and Australia to become China's biggest gas supplier, delivering 2.7 billion cubic metres that month, according to Chinese customs data.<sup>155</sup>

Russia's economic reliance on China is crucial to its prospects of winning the war. This trend is expected to continue for the foreseeable future to enable Russia to stay afloat and continue the war.

## **CHINA'S EXPORT OF WARLIKE STORES TO RUSSIA**

Since February 2022, Russia has been engaging in trade in dual-use items to help sustain its war by importing tens of thousands of dual-use goods — products that have both commercial and military applications.<sup>156</sup> Most of the dual-use items come from China. Chinese customs records show that Russia gets high technology goods, which

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<sup>154</sup> Tweets, 8 March 2023, by Alexander Gabuev, Senior Fellow at Carnegie Endowment, based on Chinese customs data, at <http://customs.gov.cn/customs/302249/zfxgk/2799825/302274/302275/index.html>.

<sup>155</sup> Max Seddon and Joe Leahy, 2023, no. 153.

<sup>156</sup> Ian Talley Follow and Anthony DeBarros, 2023, no. 152.

it desperately needs, from China. These include computer chips, infrared cameras, and radar equipment. Chinese companies — both state-owned and private — are the dominant exporters of these dual-use goods. Hong Kong and third countries are fast becoming centres of export of Chinese goods to Russia.<sup>157</sup>

China is not only involved in trade in dual-use items; it is allegedly also providing lethal weapons. In an investigative article, *Politico* has reported that Chinese companies, including one connected to the government in Beijing, has sent Russian entities 1,000 assault rifles and other equipment that could be used for military purposes, besides drone parts and body armour.<sup>158</sup> Russian and Chinese customs data does *not* show that Beijing is selling a large number of weapons to Moscow. *Politico*'s report is, perhaps, the first confirmation that China *is* sending rifles and body armour to Russian companies. The USA has also confirmed that Chinese ammunition has been used in battlefields in Ukraine, and suspects they were fired by Russian forces. However, whether the ammunition was supplied by China remains unclear.<sup>159</sup>

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<sup>157</sup> According to Bruegel, a Brussels-based think-tank, Moscow imported US\$ 4.8bn in electric machinery and parts from China last year as supplies from other countries plummeted. Chinese customs data shows that exports of certain semiconductors to Turkey — including basic items such as diodes and transistors — more than doubled in 2022, while Turkey, whose high-tech exports were previously negligible, increased sales to Russia. See, Max Seddon and Joe Leahy, 2023, no. 153.

<sup>158</sup> China North Industries Group Corporation Limited, one of the country's largest state-owned defence contractors, sent rifles (in June 2022) to a Russian company called Tekhkrim that also does business with the Russian state and military. The CQ-A rifles, modelled off of the M16 but tagged as 'civilian hunting rifles' in the data, have been reported to be in use by the paramilitary police in China, as well as by the armed forces in the Philippines, South Sudan, and Paraguay. See, Erin Banco and Sarah Anne Aarup, 'Hunting rifles' — really? China ships assault weapons and body armor to Russia', *Politico*, 16 March 2023, at <https://www.politico.com/news/2023/03/16/chinese-rifles-body-armor-russia-ukraine-00087398>, accessed 17 March 2023.

<sup>159</sup> Koyodo, 'Use of Chinese ammunition in Ukraine confirmed by U.S.', *The Japan Times*, 18 March 2023, at <https://www.japantimes.co.jp/news/2023/03/18/asia-pacific/china-russia-ukraine-war-ammunition-u-s/>, accessed 20 March 2023.



A *Defense Express* report has detailed the manner in which Russia and China are, perhaps, transporting military cargo for use by the Russian armed forces. Quoting flight tracking services, the report says these services have recorded regular flights of the AN-124 Russian heavy cargo transport aircraft of the Russian company ‘Volga-Dnepr’ to China, thereby creating an airbridge. These planes frequently turn off their transponders while flying. In November 2022, one of the flight tracking services, in particular Radarbox, reported nine AN-124 flights to China, and only three in the return direction, thereby concluding that the transponder was turned off during some of the flights. Airplanes with aircraft numbers RA-82074, RA-82044, RA-82081 were reportedly involved in the transportation.

The *Defense Express* report further states standard flight runs along the route Moscow-Novosibirsk-Zhengzhou-Novosibirsk-Moscow, with the destination of one of the flights being Urumqi. Zhengzhou is a powerful logistics and industrial hub and a powerful industrial high-tech zone, and includes units of the Chinese defence giant, Norinco. Urumqi is also the production site for a number of industrial giants.<sup>160</sup>

Such regular flights, especially with the AN-124 Russian aircraft with transponders turned off, lead to the conclusion that the Russian federation is sending aircraft for military cargo.

US Secretary of State, Antony Blinken, raised concerns regarding China providing lethal support to Russia. Blinken is reported to have said, ‘Chinese companies were already providing ‘non-lethal support’ to Russia — and new information suggests Beijing could provide ‘lethal support’ also.<sup>161</sup>

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<sup>160</sup> ‘Russia Actively Supplies Something From China With the An-124 Cargo Planes: Flights Conducted Almost Every Day’, *Defense Express*, 27 November 2022, at [https://en.defence-ua.com/events/russia\\_actively\\_supplies\\_something\\_from\\_china\\_with\\_the\\_an\\_124\\_cargo\\_planes\\_flights\\_conducted\\_almost\\_every\\_day-4974.html](https://en.defence-ua.com/events/russia_actively_supplies_something_from_china_with_the_an_124_cargo_planes_flights_conducted_almost_every_day-4974.html), accessed 28 March 2023.

<sup>161</sup> He did not elaborate on what information the USA had received about China’s potential plans. When pressed on what the USA believed China might give to Russia, he said it would be primarily weapons as well as ammunition. See, Samuel Horti and James Landale, ‘Blinken says China may give weapons to Russia’, BBC News, 19 February 2023, at <https://>

## THE USA PREVENTS CHINA FROM HELPING RUSSIA

The USA and the West have applied some of the toughest sanctions against Russia. The success of these measures stems from cutting off Russia from any source of supplies. China is one country which has the potential to fill in the void created by the West. China has been Russia's important trading partner. However, ever since Russia launched its 'special military operations', it has expanded energy cooperation as well as economic and financial relations.

The USA does not want China to act like a partial valve to the pressure generated by the sanctions. It is equally concerned about the plans of some of the countries to reduce dependence on dollars. China and Russia are at the forefront of such efforts.

The USA has warned China against material and security assistance to Russia in Moscow's war on Ukraine, laying out Washington's red line ahead of the cancelled Secretary of State Antony Blinken's February 2023 visit to Beijing. The USA has informed that it is closely monitoring the situation, and is looking for any signs of military aid or any other action which may help Russia evade sanctions. The USA has noted reports about multiple visits to China by Russian transport aircraft.

In pursuance of its efforts to prevent China from helping Russia, the USA has sanctioned Chinese companies. One such case is that of Changsha Tianyi Space Science and Technology Research Institute, which is among 16 entities slapped with curbs by the Treasury Department. The firm, also known as Spacety China, has offices in Beijing and Luxembourg. Spacety China is reported to have provided Terra Tech, a Russia-based technology firm, with synthetic aperture radar (SAR)

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[www.bbc.com/news/world-us-canada-64695042?xtor=AL-72-%5Bpartner%5D-%5Bbbc.news.twitter%5D-%5Bheadline%5D-%5Bnews%5D-%5Bbizdev%5D-%5Bisapi%5D&at\\_campaign\\_type=owned&at\\_medium=social&at\\_format=link&at\\_bbc\\_team=editorial&at\\_campaign=Social\\_Flow&at\\_ptr\\_name=twitter&at\\_link\\_id=DABF276A-B061-11ED-8604-E2B796E8478F&at\\_link\\_type=web\\_link&at\\_link\\_origin=BBCWorld](https://www.bbc.com/news/world-us-canada-64695042?xtor=AL-72-%5Bpartner%5D-%5Bbbc.news.twitter%5D-%5Bheadline%5D-%5Bnews%5D-%5Bbizdev%5D-%5Bisapi%5D&at_campaign_type=owned&at_medium=social&at_format=link&at_bbc_team=editorial&at_campaign=Social_Flow&at_ptr_name=twitter&at_link_id=DABF276A-B061-11ED-8604-E2B796E8478F&at_link_type=web_link&at_link_origin=BBCWorld), accessed 20 February 2023.

satellite images of locations in Ukraine. These images have assisted Wagner, a Russian security company with operations in Ukraine.

Military-civil fusion in China, like in Russia, is also a matter of concern for the USA. Spacety China is intimately enmeshed within the Chinese government. As per the information available on the company's website, the chief executive officer of the company, Yang Feng, is the member of China's Ministry of Science and Technology's panel of experts. The site also lists a number of working partners, including state-owned enterprises such as the China Aerospace Science and Industry Corporation, and the China Electronics Technology Group Corporation as well as the University of the Chinese Academy of Sciences.<sup>162</sup> Organisational connections, such as that of Spacety China, point to governmental complicity to help Russia mitigate the effects of sanctions.

The USA has threatened China with 'costs' if it helps Russia avoid the impact of sanctions.<sup>163</sup> As of February 2022, the USA has been unable to conclusively prove the involvement of China in the circumvention of the sanctions regime imposed by the USA and its allies after Russian forces launched 'special military operations' in Ukraine. Even though there is evidence of non-lethal military and economic assistance, it stops short of a wholesale evasion of the sanctions regime the USA and its allies imposed after Russian forces invaded Ukraine.<sup>164</sup>

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<sup>162</sup> Kelly Ng, 'US sanctions Chinese firm helping Russia's Wagner Group', BBC News, 27 January 2023, at <https://www.bbc.com/news/world-asia-china-64421915>, accessed 20 February 2023.

<sup>163</sup> Nike Ching, 'US Warns China of Red Line in Ukraine War Ahead of Blinken Visit', VOA, 19 January 2023, at <https://www.voanews.com/a/us-warns-china-of-red-line-in-ukraine-war-ahead-of-blinken-visit-/6925137.html>, accessed 28 March 2023.

<sup>164</sup> Peter Martin and Jenny Leonard, 'US Confronts China Over Companies: Ties to Russian War Effort', *Bloomberg*, 24 January 2023, at <https://www.bloomberg.com/news/articles/2023-01-24/us-confronts-china-with-evidence-of-companies-aiding-putin-s-war#xj4y7vzkg>, accessed 24 January 2023.

## CHINA NOT OPENLY SUPPORTING RUSSIA

China has great power ambitions which require western technologies, and close economic and trade ties with the Western world. However, economic and foreign policy stresses between China and the West have reached critical levels in recent days. China's domestic situation is not helping the matter, considering the country's worst economic slowdown in decades due to the severe Covid-control restrictions that it has imposed.

China's challenge is restricted not merely to its desire to have closer relations with the West. The world today is reliant on the US dollar for trade. Russia and China are working to reduce their dependence on the dollar. However, for the moment they are not any closer to transitioning to their national currencies for bilateral trade. Currently, about half of the trade between Russia and China is carried out in roubles and renminbi, respectively'. However, if one excludes energy, the share of national currencies in the bilateral trade appears to be much less impressive. The reliance on the US dollar as the prime means of payment makes many Chinese companies exporting to Russia vulnerable to secondary US sanctions, which significantly constrain bilateral trade.<sup>165</sup>

Just before the Russian 'special military operations', President Putin visited China, and the two countries declared a 'no limit partnership'.<sup>166</sup>

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<sup>165</sup> Andrey Kortunov, 'After the Summit: Next Steps in China-Russia Cooperation', RIAC, 23 March 2023, at <https://russiancouncil.ru/en/analytcs-and-comments/analytcs/after-the-summit-next-steps-in-china-russia-cooperation/>, accessed 30 May 2023.

<sup>166</sup> In a March videoconference with President Biden, President Xi sought to distance China from Russia's war without condemning it. According to people briefed on the conversation between them, President Xi told President Biden that he did not know about the Russian leader's invasion plans in advance. President Xi told the US President that he had invited President Putin in return for the latter's invitation to attend the opening of the 2014 Sochi Winter Olympics. See, Chao Deng, Ann M. Simmons, Evan Gershkovich, and William Mauldin, 'Putin, Xi Aim Russia-China Partnership Against U.S.', *The Wall Street Journal*, 4 February 2022, at [https://www.wsj.com/articles/russias-vladimir-putin-meets-with-chinese-leader-xi-jinping-in-beijing-11643966743?mod=article\\_inline](https://www.wsj.com/articles/russias-vladimir-putin-meets-with-chinese-leader-xi-jinping-in-beijing-11643966743?mod=article_inline), accessed 29 March 2023.

China has claimed ignorance regarding Russia's intention to launch full scale operations in Ukraine. Such views are incompatible with the impression given by the joint statement issued by China and Russia (4 February 2022) following a 'no limits partnership' meeting between Xi and Putin in Beijing — barely 20 days before the start of the 'special military operations'. President Xi's entente with Mr. Putin has left China increasingly isolated on the world stage.<sup>167</sup>

Russia's 'special military operations' in Ukraine have not proceeded as planned, and there are some in China who perceive Russia being likely to emerge from the conflict as a 'minor power' which will be much diminished economically and diplomatically on the world stage.<sup>168</sup> This has led China to play the role of a benevolent power attempting to restore world peace. On 17 February 2023, it proposed a 12-point peace plan. However, the West has largely rejected the plan.<sup>169</sup>

China's situation demands it to walk a diplomatic tightrope. In the recent months China has attempted to temper its relations with Russia

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<sup>167</sup> Ibid.

<sup>168</sup> 'Xi Jinping's plan to reset China's economy and win back friends', *Financial Times*, 10 January 2023, at <https://www.ft.com/content/e592033b-9e34-4e3d-ae53-17fa34c16009>, accessed 11 January 2023.

<sup>169</sup> US National Security Adviser Jake Sullivan dismissed the 12-point peace proposal, telling CNN that Beijing should have ended it after the first point, which calls for 'respecting the sovereignty of all countries'. Among its other points, the plan called for a ceasefire which would freeze Russian troops in place on Ukrainian territory, and for an immediate end to all sanctions not endorsed by the UN Security Council, in which Russia holds veto power. Further, Sullivan's response was in line with that of the European Commission President, Von der Leyen, and German Chancellor Olaf Scholz, who implied that Beijing's proposal had not changed their view that China had taken Russia's side. See, Robert Delaney, Orange Wang, and Khushboo Razdan, 'US joins EU in rejecting Beijing's peace proposal, sanctions more Chinese firms', *South China Morning Post*, 25 February 2023, at <https://www.scmp.com/news/china/diplomacy/article/3211510/us-joins-eu-rejecting-beijings-peace-proposal-sanctions-more-chinese-firms>, accessed 29 March 2023.

to avoid a collective Western backlash,<sup>170</sup> even though China has not condemned Russian actions in Ukraine and has repeatedly abstained from voting in United Nations Security Council (UNSC). China's focus is on improving relations with Europe, which has seen a downturn ever since it has been seen supporting Russia in its war in Ukraine.

China's actions are aimed at improving diplomatic ties with Europe that have soured badly in order to boost its deeply strained economy. China is attempting to do so by using its proximity to Russia to reassure Europe to prevent President Putin from taking any catastrophic action.

## INDO-RUSSIAN RELATIONS

Indo-Russia relations have a long-standing history that dates back to the Soviet era. On 9 August 1971, the two countries ushered in a strategic dimension in their relationship with the signing of the landmark agreement, the Indo-Soviet Friendship Treaty of 1971. The treaty established a framework for cooperation and coordination between the two countries in the fields of politics, defence, and economics. With this, the relationship sought to balance the US-dominated Western Bloc during the Cold War era.

Historically, Indo-Russian relations have been characterized by close cooperation in the defence and military spheres, with Russia being India's reliable and largest supplier of arms and military equipment. In addition, Russian support in various international fora, especially at the UNSC, on issues like Kashmir and the Non-aligned Movement has been greatly valued by India. However, the post-Soviet era witnessed a decline in this relationship, as Russia's focus shifted towards Europe and China, and India improved its ties with the USA.

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<sup>170</sup> China has opposed the use of nuclear weapons in Ukraine — after President Putin threatened to do so. President Xi has also sought to distance China from Russia's war without condemning it. See Lingling Wei and Marcus Walker, no. 147.

<sup>171</sup> 'What we realized in the last couple of years, based maybe on a direct fallout of the Russia-Ukraine conflict and the pandemic situation...[was] that we need to become self-reliant. We also need to have more robust and secure

In recent years, the changing geopolitical realities have rekindled the Indo-Russian relationship. India and Russia share common concerns about terrorism, energy security, and regional stability. Russia is keen on retaining India as its strategic partner in the region, and India is looking towards Russia as a reliable partner amidst the changing global order.

India and Russia continue to maintain close cooperation in areas like defence, space exploration, trade and energy. Russia remains one of India's largest trading partners, and both countries are involved in several joint projects in sectors like nuclear energy, defence, and space technology.

The future trajectory of the Indo-Russian relationship is likely to be positive, given the shared strategic interests and the need for a counterbalance to the rising influence of China in the region. However, India's closer ties with the USA and Russia's improving relationship with China could pose some challenges to the partnership. Nevertheless, given the historical ties and the shared interests, the Indo-Russian relationship is expected to remain a crucial component of India's foreign policy for the foreseeable future.

## **INDIA'S TRADE RELATIONS WITH RUSSIA**

India has long viewed Russia as a reliable partner that has supported it in the UN, and has assisted in building defence capability across domains, including by providing niche technologies which were denied by the West. Post the initiation of 'special military operations' in February 2022, India is facing challenges in its ties with Russia. Internationally, India has had to balance its support for the principle of territorial sovereignty and integrity with the abstentions at the UN. The war and the consequent sanctions, have impacted the country's energy security and defence preparedness, leading India to strongly articulate its case for continued trade ties, especially the import of Russian energy and defence equipment.

India zealously guards its policy of strategic autonomy. India's trade relationship with Russia despite Western sanctions is a significant part of its foreign policy, and furthers India's strategic independence. Despite facing sanctions from the West, Russia has continued to be one of India's key trading partners.

India is also heavily reliant on Russia for its defence needs, importing a significant proportion of its military hardware from Russia. This is despite the fact that, even before the war had started, a realisation had set in of the need to be self-reliant in defence production besides diversifying the source of defence equipment.<sup>171</sup> Despite renewed focus on self-reliance, India, in the short to medium term, will continue to be reliant on Russian equipment, ammunition, and spares.

The following chapter explores the dynamics of India's trade with Russia, particularly in the context of energy imports. India is importing oil from Russia in significant quantities. An attempt is being made to analyse how India has balanced increased imports of Russian oil with Western sanctions.

## INDIA'S DECISION TO PURCHASE RUSSIAN OIL

India is world's third largest importer of crude, after China and the USA. The Middle East and the Gulf countries have been the primary source of energy. This has changed in the last one year. According to energy cargo tracker Vortexa, from a market share of less than 1% in India's import basket before the start of the Russia-Ukraine conflict, Russia's share of India's imports rose to 1.27 million barrels per day in January 2023, raising it to 28%.<sup>172</sup> The executive body of the EU has stipulated its 27-member countries to cap the price of Russian oil at US\$ 60 as part of the West's attempt to reduce Moscow's oil revenues, and limit its ability to wage war in Ukraine while keeping steady global prices and supplies. 'Unlike Iran and Venezuela, there are no sanctions

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supply chains [...] to better handle security challenges as we move forward,' General Manoj Pande, Indian Chief of Army Staff, 14 January 2023.

<sup>172</sup> 'India's unwavering appetite for Russian crude lifts Jan. inflows to record high', PTI, *The Hindu*, 6 February 2023, at <https://www.thehindu.com/business/indias-unwavering-appetite-for-russian-crude-lifts-jan-inflows-to-record-high/article66478579.ece>, accessed 29 March 2023.

<sup>173</sup> Ibid.



on buying oil from Russia. So, anyone who can arrange for shipping, insurance and financing outside of the EU can buy oil,' an official said. The price caps are part of the EU's plan to use its clout in insurance and shipping industries to crimp Moscow.<sup>173</sup>

India has been able to negotiate a profitable deal with Russia, and is likely to continue importing Russian energy.<sup>174</sup>

## INDIA DEFENDS ITS DECISION TO PURCHASE RUSSIAN OIL

In an interview to CNN, Union Minister for Petroleum and Natural Gas, Hardeep Singh Puri, famously defended India's purchases, stating that 'India only bought 0.2 per cent, not 2 percent, of Russian oil. Moreover, we still buy a quarter of what Europe buys in one afternoon, he told the journalist, when asked about India's purchase of oil from Russia amid the Ukraine invasion'.<sup>175</sup>

India is playing an increasingly important role in global oil markets, buying huge quantity of Russian oil. India's actions are dictated by domestic expediency, and are also aligned with the West's twin goals

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<sup>174</sup> Between April and December 2022 alone, India imported US\$ 21.7 billion worth of Russian crude oil —17.1% of its total crude imports — compared to about US\$ 0.94 billion worth in 2020–2021, or 0.2% of total crude imports. See, Akriti Vasudev Kalyankar and Dante Schulz, 'Continental Drift? India-Russia Ties After One Year of War in Ukraine', *Stimson Commentary*, 9 March 2023, at [https://www.stimson.org/2023/continental-drift-india-russia-ties-after-one-year-of-war-in-ukraine/?utm\\_source=Stimson+Center&utm\\_campaign=d899078622-RA%2FComms%2FAsia%3A+India-Russia+Ties&utm\\_medium=email&utm\\_term=0\\_-d899078622-%5BLIST\\_EMAIL\\_ID%5D](https://www.stimson.org/2023/continental-drift-india-russia-ties-after-one-year-of-war-in-ukraine/?utm_source=Stimson+Center&utm_campaign=d899078622-RA%2FComms%2FAsia%3A+India-Russia+Ties&utm_medium=email&utm_term=0_-d899078622-%5BLIST_EMAIL_ID%5D), accessed 15 March 2023.

<sup>175</sup> 'Let me correct your perspective': Union minister snubs journalist on India's Russian oil purchase', *India Today*, 1 November 2022, at <https://www.indiatoday.in/amp/india/story/hardeep-singh-puri-cnn-journalist-becky-anderson-russian-oil-purchase-india-2291802-2022-11-01>, accessed 1 November 2022.

<sup>176</sup> Akriti Vasudev Kalyankar and Dante Schulz, 2023, no. 174.

of crimping Moscow's energy revenue while preventing an oil supply shock.

India imports about 85% of its total oil requirements, making it extremely sensitive to rising prices. As a developing country, its economy would be hit hard by high prices if discounted Russian oil is not made available in global markets. It is pragmatism that is driving the Indian decision and, arguably, allows India to keep the supply in the global market steady, besides preventing further Chinese leverage over Russia through greater energy purchases.<sup>176</sup>

### **INDIA IMPORTING RUSSIAN OIL DOES NOT RUN AFOUL OF THE SANCTIONS**

As of date, the West seems to be comfortable with the Indian decision, and sees India furthering the policy of G7 nations to reduce Russian oil revenues. As Europe ramps up sanctions, India is likely to become more central to a global oil map that is been redrawn by the Russia-Ukraine war.<sup>177</sup>

During his visit to India in February 2023, the US Assistant Secretary of State for Energy Resources, Geoffrey R. Pyatt, remarked (during an interview to a news agency) that USA sees 'no contradiction at all' in India remaining one of the key global partners of the USA and the country's increasing procurement of discounted Russian crude oil. He further commented that

Our experts assess that India right now is enjoying the discount of about US\$ 15 a barrel in the price that it is paying for its imports of Russian crude. So, by acting in its own interest, by driving a hard bargain to get the lowest price possible, India is

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<sup>177</sup> Yongchang Chin and Rakesh Sharma, 'Oil's New Map: How India Turns Russia Crude Into the West's Fuel', *Bloomberg*, 5 February 2023, at <https://www.bloomberg.com/news/articles/2023-02-05/oil-s-new-map-how-india-turns-russia-crude-into-the-west-s-fuel?leadSource=uverify%20wall>, accessed 6 February 2023.

furthering the policy of our G7 coalition, our G7 plus partners in seeking to reduce Russian revenues.<sup>178</sup>

It is rather interesting that some of the Russian crude oil imported by India is exported after refining to USA and Europe. There are reports to suggest that India is buying discounted crude from Russia, and then making a profit by exporting high-priced petrol and diesel. By some accounts, the No. 1 destination is USA. In November 2022, the USA is reported to have bought petro products worth US\$ 3 billion from India, presumably made from crude oil from Russia.<sup>179</sup>

## TRADE IN OTHER ITEMS

By November 2022, the impact of Western sanctions became apparent, and started negatively impacting Russia's ability to run its vital industries. In November 2022, Reuters reported that Russia sent a list of more than 500 items, including parts for cars, aircraft, and trains, which it wanted to import from India. As per the report, Russian airlines have begun experiencing an acute shortage of parts because almost all planes are foreign-made. Car parts are also in demand, with global automakers having left the market. The list of items from Russia includes car engine parts, like pistons, oil pumps, and ignition coils. For aircraft and helicopters, Russia requested 41 items, including landing gear components, fuel systems, communication systems, and fire extinguishing systems, life jackets, and aviation tyres. Russia also wants to import raw materials to produce paper, paper bags, and consumer packaging as well as materials and equipment to produce textiles, including yarns and dyes. The list includes nearly 200 metallurgy items.

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<sup>178</sup> 'India's procurement of crude oil at lowest price from Russia furthering G7 approach: U.S.', PTI, *The Hindu*, 17 February 2023, at [https://www.thehindu.com/news/national/indias-procurement-of-crude-oil-at-lowest-price-from-russia-furthering-g7-approach-us/article66520936.ece/amp/#amp\\_tf=From%20%251%24s&aoh=16766390270028&csi=1&referrer=https%3A%2F%2Fwww.google.com](https://www.thehindu.com/news/national/indias-procurement-of-crude-oil-at-lowest-price-from-russia-furthering-g7-approach-us/article66520936.ece/amp/#amp_tf=From%20%251%24s&aoh=16766390270028&csi=1&referrer=https%3A%2F%2Fwww.google.com), accessed 19 February 2023.

<sup>179</sup> Ajit Ranade, 'How Russian Oil is landing in America via India', *The Times of India*, 15 January 2023, at <https://timesofindia.indiatimes.com/india/how-russian-oil-is-landing-in-america-via-india/articleshow/97010455.cms>, accessed 4 April 2023.

It is unclear as to how many items were eventually exported. India is keen to boost its exports in order to narrow down its trade deficit with Russia even as some Indian companies have expressed concerns about potentially falling foul of Western sanctions.<sup>180</sup>

## CONCLUSION

Russia's trade with third party countries has played a significant role in helping it overcome the pressures of the sanctions imposed by the West. Of all countries, China's economic engagement has been noteworthy; it has not only helped boost Russia's economy but has also provided Russia with a reliable partner in the face of mounting sanctions from the West. While the West has tried to isolate Russia and limit its economic potential, China's cooperation has allowed Russia to mitigate some of the negative consequences of sanctions to pursue its 'special military operations'.

China is likely to be a reliable trade partner for Russia in the foreseeable future since strategy, economy, geopolitics, and political considerations are the main drivers of their economic engagement. The two countries share a common vision of a multipolar world, and have been working together to challenge the West dominated global order. Both China and Russia are concerned about the eastward expansion of NATO, and the presence of the West in the Indo-Pacific. The two countries also share similar views on many international issues, such as opposition to US interventionism, support for the principle of non-interference in the internal affairs of other countries, and the promotion of a multipolar world order. Geopolitics aside, China has an insatiable demand for Russian natural resources, while Russia needs the Chinese market. For these reasons alone, China is likely to continue to trade with Russia despite Western sanctions.

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<sup>180</sup> Aditi Shah, Aftab Ahmed, and Gleb Stolyarov, 'India asked by sanctions-hit Russia for parts for key sectors', Reuters, 29 November 2022, at <https://www.reuters.com/world/india/india-asked-by-sanctions-hit-russia-parts-key-sectors-sources-2022-11-29/>, accessed 2 June 2023.

India and Russia have a long-standing relationship which encompasses several areas: defence, trade, and mutual support in various international fora. Despite the imposition of Western sanctions, India has continued to maintain close economic ties with Russia. Like Russia and China, India too supports the vision of a multipolar world order. However, India is concerned about Chinese aggressiveness on its northern borders as also China's ambition to restrict India's influence only to South Asia.

India is seeking to balance China's rise by strengthening its ties with other countries. Russia is an important partner for India in this regard. The visit of President Xi Jinping to Russia in March 2023 has provided an impetus to boost trade between the two countries. Importantly, Russia and China have identified the main problem areas of bilateral relations — logistics, payments in national currencies, localization of production, and e-commerce, and are working to overcome them. Attempts are also on to diversify Russian exports, especially in items such as fish and seafood, pork and dairy products, soybeans, and confectionery, furniture and handicrafts, and so on. However, the long-term Russian aim would be to gradually move away from basic trade relations to deeper and more comprehensive industrial cooperation. The challenge for Russia is to become an organic part of Chinese technological and production chains, including those in high-tech areas (for example, in the aircraft industry).<sup>181</sup>

India is a major buyer of Russian defence equipment and, despite the government's thrust towards self-reliance, it would continue to import Russian equipment in the short to medium term. Russia has also emerged as a reliable and cost-effective trading partner of energy. India imports almost 85% of its domestic energy consumption. It is likely to continue to import Russia's cheap energy for the foreseeable future.

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<sup>181</sup> Kirill Babaev, 'Russian and Chinese Economies Complement Each Other Perfectly', RIAC, 23 March 2023, at [https://russiancouncil.ru/en/analytics-and-comments/analytics/russian-and-chinese-economies-complement-each-other-perfectly/?sphrase\\_id=99776693](https://russiancouncil.ru/en/analytics-and-comments/analytics/russian-and-chinese-economies-complement-each-other-perfectly/?sphrase_id=99776693), accessed 1 June 2023.

## ASSESSING THE EFFICACY OF WESTERN SANCTIONS ON RUSSIA

The impact of Western sanctions on Russia is a complex issue, and has been the subject of debate among experts and policymakers. There are claims and counterclaims from both sides regarding the efficacy of the sanctions. The USA and its allies and partners claim that sanctions and export controls are having significant and long-lasting consequences on Russia's economy and defence industrial base, irreparably degrading Russia's defence industry.

The West had initially imposed sanctions in response to Russia's annexation of Crimea, and its involvement in the conflict in eastern Ukraine in 2014. Following the launch of 'special military operations' in February 2022, the scope of the sanctions and export control measures were enhanced to target key sectors of the Russian economy, including energy, finance, and defence. One of the most significant impacts of the sanctions has been on the Russian economy. The sanctions have led to a decline in foreign investment, reduced access to capital markets, and dropped oil prices, all of which have had a negative impact on Russia's export revenues.

On the other side of the spectrum there are those who believe that Russia has weathered the shock much better than expected.<sup>182</sup> Proponents of this theory point to macroeconomic indicators suggesting that the Russian economy has proved to be resilient. Detractors of the sanctions allude to the fact that Russia is nowhere close to terminating the war as a proof that sanctions have not had their desired effect.

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<sup>182</sup> Nicholas Mulder, 'Sanctions Against Russia Ignore the Economic Challenges Facing Ukraine', *The New York Times*, 9 February 2023, at <https://www.nytimes.com/2023/02/09/opinion/sanctions-russia-ukraine-economy.html>, accessed 30 May 2023.

As the details are gradually emerging, it is likely that Russia was prepared for Western sanctions. It was able to withstand the initial stresses of the Western move. Over time, there has been a shift in Russia's economic policies, with a greater focus on enhancing trade relations with reliable partners, such as China and India. Russia has also been able to find new markets for its energy trade, replacing the traditional markets of the EU.

While there is evidence of the significant economic impact of sanctions on Russia, there are also other factors at play, such as the shift in Russia's economic policies which makes assessing the impact of Western sanctions on Russia a complex and difficult task. This chapter attempts to assess the impact of Western measures based on the available inputs.

## **THE WEST CLAIMS SANCTIONS ARE EFFECTIVE**

The USA has worked with its allies and partners around the world to impose unprecedented sanctions on Russia, and has promised to continue to impose costs on Moscow for as long as its war continues. Since February 2022, the West has taken a comprehensive set of actions to degrade the Russian economy and its war waging potential.

In order to advance their claims regarding the efficacy of the sanctions, the West is forwarding the following arguments.<sup>183</sup>

- Major supply shortages for Russian forces in Ukraine are forcing Russia to turn to less technologically advanced countries, such as Iran and North Korea, for supplies and equipment.
- Russia is struggling to import semiconductors and other key components. Export controls have forced Russia to cannibalize existing airline parts they can no longer access abroad.
- Russian hypersonic ballistic missile production has nearly ceased due to the lack of necessary semiconductors used in the manufacturing process.

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<sup>183</sup> Fact Sheet, Office of the Spokesperson, 2022, no. 47.

- Russia's military aviation program has been cut off from resupply provided by the global aviation trade.
- The Russian media reports that the production of its next-generation airborne early warning and control military aircraft has stalled due to the lack of foreign components, including semiconductors.
- Mechanical plants, including those producing surface-to-air missiles, have been shut down due to shortages of foreign-origin components.
- Russia has reverted to Soviet-era defence stocks because the West's measures have interrupted the abilities of Russian companies to replenish domestic supply chains.
- Exports on certain goods and services — including dollar-denominated banknotes, accounting, management consulting, quantum computing — and trust and corporate formation services to persons located in the Russian Federation are now prohibited.

## HOW THE SANCTIONS ARE FARING

The threat of sanctions as also their imposition by the West have not been able to curtail the Russian government's actions against Ukraine. Moreover, as the things stand today, it is unlikely that they will do so in the near to mid-term.<sup>184</sup> The threat of severe sanctions issued in

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<sup>184</sup> Since Russia's invasion of Ukraine on 24 February 2022, over 11,000 new restrictions have been placed on Russian individuals, companies, products, and technologies. While the sheer number of such restrictions is impressive, the 'sanctions from hell' so far have not delivered as much hell as originally expected. Throughout 2022, Russia's economy generally defied apocalyptic forecasts. Will the sanctions deliver? Much depends on the envisioned goal. The real question is not whether sanctions will lead to a full collapse of the Russian economy — it is unlikely Moscow will run out of money to fight the war — but whether sanctions can inflict sufficient economic, social, and political pressures on the Kremlin to constrain its options for waging war, and push it toward a cessation of hostilities. no. 142.



December 2021 did not deter Russia from invading Ukraine. The imposition of sanctions two months after the invasion sought to curb the Russian government's ability to continue its 'harmful foreign activities.' Some noted the shift from an environment of deterrence to one of attrition, and the current approach may be categorized as one of 'coercion by denial' — that is, the West's denial of the resources needed by the Russian government to continue fighting.<sup>185</sup>

In the initial days of the war, Russia enjoyed a large balance of payments surplus of over US\$ 120 billion. This helped the country to absorb the initial stresses of the sanctions. Towards the end of 2022, signs of the impact of the sanctions — even though limited — began emerging on the Russian economy. The oil embargo imposed by the EU came into force at the end of 2022. However, Russia was able to mitigate the impact of the oil embargo by tapping the markets of Asia, with China and India receiving bulk of its energy supplies. Furthermore, the 'Fortress Russia' strategy, and the Bank of Russia's skilful response, have shielded the financial-sector from the impact of sanctions and prevented a financial crisis, thus explaining the smaller-than-anticipated economic contraction.

The influence of sanctions can be explained by analysing the following factors.

- Large balance of payments surplus in Russia's favour
- Bank of Russia's actions to stabilise the financial sector
- Influence of the exports of natural resources on the Russian economy
- Macroeconomic sanctions
- Strong rouble is not a sign of the ineffectiveness of sanctions
- Trade relations with China and India
- Large Balance-of-Payments Surplus

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<sup>185</sup> no. 107.

Russia is a commodity driven emerging market. Even before the war started, its annual current account surplus was more than US\$ 120 billion in 2021, which increased dramatically in 2022. Russia's current account surplus, a measure of the difference between all money coming into the country through trade, investment, and transfers, and what flows back out, hit a record high in 2022. A fall in imports and robust oil and gas exports kept foreign money flowing in, despite Western efforts to isolate the Russian economy.<sup>186</sup> According to data released by the Russian Central Bank, the surplus for January–September stood at US\$ 198.4 billion — roughly US\$ 120 billion higher than for the same period in 2021, and more than double the previous record.<sup>187</sup> This figure rose sharply, to end the year with a record current account surplus of US\$ 227 billion in 2022.<sup>188</sup> Two main developments explain this outcome: high prices for major Russian exports, and lower imports since the onset of the war.<sup>189</sup>

The year 2022 witnessed a major decrease in imports. Russia's imports fell by roughly US\$ 8.5 billion in March 2022 compared to the previous month, and also in April. The recovery started in May 2023, with most of the imports coming from China and, to a large extent, from Belarus and Turkey. Imports from China have now returned to pre-war levels.<sup>190</sup> The imports in the first half of 2022 were to the tune of US\$ 8 billion to US\$ 9 billion lower than in the first half of 2021 (or a 6 percent drop year-on-year). While it is reasonable to assume that Russia's imports

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<sup>186</sup> Russia's trade balance — the difference between total exports and imports — has increased significantly to US\$ 282.3 billion in 2022, up from US\$ 170.1 billion the previous year.

<sup>187</sup> Source: Bank of Russia.

<sup>188</sup> 'Russia posts record current account surplus of US\$ 227 bn in 2022', Reuters, 17 January 2023, at <https://www.reuters.com/world/europe/russias-current-account-surplus-almost-doubled-2022-central-bank-2023-01-17/>, accessed 7 April 2023.

<sup>189</sup> Darvas, Z. and C. Martins, 'Russia's huge trade surplus is not a sign of economic strength', Bruegel Blog, 8 September 2022, at <https://www.bruegel.org/blog-post/russias-huge-trade-surplus-not-sign-economic-strength>, accessed 6 April 2023.

<sup>190</sup> Trade between Russia and China hit a record high of US\$ 190 billion in 2022.

will continue to increase gradually, especially as it finds alternative sources for key goods, the 2022 total could be US\$ 20 billion lower than 2021. The adjustment of export price effect with reduced imports has created surplus which cannot be cancelled out by sanctions on Russian exports. In view of the above, it is to be appreciated that the current account deficit of 2023 is likely to remain robust.

## **THE STABILISING ROLE OF THE BANK OF RUSSIA**

Immediately after the ‘special military operations’ were launched in February 2022, the West was quick to freeze Russian assets, deny access to US dollars and euros, and disconnect Russian financial institutions from the SWIFT system. However, deft handling by Russia’s Central Bank managed to cushion the impact of sanctions on the Russian financial sector, returning the structural liquidity conditions to pre-sanctions levels, following a short period of stress in March 2022. In addition, various channels continue to enable Russian banks to interact with the outside world.

There were some glitches in the initial days, when Russian bankers were unable to anticipate the actions of the West. Early and drastic measures relating to assets held abroad reduced the Bank of Russia reserves by 40 percent. However, the balance-of-payments dynamics means it is likely that Russia might be able to rebuild reserves quite quickly. Since the start of the war, the Bank of Russia has lost around US\$ 95 billion in reserves for reasons other than sanctions. Notwithstanding the loss, roughly US\$ 300 billion were available in October 2022 for intervention, should the need have arisen.

The Bank of Russia’s capital controls measures have helped support the rouble since the initial days of the sanctions. The Bank’s Governor, Elvira Nabiullina, is on record saying that the Bank has no intention to ease capital controls — including curbs on foreign currency withdrawals — that have helped make the rouble the world’s best-performing currency this year.<sup>191</sup> One of the measures of success of the Bank’s

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<sup>191</sup> ‘Russia’s Nabiullina: impossible to isolate from sanctions impact’, Reuters, 8 November 2022, at <https://www.reuters.com/markets/currencies/russian-cbank-no-need-ease-capital-controls-further-now-2022-11-08/>, accessed 7 April 2023.

intervention is the increase in corporate and retail lending during the period January–October 2022 by 9.9% and 6.7% respectively. It is expected that the positive dynamics in lending will continue.<sup>192</sup>

## DEPENDENCY ON COMMODITY EXPORT

Sergey Aleksashenko, the former Russian Deputy Minister of Finance, has highlighted the contribution of the export of raw materials in preventing the economic collapse of Russia due to the sanctions. In his *Aljazeera* article of 23 February 2023, he makes a case that, despite sanctions, there will always be a demand for Russian raw material that will mitigate any destabilising effects on economy, and prevent any fallout, both on the political front as well as on the war efforts.<sup>193</sup>

Russia is a storehouse of natural resources. In 2021, Russia provided 17.5 percent of oil sold on the world market, 47 percent of palladium, 16.7 percent of nickel, 13 percent of aluminium (not including China), and almost a quarter of potash fertilisers. Since the global economy cannot grow without increasing its consumption of natural resources, Aleksashenko maintains there will always be a demand for Russian raw materials. This, to a large extent, will protect Russian economy from the impact of sanctions.<sup>194</sup>

There are, however, analysts who are not so hopeful of the future. Andrey Kortunov highlights the need for Russia to reduce dependence on energy exports to China. He goes on to suggest that Russia has to work in order to significantly increase its non-energy exports to China. The rapid increase in Russian-Chinese trade turnover in 2022 was a success story for the two nations. However, this was largely due to the specific conjuncture of the world energy markets which turned out to be quite favourable for Russia's energy exports. However, this conjuncture will not last forever and, over time, oil and gas prices will go down. This makes it imperative for Russia to diversify Russian exports in order to consolidate the recent positive trade trends.<sup>195</sup>

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<sup>192</sup> Ibid.

<sup>193</sup> Sergey Aleksashenko, no. 99.

<sup>194</sup> Ibid.

<sup>195</sup> Andrey Kortunov, no. 165.

## MACROECONOMIC SANCTIONS

Since the start of Russia's 'special military operations', the USA and its allies and partners have imposed unprecedented economic measures against Russia. These have included barring transactions with Russia's biggest state-owned banks, prohibiting the trading of Russian sovereign bonds, limiting the ability to lend to major Russian companies, blocking key banks from the SWIFT financial messaging system, and freezing the Russian Central Bank's foreign-exchange reserves. However, through 2022, this group of sanctions was generally unsuccessful in achieving the desired outcome — the collapse of the Russian economy. The sanctions were offset by Russia's current account surplus from energy revenues as well as the sanctions-induced collapse of imports.

Other measures have also been put in place. The Kremlin introduced strict capital controls, including banning Russians from transferring foreign currency abroad above a small, fixed amount. The Russian Central Bank temporarily increased interest rates to 20 percent, and Russian exporters have been forced to sell 80 percent of their foreign currency revenue for roubles. As a result, Russia managed to stabilize and even strengthen the rouble. Subsequently, by the end of the spring of 2022, the rouble emerged as the world's best-performing currency, defeating the original expectations of sanctions experts.<sup>196</sup>

The effects of sanctions on the Russian economy have been slow to manifest. Financial stability has been maintained by decisive policy measures taken by the Bank of Russia, which have prevented the knock-on effects on the real economy. However, the jury is still out regarding the macroeconomic prospects for 2023.

## THE IMPACTS OF OIL EMBARGO AND PRICE CAP

Energy sanctions have, by some accounts, started to reflect on macroeconomic indicators, and are likely to have a major impact on

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<sup>196</sup> Maria Snegovaya, et. al, no. 142.

the economy.<sup>197</sup> To counter the loss of the European market, Russia has ramped up its oil shipments to Asia, which now account for about three-fourths of what used to be shipped to Europe.<sup>198</sup> However, it is unlikely that Asian markets will be able to fully substitute for the loss of European revenue due to the increased shipping time taken to reach Asian markets<sup>199</sup> as well as the crossing of bottlenecks.<sup>200</sup> Both these are expected to raise costs by at least US\$ 10 per barrel. Some estimates project a 15 percent decline in Russian refined oil products in 2023 and, as per one study, losing half of the current EU export of oil products may cost Russia around US\$ 8 billion per year.<sup>201</sup>

## POOR PERFORMANCE OF AUTOMOTIVE INDUSTRY

Economists and analysts working on the Russian economy quote revenue from sources other than oil and gas exports as being down by 20 percent in October 2022 as compared to a year earlier. Manufacturing industries — the part of the Russian economy most dependent on Western technologies and component parts — were the hardest hit by the sanctions. The output of the Russian automotive industry, which

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<sup>197</sup> In December, Urals crude fell in value by almost 30 percent, as its price discount compared to Brent crude increased to almost 40 percent. By some estimates, the first month of the oil embargo and price cap cost Moscow approximately •160 million (US\$ 172 million) per day, or about a 17 percent decline in Russia's earnings from fossil fuel exports. This pushed the country's energy revenues to the lowest level since August 2020. What has followed is a rapid decline of oil and gas tax revenues in early 2023, resulting in the biggest January budget deficit since the crisis year of 1998. See *ibid*.

<sup>198</sup> In the pre-invasion period of January 2021 to February 2022, China's seaborne imports from Russia averaged about 590,000 barrels per day (bpd), while in the post-invasion period up until December 2022, they averaged around 857,000 bpd, an increase of 267,000 bpd, or about 45 percent.

<sup>199</sup> Ships are likely to take about a month to reach India as opposed to only a couple of days to Rotterdam or Genoa.

<sup>200</sup> Namely the Danish straits, the Strait of Gibraltar, the Bosphorus Strait, the Suez Canal, and the Bab el-Mandeb Strait — where they run the risk of delays.

<sup>201</sup> Maria Snegovaya, et. al, no. 142.

directly or indirectly provides jobs to 3.5 million people, plummeted by two-thirds in 2022. Some analysts flag high unemployment rates to support their claim that sanctions are working.<sup>202</sup>

## **NEGATIVE IMPACT ON THE METAL INDUSTRY**

Europe was one of the largest markets for Russia's rolled steel, of which up to 4.5 million tons was exported per year. Sanctions will have a pronounced impact on Russia's metal industry. By some estimates, Russian metals producers are losing US\$ 5.7 billion a year from trade restrictions. By the end of 2022, regions with developed automotive, engineering, and metallurgic industries were reporting sharp declines in tax revenues.<sup>203</sup>

## **STRONG ROUBLE NOT A SIGN OF THE INEFFECTIVENESS OF SANCTIONS**

The sanctions have not been able to meet the desired objectives of collapsing the Russian economy. This has been largely due to the current account surplus from energy revenues, and reduced imports due to sanctions. The Bank of Russia imposed strict capital controls, including banning Russians from transferring foreign currency abroad above a small, fixed amount. The central bank temporarily increased interest rates to 20 percent, and Russian exporters have been forced to sell 80

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<sup>202</sup> Official unemployment currently stands at 3.7 percent, with only 2.7 million Russians unemployed. That is a record low. The reality, however, is that, at the end of the third quarter of 2022, almost five million Russian workers were subject to various forms of hidden unemployment. Most notably, 70 percent of them were on unpaid leave. This is comparable with the worst levels in the 1990s, during the second half of which 10 to 13 percent of Russians were unemployed. See Vladimir Milov, 'The Sanctions on Russia Are Working', *Foreign Affairs*, 18 January 2023, at <https://www.foreignaffairs.com/russian-federation/sanctions-russia-are-working>, accessed 20 January 2023.

<sup>203</sup> 'Russia Privately Warns of Deep and Prolonged Economic Damage', Bloomberg News, 5 September 2022, at <https://www.bloomberg.com/news/articles/2022-09-05/russia-risks-bigger-longer-sanctions-hit-internal-report-warns?srnd=premium-europe&leadSource=uverify%20wall>, accessed 10 April 2023.

percent of their foreign currency revenue for roubles. All these measures have contributed to making the rouble the best performing currency of 2022.<sup>204</sup>

It would be incorrect to suggest that sanctions are not working. Immediately following the announcements of sanctions, the rouble had dropped from about 70-75 to the dollar to close at 140 to the dollar. This market reaction was very short-lived. By April 2022, the exchange rate returned to below pre-invasion levels. Two main factors influenced this. First, and crucially, volumes of roubles traded fell to about a third of what they were before the war. A much smaller volume of transactions implies that the price signal is both more volatile and less informative in terms of the underlying fundamentals. The reduction in volumes transacted is the result of both sanctions and capital controls which stop non-residents from taking money out of the country. Second, for an extended period, the Bank of Russia imposed strict capital controls, ordering banks not to sell foreign currency to retail clients, and introducing a US\$ 10,000 cap on cash withdrawals from foreign currency-denominated retail accounts. Thus, the current exchange rate is not a reflection of the value of the Russian economy's fundamentals. Rather, it is indicative of the fact that financial sanctions are isolating the rouble internationally.<sup>205</sup>

## CHINA'S SUPPORT IS IMPORTANT FOR RUSSIA

Russia's economy has been adversely impacted due to a number of factors, including Western sanctions, low oil prices, and the COVID-19 pandemic. China is an important trading partner, investor, and strategic partner of Russia. In the recent years, Sino-Russian trade has multiplied manifold. In this context, continued support from China is important for Russia to shore up its economy.

<sup>204</sup> Mimansa Verma, 'How Russia made its rouble the world's top-performing currency', *Finance and Investing*, 23 May 22, at <https://qz.com/2167447/how-russia-defended-the-ruble-from-ukraine-war-sanctions#:~:text=The%20Russian%20rouble%20has%20emerged,May%2023%2C%20for%20the%20year>, accessed 7 April 2023.

<sup>205</sup> Maria Demertzis, et. al, no. 64.



China's demand for Russian energy resources, such as oil and gas, has been a key driver of this trade relationship. In addition, China has been investing heavily in Russia's infrastructure, such as the energy sector, transportation, and telecommunications. The Power of Siberia is one such project which is operational. These projects have not only helped to strengthen the economic ties between the two countries but have also contributed to the development of the regions where the projects are located. This investment has helped to support Russia's economic development, and provided much-needed capital for Russian businesses.

In addition to trade, geopolitical considerations play an important role in the relationship. China and Russia have been strengthening their strategic partnership in recent years as a counterbalance to the USA and its allies. The two countries share a common vision of a multipolar world, and have been working together to challenge the dominance of the USA in global affairs.

Thus, China's continued support is important for Russia to provide necessary backing to its economy. This relationship has helped to mitigate the impact of Western sanctions and other economic challenges faced by Russia in recent years, and is likely to follow an upward trajectory in the foreseeable future.

## **INDIA AND RUSSIA: IMPORTANT TRADING PARTNERS**

The Indo-Russian relationship is dictated, *inter alia*, by geo-political and economic considerations. India and Russia share similar views on many international issues, such as the promotion of a multipolar world order, and support for the principle of non-interference in the internal affairs of other countries. The two countries have been working together in international organizations, such as the UN, to promote their shared interests. Geopolitics aside, Indo-Russian trade relations have a long history of cooperation in various sectors, including defence, energy, and trade.

Energy cooperation is an important aspect of trade between the two countries. Russia has become a major supplier of oil and gas to India post February 2022, and both countries are seeking to expand this cooperation. India is also exploring the possibility of investing in Russia's

Arctic oil and gas projects. India and Russia have also been exploring the possibility of connecting the International North-South Transport Corridor (INSTC) with Russia's Arctic shipping routes. This connectivity project has the potential to boost trade between India and Russia, and connect South Asia with Northern Europe.

India is heavily reliant on Russian arms and defence equipment. Although it has realised the need for diversification, it is unlikely that India will be able to shed its dependence anytime soon. Trade in defence equipment will continue to form an important component of the trade relationship between the two countries.

India and Russia are also discussing a free trade agreement (FTA), that has the potential to deepen bilateral commercial ties that have flourished even after the war broke out in Ukraine. The FTA talks mark a step-up in economic relations between the two countries, despite calls from Western countries for India to gradually distance itself from its dominant weapons supplier, Russia.<sup>206</sup>

In addition to the above, India and Russia need to urgently develop and enhance the financial infrastructure, transportation, and logistics connection. The two governments also need to safely secure bilateral financial and commodity flows from interference from third parties. This will allow for the expansion of bilateral trade. Non-tariff barriers that limit bilateral trade should be reviewed in close cooperation with the businesses of both states, and account for the changed circumstances.<sup>207</sup>

## **FUTURE FORECAST**

The Russian economy has weathered the initial shock of some of the severest sanctions imposed on any country. This has been largely due

<sup>206</sup> Nidhi Verma and Krishn Kaushik, 'India, Russia talk free trade deal in step-up of relations', Reuters, 17 April 2023, at <https://www.reuters.com/world/india-russia-discussing-free-trade-agreement-russia-deputy-pm-2023-04-17/>, accessed 19 April 2023.

<sup>207</sup> Lydia Kulik Alexey Kalinin, 'Developing Russia-India Economic Ties Under New Circumstances', Policy Brief, RIAC, 43/2022, at <https://russiancouncil.ru/papers/RIAC-Russia-India-PoolicyBrief43En.pdf>, p. 15, accessed 30 May 2023.

to some advance planning and the deft handling of the situation by Russia's Central Bank. However, the future scenario does not seem very bright. The Russian economy started stagnating following the imposition of sanctions in 2014, after the annexation of Crimea. The pre-war potential was not overly optimistic, with growth at 2-3 percent per year.<sup>208</sup> In 2022, the country's economy contracted by approximately 2.2 percent, while forecasts for 2023 vary from predicting a marginal economic growth of 0.3 percent, to a decline of 2.5 percent. These predictions are subject to the condition that Russia is able to find alternative export markets for natural resources and energy. If not, then Russia's budget deficit in 2023 is likely to rise by at least 1.5 percentage points above the government's projections of 2.3 percent.

It is also pertinent to remember that Russia's sovereign wealth fund has been depleted since February 2022, and only US\$ 87.2 billion of the fund is in liquid assets.<sup>209</sup> In its January 2023 outlook, the International Monetary Fund expects the Russian economy to see a very small recovery of 0.3 percent in 2023. Meanwhile, it expects the EU to expand by a mere 0.7 percent and British GDP to fall by 0.6 percent.<sup>210</sup>

As things stand today, the Russian government has limited capacity to control inflation. The convertible foreign exchange earnings are likely to fall due to a drop in oil exports, and defence expenditures will continue putting additional pressure on the economy, eroding the effectiveness of Russia's fiscal and monetary tools. It is likely that Rosstat, which set the 2022 inflation rate in Russia at 11.9 percent, is under

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<sup>208</sup> Alexandra Prokopenko, 'The Cost of War: Russian Economy Faces a Decade of Regress', Carnegie Endowment for International Peace, 19 December 2022, at <https://carnegieendowment.org/politika/88664#:~:text=The%20Russian%20economy's%20prewar%20potential,to%20come%20to%20a%20hat>, accessed 11 April 2023.

<sup>209</sup> Maria Snegovaya, et. al, no. 142.

<sup>210</sup> 'World Economic Outlook Update (2023): Inflation Peaking amid Low Growth', International Monetary Fund, January 2023, at <https://www.imf.org/en/Publications/WEO/Issues/2023/01/31/world-economic-outlook-update-january-2023>, accessed 30 May 2023.

reporting the true levels of inflation inside the country. The present inflation rate is likely to be more, and set to increase in the future.<sup>211</sup>

The future of the Russian economy depends largely upon how soon it is able to find alternate markets for its products, and alternate sources for high technology platforms and equipment which are now being denied by the West. Even before the current sanctions were imposed, Russia was working to develop ties with the rest of the world. The sanctions, and the impasse in relations with the West, have provided the necessary stimulus for long overdue changes in its outlook towards trade and the economy. The changeover will not be easy, and it will face a number of obstacles in its attempts at diversification. Moscow must assess them realistically and objectively, and be mindful of the fact that the pivot itself will not solve all its problems. Russia has some hard and painstaking work ahead, and that too, for decades to come.<sup>212</sup>

## **SANCTIONS AS AN INSTRUMENT OF COERCION UNLIKELY TO WORK WITH RUSSIA**

### **The West's Sanctions Strategy**

In December 2021, the West threatened Russia with severe sanctions if it attacked Ukraine. The threat did not deter Russia, and it went ahead with its planned 'special military operations' in February 2022. As a result, the USA and partners imposed unprecedented sanctions on Russia with the aim of denying it resources to conduct the war. Today, the aim of the sanctions has changed from deterrence to attrition — to one which can be categorized as 'coercion by denial', that is, denying the resources the Russian government needs to continue fighting.<sup>213</sup>

The USA and its allies have long wielded financial and economic sanctions as instruments of coercion, with tangible costs imposed on

<sup>211</sup> Maria Snegovaya, et. al, no. 142.

<sup>212</sup> Ivan Timofeev, 'Can Russia Really Break Away from the West?', RIAC, 6 April 2023, at [https://russiancouncil.ru/en/analytics-and-comments/analytics/can-russia-really-break-away-from-the-west/?sphrase\\_id=99686119](https://russiancouncil.ru/en/analytics-and-comments/analytics/can-russia-really-break-away-from-the-west/?sphrase_id=99686119), accessed 30 May 2023.

<sup>213</sup> Cailleigh Glenn, no. 107.

the targeted actors. Governments on the receiving end of this tool of statecraft often take steps to minimize their exposure to the pressure of such sanctions. Russia has been a target of financial and sectoral sanctions ever since the annexation of Crimea in 2014, and its government has been preparing to defend itself by ‘sanctions-proofing.’ Historically, US sanctions have failed most of the time in achieving their objectives. Whenever the embargo has been applied as an act of containment, it has succeeded; but sanctions designed to compel changes in behaviour have failed.<sup>214</sup>

In order to assess the efficacy of the current sanctions imposed on Russia, three key criteria need to be analysed: proportionality, reciprocity, and coercive credibility.<sup>215</sup>

- Proportionality refers to the relationship between the scope and nature of the objectives being pursued, and the leverage being applied in their pursuit. For the moment the West, led by the USA, is standing by Ukraine, and is committed to Ukraine’s definition of victory as expressed by President Zelensky: to regain every inch of territory, including Crimea, reparations, and the institution of a war-crimes tribunals.<sup>216</sup> The long-term war termination objective of West also includes rebuilding Ukraine’s economy, and guarantee its independence and security against a similar attack in the future. This, in effect means, Ukraine joins the EU, and also it may be incorporated into the NATO alliance sometime in the future. In addition, Ukraine has also made it a criminal offence to negotiate with Russia as long as Russian

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<sup>214</sup> The US has imposed decades-long sanctions on some extremely poor and bankrupt countries — Venezuela, Syria, and Zimbabwe — with little to show by way of tangible results. Even ‘secondary sanctions’ were threatened against countries and companies. In every case, the target suffered severe economic costs, yet made no concessions.

<sup>215</sup> For details, see Bruce Jentleson, no. 3.

<sup>216</sup> David Remnick, ‘How the War in Ukraine Ends,’ *The New Yorker*, 17 February 2023, at <https://www.newyorker.com/news/the-new-yorker-interview/how-the-war-in-ukraine-ends>, accessed 14 April 2023.

President Vladimir Putin is present.<sup>217</sup> This calls for a regime change in Russia. The sanctions imposed by the West, and the corresponding leverage accrued, is unlikely to deter or force Russia to withdraw from Ukraine and accept the conditions elucidated above. The sanctions, in this case, have become self-defeating because their demands are, for the moment, unimplementable. Thus, the proportionality problem arises from expectations associated with sanctions — the call for regime change in Russia — rather than mere policy change by Russia and a negotiated end to war.<sup>218</sup>

- Reciprocity involves an explicit, or at least a mutually tacit, understanding of the linkage between the coercer's inducements and the target's concessions. History is a good guide to understand how sanctions work. Both the Japanese in 1941, and the Germans in 1916–1917, attempted negotiating with their isolators before choosing escalation. In both cases, domestic political constraints — which the economic isolation tightened — contributed to diplomatic failure. Western leaders should consider the circumstances under which Russia might calculate that it would be better off acceding to Western demands than continuing to defy them, which may include face-saving outs. All sanctions regimes must have an 'off-ramp' strategy, which is missing in the instant case.
- Coercive credibility means that, in addition to the running calculations comparing the costs and benefits of cooperation, the target knows that a definitive refusal to cooperate would have serious consequences.

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<sup>217</sup> 'Russian foreign minister: Want India, China to be friends; Ukraine too should negotiate on war', *The Indian Express*, 3 March 2023, at [https://indianexpress.com/article/india/russia-sergey-lavrov-raisina-dialogue-ukraine-war-india-china-8477233/lite/#amp\\_tf=From%20%251%24s&aoh=16778476047205&csi=0&referrer=https%3A%2F%2Fwww.google.com](https://indianexpress.com/article/india/russia-sergey-lavrov-raisina-dialogue-ukraine-war-india-china-8477233/lite/#amp_tf=From%20%251%24s&aoh=16778476047205&csi=0&referrer=https%3A%2F%2Fwww.google.com), accessed 14 April 2023.

<sup>218</sup> It is well known that the West is militarily supporting Ukraine in its war against Russia (in conjunction with sanctions). However, the military aid is inadequate to ensure Russia's defeat.

The sanctions imposed by the West are severe, but Russia was prepared, even though the intensity did surprise the government. Thereafter, it has managed to support its war effort though imports of critical items through third countries. Russia has also managed to find new markets in Asia for the export of oil and natural gas. Having weathered the initial shock, Russia is likely to sustain its war efforts,<sup>219</sup> even though the long-term economic prospects are bleak.

## **RUSSIA'S COUNTERSTRATEGY**

In addition to analysing the West's strategy, Russia's counterstrategies have also to be taken into account to assess the efficacy of sanctions. Russia has been systematically 'sanction-proofing' its economy since 2014. Furthermore, its ability to deal with sanctions has to factor in the rigours of domestic politics. President Putin's longevity in power depends on the domestic political line up. The key issue is: can he gain more internal political support and security by defiance? Or, are there domestic political gains to be made from improving relations with the West? This, in part, is a function of the domestic economy and its capacity to absorb and/or counter the costs being imposed through budget resources, import substitution, alternative trade partners, and other ways of reducing economic vulnerability. These are some things which the Russian government is working on.

Furthermore, President Putin is also vulnerable to the pressures from the elites within Russian society. The West has been systematically sanctioning some of the richest and most powerful Russians. If the interests of these elites are threatened beyond a threshold, they might threaten President Putin's hold over the country. For now, President Putin's hold over the government and society seems adequate. However, the West would do well to read any signs of domestic dissent.<sup>220</sup>

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<sup>219</sup> Nicholas Mulder, no. 182.

<sup>220</sup> In June 2018, the then Prime Minister, Dmitry Medvedev, announced the creation of a tax-free zone status for Russky Island, specifically to offer a destination for returning overseas Russian investments that were vulnerable to sanctions. This policy limited the exposure of wealthy Russians to financial sanctions by keeping investments in Russia while extending government

## **BLEAK FUTURE: BUT RUSSIA LIKELY TO MOBILISE RESOURCES TO FUND THE WAR**

After analysing the sanctions and export control measures imposed by the West, the strategies and counterstrategies, this study concludes that Russia faces grim economic prospects. It is likely that sanctions may have a long-term economic consequence, and may negatively affect Russia's defence industrial base. However, in the short to medium term, Russia will still have resources to fund its war in Ukraine.

## **FUTURE PROSPECTS: SANCTIONS WILL HURT RUSSIA**

If at some future date, Western sanctions start negatively impacting the Russian economy, it may choose to either negotiate a peace deal with Ukraine and the West, or it may potentially escalate the war in several different ways. It may employ risky strategies, and cause greater civilian casualties. Russia even has the option of attempting to capture Ukraine's industrial complexes, and sources of raw material, to mitigate the effects of sanctions.

## **ECONOMIC ISOLATION CAN LEAD TO RISKY STRATEGIES**

Studies on the effects of the economic isolation of states — whether through sanctions, wartime blockades, or other mechanisms — find that economic isolation rarely causes its targets to capitulate outright. Rather, economic pressure can lead states at war to adopt riskier strategies, often involving escalation. Such an effect may be termed as economic inadvertent escalation.<sup>221</sup> Economic sanctions take a long time to affect country's economy and war efforts. Russia will be able to anticipate any such worsening situation, and if President Putin feels

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influence over the destination of Russian money and investments. It also incentivized closer ties between the Kremlin and wealthy Russian individuals, thereby ensuring the fate of their money. Investments have become more closely tied to the success of government decision-making, motivating political support for the Kremlin's actions. See Caileigh Glenn, no. 107.

<sup>221</sup> Erik Sand and Suzanne Freeman, no. 20.



that escalation may provide him an opportunity to reverse his situation, he may adopt an escalatory response.

Russia has multiple ways to escalate the military situation. It can target military and humanitarian aid being provided by the West before or after it crosses the Ukrainian border. There is also a chance of an inadvertent NATO-Russia engagement, as was witnessed when Russia downed the US MQ-9 Reaper drone on March 14, using a Su-27 fighter aircraft.

Russia has not shied from nuclear sabre rattling. It has already increased the alert status of its nuclear forces. Its 2020 nuclear doctrine specifically states that Russia would consider the ‘first use’ of nuclear weapons in situations where ‘conventional aggression’ threatens ‘the very existence of the state.’ Putin has declared the sanctions ‘akin to a declaration of war.’<sup>222</sup>

## **SANCTIONS MAY LEAD TO ATTACKS ON CIVILIAN TARGETS**

Russia may choose to increase hits on civilian targets as a deliberate escalatory response, or it may be forced to do so by circumstances due to the worsening situation as a result of the sanctions. The country is dependent on imports for many of the critical parts that go into making precision guided bombs. If, in the future, there is a shortage of such bombs due to sanctions, Russian forces may be constrained to use ‘dumb bombs’, and may even increase violence against civilians — as was seen in the current war, and in places like Chechnya and Syria.

## **THE WEST SHOULD CONSIDER ‘OFF-RAMP’ STRATEGIES**

In view of the above, the West should consider ‘off-ramp’ strategies. Like any other tool of coercion, sanctions work best when punitive measures are combined with inducements and ‘off-ramp’ strategies. The West may consider articulating conditions where President Putin feels he is better off acceding to the West’s demands rather than

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<sup>222</sup> Ibid.

continuing with his 'special military operations'. The West may consider offering a road map to Russia for what the conditions for eventual sanctions relief would look like. This may perhaps bring peace to the war beleaguered nation.

**O**n 24 February 2022, President Vladimir Putin announced 'special military operation' in Ukraine. This triggered a series of sanctions by the West, resulting in restrictions on Russia's financial institutions, including its central bank and energy export, among others. Many foreign companies have withdrawn voluntarily from Russia, anticipating adverse public opinion. These measures have had a profound impact on the Russian economy. The sanctions are the most comprehensive package of financial and technological restrictions ever applied to a nuclear-armed great power.

This monograph attempts to assess the impact of sanctions on the Russian economy and war resolution efforts, and further the understanding of sanctions as a tool of economic coercion. The monograph deliberates on the impact of Western sanctions on Russia in the contemporary global environment, and assesses the scope and limits of this tool of coercive diplomacy on the Russian economy and war resolution efforts.



**Col (Dr) Rajneesh Singh (Retd)** is an Infantry officer with extensive operational experience. He has been a UN military observer in Congo. His staff experience includes tenure in the Military Operations Directorate and in Military Secretary's Branch. The officer has also been an instructor at the NDA, Khadakwasla and at DSSC, Wellington. Col Rajneesh Singh (Retd) pursued PhD at the JNU, New Delhi. Post superannuation from the army, the officer worked as a Consultant for the Ministry of Defence before joining MP-IDSA in January 2023.

Colonel Singh's areas of research include higher defence management and military studies. His current area of research focusses on self-reliance in defence production.



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**Manohar Parrikar Institute for Defence Studies and Analyses**

No.1, Development Enclave, Rao Tula Ram Marg,  
Delhi Cantt., New Delhi - 110 010  
Tel.: (91-11) 2671-7983 Fax: (91-11) 2615 4191  
Website: <http://www.idsa.in>