*IOSR Journal of Economics and Finance (IOSR-JEF)*
*e-ISSN: 2321-5933, p-ISSN: 2321-5925.Volume 13, Issue 3 Ser. IV (May. – June. 2022), PP 28-35*
*www.iosrjournals.org*

# Financial Statecraft: Economic Impact of the Sanctions Regime Against Russia

**AHAN GADKARI**

**5TH YEAR, JINDAL GLOBAL LAW SCHOOL**
**RESEARCH ASSISTANT, UN INTERNATIONAL LAW COMMISSION**

***Abstract***
*The evaluation of the effectiveness of sanctions is a highly controversial issue, both for economists and scholars of international relations. In fact, the sanctions placed are halfway between politics and the economy as they constitute one of the tools with which the nation states carry out their* economic and financial statecraft*, the set of interventions (of an economic-financial nature) used to pursue foreign policy objectives, especially when conditions of war are approaching.* Ex-ante*, through the credible threat of imposing sanctions - or carrying out boycott operations or suspending aid - one or more nation-states (defined as the* sender*) fear commercially and financially isolating another state (defined as the* target*) to eliminate the probability of its war activity.* Ex-post*, the effective imposition of sanctions determines - through commercial or financial isolation - such a state of deprivation in the* target *country to prevent them from continuing the war effort once it has started. Therefore, the result of this coercive action is not only economic-financial but also, above all, relative to the political sphere of internal and international relations. In principle, effective sanctions can alter the political capital and reputation of the incumbent government of the sanctioned country by affecting its negotiating power both vis-à-vis domestic opposition forces and sanctioning countries.*

---------------------------------------------------------------------------------------------------------------------------------------
Date of Submission: 25-05-2022 Date of Acceptance: 07-06-2022
---------------------------------------------------------------------------------------------------------------------------------------

## I. Introduction

The evaluation of the effectiveness of sanctions is a highly controversial issue, both for economists and scholars of international relations. In fact, the sanctions placed are halfway between politics and the economy as they constitute one of the tools with which the nation states carry out their*economic and financial statecraft*, the set of interventions (of an economic-financial nature) used to pursue foreign policy objectives, especially when conditions of war are approaching. *Ex-ante*, through the credible threat of imposing sanctions - or carrying out boycott operations or suspending aid - one or more nation-states (defined as the *sender*) fear commercially and financially isolating another state (defined as the *target*) to eliminate the probability of its war activity. *Ex-post*, the effective imposition of sanctions determines - through commercial or financial isolation - such a state of deprivation in the *target* country to prevent them from continuing the war effort once it has started. Therefore, the result of this coercive action is not only economic-financial but also, above all, relative to the political sphere of internal and international relations (Gadkari and Chowksey, 2021). In principle, effective sanctions can alter the political capital and reputation of the incumbent government of the sanctioned country by affecting its negotiating power both vis-à-vis domestic opposition forces and sanctioning countries.

The idea of sanctions as a weapon to guarantee peace is not new (Gadkari and Chowksey, 2021). It can be traced back to Woodrow Wilson, who in 1919 defined the state of absolute isolation caused by sanctions as "something even more terrible than the war itself" (Mulder, 2022).From that moment on, sanctions became the "economic weapon" available to the liberal states, as recognized by Article 16 of the Covenant of the League of Nations. Peace - and the economic-liberal order that accompanies it - would be based on the belief that sanctions constitute a credible deterrent against war: the simple threat of suffering a profound state of deprivation induced by sanctions would push nation-states to avoid any conflict. Moreover, Woodrow Wilson himself had not failed to underline how the strength of the sanctions derives not only from a condition of economic deprivation but also from fundamental psychological suffering linked to the possibility that - as a result of the sanctions and the consequent isolation - "is the soul to be more poisoned than the body."

Such a reality has followed a very different turn. The sanctions have proved less effective than expected, not only *ex-ante*, as a deterrent, but also *ex-post*, as an effective cost factor (Clyde, 2007), even if, with the passage of time, their ability to affect has gradually increased (Bergeijk, 2012). Furthermore, even psychological suffering is a minor factor, especially in contexts marked by the presence of autocratic or dictatorial regimes. The massive use of biased information by other *spin dictators* (including Putin, Erdogan and Orbán) allowed them to obtain a broad popular consensus - otherwise impossible to reach in conditions of free information - while generating a distorted perception of reality that can not only contain the psychological distress induced by any sanctions but even lead to a feeling of revenge - the so-called *rally-round-the-flag effect*, such that domestic groups threatened by sanctions come together with the regime to oppose the external threat (Gurviev and Treisman, 2022).

## II. The Effectiveness of Sanctions: The Theoretical Framework

In principle, sanctions are effective if they can create an isolating effect. However, achieving this objective requires the fulfilment of at least two conditions. First, detailed knowledge of the type of interdependence - fundamental and financial - between the sanctioned country and the rest of the world. Secondly, the involvement of a large number of sanctioning countries limits the possibility for the *target*country tocircumvent sanctions by having economic relations with third countries (otherthan the *target* and *sender*) (Gadkari and Chowksey, 2021).

In reality, a correct assessment of the effectiveness of sanctions must also be taken into account - especially in modern times- a complex interdependence that makes estimating the effects of sanctions a challenging task (Gadkari and Chowksey, 2021). On the one hand, the presence of feedback effects caused by these measures on the sanctioning countries themselves should also be assessed (the case of Europe dependent on Russian gas is clear). On the other hand, the presence of significant contagion effects on the financial markets should not be forgotten, which are affected by the increasing size assumed by the stocks of financial assets. Moreover, it must also be considered how globalization has generated - through the creation of complex and asymmetrical real and financial networks - a condition of *weaponized interdependence* very different from country to country. Recent contributions that have applied network theory to the study of today's globalized system show that some networks are more central than others(Goldin and Mariathasan, 2016). This means that the nation states that have effective jurisdiction over the most central nodes of the networks - such as, for example, the USA - enjoy greater sanctioning power. Finally, the possibility should not be ruled out that the same threat of sanctions pushes some countries to pursue a reduction in their degree of interdependence with the rest of the world. Once a sufficient degree of isolation is achieved, sanctions evidently become a blunt weapon. A lesson that Putin's Russia seems to have learned quite well since 2014. After the invasion of the Crimean peninsula and the imposition of numerous sanctions imposed on it by the Western world, Russia has embarked on a clear process of introversion - with the promotion of agricultural self-sufficiency, the reduction of the need for foreign financing and an extraordinary accumulation of official reserves.

*Last but not least* , a correct assessment of the effectiveness of sanctions requires consideration of both **primary sanctions** , i.e. the restrictions put in place by the sanctioning countries (*sender country*) against the sanctioned (*target country*), which of the **secondary sanctions** .

As for these, these are restrictions placed on third countries / individuals who - although not part of the sanctioning countries or the sanctioned countries (including Saudi Arabia, Argentina, Brazil, China, India, Indonesia, Israel, Mexico, South Africa and Turkey) - can suffer the effects of the same sanctions when they are caught carrying out with the *target* prohibited transactions / operations. For example, in the specific case of Russia,*sanction busters* they could be Chinese companies carrying out transactions with Russian counterparties. As a result, these Chinese companies would be sanctioned through exclusion from possible transactions with US or EU counterparties.

Overall, effective sanctions are able to impact the economic-financial system of the target country through the commercial channel (less exports and imports of components, finished goods and services), the financial channel (less inflows and outflows of capital) and the channel of expectations (dissemination of expectations of depreciation of the exchange rate and bankruptcy of banks, companies and the sovereign state such as to trigger real runs at bank branches, or episodes of *fire sale* on securities issued by banks by companies or by the sovereign).

The combined provision of these effects is given by an economic system in serious difficulty both as regards the performance of production activities and as regards the functioning of the financial markets. If the difficulties are extreme, a scenario of a very serious recession cannot be excluded, accompanied by growing unemployment and above all a financial crisis that could take a triple form: currency, banking and sovereign.

## III. Russia in the Global Economic System

According to the last relationship of the International Monetary Fund, Russia faced the pandemic in a condition of low growth, but enjoying a substantially robust macroeconomic framework - made up of a deficit and public debt and foreign debt at minimum levels - and significant room for maneuver in the monetary, currency and fiscal fields (International Monetary Fund, 2021).

The modest Russian growth in recent years is the result of both structural elements - such as the low degree of diversification of an offer strongly focused on the production of energy raw materials and the associated low dynamics of total factor productivity - and of factors attributable to sanctions imposed by the Western bloc after the invasion of Crimea. The sanctions not only had a negative effect on GDP trends, but also contributed to altering the geographical dimension of interdependence - commercial and financial - with the rest of the world.

From a geographical point of view, all the countries of the European Union continue to constitute the most important destination area for Russian exports, even if at the level of each country, the most important outlet market has become China, followed by United Kingdom and Holland. China also became the most relevant country as an area of origin for Russian imports, followed by Germany and the USA. Moreover, Russia has in the meantime strengthened its trade ties with neighboring countries such as Armenia, Belarus, Kazakhstan, and Kyrgyzstan which since 2010 have joined (at different times) the customs union defined by the Eurasian Economic Union (EAEU).

From a product point of view, Russia continues to export mainly raw materials, mostly made up of oil and gas. About 21% of world natural gas exports are Russian (about 60% of oil exports go to Europe, while 20% are sold to China; 40% of natural gas and 25% of crude oil imported from countries of the European Union come from Russia), while those of oil cover about 11%.Overall, the import export - after the marked decline in 2015-16 due to thesanctions post-invasion of Crimea - generated a trade surplus equal to 80 billion USD (corresponding to 5% of GDP) in 2020.

The trade surplus - combined with the modest payment of interest on foreign financial liabilities - has put the country in a position to record continuous surpluses in the current account (only in 2018 the surplus was equal to 7% of GDP) which allowed not only to eliminate the foreign debt, but even to reach a credit position towards the rest of the world. In fact, according to the latest estimates provided by Milesi Ferretti, at the end of September 2021 the amount of foreign activities amounted to 1,620 billion. dollars, against foreign liabilities equal to 1,180 billion. A condition that in principle strongly exposes a country like Russia to the sanctions imposed by the Western world(Milesi-Ferretti, 2022).

The achievement of creditor status is due to what happened after 2014. The combination of sanctions and the deterioration of the macroeconomic framework (associated with the drop in oil prices) has prompted foreign investors to strongly reduce the inflow of capital in Russia, while at the same time the Russian Central Bank initiated a clear policy of accumulating official reserves. At the end of January 2022, the stock of reserves exceeded 630 billion. dollars, equal to 1.7 the value of the annual import of goods and services.

The decidedly more interesting aspect concerns the consistency and composition of the stock of Official Reserves held by the Russian Central Bank. Continued balance-of-payments surpluses meant that reserves increased to reach 630 billion. of equivalent value to dollars, which constitute the most significant item of foreign assets held by the Russian system. However, dollar-denominated assets, which still accounted for almost half of total reserves in 2018, had fallen to 18% in 2018 and were only 16% of the total by the end of 2021. On the contrary, the reserves in yuan that still weighed less than 5% in 2016 have now reached 14%; while those in euros are about one third of the total (while gold is just over 20%). Behind this process of "de-dollarization" of reserves is a deliberate choice of foreign policy that reflects what Eichnegreen he defined *Martian strategy*: that is to say an approach to the accumulation and management of official reserves no longer guided by commercial and / or financial relations (as it has been and still is today for many countries) but rather by the consideration of aspects such as national security and alliances geopolitical(Eichengreen et al., 2017)

It is also interesting to note that the second most important item of the foreign assets held by the Russian system is made up of Foreign Direct Investments (FDI, equal to approximately 500 billion dollars), whose actual location is however not easy to identify (Milesi-Ferretti, 2022). Most of these FDI is in fact located in Cyprus, a financial center that basically serves to hide the true final destination of the operation. An aspect of no small importance when it comes to determining the effective capacity of sanctions such as the confiscation or freezing of *assets* held within particular jurisdictions.

## IV. From Theory to Practice: Sanctions Against Russia

The sanctions were applied according to a real one *escalation* started in the last days of February 2022, when the troops of the Russian army began to concentrate along the border with Ukraine. It is widely believed that the sanctions package introduced by the US, EU and other countries thereafter constitutes the toughest and most comprehensive set of multilateral measures ever taken against a single major nation state since the war began. Cold. The sanctions imposed in recent years against Iran, Venezuela, North Korea and Russia itself (post-invasion of Crimea) are only a small part of what has been applied against Russia after February 24, 2022

The sanctions imposed are made up of interventions of different natures (Brookings Institute et al., 2022) There are measures that directly insist on trade flows such as: bans on the export of technology and other goods and services *sensitive* towards Russia; bans on the import of Russian oil and gas (for the time being introduced only by the US and British governments); suspension of the application of the most favored nation clause (for the moment decided only by the Canadian government).

However, the main sanctions are of a financial nature, such as: exclusion of a large part of Russian intermediaries from the SWIFT international messaging system; freezing of *assets* held by the Central Bank and some Russian commercial banks; confiscation of *assets* (real and financial) owned by oligarchs and politicians close to Putin.

***A.*** *Bans on exports*

Controls and bans have been introduced on exports to Russia of products considered strategic for the aerospace, maritime and defense industries. The stated aim of these measures is to reduce and / or prevent Russia's access to *input* technologies of vital importance for the performance of numerous production activities. For example, exports to Russia of semiconductors that are strategic not only for *Information and Communication Technology have been banned,* but also for the production of war material. An important aspect not only from an economic point of view but also from a geo-political point of view. Moreover, the Biden Administration has also prohibited the exports of these goods by third countries in the event that technology made in the USA is used for their production (as in the case of goods produced in Taiwan and South Korea). Added to this is a long list of further bans - which even neutral Switzerland has adhered to in some cases - such as the ban on selling insurance services to Russian airlines (introduced by the British government).

***B.*** *Bans on imports of Russian Oil and Gas*

Being one of the major exporters of crude oil and natural gas, Russia is heavily exposed to the consequences of a possible ban on imports of oil and gas introduced by Western countries, especially European countries. At the same time, the very considerable energy dependence on Russia suffered by countries such as Germany and Italy makes the introduction of this ban a real double-edged sword. The consideration of these aspects allows us to understand the asymmetrical attitude taken by the US, UK and EU towards the imposition of bans applied to Russian oil and gas imports. While the US and UK - which import around 8% of their total crude oil imports from Russia - equal to 8.5 million barrels per day - have introduced a ban on oil imports, the EU has so far been unable to do the same as a consequence of his very strong energy dependence, which has led to an interlocutory attitude. At best (and in some ways a little unrealistic), the introduction of a limitation of this type could be considered no earlier than the end of 2023 when European imports of Russian oil and gas could have been reduced thanks to the increased supply of liquid gas from the USA.

*C. Suspension of the Application of the Most Favored Nation Clause*

The European Union, the United States and the other G7 countries have announced that they will not apply the most favored nation clause, the basic rule of the World Trade Organization, to Russia. In doing so, these countries will follow Canada which as of March 3 has begun to charge 35% tariffs on imports from Russia (and Belarus, thus sanctioning its involvement in the invasion of Ukraine).

This measure will entail considerable costs for the Russian economic system, whose exports would be drastically reduced as a result of their higher cost. Obviously, the source of the higher cost would derive not so much from lower exports to the USA - whose trade integration with Russia is very limited - but rather from lower sales to the EU - which, as already mentioned, constitutes the most important destination area for exports. Russian.

D. *De-SWIFTing of Russian Banks*

A decidedly important move is the prohibition - introduced against 7 Russian banking intermediaries representing just over a quarter of the assets of the Russian banking system - from using the SWIFT international interbank messaging system, which transmits over 40 million messages a day.

This decision has sparked a considerable debate among professionals (and not) for various reasons. First, many of the banks involved in this measure are already subject to other sanctions that prevent them from carrying out international transactions. This is the case of Sberbank which has already been inhibited from accessing systems of *clearing* of its transactions throughout the United States. In addition, there are other interbank messaging systems available to Russian banks, such as the SPFS system (developed by the Russians after the sanctions that followed the annexation of Crimea) or the CIPS system developed by the Chinese. These systems, in principle, would allow to by-pass the measure, weakening its effectiveness. However, the alternative options in reality do not exist: the use of SWIFT takes place in fact for considerably lower costs than those of systems such as SPFS and CIPS, which is why the lack of access to SWIFT constitutes a penalty capable of producing truly significant costs.

***E.*** *Freezing of **Assets** of Commercial Banks and the Central Bank*

The US Administration has taken steps to prohibit any dollar transactions within the US with some Russian banks - with the exception of the three main banks (Sberbank, Gazprombank and VTB) - and to freeze their *assets* . But the truly surprising decision concerns the freezing of the official reserves owned by the Russian Central Bank, consisting of financial assets held in a large number of jurisdictions other than the Russian one - such as the USA, the European Union, the United Kingdom, Canada, Japan, Australia and Switzerland. In principle, the reserves - despite being *assets* physically located within a foreign jurisdiction - they cannot be expropriated as they enjoy the so-called *foreign sovereign immunity* , which guarantees almost absolute protection. Last February's decision effectively cancelled the sovereign immunity enjoyed by official reserves. Operationally, this means that at least half of the over 630 billion dollar-equivalent reserves are not usable by the Central Bank to carry out interventions on the currency markets. Only the Chinese yuan reserves, which have been considerably increased within the currency paraphernalia owned by the Russian Central Bank, can be mobilized.

The measure is incisive for two reasons. First, it substantially reduces the arsenal of tools available to the Russian Central Bank for conducting ruble exchange rate stabilization operations. Not coincidentally, in the aftermath of the announcement of this sanction, the Russian currency lost more than 30% of its value, despite the very strong rise in interest rates from 9.5 to 20%: overall, the depreciation recorded by the ruble compared to the prices at the end of 2021, it reached 50%. Second, it severely limits the country's ability to pay for imports billed in Dollars, should the same sanctions result in a lack of hard currency revenues generated by residual exports. What seemed to be a fundamental weapon in the construction of the "Russian Fortress" - the accumulation of Official Reserves that had taken on a consistent size for any metric used in the space of a few years - is thus severely weakened. The famous *war chest* results in a blunt weapon.

**F.** *Confiscation and freezing of* ***Assets***

Finally,both the US, British and European Union administrations have taken decidedly restrictive measures against assets and financial assets owned by Putin, politicians - including numerous Ministers as well as a large part of the members of the Duma - and entrepreneurs / oligarchs considered close to him. Overall, more than a thousand people are subject to restrictions. In addition to the measures aimed at freezing the availability of *assets* , measures have been imposed that aim to limit the physical mobility of sanctioned individuals. With the ultimate goal of generating a growing distancing between the oligarchs and the Russian Presidency.

## V. Consequences of Sanctions for Russia

The combination of commercial and financial sanctions is already clearly producing important consequences for the productive apparatus and for the functioning of the Russian economic-financial system. In a nutshell, the sanctions determined:

*A. Collapse of the Ruble on the Currency Markets*

The devaluation reached - in the most acute phase of the crisis - 50% with evident negative impacts both on the trend of inflation - due to the greater imported component - and on the standard of living of the less well-off classes - whose consumption basket is substantially more expensive. The depreciation occurred despite the introduction of controls on outflows of capital which should have limited the downward pressure exerted on the ruble and the sharp rise in interest rates.

*B. Higher Level of Interest Rates*

To counter the vertical drop in the ruble price, the Central Bank had to react by substantially increasing policy rates, which went from 9.5 to 20%. Obviously - as typically happens in these episodes of currency crisis - the countermeasure adopted constitutes a medicine with strong unwanted side effects. The production activity - already undermined by the lack of availability of essential goods - is further placed in difficulty by the scarce availability of credit disbursed due to high rates.

*C. Collapse of the Sovereign Rating and Sovereign Quasi-Default*

Before the invasion of Ukraine, Russia was considered one of the most reliable debtors. The positive judgment was the result of the consideration of the high accumulation of reserves, of the remarkable ability to obtain hard currency through the export of hydrocarbons, but above all of the absence of foreign debt. The outbreak of the conflict and the subsequent launch of sanctions quickly altered the judgment towards the Russian sovereign who literally collapsed. Major rating agencies have brought the credit rating of the Russian sovereign to the status of *junk.* At the same time, the price of Russian ruble-denominated sovereign bonds almost zeroed (20 cents per dollar), anticipating the possible extreme consequences of sanctions and the conflict on the ability to repay debt and honor coupons. In fact, still in early March, the Russian sovereign paid the expiring coupons, honoring the commitments undertaken with the financial community, even if the payment could not reach foreign creditors due to a counter-measure imposed by the Moscow government. .

*D. Crisis of Confidence, Bank Runs and Stock Market Crash*

The depreciation of the ruble, combined with evident production difficulties and the higher level of interest rates, generated a substantial crisis of confidence in the Russian system in general and the banking system in particular. Hence the push to convert bank deposits into circulating currency, giving rise to the most classic of bank branch runs and the attempt to sell the shares of listed companies, this led to a real collapse of the stock market, which ended only with the temporary closure of the market itself.

*E. Difficulty in Carrying out Production and Consumption Activities*

Numerous supply chains, especially those most and most directly involved in the package of sanctions, are experiencing increasing difficulties in managing the normal development of production. This also entails increasing difficulties in supplying businesses with basic necessities. Hence the queues at the shops and the numerous attempts to seize increasingly scarce goods.

Taken together, all these effects will lead to a severe recession in 2022, with a sharp rise in poverty levels combined with heavy redistributive effects. If a few days after the outbreak of the war and the introduction of the first sanctions, Goldman Sachs had predicted a reduction of the Russian GDP close to 7% for 2022, the latest estimates produced by the Institute for International Finance speak of a drop in GDP of at least 15 percentage points(Institute of International Finance et al., 2022). But this last prediction is probably wrong by default and destined to increase with the continuation of the conflict, also as a result of the decisions taken by a growing number of foreign companies that have autonomously decided to cancel the purchases of Russian assets or have opted for closure. of their activities on Russian territory, implementing *de facto* a strict *self-sanctioning policy*.

## VI. Consequences of Sanctions (and Conflict) for the Rest of the World

No less important will be the effect - due to the combined provision of sanctions and conflict - on the international economic system, which will find itself experiencing the consequences of a new *stagflationary shock* (such as the one already experienced in the 1970s, as a consequence of the sharp rise in the price of oil) which overlaps the consequences of one *scenario of de-globalization* (which accentuates and exacerbates some of the aspects already highlighted by the materialization of the pandemic shock).

The growing isolation of Russia (due to sanctions) and Ukraine (due to the conflict) will have major repercussions for the international economy through several channels. Primarily, due to the lower supply of raw materials of which Russia is the world leader in various sectors: aluminum, nickel, copper, crude oil, natural gas; but also wheat and many other foodstuffs - from crabs to frozen cod, to raw beet sugar (Food and Agriculture Organization, 2022). Similarly, it should not be forgotten that Ukraine has a fundamental role in the supply of rare gases - such as neon, krypton and xenon - intensively used in the production of semi-conductors. This contraction in supply is configured as the most classic of negative shocks on the supply side, capable of producing a sharp increase in the prices of various raw materials and consequently in the general price level.

The extraordinarily significant weight of Russia within the energy and food market also poses serious problems for many countries both in terms of *energy security* (Germany and Italy above all) that of *food security* (as in the case of Egypt and numerous African countries in the Mediterranean area which are substantially dependent on imports of food raw materials from Russia and Ukraine for their food needs). It is no coincidence that many analysts have already predicted a humanitarian crisis, with a consequent increase in migratory flows to Europe. Finally, it should not be forgotten that there are also significant implications for what concerns the performance of the productive activity in various *global value chain* (GVCs), characterized by a considerable use in the upstream phases of raw materials. The risk of repetition of a *supply disruption* due to the replication of some sort of *China effect* - linked to the excessive dependence of some GVCs on raw materials produced in Russia - is not small (Korn and Stemmler).

Moreover, the functioning of GVCs - and not only those related to s agricultural and energy *supply chain* - will also be affected by the growing difficulty in moving maritime traffic, already heavily affected by the post-pandemic containment measures. Two figures are enough to make us understand the size and nature of the problem. 1 in 20 of the officers embarked on merchant ships are of Ukrainian nationality; and nearly 13% of the maritime personnel embarked on large commercial vessels come from Russia and Ukraine.

Overall, a reduction in the growth rate of the world economy is expected, which could be between 1 and 2 percentage points, due to a much greater fall in levels of economic activity in the European region than in the US. For example, the OECD has estimated the reduction in economic growth in Europe at 1.4 percentage points. However, this is a completely provisional and prudential estimate that does not consider the possible (much more disruptive) effects of a European embargo on Russian oil and gas imports. At the same time, the inflation rate - which even before the invasion of Ukraine had reached levels never experienced in the last 20 years both in Europe and in the USA - could accelerate significantly. According to the estimates produced, a 50% increase in the price of oil could contribute - over two years - to an increase in global inflation by 4.4% (reflecting a weight of energy products in the consumer basket of around 9%)(Centre for Economic Policy Research et al., 2022). The markets would reward the currencies of countries considered safe-havens such as the Swiss franc and *safe-haven* assets (such as gold).

## VII. Are There Escape Routes from Sanctions?

In reality, the first to create escape routes from sanctions are the sanctioning countries themselves. The Office of Foreign Assets Control (OFAC) has drawn up a long series of exceptions, consisting of transactions that can in any case be carried out with entities resident in Russia, or with subjects involved with them. For example, this is the case with the collection of interest on Russian sovereign debt securities; or the payment of exports of some agricultural products or medical devices. The European Union itself is at the center of the most notable exception within the broad sanction package: that constituted by the so-called *energy carve-outs.* In fact, the Russian banking system itself, which is inhibited from carrying out numerous operations, can carry out collection / payment operations concerning transactions with European countries of Russian energy products. All this with the clear objective of limiting the negative consequences for Europe triggered by an otherwise possible collapse of the import of energy sources from Russia.

In addition to the *carve-outs* granted from *sender* , there are escape routes sought by the *target* . For example, the recent announcement (not yet supported by a final decision) to force "*unfriendly countries"* to pay for oil and gas imports using rubles (only European imports of Russian gas are worth the equivalent of 7- 800 million dollars a day) is a first attempt - in clear violation of contractual terms - to escape the consequences of the sanctions applied to the stocks of Official Reserves. In this way, the traditional function of intervention on the currency market carried out by the Central Bank is in fact delegated to the same importers who - by artificially supporting the demand for rubles on the markets - limit any depreciation.

In other words, the limitation on the use of stocks would be circumvented by means of countermeasures which envisage the imposition of new rules on flows and which in fact discharge the exchange rate risk on importing countries. Indeed, starting from March 5, 2022, Russian exporters were obliged to convert at least 80% of the proceeds obtained in hard currency into rubles. After this measure, the Russian banks, the only ones able to supply rubles to the market, find themselves in the obliged condition of converting 100% of what they get as hard currency into rubles.

If - precisely as a result of the greater demand for rubles generated by the forced renaming of contracts - the ruble were to appreciate on the currency markets, this would correspond to a higher cost for the importing countries. Conversely, in the case of a further depreciation of the Russian currency. At the time of writing, Putin's decision to force "hostile" countries to use rubles to pay for their oil and gas imports, coupled with the introduction of heavy controls that limit the outflow of capital, has meant that the price of the Russian currency returned to the levels prior to February 24 (effectively eliminating the heavy depreciation).

Another possible escape route is an attempt to repay the coupons on dollar-denominated sovereign debt securities in rubles. On Wednesday, March 16, 2022, the Moscow government was due to repay $ 117 million for the payment of interest on two coupons relating to issues denominated in US currencies. However, in the days preceding the deadline, the Russian government had repeatedly evoked the possibility (which it then did not follow up) of repaying these coupons in rubles, due to the *artificial default.* induced by the sanctions themselves. In fact, representatives of the Moscow government had not failed to reiterate that this decision was to be considered "absolutely correct" given that the freezing measures - applied to more than half of the official reserves held by the Central Bank - forced the country to use dollars available only to pay for imports of strictly necessary goods (such as food and medicines). The question is also interesting because it refers to the possibility that the use of the ruble instead of the dollar is not treated as a condition of *default* . A possible case indeed, by virtue of the fact that 6 of the 15 dollar issues of Russian sovereign bonds contain one *fallbackclause* which would allow Moscow to pay off coupons and principal using an alternative currency, namely rubles (devalued). This means that a transaction of this type - which would actually produce consequences in investors' portfolios similar to those of a default - could technically not be considered as such.

Finally, the possibility of circumventing sanctions through the use of cryptocurrencies should not be underestimated, which making use of *blockchain technology* allow the anonymity of the counterparties involved in the transactions (Danielsson, 2022).

A scenario that appears to be completely realistic for two good reasons. On the demand side, it should be remembered that cryptocurrencies tend to be widely used precisely where national governments tend to hinder their use (also for reasons related to the lack of the possibility of achieving strict social control, as in Russia). On the supply side, because cryptocurrency providers - as staunch defenders of an extremely liberal vision - they oppose the obligation to freeze the current accounts of their Russian clients(Georgiev, 2022).

## VIII. Conclusions

Sanctions - which should be a powerful deterrent *ex-ante* against the outbreak of a war - could at least serve to reduce the length of the conflict by imposing a number of costs *ex-post* unsustainable already in the short to medium term for the country *target* . Even if history clearly shows how sanctions have always proved less effective than hoped for, the Western world used them again on the occasion of the invasion of Ukraine, mainly by resorting to financial measures.

This choice reflects the position of dominance that the Western world - and more particularly the USA - continues to have within the international financial system, which makes it possible to leverage what has been defined as *Financial Statecraft*(Benn Steil and Litan, 2008). The current risk is that these sanctions - despite being part of a package that has no equal in the recent history of the international system - will in any case not be able to quickly stop the conflict, which up to now has been characterized by a continuous *escalation* in the use of military force. Time will tell if and how effective the sanctioning apparatus put in place against Russia after February 24, 2022 will have been.

## References

[1]. Benn Steil, and Robert E. Litan. *Financial Statecraft : Role of Financial Markets in American Foreign Policy*. Yale University Press, 2008.

[2]. Brookings Institute, et al. "The Brookings Sanctions Tracker."*Brookings*, 14 Mar. 2022, www.brookings.edu/research/the-brookings-sanctions-tracker/.

[3]. Centre for Economic Policy Research, et al. *New CEPR Policy Insight - from Low to High Inflation: Implications for Emerging Market and Developing Economies*. 2022.

[4]. Danielsson, Jon. "Cryptocurrencies and the War in Ukraine."*Vox EU*, 2022, voxeu.org/article/cryptocurrencies-and-war-ukraine.

[5]. Eichengreen, Barry, et al. "Mars or Mercury? The Geopolitics of International Currency Choice."*NBER*, National Bureau of Economics Research, 2017, www.nber.org/papers/w24145.

[6]. Felbermayr, Gabriel, et al. "The Global Sanctions Data Base."*European Economic Review*, vol. 129, Oct. 2020, p. 103561, https://doi.org/10.1016/j.euroecorev.2020.103561.

[7]. Food and Agriculture Organization. *Impact of the Ukraine-Russia Conflict on Global Food Security and Related Matters under the Mandate of the Food and Agriculture Organization of the United Nations*. 2022.

[8]. Gadkari, Ahan, and Amogh Chowksey. "Should States Use Unilateral Coercive Measures as a Means of Economic and Political Compulsion?"*Jindal Society of International Law*, 2021, www.jindalsocietyofinternationallaw.com/post/should-states-use-unilateral-coercive-measures-as-a-means-of-economic-and-political-compulsion.

[9]. Gary Clyde Hufbauer, and Et Al. *Economic Sanctions Reconsidered : 3rd Edition*. Peterson Institute For International Economics, Cop, 2007.

[10]. Georgiev, George. "Bitcoin Is the Embodiment of Libertarian Values, Argues Kraken CEO in Response to Ukraine Vice PM."*Crypto Potato*, 2022, cryptopotato.com/bitcoin-is-the-embodiment-of-libertarian-values-argues-kraken-ceo-in-response-to-ukraine-vice-pm/.

[11]. Goldin, Ian, and Mike Mariathasan. *The Butterfly Defect : How Globalization Creates Systemic Risks, and What to Do about It*. Princeton University Press, 2016.

[12]. Guriev, S. M., and Daniel Treisman. *Spin Dictators : The Changing Face of Tyranny in the 21st Century*. Princeton University Press, 2022.

[13]. Institute of International Finance, et al. "Macro Notes – Russia: Economy to Contract Sharply in 2022."*IIF*, 2022, www.iif.com/Portals/0/Files/content/IIF20220323_MN.pdf?_cldee=YmFyaXNAYm5lLmV1&recipientid=contact-c8c50ae1e6f0e81180d102bfc0a80172-32cbc34249124e18842969889e098c7b&utm_source=ClickDimensions&utm_medium=email&utm_campaign=Press%20Emails&esid=6c098ebe-baaa-ec11-983f-000d3a16a8aa.

[14]. International Monetary Fund. "Russian Federation : 2020 Article IV Consultation-Press Release; Staff Report."*IMF*, 2021, www.imf.org/en/Publications/CR/Issues/2021/02/08/Russian-Federation-2020-Article-IV-Consultation-Press-Release-Staff-Report-50068.

[15]. Korn, Tobias, and Henry Stemmler. "Russia's War against Ukraine Might Persistently Shift Global Supply Chains."*Vox EU*, 2022, voxeu.org/article/russias-war-against-ukraine-might-persistently-shift-global-supply-chains.

[16]. Milesi-Ferretti, Gian. "Russia's External Position: Does Financial Autarky Protect against Sanctions?"*Brookings Edu*, 2022, www.brookings.edu/blog/up-front/2022/03/03/russias-external-position-does-financial-autarky-protect-against-sanctions/.

[17]. Mulder, Nicholas. *The Economic Weapon : The Rise of Sanctions as a Tool of Modern War*. Yale University Press, 2022.

[18]. Van Bergeijk, Peter. "Failure and Success of Economic Sanctions."*Vox EU*, 2012, voxeu.org/article/do-economic-sanctions-make-sense.



XXXX. “Financial Statecraft: Economic Impact of the Sanctions Regime Against Russia.” *IOSR Journal of Economics and Finance (IOSR-JEF)*, 13(03), 2022, pp. 28-35