

## **Parkiet PLUS – 5 March 2022**

### **As a result of sanctions, the ruble will become virtually non-convertible**

*The economic sanctions imposed on Russia are both harsh and lenient. The West needs to wean itself off Russian raw materials, but this requires greater US involvement in the energy market, says Christopher Hartwell of the ZHAW School of Management and Law.*

### **Economists differ quite widely in their assessments of the economic sanctions imposed by the EU, the US and other countries on Russia. Some believe they are unprecedented and will trigger a deep crisis in the Russian economy. Others argue that they are just posturing. How do you assess this?**

The West hasn't gone as far as it could have in disconnecting Russian banks from SWIFT, and for the most part there has been this odd obsession with sanctioning a few individuals close to Putin (including Putin himself and Lavrov) to see if that will change their thoughts. Of course, this isn't going to work. On the other hand, the concerted effort to seize oligarch assets abroad is new and, most devastatingly, the sanctioning of the Central Bank of Russia are much more stringent actions.

### **There is indeed a consensus on this point. What will be the consequences of closing the access of the Bank of Russia (CBR) to a large part of the foreign exchange reserves?**

Sanctioning CBR takes out one of the most powerful funders of the war, the Kremlin's foreign reserves. It might even force a default on Russian debt, which has about US\$700 million due in payments over the next month. This would effectively end the whole reason for Putin – that he brings stability unlike the chaos of the 1990s. If Russia had to declare insolvency, it would be a return to 1998, only this time it could not count on help from the International Monetary Fund.

### **What more can the West do to weaken Russia? What sanctions are possible, given the political circumstances in the EU?**

Russian banks should be completely cut off from the SWIFT system. But in my opinion, no sanctions will be really effective unless the West simultaneously rearms Ukraine so that it can inflict as much physical damage as possible on Russia's military - this will increase the impact of financial sanctions. This includes providing not only defensive but also offensive weapons, including fighter jets. The West should also convince Israel, which itself has received a lot of international support in the past, to send the Iron Dome air defense system to Ukraine. Sweden and Finland should also be admitted to NATO. Closing the airspace over Ukraine, on the other hand, is unrealistic, because that would mean air clashes between Russia and NATO. It is also a mistake to demonize everything Russian. The West should rather support those Russians who oppose Putin's dictatorship. And it should impose equally harsh sanctions on Belarus.

### **Will these sanctions that have already been put in place reduce Russia's ability to export raw materials? So far this has not been seen. On the contrary, gas exports from Russia to Europe have even increased, but maybe that's because the cutoff of some Russian banks from the SWIFT system is only a week away?**

The only real sanction hitting the Russian energy sector is the burying of Nord Stream 2. It also seems that Russia is having some difficulties transporting some raw materials. But the gas pipelines are running smoothly. In my opinion, sanctions do not go far enough in this area.

**And would Europe be able to do without Russian raw materials?**

It would be easier if the U.S. had a position in the energy market as it did, even three years ago, under Donald Trump. President Joe Biden is too influenced by left-wing extremists, but the EU should push him anyway to maximize the US supply of energy resources. He also needs to give up his obsession with the green transition. Without this, any attempt to diversify raw material supply sources will force the EU to increase purchases from Gulf regimes of rather dubious repute. Of course, Europe can also turn back from the path of eliminating nuclear power.

**Some of the sanctions are meant to weaken Russia in the long term. This includes, for example, banning the sale of certain technologies to companies there. Will this be painful for Russia?**

In my opinion, this kind of sanction will not have the expected effect. Russia is a big country with many talented scientists, engineers. Since the annexation of Crimea and the sanctions that Western countries imposed on Russia in response, the Russian economy has become quite good at import substitution, especially in the field of technology. Besides, in the long run, hitting the parts of the economy that would reduce Russia's dependence on raw material exports is not a wise move. In the short term, the West will seek regime change in Russia, but in the longer term it will have to support the building of a stable and prosperous economy there that is not dependent on oil and gas. Holding back technological progress will not help in this.

**Is Russia self-sufficient in terms of food production? Because potentially here one could look for opportunities to influence Putin's policies.**

Russian food imports are consistently about 12% of GDP, and of course Muscovites like the luxury items they get from Europe. Any attempt to squeeze Russia's food production would also be counterproductive, as they could turn to China or Brazil.

**You mentioned Russia's import substitution policy. In retrospect, that looks like an attempt to prepare for a possible next round of economic sanctions in the future. Has that been successful?**

I was living in Moscow at the time of the illegal annexation of Crimea. After the West imposed the first sanctions on Russia, there was a sense of relief there that they were so toothless, painless. Russians thought that the West has lost its fight, and they thought the same thing this time around. My view is that since then, although Russia was clearly preparing for future sanctions, the economy there has become weaker. It is less diversified, more dependent on natural resource exports, more dominated by state-owned and semi-state-owned corporations and monopolies. Russia started to build its own system of communication between banks, which would be an alternative to SWIFT, but it did not finish it. Anyway, this system would be worthless if Russia were truly isolated. In my view, the authorities there are no less shocked by the scale of sanctions the West has now decided on than the West is by the Russian attack on Ukraine.

**The consequence of the sanctions imposed on Russia is, among other things, a collapse in the ruble quotations. Will the Bank of Russia, cut off from part of the reserves, be able to stabilize the currency? What will be the consequences of the currency crisis?**

Yes, the ruble exchange rate will eventually stabilize, but this will require the Bank of Russia to maintain capital controls and very high interest rates. Besides, given that the ruble will not be exchangeable for anything, it will have a purely settlement function, it will not be suitable for storing value. I imagine that the ruble will become virtually non-convertible into other currencies, which will make international trade very difficult. Of course, a collapse in the ruble's quotation will also mean higher inflation. I don't envy the authorities there, facing this situation.

**Weakening of the ruble hits also the zloty. And the strong depreciation of the Polish currency has revived the debate about the euro in Poland. Some economists, even those who previously opposed the euro, now believe that we would be safer in the currency union.**

I don't see much connection between what is happening now and the euro issue in Poland. Besides, public opinion in Poland is overwhelmingly against it, so adopting the euro doesn't seem to be a realistic scenario either. In my opinion, Poland should stay with its currency and let the automatic economic stabilizer, i.e., exchange rate changes, work. Sooner or later, the outflow of capital from Poland will stop. And then Poland will be in a better situation as it will be outside the eurozone and will be able to conduct its own monetary policy.

**You lived for some time in Russia, you know many Russians. How do you think they will react to the difficulties that will result from sanctions, such as rising inflation, unavailability of certain goods, inability to travel, etc.? Will they rebel against Putin, or on the contrary, will they develop an aversion to Europe and recognize that Putin is the only guarantor of their security?**

The reaction to sanctions will probably follow the current divisions in Russia. Educated people who have been to the West and have friends there will hold Putin responsible for this misery. But the average Russian, fed by state propaganda, will continue to believe that Putin is defending him from even greater deprivation. For such a populous country, it is difficult to make any meaningful generalizations, but in a nutshell, it can be said that Russians' reaction to sanctions will depend on who gets their information from where. As for the revolt against Putin, it is encouraging to see some Russians taking to the streets to protest the war. But we've seen this before, and Putin has successfully managed to stifle any resistance. Nemtsov is dead, Navalny is in prison. It's hard to expect anyone to want to stand up to Putin. It's sad, but unfortunately true.

**One of the side effects of sanctions, particularly the freezing of part of the reserves of the Bank of Russia, may be a change in the approach of other countries to building such reserves. Some economists fear that central banks of emerging countries will turn away from the dollar and the euro en masse and keep their reserves in gold and other precious metals. Is this possible?**

Certainly, central banks may seek to increase the share of gold in reserves, but they will not be able to abandon fiat currencies. Reserves must be liquid, and gold, platinum, or other commodities do not guarantee that.

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