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ECONOMIC IMPACT OF THE EU-RUSSIAN SANCTIONS

Summary:
The current sustainable development of the world is threatened by a lot of factors, e.g. armed conflicts, terrorism, migration waves and others. Nowadays, the most significant factor for the Slovak Republic, and the whole Middle Europe, is the conflict in the Ukraine. The European Union has been joined to solution of this conflict since its beginning. The contribution summarizes the sanctions development between the Russian Federation and the European Union. The sanctions have relevant impact on the development of various economic indicators, through which we can describe the economy development of the country. The main aim of the paper is to describe the development of strategic raw materials prices and their correlation with imposed sanctions.

Key words:
sanctions, embargoes, crisis, Ukraine conflict, consequences

Introduction

The relationship between NATO and the former Soviet Union and now Russia has been at the centre of European and international politics for over 60 years. NATO and Russia have not been able to achieve the stated intention of forging a partnership. Russia's sensitivity regarding the enlargement of the NATO Alliance has been a consistent source of serious tension. Although few might have anticipated the deterioration of the European/Eurasian security environment that we have witnessed as a result of the Ukrainian conflict, in many respects, Russia's clash with the West over Ukraine might have been anticipated.

The tensions between Russia and NATO (EU) countries have culminated in the current crisis in Ukraine, which threatens not only to devastate the society, but also to unravel all progress achieved in building greater peace and security in Europe and the world since the end of the Cold War.

Background of conflict in the Ukraine

Conflict between the pro-Russian separatists and the Ukrainian armed forces represents a serious threat to the global security and the disruption of a peaceful order in Europe. It is so difficult to clearly identify what was the trigger sequence of events which resulted in the current situation. Perhaps we can only assume that dissatisfaction of Ukraine citizens come from results of elections in 2004 and the suspension of negotiations on the Association Agreement with the European Union has escalated so much that they started to show their opposition publicly. On 21st November 2013, the Ukrainian president Viktor Yanukovych suspended preparations for an Association Agreement and the Deep and Comprehensive Free Trade Agreement with the European Union. The announcement initiated protests among those favouring stronger ties with the European Union, which, in February 2014 resulted in a change of the Ukrainian government.

However, residents of southern and eastern Ukraine demonstrated against this new pro-European administration and eventually began to actually fight for closer ties with the Russian Federation. Conflict between Ukraine and pro-Russian forces has started on 27th February 2014, when the invaders took over the public buildings in Crimea[1].

On 1st March 2014, Russian president Vladimir Putin sent out troops to Crimea to protect ethnic Russians from anti-government protesters in Kiev. The Russian troops surrounded the Ukrainian military bases and within two days Crimea was in virtual control of Russia. On 4th March, Putin denied suspicion of military conflict though he maintained that Russia "reserves the right to use all means at its disposal to protect" Russian citizens and ethnic Russians in the region. On 25th March, Oleksandr Turchynov, Ukraine's acting president, ordered the Ukrainian troops to withdraw from Crimea after formal Russian annexation[2].

Ongoing fighting in Ukraine and loss of life or damage to property related to that cannot be unnoticed by the international organizations. They take an initiative to resolve the existing conflict as fast as possible in a peaceful way. The EU decided to solve the situation by imposition of sanctions (e.g. freezing Ukrainian government accounts) in February 2014, and then the sanctions were directed also against the Russian Federation, which according to available information supports pro-Russian separatist activities.

[1] S. Cross, *NATO–Russia security challenges in the aftermath of Ukraine conflict: managing Black Sea security and beyond*, "Journal of Southeast European and Black Sea", 2015, Vol. 15, No. 2, pp. 151-177.

[2] S.J. Ahsan, *The Ukraine Crisis: Awaited Revolution*, "Defence Journal" 2015, 03, vol. 18, no. 8, pp. 25-33.

Brief history of the imposed sanctions

Organizations of international crisis management took an initiative to end the conflict in a peaceful way and as soon as possible. Mentioned sanctions imposed against the Russian Federation included:

- an asset freeze for certain individuals (total of 151) and entities (total of 37) and a travel ban for certain individuals because of their direct involvement in the situation development in Ukraine[3];
- the sectorial sanctions targeting Russia's oil industry, financial sector and the military or arms industry, which include following restrictions:
    - restrictions on financing some companies owned by the Russian government (banks, oil companies and companies and entities engaged in designing production, sales or export of military equipment or services); this restriction includes a prohibition to deal in security and money market instruments, issued by the companies mentioned above, with a maturity above 30 days;
    - restrictions to provide, directly or indirectly, loans or credit to the above mentioned companies with a maturity exceeding 30 days;
    - restrictions on export of military and dual-use items to Russia and for use in Russia[4];
    - restrictions on the export and supply of certain oil-related goods and technologies to Russia and for use in Russia;
- imposition of the strictest sanctions targeted towards trade with Crimea and Sevastopol in response to the illegal annexation of Crimea and Sevastopol[5].

General Assembly of the UN adopted resolution no. 68/262 about territorial integrity of Ukraine which recalls the obligations of all states under Article 2 of the Charter of the UN to refrain in their international relations from the threat or use of force against the territorial integrity or political independence of any

[3] Council Regulation (EU) No 269/2014 concerning restrictive measures in respect of actions undermining or threatening the territorial integrity, sovereignty and independence of Ukraine, <http://eur-lex.europa.eu/legal-content/SK/TXT/HTML/?uri=CELEX:32014R0269&from=SK> (16.10.2015).

[4] Council Decision 2014/512/CFSP concerning restrictive measures in view of Russia's actions destabilising the situation in Ukraine, <http://eur-lex.europa.eu/legal-content/SK/TXT/HTML/?uri=CELEX:32014D0512 &from=EN> (16.03.2015); Council Regulation (EU) No 833/2014 concerning restrictive measures in view of Russia's actions destabilising the situation in Ukraine, <http://eur-lex.europa.eu/legal-content/SK/TXT/HTML/?uri=CELEX:32014 R0833&from=EN> (16.03.2015).

[5] Council Regulation (EU) No 960/2014 amending Regulation (EU) No 833/2014 concerning restrictive measures in view of Russia's actions destabilising the situation in Ukraine, <http://eur-lex.europa.eu/legal-content/SK/TXT/HTML/?uri=CELEX:32014R0960&from=EN> (16.03.2015).

State, and to settle their international disputes by peaceful means[6]. This resolution notes that the referendum held in the Autonomous Republic of Crimea and the city of Sevastopol in March 2014 was not authorized by Ukraine. In direct connection with the UN resolution, the EU Council adopted decision No. 2014/386/CFSP and EU Regulations No. 692/2014 (June 2014) and No. 825/2014 (July 2014), which were significantly extended by the EU Regulation No. 1351/2014 in December 2014. Through this regulation any trade and investment in Crimea and Sevastopol was practically restricted.

The Russian Federation responded with sanctions against the EU through the adoption of retaliatory measures in March 2014. At first, it was asset freeze and travel ban for people, including even government officials to Russia. In August, the Russian president V. V. Putin signed a decree on the application of specific economic measures, which imposed annual ban on import of majority of agricultural products from countries, which had adopted sanctions against Russia. Next day, the Russian Federation government adopted a decree with the list of countries and different products to which the embargo is targeted. It should be noted that before imposing an embargo, food export from the EU to Russia was approximately about 11.8 billion €, which represents 10% of the Russian consumption[7].

The EU tries to resolve existing conflict by using different instruments than sanctions. In November 2014 an agreement has been signed between the EU and Ukraine on the establishment of a mission EUAM (the EU Advisory Mission for Civilian Sector Reform Ukraine). This mission is focused on assisting and helping Ukraine in the security sector reform issues, including the security forces, prosecution, the judiciary and others. The mandate of the operation is approved for two years. An extension of it will be based on the achieved results. The headquarters of EUAM Ukraine is situated in Kiev. It is necessary to emphasize that EUAM Ukraine is a non-combatant and unarmed civilian mission of the EU[8].

Sanctions consequences

Sanctions are a kind of trade nontariff barrier aimed at achieving political goals at the cost of unacceptable economic losses. However, in the open global economy, the introduction of sanctions in major countries leads to negative

[6] Resolution Adopted by General Assembly No. 68/262 Territorial integrity of Ukraine, <http://www.un.org/en/ga/search/view_doc.asp?symbol=A/RES/68/262> (16.03.2015).
[7] Russia Hits West with Food Import Ban in Sanctions Row, <http://www.bbc.com/news/world-europe-28687172> (16.03.2015).
[8] Fact Sheet – EU – Ukraine relations. 2015, <http://eeas.europa.eu/statements/docs/2014/140514_02_en.pdf> (10.03.2015).

mirror effects[9]. Sanctions and embargoes are political and trade restrictions. They are imposed on target countries to maintain or restore peace and security in the region. According to Filip, sanctions are economic instruments used in international crisis management. They keep influencing on the state of a crisis development through the prosperity of another country[10]. They are divided into economic rewards and economic sanctions. The sanctions are a particular form of economic punishment against the target country. The domestic impact on Russia can be divided into three aspects:

- impact on the Russian economy,
- impact on the Russian domestic politics,
- impact on the current situation in Ukraine.

Economic sanctions have certain negative effects on the Russian economy. The most important for Russian channels of the sanctions impact on economic dynamics are limitations of debt financing on markets in the European Union, trade restrictions of dual use goods, the decrease in industrial cooperation, a reduction in foreign direct investment from the countries of the European Union, growth in the internal prices of certain products, and an embargo on access to high technologies in energy sector.

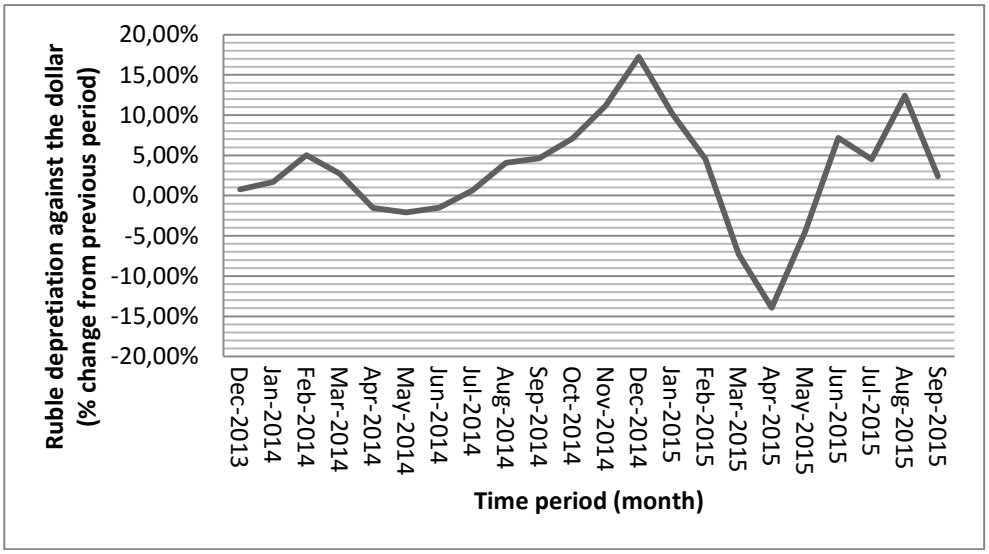
Economic impact of imposed sanctions also includes changes of rouble exchange rate against US dollar. Changes of several commodities prices, for example crude oil and gas, can be considered as an indirect consequence. Sanctions against Russia were adopted in March and December 2014. Restriction measures adopted in December can be classified as more strict. In August, Russia responded by imposing an embargo on import of agricultural products from countries which had adopted restrictive measures against it. This paper pays attention mainly to the development of the above mentioned indicators, namely, in short term after imposition of sanctions.

Progress of exchange rate reflects the confidence level of financial markets to a specific country. Figure 1 shows change of the rouble exchange rate against the exchange rate of the US dollar. The rouble exchange rate is significantly influenced by the EU sanctions. Due to the first sanctions introduced in March 2014, its exchange rate decreased. However, the decrease was not so significant, so the rouble remained relatively stable. After stricter sanctions imposed in December 2014, exchange rate of the rouble had already declined significantly, namely by over 10% per month. Russia has responded by adopting several monetary measures. Through them, the rouble exchange rate slightly appreciated in March 2015. It can be assumed that development of the rouble exchange rate will be influenced by Council Decision 2015/959 CFSP, which extended the sanctions until 23 June 2016. In absolute numbers in November 2013 was the rouble exchange rate against the dollar was 32,645 rouble per 1

[9] A.A. Shirov, A.A. Yantovskii, V.V. Potapenko. *Evaluation of the Potential Effect of Sanctions on the Economic Development of Russia and the European Union,* "Studies on Russian Economic Development" 2015, vol. 26, no. 4, pp. 317-326.
[10] Novak L. et al., *Resource Planning for Solution of Crisis Situations*, Bratislava 2010.

dollar. In September 2015 it was 66,766 rouble per 1 dollar. Due to imposed sanctions the rouble against the dollar exchange rate is more than 2-times weaker than it was before sanctions[11].

Fig. 1. Graph of the rouble exchange rate development.



Source: Monthly Monetary and Financial Statistics (MEI): Interest Rates, <http://stats.oecd.org/index.aspx?queryid=86> (16.07.2015).

The short-term interest rate was and still is one of the most important tools used to stabilize the rouble exchange rate. After imposition of the sanctions in December 2014, the short-term interest rate in Russia increased above 20%. The main aim of this measure was to avoid mass cash withdrawal and thus subsequent loss of liquidity by Russian banks. Currently, value of the short-term interest rate is still higher than it was before sanctions imposing. Totally it was more than 7%. The average value of long-term interest rate was 8% in the Russian Federation, but after imposition of the sanctions in December 2014 it increased to 10%. On the contrary, value of the long-term interest rate in the EU has been decreasing since January 2014. It decreased from 3.21% in January 2014 to 0.85% in April 2015[12].

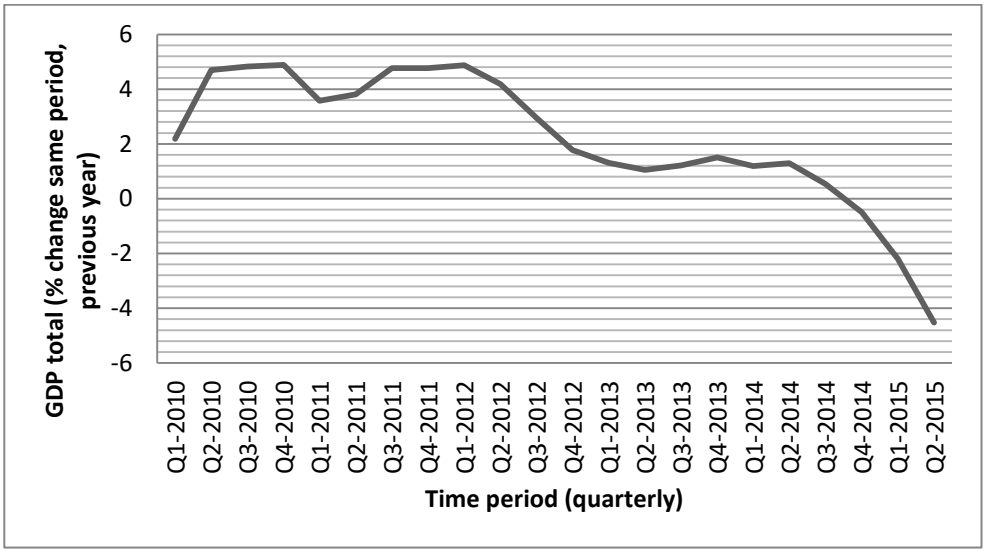
Inflation, as an indicator, expresses the increase of the price level. The highest inflation rate in Russia, since the sanctions imposition, was during December 2014 and January 2015. It was directly caused by the depreciation of

[11] Monthly Monetary and Financial Statistics (MEI): Exchange Rates (USD Monthly Averages), <http://stats.oecd.org/index.aspx?queryid=169> (16.07.2015).
[12] Monthly Monetary and Financial Statistics (MEI): Interest Rates, <http://stats.oecd.org/index.aspx?queryid=86> (16.07.2015).

rouble and increase of the short-term and long-term interest rates. Although, inflation rate in Russia is still growing after February 2015, its growth is slower. Before sanctions were imposed, inflation had index 124,2 (November 2013). After sanctions were imposed, inflations had index 153,5 (September 2015). Index 100 means level of inflation, which was at the selected month in year 2010[13].

Russian gross domestic product (GDP) has survived the combined pressure of the global economy and sanctions quite well in 2014 by showing an average of 0,6 % growth (fig. 2). Negative effects appeared first in Q1 2015 when the Russian economy declined by 2,2 %. The decline was even deeper in Q2 2015 when the GDP dropped 4,5 %. When comparing the Russian GDP drop in Q2 2015 with the GDP growth of Eurozone (0.4%), the negative effect is evident. However, when one compares the decline of GDP in Russia with the economic decline in Ukraine (-17.2% in Q2 2015), it is even more evident that current sanctions have not been sufficient to bring the level of costs of continuing the conflict in Russia as high as it has been with the Ukrainian economy[14].

Fig. 2. Graph of Russian GDP development.



Source: J. Jansen, *EU Sanctions Against Russia: New Targets and State of Play*, DLA Paper, 11.02.2015,

[13] Consumer Prices (MEI): Consumer Prices, <http://stats.oecd.org/Index.aspx?DatasetCode=MEI_PRICES#> (16.05.2015).

[14] Veebel V., R. Markus, *Lessons from the EU-Russia Sanctions 2014-2015*, "Baltic Journal of Law and Politics" 2015, vol. 8 no. 1, pp. 165-194; Domestic product, <https://data.oecd.org/gdp/quarterly-gdp.htm#indicator-chart> (16.07.2015).

<https://www.dlapiper.com/en/us/insights/publications/2015/02/eu-sanctions-against-russia/> (16.03.2015).

Based on the selected indicators, we can conclude that the EU sanctions significantly influence economy of the Russian Federation. The European Commission estimates that GDP growth in Russia will decrease at least by 1.1 % in 2015 and it will be influenced by sanctions against Russia. Furthermore, rouble depreciated and significant outflow of capital from Russia began. Overall, capital value is in the amount of 130 billion dollars. According to estimates of the European Commission, the sanctions will also reduce GDP growth in the EU by 0.2-0.3 % in 2015. According to available information sources, decrease of export from the EU to the Russian Federation is in the amount of more than 60 %[15].

The sanctions have caused no impact on Russia's domestic politics. The EU sanctions against Russia have inspired strong patriotism and nationalism in Russians. Rather than shake the public's support for the government, the sanctions have helped the government to mobilize its citizens. As phrased by Igor Yurgens, the President of the Russian think tank Institute for Contemporary Development, "Sanctions do not destabilize Russia's regime; on the contrary, they help Putin mobilize nationalism among the political elites"[16]

Sanctions' impact on raw commodity prices

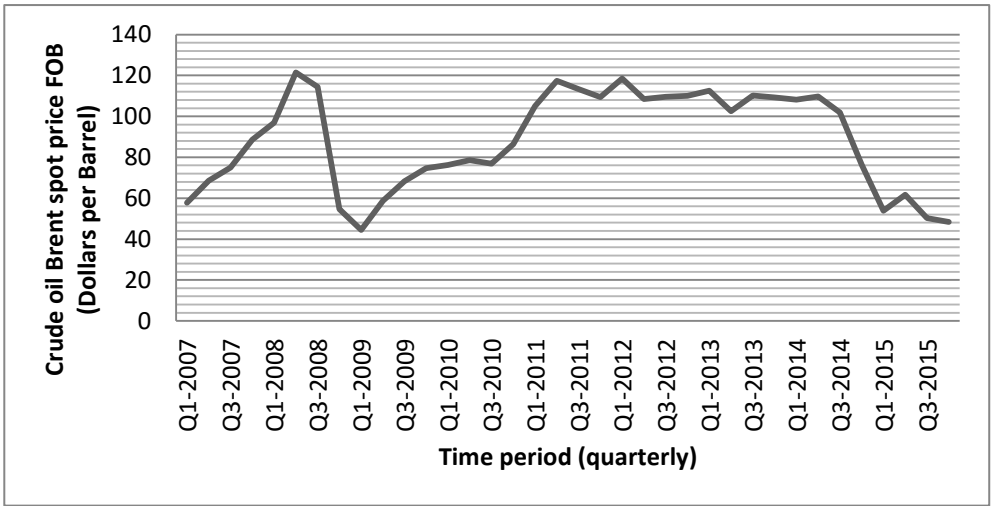
In addition to the changes in exchange rates and inflation rate caused directly by sanctions and embargoes, there are also other indicators which should be paid attention to. It is, for example, price of strategic raw materials, such as oil and natural gas. These commodities are among the most important sources of the Russian Federation's income. The EU together with the United States has the political and economic instruments to reduce prices of these commodities, either by influencing the world stock exchanges, or exerting pressure on OPEC members[17].

In fig. 3 we can see a decline in oil prices, which is more than 50% in one year. However, we can only assume that oil prices decline was an indirect revenge of the United States and other countries to which Russia imposed embargo on goods import[18]. Another explanation could be that production of crude oil is still growing more[19] than demand on markets, which pushes price down.

[15] J. Jansen, *op. cit.*
[16] W. Wang, *Impact of Western Sanctions on Russia in the Ukraine Crisis*, "Journal of Politics and Law" 2015, vol. 8, no. 2, pp. 1-6.
[17] OPEC means Organization of the Petroleum Exporting Countries.
[18] Petroleum and others liquid, <https://www.eia.gov/dnav/pet/pet_pri_spt_s1_m.htm> (16.07.2015).
[19] World Crude Oil Production, <https://ycharts.com/indicators/world_crude_oil_production> (16.07.2015).

Price of gas did not fall as much as the oil price. The gas price declined more than 25% in one year. More significant decline was after imposing sanctions against Russia in December 2014. Nowadays the natural gas price is still decreasing[20].

Fig. 3. Graph of crude oil Brent spot prices development.



Source: World Crude Oil Production, <https://ycharts.com/indicators/world_crude_oil_production> (16.07.2015).

Situation in Ukraine influences the global security environment. Changes in the security environment also reflect in the economic environment, for example by growth of strategic commodities prices, namely oil and gas. The above mentioned strategic commodities are necessary for the sustainable economic growth of each country. Especially ensuring resources for future development of the country is considered as a strategic priority of security[21]. Sanctions raised concerns about the possible suspension of energy resources supply to Europe. Especially Eastern Europe countries are dependent on Russian gas. These countries rely on Russia for at least 60% of their gas[22]. Commodity prices did not increase, on the contrary, price decreased. Based on the current prices

[20] Henry Hub Natural Gas Spot Price, <https://ycharts.com/indicators/natural_gas_spot_price> (16.07.2015).

[21] A. Kelisek et al., *Economic Security - A Principal Component of Multilevel Security Concept in Global Economy*, "Communications – Scientific Letters of the University of Žilina" 2011, vol. 13. no. 2, pp. 44-48.

[22] E. Sventekova et. al., *Solution of Gas Crisis as a Task of Risk Management in Slovakia, Proc. of WMSCI 2009 The 13th World Multi-Conference on Systemics, Cybernetics and Informatics (jointly with The 15th International Conference on Information Systems Analysis and Synthesis, ISAS 2009)*, Orlando 2009, pp. 384-388.

development, it can be stated that they will be regulated in some way by countries, which adopted sanctions against Russia. It could mean, from one point of view, as another form of sanctions against Russia. However, this statement is not possible to substantiate by any official sources.

Conclusion

We can make some conclusions based on the description of sanctions and embargoes as such, but these conclusions are mainly based on characterization of specific measures imposed by the EU against the Russian Federation. Imposition of sanctions by the EU definitely disrupted economy of the Russian Federation. The exchange rate of rouble decreased and inflation rate in the country increased. Whether the adoption of specific restrictive measures fulfilled the primary purpose is already difficult to say with certainty. The main purpose of all these measures was the peaceful resolution of the conflict in Ukraine. Another purpose was to persuade Russia to cease to support efforts of Crimea peninsula inhabitants to affiliate to the Russian Federation by its activities. Despite of the ceasefire, there are still a lot of attacks and fights, so the effectiveness of these measures is questionable.

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