

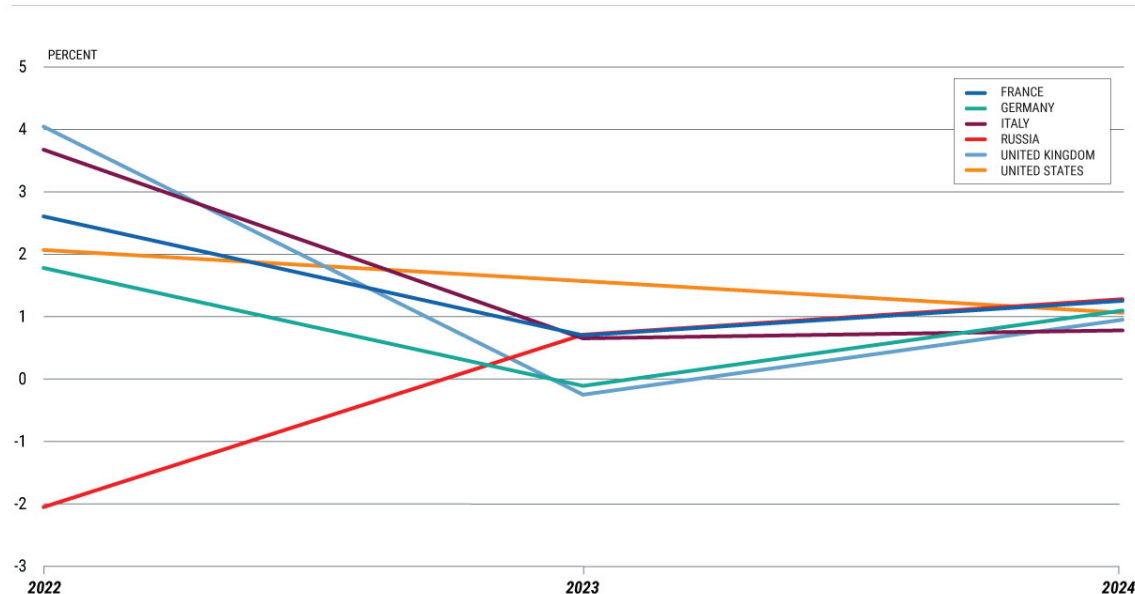
Can Russia Gang Up on the West?

by Antonia Colibasanu - May 10, 2023

In February 2022, the global economy started what became an unprecedented event: The West, led by the United States, severed trade, financial and personal ties with Russia, a country that spans 11 time zones, sits at the heart of Eurasia and is essential to global commerce as a supplier of key commodities. Before that, similar punitive measures tended to target countries on the edge of the global economy like Venezuela and Iran. Unsurprisingly, global growth forecasts for 2023 have been revised downward.

The International Monetary Fund reported in April that the baseline prediction for growth is 3.4 percent in 2022, 2.8 percent in 2023 and 3 percent in 2024. But it also warned that in the event of increased financial sector stress, global growth would fall to around 2.5 percent in 2023, with advanced economies growing at or below 1 percent. Meanwhile, the IMF predicted that Russia's economy will grow 0.7 percent more quickly than Germany's and the United Kingdom's, both of which are forecast to enter a recession (and experience negative growth), and will keep pace with growth in France and Italy in 2023. In other words, Russia's economic growth is expected to compete with, if not outperform, four of the G-7 countries leading the sanctions charge.

IMF Forecasts for GDP Growth



Source: International Monetary Fund

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The West believed that by impounding Russian foreign exchange reserves held abroad, imposing harsh restrictions on Russian banks and individuals, and severing trade in technology and raw materials, the Russian economy would collapse and force President Vladimir Putin to abandon the war in Ukraine. Less than two months after the invasion, the IMF forecast that Russia's economy would contract by 8.5 percent in 2022 and by 2.3 percent this year. Since then, however, the fund has revised its estimates upward by a cumulative 9.4 percentage points. Sure, at least some of the IMF forecasting comes from Russian figures that are arguably inflated – but the Russian economy nonetheless resisted sanctions during the first months of 2022.

In fact, Russia was prepared for the sanctions. It had been under them since it took Crimea in 2014, and the West had advertised its intentions well ahead of the invasion. The West failed to recognize as much, and it overestimated its power to dominate the most critical parts of the global economy. The West was also inexplicably slow to realize that, when cornered, authoritarian governments deprioritize rational economic considerations and spur Western conventions.

Meanwhile, China, India, Malaysia and Singapore have begun to import more Russian oil. Turkey, the United Arab Emirates, Kazakhstan, Armenia and other former Soviet republics have acted as middlemen for Western exporters and Russian importers on anything from cell phones to machine

tools. Thus developed a network of parallel imports and informal shipping fleets. Legal loopholes, opportunistic business activity and a lack of collaboration by emerging economies have conspired to blunt the impact of sanctions.

Even so, it would be a mistake to say the sanctions have failed. There are clear indications that they are affecting the Russian economy, so from the West's perspective, they are better than allowing Russia to support the war with a limitless budget funded by export payments.

Indeed, Moscow has already been forced to sell commodities at lower prices and to pay a premium for technology (due to the price of avoiding legal obstacles and the increased cost of transportation, not to mention the investment needed to create new trade corridors). This year, Russia's federal budget is under strain from military and security spending, which accounts for a record-high one-third of total expenditure, and from mandatory import substitutes. The Kremlin can afford to cover these expenditures for now, but any external shock could severely undermine Russian finances.

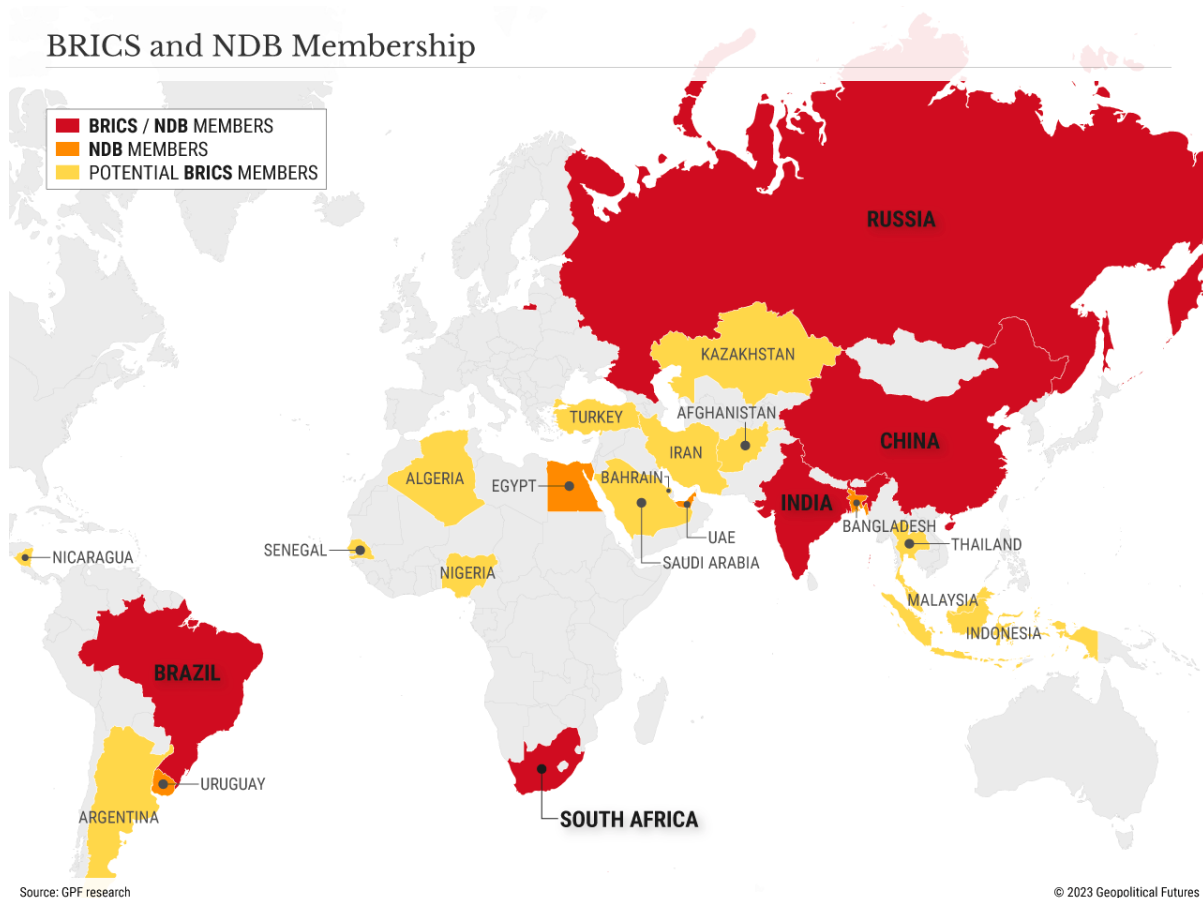
To mitigate these risks, Russian authorities are squeezing the economy for more revenue. In April, Putin changed the way the country taxes oil businesses by basing levies on the Brent crude worldwide benchmark price minus a predetermined discount, rather than the price of Urals, the country's principal export crude, which has been trading at a lower price than Brent in recent months. Moscow expects to net 600 billion rubles (\$8 billion) in revenue from the levies. The government also announced last month that the publication of statistics on oil, gas and condensate production will be suspended until April 2024, indicating further trouble may affect the industry. It's unclear how the departure of Western companies has affected energy production, but the Kremlin isn't taking any risks: It's asking all Western firms leaving the country to pay a contribution to the federal budget equal to at least 10 percent of the market value of their assets (on top of a 50 percent discount on property values). The moves are clearly meant to offset the losses in the hydrocarbons sector, the revenue from which declined by 45 percent year on year in the first four months of 2023 because of sales at discounted prices.

Given Russia's bleak fiscal outlook, the role of the country's oligarchs will become increasingly important. Russian elites, including senior officials and corporate leaders, are highly pragmatic and often apolitical. Like Moscow itself, they were prepared for sanctions but were ill-equipped to deal with a forever war of attrition. Restoring international operations and finding new customers is therefore their primary concern, even though they will continue to do business with the Kremlin. Their current reward for doing so is large cash flows from Asia and the global south. With limited opportunities to get back on the Western market, Moscow must make sure that Russian companies

enjoy a friendly environment elsewhere.

This is why for the past year Moscow has focused on building its leadership role within the Eurasian Economic Union and promoting its interests in multinational organizations such as the BRICS and the Shanghai Cooperation Organization. These groups are designed to challenge the U.S. hegemony by promoting their members' view of a multipolar world. But they are often too mired in rivalry and conflicting interests to get much done. Larger members like Brazil and India see these organizations as places to confer with their peers while maintaining their strategy of non-alignment. The smaller players seek access to wider markets for growing their profits.

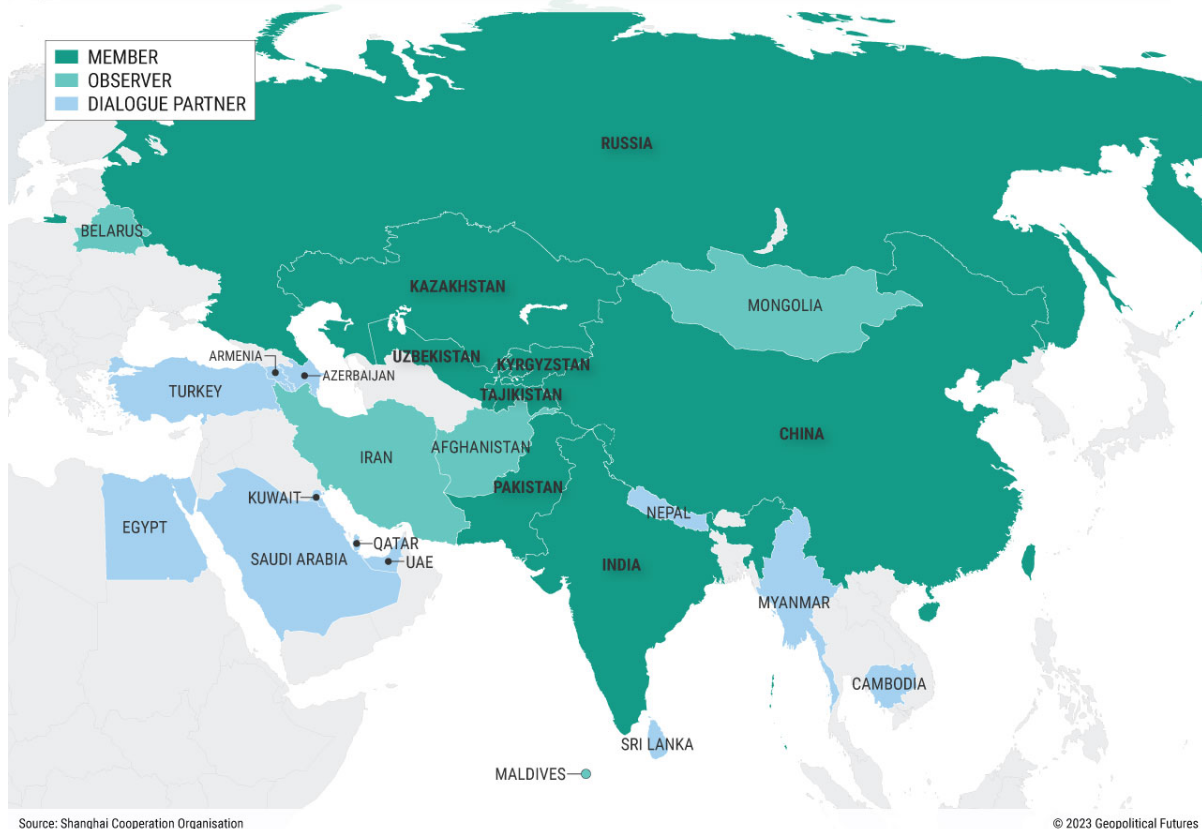
Larger emerging markets such as Brazil and India have actually benefitted from Russia's parallel imports, but for the most part, smaller ones were hurt, however indirectly, by the Western sanctions regime. They may be indifferent to the Ukraine conflict itself, but they have every reason to try to insulate themselves against further risk, even if that means cooperating with Russia. And the BRICS is an ideal forum within which to do so. The bloc focuses on economic policy coordination to establish better terms for its members to participate in the world economy. It eschews the imposition of values on its members, most of whom broadly share the belief that a multipolar world is a more profitable world for them. This explains the bloc's appeal to less affluent countries that can't go toe-to-toe with the G-7, and it explains why 18 more countries have applied for membership since its founding in 2006. The 15th BRICS summit will be held in South Africa in August, where it will examine, among other things, the admission of 17 new members from Asia, Africa, South America and the Middle East. (The United States asked to attend the meeting but was denied.)



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More recently, a two-day summit of the Shanghai Cooperation Organization in Goa, India, brought together the majority of the Asian and Eurasian members of the nascent BRICS grouping. The meeting was advertised as an opportunity to begin working through internal conflicts and to capitalize on the economic opportunities from improved relations. The SCO is similar to BRICS in that it is dominated by China and Russia, but the organization is primarily concerned with regional security challenges, including the fight against regional terrorism, ethnic separatism and religious extremism. It has largely focused on Asia but has slowly expanded its aperture as new members join.

Shanghai Cooperation Organization



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Perhaps the most important takeaway from the meeting in Goa was that Russia and India concluded that they can't fully de-dollarize their bilateral trade. The value of India's Russian imports increased from \$9.86 billion to \$41.55 billion in the previous fiscal year, while Russia's contribution to Indian imports rose from 1.6 percent to 6.5 percent. During the same period, India's exports to Russia reached \$2.8 billion, resulting in a \$38.74 billion imbalance for New Delhi.

All of this is impressive. Russia is currently making money by exporting crude oil to India, but it is having difficulty accessing the funds since the rupee is not freely convertible. As a result, \$400 million in Russian dividends belonging to Indian corporations have been stranded in Russia. According to Russia's foreign minister, Moscow has acquired "billions" of limited convertible rupees from accounts in Indian banks in trade settlements it cannot use.

Russia now has a significant trade surplus with India, but it has no purpose for all the rupees it has amassed because India produces little that Russia wants to buy. And, because India has a large

trade imbalance, it has been unable to earn enough foreign money to completely pay for its Russian imports in other currencies. And though many believe bilateral payments are still made in U.S. dollars, as well as dirhams, yuans and “several other currencies,” Russia hoped to convince India to agree on a rupee settlement mechanism to help lower currency conversion costs and make sure it can continue working with India if the West imposes sanctions on third countries. Having a bilateral mechanism gives Moscow the flexibility it needs, especially since India has no interest in making its rupee fully convertible.

Moscow’s failure to reach an agreement with India shows the limit of its influence on one of the prominent BRICS members. Moreover, the fact that Beijing announced its foreign minister would visit Germany and France days after the SCO summit ended – the same day Brussels said it would consider sanctions on Chinese companies for supporting Russia’s war machine – suggests Moscow hasn’t convinced Beijing to side with it and help the de-dollarization process either. The potential for the West to tighten sanctions and hit third countries that are facilitating trade with Moscow is clearly a concern among larger BRICS members.

Though the expansion of the SCO and the BRICS is one of the unintended consequences of Western sanctions, bucking U.S. hegemony is impossible so long as all emerging countries want dollars to fund growth – and so long as they are unwilling to give up the Western market. In that sense, they can’t form a realistic alliance that Russia can use against the West. If anything, the groupings demonstrate why Western sanctions against Russia are working, albeit slowly and problematically for everyone involved.

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