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U.S. Sanctions Against Russia:

Theory, Scope, and Intended and Unintended Consequences for the Investment Behavior of Russian Business Owners

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Abstract

The purpose of this research paper is to explore the use of sanctions against Russian individual businessmen. It seeks to understand how the sanctioning of individuals fits into the overall policy of U.S. sanctions against Russia. It asks what specific sanction policies goals were furthered by sanctioning specific businessmen, for what actions they were selected as targets of the sanctions and if there is a logical connection between the two. Finally, it asks if the sanctions were effective and if there were any unintended consequences of them.

I. Introduction

This paper explores the use of sanctions against Russian individual businessmen. It seeks to understand how the sanctioning of individuals fits into the overall policy of U.S. sanctions against Russia. It asks what specific sanction policies goals were furthered by sanctioning specific businessmen, for what actions they were selected as targets of the sanctions and if there is a logical connection between the two. Finally, it asks if the sanctions were effective and if there were any unintended consequences of them.

II. Post-Cold War U.S. Sanctions Against Russia

Beginning with the death of Sergei Magnitsky in a Russian prison in 2009, the United States has imposed a range of sanctions against Russian individuals for different reasons and with different purposes.

A. Magnitsky Act

The Magnitsky Act was signed into law by President Obama in December 2012 after being passed by the Senate 92-4 (TITLE IV of 112th Congress Public Law 208). It cited the purpose of the law as, “that the United States should continue to strongly support, and provide assistance to, the efforts of the Russian people to establish a vibrant democratic political system that respects individual liberties and human rights, including by enhancing the provision of objective information through all relevant media, such as Radio Liberty and the internet.” It cites Russia’s international commitments to human rights and, besides describing the case of Magnitsky in great detail, including the conclusions of Russia's own Human Rights Council, it lists 24 victims of murder or human rights abuses.

It targets those responsible for Magnitsky’s detention, abuse and death and those involved in the “criminal conspiracy” that he uncovered. Importantly, it also sanctions anyone, “responsible for extrajudicial killings, torture, or other gross violations of internationally recognized human rights committed against individuals seeking to” expose illegal activity by Russian Government officials or anyone attempting to exercise or promote human rights. It requires the President to identify and list such individuals within 120 days and update the list regularly thereafter. Thus, the Act establishes a basis for future sanctioning of any Russia official or other person deemed to have committed a gross violation of someone's human rights.

The sanctions against the listed individuals were freezing their U.S. assets (Section 406) and making them ineligible for visas (Section 405).[1]

B. Sanctions Related to Russia's Annexation of Crimea and Activities Related to Ukraine

During 2014 President Barack Obama issued three Executive Orders enacting sanctions against Russia regarding Ukraine (No. 13660 - 79 Fed. Reg. 1349; No. 13661 - 79 Fed. Reg. 15535; No. 13662 - 79 Fed. Reg. 16169), which were then reinforced by two laws enacted that year: the Support for the Sovereignty, Integrity, Democracy, and Economic Stability of Ukraine Act of 2014, signed into law April 3rd (Public Law 113–95), and the Ukraine Freedom Support Act signed on December 18th (Public Law 113–272; 22 U.S.C. 8921).

The Support for the Sovereignty, Integrity, Democracy, and Economic Stability of Ukraine Act was the primary law that enacted sanctions against Russia for its activities against Ukraine. The purpose of the law was to support the territorial integrity of Ukraine and its independence as a democracy oriented towards the European Union and the West. Its Section 8 targeted sanctions against any individual, including Russian Government officials, who directly participated in acts undermining the territorial integrity of Ukraine or who "materially assisted, sponsored, or provided financial, material, or technological support for, or goods or services in support of" its undermining.

Section 9 further targeted any individual, including Russian Government officials, "responsible for, or complicit in, or responsible for ordering, controlling, or otherwise directing, acts of significant corruption in the Russian Federation, including the expropriation of private or public assets for personal gain, corruption related to government contracts or the extraction of natural resources, bribery, or the facilitation or transfer of the proceeds of corruption to foreign jurisdictions." This broad clause was apparently spurred by the effort to track down and return to Ukraine assets stolen by the former president of Ukraine Yanukovich and his associates, but as worded covers all corruption occurring in Russia, whether connected to Russia's actions in

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[1] U.S. Government Printing Office, 112th Congress Public Law 208, December 12, 2020, https://www.govinfo.gov/content/pkg/PLAW-112publ208/html/PLAW-112publ208.htm

Ukraine or not. Like the Magnitsky Act, the sanctions froze U.S. assets and excluded individuals from the U.S.[2]

Thus this Act added corruption in general to human rights violations as a basis for establishing sanctions against a Russian organization or individual.

The Ukraine Freedom Support Act's purpose was "to further assist the Government of Ukraine in restoring its sovereignty and territorial integrity to deter the Government of the Russian Federation from further destabilizing and invading Ukraine and other independent countries in Central and Eastern Europe, the Caucasus, and Central Asia." It established two different sanctions regimes for two sets of activities: (a) defense exports to Syria, Ukraine, Georgia and Moldova and other countries that the President might specify; (b) development of "special Russian crude oil projects." The latter were defined not as specific projects, but rather as any project in any of three categories of technologically challenging projects that would benefit from foreign expertise, including "shale formations" in Russia.

Regarding (a), the Act targeted Russian organizations and individuals and *required* that the President enact at least three of the nine sanctions in the list. Regarding (b), the Act targeted *foreign* organizations and individuals and stipulated that the President *may* enact three or more of the same nine sanctions. The nine potential sanctions included the typical visa ban and asset freezing, but also a prohibition for all individuals and organizations subject to U.S. regulation to conducting investment, trade, banking and property transactions with the sanctioned foreign person. Section 5 of the Act also gave the President specific authority to apply the sanctions to any Russian or other foreign financial institution that violated it.

This Act constituted a major expansion of sanctions against Russia in two ways:

First, in sanctioning broad categories of oil field development projects, it departed from sanctioning only individuals and organizations involved in specific Russian activities to which the U.S. objected as being illegal – cases of violations of individual human rights or corruption. Thus for the first time a Russian individual could be sanctioned for doing something that was not against Russian or international law.

Second, it was the first time that U.S. sanctions against Russia potentially targeted non-Russians, thus creating the goal of not only sanctioning Russians by keeping them and their

[2] U.S. Government Printing Office, 113th Congress Public Law 95, December 12, 2020, https://www.govinfo.gov/content/pkg/PLAW-113publ95/html/PLAW-113publ95.htm

assets out of the U.S., but of effectively blocking them from ANY financial activity outside of Russia. For example, the sanctions effectively force internationals banks and other companies to choose between retaining a sanctioned Russian customer or ceasing business with the U.S. However, it is important to note that the Act gave the President the *option* of imposing such sanctions but did not *require* him to do so – however, later Section 226 of the CAATSA changed "may impose" to "shall impose".

When combined with making high tech oil projects the subject of sanctions, it also effectively created the goal of preventing Russia from developing its oil reserves.[3]

C. Countering America's Adversaries Through Sanctions Act (CAATSA)

Signed into law on August 2nd 2017 as 115th Congress Public Law 44) after being passed by votes of 419-3 and 98-2, with Title II applying to Russia, and entitled, "Countering Russian Influence in Europe and Eurasia Act of 2017."

The purpose of Title II of CAATSA is described in several paragraphs. It was the sense of the Congress that the President should "vigorously enforce compliance" with existing sanctions against Russia regarding "the crisis in eastern Ukraine, cyber intrusions and attacks,and human rights violators in the Russian Federation." Part 1 of the Act sought to limit the President's ability to remove sanctions already applied by allowing Congress the opportunity to issue "Joint Resolutions of Disapproval" to block such actions. Part 2 of the Act codified the sanctions established by the three 2014 Executive Orders listed above, a fourth Order on Ukraine and two Orders on cyber election interference. Section 223 effectively expanded the scope of the existing sanctions to target U.S. persons in addition to foreign persons who support the "special Russian energy projects" and other activities specified in the existing Orders and laws.

Once again, Section 226 made it mandatory for the President to sanction foreign actors involved in Russian advanced technology energy projects. Section 227 changed the provision of the Stability of Ukraine Act of 2014 that "encouraged" the President to impose sanctions on corrupt activities inside Russia to say that he "shall" do so. The Act also modifies existing law to add sanctions on human rights abuses in "any territory forcibly occupied or otherwise

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[3] U.S. Government Printing Office, 115th Congress Public Law 272, December 12, 2020,https://www.congress.gov/bill/113th-congress/house-bill/5859/text?overview=closed

controlled" by Russia. Section 233 added investment in privatization of Russian state-owned companies where officials or their families "unjustly benefit" to the list of activities that the President is required to sanction.

Section 224 added the category of cybersecurity to the subject areas where the President is *required* to impose sanctions on anyone "engages in significant activities undermining cybersecurity against any person, including a democratic institution, or government on behalf of" Russia. Section 231 adds transactions with the Russian defense and intelligence sectors to the basis for sanctions.

In another major addition to the categories of sanctions, Section 232 added pipelines as a category of activity where the President *may* impose sanctions on any person involved in their development. This measure effectively put at risk another major sector of the Russian economy and foreign investment in it.

Section 241 "Report on Oligarchs and Parastatal Entities of the Russian Federation"

For the purposes of this research this section is of particular interest. It required that within 180 days the President identify the "most significant senior foreign political figures and oligarchs in the Russian Federation, as determined by their closeness to the Russian regime and their net worth." For each person on the list the report had to: (a) assess their ties to Putin and "other member of the Russian ruling elite"; (b) assess their level of corruption; (c) estimate individual and family net worth and business interests; (d) list non-Russian business affiliations. Point (5) of the section requires the President to report on "The potential impacts of imposing secondary sanctions with respect to Russian oligarchs, Russian state-owned enterprises, and Russian parastatal entities, including impacts on the entities themselves and on the economy of the Russian Federation, as well as on the economies of the United States and allies of the United States."[4]

Overall, CAATSA represented the broadest U.S. sanctioning of Russia since the height of the Cold War and effectively declared economic war on Russia in response to its ongoing undermining of Ukraine as a state, cyber interference in U.S. and European domestic politics and support for the Assad government in Syria.

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[4] U.S. Government Printing Office, 115th Congress Public Law 44, December 12, 2020, https://www.govinfo.gov/content/pkg/PLAW-115publ44/html/PLAW-115publ44.htm

D. Oligarch Lists and Specific Sanctions Against Russian Businesspeople

On January 29, 2018 the Treasury Department issued the report required by Section 241 of the CAATSA listing 96 "individuals who, according to reliable public sources, have an estimated net worth of $1 billion or more." It emphasized that the list was in no way connected to any activities of the listed individuals and noted that any individual who was "separately subject to sanctions pursuant to sanctions established in U.S. law are denoted with an asterisk (*)." Of the oligarchs listed four individual with close personal connections to Vladimir Putin had asterisks: Yuri Kovalchuk, Arkady & Boris Rotenberg, and Gennady Timchenko.

On April 6, 2018, the Department's Office of Foreign Assets Control (OFAC) designated seven oligarchs from the list (as well as 17 senior Russian officials) for sanctions under CAATSA. It stated that, "Russian oligarchs and elites who profit from this corrupt system will no longer be insulated from the consequences of their government's destabilizing activities…. All assets subject to U.S. jurisdiction of the designated individuals and entities, and of any other entities blocked by operation of law as a result of their ownership by a sanctioned party, are frozen, and U.S. persons are generally prohibited from dealings with them. Additionally, non-U.S. persons could face sanctions for knowingly facilitating significant transactions for or on behalf of the individuals or entities blocked today."[5] The table below lists the individuals and descriptions of them found in the press release.

OLIGARCH	DESCRIPTION
Vladimir Bogdanov	designated for operating in the energy sector of the Russian Federation economy. Bogdanov is the Director General and Vice Chairman of the Board of Directors of Surgutneftegaz, a vertically integrated oil company operating in Russia. OFAC imposed sectoral sanctions on Surgutneftegaz pursuant to Directive 4 issued under E.O. 13662 in September 2014.
Oleg Deripaska	designated pursuant to E.O. 13661 for having acted or purported to act for or on behalf of, directly or indirectly, a senior official of the Government of the Russian Federation, as well as pursuant to E.O. 13662 for operating in the energy sector of the Russian Federation economy. Deripaska has said that he does not separate himself from the Russian state. He has also acknowledged possessing a Russian diplomatic passport, and claims to have represented the Russian government in other countries. Deripaska has been investigated for money laundering, and has been accused of threatening the lives of business rivals, illegally wiretapping a government official, and taking part in extortion and racketeering. There are also allegations that Deripaska bribed a government official, ordered the murder of a businessman, and had links to a Russian organized crime group.

[5] U.S. Department of the Treasury website, December 12, 2020, https://home.treasury.gov/news/press-releases/sm0338

Suleiman Kerimov	designated for being an official of the Government of the Russian Federation. Kerimov is a member of the Russian Federation Council. On November 20, 2017, Kerimov was detained in France and held for two days. He is alleged to have brought hundreds of millions of euros into France – transporting as much as 20 million euros at a time in suitcases, in addition to conducting more conventional funds transfers – without reporting the money to French tax authorities. Kerimov allegedly launders the funds through the purchase of villas. Kerimov was also accused of failing to pay 400 million euros in taxes related to villas.
Igor Rotenberg	designated for operating in the energy sector of the Russian Federation economy. Rotenberg acquired significant assets from his father, Arkady Rotenberg, after OFAC designated the latter in March 2014. Specifically Arkady Rotenberg sold Igor Rotenberg 79 percent of the Russian oil and gas drilling company Gazprom Burenie. Igor Rotenberg's uncle, Boris Rotenberg, owns 16 percent of the company. Like his brother Arkady Rotenberg, Boris Rotenberg was designated in March 2014.
Kirill Shamalov	designated for operating in the energy sector of the Russian Federation economy. Shamalov married Putin's daughter Katerina Tikhonova in February 2013 and his fortunes drastically improved following the marriage; within 18 months, he acquired a large portion of shares of Sibur, a Russia-based company involved in oil and gas exploration, production, processing, and refining. A year later, he was able to borrow more than one $1 billion through a loan from Gazprombank, a state-owned entity subject to sectoral sanctions pursuant to E.O. 13662. That same year, long-time Putin associate Gennady Timchenko, who is himself designated pursuant to E.O. 13661, sold an additional 17 percent of Sibur's shares to Shamalov. Shortly thereafter, Kirill Shamalov joined the ranks of the billionaire elite around Putin.
Andrei Skoch	designated for being an official of the Government of the Russian Federation. Skoch is a deputy of the Russian Federation's State Duma. Skoch has longstanding ties to Russian organized criminal groups, including time spent leading one such enterprise.
Viktor Vekselberg	designated for operating in the energy sector of the Russian Federation economy. Vekselberg is the founder and Chairman of the Board of Directors of the Renova Group. The Renova Group is comprised of asset management companies and investment funds that own and manage assets in several sectors of the Russian economy, including energy. In 2016, Russian prosecutors raided Renova's offices and arrested two associates of Vekselberg, including the company's chief managing director and another top executive, for bribing officials connected to a power generation project in Russia.

III. The Theoretical Framework for Sanctions

Within the realm of foreign policy, theorists have described the range of tools that a country has to influence the behavior of other countries, from their internal governing structures and conduct towards their own people, to their policies towards their neighbors and the outside world in general. The latter includes everything from import and export policies and tariffs to invading other countries or interfering in their domestic politics. Of course, the ability of one country to influence another is related to the relative power of the two countries and how they are connected geographically, economically and culturally. Importantly, the fact that a tool is available does not mean that it will be used – a country will weigh the cost of using a tool versus the benefit likely to be achieved from using it.

Beginning in 1990 Joseph Nye created a framework for categorizing those tools: “hard power” and “soft power”. He described them this way: “when one country gets other countries to want what it wants might be called co-optive or soft power in contrast with the hard or command power of ordering others to do what it wants.”[6] He argued that, “Seduction is always more effective than coercion, and many values like democracy, human rights, and individual opportunities are deeply seductive.”

Hillary Clinton elaborated on applying soft power in diplomacy when she put forth the concept of modernizing U.S. foreign policy to employ “economic statecraft”, with soft power tactics being among its tools. Stating that, “America’s economic strength and our global leadership are a package deal”, she proposed that the U.S., “harness the forces and use the tools of global economics to strengthen our diplomacy and presence abroad.” She cited as an example U.S. efforts to help Russia join the WTO. She argued for applying “market-minded creativity and sophistication in addressing security challenges. Regarding sanctions, she advocated using “ever more targeted and hard-hitting tools, not only sanctions against leaders and generals…but more sophisticated measures to cut these regimes off from insurance, banking, and shipping industries as well as the shell companies that they depend on. We are committed to raising the economic cost of unacceptable behavior and denying the resources that make it possible.”[7]

In 2012 Clinton described how widely adopted sanctions in which the EU and in some cases even China and Russia participated, were being used “to address one of the world's preeminent security challenges: Iran. A broad coalition is revolutionizing how the international community enforces sanctions and builds pressure. We went after Iran's central bank and finance sector, and we reached out to private insurers, shippers, oil companies, and financial institutions to help us target pressure points that make it harder for companies and governments to do business with Iran…Now, regimes in places like Tehran and Pyongyang, that violate

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[6] Nye, Joseph S. (1990), Bound to Lead: The Changing Nature of American Power, 1990, New York, Basic Books, ISBN 9780465001774.

[7] U.S. Department of State, Hillary Clinton remarks, October 14, 2011, https://2009-2017.state.gov/secretary/20092013clinton/rm/2011/10/175552.htm

international norms and beggar their people in pursuit of greater military strength pose a stark contrast with emerging economic powers that are delivering benefits for their people."[8]

Indeed, research has shown that sanctions can be effective when the measures applied are supported by all of the target country's key partners in the relevant industry. In May 2014, as the U.S. applied its first sanctions against Russian for its violations of Ukraine's territorial integrity, Gary Hufbauer and his colleagues published commentary on their potential effectiveness. Hufbauer has published three editions of his authoritative analysis of the history of sanctions, *Economic Sanctions Reconsidered*, and noted that the book "lists past sanction cases in the category of attempts to disrupt military action when the target country is medium-sized or larger", with an average success level of only 5 on a scale of 1 to 16. They offered several "general lessons"[9]:

- Don't Overreach: Forestalling an invasion of eastern Ukraine vs. overturning the annexation of Crimea
- Russian economic integration with the West provides leverage
- Don't count on Russian public opinion
- Look before you leap: "weigh means and objectives against unintended costs and consequences"

In a 2017 Foreign Affairs article, Walker and Ludwig describe the aggressive, but increasingly refined, use of "sharp power" by the authoritarian governments of Russia and China. They state that, "Russian officials…determined that they did not need to convince the world that their autocratic system was appealing in its own right. Instead, they realized that they could achieve their objectives by making democracy appear relatively less attractive" - undermining the idea of Western democracy as a model for society. "Sharp power likewise enables the authoritarians to cut into the fabric of a society, stoking and amplifying existing divisions…. [it] captures the malign and aggressive nature of the authoritarian projects, which bear little resemblance to the benign attraction of soft power."[10]

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[8] U.S. Department of State, Hillary Clinton remarks, November 17, 2012, https://2009-2017.state.gov/secretary/20092013clinton/rm/2012/11/200664.htm

[9] Gary Clyde Hufbauer, Cathleen Cimino-Isaacs, Tyler Moran, "Ukraine-Related Sanctions: Facts and Assessment", Peterson Institute for International Economics, May 12, 2014, https://www.piie.com/blogs/trade-investment-policy-watch/ukraine-related-sanctions-facts-and-assessment

[10] Christopher Walker and Jessica Ludwig, "The Meaning of Sharp Power", Foreign Affairs, November 16, 2017, https://www.foreignaffairs.com/articles/china/2017-11-16/meaning-sharp-power

Thus, sharp power is kind of the flip side of soft power – if a country does not have the positive image to aspire to what is soft power, then disrupt the soft power of countries whose ideals and image are perceived to present a threat to the stability of your system. It is also an attractive tool for countries like Russia and China because, unlike sanctions, it does not put at risk the exports on which their economies are so dependent. More broadly, other conservative, often authoritarian, leaders (such as Orban in Hungary, Morawiecki in Poland and Duterte in the Philippines) have successfully gained followings by rejecting the current trends in liberal democracies of the West as attacking traditional values of their societies. They essentially seek to reject Nye's argument that the "human rights, and individual opportunities" of today remain "deeply seductive" to the people that they lead.

The above unexpected turn of events – members of the European Union rejecting the liberal lead of their older and larger sister nations whom they presumably aspired to emulate when they joined the EU – reminds us that perhaps we have not reached the 'end of history' and that not every country in the world is on an inevitable path towards adoption of Western liberal values. Raymond Cohen, in his foundational book *Negotiating Across Cultures,* extensively laid out the fundamental difference in outlook and priorities between high-context based cultures traditionally associated with the East and the low context culture of the West. If indeed high-context cultures do not view Western liberalism as an aspirational goal, then how effective will Nye's Western soft power be in countries whose people don't find them "deeply seductive" and whose governments view them either a threat to their power or a useful political rallying cry for consolidating the support of conservative constituents?

The sanctions that the U.S. has implemented against Russia are designed to be "smart sanctions" that affect specific individuals and businesses that are directly related to the state's capabilities, while avoiding collateral damage to average citizens and the state's economy as a whole. Such sanctions are intended to punish a government or specific elites, while not seeking to cut off all ties with the country. The U.S. has employed such sanctions when it seeks to change specific policies rather than create the type of economic hardship that it might hope would lead the people to throw out their government – i.e., seek "regime change".

IV. Effects of the Sanctions

The U.S. laws outlined above created both mandatory and potential sanctions, the latter at the discretion of the President. This section will briefly look at the effect of the laws on the Russian policies that were the stated reasons for the enactment of the sanctions, on the overall economy of Russia, and on the Government officials sanctioned. It will then look in more detail at the effect on Russian oligarchs and business investors in general.

In the section above Hufbauer advised that, "it may make more sense to achieve the modest goal of thwarting an impending invasion of Eastern Ukraine than to try to reverse the *fait accompli* of Russia's annexation of Crimea." Indeed, if we look back at all of the Russian actions and potential actions that prompted the sanctions, it can be argued that in no case did Russia reverse its policies: it did not give back Crimea or end its support for Assad in Syria. However, Russia did refrain from openly invading eastern Ukraine with its armed forces to take over the regions and annex them like it did Crimea. It also does not seem to have extensively interfered in the 2020 U.S. Presidential elections, although some attempts were made to spread false information about candidates.

In 2014 it appears that the European Union, led by Germany, joining the U.S. in sanctions took the Russian leadership by surprise and created real concern that Russia's energy relationship with the EU would be in jeopardy if it moved to take over additional territories. Similarly, EU push back against interference in its internal politics and negative outcomes for local politicians preferred by Russia after the exposure of Russian financial support seems to have led Russia to conclude that further large-scale interference would be counter-productive.

Although only a relatively small number of Russian businesses and oligarchs have actually been sanctioned by the Treasury Departments of the Obama and Trump administrations, the effect of declaring that sanctions shall or may be imposed for doing business with any Russian company engaged in high technology oil exploration projects, in pipeline projects or in facilitating corruption, creates great risks for financial institutions that often prompts them to decline new business. In an overview of sanctions written for the Council on Foreign Relations, Jonathan Masters wrote:

"Experts say that these measures fundamentally reshaped the financial regulatory environment, greatly raising the risks for banks and other institutions engaged in suspicious

activity, even unwittingly. The centrality of New York and the dollar to the global financial system means these U.S. policies are felt globally.
Penalties for sanctions violations can be huge in terms of fines, loss of business, and reputational damage. Federal and state authorities have been particularly rigorous in prosecuting banks in recent years, settling at least fifteen cases with fines over $100 million since 2009. In a record settlement, France's largest lender, BNP Paribas, pleaded guilty in 2014 to processing billions of dollars for blacklisted Cuban, Iranian, and Sudanese entities. The bank was fined nearly $9 billion—by far the largest such penalty in history—and lost the right to convert foreign currency into dollars for certain types of transactions for one year."[11]

In a recent Wilson Center discussion of U.S. sanctions, Daniel Ahn, Chief U.S. Economist and Head of Macroeconomic Strategy, BNP Paribas, stated that, "What has happened is by denying key Western financial legal technological and other services that may account for a relatively small amount of value added but are actually critical for the operations of said company, we have had an outsized impact upon the Russian economy."[12] In the commentary cited above, Hufbauer wrote that, "Russia's GDP was expected to grow by 3 percent earlier in 2014, but the IMF reduced this projection to 1.3 percent in early April and cut the figure again to 0.2 percent at the end of April. Since the US and EU sanctions have thus far been incremental and limited to high-profile individuals and a few entities, their adverse impact has been felt mainly through declining confidence in the Russian economy and a dip in financial markets."

How have sanctions ended up affecting the Russian economy? In 2019 Rodney Ludema and Daniel Ahn at Georgetown published a study on the economics of targeted sanctions. Their analysis of collateral damage of the sanctions on the Russian economy concluded that "oil prices manage to drive the majority of Russian economic performance since 2004, with sanctions playing a secondary role compared to oil prices at the macroeconomic level. From peak-to-trough, Russia's real GDP declined by about 5 percent, and therefore at most 20 percent of that, or 1 percent of GDP can be potentially explained by sanctions." They also looked at the impact of Russia's lower GDP and its counter-sanctions of the economies of the EU and found that "sanctions and countersanctions have had a small effect on the economies of most EU countries. Adding together the impacts of sanctions and countersanctions on exports –the main vulnerability –gives a median impact across EU countries of just -0.13 percent of GDP."

[11] Jonathan Master, "What Are Economic Sanctions?", Council on Foreign Relations, August 12, 2019, https://www.cfr.org/backgrounder/what-are-economic-sanctions
[12] "The Primacy of Sanctions: An Assessment of U.S. Sanctions on Russia", Wilson Center, December 7, 2020, https://www.wilsoncenter.org/event/primacy-sanctions-assessment-us-sanctions-russia?

What about the companies targeted by the sanctions? Ahn and Ludema found that "targeted companies are indeed harmed by sanctions relative to their nontargeted peers. On average, a targeted company loses roughly one-quarter of its operating revenue, over one-half of its asset value, and about one-third of its employees after being added to a targeted sanctions list compared to non-targeted peer companies. These estimates, which are large, statistically significant and robust, suggest targeted sanctions do have a powerful impact on the targets themselves." They also concluded that "minority-owned subsidiaries of sanctioned companies (which technically are not themselves sanctioned) suffer similar losses." Sanctioned companies considered strategic by the Russian Government were given bail outs to keep them performing their strategic functions. They concluded that "the total cost to the Russian government from sanctions related bailouts during the 2014-2016 period was a significant share (about 45 percent) of the overall cost of sanctions to the country."[13] The 43 page paper describes a rigorous quantitative analysis that they authors made analyzing the full set of sanction companies and their subsidiaries – 542 sanctioned firms plus 2,290 subsidiaries, with 77,995 peer companies from the same industries used as a basis of comparison.

Unfortunately, the strong research by Ahn and Ludema does not help us understand what effect the sanctions have had on the wealth and businesses of the seven oligarchs listed in the April 2018 sanctions. The sanctioned companies can be divided into three categories: state-owned corporations, privately owned companies whose primary customers are the Russian Government and projects financed by the Russian national budget, and other companies that primarily provide goods or services to other private companies or directly to consumers. Unfortunately, the research above has no way of separating the sanctioned companies and their subsidiaries by these categories. To date, no other research on the effects of the sanctions has been published and thus there is no existing work that we can utilize to draw conclusions.

[13] Daniel Ahn & Rodney Ludema, "The Sword and the Shield" the Economics of Targeted Sanctions", CESFIO WORKING PAPERS, April 2019.

V. Effects of the Sanctions on the Investment Behavior of Russian Entrepreneurs

Therefore, to attempt to evaluate the effect of the sanctions on the oligarchs, their businesses, and on the behavior of Russian businesspeople in general I took two approaches. The first is a purely logic and culturally based approach, and the second is data based. I used the logic-based approach to develop a hypothesis, then I searched for data to confirm or refute the hypothesis.

The logic-based hypothesis development begins with analyzing the mentality of Russian businesspeople. During 20 years of working in commercial real estate in Moscow I had the opportunity to work with dozens of private business owners, from oligarchs such as Mikhail Khodorkovsky and Len Blavatnik, to small entrepreneurs who developed manufacturing and services businesses from scratch. The company that I led (now called CBRE) also employed over 500 Russians from across the country.

The primary factor that is relevant here is how Russian businesspeople evaluate risk when making investments and deciding what to do with excess capital accumulated beyond the working capital needs of their business. They have the option of (a) re-investing it in the current business in the current location, (b) investing in business in a new location, or (c) setting aside reserves for long term capital appreciation. Regarding options (b) and (c), they may choose a location inside Russia or abroad.

In my experience, most Russians would take their first excess capital and reinvest part of it in their existing business if they saw opportunities for growth and put part of it aside for long term appreciation – both in their home market that they know and can best evaluate the risk. In Russia since the collapse of the Soviet Union there have been at least three major banking crises and four devaluations of the ruble. As a result, Russians do not view putting rubles in a privately owned bank as a means of "capital preservation". Sophisticated Russian investors who work in the finance sector would likely park some money in rubles in a major state bank and another portion of their capital in Euros or USD in the Russian subsidiary of an international bank.

But all Russians, including sophisticated investors, know from experience that the most currency neutral investment that is also immune to the next banking collapse is an investment in Moscow real estate, particularly an apartment located near a metro station. Owning the place where one lives is the first financial goal of every Russian. Owning a dacha or an apartment nearby for one's child (most Russians only have one) is generally the second. For a Russian small entrepreneur, the first excess capital often goes to buying office space for one's business. Thus, condominium-ownership business centers with dozens of owners became very successful developments over the past twenty years.

Most successful Russian businesspeople understand the principle of diversifying risk and thus eventually seek alternatives for their excess capital other than buying a yet another apartment or more office space in Moscow. Most of them also enjoy traveling abroad – to London, New York, Miami, Italy, and/or France. And while it is satisfying to be able to afford to conspicuously pay for suites in the best hotels, they recognize that repeatedly doing so is not a means of preserving capital for long term appreciation. Thus, traditionally the next step in risk diversification and capital preservation for oligarchs and small entrepreneurs alike is to buy an apartment or villa in one's favorite foreign vacation destination. Beyond that, I have seen many Russian real estate developers gradually sell off their Moscow projects and shift more and more of their assets and time spent to European and American markets.

Most Russian businesses deal primarily with Russia's 130+ million consumers or other businesses that serve them. But most Russian businesses also have Russian government or state-owned businesses as customers as well. For example, any large Moscow business center will have 10+, if not dozens, of tenants – and at least a few of them will be companies that could fall into one of the three broad categories that are sanctionable under existing law: they work in or provide support to the high tech oil industry or pipeline projects or are a company that has dealings with the government and may have been involved in corruption. Many major Russian companies have somehow been involved in corruption. Thus, virtually every Russian business owner found himself potentially exposed to sanctions. The only way to remove such exposure would theoretically be to stop doing business with any customer one viewed as likely being in one of the three categories. But in a declining economy would a business voluntarily reject customers? And politically how would it explain rejecting working for the government? Any business to do so against a politically popular government might certainly face a boycott if not action against it by its own government. This perception was widely expressed in the main Russian business newspapers Vedomosti and Kommertsant, particularly after the Treasury Department published its list of 96 oligarchs in 2018.

For example, one December 2018 Vedomosti article argued that, "The most obvious negative consequence of the imposition of sanctions by the United States and its allies for the Russian economy today is the atmosphere of uncertainty and unpredictability for doing business." It described in detail the example of Valery Gapontsev, who appeared on the Treasury Department list but was not sanctioned. According to the article he is an American citizen and 98% of the production capacity of his company IPG Photonics is located in the U.S., but because he appeared on the list "potential business partners, banks and creditors, and bureaucrats controlling government contracts all viewed his company as 'toxic'. It concluded that 'today each businessperson cannot count on not having such threats have unpredictable effects on his business."[14]

Thus, my hypothesis is that Russian investment in Western real estate has fallen substantially since publication of the oligarch list, if not earlier. Russian businesspeople are effectively forced to choose between eliminating the perceived risk – probably by selling one's business – or foregoing investments abroad that are at risk of being frozen.

It is true that many Russian business owners have chosen to leave Russia because of the poor economic situation in the country and ongoing very weak rule of law, including the raiding of private businesses and widespread rent-seeking among government bureaucrats. But rather than set up incentives for Russian business owners to do so, the U.S has painted Russian oligarchs grey, if not black, ironically creating a perception that the entrepreneurial class - that arguably been most victimized by the Putin government - is part of the Russian government machine.

The next step in this line of research would be to review real estate research reports of the major Western metropolitan markets listed above that have historically been the favorite places for Russian investment and evaluate the volumes of sales to Russians over the past ten years. Of course, the Russian economy has struggled since 2014, so one way to evaluate if a decrease in such investment was indicative of a change in investment habits would be to compare the trends with the trends of analogous real estate investments in Moscow.

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[14] "Sergei Dubinin, "Why the Time of the Harshest Sanctions Has Not Yet Arrived", Vedomosti, December 25, 2018, https://www.vedomosti.ru/opinion/articles/2018/12/25/790386-zhestkih-sanktsii