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The power of sanctions

Sanctions are perceived as a low-cost, low-risk way to influence the behaviour of a nation. But how effective will they be in the current situation with Russia? BNY Mellon Investment Management's chief economist Shamik Dhar discusses the economic effect of such actions.

The invasion of Ukraine by Russia has prompted the international community to start imposing sanctions on Russia. It's not the first time sanctions have been levelled at the country.

The success rate of sanctions is about 51% of the time (to effect modest policy changes, and 31% to stop military action).[1] The potency of economic sanctions depends on where they're aimed at, what the sanctioners want to achieve, and what the resilience is of the target.

Now on the docket of example is the unfortunate past: in 2014 Russia annexed Crimea from Ukraine. Then, as at present, sanctions were levied on Russia. It's estimated that the penalties along with a falling oil price shaved off 2.5% from Russia's GDP in 2014.[2]

Bigger picture, economic sanctions can work, to a degree (as they did, for example, in Iran after 1979 and South Africa beginning in 1985). The economic sanctions imposed on Russia in 2014 did affect its GDP growth rate, and since then growth has been negative or anaemic at best. Between 2014 and the first half of 2021, Russia's GDP grew by an average of 0.3% per year, while the global average was 2.3% per year over the same time frame.[3] Russian GDP growth did accelerate to 5% in the latter half of 2021 owing to rising oil prices because of the pandemic, but it's estimated to fall in 2022, to 2.8%, while estimates for global growth is 4.4%.[4]

Stronger position

But there's a caveat to all this: the Russian economy is much different today than it was in 2014. Then its economy was feeble, its balance sheet was weaker, its external debt higher, and its financial connections with major economies less extensive.

For nearly the past decade, there has been a priority to strengthen its financial system. Russian authorities have been preparing the economy to better protect itself from incursions on the strength of its economy. Among the many ways Russia has done this has been to de-dollarize its foreign reserves, amassing more than US$630bn in mostly gold, non-dollar currencies such as the euro and Chinese yuan, and special drawing rights (a weighted average of various convertible currencies).[5]

Further, Russia developed alternative financial channels to bypass, if necessary, the Western financial system, by constructing its own version of SWIFT called the System for Transfer of Financial Messages. There's also China's equivalent in the China International Payments System, which Russia joined in 2019. (How meaningful these two systems are and will be to Russia during the pressures of sanctions remains to be seen.)

[1] Do economic sanctions work? Norwich University, October 6, 2020.
[2] The sanctions that could really hurt Russia, CNN Business, February 2, 2022.
[3] The impact of Western sanctions on Russia, Atlantic Council, May 2021.
[4] Statista, December 2021; IMF trims Russian 2022 GDP growth forecast, Reuters, January 25, 2022; IMF downgrades 2022 global growth forecast to 4.4%, CNBC, January 25, 2022.
[5] "Russia's foreign currency and gold reserves hit record high," Bank of Finland Institute for Emerging Economies, January 21, 2022

What's next?

The unknown in this conflict is China. Will China be willing to provide Russia some relief from the tightening pressures of international sanctions? China could make greater purchases of energy and other commodities. But China may make the calculation that it will help, but not likely to cause severe disruptions with the West. There's too much money involved.

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