INSTITUTE for DEVELOPMENT and DIPLOMACY

ANALYTIC POLICY BRIEF

4 April 2022

# Does Western Solidarity With Ukraine Amount to Geo-Economic Malpractice?

## Some Unforeseen Consequences of the Sanctions Against Russia

*Damjan Krnjević Mišković*

*"Yes, there are consequences to countries that actively attempt to circumvent or backfill the sanctions, […] create mechanisms that prop up the ruble, and […] attempt to undermine the dollar-based financial system."*

– Daleep Singh, U.S. Deputy Assistant National Security Adviser for International Economics, news conference in New Delhi, 31 March 2022

This analytic brief is the first of at least two such papers on this general theme that I will produce for the Institute for Development and Diplomacy.

The present one consists of a set of preliminary observations on some of the unforeseen geo-economic effects of the Western-led sanctions and export restrictions regime launched against the Russian Federation in the immediate wake of the onset of the current phase of the conflict over Ukraine, which began on 24 February 2022. The next one will focus more on the geopolitical and ethical consequences of the present conflagration.

## *Extraterritorial Overreach*

By way of introduction, here is a brief primer on aspects of the Western-led sanctions regime put in place against Russia, which is of questionable legality for at least two interrelated reasons.

*Damjan Krnjević Mišković, a former senior Serbian and UN official, is Professor of Practice at ADA University and oversees policy research, analysis, and publications at its Institute for Development and Diplomacy (IDD), where he concurrently serves as Senior Editorial Consultant for* Baku Dialogues. *An earlier version of this paper was delivered to a conference organized by the Islamabad-based Center for South Asia & International Studies (CSAIS). The views and opinions expressed herein are solely those of the author.*

First, it is unauthorized by the UN Security Council, the sole body with the undisputed legitimacy under international law to impose sanctions and to obligate all UN member states to comply with said sanctions (see Articles 39 to 41 of the UN Charter).

Second, this Western-led sanctions regime has been purposefully designed to have extraterritorial reach. This means that that one of its goals is to regulate and apply its provisions to the legitimate and legal activities between non-nationals (both natural and legal persons) of sanctioning states and the targeted state, namely Russia. These provisions also provide for the imposition of a variety of "consequences" towards these non-nationals if they do not comply with the extraterritorial legislative or executive frameworks of the sanctioning states (at least in some cases). Now, for those states that have chosen to align themselves with the sanctions regime against Russia, its extraterritorial reach does not pose much of a problem, both as a matter of foreign policy and international law. But for those states that have not done so, it obviously does.

Tellingly, at least as late as 2021, the European Union had consistently viewed the extraterritorial application of unilateral measures by third countries against EU citizens and legal persons based in the EU to be a violation of international law. For instance, in the context of advocating policies to advance the EU's "strategic autonomy," its foreign policy chief, Josef Borrell, indicated the EU's intention to "strengthen the international role of the euro, develop further the EU's financial infrastructure, [and] increase their resilience to the extraterritorial application of unilateral foreign sanctions."

The EU appears to have reversed its longstanding principled position in the present case—obviously for political reasons. Still, the legal and political reasoning it had previously embraced and actively defended continues to be upheld by a majority of UN member states and international organizations. There are untold numbers of examples that I could provide, but two will suffice for present purposes. Last week, Director-General for European Affairs at the Chinese Foreign Ministry by Wang Lutong said that "China is not a related party to the crisis over Ukraine. We don't think our normal trade with any other country should be affected." Second example: of the various documents adopted prior to and during the Azerbaijani chairmanship of the Non-aligned Movement reaffirming its opposition to the extraterritorial effect of sanctions on both targeted countries and third countries, I refer to a 2021 UN document sponsored by NAM which underscored these constitute a "contravention of the basic principles of international law, in a manner that will coerce the latter also to apply the unilateral coercive measures" (A/HRC/46/5).

All this points to the increasingly fundamental distinction between two conceptions of contemporary world order: an UN-centered multilateral order underpinned by a system of international law and one that its proponents call the "rules-based liberal international order." I believe that the way in which the geo-economic and the geopolitical implications of this distinction play themselves out will likely determine the strategic course of international relations in the twenty-first century.

## *Two Numbers*

Here are two numbers to get us started: 141 and 48. The first refers to the 2 March 2022 result of the vote in the Eleventh Emergency Special Session of the UN General Assembly, which condemned what the Kremlin calls a "special military operation" and the Western-initiated resolution terms an "aggression" (another resolution on the same basic issue was adopted on 24 March 2022, and there the number was 140).

At first glance, 141 is quite an impressive figure, given that there are 193 UN member states. But this number is actually not that meaningful, for at least two reasons. The first is obvious yet underemphasized: for all the huff and puff associated with its alleged significance, all it really demonstrates is that Western diplomacy is more effective at projecting its influence in a multilateral setting that was intentionally designed by its founders to be little more than an international relations talk-shop. But the truth is that votes like this one have no binding effect whatsoever: such and similar resolutions are completely symbolic. Two examples will suffice. I recall a General Assembly resolution from December 2012 that "strongly condemned" the human rights situation in Syria passing with 135 votes. The practical effect was negligible, to no one's actual surprise. The second example is even more striking. Since 1992, the General Assembly has passed a resolution each year on the "necessity of ending the economic, commercial, and financial embargo imposed by the United States against Cuba." During the present session, the number of countries voting in favor of this resolution was 184. Again, the practical effect has been negligible.

Moreover, in the case of the Western-led sanctions against Russia, it is hardly inconceivable that many of the non-Western states within this block of 141 (and perhaps a few Western ones, as well) voted the way they did because doing so represented the diplomatic path of least resistance, given concerted Western pressure on the one hand, and the actual meaninglessness of the vote, on the other.

This is not to say that the UN General Assembly does not serve any valuable purpose. If nothing else, its convening power remains second to none. Yet not a single foreign minister, much less a head of state or government, chose to travel to New York to address the General Assembly during the aforementioned proceedings that produced the much-vaunted 141 number.

The second reason that famous figure is not substantively meaningful requires that we look more closely at the UN member states that did not support the General Assembly resolution that condemned Russia's foray into Ukraine. The list includes Russia, obviously, but also Armenia, Azerbaijan, China, Ethiopia, India, Iran, Iraq, Kazakhstan, Morocco, Pakistan, Senegal, South Africa, Uzbekistan, and Vietnam, together with about 35 other UN member states. Those states make up roughly half the globe; not half the world's economy—not yet, anyway, although it may be pretty close by some metrics. But half the world nonetheless, certainly in terms of geography and demographics.

Contrast this to 48—which is a much more important figure and the second integer to which I referred above. It is the number of states or jurisdictions that Russia formally listed as "unfriendly" on 8 March 2022. Thus, 48 can be said to represent, more or less, the maximal number of countries that have imposed *any* sort of sanctions or export restrictions on Russia since the conflict over Ukraine entered its present phase. The Russian list includes all NATO and EU member states, plus nations like Australia, Japan, New Zealand, Singapore, South Korea, and Switzerland, but also truly minor players like Albania, Andorra, Micronesia, Montenegro, North Macedonia, and San Marino. It is of both geopolitical and geo-economical significance that of these 48, not even a single one is a non-Western G20 state.

How to explain the discursive disparity between these two numbers? Helpful is the concept of "false universalism"—that is, the tendency to present as global in scope something that is in fact predominantly Western or Western-led. An illustrative example is the recurring, mantra-like use of the term "international community" by Western or Western-based political figures, the expert and academic community, and media outlets. Hence the current political and journalistic rhetoric giving the impression that effectually the entire world has joined the West in imposing sanctions and export restrictions against Russia.

Of the many consequences of such "false universalism" in the context of the conflict over Ukraine, here I can mention two: first, the citizens of Western countries exposed to such discursive sleight of hand tend to believe that, indeed, the entire globe has joined this initiative; second, its continuous use can be characterized as constituting what psychologists call "consensus bias" or the "false consensus effect" on Western decisionmakers. In a 26 March 2022 tweet, Gérard Araud—France's former permanent representative to the UN as well as the country's former ambassador to the United States—made this point succinctly: "We, in the West, underestimate the resentment of the rest of the world against us."

## *Very Harsh, but Not the End of the World*

I certainly do not mean to downplay the force and impact of the Western-led sanction regime on the targeted country. It appears to be doing real harm to the Russian financial system, its economy, and its technology base—especially given that it has also legally compelled or politically pressured hundreds of multilateral corporations headquartered in the West to withdraw from the Russian market, coupled with its extraterritorial ambitions (as discussed above).

Still, it seems unlikely that the increasingly harsh Western-led sanctions regime will *fundamentally* impact on the Kremlin's pursuit of its national interests as it defines them. What George Friedman wrote in May 2014 still applies: "sanctions can be countered and always ignore a key truth: Russia has always been economically dysfunctional. It has created great empires and defeated Napoleon and Hitler in spite of that. Undermining Russia's economy may be possible, but that does not always undermine Russia's military power."

## Global Impacts

Moreover, it does not appear that Western leaders had well-thought-out contingency plans for mitigating the impact of the scale and scope of the economic damage that is inevitably incurring *outside* Russia by the sanctions and restrictions they themselves imposed *on* Russia. Some of this may be a consequence of the political imperative that seems to have prioritized rapidity of rollout: the first tranche of the Western-led sanctions regime was announced within a day or so of the launch of Russia's "special military operation." Depending on how all this plays out in the time ahead, however, Western decisionmakers may end up approaching the threshold of being charged with geo-economic malpractice.

Indeed, the Western-led sanctions regime against Russia is many orders of magnitude more impactful on the world economy—on globalization as an operating principle, one might even say—than has been any previous Western-led or even UN-authorized one.

Consider that Russia supplies and/or exports about one sixth of global commodities. That fraction goes up slightly when Belarus is included, which has also been placed under the Western-led sanctions regime, and slightly more when Ukraine's contribution—which can't export much of anything at present for obvious reasons—is also taken into account.

For instance, Russia alone is the world's largest grains exporter. Together with Ukraine, it exports close to 30 percent of the world's wheat, nearly 80 percent of the world's sunflower oil, and around 20 percent of the world's corn. Moreover, Russia is the world number one fertilizer exporter.

Perhaps Western consumers may grin and bear rising prices for such staples (at least in the short-term), but the last serious spike in grain prices was a catalyst of the Arab Spring. At present, the Middle East accounts for one third of worldwide wheat imports.

Russia also produces 40 percent of the world's palladium. The country is the third-largest exporter of coal and steel; and it's a top exporter of aluminum, iron, and nickel. The list goes on.

Again, Russia supplies the globe with one sixth of all commodities. And the longer the conflict over Ukraine goes on, the higher the prices will rise for virtually all commodities, which will in turn affect wholesale and ultimately retail prices for a plethora of goods and service worldwide.

This brings me to the topic of energy. Russia declared that "unfriendly countries" will need to make payments for hydrocarbon deliveries in rubles instead of U.S. dollars. I will not discuss it here, for although this new policy was supposed to go into effect on 1 April 2022, Kremlin spokesperson Dmitry Peskov indicated this will happen only "in the second half of the month of April, or even at the beginning of May."

However that may be, consider that in early December 2021, the cost of a typical oil cargo of 2 million barrels was about $140 million. At one point three weeks ago or so, the same cargo was worth almost $280 million. That figure has gone down slightly, but not by that much. In general, oil, gas and electricity prices will likely stay quite high, for perfectly sound and entirely foreseeable geo-economic reasons.

Let me next put this alongside three other facts directly related to energy: one, Russia is tied with Saudi Arabia as the largest global oil exporter; two, *by itself*, Russia is the world's largest gas exporter; three, there is no other exporter or combination of exporters on the planet that can adequately compensate for Russian gas—this is also true, but to a lesser extent, for oil.

Thus, not only will the overall price of hydrocarbons stay high, which means that prices will stay high for pretty much anything that gets shipped from anywhere to anywhere else. It also means that significant pressure will continue being put on the global financial system because of the Western-led sanctions regime against Russia.

## *The Shadow of Stagflation*

Few really understand the potentially global consequences of this, and I am admittedly no expert in the field of international finance. But a basic perusal of relevant publications indicates that over the past few weeks there has been a large surge of margin calls in the world of commodity trading due to a combination of higher prices overall and higher volatility. As I understand it, this basically means that the amount of cash the traders need to back up their deals in the commodities derivatives market rises significantly. And these "variation margin calls" have run into nearly $1 trillion per day in recent weeks.

This brings to light one of the weakest points of the commodities trading system: commodities trading houses are at heightened risk of defaulting due to the onset of the Western-led sanctions regime against Russia. Just the top four commodity firms move the equivalent of more than $700 billion worth of raw materials. That's just basic buying and selling. The derivatives market is much larger, more opaque, riskier, and less regulated.

Add to this the fact that there is much less corporate consolidation in the commodities trading industry; to stay competitive, the smaller firms tend to take greater risks, which is quite disconcerting, given present geo-economic circumstances.

The risk to the global economy of one or more of the major commodities firms defaulting is in some ways reminiscent of tipping-point events that precipitated the onset of the 2008 Great Recession, like the bankruptcy of Lehman Brothers. Maybe this is an overblown assessment. So, let's say there's no too-big-to-fail default; but if the sanctions regime against Russia continues unabated, the G7 countries (and potentially others) will likely feel heightened inflationary pressures on their economies. Put this together with suboptimal growth and/or unemployment rates in the same set of countries. Economists call such a lethal combination "stagflation."

The last time the West faced stagflation was in the 1970s. That geo-economic phenomenon from 50 years ago also had a lot to do with a sudden reduction in the supply of oil and a consequent spike in prices. Then, as now, the cause was entirely geopolitical.

Let me come back to the list of states that are actually participating in the Western-led sanctions against Russia (as opposed to just voting in favor of two Western-sponsored resolutions at the UN General Assembly). Saudi Arabia and the UAE are not on that list. That's important because they export significant amounts of oil and gas. The same goes for Azerbaijan, Kazakhstan, Qatar, and Venezuela, for instance.

For various reasons, they and others are, or are likely soon to be, increasing their respective hydrocarbon production outputs. No doubt, this will to some extent mitigate the effects of the Western-led sanctions against Russia. But none of the aforementioned states have indicated a willingness to sell their oil and gas to the West at below-market rates. And it seems unlikely that a critical mass of these countries will maximally increase their outputs.

Moreover, the effects of supply increases by the aforementioned countries will not kick in instantaneously, especially in the context of oil. For instance, *to get an additional barrel of Persian Gulf oil to most major markets takes between two and three months. This means higher price perpetuation—at least until then, and probably for longer. And this concerns just oil—and even in that best case scenario, it is unlikely result in a one-to-one effect. With respect to gas, no alternative supplier can come close to fully compensating for Russia's position in the global market. Here higher price perpetuation seems locked in for the foreseeable future, taking into account seasonal variability.*

Moreover, as noted in a recent blog entry posted on the website of the International Monetary Fund, the world may be on the cusp of "fundamentally alter[ing] the global economic and geopolitical order should energy trade shift, supply chains reconfigure, payment networks fragment, and countries rethink reserve currency holdings. Increased geopolitical tension further raises risks of economic fragmentation, especially for trade and technology." Translated into ordinary language, this means that de-coupling and even full-on de-globalization may be right around the corner, in part because the pace of the de-dollarization trend is likely to increase in the time ahead. (For more on this, follow what Gita Gopinath, the IMF's First Deputy Managing Director, says and writes.)

## *Geopolitical Preview*

The geopolitical logic behind this last assessment is as follows: if a major non-Western country may want to have *merely the option* of pursuing a foreign policy that could be opposed by the United States and its allies at some point in the future, then it stands to reason that such a country will begin a deliberate process of diversifying its U.S. dollar-based transactions as well as U.S. dollar assets held abroad (and in the West in particular). This calculus would be based on the now-real possibility that these could be weaponized—that is, frozen and effectually confiscated under a sanctions regime like what is being done to Russia now.

The list of candidates for at least thinking about adopting such a policy obviously begins with China, which will watch and learn from the Russian experience. But there are quite literally dozens of others states whose policy planners, we can assume, are thinking hard about such contingencies. Brazil, India, and South Africa may be bellwethers in this regard, as may be Saudi Arabia. The recent agreement between Riyadh and Beijing to settle oil trades in renminbi (China's currency), is particularly instructive. This is what former Editor-in-Chief of *Al Arabiya English* Mohammed Alyahya wrote last week on the potential consequences of this new arrangement: "Beijing is offering Riyadh a simple deal: sell us your oil and choose whatever military equipment you want from our catalogue; in return, help us to stabilize global energy markets. In other words, the Chinese are offering what increasingly appears modeled on the American-Saudi deal that stabilized the Middle East for 70 years." The weight of this conclusion should not be underestimated.

I hasten to add that that the de-dollarization trend is nothing new. In 1999, at the height of the unipolar moment, the global share of foreign reserves held in U.S. dollar-denominated assets stood at 70 percent. This figure now stands reduced to 59 percent, and the trend will almost certainly continue unabated. The Russian response to the Western-led sanctions can only add fuel to that fire, as it were. The renminbi has accounted for around one quarter of the aforementioned change, and that fraction is likely to increase. Lastly, in the coming period, the mainstreaming of digital financial instruments like cryptocurrencies, stablecoins, and central bank digital currencies could also significantly impact upon the de-dollarization trend.

Woven together, these threads could end up greatly undermining the U.S. dollar's role as the world's go-to reserve currency, which would inevitably have great ramifications for America's claim to leadership of what its proponents call the "rules-based liberal international order."

Evidently, this is a long-term forecast, but the onset of de-globalization may turn out to be the most important strategic consequence of the trend that has been triggered (or accelerated) by the Western-led sanctions and export restrictions regime directed against Russia. Hence my raising the possibility that the policies being pursued presently by Western decisionmakers may amount to geo-economic malpractice—and, indeed, geopolitical malpractice. No one should expect to know for sure, though, before decade's end. But it might be a prudent idea to start making appropriate plans, just in case.