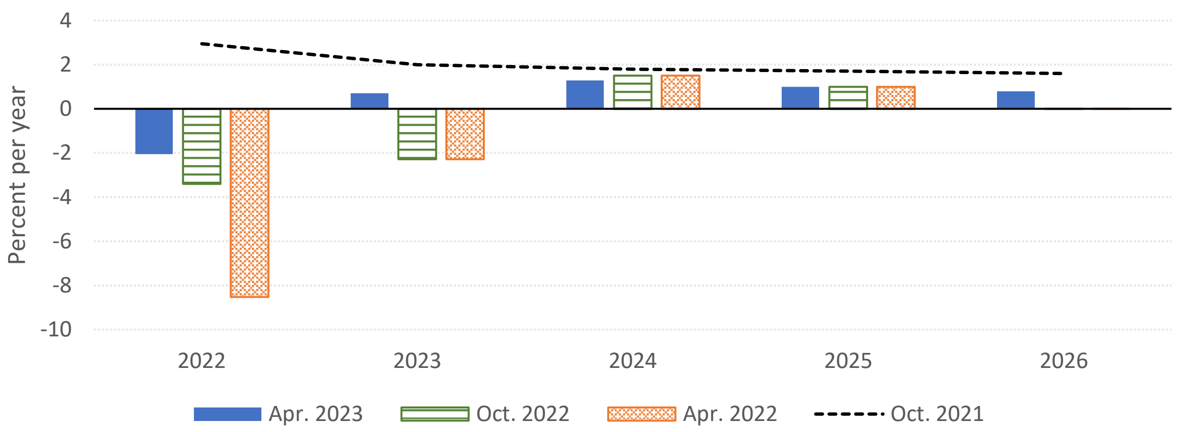
Sanctions on Russia: an update – Peter A.G. van Bergeijk, Erasmus University[1]

The economic literature on economic diplomacy tends to focus on positive interaction: trade and investment promotion, state visits, development cooperation, upgrading the network of embassies and consulates, treaties, regional integration, membership of international organization (van Bergeijk and Moons 2018). Typically, the consensus is that positive economic diplomacy works (Moons and van Bergeijk 2017). In contrast the literature does not find a genuine effect for negative economic diplomacy (in particular the use of economic sanctions). Indeed, currently he most frequently asked question for international economists regarding the Russian war on the Ukraine is probably ‘why do the economic sanctions not work?’. That appears to be a quite relevant question. Consider Figure 1 that presents three forecasts for the growth rate of Russia’s Gross Domestic Product (GDP) that appear in the IMF’s biannual flagship publication *The World Economic Outlook*.

Figure 1 Four IMF forecasts for Russian GDP growth (one before and three during the war)



The forecast of October 2021 (dashed line in black) predates the conflict: it is what according to the IMF would have happened when Moskov had not waged its war on Kyiv. The most recent IMF forecast was published in April 2013 (solid bar in blue). According to the IMF, the Russian GDP contracted by 2 percent in 2022 and for 2023 a meagre 3/4 % is in the books. Compared to the forecast in April last year (orange grayscale) the contraction is less disastrous as the IMF last year predicted a 9 percent collapse for 2022. So, the impact of the sanctions seems much smaller than originally anticipated by the IMF. Moreover, the forecasted growth rates turn from negative into positive in 2024. So, the economic sanctions that from the start been praised as ‘unprecedented’ do not seem to bite as hard as expected (the IMF forecast was not exceptionally large among the many forecasts produced early 2022, see van Bergeijk, 2022c, Table 1).

Firstly, it should be noted that that both strategic data opaqueness and national accounting practices may bias the reported impact of economic sanctions. Official statistics are among the first victims of wars since it is rational to hide the costs of conflict from public opinion and foreign intelligence and to conceal economic assets including details on supply lines and sanctions evaders. So, one can expect significant distortions of the economic statistics of all parties involved in international conflicts (van Bergeijk (1995a,b). A tradition for distorting statistics goes back a long way in history in this case that concerns the former Soviet Union, as many central planning failures were hidden from the population and observers in other countries. The latter aspects of the

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unreliability of statistics is well recognized and moreover the bias (upward reporting of GDP numbers) tends to be stronger in autocracies than in democracies.

Secondly, GDP in the war economy is a perverse measure of economic impact and economic welfare. The destructive creation of weapons by National Accounting conventions generates income, and this provides a cushion in the GDP numbers. Russia is producing rockets and grenades, and this directly enhances GDP although it does not create anything of value. Weapons production drives out civilian production and if the increase in the military industrial complex exceeds the civilian loss GDP rises while the country has less goods to invest and consume than before. This problem is exaggerated by some of the rules that statisticians use to report on the economy. By convention of the National Accounts all military equipment is consumed at the moment of production or purchase, unlike, for example, machines and factories that are depreciated over many years. Infrastructure in contrast exists by the same conventions 'for ever'. There will be wear and tear, but that is reported as maintenance. On the battlefield one can observe the 'war paradox of National Accounting'. The 'non-existing' tank destroys a 'for ever existing' bridge and the effect is zero by virtue of the statistical conventions. Relatedly and also by convention, a reduction of Russian imports due to sanctions in the short-term increases measured Russian GDP by virtue of the macroeconomic accounting identity:

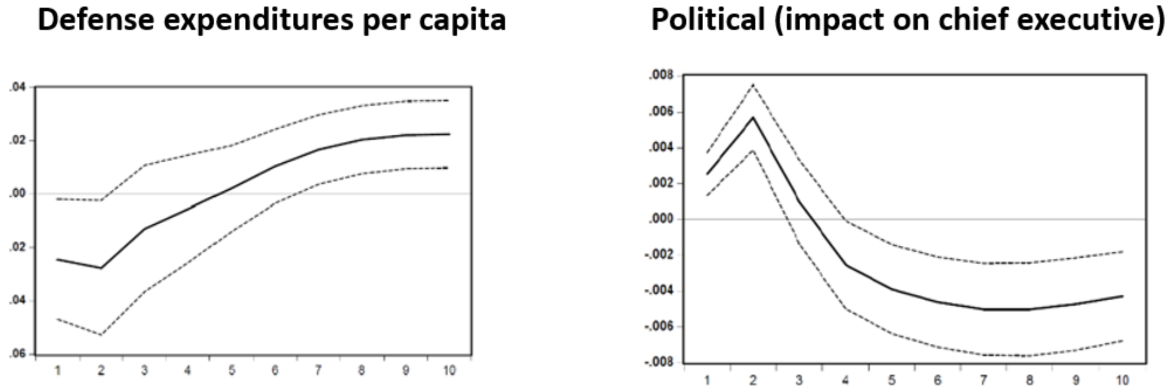
$$GDP = Consumption + Investment + Government\ expenditure + Exports - Imports$$

In the somewhat longer-term, however, production will come under downward pressure because civilian investment and consumption are squeezed out by war production and consumption while inventories of raw materials, spare parts and intermediate goods run down thus creating supply side bottlenecks.

Thirdly, the focus on observed and predicted growth rates is a common source of mistake in the popular press. The first reason for the confusion is that the growth that 'is' is taken as the outcome of the economic sanctions, but the 'is' is meaningless without the 'what could have been', that is: what would have happened if these policy measures had not been imposed by the West. So, key in understanding sanction impact is that we ask ourselves a 'what-if' question: 'What if the sanctions had not been imposed?'. This what-if question is the counterfactual. One could make this counterfactual wide ranging by considering the impact of non-sanctioning on the battlefield or perhaps even on further future expansion by Russia, but in order to keep the question manageable and answerable we will limit the counterfactual to the economic domain proper. Now let's take a look again at Figure 1 with our what-if question in mind. The most obvious counterfactual is the October 2021 forecast of the IMF that predates the Russian invasion of Ukraine. The impact of the sanctions is the difference between the October forecasts produced in 2021 (the white bars in Figure 1) versus 2022 (the solid green bars). Yes, the impact of the sanctions on the Russian economy in the IMF forecasts has been adjusted and is smaller than foreseen in April 2021, but the impact is larger than the reported growth rate and amounts to a bit more than 6% of Russia's GDP. An additional 4% loss according to the IMF forecasts occurs in 2022. For a proper understanding of the economic impact of sanctions it is therefore crucial to make a comparison between the economy's growth trajectory before and after the imposition of sanctions.

Finally, we need to consider the dynamics of sanctions. Goods that have been shipped before the imposition of an embargo or a boycott, for example, will sometimes be underway for considerable time and arrive at their destination sometimes months after the imposition of sanctions. Moreover, while the US imposed a full ban on Russian oil, gas and derivative products, the EU did only impose a ban on Russian crude oil shipping on December 5, 2022, and a ban on petroleum on February 5, 2023. (Also, exemptions were and are granted to several EU members.) The EU at the time of writing did not impose sanctions on gas but only strived for significant independence from Russia. Moreover, price movements of oil and gas initially significantly increased thus compensating for quantity reductions. It was not until the sixth EU sanction package and the reduction of oil and gas prices in early 2023 that sanctions started to bite the macroeconomy in a significant way (van Bergeijk 2022b). Up to that point in time, the only really important measure had been the freezing of the foreign currency holdings of the Russian Central Bank that effectively immobilized Moskov's war chest, but other measures were either applied at the level of selected individuals and firms with insufficient coverage (for example, SWIFT sanctions initially aimed at a rather limited share of the Russian Banking sector). Also, the spontaneous private sector sanctions (divestment) that drew a lot of (hopeful) attention early 2022 have been much harder to implement than originally thought. From this perspective, sanctions simply have at the time of writing simply not been applied long enough to expect to see their full impact (van Bergeijk 2022).

Figure 2 Simulated sanction impact (impulse response functions)



Source: van Bergeijk and Dizaji 2022

Figure 2 provides an empirical perspective based on a recent econometric exercise that investigates the economic and political impact of sanctions on Russia. The horizontal axis shows the number of years since the effective implementation of sanctions. Vertically the impact variables are reported in terms of their standard deviations. The middle line is the predicted impacted; the dashed (---) lines are the confidence intervals.[2] I have selected two outcome variables. As to defense expenditures (lefthand panel) the graph indicates that per capita military expenditures are initially under downward pressure. This effect is statistically significant in the first two years of sanction application. However, after seven years the effect is the opposite. As to the political impact (right hand panel) we see a similar picture. Impact on the Chief Executive of Russia is significantly positive in the first three years, but from then on will be on a downward trajectory and that influence turns statistically significant in the fifth year of sanction imposition.

These findings should not be interpreted as predictions, but rather as a numerical assessment that establishes that the boycott of Russian oil (and potentially gas) meets a *necessary* condition for sanction success. The model results show that the boycott initially both indirectly and directly contributes towards moving the Russian political system away from autocracy. The model does not demonstrate that the sanctions meet a *sufficient* condition for success. It could be argued that sanctions against Russia are less promising because of its (a) autocratic system, (b) its opportunity and ability to adjust (c) the continuation and in some cases intensification of oil trade relations with countries that do not participate in the boycott measures and (d) the weak 2014 sanctions that reduced the credibility of broad-based EU sanctions and/or the threat of scaling up targeted sanctions (van Bergeijk 2022a). However, even under these conditions a boycott of Russian oil negatively impacts on the Russian war capacities and contributes to behavioral change. Importantly, the impact of sanctions on the political system is strongest in the second year of sanction implementation and after that their impact wanes off until the impact turns insignificant in the

[2] The selection is representative of the patterns found for other outcome variables including investment, public consumption and imports as well as alternative measures of political impact. The technical detail are beyond the scope of this short contribution; the reader is referred to van Bergeijk and Dizaji (2022).

fourth year. Hence, sanctions do create a window of opportunity in this case, but also that this window closes in the medium to long term.

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