Sanctions on Russia are increasing, not decreasing, its revenue

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The European Union has just approved new sanctions against Russia, including a price cap on oil sales, following the United States' Sept. 30

announcement of new economic sanctions. Both announcements are in response to Russia's annexation of four regions of Ukraine.

The goal of sanctions against Russia is to cripple Russia's capacity to wage war and reduce Vladimir Putin's access to the materials and financing necessary to fight.

However, because there are still countries willing to purchase Russia's petroleum products, sanctions are increasing Russia's revenue, not decreasing it.

Worse yet, the sanctions are driving up global oil and natural gas prices, causing spikes in inflation worldwide and, ironically, reducing the world's access to the metals and minerals necessary for the transition away from oil and natural gas.

Widespread impact from sanctions

In early March, the sanctions on Russia's oil sector had driven oil price estimates up to US$185 per barrel and the price of natural gas in Europe nearly reached US$500 per barrel. In late August, the price of natural gas lowered to US$410 per barrel.

As the winter approaches, Anne-Sophie Corbeau, Global Research Scholar at the Center on Global Energy Policy of Columbia University, stated that current natural gas prices of US$300 per barrel could generate not only a natural gas crisis, but also a power crisis.

This increase has had widespread effects beyond the oil and natural gas industry, impacting agricultural products, minerals and rare metals needed for green technologies, manufacturing industries and fertilizer production.

There's concern that the monetary policies implemented to contain those inflationary effects could squeeze the amount of money and assistance that have been previously directed to green energy investments.

Another concern is that some countries will revise their short- and long-term energy security policies, putting energy security before energy transition.

Sanction picking is ineffective

Unlike previous "one-size-fits-all" sanctions on Iran and Venezuela, countries boycotting Russia are only picking the restrictions they can afford. All major oil importers will need to reject Russia's oil exports for the sanctions to be effective, but so far this has not happened.

Christof Rühl, a senior research scholar at Columbia University, has described this "sanction-picking" as a reckless gamble. He's warned that energy sanctions will backfire, causing oil prices to surge, which will be economically detrimental to sanctioning countries.

The perception that sanctions on Russia's oil will economically restrain Russia does not account for the dynamics of the global oil market. The U.S. Treasury Secretary cautioned Europe against imposing full sanctions on Russia's energy exports, warning that it could result in elevated oil prices that would benefit Russia but be detrimental to the global economy.

Although Russia's crude oil has been sold at a discount this year, the price is still higher than before the pandemic. This means Russia is still making more than the minimum price needed to finance its government budget and international financial obligations.

There is also the issue of Russian oil being traded under the radar. This could result in the emergence of three distinct groups: countries that are willing to trade with Russia, countries that are energy-independent of Russia and countries that are not energy secure and must take a neutral position. This would support further sanction-picking and set us back from our global energy security and transition goals.

Reorienting international trade

Despite the sanctions, Russia's exports are still flowing into the global economy. This is because although trading firms have ceased new business with Russia, they continue to honor their contracts from before the conflict. Those contracts give trading firms the flexibility to purchase as much oil as they can every month.

Although some of Russia's exports will be lost, export flows are likely to change. Some of Russia's crude oil intended for Europe will be redirected to Asia because of the EU's reluctance to purchase Russia's oil . Refineries, particularly in China and India, are still willing to buy discounted Russian oil.

To wean itself off Russian exports, Europe is seeking to replace Russian petroleum imports with supplies from the Middle East and Asia to the extent that their contractual commitments, refining configuration and import capacity permit. One outcome of this trade reshuffling is that diesel prices in Europe will increase due to higher transportation costs.

Russia is resilient against sanctions

While some experts have argued that imposing sanctions on Russia's oil sector, rather than their gas sector, will be more effective, this isn't the case. The argument that oil is Russia's biggest source of income is not supported by .

The World Bank concentration index indicates that Russia's economy was relatively diversified in 2020, with a 0.26 concentration index. To put that in context, Saudi Arabia was in the top 20 percent of least diversified economies with a 0.55 concentration index.

Russia has also shifted away from western markets, toward the Chinese market, since following its annexation of Crimea.

This means that imposing sanctions on Russia's oil sector will have limited effects on Russia's economy.

What can be done?

The sanctions against Russia are strangling an important international source of energy, critical metals and minerals, causing non-renewable and green energy shortages, and driving up inflation. Given the role Russia plays in energy supply, the global economy could soon be faced with one of the largest energy supply shocks ever.

Ultimately, the impact of oil sanctions on Russia is limited, while repercussions on the global economy and countries' abilities to achieve energy security and transition are severe.

As Nikos Tsafos, the previous energy chair at the Center for Strategic and International Studies wrote in March: "A weapon is most useful when aimed at something—it is not clear what the western weaponization of energy exports is meant to accomplish exactly."

It is time to evaluate the economic costs of the sanctions on the world and on Russia. Polls show inflation is the most pressing issue for the public in many countries. There is room for political leaders to make the case that some sanctions are not working and should be changed.

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