"Sanctions Priorities 2023": Key Messages

Prepared by KSE Institute Sanctions Team, February 24th, 2023

Sanctions have had a major impact so far: They nearly triggered a financial crisis in Russia last spring, and they have forced a contraction in Russia despite high energy prices. Among other impacts, sanctions have driven a discount in Russian oil which has reduced oil revenues by $64 bn over the last year, output in the Russian car industry is running at less than half its pre-invasion level, and Russia has lost its role as a key energy supplier to Europe, which the IEA estimate will cost Russia $1 trillion by 2030.

And the impact is increasing: While sanctions have not stopped the invasion, the shield of high oil and gas revenues which protected Russia's economy last year has been eroded, as sanctions drove a deep discount on Russian oil, and Europe stopped purchases of Russian gas. As a result, Russia's economy is under increasing pressure: the trade balance has narrowed sharply, the ruble has fallen 20% in the last 3 months, and the deficit has widened sharply, forcing Russia to step up domestic borrowing and use of the oil fund.

Now Ukraine's allies should finish the job with a "sanctions for victory" package: Even on current policies, we forecast that Russia's economy will contract more deeply than last year (-5% vs -2.1%), and the deficit will widen (-2.1% to -6% of GDP), as oil and gas export revenues halve from $350 bn to $170 bn. But the evidence of the cumulative effectiveness of sanctions highlights a clear opportunity to intensify them to constrain Russia more rapidly. On the anniversary of Russia's full-scale invasion, we call on Ukraine's allies to accelerate the end of the war, through a comprehensive sanctions package.

The proposed package has three pillars:

1. **Constraining Russia:** Oil and gas are the lifeblood of the Russian economy, accounting for over 60% of exports and over 40% of budget revenues. The key is to target this vulnerability. With production costs of $10-15/bbl, the oil price cap can be ratcheted much lower without undermining the incentive to supply. We propose to reduce the oil price cap from the current $60/bbl to $30/bbl, while strengthening enforcement. At this oil price, Russia will be constrained by its weak currency and banks, and wide budget deficit. To reinforce this impact, we also call for an end to direct Russian gas sales to Europe, a ban by Japan, South Korea and Taiwan on Russian oil, coal and LNG, a price cap on nitrogen fertiliser exports, ,eand bans on further goods, including diamonds, uranium, iron ore, steel products, timber and fish.
2. **Isolating Russia.** More systematic and comprehensive sanctions will underline that there will be no normal relations with Russia until it stops trying to redraw borders by force, and withdraws from Ukraine. In particular we propose full sanctions on the main companies in the oil and gas industry, now that the West is no longer dependent on Russian energy, on the main metals and mining companies, which are key suppliers to the Russian military, and further steps to tighten financial sanctions by sanctioning Gazprombank, and requiring exit of remaining Western banks from Russia. Further, we propose to sanction every legal entity in the Russian military-industrial complex, every senior Russian official and every Russian official acting in Ukraine, as well as impose a licensing regime on all high-technology exports to Russia or Russian companies.
3. **Making Russia Pay.** Russia has talked of "outlasting" Ukraine. In the name of justice, we propose to confiscate frozen Russian assets and start to disburse them this year, under international governance and with transparent reporting, to pay compensation to all Ukrainians, and more to those killed, injured and displaced by Russia's invasion, and to finance Ukrainian reconstruction. This funding – including $300 bn in frozen Russian official assets – provides a funding backstop for the Ukrainian economy, currency and budget, which may need exceptional funding of $40-50 bn pa in wartime, for the war's duration. At a stroke, this undermines any Russian plan to exploit donor fatigue to outlast Ukraine.

Mechanically, we estimate that this package will:

- reduce Russia's exports by a further $70 bn, eliminating Russia's current account surplus.
- widen the budget deficit from 6% to 8-9% of GDP, consuming all liquid assets in the oil fund this year.
- reduce growth by a further 2-3% of GDP from a 5% of GDP contraction to a 7-8% contraction.

This economic and fiscal deterioration will put Russia's economy and budget into a fragile and constrained state, with high risks of a weak currency and bank runs, unless policy is tightened aggressively. And tighter policy – higher rates and fiscal consolidation – will itself constrain Russian action.

Summary: 10 Point Sanctions Package

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The 10 point sanctions package to constrain Russia and accelerate the end of the war, consists of:

Pillar One: Constrain Russia

1. Oil Price Cap. Ratchet down the crude oil price cap to $30/bbl, and the product price caps to $15/bbl for low value products and $70/bbl for high value products, while strengthening enforcement, to put the Russian budget, economy and currency into a fragile state, with a wide deficit, a deep contraction and a chronically weak currency.

2. European Gas. Close the European Union to direct sales of Russian gas, preventing supplies into the EU from the Turkstream pipeline and ending Russian LNG sales to Europe, leaving the Ukrainian GTS as the sole source of supply for Russian gas into Europe.

3. Other exports. Japan, South Korea and Taiwan to follow the European example and ban Russian coal, oil and LNG, with targeted exemptions if necessary. Extend the price cap mechanism to fertilizer, only allowing fertilizer to be sold into Ukraine's allies at a price consistent with a gas price under $175/mcm (gas equivalent of $30/bbl), unless it is exported via the Togliatti-Odessa pipeline. Further bans on Russian goods, including mined uranium, diamonds, iron ore, steel products, timber, and fish.

Pillar Two: Isolate Russia

4. Oil and Gas industry. Now that the West is no longer directly dependent on Russian energy, impose full sanctions on all Russian oil and gas companies, including Rosneft, Gazprom, Gazpromrneft, Zarubzhneft, Surgutneftegaz, Lukoil, Novatek, Tatneft, Transneft and Sibur.

5. Mining Industry. Full sanctions on the main companies in Russia's metals and mining industry who are key suppliers to the Russian military, notably MMK, NLMK, Evraz, Severstal, Mechel, Rusal and Uralsteel.

6. Finance. Full sanctions on Gazprombank, MTS, Rosselkhozbank, Credit Bank of Moscow, Bank Dom RF, Bank St Petersburg. ECB to require Unicredit and Raiffaisen to exit Russia by year end.

7. Military. Full sanctions on every Russian and Belarussian military-industrial enterprise, including all legal entities in the military-industrial complex, to complicate the smuggling of the components needed for their weapons. Strengthen the export licensing process, increasing enforcement capabilities, and implement stricter end-use restrictions.

8. Technology. Impose a licensing regime for all high-technology exports to Russia/Belarus or to Russian/Belarussian companies, and strengthen enforcement.

9. Personal. Sanctions (asset freeze and visa ban) on every senior Russian government official and senior SOE official, as well as on officials (e.g. CBR, Rostelekom, Rosatom) working in the occupied territories or who visit sovereign Ukrainian territory without permission of the Ukrainian government. Maintain a ban on Russian/Belarusian athletes participating in international sporting competitions, in particular the Olympics.

Pillar Three: Make Russia Pay

10. Confiscate and Disburse. Confiscate frozen Russian assets, both state and private, and start to spend them on compensation and reconstruction, through a fund with international oversight and enhanced governance and reporting. Target initial payment of a compensation payment to every Ukrainian this calendar year.