

# HOW THE WAR IN UKRAINE AFFECTS RUSSIAN ECONOMY AND SINO-RUSSIAN RELATIONS

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**Abstract:** The aim of this research was to find out if the war in Ukraine affects the Russian society and Sino-Russian relations and if Beijing is capable of saving the Russian economy from destruction. With regards to research methods, a document analysis method was used to obtain valid information about the socio-economic consequences of the war. A wide range of documents

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and scholarly articles were analyzed in order to obtain reliable and objective information. The research revealed that the war has devastating effect on Russia's economy and could cause aggravation of socio-economic problems in the future. Russia could become an isolated and impoverished country. The war has also negative effect on Sino-Russian relations. Despite having close ties with Russia, Beijing refuses to support Russia during these difficult times and does not offer financial, economic and military assistance to Kremlin. Indeed, China's ability to save Russia from economic disaster is limited.

**Keywords: War in Ukraine, sanctions, economic isolation, Sino -Russian relations**

### *Introduction - the imposition of sanctions on Russia*

Russia surprised the international community when it decided to invade Ukraine on 24<sup>th</sup> of February 2022. Russian President Vladimir Putin announced the launch of a "military operation" in Ukraine under the pretext of protecting the separatist regions of Donetsk and Luhansk. Putin called on Ukrainian soldiers to lay down their arms. According to journalists working in Ukraine, shortly after Putin's announcement, the Russian army started bombing strategic facilities in the suburbs of Ukrainian cities, including Kyiv.

European leaders did their best to avoid the escalation of war and held talks with Putin before the outbreak of war, but all efforts to avoid the escalation of conflict in Ukraine were futile. Putin decided to start a full -scale war against a sovereign country which is a blatant violation of international law. The West decided to impose sanctions on Russia aimed at weakening the Russian economy. Some of the sanctions have already been announced by the US, the EU, Great Britain, Canada and other Western powers. Following Russia's recognition of the independence of the Donetsk and Luhansk regions, Biden issued a decree banning American citizens from

investing or engaging in financial activities in these regions. After the Russian invasion of Ukraine, The US decided to punish Russia and isolate it from the Western financial companies and markets. The Federal Government of the United States took a decision to impose more sanctions on Russia and disconnected major Russian banks from the global financial system. The rain of sanctions and economic blockades on Russia is incessant and will continue to tighten, in line with Moscow's attack on Kyiv and other cities in Ukraine. The sanctions against the Central Bank of Russia are probably the single largest sanctions actioned in modern history.

Over the last years Russia's central bank has accumulated a serious amount of foreign exchange reserves and therefore, Putin believed that he had enough financial resources to wage a war in Ukraine. When Russia invaded Ukraine, it had foreign currency reserves totaling 630 billion US dollars despite being only the 11<sup>th</sup> largest economy in the world. Putin therefore was confident that he could start a military operation in Ukraine and he had enough foreign exchange reserves to finance his war and protect the Russian economy. The idea that the West would aggressively sanction the central bank of a G20 country, that is so intertwined with the global economy, seemed pretty unlikely. Unfortunately for Putin though, The West has decided to impose sanctions and punish Russia because of committing military aggression against a sovereign country. The West and Japan have frozen roughly half of Russia's Central Bank reserves totaling some 300 billion dollars. This act will have terrible economic consequences for Russia and will seriously limit Putin's ability to finance his war. The Central Bank of Russia is unable to use its foreign exchange reserves to stabilize the ruble. Several commercial banks have had their assets frozen too and face lots of problems. So, since the beginning of the war sanctions have escalated dramatically. These sanctions are unprecedented in history and economically destructive for Russia. Currency depreciation is inevitable which affects ordinary Russians. Russian people have not been prepared for this wartime sanctions.

One of the most important sanctions imposed by Germany is the closure of the Nord Stream 2 gas pipeline. German

government decided to stop the Nord Stream 2 Baltic Sea gas pipeline project, after Kremlin recognized the independence of breakaway regions of Ukraine, Donetsk and Luhansk (Marsh & Chambers, 2022). It is noteworthy that the construction of the pipeline has been completed, although it is still awaiting a regulatory approval from the German authorities. The Kremlin is desperate and wants to accelerate the certification of the pipeline, but without the permission of the German government, it cannot go into operation. Nord Stream 2 is a 1,200-kilometer-long pipeline that runs along the bottom of the Baltic Sea and supplies natural gas from Russia to Germany. This pipeline has the capacity to deliver 55 billion cubic meters of natural gas annually to Germany (Riley & Horowitz, 2022). The closure of the North Stream 2 gas pipeline will inflict a lot of damage on Russia's Economy.

The president of the European Union commission Ursula von der Leyen stated that member states of the European Union decided to impose a wide range of sanctions on Russia. She condemned Russia's aggression against Ukraine and stated: "we will present a package of massive and targeted sanctions, to European Leaders for approval. With this package, we will target strategic sectors of the Russian economy by blocking their access to technologies and markets that are key for Russia. We will weaken Russia's economic base and its capacity to modernize and, in addition, we will freeze Russian assets in the European Union and stop the access of Russian banks to European financial markets" (European Commission, 2022). These measures will have a serious impact on Russia. They will increase capital outflows, inflation and gradually destroy Russia's industrial base. Russian oligarchs have been sanctioned by the West and as a result they have lost billions of dollars in wealth mostly due to asset seizures and financial penalties. The sanctions are aimed at building pressure on Putin. Russian business typhoons who have amassed billions in personal wealth by leveraging their connections to the Kremlin were affected by these sanctions. Most of them rose to prominence in the 1990-s thanks to the privatization process and economic reforms that followed the disintegration of the Soviet Union. Three decades on they have been sanctioned

because of the war in Ukraine. As the sanctions intensify it will be interesting to see if they will continue to support Putin.

### *The impact of Sanctions on the Russian economy*

Ukraine is fighting a multifront war, so is Russia. Western sanctions target almost everything. Russia is basically cut off from the Western market. European companies have decided to stop any economic and financial activities in Russia. Russia's war in Ukraine is bleeding the Russian economy. Kremlin views these sanctions as an act of war. The West is fighting a financial war against Russia. The main target of these sanctions is the Russia's banking system. The Western countries have decided to ban several Russian banks from an international payment system called SWIFT. SWIFT is the main messaging system that banks use to send money quickly across borders (Blenkinsop, 2022). Without it, any international transaction gets much more complicated. So, importing or exporting goods and products is much more complicated now in Russia and that pushes prices up for ordinary Russians. President of the European Commission, Ursula von der Leyen thinks that Russian banks will face a lot of problems in the future and won't be able to operate globally. The Russian economy is under severe pressure from the Western sanctions. With regards to inflation, before the sanctions were announced, as of February 25<sup>th</sup> 2022, it was 9%. By the end of this year inflation could be 17%.

The Russian economy was expected to grow by 2% this year. According to estimates, after the start of the war, the economy is crumbling and there will be no growth at all in the future. Russia's economy will shrink by 7% this year as a result of Western sanctions (Partington, 2022). Moscow's stock exchange has been shut for four days. It simply is not trading. Ordinary Russian people are suffering because of sanctions. Prices are constantly rising; savings are shrinking and stocks are falling. There have been queues at cash machines as people try to withdraw their money. Since the start of the war Russians pulled massive amounts of money from their banks. Individuals and businesses withdrew 113.3 billion rubles which is equivalent to 1.3 billion US dollars. Thousands of

Russians lined up in front of the banks in order to withdraw money. If the war in Ukraine continues, it could lead to a big economic crisis.

Western companies have decided to stop their activities in Russia and are leaving the country. There is a large list of Western companies pulling out of Russia. Russia has been cut off from the Western market and is completely isolated. Visa and Mastercard have decided to ban all operations in Russia. Executive director of Visa, Al Kelly has condemned Russia's invasion of Ukraine and has decided to punish Kremlin for committing war crimes. The population of Russia can no longer use these types of cards. A statement from MasterCard states that Russian banks will no longer be able to use their network. The company amid existing anti-Russian sanctions has decided to suspend network services in Russia (Bayar, 2022). The Kremlin is now looking for a solution and is trying to join the Chinese financial system.

Sanctions are not targeting just the banking sector; in reality it is affecting all spheres of life. Many member states of the European Union have closed their airspace for the Russian planes. The United States of America, United Kingdom and Japan are also stopping the sale of high-tech equipment to Russia. Putin himself, and his foreign minister, Sergey Lavrov, have had their assets frozen by the United States and the European Union. It's the first time they have been personally targeted. Dozens of superrich Russians, with ties to state or military, are on sanctions lists, too.

The West is working on new sanctions. Washington intends to discuss the issue of banning Russian oil imports with its European allies. Sanctions on oil exports will be an unprecedented move that is likely to lead to a sharp rise in prices. Sanctions on oil exports will also hit the Russian economy very hard.

What could Vladimir Putin do in order to avoid the total collapse of Russian economy? He could look for backdoors like cryptocurrencies for instance. We should take into account the fact that no single nation controls Bitcoin so far. They have special crypto exchanges and most of them are opposed of

banning Russia because they think that this is against their principle. The entire idea behind Crypto is to eliminate government oversight. They think about the people instead of governments. Crypto exchanges will continue working in Russia and the numbers corroborate this trend. Bitcoin has risen 12% over the last five days, Ethereum is up to 6% and Binance coin is 11%. Clearly, Crypto is a backdoor. The question is how big is this backdoor. Around 12% of people in Russia own cryptocurrency which is not simply enough to blunt the sanctions. Russia's state-owned enterprises are worth 1,4 trillion dollars. The entire crypto market is worth only 1,9 trillion dollars. It is not large enough to sustain the country like Russia and this is a big headache for Kremlin.

Already there is a massive anti-war sentiment in Russia. People are aware that this war will have negative impact on the economic development of Russia. People see that Russia is heading towards recession and therefore, they organize mass rallies against the war.

The United States of America sanctioned Russian oil refineries. US government states that Russian gas is also on the radar and if that happens it will inflict enormous damage on the Russian economy. Putin may destroy Ukraine but the war could leave Russia broke and ruined.

### ***The impact of war on Sino – Russian relations. Can Beijing save Russia?***

It is not secret that China leaned towards Russia in this conflict. Beijing is often viewed as a close partner of Moscow. When the war broke out between Russia and Ukraine, Beijing officially condemned the Western sanctions. It has opposed the actions of the West. However, now China is changing its mind. Initially China supported Russia. Beijing practically dictated when invasion should begin. That's what Western intelligence claims. According to Western intelligence reports, Beijing has asked Russia to delay this offensive (Wong & Barnes, 2022) The request was made in February during the Winter Olympics. Beijing had direct knowledge of Russia's intentions. Beijing did not ask Russia to stop, they asked Russia to delay the attack until the Olympic games were over.

Many western analysts predicted the invasion after the Olympic Games. Vladimir Putin was China's the most high-profile guest during the Olympic games. He met with Xi Jinping and Beijing offered its full support to Moscow. After this meeting, Russia and China released a very long statement declaring that cooperation and partnership between them had no limits. Both states declared that they would create a new global order and a genuine democracy in the world (Wong & Barnes, 2022). The European leaders and western countries were alarmed by this statement and expressed great concern because they perceived the China-Russia rapprochement as a threat. Washington accused Russia and China of making efforts to create an illiberal world order (McDonnell, 2022).

Since the beginning of the war, China has officially sided with Russia and has not condemned Kremlin's aggressive military actions against Ukraine. Beijing now seems to be regretting that decision. There are developments which indicate that China has had a rethink: Chinese banks have restricted financing for Russian commodities. This decision was taken on the second day of the invasion. Two state-owned banks have imposed curbs: the Bank of China and the Industrial and Commercial Bank of China. They have refused to offer financing to buy Russian exports. Russian coal supplies have been affected. Chinese power plants and steel makers are now looking for other suppliers. It seems that sanctions have forced China to cut back on their dealings with Russia. China is also pulling back diplomatic support. China's foreign minister Wang Yi has signaled a shift. Instead of supporting Russian military actions, this time China has suddenly called for peace. It called for de-escalation and a negotiated truce between Ukraine and Russia. As Wang Yi stated China supports and encourages all diplomatic efforts conducive to a peaceful settlement of Ukraine crisis. Chinese president called Vladimir Putin and asked him to negotiate with Ukraine.

Beijing sent more signals to Moscow, which indicates that China no longer supports Russia in this war. China refuses to use veto power for Russia at a security council. It chose to abstain when anti-Russian resolution came up. The invasion of Ukraine is costing Russia dearly. From a diplomatic point

of view, Moscow is practically alone. On Wednesday, the UN Assembly demonstrated this. Of the 193 member countries, 141 voted in favor of the resolution condemning the attack, thereby urging Russia to withdraw from Ukraine unconditionally. 35 countries abstained, 12 did not attend and only five voted against (Belarus, North Korea, Eritrea, Russia itself and Syria). Moscow ended up killing the resolution with its veto power, but the lack of Chinese support embarrassed Russia. Reports say that the voting on this resolution was delayed for two hours. This happened because the USA was negotiating with China. The USA did not get a Chinese support for this resolution, but it did manage Beijing to abstain.

China is now openly criticizing Russia's Ukraine invasion. On 28th of February the following statement was issued by Chinese foreign ministry: "No country should unscrupulously damage other countries sovereignty and security in pursuit of its own absolutely military advantage and absolute security" (Sun, 2022). China is now following those words and actions. Beijing is not helping Moscow to escape Western sanctions. No assistance was offered to Moscow so far to evade sanctions. China does have enough financial and economic resources and could have helped Russia. It has its own financial system. However, China is not giving any lifelines to Russia. It seems that China-Russia partnership does have its limits after all. The question arises, what made Beijing change its mind? Why has China withdrawn support for Russia? Although Beijing has not offered any official explanation so far, we can guess the motives behind this decision. As we all know Beijing is economically dependent on the West and has very close economic, financial and commercial links with Western countries. China's economy could suffer if these relations will be damaged. China cannot afford to openly support Russia in this war, because it could be isolated like Russia. We should not forget that China, thanks to the western investments in the 1990-s, achieved economic prosperity and progress. The West played very important role in the modernization and economic development of China. Although China has very strained relations with the USA and the West at the moment, it cannot afford to cease any kind of relations with the

Western world because Beijing would suffer terrible economic and financial consequences. Beijing knows that supporting a rogue state could have devastating economic, financial and political consequences for China. Chinese officials may want to support Russia, but they are not willing to openly violate the sanctions imposed on Russia for fear of jeopardizing China's prosperity.

In fact, China's ability to support Russia is very limited. Although these two countries are very close partners, their geopolitical and geoeconomic interests do not always coincide. China needs access to U.S. and European markets and therefore, is interested in maintaining close ties with the West. China views the West as more important trading partner than Russia. China's trade with Russia is limited to 146,9 billion US dollars, whereas the trade turnover with the United States and EU is 1.6 trillion (McDonald, 2022).

## ***CONCLUSION***

When Putin invaded Ukraine, he hoped to achieve a quick victory. But recent events proved that Russia is unable to conquer Ukraine so swiftly. The war in Ukraine has had a terrible impact on Russia's economy. The West has condemned Russia's aggressive behavior and decided to impose a wide range of sanctions on Kremlin. Russia is completely isolated and Western countries refuse to cooperate with Putin's dictatorial regime. The longer the war lasts, the more likely it is that the West will impose even more sanctions on Russia. Despite having close ties with Russia, China refuses to offer full economic and financial support to Putin. Economic dependence on the West forces Beijing to act carefully. Chinese government officials are aware that without trading with the Western countries China cannot develop and achieve economic progress. In fact, China's ability to save Russia from the economic collapse is limited.

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