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Richard Connolly
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Introduction

Russia is isolated with its economy in tatters.
Barack Obama (*Moscow Times* 2015)

After Russia's annexation of Crimea in March 2014 and its subsequent involvement in the conflict in eastern Ukraine, economic sanctions became the primary – though by no means the only – instrument of statecraft used by the West to exert pressure on Russia to modify its foreign policy. Initially, sanctions were aimed at selected individuals in and around the Russian foreign policy elite. But as the conflict in eastern Ukraine intensified over the summer of 2014, the scope of sanctions was extended to encompass three of the most important sectors in the Russian economy. While some observers may have questioned whether sanctions represented a sufficiently robust response to Russia's actions, it was clear that their imposition was no trivial matter. This was the first time in the post-Cold War era that such wide-ranging sanctions had been imposed on a country as large and strategically important as Russia. As a permanent member of the United Nations Security Council, and possessing among the largest and most potentially destructive armed forces in the world, Russia carried more political and military importance than any other country that had been subjected to sanctions regimes in the post-Cold War period. In economic terms, it was also much more important than the likes of Iran, Iraq, or Yugoslavia. Measured by purchasing power parity (PPP), in 2014 its economy was the sixth largest in the world. It was also the world's largest exporter of hydrocarbons and second-largest exporter of armaments.

That Russia found itself under sanctions came as a great source of disappointment to those in that country and the rest of the world who had hoped that it would continue on its journey toward becoming a dynamic

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and globally integrated economic power. After all, its transformation after the disintegration of the Soviet Union was certainly impressive, even if not quite as complete as some might have hoped. Thirty years before sanctions were imposed, Russia, as part of the larger Soviet Union, was part of a centrally planned economic system that was only weakly integrated with the nonsocialist part of the global economy. Three decades on, however, things were much different. Economic reform in the 1990s put the foundations of a market economy in place. Economic activity in Russia was no longer directed and coordinated by the state, but was instead based on the decentralized decisions of millions of independent enterprises and households.

Russia had also become a much more closely integrated member of the global economy. In 2012, it joined the World Trade Organization (WTO). Large multinational companies (MNCs) were active in Russia, investing in a wide range of sectors of the economy. Indeed, in 2013 a United Nations report ranked Russia as the third most attractive country in the world for foreign investment, behind only the United States and China. The weight of Russian firms was felt abroad, too. Russia's large energy and mining companies had a presence across the world, and Russian banks and nonfinancial enterprises borrowed huge sums on global capital markets. To be sure, progress was uneven. For many observers, the state retained an excessively strong presence in the domestic economy, while property rights and the wider institutional environment were considered to be too weak to support sustained growth and modernization. And Russia remained overly dependent on the production and export of natural resources. Nevertheless, it is fair to say that Russia in 2014 was a freer and more open economy than at any other time in its modern history.

The events of 2014 threatened to reverse this trajectory. Western powers' use of economic instruments of statecraft was in many ways predictable. Outright military confrontation was always likely to be eschewed, given Russia's considerable military power. This reduced policymakers' options. Perhaps most importantly, both the United States and the EU had developed an established track record of using sanctions to achieve foreign policy objectives. The post-Cold War period saw an exponential increase in the use of sanctions, signaling both an evolution in the nature of modern interstate conflict and a preference for using their economic strength as an instrument of statecraft. Russia's reintegration with the global economy meant that it was more vulnerable to the imposition of economic sanctions than ever before. Its energy companies tapped the global economy for technology and capital; its defense industry imported components from

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Western sources; and its banks relied heavily on foreign capital. Exposure and vulnerability were the flipside of a freer and more globalized economy.

Sanctions appeared to exert an almost immediate effect. In the winter of 2014–2015, a sense of panic swept over Russia. Serendipitously – for Western policymakers, at least – the price of oil, Russia's primary source of export revenue, plunged. This caused a sharp depreciation of the currency and a surge in inflation. Interest rates rose, along with the budget deficit, and official foreign currency reserves dwindled. It was at this point that US President Barack Obama declared that Russia's economy lay "in tatters" (*Moscow Times* 2015). He was not the only one to hold this opinion. British Prime Minister David Cameron stated that sanctions were the reason for Russia's poor economic performance (Wintour 2014). For those hoping that inflicting economic pain on Russia might yield political results, these reports of economic distress in early 2015 made for satisfying reading.

This, however, proved to be the low point for the Russian economy. Although a protracted recession gripped Russia over 2015–2016, most indicators signaled a slow return to normality. The ruble stabilized, the rate of inflation declined, and Russia's foreign currency reserves began to rise again. By 2017, the World Bank had been persuaded that the effects of sanctions had "worn off." Perhaps more importantly, those sectors of the economy targeted by sanctions – energy, defense, and finance – were functioning in a relatively normal fashion. Russia posted post-Soviet record-high oil production figures. The defense industry simultaneously provided large quantities of weaponry to the domestic armed forces as part of a military modernization program while maintaining its position as the world's second-largest arms exporter. And the financial sector continued to supply capital to Russian borrowers. Evidently, these sectors were not in tatters; instead, they appeared to have adapted to the new environment. It is this process of adaptation that is the subject of this book.

PURPOSES OF THE BOOK

This book is intended to answer three primary research questions. First, what impact did Western sanctions have on political economy in Russia in the three-year period after they were put in place? My thesis is that while sanctions caused some initial disruption, the impact on targeted sectors quickly subsided. Second, what was the Russian authorities' strategic response to sanctions, and how did this mediate their impact? My thesis

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here is that the Russian authorities were able to utilize a range of tools and resources – many of which were readily available due to the specific characteristics of Russia's system of political economy – to cushion the targeted sectors from the worst effects of sanctions. Third, in what way did sanctions and the Russian strategic response to sanctions reshape both the structure of Russia's domestic political economy and its place in the wider global economy? My thesis is that sanctions and the Russian response resulted in a clear shift toward greater reliance on domestic resources – or Russification – on the one hand, and toward a more pluridirectional foreign economic policy that emphasizes closer relations with non-Western countries on the other. This process is, at the time of writing, far from complete. Obstacles to developing alternative trading partners and sources of external capital were encountered between 2014 and 2017, and new ones will no doubt emerge in the future. But the direction of travel is clear.

The book is intended to make a contribution to two strands of scholarship. First and foremost, this book is intended to support a more precise understanding of how sanctions affected political economy in Russia after 2014. In this respect, the book is intended to appeal to those with an academic or practical interest both in contemporary Russian political economy and in Russia's place in the world. The book is intended to serve as the first in-depth, monograph-length study of how sanctions affected Russia. The focus is not on whether the objectives of the sender states were achieved, but instead on how much economic pain was inflicted on Russia and how policymakers adjusted to this threat. This is important from both a scholarly and a practical point of view. In terms of scholarship, there exist very few attempts at conceptualizing the modern Russian economy, let alone at using this conceptualization as a starting point for understanding the impact of sanctions. It is hoped that this book will go some way toward filling this gap. From a practical point of view, I hope that the book will help those with an interest in understanding Russia to do so with the aid of a balanced and evidence-based account of the nature of the contemporary Russian political economy. Policymakers and other public figures prone to making hyperbolic statements about the state of the Russian economy today, and then using those statements as a basis for formulating policy and attitudes toward the country, often appear to do so without the aid of even a rudimentary understanding of Russia and its economy. It is my hope that this book will at least offer an alternative to much of the ignorance that characterizes the public understanding of Russia at the time of writing.

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The book is also intended to make a contribution to the wider field of political science and international relations that is concerned with understanding the impact of sanctions on targeted countries. As I show in Chapter 1, a large proportion of the literature that is devoted to examining the phenomenon of sanctions does so without much in the way of book-length analysis of the impact on and responses of target countries. This, I argue, is unfortunate, not least because it is difficult to take seriously the conclusions of studies that are invariably based on only superficial analyses of how target countries are affected by sanctions. Again, this weakness in the existing literature is of both intellectual and practical importance. Intellectually, some of the excellent work in the development of academic theory ought to be supported by robust empirical analysis. In this respect, there is clearly an important role to be played by language-based Area Studies scholars in providing theoretically informed analyses of how sanctions have affected countries from across the world. This need not and ought not to be the preserve of large-*N*, quantitative studies, or comparative works based on short case studies. In practical terms, understanding the dynamics of sanctions in target countries is as important as ever due to the increasing frequency with which sanctions have been employed over the past three decades. While sanctions have always been a tool of statecraft used by countries, the end of the Cold War coincided with a growing number of countries, led by the United States and the EU, using sanctions in the pursuit of their policy objectives. This led one prominent scholar in the field of sanctions to describe the post-Cold War period as the "golden era of economic statecraft" (Drezner 2015, p. 755). For some observers, this era is not nearly golden enough: A recent study by Robert Blackwill and Jennifer Harris (2016) argued that sanctions and other instruments of economic statecraft were not used enough, and that the United States should consider how to use sanctions more frequently and effectively in the future. As a result, understanding the dynamics of how sanctions affect targeted countries is more important than ever.

THE STRUCTURE OF THE BOOK

The principal purpose of the book is to examine how sanctions affected the political economy of Russia. In order to do this in as rigorous and systematic a fashion as possible, the book is organized as follows. In Chapter 1, the existing scholarship concerned with the study of sanctions is briefly surveyed. It is argued that there is a relative paucity of literature dealing with the impact of sanctions on the domestic political economy of

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target countries. A straightforward framework for analyzing how sanctions might affect a target country's political economy is outlined. In Chapter 2, the nature of Russia's system of political economy in its form at the outset of sanctions in 2014 is presented. Here, I argue that the Russian state has played an important role in coordinating the flow of natural resource revenues to other parts of the economy. This system benefited some sectors, but also constrained the development of others. The precise nature of the sanctions imposed by Western countries on Russia is laid out in Chapter 3. This is followed by a broad outline of the Russian strategic response to sanctions, which is presented as comprising three main components: the securitization of economic policy in those areas of the economy targeted by sanctions; the Russification of technology and capital in targeted sectors; and the parallel diversification of Russia's foreign economic relations beyond its traditional partners in the West, especially Europe. Chapters 4–6 focus on each of the three sectors targeted by Western sanctions: energy, defense-industrial production, and finance. In each chapter, I show the trajectory of development in each sector prior to the imposition of sanctions. This is followed by an analysis of what sanctions were put in place, how the Russian authorities responded to them, and what influence these sanctions exerted over the functioning and performance of each respective sector. In each case, I show how the three-pronged strategic response of securitization, Russification, and foreign economic diversification played out after 2014. The different threads of the argument are brought together in the conclusion, where I consider what we can learn from the Russian experience with sanctions after 2014, and what it might mean for the country's future political and economic development.

WHAT THE BOOK DOES NOT ADDRESS

It is important to be clear as to what this book is *not* about. First, the focus of the book is on how the response of the Russian state mediated the impact of sectoral sanctions in the three sectors directly targeted by Western sanctions. The decision to focus on sectoral sanctions was taken because, from a methodological perspective, it is more feasible to examine developments within key sectors of the Russian economy, where data and reports are readily available, than it is to examine how asset freezes or travel bans have affected the decision-making of individual elite political actors. In the latter case, data availability and access to key targeted individuals represents an obvious obstacle to any meaningful examination

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of the impact of how sanctions might have affected individuals in target countries. Neither is the book intended to deliver a quantitative estimate – such as "lost" GDP or tax revenues – of the dollar or ruble impact of sanctions. Quite apart from the numerous methodological difficulties in arriving at such an estimate, especially in the context of the sharp decline in oil prices that took place at around the same time the sanctions were put in place, a quantitative estimate of "losses" tells us nothing about the nature of the policy response or the qualitative changes that take place when a country responds to sanctions.

Second, because this book is intended to show how specific systems of political economy in target countries can adjust to sanctions to reduce their intended impact, Russia's so-called countersanctions in the agricultural sector are not considered either. This is because, in the case of countersanctions, Russia was acting as the "sender" country rather than as the "target." As a result, the dynamics of adjustment do not apply in precisely the same way. Thus, to maintain a consistent and coherent approach to the subject matter, the analysis is limited to Russian efforts taken in response to Western sanctions, even though many of the same concerns and motivations that were evident in Russia's response in the financial, defense-industrial and energy sectors – such as concerns for economic security and sovereignty, a commitment to import substitution, and preference for greater diversity in foreign economic relations – were also evident in Russia's own countersanctions regime (Wegren, Nilssen, and Elvestad 2016; Wegren, Nikulin, and Trotsuk, 2017). And because the focus of the book is on the target country, I do not seek to estimate the quantitative economic cost – in the form of foregone trade or investment, for example – to sender countries.

Third, because I am principally concerned with assessing how sanctions affected the dynamics of Russia's system of political economy, I do not seek to analyze whether sanctions achieved the other objectives that sender countries may have had when they were put in place. As such, whether sanctions sent a strong enough "signal" to domestic audiences of the United States or EU, or what the impact of sanctions was on third countries in "signaling" the intent of the United States and EU to uphold the "rules-based international order," are beyond the scope of the analysis. Nor do I seek to make any claims about the efficacy of Western sanctions. As I argue in subsequent chapters, the imposition of a significant economic and political cost on the target country is a necessary, although not sufficient, condition for sanctions to "work," in so far as they were designed to bring about a modification of Russia's foreign policy. As such, any

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assessment of efficacy must be preceded by an assessment of impact. Given the above, it may come as no surprise that I do not seek to deliver a verdict on the normative desirability of sanctions, either. Whether the West was "right" or "wrong" in imposing sanctions is analytically distinct from understanding the dynamics of sanctions within the target country. This book is concerned only with the latter.

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