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PERSPECTIVES

Three Lessons from the Front: Economic Warfare in Russia / Ukraine

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It's the Economy...

A country's economy is core to its ability to provide a better life for its people, develop and fund social services, and ultimately create the means for war. Presidents Xi Jinping and Donald Trump both used speeches in 2017 to directly link economic might to the pursuit of national interests. It should therefore come as no surprise that economic warfare tactics are getting a much-needed refresh as we re-enter a multi-polar world with specific challenges to both the United States' economic hegemony, as well as the international rules-based system.

Sanctions remain the most widely implemented economic warfare tactics. Modern day best practices for sanctions construction and implementation have been outlined by organizations such as the Atlantic Council and the Wilson Center. Summarized, these argue that goals for sanctions must be well identified and explained in advance, that implementing coalitions must be as large and as complete as possible, and that private sector coordination is a critical component to sanctions efficacy. While the guidance is solid, there remain several gaps between these best practices and real-world implementation, as the Russian-Ukrainian conflict illustrates, especially in the finance, energy, and cyber realms.

The Gap Between Theory and Practice

Academics and current and former government officials from Nicholas Mulder to Agathe Demarais represent a rising chorus of voices arguing that while sanctions "fill the void between empty diplomatic declarations and deadly military interventions," their overuse means that "the golden days of U.S. sanctions may soon be over." Others including Council on Foreign Relations President Richard Haass have suggested that despite the rising sophistication of economic tools inclusive of a shift from "smart" trade restrictions to targeted financial sanctions, "all too often sanctions turn out to be little more than expressions of US preference that hurt American interests without changing the target's behavior for the better." The lack of an immediate collapse of the Russian economy in 2022 after western powers levied sanctions on Russia's banking, technology, metals, mining, and energy sectors in response to Russia's aggression in Ukraine is taken by many as a sign that the sanctions regime deployed most recently is having little impact.

But these conclusions are based on flawed (or at least incomplete) analysis. The case studies below will illustrate gaps between best practice and implementation in the current conflict that led to these flawed conclusions.

Lesson #1: The Need to Balance Efficacy and Coalition Size

Economic sanctions led by the United States, the European Union, and Canada were announced the day after the Crimean referendum and prior to Russia's declaration of Crimea as an independent state in 2014. These initial coalition partners were soon joined by Australia, Albania, Iceland and Montenegro in April 2014. Russia's invasion of Ukraine in 2022 expanded this list to countries representing 70 percent of global GDP including Japan, South Korea, and Singapore, although many emerging market nations inclusive of China, India, Mexico, and Brazil are not directly participating.

Sanctions against a range of Russian industries were specifically designed to restrain Russia's capacity to make war after the invasion of Ukraine. Economic warfare tactics ranged from restricting imports and exports, severing Russian banks' access to SWIFT, and seizing assets of the Russian central bank and the Russian government, and the personal assets of Russian oligarchs.

The best historical parallel to these sanctions are those applied to Italy (then the eighth largest economy in the world vs. Russia as the eleventh largest today) in 1935, after its invasion of Ethiopia. Italy post-sanctions saw a 47 percent dip in exports and a 21 percent reduction in industrial production between 1935 and 1936 (albeit even this did not dislodge Italy from Ethiopia). Russia has in some ways seen similar impacts, with 60 to 80 percent reductions in specialized manufacturing dependent on western imports, particularly technology, such as locomotives, refrigerators, internal combustion engines, and freight cars. That said, while the Russian ruble initially lost 90 percent of its value post-sanctions implementation, it soon recovered to a level 20 percent higher than before. Initial forecasts for Russian GDP targeted a 10 percent year-on-year fall, which by the end of 2022 had mitigated to only a 3 percent decline.

The supposed failure of the Russian economy to fall off a cliff in short order illustrates the criticality of defining goals clearly in advance, as well as the inherent conflict between the efficacy of short-term sanctions and coalition size.

The United States lauded the initial collapse of the ruble as evidence of sanctions efficacy. This obfuscated the goal of these sanctions—which was restraining Russia's capacity to make war, rather than an immediate collapse of its economy—and implied an immediacy of impact that could not be met.

Efforts to increase the short-term efficacy of economic warfare tactics must be balanced against the risk that too much economic disruption causes coalition partners to fall out due to domestic pressures. The Russian-Ukrainian crisis is the first in modern times in which a major energy producer is pitted against its consumers. Previous energy-related conflicts were largely between producers, such as price wars between Russia and Saudi Arabia in 1986 and 2020 which were largely price depressive. Analysts estimate that a total removal of Russian oil exports from the market by the current round of sanctions would drive global oil prices as high as $380 per barrel. This would trigger severe economic stress, if not outright collapse, for many oil-importing countries around the world. Oil prices that high would also allow Russia to achieve supranormal profits on any oil that successfully evaded sanctions. The sanctions regime was forced to balance curtailing overall Russian economic activity while also avoiding undue volatility in global energy markets. The sanctions regime therefore included mechanisms to allow some Russian oil sales in order to maintain coalition cohesion.

Criticism of mechanisms to allow these sales has misunderstood the design and goal of oil sanctions. The primary mechanism deployed, beyond the complete ban of exports to EU and G7 nations, was a price cap of $60 on oil sold to other nations (primarily China and India, the latter seeing a 30-fold increase in Russian oil imports). On the one hand this measure allowed more Russian oil to flow (thereby stabilizing global oil markets). These oil sales drove a 3.4-fold increase in Russia's current account in 2022, mitigating short-term negative impact on economic growth and currency depreciation. If the goal was strictly short-term efficacy, then one can term this a failure. On the other, sales at the lower price are estimated to have reduced Russia's 2022 potential GDP by four to eight percent. This balanced approach both negatively impacted the Russian economy, while also preventing large increases in energy prices to the consumer which could have then reduced the size of the coalition of nations implementing sanctions. If the goal was balancing short-term efficacy with long-term coalition cohesion, the short-term four to eight percent reduction in GDP referenced above paired with forecasts of zero Russian economic growth into the future and a potential ten to 15 percent decline in Russian oil production as a result of sanctions seem like laudable achievements.

Lesson #2: Conflicts Require Both Offense and Defense

Many economic policies, particularly in the sanctions space, focus primarily on offense. As noted above, offensive economic sanctions targeting Russian banking, metals, mining, technology and energy sectors resulted in the US$1.8 trillion Russian economy shrinking by two to three percent in 2022. Meanwhile, Ukraine's US$200 billion economy also lost at least 30 percent of its productive capacity. Shorter term "defensive" investments to shore up the Ukrainian economy inclusive of investments in critical infrastructure resilience, cyber resilience (as referenced below), and basic food security and services provision are of as critical importance as offensive measures deployed against Russia. Longer term "defensive" measures could include a "Marshall Plan" for Ukraine. This will require significant planning from many parties. There is little sign this has begun.

Lesson #3: Private Sector Coordination Is Key

Economic warfare tactics will, in practice, almost always involve private sector players in their implementation. This requires extensive coordination between governments and a wide range of industries. The Russian case study illustrates areas with clear historical precedent, areas where new strategies such as energy and technology sanctions are achieving strong results, and areas where incremental improvement is required.

Economic warfare tactics involving the financial services industry have perhaps the most precedent, particularly with the significant expansion of their use led by the U.S. Department of the Treasury in the post-9/11 era to eliminate the use of western banking infrastructure to finance terror. These efforts are assisted by the ongoing primacy of the U.S. dollar and the central role this creates for the U.S. banking system. These same tactics have been deployed against the Russian financial system to strong effect, as examples included here show.

Financial and technology sanctions on the energy industry in Russia have led to a significant exodus of international oil companies. These oil majors are not only removing capital from the country, but also the production technology that Russia needs to viably extract its mineral resources, given the complexity of Russian geology.

Private sector coordination in the cyber realm is one example where incremental improvement is required. Cyber defense assistance in Ukraine has been conducted almost completely by the private sector with little facilitation or funding from governments outside of Ukraine. Two examples are the Cyber Defense Assistance Collaborative which has established an ongoing effort to assist the Ukrainian National Security and Defense Council, and the Global Cyber Cooperation Center, a public-private partnership with a collective of over 15 Western cyber security and technology companies. Western governments have yet to engage fully and effectively in the digital conflict in Ukraine. The U.S. government has been hampered in providing assistance based on a lack of clear policy guidance and appropriate funding mechanisms. This is one reason why U.S. Agency for International Development funds that are available have largely not been deployed.

Ensuring the Ukrainians establish their own capacity for cyber defense and digital resiliency is crucial in an environment where Russian irregular warfare tactics likely continue after the current military conflict stops. The U.S. government and its allies lack a coherent process for engagement with the Ukrainians in this crucial element of conflict resolution and post-conflict stability. No evidence exists that ensuring a strong Ukrainian cyber defense or broader digital resiliency has become part of a considered, broader U.S., NATO or Western strategy of increasing costs for the Russians during this war or in the future.

Next Steps

Current implementation of economic warfare tactics in the Russian-Ukrainian conflict illustrates several areas of potential focus for policymakers. First, officials from countries pursuing economic strategies against Russia need to outline clear, definitive goals for the tactics deployed which consider the inherent balancing act between impact on the target country and secondary impacts on coalition partners. Second, tactical options must be expanded from the almost knee-jerk focus solely on offensive options to include critical defensive measures. Third, the centrality of private sector participation must be recognized upfront, driving its inclusion in both planning and implantation of tactics deployed.

There is one final, overarching issue for consideration. Care must be taken to understand how far to pursue economic warfare tactics. There is evidence that weakened economies can drive conflict through multiple channels. One such example comes from research showing that the odds of a conflict being escalated during a presidential election year *concurrent* with a weak economy is 60 percent, double that during a non-presidential election year and/or a strong economy.

Risks are also illustrated through another current target of United States economic sanctions—China. An economically impaired China may begin to reinforce identity security by emphasizing a nationalism that looks to reverse perceived attempts by western powers to subjugate the country. A cornered adversary is a dangerous adversary, and the application of economic tools can perhaps be taken too far.

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