

Sanctions against Russia, their effectiveness and impacts on Finland

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Abstract

Russia's war of aggression in Ukraine has been widely condemned. The EU, the UK and the USA, together with their allies, have imposed unprecedentedly extensive and well-coordinated sanctions on Russia. The sanctions target the key sectors of the Russian economy, undermining Russia's technological and industrial development, and isolating Russia from the global economy and international financial market. The economic situation in Russia is aggravated by other consequences of the war, such as the large-scale withdrawal of Western companies, and the accelerated brain drain. However, due to Russia's integration into world markets and the EU's dependence on Russian energy, for instance, the impacts of the sanctions are also felt on the international economy and on countries that imposed them, including Finland. This study reviews the main sanctions of the EU, the UK, and the USA by sector, and examines their effectiveness with regard to their target, Russia. In addition, the impacts of the war in Ukraine and the sanctions on Finland's foreign trade and Finnish companies are assessed.

Key words: Sanctions against Russia, effectiveness of sanctions, impacts of sanctions, Finland's trade with Russia, Finnish companies

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1. Introduction

Russia's war of aggression in Ukraine has been widely condemned. Consequently, the European Union (EU), the United Kingdom (UK), the United States (USA), and their allies have imposed unprecedentedly extensive economic sanctions on Russia, in addition to the earlier sanctions resulting from the occupation of Crimea in 2014 and the Donbas war. The EU, the UK, and the USA have formed a united front condemning the Russian military offensive and have sought to make coordinated progress in imposing sanctions. The goal of the sanctions is to cause significant harm to the Russian economy and impair the country's ability to wage war in Ukraine. However, because the target of the sanctions is a relatively large economy integrated into global markets, and due to the dependence particularly the EU has had on Russian energy, the sanctions have significant economic impacts not only on their intended target but also more broadly on the international economy (Moret 2022).

As the sanctions have also had impacts on the countries that imposed them, including Finland, their effectiveness requires uniformity and resilience from these countries. According to Finnish Customs, there were more than 2,000 companies exporting goods to Russia in Finland in 2021, and these exports accounted for 5.4 percent of Finland's total exports of goods (Finnish Customs 2022a). The sanctions have directly or indirectly affected all Finnish companies involved in trade with Russia – through import and export restrictions, sanctions against financial transactions and restrictions in the logistics sector, for instance. In addition to the significant decrease in trade with Russia, Russia's attack on Ukraine has triggered a large-scale withdrawal of foreign companies from the Russian market. Finnish companies have also actively discontinued their operations in Russia.

This report looks into the sanctions imposed on Russia by the EU, the UK, and the USA due to the war in Ukraine, as well as their impacts. The report reviews the main sanctions of the EU, the UK, and the USA by sector, and examines their effectiveness with regard to their target, Russia. In addition, the impacts of the war in Ukraine and the sanctions on Finland's foreign trade and Finnish companies are assessed. The report focuses on sector-specific economic sanctions, in addition to which the EU, the UK, and the USA have imposed sanctions on individuals and entities, as well as on areas annexed by Russia and outside the control of the Ukrainian government. The report is based on a study funded by Suomen Ulkomaankaupan Edistämisrahasto (SUE, the Finnish Foreign Trade Promotion Fund)¹.

2. Sanctions against Russia and their effectiveness

2.1. Energy sector

Sanctions in the energy sector are among the most important economic means of exerting influence on Russia. At the same time, imposing them has been difficult, especially for the EU, which is highly dependent on Russian energy. In 2021, energy accounted for more than 60 percent of the EU's total imports from Russia, amounting to EUR 99 billion. The EU is particularly dependent on Russian natural gas – its share of the EU's total gas consumption in 2021 was nearly 40 percent. Oil imported from Russia accounted for almost 30 percent of the EU's total oil imports and Russian coal accounted for almost half of total coal imports. (European Commission 2022b) After lengthy negotiations, the EU countries banned the import of Russian crude oil and petroleum products in the sixth sanctions package in June 2022. Oil imports will be phased out: the ban on crude oil imports will enter into force in December 2022 and the ban on imports of other refined petroleum products in February 2023, with certain exceptions.² In previous rounds of sanctions, the EU had already banned imports of coal and other solid fossil fuels, as well as new investments in Russia's energy sector. (European Council and Council of the European Union

1 The views expressed in the report are those of the author and do not necessarily reflect the views of SUE or the members of its Board of Directors.

2 For the time being, however, the EU allows crude oil to be delivered by pipeline to those Member States that are particularly dependent on it because of their geographical location. The EU also granted temporary exceptions for importing crude oil by sea to Bulgaria and importing vacuum gas oil to Croatia. (European Council and Council of the European Union 2022c)

2022e) The EU has not imposed sanctions on imports of natural gas, but according to the President of the European Commission Ursula von der Leyen, Russia's share of the EU's natural gas imports has fallen from 40 percent before the war to 9 percent by September 2022 (European Commission 2022c).

The EU has also banned the maritime transport of crude oil³ and petroleum products⁴ from Russia to third countries, and the provision of related services, such as insurance and financing. As an exception to the ban, the EU has decided on the possibility of introducing an oil price cap, allowing maritime transport and related services to be provided for oil or petroleum products purchased at or below the price cap. (Official Journal of the European Union 2022) The UK and the USA have also agreed, together with the other G7 countries, to impose a price cap on Russian oil (BBC 2022a). Most of Russian oil is exported by sea, and restrictions on maritime transport complicate Russia's oil exports also to countries outside the sanctions front (BOFIT 2022d). The purpose of the price cap is to allow the flow of Russian oil onto the world market and to curb the rise in energy prices, but at the same time to limit Russia's revenue from oil exports.

In addition to the EU, the UK has also banned the imports of coal and coal products from Russia, as well as the imports of oil and petroleum products as of the beginning of 2023 (The Russia (Sanctions) (EU Exit) Regulations 2019). The UK has also announced that it will stop importing liquefied natural gas (LNG) as soon as possible after the turn of the year (GOV.UK 2022e). Before the war, the UK imported mainly coal from Russia, which accounted for 27 percent of the coal used in the country in 2021 (Bolton 2022).

The USA has proceeded faster in its energy sector sanctions than the EU and the UK, banning Russian oil, gas, and coal imports as early as in March 2022. Indeed, it has been easier for the USA to abandon Russian energy imports than for the EU, as the USA is hardly at all dependent on them.⁵ At the same time, the USA banned new investments in the Russian energy sector. (Executive Office of the President 2022a) Later the investment ban was extended to all new investments in Russia (Executive Office of the President 2022c). The UK has also banned all investments in Russia (GOV.UK 2022e). In addition to bans on energy imports, the export restrictions by the EU, the USA, and the UK on energy industry products and technologies will weaken Russia's most important industry (European Council and Council of the European Union 2022b; GOV.UK 2022c; U.S Department of State 2022b).

According to the EU, the ban on oil imports it has imposed will, by the end of the year, cover 90 percent of the oil imported from Russia to the EU, which will significantly cut Russia's revenue from oil exports (European Council and Council of the European Union 2022c). In 2021, the EU countries' imports of crude oil and petroleum products from Russia amounted to approximately EUR 70 billion (Eurostat 2022). All in all, energy exports generated just under half of Russia's total revenue from goods and services exports in 2021 (BOFIT 2022c). According to the constant tracking of the Centre for Research on Energy and Clean Air (CREA)⁶, China has been the largest importer of Russian fossil energy, especially oil, since the start of the war in Ukraine. CREA's tracking also shows that of the non-EU countries, India and Turkey have also purchased large quantities of Russian oil. With the decrease in demand for Russian oil, the price of Urals oil has also fallen in relation to Brent oil⁷, which may make it difficult for Russia to obtain, from substitute markets, revenue equivalent to EU exports.

2.2. Transport sector

The EU, the UK, and the USA have imposed significant transport operation restrictions on Russian operators. They have closed their airspace to Russian-owned and Russian-registered aircraft, and closed their ports to Russian vessels. In addition, the EU has imposed an operating and transit ban on Russian road goods transport operators on EU territory. (European Council and Council of the European Union 2022c; GOV.UK 2022c; The White House 2022b; 2022d) The EU, the UK, and the USA have also imposed export restrictions on products and technologies used in shipping and aviation, such as navigation and

3 From December 2022.

4 From February 2023.

5 In 2021, Russian oil accounted for 8 percent of the USA's total oil imports – only 3 percent of crude oil imports but a fifth of petroleum products came from Russia. Russian coal accounted for 6 percent of total coal imports; however, the USA is a net exporter of coal and thus practically self-sufficient in this field. The USA is also self-sufficient in natural gas. (U.S. Energy Information Administration 2022a; 2022b; 2022c)

6 See <https://www.russiafossiltracker.com/>

7 See <https://www.neste.com/investors/market-data/urals-brent-price-difference>

radiocommunication equipment and aircraft and their components (Council of the European Union 2014b; The Russia (Sanctions) (EU Exit) Regulations 2019; The White House 2022a).

The bans on the export of aircraft and their components are a major obstacle to Russia's ability to keep its fleet operational, since, according to the European Commission, three quarters of the commercial aircraft fleet used by Russia are built in the EU, the USA, or Canada (European Commission 2022a). There have already been reports in the media of used aircraft being dismantled as spare parts in Russia (Reuters 2022). The sanctions in the logistics sector isolate Russia from the rest of the world, restrict its industry's ability to purchase key products from the Western countries, and hamper its exports and imports.

2.3. Defence and security sector

The EU, the UK, and the USA have sought to weaken Russia's military capabilities by extensively banning the exports of defence and security products and technologies to Russia. Export restrictions also apply to dual-use goods, software and technologies, such as drones, semiconductors, encryption technologies and chemicals that could be used in chemical weapons. (European Commission 2022a; European Council and Council of the European Union 2022b; The Russia (Sanctions) (EU Exit) Regulations 2019; The White House 2022a; U.S. Department of State 2022e) In addition to sanctions on certain products and technologies, the EU, the UK, and the USA have imposed extensive sanctions on Russian defence companies, research institutes and other operators, such as the entire Rostec Corporation (U.S. Department of the Treasury 2022b).

Russia's modern weapons systems have been found to be highly dependent on high-tech products manufactured in the Western countries, such as microchips, cameras and communication systems. According to the British think tank Royal United Services Institute (RUSI), hundreds of different components made especially in the USA but also in the EU and the UK have been found in the weapons used by Russia in Ukraine. The exports of dual-use products to Russia was restricted already after the occupation of Crimea and again more intensively in 2022. According to RUSI, tightening the export controls and preventing the circumvention of sanctions could significantly undermine Russia's ability to wage war in Ukraine. (Gardner 2022; RUSI 2022) In addition to circumventing the sanctions, Russia is trying to buy weapons elsewhere. For instance, in October 2022, Russia was reported to have used Iranian drones in its attack in Ukraine, which resulted in additional sanctions being imposed on Iran (European Council and Council of the European Union 2022d; U.S. Department of State 2022a).

2.4. Financial sector

In practice, all major Russian banks are currently subject to various degrees of sanctions in the EU, the UK, and the USA, ranging from bans on lending and securities transactions to full bans on pursuing business operations and the freezing of assets. As a result, the sanctions cover a significant part of the Russian banking sector⁸. Ten Russian banks⁹ have been excluded from the international information exchange system SWIFT, and consequently, they cannot make or receive international payments via SWIFT. This prevents the banks from receiving foreign currency and transferring funds abroad. (European Council and Council of the European Union 2022c) The EU, the UK, and the USA have frozen the assets of a number of Russian banks, including Russia's largest bank, Sberbank, and banned transactions with them¹⁰. Unlike the EU, the UK and the USA have also frozen the assets of Russia's largest private bank, Alfa-Bank. (Council of the European Union 2014a; GOV.UK 2022a; OFAC 2022) Only Gazprombank, which is a key payment processor for Russia's oil and gas deliveries, has avoided most of the sanctions – only the UK has frozen its assets and banned all business transactions with it, while the USA has restricted the possibility for American creditors to finance the bank (Kowsmann & Osipovich 2022; RFE/RL 2022). Various degrees of business, lending, and financing bans have been imposed on, inter alia, the Russian State, the Russian

⁸ Banks subject to various degrees of sanctions account for the following shares of the Russian banking system: Sberbank 37%; VTB Bank 19%; Gazprombank 8%; Alfa-Bank 6%; Rosselkhozbank (Russian Agricultural Bank) 4%; Credit Bank of Moscow 3%; Bank Otkritie 3%; Sovcombank 2%; Bank Rossiya 1%; Novicombank less than 1% (BOFIT 2022b).

⁹ Bank Otkritie, Bank Rossiya, Credit Bank of Moscow, Novicombank, Promsvyazbank, Rosselkhozbank, Sberbank, Sovcombank, VEB and VTB Bank.

¹⁰ E.g. Bank Otkritie, Bank Rossiya, Promsvyazbank, Sberbank, Sovcombank, VEB and VTB Bank.

government, public authorities, banks, and state-owned enterprises (Council of the European Union 2014b; The Russia (Sanctions) (EU Exit) Regulations 2019; U.S. Department of the Treasury 2022a).

The Central Bank of Russia has been subject to massive sanctions, which have prevented it from accessing funds held in the EU, the UK, and the USA. Taking into account the sanctions imposed on the Central Bank of Russia by all countries (including, for instance, Canada), it is estimated that more than half of Russia's foreign currency reserves¹¹ have been frozen. Therefore, they are not available for purposes such as stabilising the rouble's exchange rate or, more generally, acting as a buffer to mitigate the impacts of other sanctions. (European Council and Council of the European Union 2022c) The EU, the UK, and the USA have also banned the provision of banknotes to Russia in order to prevent sanctions from being circumvented through the use of cash. The EU and the UK have also restricted cash flows from Russia by prohibiting large deposits by Russians in EU and UK banks. (Council of the European Union 2014b; Executive Office of the President 2022b; GOV.UK 2022b; The Russia (Sanctions) (EU Exit) Regulations 2019) In addition, the EU has imposed bans on public financing and public procurement, for instance (Council of the European Union 2014b).

The financial sector sanctions imposed on Russia, such as the exclusion of Russian banks from SWIFT and the severe restrictions imposed on the Central Bank of Russia, effectively isolate the country from the international economic system and impair the country's financing options. In particular, the impacts of the USA's sanctions are extensive, as the USA has significant power in international financial markets, mainly due to the strong position of the US dollar as a global reserve currency (Lempiäinen & Soirila 2022). Indeed, the USA's sanctions indirectly restrict also the operators from other countries, including Finland. Examples of this have been seen especially in the financial sector, even before the war in Ukraine, when Finnish banks have refused to transfer the payments of individuals on the sanctions list of the Office of Foreign Assets Control (OFAC), which administers and implements the USA's sanctions, and have terminated these individuals' customer relationships with the bank (See e.g. Halminen 2021; Lempiäinen & Soirila 2022; Pietiläinen & Vuorikoski 2022). The reason for banks' caution is the fear of becoming subject to US sanctions themselves, as US legislation allows for sanctions to be extended to include banks that have facilitated a significant business transaction to be carried out by a sanctioned entity. In that case, banks would no longer be able to use the dollar in their transactions, which would prevent them from executing international payment orders, and furthermore, other banks would also terminate their relationship with the sanctioned bank. In practice, this could cause the bank's failure. (Lempiäinen & Soirila 2022) Consequently, co-operation with parties subject to US sanctions is very risky.

2.5. Communications sector

The EU, the UK, and the USA have imposed sanctions on the Russian state-owned media, which they see as responsible for spreading propaganda and disinformation. The aim is to impair Russia's ability to destabilise the Western countries with information operations carried out through state-owned media. The EU has suspended all broadcasting from five Russian state-owned media: Rossiya RTR/RTR Planeta, Rossiya 24/Russia 24, RT (former Russia Today), Sputnik, and TV Centre International. The restrictions apply to all broadcasting and distribution channels of these media operating in or targeted at the EU Member States, such as cable and satellite connections and Internet-based distribution. In addition, the EU has banned the advertising of products and services in these media. (Council of the European Union 2014b; European Council and Council of the European Union 2022c)

The UK has imposed restrictions on the online distribution of content produced by two Russian media companies: TV-Novosti, which owns RT, and Rossiya Segodnya, which owns Sputnik. According to the restrictions, social media services must prevent access to content produced and distributed by these media companies, internet service providers must prevent access to their websites, and application stores must prevent the downloading of their applications. (The Russia (Sanctions) (EU Exit) Regulations 2019) In addition, the communications regulator Ofcom has cancelled RT's broadcasting licence in the UK (Ofcom 2022). Within the scope of its sanctions on individuals and entities, the USA has imposed sanctions on parties it considers to be spreading disinformation, such as the Kremlin's press secretary, Dmitry Peskov, and the television channels NTV, Pervyi Kanal and Rossiya-1 (U.S. Department of State 2022c; 2022d).

¹¹ In February 2022, Russia's foreign currency reserves amounted to EUR 579 billion (European Council and Council of the European Union 2022c).

2.6. Other trade and investment restrictions

In addition to the sanctions in the sectors described above, the EU, the UK, and the USA have imposed other import, export, and investment restrictions on Russia. The goal has been to maximise the impacts of the import bans on the Russian economy by prohibiting the import of products that generate significant revenue for Russia, such as fish and shellfish (including caviar), alcoholic beverages, timber and timber products, tyres, and diamonds. (Council of the European Union 2014b; Executive Office of the President 2022b; The Russia (Sanctions) (EU Exit) Regulations 2019) Import of gold, Russia's most profitable export item after energy, into the EU, the UK, and the USA is also prohibited. The gold import ban is believed to impair Russia's opportunities to raise funds for its war in Ukraine and the opportunities of oligarchs to circumvent sanctions by exchanging their assets for gold. (European Council and Council of the European Union 2022e; GOV.UK 2022f; Toivonen 2022) In addition, the UK and the USA have imposed increased import duties on Russian products that are not covered by a full import ban (GOV.UK 2022f; White House 2022c). Instead of increasing customs duties, the EU has taken the approach of restricting the imports or exports of certain products and technologies as a whole (European Council and Council of the European Union 2022c).

The aim of the export sanctions is especially to undermine Russia's technological and industrial capabilities by restricting its access to high-tech products and technology and other critical equipment, components and materials (The Russia (Sanctions) (EU Exit) Regulations 2019; European Commission 2022a). The Russian elite, in particular, is subject to the export ban of luxury goods such as alcoholic beverages, perfumes, watches and cigarettes (Bureau of Industry and Security 2022; Council of the European Union 2014b; The Russia (Sanctions) (EU Exit) Regulations 2019). The UK and the USA have also banned all new investments in Russia (Executive Office of the President 2022c; GOV.UK 2022e). Service exports to Russia have also been restricted with regard to business services, such as consultancy, accounting, and PR services, IT consultancy and legal advisory services, and architectural services, for instance (European Council and Council of the European Union 2022a; GOV.UK 2022d; U.S Department of State 2022b).

In particular, the restrictions imposed by the EU affect Russian exports. According to expert calculations by the CEPIL, a French institute for research into international economics, sanctions from the 1st to 6th sanctions packages will cover 65 percent of the EU's imports from Russia by the end of 2022. The coverage of sanctions varies by product group – for instance, all imports of timber are already banned, and the majority of energy imports will be banned by the end of the year. The effectiveness of sanctions is enhanced by the fact that, as an export market, the EU is considerably more important for Russia's foreign trade than imports from Russia are for the EU – the EU's sanctions cover a quarter of Russia's total exports, while they account for only 5 percent of the EU's total imports. (Bellora et al. 2022) The import substitution policy adopted by Russia since the occupation of Crimea in 2014 has not worked as expected, and the country's industrial production is highly dependent on imports, especially in many medium-tech and high-tech sectors (Simola 2022). Examples of the negative impacts of the sanctions on production have already been observed in some import-dependent sectors. For instance, the Russian automotive industry has suffered greatly as a result of the withdrawal of foreign car manufacturers from the country and the shortage of components caused by the sanctions (Autostat 2022; The Moscow Times 2022).

When it comes to the effectiveness of sanctions, circumvention is a major challenge. A common way to circumvent export restrictions is to recycle purchases through third countries, using buffer companies and cover networks in the procurement of goods subject to sanctions. There are examples of this with Russia, too, at least regarding products that have ended up being used for military purposes. (RUSI 2022) In addition, Russia seeks to circumvent sanctions through parallel imports of certain goods, which it legalised in May 2022. Parallel imports refers to imports without the permission of the trademark owner and bypassing the authorised distributor. Goods for which parallel imports are authorised include, among other things, automotive parts, industrial machinery and equipment, electronics, and various consumer products, such as clothing, footwear, and cosmetics. Parallel imports aim to improve the availability of imported goods on the Russian market and to harm especially companies in "unfriendly countries". (BOFIT 2022a; Saarto 2022) Russia has carried out parallel imports through the countries of the Eurasian Economic Union¹², for instance (Meduza 2022).

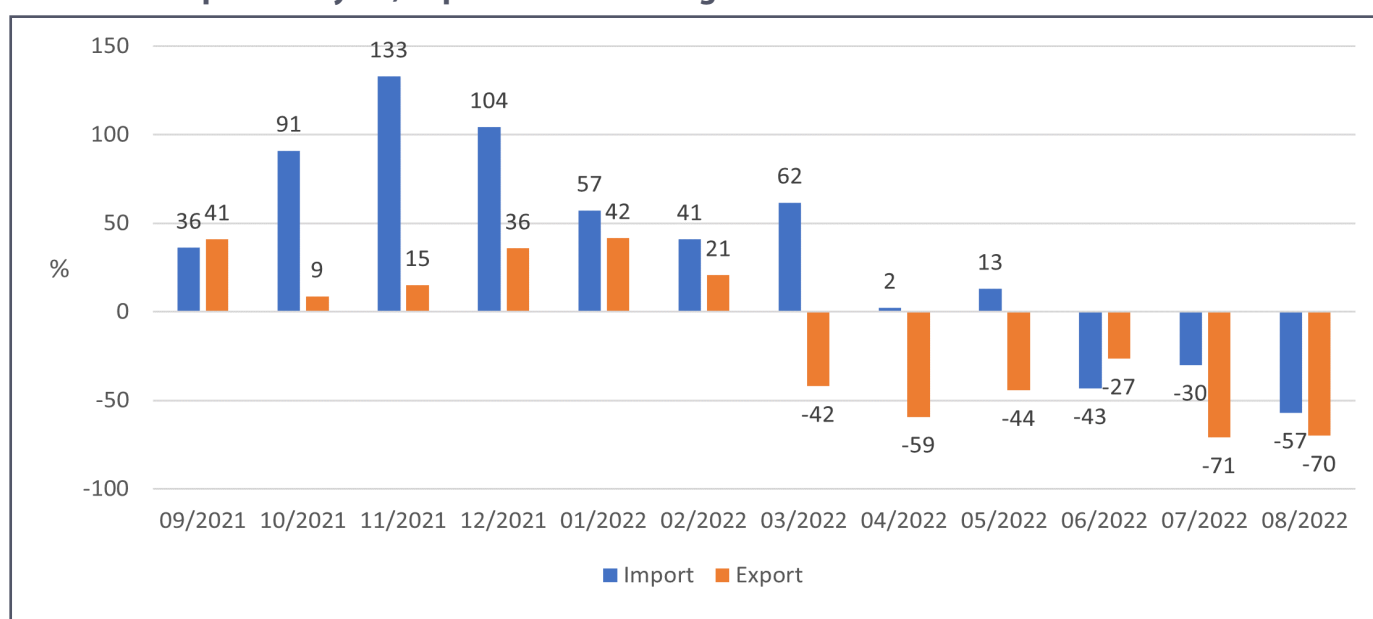
12 Armenia, Kazakhstan, Kyrgyzstan, and Belarus, in addition to Russia.

5. Impacts of the war in Ukraine and the sanctions on Finland's foreign trade

Russia's significance for the Finnish economy has been declining for a long time, in particular due to the economic sanctions following the occupation of Crimea in 2014, Russia's counter-sanctions, and the collapse of the demand for tourism services caused by the coronavirus pandemic. Finland's exports to Russia in particular have decreased. (Lavikainen et al. 2022) In 2021, Finland's goods exports to Russia totalled EUR 3.7 billion and accounted for 5.4 percent of total goods exports (Finnish Customs 2022a). Russia was Finland's fifth most important export country (Statistics Finland 2022a). The most significant export product group was machines and equipment, followed by paper products, and copper and articles of copper. The number of companies exporting goods to Russia has also decreased – in 2013, there were 3,700 Finnish companies exporting goods to Russia, but in 2021, the number had decreased to 2,200. (Ali-Yrkkö et al. 2022) In imports, Russia's role has remained larger, as Russia was Finland's second most important import country in 2021 (Statistics Finland 2022a). The value of goods imported from Russia was EUR 8.6 billion, and their share of total imports was 11.9 percent (Finnish Customs 2022a). Crude and refined oil accounted for 40 percent of imports from Russia and fuels and lubricants altogether 56 percent (Lavikainen et al. 2022).

As a result of the sanctions imposed due to the war in Ukraine, Finland's trade with Russia has decreased significantly, and will continue to do so once the transitional periods for the sanctions already imposed have passed. According to Finnish Customs' international trade statistics, exports to Russia declined immediately when the sanctions were imposed in March 2022, but imports started to decline only in June (Figure 1). The value of imports has remained high due to the significantly higher prices of energy products, even if import volumes have actually decreased (Finnish Customs 2022d).

Figure 1. Change in the value of imports from and exports to Russia, compared to the corresponding month of the previous year, September 2021–August 2022



Source: Finnish Customs 2022c.

According to the statistics on international trade, provided by Finnish Customs, in August 2022, the value of Finnish imports of goods from Russia decreased by 57 percent and the value of Finnish exports of goods to Russia by 70 percent year-on-year (Finnish Customs 2022c). According to preliminary statistics, both imports and exports have collapsed in almost all categories of goods. However, imports of petroleum products increased by more than 80 percent in August 2022 compared to the corresponding period of the previous year, and imports of nickel mattes by 124 percent. In August, more than half of the value of Finland's imports from Russia consisted of imports of nickel mattes. Exports of copper mattes to Russia, in turn, grew by 50 percent. (Finnish Customs 2022b) Nickel, used for instance in battery manufacturing, has not yet been sanctioned by the EU (Blencowe 2022).

The most significant export sanctions for the Finnish economy and Finnish companies are especially export bans on high-tech products, such as various kinds of machines and equipment (Urrila 2022). In imports, Finland has been especially affected by the end of fossil fuel imports from Russia, as before the war and the sanctions, Finland was highly dependent on Russia in this regard: in 2021, 92 percent of the natural gas consumed in Finland came from Russia as did 67 percent of the oil consumed and 52 percent of the coal consumed. All in all, energy imported from Russia accounted for approximately one third of Finland's total energy consumption. (Statistics Finland 2022b) The sanctions imposed by the EU ended the import of coal from Russia in August 2022. The import of crude oil will end in December 2022, and the import of petroleum products in February 2023. (European Council and Council of the European Union 2022c) The Finnish oil company Neste has already announced that the supply agreements for Russian crude oil ended in July 2022. This also coincided with their last shipment of crude oil from Russia to Finland. (Neste 2022) According to Finnish customs, Norwegian oil has largely replaced imports from Russia (Finnish Customs 2022d). Russian companies Gazprom and RAO Nordic cut off pipeline gas and electricity deliveries to Finland already in May (Hanhinen 2022a; 2022b). Pipeline gas now comes to Finland only through the Balticconnector pipeline between Finland and Estonia, and the availability of natural gas is also improved by the leasing of the floating LNG terminal (Valtioneuvosto 2022). However, Russian LNG has also still been imported to Finland by sea (Oksanen 2022). Electricity produced by the Olkiluoto 3 nuclear reactor, currently in the testing phase, will replace electricity previously imported from Russia, once the new reactor is in operation, possibly in December 2022 (Laakso 2022). Despite the preparations, energy shortages in the coming winter are possible in Finland, too.

4. Impacts of the war in Ukraine and the sanctions on Finnish companies

Russia's attack on Ukraine and the resulting sanctions have had major impacts on Finnish companies, both those operating in Russia and those involved in trade with Russia. Both exports to and imports from Russia have decreased significantly. Furthermore, Finnish companies operating in Russia have withdrawn from the country on a wide front. According to the latest data from 2019, the number of Finnish companies' subsidiaries in Russia was approximately 300, and 180 Finnish companies had at least one subsidiary in Russia. Since 2010, the number of subsidiaries in Russia has decreased by nearly one third. (Ali-Yrkkö et al. 2022) So, the local presence of Finnish companies in Russia has been decreasing for a long time, but the war in Ukraine has nevertheless significantly boosted this existing trend. None of the Finnish companies tracked by Yale University continued their operations as before, and approximately 80 percent of them have frozen their operations or completely withdrawn from Russia¹³ (Yale Chief Executive Leadership Institute 2022). According to a report published by Yle, the Finnish Broadcasting Company, in October, almost all of the 88 large Finnish companies covered by the report either have already withdrawn or are about to withdraw from Russia. Less than ten companies are still operating in the country, and almost all of them have cut down their operations drastically. (Yle 2022)

Although the EU has acted as a reasonably united front in the imposition of sanctions, there are differences among EU countries in their approach to the war in Ukraine, and to Russia. Furthermore, the solidarity felt for Ukraine may begin to fracture, as the economic impacts of the war and the sanctions on EU countries intensify. (Krastev & Leonard 2022) On the other hand, Finns have been very united in their attitude towards Russia's war of aggression and support for Ukraine. For instance, in the survey conducted by the European Council of Foreign Relations (ECFR) think tank, 90 percent of Finns considered Russia to be responsible for the war, which was the highest figure among all countries surveyed (Krastev & Leonard 2022). Indeed, it seems that the mental impacts of Russia's war of aggression have been greater in Finland than in many other EU countries, due to factors such as the geographical proximity of Russia, and the war experiences in Finland's recent history.

The united attitude of Finns towards the war has also been reflected in the desire of Finnish companies to withdraw from Russia. According to the experts interviewed for this report¹⁴, a final or temporary withdrawal has been the key strategy for Finnish companies operating in Russia. Often, the actual cause

13 The situation on the 7th of November, 2022.

14 In addition to written sources, expert interviews have been used as source materials for this section. The interviewees were EastCham Finland's CEO Jaana Rekolainen, East Office of Finnish Industries' Senior Analyst Sinikka Parviainen, and the Confederation of Finnish Industries' Senior Advisor Heli Siikaluoma. The interviews were conducted in June and July 2022.

of the withdrawal has not been the sanctions, although the restrictions on the export of components to Russia make it difficult to continue production in the country, but rather companies' own decision based on reasons such as the constantly more challenging business environment. A key driver of withdrawal has also been the reputational damage caused by operating in Russia and the public pressure especially on companies operating in the consumer market. Companies have not necessarily been under similar pressure in all EU countries. According to Yale University's tracking, Swedish and British companies (non-EU) have been active in withdrawing, while many Italian, French and German companies, for instance, continue to operate as usual in Russia (Yale Chief Executive Leadership Institute 2022). Indeed, expert interviews revealed that as Finnish companies are planning their exit from Russia and selling their local business operations, buyer candidates have even included companies from other EU countries.

Although many Finnish companies were prepared for the increased Russia-related risks, especially after the occupation of Crimea, the sudden and comprehensive crisis caused by the Russian war of aggression has come as a surprise to everyone. It also marked a sudden turnaround in the positive expectations of many companies with regard to exports to and business in Russia after the difficulties caused by the coronavirus pandemic had receded. The sudden onset of the crisis and the rapid entry into force of extensive and sometimes very complicated sanctions have created a huge need for information and advice. With the introduction of sanctions in the logistics and financial sectors, their impacts have expanded to an increasing number of Finnish companies. Restrictions in the logistics sector, in particular the operating ban on Russian and Belarusian road transport operators, have also hindered the flow of allowed exports and imports, and increased freight rates. Sanctions in the financial sector, in turn, have complicated many of the payment transactions between Russia and Finland.

According to EastCham Finland's survey, 75 percent of the companies have had problems with payment transactions from Russia and 53 percent have had problems with payment transactions to Russia. In particular, it has been difficult to receive payments for already delivered products and services from Russian customers. There have also been problems with payments to Russian customers and intra-group payments. Half of the companies that responded to the survey reported that their finances have been jeopardised due to the difficulties in payment transactions. The main cause of payment-related problems is the overcautious attitude of banks towards the processing of all Russia-related payment transactions, including those related to non-sanctioned parties and products. According to the survey, the attitude of Finnish banks towards the processing of Russia-related money transfers is considered to be much stricter than that of many European banks, for instance. (EastCham Finland 2022a) Expert interviews also revealed that companies that are customers of Nordic banks face more payment transaction challenges than their counterparts in Central Europe. In addition to the EU's sanctions, the USA's sanctions also have a significant impact on Finnish operators, even though they are legally binding only for US entities and entities operating in the USA.

The withdrawal from Russia and the sale of business operations have been challenging for some Finnish companies. From time to time, it may have been difficult to find buyers who are not subject to sanctions, as there have also been suspected buffer companies among buyer candidates. Companies have also been sold at significant discounts. However, there are several reasons why companies prefer avoiding the complete termination of business operations. Finnish companies have had tens of thousands of employees¹⁵ in Russia and want to avoid their becoming unemployed. In addition, the Russian authorities have exerted various forms of pressure on foreign companies planning to withdraw from the country and on the local management of their subsidiaries. The Russian Duma has, among other things, been preparing legislation on criminalising compliance with Western sanctions and transferring the subsidiaries of foreign groups, which have announced their withdrawal from the country, under Russian control (Gershkovich 2022; Simmons 2022). However, the hard rhetoric at the beginning of the war has since become somewhat more moderate (Hyytinen 2022). War censorship has also created challenges: In March, a law came into force in Russia criminalising the dissemination of "fake news" about the Russian army, which meant that the war in Ukraine was to be referred to as a "special operation" (RFE/RL 2022). As a result, companies have had to be cautious also in their internal communications in order to protect their local personnel from criminal liability.

The war in Ukraine and the sanctions have had indirect impacts related to, for instance, the availability of energy and raw materials and the increase in prices, that affect all companies. However, the direct impacts of the war and the sanctions have been most severe in SMEs that have built their business relying on the

15 According to Ali-Yrkkö et. al (2022), in 2019, the subsidiaries of Finnish companies employed more than 32,000 people in Russia

Russian market. By contrast, for large companies, Russia has not played such a significant role in their business operations, their preparedness for sudden changes through risk management and buffers is better, and they can direct their operations to substitute markets more flexibly. In the survey conducted by EastCham Finland in April 2022, 65 percent of the companies that are involved in trade with Russia believed that they could find substitute markets for some of their products, while 18 percent believed they could find substitute markets for all products, and 16 percent did not believe they could find substitute markets for any of their products. Sweden, Germany, the USA, Central Asia, and China were mentioned as the most potential substitute markets. (EastCham Finland 2022b) Sweden, Germany, the USA, and China have been important trading partners for Finland even before the war and the sanctions (Statistics Finland 2022a), so increasing foreign trade with them is a natural option. According to the interviewees, Sweden, Germany, the USA, and the Russian-speaking markets in Central Asia, in particular Kazakhstan and Uzbekistan, have also evoked the most interest among the companies. Kazakhstan, in particular, has also actively attracted foreign companies to the country. In addition, when the war is over, the reconstruction of Ukraine can offer opportunities for Finnish companies. Although internationalisation as such is vital for many Finnish companies, the crisis has demonstrated very concretely that authoritarian countries entail a stronger political risk than democratic countries. Therefore, business opportunities in non-democratic countries – including China – will be examined more critically in the future.

The interviewees considered the future of the Russian market very gloomy. The lifting of the sanctions would require a lasting peace in Ukraine and a change of regime in Russia, neither of which is currently in sight. Moreover, lifting sanctions is often a much more difficult and protracted process than imposing them. The small-scale recovery of export and import trade is considered more likely than the re-activation of investments, but this also requires a mitigation of the sanctions. On the other hand, Finnish investors' confidence in the Russian market has been completely lost, and the crisis is likely to become an experience shared by an entire generation which will not return to Russia. In other European countries, however, the situation with regard to returning to the Russian market may be different¹⁶.

5. Conclusions

Russia's brutal war of aggression in Ukraine has been condemned all over the world. The EU, the UK and the USA, and their allies, including Australia, Canada and Japan, have imposed unprecedentedly extensive and well-coordinated sanctions on Russia. The goal has been to target the sanctions at the key sectors of the Russian economy, undermining Russia's technological and military development and, in the long term, Russia's ability to finance its war in Ukraine. In general, however, sanctions are a slow way to exert influence, and they rarely lead directly to the collapse of the regime. Furthermore, examples such as Cuba, North Korea, and Venezuela show that in autocratic regimes, the economic impoverishment caused by sanctions can be tolerated for quite a long time. In the case of Russia, too, the sanctions do not cause the country's economy to collapse suddenly, but they do weaken it gradually and isolate the country economically from the rest of the world. The impacts are already evident in the standard of living of ordinary Russians, too, due to factors such as higher prices. In addition, the situation in Russia is aggravated by other consequences of the war, such as the large-scale withdrawal of Western companies, and the accelerated brain drain resulting from the war and the partial mobilisation announced in September 2022. As a result of the mobilisation, the war has affected more and more Russians.

The war and the sanctions have weakened Russia's economic and social ties with the Western countries significantly, and the country is not only turning inwards but also increasingly becoming oriented towards Asia. In order to mitigate the impacts of the sanctions, Russia is seeking to increase its trade with countries that are not part of the sanctions front. However, Russia's war of aggression has led countries like Kazakhstan, one of the country's closest allies, to distance itself from Russia (See e.g. EURACTIV 2022; Hakala 2022). China has not condemned Russia's military attack on Ukraine. However, China's status as Russia's ally is not straightforward: although it has sought to position itself as Russia's partner in order to stem the influence of the USA in the world economy, showing too much support for Russia risks damaging China's own economic relations with the Western countries. By helping Russia to circumvent sanctions, Chinese companies would face the risk of becoming subject to US sanctions themselves. (Mattlin 2022)

¹⁶ For instance, the media have reported that Renault has retained the option to buy back part of its Russian operations in a few years' time (BBC 2022b).

Although Russia needs China's support at the moment, it is probably also cautious about China's growing influence in the country. China tends to use economic means, such as investments and trade, to create economic dependencies that it can utilize to gain political leverage. Nevertheless, the way that relations between China and Russia develop is an important issue for the future effectiveness of the sanctions.

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