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Russian Journal of Economics 1 (2015) 359–385

Russian Journal of Economics

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# The impact of financial sanctions on the Russian economy ☆

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**Abstract**

This paper examines the impact of the current Western financial sanctions on the Russian economy. Modeling the capital flow components (accounting for the influence of other factors, including falling oil prices) reveals that sanctions have directly affected sanctioned state-controlled banks, oil, gas and arms companies by severely constraining foreign funding and have indirectly affected non-sanctioned companies by reducing inflows of foreign direct investment and causing funding conditions to deteriorate. The overall negative effect on gross capital inflow over 2014–2017 is estimated at approximately $280bn. However, the effect on net capital inflow is significantly lower ($160–170bn) due to Russian companies' self-adjustment, which is evidenced by their utilization of foreign assets accumulated earlier for debt repayment and an overall decrease in gross capital outflow. The sanctions' estimated effect on GDP is significant (–2.4 p.p. by 2017, compared with a hypothetical scenario with no sanctions) but 3.3 times lower than the estimated effects of the oil price shock.


*JEL classification*: F32, F37, F47.
*Keywords:* financial sanctions, balance of payments adjustment, external debt, capital flows.

## 1. Introduction

In March 2014, the EU, the U.S. and a number of other states introduced the first sanctions against Russia in connection with the situation in the Crimea

☆ The updated English version of the article published in Russian in *Voprosy Ekonomiki*, 2016, No. 1, pp. 5–35. This article represents an extended version of the report "Scenarios of development for the Russian economy in the conditions of sanctions and falling oil prices" produced for the Civil Initiatives Committee in December 2014.

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Peer review under responsibility of Voprosy Ekonomiki.

http://dx.doi.org/10.1016/j.ruje.2016.02.002

and eastern Ukraine. At first, these were individual sanctions against specific people and companies that were not significant to the Russian economy as a whole. However, in July 2014, additional sectoral sanctions were imposed that limited foreign financing for leading public banks and oil and gas companies and restricted Russian oil and gas companies' access to advanced production technologies. In response, Russia imposed an embargo on a wide range of agricultural products from Western countries in August 2014. Today, there seems to be no chance of the sanctions being lifted any time soon, although the situation in Ukraine has somewhat stabilized: in June 2015, the EU announced the extension of the sanctions until at least the end of the year (and in December 2015, they were further prolonged until July 31$^{st}$, 2016 at the very least), while the U.S. actually expanded the list of companies falling under its sectoral sanctions. In turn, Russia prolonged its food embargo for another year.

Although the sanctions have now been in force for quite some time, there still has been no convincing evaluation of their effects, and there is no consensus on their qualitative impact. For example, speaking before the U.S. Congress in January 2015, B. Obama said that "the Russian economy is in tatters,"[1] although some economists believe that the sanctions are of little or no significance. An IMF (2015) report on the Russian economy indicates that the sanctions and retaliatory sanctions may lead Russia to experience a reduction in GDP of 1.0%–1.5% over the short term, although the accumulated loss may reach 9.0% of GDP over the medium term. However, this report fails to explicate what is considered "short term" and "medium term". A. Shirov et al. place the direct impact of the sanctions between 8% and 10% of Russia's GDP but posit that compensating measures may reduce this figure significantly. However, the Shirov study does not explicate the time horizon over which this effect may be achieved (Shirov et al., 2015). According to experts at the Bank of Russia, the sanctions chipped away 0.5% of Russia's GDP during the first year they were in effect and 0.6% during the second year (Sinyakov et al., 2015). However, the immediate effects of the sanctions were assessed rather tentatively: these authors assumed only that Russia's private sector lost all access to the foreign capital markets. Rautava (2014) and Vercueil (2014) consider the overall effects of the uncertainty associated with Ukraine. The first study (published before the sectoral sanctions were adopted) estimated the impact as a 1 p.p. reduction in the 2014 GDP growth rate (Rautava, 2014). The second study indicates that in a "de-escalation" scenario in which financial sanctions were gradually lifted, GDP would grow an additional 2 p.p. in 2015 than it would under the scenario of a standing conflict in eastern Ukraine. However, no method of evaluating this effect was cited. Boulanger et al. (2015) considered only the impact of Russia's retaliatory sanctions on public welfare: based on their static model, the authors estimated a reduction of 0.25%.

This paper aims to study the financial channel of the sanctions' impact on the Russian economy that is associated with limits on foreign borrowing. As a result of their economic nature, such borrowing limitations are similar to a sudden stop of capital inflow, i.e., a precipitous decrease in foreign capital inflow. Indeed, the value of foreign capital inflow changed dramatically: in 2014, foreign liabili-

[1] https://www.whitehouse.gov/the-press-office/2015/01/20/remarks-president-state-union-address-january-20-2015.