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The EU-Russia Sanctions Regime: Theory-Practice Interplay

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Economic sanctions have long been instrumentalised as a policy of coercion, albeit to different degrees of success. In this context, there has been a vivid debate about whether sanctions could reach their goals and be an effective means of economic foreign policy. According to the findings made by academics, sanctions are successful only in 35% of cases (Hufbauer, Schott and Elliott, 1991). The ongoing Ukrainian crisis and an unprecedented deterioration of relations between the West (the EU in particular) and Russia have presented another case of sanctions policy.

Using the EU-Russia sanctions regime as a single case study[1], this essay purports to argue that the effectiveness of the EU sanctions[2] imposed on Russia is limited. Drawing on theoretical underpinnings of sanctions policy, this paper distinguishes between economic and political components. By identifying a set of criteria for sanctions effectiveness, empirical information in both fields will be judged against it. Therefore, a conclusion will be made that although it is possible to argue about the sanctions' relative effectiveness in the economic domain, the strength of variables in the political domain is not sufficient to achieve the set goals. To analyse this hypothesis, this paper will start with setting a ground and discussing the nature of the sanctions imposed by the EU. Then, a ground for the sanctions regime effectiveness in the economic field will be revealed. In the last section, a theory-practice interplay will be discussed in the light of the institutional theory of economic sanctions. It will explain why the political objectives of the sanctions have not been achieved. This eventually hampered the overall strategy of the discussed sanctions policy.

Three stages of the EU's sanctions regime

The EU has used the sanctions mechanism as a response to Russian actions in Crimea in March 2014 and the unfolding crisis in the east of Ukraine. The sanctions policy in this case is above all a pressure tool for the initiator (the EU) enabling it to exert its power in a non-military area. The structure of the current sanctions regime comprises three stages: diplomatic, targeted (individuals, companies) and sectoral economic sanctions. The first step was concerned with Russian activities in the international arena. The EU-Russia visa liberalisation negotiations were stopped (ECFR Scorecard, 2015). The G8 summit which was due to take place in Sochi was cancelled, instead the G7 summit was held in Brussels without Russia (Reuters, 2014). Pressure was put on the Russian delegation at the PACE (Russia Today, 2015). And later the negotiations on Russia's acceptance to the OECD and the International Energy Agency were suspended (EU Newsroom, 2016). All these steps can be categorised as first-stage measures. Being mainly diplomatic in nature, they were employed to convey a particular political message. Using the terminology of the signalling approach (Whang and Kim, 2015), these measures were mainly a precursor of a further set of actions.

In the next round the EU imposed sanctions on more than one-hundred individuals and over 30 entities closely affiliated with the Russian government and responsible for "action against Ukraine's territorial integrity" (EU Newsroom, 2016). This included such measures as asset freezes and travel bans (ibid.). These targeted or "smart sanctions" (Drezner, 2011) are aimed at key decision-makers and support groups of the Russian political establishment. Their objective could be viewed as to change the calculations of these elite groups and thus to bring about changes from within.

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The most important part of the current sanctions policy is the third round. These measures are an embodiment of traditional sanctions and are *economic sanctions* as such. These measures have covered many areas of EU-Russia sectoral cooperation. Several Russian state-owned energy, defence companies and banks have no longer access to the EU financial market (EU Newsroom, 2016). The export and import of arms, technological equipment, and dual use goods is banned (ibid.). This sanctions package is considered to be the most severe and compels attention with regards to its effectiveness.

The EU has often reiterated that the lifting of sanctions is dependent on Russia fulfilling the Minsk agreements^[3] signed in 2015 (EurActiv, 2015). In this vein, the EU's demand is that Russia must respect Ukrainian territorial integrity and sovereignty. Therefore, it is possible to argue that the main purpose of the EU's sanctions regime is to make Russia change its foreign policy vis-à-vis Ukraine. That is why this paper is focused only on the sender-recipient interaction. It does not look at symbolic aspects of the sanctions policy, i.e. the role of domestic audience (for symbolism e.g. Lindsay, 1986) in the EU countries is not reviewed.

Economic components of the EU's sanctions regime

The logic behind the implementation of sanctions have been mainly elaborated within the ideas of a non-military response and coercion of an opponent. Before moving to addressing the issue of sanctions from the institutional theory standpoint, this section will look at empirical information and the economic dynamics of the sanctions regime. This paper draws upon the existing variables of evaluation of sanctions success (Hufbauer, Schott and Elliott, 1991) – the multilateral/unilateral nature of sanctions, the relative size of a sender's economy to a recipient's one and the degree of economic dependence of a recipient on a sender. Taking into consideration overarching macroeconomic findings of Domanska and Kardas (2016), this paper posits that the EU sanctions are multilateral, the relative size of the EU's economy is bigger than the Russian economy, and the dependency of the Russian economy on the EU's economy is higher than vice versa. The inference of this hypothesis is the assumption that a considerable amount of economic harm could be caused to the Russian economy. The rationale of the analysis is developed here according to the punishment theory (Lektzian and Souva, 2007, pp. 850–852). Thus, the sender (the EU) employs the sanctions policy to make enough economic harm and to achieve either a policy change or limit the economic/political capacities of the target (Russia). The further analysis will look whether the empirical information can confirm the formulated hypothesis.

From the purely economic standpoint, sanctions change a cost-benefit analysis of a target and impedes it to find alternative sources of particular goods (Hufbauer, Schott and Elliott, 1991). Regarding the third stage measures (e.g. access to specific technologies), Russia has an option either to resort to other countries or start producing the necessary technologies with its own capacities. In this regard, Russia initiated the so called policy of "import substitution" (Mercouris, 2016). The hasty decision to start substituting import from the West was not a well planned economic policy, rather it was motivated by political and ideological incentives. Russia is deeply embedded in international production chains, and these attempts clearly show that such a policy can have serious negative effects. Some research in this field shows that the import substitution does not have enough capacity to compensate for the losses from the sanctions and does not stimulate domestic production (Moody's in Portanskiy, 2014). Taking this into account, one might argue that this policy does not have well-formulated and calculated economic foundations.

The sanctions policy has already started (albeit with a delayed effect) showing negative effects in particular sectors of the Russian economy. Apart from other measures imposed on Russia in the spring of 2014, restrictions on access to Western financial and capital markets as well as to technological equipment might be considered as the most sensitive. Furthermore, a new package of sanctions also affected Russia's oil and gas industry, and several major companies (e.g. Rosneft and Gazprom) are now on the ban lists (EU Newsroom, 2016). To be more specific, the EU stopped providing services to Russian energy companies in the field of oil exploration, oil production and the development of shale deposits in the Arctic (ibid.). According to some data (Luhn, 2016), these measures have already significantly reduced Russia's budget revenues from oil and gas sales.

Speaking about financial aspects, these measures aim at depriving Russia of investments in mid- and long-terms. Several Russian companies and large banks with a state share are on the ban lists which restricts the possibility to

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conduct financial operations. Russia can not now return to the market of sovereign Eurobonds (Seddon, 2016). The financial sanctions have also had indirect consequences. Foreign direct investment and capital inflows into the market of public debt has fallen, as a result non-banned companies have also been affected by the shortage of necessary loans (Pettersen, 2016). For instance, Russian market-players with the help of Eurobonds managed to get \$ 46.4 billion in 2013, in 2014 only \$ 10.4 billion, and in 2015 – slightly more than \$ 5 billion (PwC, 2016). A different example is the problem of the “Vneshekonombank” (on the sanctions list). This bank is a ‘too big to fail’ bank in the Russian banking system and needs a bailout plan which is equal to the 1.7% of Russian GDP (Papchenkova and Korsunskaya, 2016). The words of the bank’s top manager “if it weren’t for the sanctions, nobody would notice the bank’s problems” (FreeNews, 2016) are good proof of the causation between the sanctions and direct harm to the economy.

Another aspect of the negative consequences of the sanctions regime is the issue of trust. Trust is an invaluable asset of any business and goes hand in hand with all the other forms of capital (Portanskiy, 2014). Absence of trust prevents long-term investment planning. As the case with Russia shows us, reduced confidence spurred capital outflows from the country. Due to the sanctions measures, more capital was exported from Russia during the first three months of 2014 than in the year 2013 (EurasiaNet, 2105). By some estimations, the total amount of capital which left Russia by the end of 2014 reached US \$120 billion (ibid.). This does not only worsen the overall investment climate, but also has other consequences for the national economy. The delayed effect in macroeconomic terms is that capital outflow creates additional pressure on the rouble (the national currency) and increases inflation rates (Portanskiy, 2014).

The imposed sanctions coincided with the drastic fall of oil prices. With its dependency on the revenues for oil and gas sales, a rapid downturn started in the Russian economy. That is why a debate has begun whether the sanctions policy could contribute to the damage caused to the Russian economy. The recent findings (Gurvich and Prilepskiy in Domanska and Kardas, 2016) show that the fall of oil prices even exacerbates the effect of sanctions. All in all, this empirical information sheds light on the current dynamics of the Russian economy challenged by the EU’s sanctions regime. It lets one assert that the nature of the imposed sanctions has managed to cause enough economic harm. Coming back to the formulated hypothesis it is possible to partially confirm this. The EU’s sanctions did not induce a policy change in Russia, but together with a snowball effect they continue being effective in damaging the Russian economy’s domestic and international capacities.

Political components of the sanctions and the institutional theory of economic sanctions

The review of purely economic aspects let one argue that sanctions do increase costs for Russia. US President Obama once even mentioned in his speech that “the Russian economy is in tatters” (Bershidsky, 2015). However, this statement seems to be an example of a common mistake made in the rhetoric of politicians and commentators. Since sanctions are an instrument of a broader foreign policy toolset, it is foreign policy which should be a primary area of focus. One may not disentangle economic sanctions from a broader political discourse and effectively gauge a potential impact of economic sanctions.

In this section the issue of the EU’s sanctions policy is analysed within the political context of EU-Russia relations. The (in)effectiveness is judged against the objective of the imposed sanctions – to make Russia implement the Minsk agreements plan (EurActiv, 2015), i.e. to abandon its current policy towards Ukraine. In this respect, the logic of the analysis is developed according to the thesis of Cortright and Lopez (2000) that sanctions could be considered as successful if they encourage dialogue and do not lead to a further confrontation. The analysis will proceed by using components of the institutional theory of economic sanctions (Allen, 2005; Lektzian and Souva, 2007; Early and Spice, 2015). By doing so, this paper will seek answers to the questions: 1) are the political costs high enough for the country’s leadership to change the political course of actions? 2) is the demand made reasonable and can it make the target yield and not continue enduring sanctions?

The stepping stone of the undertaken analysis in this section is the assumption that the success of imposed sanctions on a nondemocratic country is less likely than on a democratic one (Lektzian and Souva, 2007, p. 849). Against this backdrop, it is important to reveal the nature of the Russian political system. This paper considers

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Russia as a country with an authoritarian regime type. This assumption is made based on the Project IV dataset by the Centre for Systemic Peace (2014) and the Freedom House Index (2015). In this vein, an inference could be made that the winning coalition of the Russian political system is quite small (while in a democracy it is 50% of the population (Lektzian and Souva, 2007, p. 852). This winning coalition encompasses President Putin's inner circle, a group of elites from business and state security services (Kaczmarek, 2014).

According to the institutional theory of sanctions, in a non-democracy with a small winning coalition major domestic agents (political leadership) seek mainly private goods and are less accountable to the population and are less dependent on economic prosperity (ibid., 852-854). Thus, the third stage of the EU's sanctions, which is having a potential negative impact on different branches of the Russian economy, does not prevent the leadership from retaining office. Although an overall nation's welfare is threatened, this logic postulates that this development does not constitute a sufficient amount of political costs to the leadership. One may conclude then that there is no ground to consider that the Russian government can yield to the EU's sanctions.

It seems that in the light of this rationale, the EU also used the targeted sanctions. As it was presented earlier, this type of sanctions took the form of travel bans and assets freezing and was aimed at the inner circle of the Russian political establishment. Hence it was exactly the small winning coalition within the autocratic political system targeted as an object of the EU's policy. Therefore, a question arises whether the harm caused to this winning coalition can be enough to make it yield. A more reality oriented formulation of the question could be whether dissatisfaction of these groups of political elites can eventually lead to regime change.

It seems it could be the case in the long-term, however this analysis is not supposed to engage with future predictions. The aspects of this theoretical framework rather help us to maintain that the likelihood of success is also low. One may hypothesise in this context that existence and stability of political agents of the winning coalition is contingent on the existing political structure. A possible cost-benefit analysis of any political elite group in Russia can assume that a radical change of structure will lead to the creation of uncertainty and as a result of its marginalisation, i.e. the loss of wealth and power. As long as the current structure of the political regime allows all the groups of interest (hit by the sanctions) to extract rents and provide private benefits (Lektzian and Souva, 2007, p. 853), there is no incentive to change the regime and to yield. That is why the possibility of the sanctions' success in this regard can be considered as low.

Taking into account the unprecedented deterioration of EU-Russia relations and the focus on this political discourse, it is worth now moving on to the major explanatory variable – the size of the demand. As Hufbauer et al. argued minor goals are more likely to lead to success rather than major goals (in Lektzian and Souva, 2007, p. 854). Therefore, the analysis should here concentrate on seeking an answer to the question whether for Russia the option of compliance (changing its policy towards Ukraine) is better than the option of enduring sanctions (continue the business-as-usual scenario).

The demand made of Russia by the EU is the reflection of diplomatic efforts put into the Minsk agreements. These efforts could be better scrutinised through the lens of the Normative Power Europe approach (Manners, 2002). According to Manners (2002, p. 236), the ideational foundations of the EU's power allow it to determine what could be considered normal in international politics. In this case, the EU was mainly interested in maintaining the existing norms of international politics (by projecting its own normative image) and thus punishing Russia as a rule-breaker and a power-maximiser (Mearsheimer, 2001). The diplomatic, military, and economic support to Ukraine is an instrumentalisation of respect to "the territorial integrity, sovereignty and independence of Ukraine" (European Council, 2016). From a different angle, it could be argued that the normative power approach underlies the classic realist assumptions of national security, hard power and a sphere of interest policy of the EU. In the framework of the undertaken analysis, such calculations do not play a significant role. What is important is the fact that due to its path-dependency or deeply embedded nature of a normative power, the EU has to make such demands in the given conditions and use sanctions as a leverage.

The reaction of a target state regarding the demands made is important for the analysis of the sanctions policy's prospects. What the EU (and the West in general) de-facto wants is bringing Crimea back under Ukrainian

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sovereignty and stopping the war in the east of Ukraine, i.e. Russia stops providing support to its proxies in the region. These issues could be viewed as vital security interests. Using the terminology proposed by Hufbauer et al. the demand made by the EU falls into the highest category, i.e. a change of a policy in a major way (in Lektzian and Souva, 2007, p. 859). Coming back to the question of the political system in Russia, it is possible to identify a clear connection between national security, national interests and the security and interests of the current political regime.

One may hypothesise that if Russia yields to these demands, the consequences will have profound effects on global, regional, and domestic levels. Specifically, such a retreat would mean Russia losing ground vis-à-vis others in different parts of the world (e.g. the Syrian crisis) as well as losing face as an alternative power and eventually undermining its robust (albeit controversial) foreign policy revival. With regards to its neighbourhood, such change might have more tangible consequences. For instance, unfreezing the conflicts in Georgia or in Nagorno-Karabakh and inability to play a role of a hegemon (Webb and Krasner, 1989) in the post-soviet space (e.g. in the Eurasian Economic Union). At a domestic level, the “return of Crimea” (UA today, 2016) and the ensuing “post-Crimean syndrome” (Kolesnikov, 2016) together with the war in the east of Ukraine play a significant role as the regime’s legitimisation tools. It should also be noted that the current Russian political dynamic is a clear example of the failure of the thesis outlined by Galtung (1967, p. 388): “the more value-deprivation, the more political disintegration”. This punishment rationale did not work in this case. On the contrary, a rally-around-the-flag effect took shape when Russian citizens, heartened by the sense of nationalism, (for nationalism in a target state see Pape, 1997, p. 93) expressed their support of the government’s policies to confront the EU’s sanctions regime. To illustrate, according to the Pew Research Centre survey (2015), the approval of Putin’s foreign and domestic policies reached the rate of 87%, despite many citizens acknowledging a negative impact of the imposed sanctions for the country’s economy.

Moscow’s domestic policy in this regard has crossed the Rubicon. Both image and strategic calculations let one assert that continuing the current standoff is the only rational behaviour for the country’s political leadership. At the moment Russia’s political leadership has a specific type of interests, goals, and values projected in the country’s foreign and domestic policies. The EU’s sanctions regime demands a U-turn which would affect all dimensions of Russia’s current positioning. Therefore, taking all this into account, it is possible to conclude according to the logic of the following hypothesis proposed by Lektzian and Souva – “the greater the demand made of the target, the less likely the target is to comply” (2007, p. 856). In other words, according to this rationale Russia will not yield, since the demands made by the EU are interpreted as unreasonable and are outweighed by the choice to endure sanctions.

Conclusion

The EU’s sanctions regime imposed on Russia has compelled much attention in contemporary international politics. The issue of the sanctions’ viability is widely discussed among academia and policy-makers. This analysis has tried to contribute to this debate by using existing theoretical concepts of sanctions and looked in turn at economic (narrow approach) and at political (broad approach) dimensions of the EU’s sanctions regime. In an economic domain it is possible to partially confirm the formulated hypothesis. Thus one may maintain that a punishment rationale can lead to serious damage and adversely affect Russia’s economic potential. Further this paper looks beyond purely economic aspects and contends to argue that the effectiveness of the sanctions should be assessed in the context of the policy’s objective. The institutional theory of sanctions helped to choose two variables – costs for the winning coalition and a size of the demand made. Thus it has been established that neither economic nor targeted sanctions impose enough costs on the winning coalition in Russia. Furthermore, the size of the demand is considered as being unreasonably high and cannot be fulfilled. Therefore, Russia has to continue enduring sanctions in the given political reality, which means it will not resort to a policy change. In this vein, in terms of the stated objective to make Russia comply with the EU’s political demands, the sanctions’ effectiveness could be considered as low. Further research could incorporate a larger set of empirical data and quantitatively evaluate the role of particular economic indicators for a specific sector of the economy or an elite group. In the long term, a valuable analysis could be made by focusing more specifically on the economics-politics interplay at a domestic level.

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[1] These sanctions were imposed by the EU, the US, and countries of the EEA together with other partners. For the sake of consistency and analytical clarity this research uses the term *EU sanctions policy*. The sanctions of the EU are considered to have the same degree of contribution and possible effectiveness

[2] This paper does not analyse the Russian reciprocal response, i.e. the food embargo

[3] This paper uses the phrase *Minsk agreements* with regards to the *Minsk II Accords* signed on 11th February 2015. Russia is de jure a guarantor, not a party to the conflict (Markedonov, 2015).

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