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Contents

About the Author ....................................................................................................2
Acknowledgments ..................................................................................................2
About The Henry Jackson Society .......................................................................4
About the Russia & Eurasia Studies Centre..............................................................4
Executive Summary...................................................................................................5
1. Introduction...........................................................................................................6
2. US and EU Sanctions................................................................................................8
3. The Economic Consequences of Corruption and the Rule of Law ..............12
4. The Impact of Sanctions?..................................................................................15
5. Conclusion: The Effectiveness of Sanctions on Russia ................................20
   6.1 Time for a Broad Review of the Western Sanctions Regime ..................23
   6.2 Developing the Role of the UK Post-Brexit ..............................................23
About Us

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About the Russia and Eurasia Studies Centre

The Russia and Eurasia Studies Centre undertakes in-depth, analytically-focussed research into domestic and foreign policy issues in Russia and the other post-Soviet states. Established in 2010 as the Russia Studies Centre, the programme’s geographical scope has widened since 2014, mirroring the high level of importance attached to the region.
Executive Summary

Impact & Effectiveness: Sanctions on Russia 2014-2020

- EU and US Sanctions on Russia are the most significant ‘at scale’ economic sanctions imposed on a major economy since 1945. They have also been effective. In 2014 they deterred Moscow from taking any further Ukrainian territory which has enabled a land bridge with Crimea.

- The first round of financial sanctions, imposed in 2014, caused a major funding crisis for Russian business with the state having to step in and use its limited funds to protect key enterprises. Sanctions both reduced access to capital and reduced the Kremlin’s financial resources. Further sanctions, imposed in the years since 2014, have also had direct and immediate effects, notably in respect of Nord Stream 2. Sanctions have ensured that the pipeline has not been completed.

- Slower-burning sanctions have also been effective. It is easy to criticise these sanctions in the finance and energy sectors for their limited immediate effects. However, capital and technology starvation place immense burdens on the Russian economy. It depends heavily on Western external capital and the Russian state depends on the energy sector for 50% of its revenue for which Western technology and capital is vital.

- The impact of these slower-burning sanctions is reinforced by the dysfunctional nature of Russia’s economic governance. High and low-level corruption undermines the incentive of the public and private sector to invest. That disincentive is reinforced by large scale corporate raiding (reiderstvo) of private businesses by state and state-connected actors. This makes it almost impossible for the state to develop domestic sources of growth to replace those lost due to sanctions.

- After six years of US and EU sanctions, it is time for a review. Not only is the US acting increasingly unilaterally when it comes to sanctions, but the number and type of sanctions imposed against Russia for differing purposes and with different legal bases have increased. There is, therefore, a compelling argument for the West to re-assess and re-consider it sanctions regime against Russia. Given also Brexit, for the UK it is worth considering how its new independent sanctions power can provide added value to itself and its allies in this new environment.

- Brexit may give the opportunity UK to become a source of sanctions innovation and to move more rapidly with like-minded allies in the imposition of sanctions. Though the UK will have to balance such opportunities with its broader economic and security interests.
1. Introduction

This paper argues that the sanctions imposed by the European Union (EU) and the United States (US) on Russia following its annexation of Crimea in March 2014 and invasion and occupation of parts of eastern Ukraine have had a significant impact on Russia’s economy. These sanctions have been effective, or at least they were in terms of their immediate objective: to stop further territorial aggression by Russia against Ukraine. The slower-burning financial and energy sanctions, combined with the prospect of personal sanctions against elite members of Vladimir Putin’s regime, have also increased pressure on the elites, even if they have not led to any significant changes of elite or regime behaviour. Moreover, it is the case that specific targeted sanctions, such as those imposed against the Nord Stream 2 pipeline by the US, have been effective.

However, after almost six years of sanctions, it is time for the EU and the US to review the sanctions regime. Such a review would allow the EU, the US and the United Kingdom (UK) (post-Brexit) to consider what they are seeking to achieve, to identify specific objectives and to tailor the slower-burning sanctions to the existing deep flaws in the judicial and economic sectors to enhance the effectiveness of Western sanctions.

As sanctions have increased in number and scope owing to the shooting-down of MH-17, cyberattacks, the attempted assassination of Sergei Skripal and election interference, there now exists a ‘regime’ with multiple objectives and different legal bases. In addition, over time the US has resorted to a greater number of unilateral sanctions against Russia. However, EU cooperation here is vital because the EU engages in approximately ten times as much trade with Russia as the US. Without such cooperation, there is a real danger that the unilateralism of the US sanctions could lead to further political discord between Washington, DC, and Brussels.

In the case of the UK, a review of the existing sanctions regimes is timely, given that the UK formally left the European Union on 31 January 2020 and will have full autonomy over its sanctions regime at the end of the transitional period, which is scheduled for 31 December 2020. Indeed, the UK has already acted autonomously from the EU on sanctions, announcing a so-called ‘Magnitsky List’ in July 2020 and using this legislation to impose sanctions on members of the Belarusian regime, including President Alexander Lukashenko, in September 2020. The transitional period gives the UK authorities time to consider how to develop the UK sanctions regime post-Brexit. Clearly, for reasons of geographical proximity, economic scale and the outsized role of the City of London, there are good reasons for continued EU-UK cooperation. However, there are also options for the UK to become a source of sanctions innovation. Additionally, the UK might have an advantage of being able to use its greater autonomy to move at a speed that is more in lockstep with the US in some market sectors.

There is also the broader question of the effectiveness of the slower-burning sanctions in the finance and energy sectors. These sanctions place continuing pressure on the Russian regime and its elites and are re-enforced by the deep structural flaws across the Russian economy.

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not least the weak adherence to the rule of law, lack of judicial independence and predatory bureaucratic, economic and political actors who undermine Russia’s commercial sector. Those flaws both magnify the effect of sanctions and close the door on opportunities to provide sanctions relief via alternative forms of economic growth.

This paper first considers the nature of the US and EU sanctions regime from their implementation in spring 2014 to the more recent major imposition of sanctions on Nord Stream 2 in late December 2019. It then briefly analyses the state of the Russian economy, emphasising the wide-scale plundering of the Russian state budget and the predatory behaviour of the elites acquiring businesses across Russia (either by outright acquisition by force without compensation or by forced sale at below-market prices), before discussing the impact of US and EU sanctions on the economy. It argues that the sanctions have had a significant impact and that this impact was exacerbated by the lack of judicial independence and rampant state corruption.

The paper turns then to the question of effectiveness. It argues that the immediate objective of the 2014 sanctions was achieved in that they did deter Russia from further territorial aggression against Ukraine. It also argues that the slower-burning sanctions place considerable pressure on the regime; they close down its options for economic growth and limit its room for manoeuvre in maintaining domestic political support. Finally, the paper argues for a review of the sanctions regime to ensure that the UK’s objectives are coherent, that pressure is sustained on the regime, and that our capacity to respond with effective targeted sanctions to Russian attempts to undermine the international order is maintained.
2. US and EU Sanctions

Since the spring of 2014, the US and the EU have maintained a remarkable degree of alignment on sanctions against Russia, even if this has come under stress during the Trump Administration. This feat of alignment is all the more remarkable because of the differing constitutional, legal and political structures of the US and the EU.

The US can act with a degree of speed and decisiveness in the sanctions field that the EU is unable to match. This is because since the late 1970s the US President has had substantial executive powers to adopt economic sanctions principally under the International Emergency Economic Powers Act 1977 (IEEPA). These powers are broad and relatively unconstrained and in effect permit the executive to take foreign policy measures against hostile or potentially hostile powers with limited legislative oversight via executive orders under the IEEPA.

By contrast, the EU, under its Common Foreign and Security Policy (CFSP) regime, finds it much more difficult to adopt and apply sanctions. This is partly because 27 member states have to support any proposed sanctions. But it is also because of the nature of the EU legal order which requires legislation to adopt sanctions. Additionally, the EU sanctions regime is subject to the surveillance of the EU courts who have imposed significant evidential requirements on targeted sanctions legislation. It can be difficult to meet these evidential requirements with solely unclassified information.

The initial response of the US and the EU to the invasion of Crimea and the occupation of parts of eastern Ukraine in the spring of 2014 was to begin to develop a sanctions regime, in the hope that it would at least deter Moscow from further aggression. To that end, the Obama Administration and the EU Council adopted respectively executive orders and EU Regulations. These initially focused upon several targeted sanctions against Russian officials involved in the annexation of Crimea and the occupation of eastern Ukraine. However, developing an effective sanctions regime against Russia was no easy matter.

Both the EU and the US had a number of practical economic considerations in play. The EU in particular had much more economic skin in the game than the US. To give some sense of the scale of EU-Russian trade, it is worth noting that at the onset of the Ukraine crisis in 2014, the value of EU-Russian exports was €336 billion, and total EU investment in Russia was €170 billion. US exports, by contrast, were approximately one-tenth of that level, at around $40 billion. A further concern for both Brussels and Washington was that no one since 1945 had sought to impose significant economic sanctions on such a major player in the world economy as Russia; in 2014, it was one of the ten largest economies globally (measured by GDP). As a consequence, any sanctions regime would have to avoid causing significant collateral damage to EU commercial interests, protect energy flows and not destabilise the global financial system, while effectively deterring Russia from undertaking further aggression.

The initial round of US and EU sanctions was announced in March 2014, then in July 2014 the US and EU moved to adopt significant sectoral sanctions. Any lack of willingness on the part of the US and the EU to undertake significant actions in response to Russian aggression could be seen as an abandonment of principles that have long been central to US and EU foreign policy.

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6 In imposing comprehensive sanctions on Russia, the US was imposing sanctions on a country with more than twice the GDP of all the other countries currently subject to US sanctions.
part of the EU to impose a second round of sanctions was removed by the shooting-down of Malaysian Airlines flight MH-17 over eastern Ukraine in the same month. The sectoral sanctions were focused upon the financial, energy and defence sectors. The US developed a new form of sanction in the ‘sectoral sanctions identifications’ (SSI), followed by the EU, prohibiting specific types of transactions in the energy and finance sectors. This, it was argued, would be more targeted and not generate as much collateral economic damage on the population than broader sectoral restrictions or sanctions.8

In the financial sector, the focus was on cutting off access to new equity and debt. Financial support could only be provided for 30 days for Russian banks and up to 90 days for Russian energy companies. These sanctions were targeted at the significant external debt of Russian companies that required tens of billions of dollars of refinancing in 2014, and approximately $120 billion in 2015.9

In the energy sector, the focus was on leaving current production in place while directing sanctions pressure on the areas that Russia would have to develop to ensure future production. This led the EU and the US to focus upon exports of technology in deepwater energy development and shale.

Defence sanctions were much more traditional and involved measures against Russian defence companies, asset freezes and the adoption of a tougher dual-use goods regime.

This sanctions regime remained in place through the following years, with the EU renewing them every six months. Some additional sanctions were enacted by the US in respect of cyberattacks during the 2016 presidential election campaign. However, with the transfer of power in January 2017 to the Trump Administration it quickly became apparent that there was an intent by the new Administration to cancel or at least roll back on the existing sanctions regime. This was in principle easy enough to do, as US sanctions were adopted by executive orders and could as easily be cancelled by the President.

As a consequence, in August 2017 Congress adopted the Countering America’s Adversaries Through Sanctions Act (CAATSA), which largely recast the executive orders as legislative provisions.10 Given that the House voted 419–3 and the Senate voted 98–2, President Trump had no alternative but to accept the enactment of the legislation.11 CAATSA then at least ensured that President Trump could not use his executive powers to cancel existing sanctions by cancelling the Obama-era executive orders.

CAATSA also extended US sanctions powers. These extended powers have not resulted in any subsequent significant alignment with EU sanctions.

The most notable new feature of the CAATSA sanctions powers was in respect of cybersecurity. This included, in Section 224, cyberattacks against any person, including a democratic institution or government. Accordingly, under Section 224 at least 40 FSB and GRU officials 12

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11 Under Article I, Section 7, Clause 2 of the US Constitution, if a bill is vetoed by the President, Congress can override the veto with a subsequent two-thirds-majority vote approving the bill in both houses. The bill will then become law despite the Presidential veto.
12 FSB is the Russian equivalent of the UK Security Service MI5 and the GRU is Russian military intelligence.
have been designated for election-related malicious cyberactivities. In addition, Section 228 permitted sanctions to be imposed on individuals who had committed serious human rights abuses “in any territory forcibly occupied, or otherwise controlled”. In November 2018, three individuals were designated under Section 228 in respect of abuses in occupied Ukraine. These additional sanctions did not result in the EU rapidly adopting sanctions in parallel.

CAATSA also served notice on the Russian government, Russian enterprises and Russian elites that additional sanctions could be imposed. In particular, Section 241 provided for the Treasury Department to send Congress a detailed report on senior political figures and oligarchs in the Russian Federation in terms of regime proximity, indications of corruption, net worth and impact of applying secondary sanctions. The report was also intended to make a broader sanctions assessment on state-owned, state-controlled and state-influenced enterprises, including a range of debt and equity restrictions on such enterprises. The concern in Moscow was that such a list could provide the basis for a further round of sanctions that would target the Russian elites and their wealth. The Treasury Department submitted this unclassified report in January 2018 and it drew on publicly available lists of persons close to the regime and those of significant wealth.

This was derided in some quarters as the ‘Forbes List’, or simply a list of wealthy and elite Russians with no assessment of their actual proximity to the regime, whether they have engaged with regime activities or entered into corruption. This derision overlooked two important points. First, the unclassified report cast a long shadow, as the extensive nature of the listing in the report indicated that the entire Russian elite could theoretically be sanctioned. Second, the unclassified report was accompanied by a classified annexe. According to the Treasury Department, the annexe provides a thorough analysis of information linking to corruption and the international business affiliations of specifically named senior Russian figures.

In essence, in its application of Section 241, the US government had created a question mark for the entire Russian elite as to whether their foreign located assets and capacity to travel internationally continued to be secure.

Drawing upon Section 241, in April 2018 the Treasury Department targeted seven Russian oligarchs, a dozen companies they owned and controlled, 17 Russian officials, a Russian state-owned arms trading company and a bank it also controlled. In a blunt but directed comment, the Treasury Department stated:

Russian oligarchs and elites who profit from a corrupt system will no longer be insulated from the consequences of their government’s destabilizing activities.

A battery of other legislative powers has also been deployed against Russian individuals, corporations and entities. These include the two Magnitsky Acts: the Sergei Magnitsky Act 2012, aimed at protecting human rights defenders and whistleblowers in Russia, and the broader Global Sergei Magnitsky Human Rights Accountability Act 2016 (hereafter the Global Magnitsky Act). Under the former, 55 Russian citizens have been sanctioned, of which 40 were linked to the murder of Sergei Magnitsky. Two Russian citizens were designated for high-level corruption under the Global Magnitsky Act.
Russian arms trading firms led by state-owned arms exporter Rosoboronexport have been denied access to US government contracts, licences and trade in items controlled by the US Munitions List. These sanctions have been imposed under the Iran, North Korea and Syria Nonproliferation Act. Rosoboronexport is also subject to Ukraine-related sectoral sanctions. Furthermore, the Trump Administration has sanctioned Russian-related individuals and entities in respect of trade and financial transactions with North Korea and Syria. In 2019 the Administration also designated a bank jointly owned by Russian and Venezuelan state-owned entities. This was followed up in 2020 when two subsidiaries of Rosneft were designated for operating within the Venezuelan oil sector.19

In addition, following the use of chemical weapons by agents of the Russian Federation in the UK in March 2018 (the Skripal incident), the Department of State published a notice in August 2018 triggering mandatory sanctions. These sanctions were implemented under the Chemical and Biological Weapons Control and Warfare Act 1991. Under the Act, most remaining types of potential sales of military goods and services are prohibited. All forms of financial assistance from the US government are blocked. Additional sanctions are imposed on dual-use goods. Further rounds of comprehensive sanctions may be imposed under the Act to eliminate all exports of US goods or technology and restrictions of imports from Russia.20 Such sanctions under the Act last at least one year.

Increasingly, however, the unilateralism of US sanctions under the Trump Administration is threatening cooperation, alignment and the overall effectiveness of EU–US sanctions, which have so far remained remarkably intact, despite recent stresses and strains. These stresses and strains include not only the disputes over Rusal but also US unilateralism over the Iranian sanctions regime, which undermines trust and confidence between Washington and EU capitals.21

The latest significant imposition of US sanctions occurred on 20 December 2019. These were imposed on Russian export pipelines Nord Stream 2 and TurkStream 2 by Section 7503 of the National Defense Authorization Act (NDAA) and could be viewed as an indication of yet another American unilateral act without consultation with European allies. However, it has to be recognised that only a small group of European states, led by Germany, was opposed to such sanctions, while the majority of European states approved of them. The sanctions were targeted solely against the use of pipe-laying vessels capable of operating at a depth of 100 feet or more. The sanctions had an instant impact in that construction operations ceased immediately the NDAA came into force, leaving the pipeline uncompleted. Section 7503 also underpinned the subsequent deal ten days later between the Russian and Ukrainian state energy companies, Gazprom and Naftogaz, to continue the transit of gas through Ukraine for a further five years.22


20 Sanctions under the Act are mandatory once a finding of chemical weapons use has been made. Further rounds of sanctions can be imposed under the Act.


3. The Economic Consequences of Corruption and the Rule of Law

Absent sanctions, the Russian government should be able to generate very high levels of economic growth and high standards of living for its people. The Russian Federation is the world’s largest country and has immense natural resources and an educated population of 140 million. Centuries of Tsarist autocracy followed by Soviet Communism did not make it impossible culturally or historically for Russia to prosper economically: in the period from the emancipation of the serfs in 1861 to the First World War, Russia adopted market-liberalising measures and saw decades of high levels of economic growth and rising living standards.

In more recent times, this thesis can be demonstrated in that, despite the political and social chaos after the fall of the USSR in 1991, the Russian economy began to grow once market measures were introduced. Vladimir Putin in his first term adopted a raft of such measures, moreover, which (assisted by enlarged oil revenues) delivered annual economic growth of the order of 7% per year between 2000 and the financial crisis of 2008.

However, the establishment of Putin’s vertical of power, with its control of the judiciary, weak rule of law and establishment of an elite system of plunder with the Kremlin at the centre, compounded with the exhaustion of the initial sources of economic growth, has put the Russian economy on a low-growth trajectory. For example, the World Bank, even before the onset of the pandemic, forecasted GDP growth at a rate of between 1.6% and 1.8% until 2021.23

The institutional reforms that were introduced both before and after the accession to the presidency by Putin, when combined with the economic measures discussed below, stimulated economic growth and demonstrated the potential for driving Russia’s economy forward. This model relied on some responsible economic policies supported by then Finance Minister Herman Gref as a means of ensuring the longevity of the regime, including maintaining a low debt profile, ensuring some of the oil revenues were held in reserve funds and being willing to tolerate depreciation in times of crisis as the basis for regime stability.24 These steps were interpreted by many Western commentators as indicating the Kremlin’s intent to build a Western-style market democracy.

However, the effect of these measures was very different. The elites used these positive steps to build a platform for an entirely different model of power, where corruption became a defining feature of the system and those close to the centre of power were able to loot the country. The early Putin governments were assisted in building this framework by rising oil prices, thus delivering a higher standard of living for most Russians. This allowed the regime to generate political consent while building a financial framework and power structure that would make rent extraction and looting a permanent feature of the regime.

Elite rent extraction was and remains the primary purpose of the regime. Writing in 2014, the US academic Karen Dawisha estimated that approximately US$300 billion is paid annually in various forms of rent extraction, embezzlement and bribes.25 This sum is larger than the total

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24 Under the guidance of Finance Minister Gref, the early Putin Administration established two reserve funds which sought to take some of the oil revenues and hold them in funds that would not be used for general public expenditure. The underlying aim was to protect the Russian Federation from fluctuation in the oil price and be able to sustain state budgets over time. For an overview of the early economic reforms, see Åslund, A., Russia’s Capitalist Revolution: Why Market Reform Succeeded and Democracy Failed (Washington: Peterson Institute for International Economics, 2007), p.234.

Russian annual public expenditure. The nature of this rent extraction from across Russian society and the economy can vary, from payments made by citizens to low-ranking officials through to significant rent extraction from state-owned companies by elites closely connected to the Kremlin. The potential for rent extraction is only limited by the imagination of officials in a system without any effective controls on officialdom. Classically, it involves fees for the delivery of ostensibly free or low-cost public services.

Another form of rent extraction enjoyed by senior and mid-ranking officials results from the persecution of business owners. This practice ranges from officials seeking payments to outright theft of businesses. The scale of these operations against Russian entrepreneurs is so great that such harassment is a significant deterrent to people expanding existing businesses or developing new ones. For example, in 2015 Putin admitted that more than 200,000 business-related criminal cases had been opened in the previous year, of which only 46,000 had reached the courts. However, 83% of the executives involved in those 200,000 cases had lost their business. No formal criminal convictions were necessary since business owners were “merely” intimidated and threatened. Only when they handed over their assets were they released. This form of rent extraction is particularly deadly for the development of a high-value private commercial sector across the Russian economy, as most potential high-value businesses always have the option of leaving the country and setting up elsewhere.

In the early Putin years, the top-down rent extraction operations were not fully in place. To the extent that they did hobble the economy, they were offset by oil revenues. Moreover, there were significant economic gains from cheap Russian labour, providing an attractive pool of skilled but low-cost workers near European markets. Other advantages included the investment dowry of the Soviet Union and the huge capital investments made in the USSR – particularly in the oil and gas sector – which could, at least for a while, help drive economic growth and growing consumer credit. These factors provided the basis for the almost decade-long high levels of Russia’s approximately 7% annual economic growth.

However, even before the global financial crisis of 2008, Russian economic growth was slowing down as labour costs rose and the Soviet investment legacy began to become exhausted, oil fields became depleted, and consumer credit markets became saturated as consumers were unwilling to take on more debt. Since the 2008 financial crisis, Russian economic growth has fallen to approximately 1% to 1.5% annually.

To now stimulate greater economic activity, the Kremlin would need to encourage more domestic and foreign investment. To do this, however, would require establishing the effective application of the rule of law and the independence of the courts, as well as

28 Ibid.
29 A report in Vedomosti indicated that more than 250,000 economic crime cases were opened in 2016. Interestingly, only 20% of the cases proceeded to trial. These figures would also suggest that, as the conviction rates are well over 90%, approximately 50,000 people were convicted in that year, with a significant proportion receiving prison sentences. This would accord with the view that the number of entrepreneurs and executives in gaol was more than 100,000. Furthermore, those figures suggest that one of the principal reasons that 80% of the cases did not proceed to actual conviction was that the entrepreneurs had to make accommodations with the authorities in respect of business assets and other properties. It is also noticeable from the Vedomosti report that, while the highest number of cases opened was in 2010, with more than 367,000, in the last few years the number of cases being opened on year on year has been rising again. See ‘How to Protect Business from Prosecution’, Vedomosti, 10 April 2017.
restraining the predatory activities of the state bureaucracy. Although this is now an even more urgent necessity as a result of the economic impact of the pandemic, any such attempt would undermine the capacity of the elites to continue to plunder state revenues and the broader economy and undermine the corruption-loyalty system of the state bureaucracy. The principal *raison d’être* of the power elites – to plunder the country – would be undermined by the effective application of the rule of law. As a consequence, it is highly unlikely that any such reforms, pandemic or no pandemic, would be credibly executed as long as the current regime remains in power.

While a temporary upswing in oil prices may refill the Kremlin’s coffers, the exhaustion of other sources of growth combined with rampant looting and corporate raiding by the elites has pushed the Russian economy onto a low growth plateau. Regime inability to strengthen the independence of the judiciary undermines the willingness of domestic and foreign investment to enter the market. It also, understandably, undermines the willingness of entrepreneurs to establish new businesses if contracts will not be honoured and their businesses can easily be taken from them. As the OECD pointed out in 2013, the biggest losses from high levels of corruption are not directly from the bribes or other forms of rent extraction, but from the enormous losses of output from misallocation of resources and distortion of incentives across the economy. 31

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Any discussion of US and EU sanctions on the Russian economy has to distinguish between impact and effectiveness. The impact is actual physical impact on the economy. Effectiveness relates to the actual change that such impact (if there is any) may have on Russian political behaviour and policy direction. In this section, the discussion focuses on the impact of sanctions.

One view of US and EU sanctions on Russia is that they are likely to have minimal impact or that they will in fact end up strengthening the power and overall political position of Putin. This argument usually commences by highlighting the low levels of Russian government debt, which remains at approximately 15% of GDP (compared with an average of more than 78% in EU countries and more than 100% in the US), and the maintenance of a sovereign wealth fund of more than $157 billion. Given such a positive financial profile, global demand for its primary export products of oil and gas and the Russian state’s capacity to accommodate low oil prices, sanctions are likely to have only a minimal impact on the Russian economy. Russia has limited international financial obligations, maintains reserves and has virtually unsanctionable products in oil and gas that are tradeable in international markets.

It is also argued that, to the extent that sanctions hit parts of the Russian economy, Russians are much more able to absorb economic pain than Westerners. Not only did the Soviet citizenry stoically survive the siege of Leningrad during the Second World War but, more recently, in the early 1990s Russians survived a 40% fall in household income. This personal resilience, reinforced by family ties and access to non-market resources, such as home-grown produce on family plots, is matched by the underlying primitive nature of the Russian economy. Russia has an economy, it is argued, that can withstand sophisticated Western sanctions and still sustain itself. The economy’s very inefficiency and lack of competitiveness give it the capacity to keep functioning despite measures the West takes against it. Even with the loss of access to Western products and services, the economy survives because it is not dependent on shiny Western technology.

Another argument made against the impact of sanctions is that, since the US and the EU are no longer as dominant in the global economy as in the past, Western sanctions cannot

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34 ‘General government gross debt’, International Monetary Fund.
36 What is overlooked in much of the analysis on Russian dependence on oil revenues is that under President Putin, an extremely robust ‘Putin business model’ has been developed. Under this business model, the Russian state maintains very low debt levels, keeps budget expenditure under control and maintains cushion funds, such as the National Welfare Fund, with the aim that during times of high oil prices the fund is topped up with revenue flows. The model assumes that during times of low oil prices the primary defence of Russian economic and political stability is the state’s willingness to tolerate a falling ruble. This has the effect of minimising revenue losses, as most Russian costs are in rubles while revenues are in dollars. On the other hand, the cushion funds can be deployed to maintain public expenditure in a society in which people have been conditioned to accept low levels of state spending.
37 This is the case with gas as the European states would never accept sanctions given their level of dependence on Russian gas. Equally, the role of Russian oil on European and global markets would make sanctioning Russian oil flows extremely difficult, undermining any Western consensus, and would be likely to significantly raise oil prices for everyone – essentially backfiring.
38 For a more recent discussion of Russian resilience see Morris Working Class Resilience in Russia (2016) Current History, p.264.
completely isolate the Russian economy from the rest of the world. Russia has alternatives, principally the other members of the so-called BRIC countries and other fast-developing Asian, African and Latin American economies. For instance, despite sanctions on defence exports, Russia has sold the S-400 air defence missile system to China, India and Turkey in the last two years. 41 Russia has also turned to Chinese banks to fund energy projects in Yamal and its next generation of Liquid Natural Gas (LNG) projects. 42

Some experts argue that sanctions merely damage those parts of the Russian economy that are often the most developed, independent and Westernised. Instead, they increase the power of state-owned entities dependent on the Kremlin, encourage more protectionism and state interference, and make previously more independent and Westernised firms more dependent on state financing and the Russian government. 43

The other major point against the impact of sanctions is that they were imposed at the same time as oil prices began to fall. Much of the economic damage that is often attributed to sanctions is more the result of the impact of low oil prices reducing incentives to invest in the Russian market.

The barrage of arguments used to argue for the pointlessness or lack of impact of Western sanctions does have a significant basis. The Russian economy has a degree of shock absorbency from its low debt profile, sovereign wealth fund and market inefficiencies. The post-2014 fall in the oil price is also responsible for significantly more short-term damage to the Russian economy than sanctions.

Nevertheless, there has been a direct economic impact of Western sanctions since 2014. As explained above, throughout this period the greatest direct negative impact on Russian growth was falling oil prices. Most studies suggest that this was greater than sanctions by a factor of three. The IMF’s initial analysis of US and EU sanctions suggested a loss of 1% to 1.5% of GDP with a cumulative loss of GDP of up to 9%. 44 This cumulative loss stems from lower capital accumulation and lower levels of technology transfers weakening productivity growth, which was already not very strong. Later analysis suggested that the cumulative impact is more limited to 6% of GDP and may be as low as 0.2% per year of GDP for every year that sanctions are imposed. 45 However, any assessment of the totality of the impact of sanctions has to take into account the broader economic consequences, including that much of the impact of the sanctions regime is intended to be over the long term and slow burning.

Overall economic indicators indicate that growth has fallen to no more than 1.6% of GDP throughout the 2014–2020 period that sanctions have been imposed, except for 2018. In 2018 a series of exceptional items, including spending related to the World Cup, raised economic growth to 2.3%. In 2019, growth returned to the low-growth ‘sanctions era’ trend of 1.3%. Even when oil prices rose, economic growth could not pick up significantly. 46 At the same time, foreign direct investment into Russia collapsed when sanctions were introduced and did not

45 Korhonen, I., ‘Sanctions and Counter-Sanctions-What are Their Economic Effects in Russia and Elsewhere?’, BOFIT, 2019.
Impact and Effectiveness: Sanctions on Russia 2014–2020

revive when oil prices increased, even though actual FDI sanctions were limited. Since sanctions were initially imposed in 2014, FDI has fallen on average to 1.3%.\(^{47}\) Even with an oil price revival in 2016, there was no returning FDI surge. Before the onset of the COVID-19 pandemic in the first quarter of 2020, inward investment had fallen to a new low of just $200 million.\(^{48}\)

Equally, living standards have fallen, as every year since 2013 Russians’ disposable incomes (even when adjusted for inflation) have fallen. Sanctions have had some direct impact on economic growth, FDI and living standards, alongside occasional falling oil prices and Russian institutional and market dysfunctionality, as discussed in section 3.

There are also significant indirect sanction costs. Already before sanctions, the regime had maintained a very conservative fiscal stance. Sanctions reinforced that stance. Russia has run a sizeable budget surplus and, before the pandemic, was planning to continue that into the fiscal year 2021 for fear of further sanctions being imposed. As a result, public expenditure has been slashed in every ministry save defence, pensions and sport (the latter thanks to the World Cup). Adjusting for inflation, health care spending is down 16% since 2012 and education by 14%.\(^{49}\) The state’s pension obligations were also to be lightened by raising the retirement age.\(^{50}\) The impact of this conservative financial approach was reinforced by tax increases, particularly in respect of VAT.

This unwillingness to spend to develop the economy or even to maintain core services for fear of sanctions imposing further financial constraints that could threaten regime stability has a knock-on effect on both living standards and economic growth. Regime unwillingness to pursue economic development combined with sanctions also further undermines both foreign and internal investors’ incentives to invest. That unwillingness to be exposed to sanctions risk is underlined by the Kremlin’s minimalist approach to economic support and stimulus during the coronavirus crisis. The core of its approach appears to be that it can grow the Russian economy on the back of the stimulus of other states.\(^{51}\)

The most significant overall impact in both the short and the long term, however, has been in the financial sector. Here the impact is not merely the threat of sanctions in respect of FDI but also of foreign debt exposure. As EU and US sanctions bore down on financing from Western banks, foreign debt exposure fell dramatically from $733 billion in 2013 to $468 billion in 2019. Because of such sanctions, Russia’s largest banks, such as Sberbank and VTB, were not able to obtain any new long-term financing from either the EU or the US and, as a consequence, paid down the debt. During the financial crisis of 2008, a similar decline of Russian foreign debt occurred. The difference, however, was that after the 2008 crisis, debt levels recovered

\(^{47}\) This compares badly with the economic recovery from the effects of the financial crisis from 2010 onwards when annual economic growth hovered around 3% to 4.5% of GDP before the Crimean crisis and absent sanctions and oil price declines. See ‘GDP growth (annual %) – Russian Federation, The World Bank’, available at: https://data.worldbank.org/indicator/NY.GDP.MKTP.KD.ZG?locations=RU, last visited: 25 November 2020.


\(^{50}\) The raising of the retirement age in Russia is a much more sensitive issue (with greater impact on state resources) than in OECD countries. This is because, although female life expectancy is 78 years, male life expectancy is only 68 years. The reform raised the pension age for women to 60 and men to 65. A significant minority of men (around 40%) will never even reach retirement age. For details of Russian life expectancy, see ‘Alcohol policy impact case study: the effects of alcohol control measures on mortality and life expectancy in the Russian Federation’, World Health Organization, 2019, available at: https://www.euro.who.int/en/publications/abstracts/alcohol-policy-impact-case-study-the-effects-of-alcohol-control-measures-on-mortality-and-life-expectancy-in-the-russian-federation-2019, last visited: 26 November 2020.

rapidly. In a sanctions context, Russia experienced a significant deleveraging with the sale of foreign assets to pay down debt and rescue finance from the state. Finance from state resources was provided principally to favoured state-owned, state-controlled or state-influenced enterprises. This reduced state resources for other projects and reinforced the state’s conservative fiscal stance. It also set up an ‘insiders’–‘outsiders’ divide between connected enterprises who received support and could sustain their operations and those, often more entrepreneurial firms, without state connections and usually reliant on foreign finance who had to downsize operations or exit the market.

The view of the Russian economy that holds that it is unreachable by sanctions wholly underestimates the extent to which it is dependent on Western capital and technology. Before the invasion of Ukraine, the EU alone provided 75% of FDI entering Russia. With the wide range of financial sanctions imposed by the US and the EU, Russian access to capital has been significantly curtailed. Approximately 60% of the Russian banking sector itself is now barred from accessing Western capital markets. The consequences of this capital scarcity, as indicated above, have been considerable. The cost of credit has increased, projects have been cancelled and growth as a consequence has been lower.

One Kremlin response to Western pressure, Russia’s proposed ‘Pivot to Asia’, ignores the reality of trade gravity. While it is true that Russia has been looking for financing from China, only two major energy projects have received funding from Chinese banks. There is no indication of interest from China, or from anyone else, in replacing at scale Western investment in Russia.

The other major target of economic sanctions is the oil and gas sector. The aim here is to undermine the medium- to long-term production capacity of the Russian Federation. To this end, the focus of sanctions has been on energy technology in areas such as shale, LNG and deepwater extraction. The Russian energy sector is heavily dependent on Western technology, much of which is not easily replaceable from alternative suppliers. It also requires significant foreign capital investment to develop new oil and gas fields. This is no small issue. Russia needs to develop significant numbers of new fields to just keep oil and gas production flowing. Limited access to oil and gas technology is a significant strategic threat to the finances of the Russian state.

The impact of the Western sanctions regime is reinforced by its broad scope, particularly those imposed by the US. In US legislation, now substantially found in CAATSA, there are equally broadly drawn rules in respect of entities partly owned by sanctioned persons. The consequence of such rules is that potential investors and commercial partners tend to take

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57 Nevskaya, A., ‘US Sanctions on Russian energy sector: first results and side effects, Centre for European Studies, IMEMO, 2018, available at: https://www.imemo.ru/files/File/ru/conf/2018/23012018/Nevskaya.pdf, last visited: 25 November 2020. It is estimated that sanctions affect 68% of imported equipment and 80% of the software deployed in devices imported from the West; in the case of sub-sea equipment, 80% of the equipment and 90% of the software must be imported.
58 ‘World Energy Outlook 2011’, IEA, available at: https://www.iea.org/reports/world-energy-outlook-2011, last visited: 25 November 2020. In a special report attached to the 2011 outlook examining the Russian oil and gas sector, the IEA estimated that the Russian Federation would have to spend at least $1.5 trillion (in 2010 dollars) by 2035 just to maintain current production.
a very broad view of the potential impact of existing sanctions, broader than the language strictly stated in the text. 59 Such a ‘penumbra’ approach to interpreting the sanctions regime operates as an additional chilling effect on investment and commercial transactions, reinforcing the impact of the sanctions regime.

The impact of sanctions is, in turn, exacerbated by the pre-existing deep rule of law and corruption flaws of the regime in two ways. First, those flaws magnify the impact of the sanctions, particularly in such sectors as finance and energy. Lack of a robust legal order and judicial independence makes it impossible to develop more liquid domestic financial markets which could assist in providing alternatives to foreign financial flows. Equally, elite and bureaucratic predation of entrepreneurial and innovative companies makes it much more difficult to rapidly develop alternative energy technology to that lost owing to US and EU sanctions. Second, the absence of a robust and independent legal order and extensive elite and bureaucratic predation makes it extremely difficult for the Russian economy to generate alternative sources of growth, from new products to new services to new market sectors that could mitigate, if not entirely replace, lost growth as a result of sanctions.

5. Conclusion: The Effectiveness of Sanctions on Russia

It has been contended that even if there is a significant material impact of Western sanctions in economic terms on the Russian Federation, they lack effectiveness. 60 The sanctions may hurt the Russian economy but have not significantly changed the behaviour of the Russian authorities. They do not result in regime change or policy shifts to any significant degree in the direction of Western policy goals. Russia continues to occupy Ukraine and seeks to undermine Western democracies. The sanctions regime largely strengthens Putin, at least among oligarchs reliant on Western finance and Western markets. 61

In answering the question about whether sanctions are effective, it is necessary to consider the immediate goal of the first round of EU-US sanctions when they were imposed in 2014. This was to dissuade Russia from taking any more of eastern Ukraine and in particular to seek to create a land bridge to Crimea.

First, sanctions were effective in making it clear to the Russian Federation that the invasion of parts of eastern Ukraine and the annexion had a direct cost to the Russian Federation and those who enable its kleptocratic form of governance. 62 The prospect of rolling and ever tougher sanctions as Russia-controlled forces made ever further encroachments into Ukraine, while at the same time facing ever more determined Ukrainian military resistance, made Moscow think again. 63 The Russia analyst, Dr Nigel Gould-Davies says:

There is strong evidence that at moments of intense fighting in 2014–15, the prospect of significant further sanctions curbed Russian escalation on the ground and, together with Ukrainian resilience, forced Russia to scale back its ambitions. 64

Russia has continued to operate in Ukraine, sometimes with great aggression - for instance, the heavy bombardment and extensive military exchange in February 2020. 65 However, no sanctions regime is likely to be able to deter every act of the target state. Sanctions, though, have since 2014 assisted in deterring Russia from extending its war of territorial aggression against Ukraine.

Second, the EU and US sanctions effectively laid down a marker reasserting international law and condemning its violation. The scale and immediacy of the sanctions did indicate to Russia and the rest of the world that there is a price to pay for such gross breaches of international law as the annexation and occupation of another state's territory.

61 There is a broader ‘Kremlin power’ argument that the actual impact of sanctions is to make the whole of the Russian economy more dependent on the state in that with lack of access to finance outside Russia and limited access to foreign markets, the state becomes the ultimate arbiter in the distribution of finance and market access.
62 In addition, some of the financial sector sanctions had an immediate impact and had the effect of forcing the Kremlin to compensate some Russian companies from its foreign exchange reserves and thus reducing its future room for manoeuvre. See Christie, E. H., ‘Sanctions After Crimea: Have They Worked?’, NATO Review, 13 July 2015, available at: https://www.nato.int/docu/review/articles/2015/07/13/sanctions-after-crimea-have-they-worked/index.html, last visited: 26 November 2020.
Part of the reason for questioning the effectiveness of the sanctions regime since 2014 is that much of it relates to the energy and finance sectors, and the impact in these sectors is not visible in the short term. Sanctions are not expected or intended to have an immediate impact or be immediately effective.

Pressure from these slow-burning energy and finance sanctions continues to grow on the elites, creating divisions within their ranks. The Russian elites are aware that, as the energy sanctions begin to bite, oil and gas production will decline, making it much more difficult to finance the state and maintain political support among the regime’s client base in the broader population. The prospect of losing the capacity to maintain the support of the client base in the near future is a major regime interest, likely to induce a greater willingness to compromise on its political goals. The financial sanctions also undermine the capacity of the private sector to fund non-oil growth. The effect here is to shut off alternative growth sources, further undermining the capacity of the economy to generate revenues for the state budget and regime supporters.

The elites’ concern with revenue flows in order to maintain its grip on power is even more acute when it comes to funding the military and security services. Falling revenue flows affect the regime’s ability to maintain control and suppress dissent, while also reducing its capacity to launch diversionary actions outside Russia.

Also, the potential of sanctions being targeted at significant numbers of the elites personally via Section 241 of CAATSA is a menacing prospect. The prospect of the freezing of their assets, undermining of business transactions and restricting their access to Western states, piles on pressure onto the elites. The potential application of Section 241 disturb elite comfort and security. Are they on any of the Section 241 lists and if not are they next? Fundamentally, the ‘Putin business model’ is dependent on being able to export the profits of corruption and the looting of state assets to secure Western locations. No member of the elite wants to keep the majority of the assets they have acquired in Russia, and they want a way out for their families and themselves. The elites are fearing for the future – a not unreasonable fear given Russian history and the economic and political instability of the current regime, exacerbated by existing sanctions – and they want to be able to educate and maintain their families in safe and ambient Western cities. The prospect of the removal of that comfort and security at scale will further disturb elite willingness to sustain a regime that could trap them in Russia with no means of escape and no means to protect or access their assets.

The deep rule of law and corruption flaws of the regime add to all these sanctions pressures to further disturb elite equanimity. As long as corruption and plunder remain the operating principles of the regime, the effectiveness of sanctions cannot be offset by growth in other parts of the economy. The political, economic and bureaucratic elites are locked into its operating principles, with no obvious way out to avoid the increasing pressures from Western sanctions.

The COVID-19 pandemic reinforces the effectiveness of the sanctions. The immediate impact of the pandemic is a further collapse in oil prices, hitting a Russian state budget that depends on oil and gas receipts for almost 50% of its revenues. Moscow can draw upon its $157 billion

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67 The twin impact of falling oil prices and sanctions has already created downward pressure on Russian military spending. Hille, K., ‘Russian military spending falls as sanctions bite’, Financial Times, 2 May 2018, available at: https://www.ft.com/content/092f8cc6-4dce-11e8-8a8e-22951a2d8493, last visited: 26 November 2020.

68 One consequence is that Russia may double down on much cheaper hybrid warfare mechanisms rather than seek to engage in much more expensive military-led actions, such as in Crimea, Donbass or Syria. However, the difficulty with hybrid warfare is that it does not have the same domestic political payback as a military-led conflict.
National Welfare Fund to protect key national expenditures. However, drawing down on the Fund reduces Moscow's capacity to sustain the existing policy configuration of the regime and makes it more vulnerable to existing and potential future sanctions. As a consequence, Moscow has taken very few steps to support Russian businesses and appears to be hoping that it can freeride off the stimulus of third states, rather than dipping too far into its ‘survival’ Fund.

Clearly, with the pandemic hitting Russia hard, the US and the EU should be prepared to provide humanitarian support. It should be remembered, however, that the clear path for Moscow to obtain relief to deal with the economic effects of the pandemic always remain available: withdraw its forces from Crimea and eastern Ukraine, then the sanctions will be lifted and economic activity will accelerate.

Overall, one can argue that the EU and US should increase sanctions to encourage a speedier change of regime policies. Sanctions policy should not be slow-burning. However, the approach of calibrating sanctions by Brussels and Washington is probably wiser. Aside from direct and immediate sanctions to deter further aggression, targeted sanctions, such as against Nord Stream 2 and those related to election interference, is the right approach. In the back of the minds of policymakers is that shifting from a largely graduated approach to a much heavier and impactful sanctions regime could encourage a desperate aggressive move by Moscow, which is much more fragile and weaker than it appears.69

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69 The historical example for policymakers is the imposition of the oil embargo on Japan in 1941 at a point when the US was the principal source of oil imports to that country. Anderson, I. H., ‘The 1941 De Facto Embargo on Oil to Japan: A Bureaucratic Reflex’, Pacific Historical Review, 44.2 (May 1975), pp.201-231.
6. Recommendations: EU, US and now UK Sanctions

6.1: Time for a Broad Review of the Western Sanctions Regime

What does undermine the argument as to the effectiveness of sanctions is the question of their purpose. The purpose of the first wave of sanctions was reasonably clear: deterring Russia from the aggressive acquisition of Ukrainian territory. However, over time, with the MH-17 disaster, the Skripal incident, cyberattacks, election interference and Nord Stream 2, sanctions appear to have developed multiple purposes. The expansion of sanctions owing to differing acts of the Russian state not directly connected with the invasion and annexation of parts of Ukraine creates further objectives. The expansion also adds to the complexity of the operation and creates greater difficulties in regard to maintaining cooperation between the EU and the US, especially where the EU does not participate in new sanctions.

A question now for policymakers therefore is: where are Western sanctions heading on Russia? Is the overall purpose in sanctioning Russia to encourage it to become a member of the international community that complies with international law and acts in (reasonably) good faith? That would give the slow-burning sanctions a coherent objective, though clearly one that is not likely to be achieved soon. Within that overall objective, there could be several discrete and targeted sanctions in response to specific Russian measures – for example, election interference and Nord Stream 2. However, at the very least it should be recognised that multiple objectives, now often undertaken by the US and not the EU, can undermine the coherence and effectiveness of the sanctions regime. Some consideration needs to be given by policymakers to ensure as far as possible that the purpose of sanctions is thought through, and that their relationship with other sanctions and their potential impact and effectiveness are properly considered and assessed. And, where possible, maximum cooperation between Washington and Brussels should be maintained even if Brussels does not directly participate.

After six years, a comprehensive review of Western sanctions is required, to think through the objectives we are seeking to achieve. At the same time, greater consideration should be given to thinking through the options for developing more targeted and effective sanctions, such as those relating to Nord Stream 2, which rapidly brought one major Russian project to a halt. Greater consideration could also be given to seeking to increase the effectiveness of the slow-burning sanctions in the context of a weak legal order and a predatory elite.

For example, one option that could be further developed would be to make it more difficult for the Russian elite to park their assets in the West. Contrary to popular belief, most Russian assets are not held in the Cayman Islands, but in London, New York or Paris. The only places that have both investment scale and legal security are the countries that make up the Western Alliance. The US and the EU could develop a transparency regime for existing foreign assets and new transfers to identify the owner and source of funds. A transparency regime alongside a more comprehensive US and EU parallel elite personal sanction regime, building on Section 241 of CAATSA, could be very effective.

6.2: Developing the Role of the UK Post-Brexit

The UK formally left the EU on 31 January 2020. The UK played a major role in the EU sanctions regime. It provided significant technical support, intelligence capability and knowhow, particularly with regard to the financial services sector. These capabilities led in fact to the establishment of the Office of Financial Sanctions Implementation (OFSI) in 2017, which acts

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as a hub for UK competence in the sanctions field. It is also the case that the UK and the EU are likely to continue to closely consult and cooperate on sanctions measures for three key reasons: geographical proximity, economic scale of the UK and the outsize role of the City of London as a global financial centre, Brexit or no Brexit. 71

There has been criticism from the House of Commons Foreign Affairs Committee of UK sanctions policy in the run-up to Brexit, that it has been “fragmented and incoherent”. 72 This appears to be in large part because of the burdens of the Brexit process across government. However, most of the existing EU sanctions regime has already been cast into UK legislative form as Statutory Instruments so they can be applied from the end of the transition period on 31 December 2020. What is recommended here is that, as Britain is now in transition, consideration should be given to how sanctions policy can be developed.

As indicated above, for reasons of capability, proximity, economic scale and the City, there are incentives on both sides for consultation and cooperation. The EU recognises the danger of ‘sanctions dumping’ by the UK, whereby the UK gains an economic advantage in adopting weaker sanctions than the EU. Equally, the UK has interests in ensuring that sanctions adopted by the EU do not unduly interfere in the UK’s commercial or political interests. There will also be EU interest in tapping into UK capabilities and knowhow in the sanctions field.

Aside from the possibilities for consultation and cooperation given UK capabilities in the sanctions field, there may well be opportunities via Cabinet Office and OFSI for the UK to become a source of innovation in the sanctions field for both the EU and the US. One of the lessons from the Nord Stream 2 sanctions is the effect that well-researched, targeted sanctions can have. Developing UK sanctions skills in this direction would be plus for the UK, the EU and the US. One particular option for the UK, given that it is a target for Russian money flows, is to develop an effective transparency regime for Russian assets in parallel with a mechanism to identify members of the Russian elite who could be blocked from accessing assets, financial and business services together with loss of visa access. Such a mechanism could potentially become a model for other Western states.

Autonomy will also make it easier for the UK to act more rapidly than the EU, which may mean that the UK will able to operate in lockstep with the US, with its own greater capacity to act with speed. The area where such speed of action may be valuable is in the financial services sector where, in some financial markets, cutting off or limiting access to both the New York and the London markets would have a major and immediate effect on the target.

The UK will, however, have to weigh the costs of direct sanctions cooperation with the US, which may mean imposing sanctions obligations on UK companies that companies in the EU would not face. 73 Equally, imposing financial sanctions that affect the City of London in lockstep with the US or out on its own could encourage a transfer of business from London to Frankfurt, Dublin and Amsterdam. While there will be opportunities to develop sanctions policy and enhance the UK’s reputation as a sanctions innovator, the UK government and OFSI will need to balance both the opportunities and the potential downsides from their new sanctions powers.


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