

Influence of Sanctions at the Russian Federation Economy

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Abstract

The article discusses the sanctions, which were directed against the Russian Federation for the past two years, their description, causes and consequences, specified possible ways of cooperation between Russia and other foreign countries.

Keywords

Economy, market, export, import, financial sector, Central Bank, monetary policy, securities, import substitution

Влияние санкций на экономику Российской Федерации

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Аннотация

В статье рассматриваются санкции, которые были направлены против Российской Федерации за последние два года, дается их описание, причины и последствия, указаны пути возможного нового сотрудничества России с другими зарубежными странами.

Ключевые слова

Экономика, рынок, экспорт, импорт, финансовый сектор, денежно-кредитная политика, Центробанк, ценные бумаги, импортозамещение

In February 2014 stormy events happened on geopolitical arena. An overthrow of the government in Ukraine, Crimea transition to Russian Federation in March, beginning of the armed collisions on Ukraine Southeast between new power in Kyiv and supporters of the Donetsk and Luhansk national republics in April, Malaysian «Boeing» brought down in July.

The economic sanctions against Russia have various mechanisms, structure and objectives. Distinctive feature of these sanctions is their point orientation – restrictions are imposed not on the state in general, and on certain residents of the country: commercial structures and natural people. Also, it is necessary to note, that sanctions proceed not only from the separate sovereign state.

Economic sanctions are domestic penalties applied unilaterally by one country (or multilaterally, by a group of countries) on another country (or group of countries). Economic sanctions may include various forms of trade barriers and restrictions on financial transactions, but also from the ex-territorial organizations.¹

If to analyse branch structure of sanctions against Russia, it is possible to detect, that sanctions are directed against key (competitive) branches of the Russian Federation economy: oil, gas, nuclear and a military industry of the Russian Federation, as well against the Russian banking capital. As the biggest stake of Russian export is focused on the European market, in practice, sanctions, directed against the Russian Federation mean replacement of the Russian companies from the European market.²

First sanctions against Russia have been entered at 6 March 2014, but they looked like unfriendly gesture from the West, than on actual impact on economy. Sanctions provide an interdiction on entrance to these countries for the people who are being under sanctions, freezing of their actives, as well as an interdiction on business operations with these people and the companies. In July 2014 sanctions concerning defensive, power industry and financial sectors of Russia were entered. As for financial sector, for six largest Russian state banks, and also the enterprises of power industry and defensive branches access to the EU and USA financial markets was sharply limited. Since September 2014, these organizations can't apply for the loans and emit debt obligations.

In defensive sector of the USA and the EU reduced access to financing to the largest Russian companies and imposed a ban on export of production and dual-use technologies concerning 14 companies concerning defense industry. The sanctions, limiting cooperation with Russia in the defensive sphere, are entered by Great Britain, Israel, Switzerland and Sweden. In the energy sector of the USA and the EU is limited access to financing to the largest Russian oil and gas companies. Besides, these countries imposed a ban on export of goods and services or technologies in support of deep-water drilling, investigation or production of resources on the Arctic shelf or slate raw materials.

In response to these sanctions on August 7, 2014 the Russian Federation imposed a ban on import of foodstuff from a number of the Western countries for one year. This ban spread on import of meat, fish, seafood, vegetable production, milk, dairy products and the wide range of semi-finished products from the USA, EU the Union, Australia, Canada and Norway. Later this list, in addition, included other countries. Sanctions and countermeasures had serious impact on economy on two channels.

First, they increased volatility in the money-market and essential depreciation national currency. Large-scale outflow led to state deterioration of the operations account with the capital and financial instruments and shortening of net international reserves. In the second half of 2014 ruble confidence was falling in anticipation of ruble depreciation while oil price-cutting finally led to double ruble depreciation by half against the dollar.

However, ruble exchange weakening did not lead to oil exports increasing. In the short term, beneficial effect of import substitution can be increasingly used to promote protectionist measures. For example, since the ban introduction the Russian Minister of agriculture negotiated about import increasing of banned products with the countries of Latina America (for example, Brazil and Argentina), Central Asia (e.g. Azerbaijan and Armenia), Africa and the Middle East (e.g., Morocco and Iran), as well as with European States outside the EU (such as Turkey and Serbia).³

¹ Market-lab: Financial Innovations, "Sanctions against Russia: system analysis", September 13, 2014.

² Weic. info, "Economic sanctions against Russia: causes, analysis, lists the consequences", August 5, 2014.

³ Interfax.ru, "The World Bank has promised Russia "serious consequences" of sanctions", April 1, 2015.

Even before the rise of the current geopolitical tension, the government showed interest in supporting separate enterprises and sectors, that can benefit from import substitution. Prohibition of food importation in August 2014 led to food prices increase. By February 2015, food inflation reached 23%.

In response to high inflationary pressure and to support the ruble, the CBR significantly tightened monetary policy in the second half of 2014. It has led to an increase in the cost of domestic borrowing and further restricted access to internal credit resources for investors and consumers.

Secondly, another channel was a limitation on Russia's access to international financial markets, which began to appear already from the moment of occurrence of tension.

The amount of new foreign borrowing decreased in the first half of 2014 almost disappeared in the second half of 2014 after the imposition of sanctions.

More stringent credit terms on foreign and domestic market had a negative impact on investment and consumer decisions that led to postponement. Sanctions against the financial sector had the most negative influence. After the imposition of sanctions, a lot of foreign financial institutions have provided financing Russia, and most Western financial markets and most Western financial markets and remain closed for Russian banks and businesses. External terms of financing have tightened even for those enterprises and banks, which are not subject to sanctions. For example, in the first and second semester of 2014 has dramatically decreased capacity issue of bonds of Russian companies to the corresponding period of the previous year.

U.S.A. and the EU sanctions is aimed, primarily, at the key sector of the Russian economy - oil complex. They have blocked access to the technology of mastering for Arctic, shale and tight oil fields. The technological breach in some extent, can be closed by import of equipment from other countries, including from China, although it is in its characteristics inferior to the Western models.

However, many analogues of imported technologies used in Russia, China has not got. China has no experience in shale oil production, development of offshore fields. In the next year or two, ban on the export of technologies will not be affected, because there are reserves in those areas at the expense of the previously concluded contracts, but in the longer term, in the absence of innovation technique, effective tax and other measures that stimulate oil production will drop its extraction. By estimates of the Institute of economy in three years will be a decline in oil production in the range of 10-20 million tons from 2013, when before production totaled 523 million tons. However, if the sanctions will remain and investment capacity in the significant toughening credit arrangements will be appreciably reduced, at the end of the decade we should expect falling of oil production to 450 million tons and lower. Reduction of liquid fuel production will be accompanied by oil export decrease. However, reduce of oil production can be offset by increases in gas production.

Also, important to know that all sanctions actively strikes at a certain group of individuals in government organizations, blocking their assets. For example, the Bank "Russia", the largest shareholder of which is Kovalchuk, on the list of the Ministry of Finance of the USA. The Bank's assets reach 10 billion dollars and according to U.S. Bank is the "personal Bank of the Russian Federation senior officials", in consequence of all dollar accounts will be frozen.

The Bank "Russia" has 55% of assets in Cyprus Telcrest, which owns a 25.2% shares in CTC Media. "50% rule" is not act on this media campaign, but its shares are traded in the U.S. on NASDAQ. Price fell 1.5% to \$8.6. These sanctions against the Bank "Russia" can have an influence on CTC Media. The Bank owns 30% of company shares VI - the largest seller of TV television commercials in Russia. If sanctions will be extended to this campaign, advertisers with headquarters in United States will be recommended to stop the collaboration with Vi.

In other words, sanctions, which at first glance are harmful to specific people, actually have a whole chain of negative consequences, in this case, for a TV advertising network.

Third, sanctions against the Rotenberg brothers affected on the major sphere of the Russian economy. Among their assets are the campaign "North European pipe project", besides they hold 33,4 % of the German trading house «Eurotube», which sells pipes of the European concern Europipe and other producers to "Gazprom", "Transneft", "Rosatom", "Surgutneftegas" and other campaigns. The analogues of these pipes, campaign can't find in Russia. In 2010, the campaign has delivered 200,000 tons of pipes. Their cost is about 300 million euros. It makes to a third of all import of pipes to the country. Thus, the U.S. and the EU can paralyze the oil and gas industry of Russia in the long term. It can have serious consequences for the Russian economy in general.⁴

Another important point – the sanctions do not affect existing contracts, and it means, for example, that the largest private gas producer in Russia NOVATEK will be able to continue cooperation with the French «Technip» and «Entrepose», and also German "Siemens" within the framework of construction of the terminal on production of natural gas of Yamal LNG.

The most severe sanctions were imposed by the West on Russia's financial sector. Limiting loans to Russian banks, the state's share, exceeding 50%, the U.S. and EU will embarrass the refinancing of the current external debt of the banking sector. According to analysts Sberbank, today the debt is about 207 billion dollars, in 2014 must be repaid to 20.6 billion dollars, and in 2015 – \$ 30 billion.

The state-owned banks – Sberbank, VTB, Rosselkhozbank, Vnesheconombank, and Gazprombank and Bank of Moscow – will not be able to issue Eurobonds, but traded in the market securities, 70% of which are foreign investors from the US and EU sanctions will not affect. Subsidiaries of Russian banks in Europe will not suffer too.

The Central Bank has pledged to support banks from the blacklist, if they will face a shortage of liquidity. But this assistance can be fairly expensive due to the high key rate (8%). Amplification of isolation can lead to the tightening of monetary policy, the ruble will become manageable, and the key rate will continue to grow for the sake of curbing inflation, analysts predict Morgan Stanley. To compensate tough monetary policy, Russia has to use oil funds and consider simplification of the budget rule.

In addition, next year the Federal budget could be short of about a trillion rubles of income because of problems with economic growth. Also the Plan of state loans may not be made. In order not to increase the budget deficit above 1% of GDP, which will have a negative influence on the state of the Russian debt, the government will raise taxes since 2015, which will hit both the private sector and ordinary citizens. All this - is a direct or indirect influence of sanctions on the Russian economy, which has been losing pace of growth the last two years to nowadays.

Variants of the situation development in Russia suggest a warming of relations with the West, the return of Russian companies to European financial market, the removal of all substantial sanctions, a balanced budget and inflation targeting, as well as preservation of the market economy in Russia in its current form. But in a pragmatic option do not believe even the analysts, noting the drift towards Patriotic script with isolation from the outside world.⁵

Nowadays, while Russia focuses on the West and the East, at the same time this historical period of the Western direction – prevail. Last year a discussion about the necessity of turning to the East in order to diversify its partners had arisen. First of all, eastward is geo-

⁴ SCI-ARTICLE.RU, "Implications of the US and EU sanctions for the Russian economy", № 14, October 2014.

⁵ Kapital-rus.ru, "What will happen after the sanctions against Russia: isolation or out of the crisis? ", Alexander Melnikov, July 31, 2014.

graphically close to our region, secondly, it is a dynamic developing market with high growth rates, and third, it is a region open to cooperation. Now the share of countries in East and South-East Asia in the trade balance is significantly below the EU, cooperation in the investment sphere also weak.

About the priority of the Eastern vector say some facts. It is the proclamation of a national priority development of the Far East the revision of the current Energy strategy in favor of intensifying cooperation with the countries of the Asia-Pacific region the organization of the first Russian business mission to the ASEAN countries headed by the Deputy Minister of economic development of Russia Alexey Likhachev. Traditionally, the largest Eastern partners in Russia were a neighboring countries – China, Japan and Korea. Now the public policy is directed at strengthening relations with the countries of ASEAN, where on the first meeting went 30 representatives of Russian companies working in fields from pharmaceuticals to heavy engineering.

Excessive orientation towards the East, or rather the Chinese market, can really put the country into dependence on China. Already now, 16.7% of the total amount of import fall to the share of China, that is mean that, this East neighbor is the main supplier to Russia, that had overtaken Germany and even in a total trade with the CIS countries. Now Russia buys from China high-tech products, while it sells fuel-energy resources (74%).⁶

Also important, that in November in Moscow is planned a Morocco Large festival. The action purpose – promotion of Moroccan products and the increasing cooperation of Africa with Russia. The festival will be attended by manufacturers of grocery products, cosmetics, and home textiles. Morocco is going to replace most imports of products, hat previously was exported to Russia from the Netherlands and other countries, against which sanctions have been imposed. Also Russia continues to expand trade relations with Asia.

Nowadays almost 70% of goods imported to Russia from Morocco, are vegetables and fruits. For the first half of the current year, the volume of deliveries amounted to more than \$250 million. According to the forecast of economists, by the end of the current year, the volume of Russian-Moroccan trade, including import and export, may amount \$2 billion. Now, the Moroccan producers are ready to offer Russia a higher range of products today. Morocco is a major supplier of fruits to the USA, the UK and the Scandinavian countries. There is an opinion, that a significant part of Moroccan fruits, by re-exporting the goods, was transported from the Netherlands to Russia.

According to experts, in the future Russia is going to pay attention to its partnership with Ethiopia, which Moscow considers to be "the preferred Russian partner on the African continent". According to the website of Russian state agencies, special attention will be paid to the implementation of major joint projects in energy, hydrocarbon production, agriculture, construction of transport infrastructure.

In Zimbabwe, the Russian authorities concluded a treaty on joint development of the second largest world deposits of platinum in the Darwendale district. This event Sergey Lavrov, minister of foreign affairs, called "the locomotive of development of whole complex of bilateral trade-economic and investment ties."⁷

To sum up, I want to say, that I hope that the government of Russia has world-class experts who could develop emergency measures to prevent the potential of a possible economic collapse, even if its probability is less than 5-10%. Maybe it is better to study the experience of countries that have experienced decades of sanctions, such as Iran, and to make a model of mobilization of the economy in which our country becomes self-sufficient and sustainable in the medium term.

⁶ rusrand.ru, "Russia and sanctions: scenarios of economic development", Ludmila Kravchenko, April 5, 2014.

⁷ headliner-logistic.ru, "Russia is looking for new partners".

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