DNSA Singh: Hollow Myths and Harsh Realities

I want to thank Brookings for hosting this event and especially my former colleague Ben Harris for inviting me here and bringing together so many friends from the world of economics and national security. To borrow from the 20th century philosopher George Costanza, these worlds are colliding – and at the intersection is my job as Deputy National Security Advisor for International Economics, and I know it's also the animating theme of this conference.

For a bit of personal context, I was serving in my current role when President Putin launched a full-scale invasion of Ukraine on February 24, 2022. Prior to this tragic decision, National Security Advisor Jake Sullivan had marshaled a team across the U.S. government and worked the phones with allies every day, for months, so that within hours, we were ready to move in lockstep with almost 40 partners to enact the most severe and comprehensive sanctions ever taken against a major economy. I left government later that summer – knowing our work was far from done – and earlier this year I returned with a strong sense of unfinished business, so I appreciate this chance to take stock of our efforts and what they show about both the power and limits of sanctions as a foreign policy tool.

The truth is, even as Russian tanks rolled into Ukraine, it was no sure thing we would convince our partners to collectively impose severe sanctions on Russia – a G20 member, permanent member of the UN Security Council, a leading nuclear power, and a top energy exporter deeply integrated with the global economy, and Europe in particular.

It was President Zelensky's address that night to European leaders, when he said it might be the last time they saw him alive, that generated the emotional valence needed for decisive action. Before the week's end, we had sanctioned Russia's largest banks and state-owned enterprises, cut off the Kremlin from leading-edge technology, and immobilized more than $300 billion of Russia's sovereign assets.

In some ways this marked the "shock and awe" phase of the sanctions campaign. But so much of what makes sanctions and export controls work is stamina – the grinding, painstaking effort to stay the course.

With that context in mind, I'd like to distinguish between myths and realities about what our sanctions are achieving and where we can go from here.

Myth 1: Sanctions haven't worked because they didn't prevent or reverse Russia's invasion.

I've said many times that the best sanctions are those that never get used. Sometimes a credible economic threat can prevent a far worse geopolitical reality. We understood that President Putin, however, was likely on a pre-set course to invade Ukraine (again) long before February 2022 – both from his repeated claims and recurring pattern of aggression.[1] Even so, we made every effort – starting with President Biden and Jake Sullivan – to shape Russia's expectations about the costs of prosecuting the war by signaling in public and sharing in private our readiness to collectively impose the most severe sanctions in our arsenal with key partners. Deploying these measures pre-emptively, as some argued for, would have only broken unity

[1] See, for example, "On the Historical Unity of Russians and Ukrainians," July 2021 http://en.kremlin.ru/events/president/news/66181

with our partners and given Putin the pretext to invade under the guise that the U.S. never had a genuine intention to preserve the peace.

Once the invasion began, the strategic objectives for sanctions evolved along three dimensions: to raise the immediate costs for the continuation of the war, degrade Russia's ability to project power over the medium-term, and deter other would-be aggressors over the long run.

It bears repeating that in pursuing these objectives – and evaluating our success[2] – sanctions are just one tool embedded within a broader strategy: to arm Ukraine's fight for freedom on the battlefield, to lessen the global spillovers from Putin's war, to wean Europe from its reliance on Russian gas, and to finance Ukraine's economic future as a successful alternative to Russian-style kleptocracy – including by unlocking the value of the assets we immobilized (a topic I will return to in closing). Executing on all those fronts gives us our best chance of shaping Putin's calculus, and staying the course is how we'll create strategic leverage for Ukraine to secure a just and sustained peace.

As for the proximate effects of sanctions, reasonable people can disagree about whether we struck the right balance between imposing costs on Putin while limiting spillovers to the U.S. and global economy. Certain macroeconomic indicators in Russia are better than many projections at the start of the invasion – including my own. But indicators of Russian resilience are a Potemkin façade: they mask the reality that Russia's prospects are bleak.

To prevent a collapse of his economy in the short run, Putin has sacrificed Russia's long-term potential in at least three important ways.

First, capital controls limited the flow of money out of Russia, helping to prevent the freefall of the ruble and the collapse of the financial system, but at the cost of limiting the flow of goods and services coming into Russia and reinforcing its isolation from the global economy. Imports from coalition countries are down by almost three-quarters since 2022, including a drop of almost 95 percent in items deemed critical to Russia's weapons production and at least a comparable percentage in imports of the advanced technology imports in areas like AI, semiconductors, and biotech.[3]

Second, Putin's decision to weaponize Russia's energy supplies drove a spike in oil and gas prices in 2022 that contributed to record Russian trade surpluses and flattered its GDP growth in the short-term – but at the cost of potentially losing half its market share by the end of the decade, according to IEA estimates.[4] Gazprom is a case in point. Once Russia's most profitable company, it just reported an annual net loss in 2023 – its first since 1999 – due to the dwindling gas trade with Europe.

Lastly, Russia ramped up government spending to as much as 8 percent of GDP, a post-Soviet record.[5] Fueling the war economy with government spending cushioned the contraction, but at the expense of depleting Russia's economic buffers and undermining Putin's previous ambitions for diversified and productive growth. Since the start of the war, the liquid portion of the

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[2] I would argue that "success" should be measured against counterfactual scenario of the next best alternative, rather than the pre-invasion trajectory or the ex-post outcome.

[3] Commerce BIS as of 5/24/24

[4] https://www.iea.org/reports/world-energy-outlook-2022

[5] https://carnegieendowment.org/research/2024/03/is-the-kremlin-overconfident-about-russias-economic-stability?lang=en

National Wealth Fund has fallen by nearly half. Defense outlays in the budget have almost tripled from pre-invasion levels to roughly one-third of the budget, while the share of spending on domestic infrastructure and education[6] has been frozen, resulting in a real cut to multi-decade lows.[7] Tanks and mortars don't raise living standards; they destroy lives and productive livelihoods. Inflation and benchmark interest rates have subsequently risen to 8 percent and 16 percent, respectively – both more than double the G20 median.

Nosebleed inflation and interest rates will inevitably choke off Russia's growth. So will its loss of access to the world's leading financial centers, cutting-edge technology, and many of the largest energy consumers. So will the emigration, conscription, or flight of over a million citizens from Russia.[8] So will the exit of more than a thousand multinational companies.[9]

Less capital, less technology, and less talent imply a smaller, weaker, and less productive Russian economy for a generation to come, and it should be remembered as another tragic consequence of Putin's war.

Myth 2: Russia is adapting and innovating around our sanctions and export controls, and we can't keep up.

Sanctions are like antibiotics: repeat usage builds up resistance. So it's not surprising that Russia is making every effort to circumvent our sanctions; in fact, it's inevitable.

But these efforts aren't costless. Russia's near-constant need to adapt and reorient its supply chains creates inefficiency, uncertainty, and complexity. By dumping pounds of sand into the gears of Russia's war machine, we're forcing the Kremlin to rely on ever more elaborate and expensive procurement networks.

Despite the near tripling of Russia's spending on defense since the invasion, its imports of key components have fallen by a third. Shortages of G7-origin electronics and the depletion of stockpiles are forcing Russia to rely on less reliable alternatives – nearly 40 percent of the lagging-edge semiconductors China provides to Russia, for example, are defective.[10] Countries that continue to trade with Russia in sanctioned goods are charging a steep premium to do so, perhaps more than 60 percent.[11]

Meanwhile, we're adapting, too. In the geopolitical economy of sanctions, standing still means you'll slip behind – particularly when the target has transformed its economy into a factory of war. That's why nearly every day since the invasion began in 2022, Jake Sullivan has convened

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[6] https://carnegieendowment.org/russia-eurasia/politika/2023/09/russias-2024-budget-shows-its-planning-for-a-long-war-in-ukraine?lang=en

[7] https://www.reuters.com/world/europe/everything-front-russia-allots-third-2024-spending-defence-2023-10-02/#:~:text=The%20finance%20ministry%20has%20allocated,at%20around%2033.5%20trillion%20roubles.

[8] Adeyemo Berlin speech; also see https://www.economist.com/graphic-detail/2023/08/23/russians-have-emigrated-in-huge-numbers-since-the-war-in-ukraine

[9] https://som.yale.edu/story/2022/over-1000-companies-have-curtailed-operations-russia-some-remain

[10] https://home.treasury.gov/news/press-releases/jy1286

[11] Bank of Finland Institute for Emerging Economies, Policy Brief 2023 No. 15, "Latest developments in Russin imports of sanctioned technology products." https://publications.bof.fi/bitstream/handle/10024/53179/bpb1523.pdf. Also see https://www.aei.org/wp-content/uploads/2024/04/The-Impact-of-Semiconductor-Sanctions-on-Russia.pdf?x85095 on price increases for semiconductors.

a team of experts in relentless pursuit of matching circumvention with countermeasures. It's why we've imposed sanctions and export controls on over 4,500 individuals and entities – many of which are front and shell companies, intermediaries, and service providers in Russia or third countries that didn't exist prior to the invasion but were emerging as nodes in Russia's shadow production network.

We know that circumvention networks will continue to evolve; necessity is the mother of invention. Our ambition is to replicate the sophistication of the financial sanctions architecture – a process that took decades to build after 9/11 – in the enforcement of our controls for goods and technology, at a fraction of the time.

I don't want to sugarcoat the challenges and risks involved – we are facing the sobering potential for Russia's military-industrial complex to grow stronger than it was before the war, and to directly threaten European and transatlantic security. Meeting this challenge will require an intensification of several efforts underway.

Our monitoring capabilities are improving with more personnel and the application of new technology, including big data analytics and AI tools to help us map critical supply chains and spot anomalies faster and with greater fidelity. But we'll undoubtedly need more resources – the budget for the unit charged with implementing export controls at the Department of Commerce has remained essentially flat since the war, despite the expansion of controls to thousands of items destined for Russia.[12]

We're strengthening institutional connectivity with regulators and international partners. Thirty-nine countries have joined the Global Export Control Coalition, a pact to impose substantially similar export controls on goods and technology to Russia. Together with the European Union, Japan, and the United Kingdom, we have developed the Common High Priority List to harmonize information that exporters, shippers, and financial institutions need to conduct due diligence. We also recognize that in an increasingly adversarial geopolitical environment, the legacy approach to consensus-based coordination needs a refresh to meet the new realities, and we'll keep pushing creative approaches to address the gaps.

We're also deepening cooperation with U.S. industry, sharing actionable information on high-risk suppliers, suspected transhippers, and product flows. Exporters are using this information to improve red-flag systems and inspections, especially for dual use items going to high-risk jurisdictions. But on this point I want to issue an urgent call for corporate responsibility: the percentage of Russian battlefield weaponry with U.S.- or allied-branded components is alarmingly and unacceptably high. Put your creativity and resources to work. Know your customers, their customers, and the end users. Ensure that American firms aren't unwitting cogs in Russia's arsenal of autocracy.

Lastly, we're looking to expand our own authorities to recognize that Russia is shifting its entire economy to a war footing – a development punctuated by the appointment of an economist as Defense Minister. In this regard, we're actively exploring options to broaden the definition of financial facilitation in our sanctions regime, as well as the scope of our export controls for U.S.-origin or U.S.-branded products.

Myth 3: U.S. sanctions have driven Russia and China closer together.

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[12] https://www.bis.doc.gov/index.php/documents/about-bis/newsroom/press-releases/3452-2024-02-23-bis-press-release-russia-two-year-actions/file

Many observe that our sanctions and export controls have pulled Russia and China closer together. These observations confuse symptoms with root causes: Russia's decision to invade and terrorize Ukraine, and China's choice to enable Putin's war. We think it's a losing bet for both.

Russia once had open access to global pools of capital and the most cutting-edge technology; now it's utterly reliant on China, giving Beijing enormous leverage over Russia's ability to project power and exert influence. Ninety percent of semiconductors and microelectronics imported by Russia in 2023 were shipped via the PRC, and 70 percent of its machine tools came from China in Q4 of last year.[13]

It may be a partnership without limits – only time will tell – but it's increasingly without symmetry. China accounted for over half (54%) of Russia's imports and more than one-third (35%) of its exports in 2023.[14] Russia, in turn, makes up only 3 percent of China's exports and 5 percent of China's imports.[15]

There are also growing risks and costs to China from the "no limits" partnership. While China-Russia trade has increased, China is well aware that its combined goods trade with the U.S. and the EU was almost 7 times larger than with Russia in 2023. More fundamentally, China has a stated interest in being seen a responsible global stakeholder. It therefore has little to gain and much to lose from Russia's intensification of the war, which has driven up energy and food prices across the developing world, while causing profound reputational damage to the commercial relationships it needs at a time of domestic weakness.

To be clear – we have no desire to disrupt all trade between Russia and China. But we and our partners are prepared to use our sanctions and export controls to prevent the trade of goods and technologies that threaten our collective security. In this regard, it's worth noting the drop in PRC-Russia trade since the President expanded Treasury's ability to target financial institutions that facilitate Russia's war – and these authorities may expand further.[16]

Myth 4: We have failed to make the case on the Russian sanctions regime to the rest of the world.

Though we are acting together with nearly 40 allies and partners to defend principles at the heart of the UN charter, we should reflect on the reality that most countries have not joined in the sanctions and export controls we've placed against Russia. Some leaders have raised concerns that our sanctions won't be effective in changing the calculus of President Putin. Some have suggested sanctions are an illegitimate exercise of brute economic force. Some of these arguments are made in bad faith by leaders who have refused to condemn Russia's war

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[13] State/OCE data.

[14] https://carnegieendowment.org/research/2024/03/is-the-kremlin-overconfident-about-russias-economic-stability?lang=en with updates by UST on 5-22-24.

[15] UST analysis 5-22-24; also see https://www.wsj.com/world/russia/russia-china-unequal-relationship-35732f24#:~:text=Beijing%20has%20provided%20a%20lifeline,to%20data%20provider%20CEIC%20Data.

[16] Chinese exports to Russia were falling as of this spring, down 16% in March from a year earlier. https://carnegieendowment.org/russia-eurasia/politika/2024/05/china-russia-yuan?lang=en&center=russia-eurasia and https://www.bloomberg.com/news/articles/2024-04-16/china-s-exports-to-russia-slump-amid-us-threat-of-war-sanctions.

at all. But they nonetheless deserve a fair hearing, not least because the force of sanctions greatly depends on the size of the coalition upholding them.

For that reason, we should continue to put serious effort toward developing a doctrine of economic statecraft that lays out clear principles for employing restrictive tools – to ensure these tools are used sparingly, avoid unnecessary spillovers, retain flexibility, surpass a threshold of efficacy, allow for maximal coordination with partners, can be sustained, and are designed with a sense of humility towards their consequences – some of which are unforeseeable. Laying down such a doctrine can help to reassure other countries that the United States, as the world's leading economic power, will not fire its economic weapons in an arbitrary or reflexive manner. It would further enhance the credibility of our conduct.

Having said this, we would never expect that every country will be in a position to formally join in each of the actions we and our closest partners are taking against Russia.

But sometimes the measure of sanctions – one that by definition will never make headlines – is what's *not* happening because of the chilling effect of our actions and warnings: The banking relationships and trade ties that don't exist. The investments that weren't made. The front companies that weren't created. It's why we engage a broad range of countries – outside our formal coalition, in ways that often aren't meant to be publicized – with specific evidence of circumvention. And while we may not always highlight the success stories from sanctions diplomacy, evidence of a pullback from Russian counterparts is plain to see, from Eurasia to the Gulf to South and Central Asia.

Myth 5: Our coalition won't implement tough sanctions on Russia for fear of spiking energy prices.

From the start, this has been one of the hardest challenges we've had to confront. Russia doesn't have easy substitutes for our coalition's financial markets and technology – but the dependencies cut both ways when it comes to fossil fuel supply, at least until our energy transition is further underway.

In the early weeks of the war, we simultaneously cut off imports of Russian energy exports and surged global supply with releases from our strategic reserves. We saw the risk, however, that in a tight global market, the impact of quantity restrictions could be offset by price increases that would translate into a net benefit for Putin's revenues and drive up global inflation.

For this reason, we now have both a G7 import ban on Russian seaborne oil and price caps on Russian crude oil and petroleum products when G7 services are involved. The leverage to enforce these caps comes from the dominant UK and EU position in global shipping insurance and trade finance – services that are prohibited unless there is verification that the oil is being sold below the cap.

Our judgment is that the price cap, alongside our import bans and other sanctions, has reduced Russia's earnings. Russia's oil tax revenue dropped nearly 30 percent from 2022 to 2023, in part due to our sanctions. And when Russia took action to evade the price cap – we worked with our partners to tighten enforcement, and we can take further action to increase the costs of the shadow fleet.   Energy analysts – and even Russian officials themselves – have linked our increased enforcement activities to the increased discount on Russian oil. At the same time, Russian export *volumes* have remained high, avoiding the price spike that many feared in 2022.

The price cap was a product of compromise and is complex to enforce. But stepping back, I'd argue it provides a powerful template of statecraft in an increasingly weaponized global energy market.

Myth 6: Mobilizing Russia's sovereign assets would be a big mistake.

Let me close with where I started. Just two days after the invasion began in February 2022, and together with our partners, we took the historic decision to immobilize Russian sovereign assets held in our respective jurisdictions. Market participants weren't expecting this decision – neither was the Kremlin for that matter. Nor did they expect this step would be taken at once by the world's most prominent reserve currency issuers.[17] Despite its shock value and the considerable risks involved, the decision did not lead to an appreciable shift away from G7 currencies.

And now, more than two years later – at a moment of great peril for Ukraine – our leaders have the opportunity to generate a financial return, at scale, from the risk already taken. The need is clear: even after taking account of the U.S. supplemental package and the EU's €50 billion facility, Ukraine still has a sizeable external financing gap over the coming years if the war continues and military spending remains steady. The G7 Summit represents the best opportunity before November to close the gap, and to deliver an unambiguous signal that we will not fatigue – while maintaining unity and without violating any jurisdiction's rule of law.

Of course there are risks involved with mobilizing these assets. But policy is about tradeoffs, and the much greater danger in this moment would be to leave Ukraine insufficiently financed to fight for its freedom. To allow one of the most egregious violations of international law in recent history to go unchecked in the heart of Europe. The precedent that failure would set, the chilling effects it would cause, the economic and financial instability it might trigger, the signal it would send to aggressors around the world – these are the costs we find unacceptable.

We can be on the right side of history while being humbled by the uncertainties of taking this momentous step. For the United States, it should stiffen our resolve to shore up the competitive advantages that gave rise to the potency of our sanctions regime in the first place: the primacy of the dollar; the integrity of our institutions; the dynamism of our capital markets; our capacity to innovate; the unmatched purchasing power of the American consumer; our net exporter status in energy and food; our unrivaled network of alliances and institutions; our ability to attract ideas, talent, investment, and goodwill; and most of all, the power of our story and trust in our leadership as a faithful steward of the international order.

Thank you.

[17] U.S. dollars, euros, yen, British pounds, and Canadian dollars account for almost 90 percent of global reserve currency holdings.