

DECONSTRUCTING THE RUSSIA SANCTIONS AND ITS IMPACT ON INDIA

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Introduction

The continued imposition of economic sanctions against Russia by the United States and its close allies has added an additional layer of complexity to the Ukrainian military conflict. In a globally inter-connected economy, any disruptive change to its underlying legal and financial architecture has the potential to result in spillover economic shocks for all market participants. This article presents a snapshot of the legal basis for the sanctions; the mechanism of its working; and its potential impact on global and Indian affairs.

Law-fare in Response to Warfare?

Weaponization of legal measures to achieve foreign policy objectives has been described as a form of “*law-fare*” by legal scholars.¹ While the prohibition on use of force against the territorial integrity of any State is clear under international law, lawfulness of economic sanctions that have extra-territorial implications, remains a subject of academic debate.² This is because in contrast to collective economic sanctions mandated by the UN Security Council under Article 41 of its Charter, the Russia sanctions are in the nature of unilateral economic sanctions, imposed by a group of countries acting in close coordination with one another. The purpose of any economic sanction is to “*induce compliance with some international obligation that the target State has failed to observe*”.³ It accordingly follows that in the present context, sanctions can be understood as instruments of coercive diplomacy, employed primarily by the Western countries to deter Russia by making the economic cost of what has been described as “military aggression”, prohibitively high.

¹ Charles J. Dunlap Jr., "Lawfare Today: A Perspective," Yale Journal of International Affairs 3, no. 1 (Winter 2008): 146-154.

² Lori Fisler Damrosch, "The Legitimacy of Economic Sanctions as Countermeasures for Wrongful Acts," Ecology Law Quarterly 46, no. 1 (2019): 95-110.

³ Paul Szasz, "The Law of Economic Sanctions," International Law Studies Series, US Naval War College 71 (1998): 455-482.

Decoding US Sanctions on Russia

The sanctions have been imposed by the US President via US Department of the Treasury's Office of Foreign Assets Control (OFAC) by issuing executive orders under power vested by Countering America's Adversaries Through Sanctions Act, 2017 (CAATSA) and International Emergency Economic Powers Act (IEEPA), 1977. The highly complex and evolving sanctions package can be found on the website of the U.S. Department of the Treasury.⁴

For convenience, we have delineated the same into six broad categories:

One, US and its allies have removed select Russian banks from the Society for Worldwide Interbank Financial Telecommunication (SWIFT), which is the dominant inter-bank messaging system that facilitates cross-border transactions. Two, export controls have been imposed on Russia to prevent the export of US goods and technologies in certain sensitive sectors. Three, in a move that brings into question, the dependency of Dollar as a reliable reserve currency, Russia's central bank has been specifically sanctioned from accessing its own foreign exchange reserves, which are located off-shore in bank accounts of various intergovernmental organizations. Four, Russian businesses have been cut off from the capital markets in the US, which directly limits their ability to borrow and raise capital. Five, efforts are being made to seize the assets of wealthy Russian individuals, often described as "oligarchs". Finally, in an effort to attack the "main artery" of the Russian economy, US has banned Russian oil and gas imports to the country. A varying combination of these sanctions have further been imposed on Russia by a growing list of countries including the European Union, United Kingdom, Canada, Japan, Australia, New Zealand, Taiwan, and South Korea. A preliminary analysis of these sanctions suggests that India will be adversely impacted in three related ways.

Maintaining Business Continuity

⁴ US Department of the Treasury, "Ukraine-/Russia-related Sanctions", <https://home.treasury.gov/policy-issues/financial-sanctions/sanctions-programs-and-country-information/ukraine-russia-related-sanctions>, n/d, accessed March 9, 2022.

According to government figures, India's bilateral trade with Russia during the financial year 2020-21 amounted to \$8.1 billion.⁵ While this may be relatively modest, sustaining market access to and from Russia is crucial to trade in many critical sectors. In this context, it is relevant to consider that the SWIFT sanction was effectuated taking advantage of the fact that the platform is run by a Belgium-headquartered organization that is largely controlled by central banks of G-10 countries (of which India is not a member).⁶ This sanction only has the effect of cutting off access of some Russian financial institutions to a messaging network which enables the settlement of cross-border transactions in an expedited manner. It consequently follows that the sanction will have a limited effect of slowing down transactions with these Russian financial institutions, and they will not be precluded from using other alternatives such as Cross-Border Interbank Payment System (CIPS) and System for Transfer of Financial Messages (SPFS). Thus, while the removal of Russian financial institutions is a challenge for Indian banks, they will devise alternative channels of cross-border financial communication to settle transactions with Russian lenders and creditors.

Given the limits of the SWIFT system, US has repeatedly called upon other countries to impose similar sanctions on Russian financial institutions, with the intent to universalize the financial exclusion of Russia, to the extent possible. In what is being seen as an "economic lifeline to Russia" by many experts, China has refused to join the bandwagon, by stating that the unilateral sanctions have "no legal grounds".⁷

Legality of unilateral sanctions notwithstanding, India will no doubt be prepared to mitigate the economic impact, should the same subsist. It can take inspiration from the countermeasures it once employed to circumvent the sanctions imposed by the US on Iran in 2012. India and Iran set up a "rupee-rial" trading mechanism to bypass the dollar for its crude oil purchases. Under this arrangement, Iran opened a bank account with UCO Bank, India which had no exposure to the US financial system, and India used the same to make payments for its oil

⁵ Embassy of India, Russia, "Brief on India-Russia Economic Relations", <https://www.indianembassy-moscow.gov.in/overview.php>, n/d, accessed March 9, 2022.

⁶ BBC News, "What is Swift and why is banning Russia so significant?", <https://www.bbc.com/news/business-60521822>, February 27, 2022, accessed March 9, 2022.

⁷ Reuters, "China will not join sanctions on Russia, banking regulator says", <https://www.reuters.com/markets/europe/china-banking-regulator-sees-limited-impact-sanctions-russia-2022-03-02/>, March 2, 2022, accessed March 9, 2022.

imports in rupees. These payments, received by Iran in its UCO Bank account, were used to pay for export of goods and services from India. It is crucial to note that while announcing the arrangement, the then Minister for Petroleum took the position that while India “will abide by UN sanctions”, it was “not duty-bound to implement unilateral sanctions by the US and the EU”.⁸

Preparing for “Secondary Sanctions”

From the perspective of India, it is important to note that countries which do not comply with the US demand to sanction Russia may be subject to “secondary sanctions”. In this context, it is important to consider that a broad interpretation of US law suggests that the US President can extend sanctions to third party states. This can be done by enforcing Section 535.329 of Code of Federal Regulations (CFR) which enables the US, to act against any entity, “whosoever organized or doing business which is owned or controlled by US”.⁹ Thus, the US could theoretically sanction an India located corporation or financial institution.

The defence sector: A further cause for concern from the Indian standpoint arises from the special focus of the sanctions regime on the defence sector. Section 231 (a), CAATSA provides that the US President “*shall*” impose at least five types of sanctions mentioned therein, on a person that “*engages in a significant transaction with a person that is part of, or operates for or on behalf of, the defense or intelligence sectors of the Government of the Russian Federation*”. Section 231 (b) further provides that the President “*may*” waive the application of the said sanctions by providing a “*written determination*” to the appropriate congressional committee.¹⁰ India and Russia have historical defence ties and are currently in the midst of a deal involving a critical missile defense system called S-400. Given the sanction regime, it follows that India faces a risk of being sanctioned in the absence of a Presidential waiver. On March 4, 2022, the US Senate Foreign Relations Subcommittee on South Asia was informed

⁸ The Indian Express Archives, “Sanctions on Iran: With UCO Bank, India works way out”, <http://archive.indianexpress.com/news/sanctions-on-iran-with-uco-bank-india-works-way-out/906854/0>, February 2, 2012, accessed March 9, 2022.

⁹ Legal Information Institute, Cornell Law School, “CFR 535.329- Person subject to the jurisdiction of the United States”, <https://www.law.cornell.edu/cfr/text/31/535.329>, n/d, accessed March 9, 2022.

¹⁰ US Department of State, “Section 231 of the Countering America’s Adversaries Through Sanctions Act of 2017”, <https://www.state.gov/countering-americas-adversaries-through-sanctions-act-of-2017/sections-231-and-235/>, n/d, accessed March 10, 2022.

that the President is yet to enforce the law and is considering whether to apply or waive sanctions on India.¹¹ Despite the fact that consignments of S-400 have started to arrive on Indian soil, Washington is yet to take a formal position on the application of CAATSA to the India - Russia deal. This is in contrast to its prompt sanctions on Turkey in 2020, when it chose to procure the same S-400 surface-to-air missile system.¹² Hence bilateral relations do come into play in adopting different approaches in the exact same situations. Considerations of waiver apart, Russia's ability to execute defence deals is likely to be impacted to the extent it relies on Western technology.¹³

Mitigating Supply Chain Shocks

In a globally-interlinked economy, the importance of seamless access to all global markets cannot be overly emphasised. When supply chains were already stressed owing to the varied impacts of COVID-19, semiconductor shortage, and fluctuations in demand, the Ukrainian conflict and consequent sanctions are bound to adversely impact many sectors of the global economy. Coupled with the increase in energy prices, the Ukraine crisis will test the resilience of the Indian economy. India's adaptation strategy is likely to be focused on finding alternatives and reducing dependency to help mitigate future risks.

Conclusion

In summary, the scale and longevity of the conflict will determine the nature of impact on India. Given that the sanctions are goal-oriented and issued to deter what has been described as "Russian aggression", their severity and sustenance is completely dependent on how the conflict shapes up in the coming weeks. In Iran's case, the first round of sanctions were imposed in 2007 and subsisted until 2015 when a deal to limit its nuclear activities was reached,

¹¹ Business Standard, "Biden will decide on sanctions on India: US official on Russian S-400 deal", https://www.business-standard.com/article/current-affairs/biden-will-decide-on-sanctions-on-india-us-official-on-russian-s-400-deal-122030300447_1.html, March 4, 2022, accessed March 10, 2022.

¹² US Department of State, "Press Statement: The United States Sanctions Turkey Under CAATSA 231", <https://2017-2021.state.gov/the-united-states-sanctions-turkey-under-caatsa-231/index.html>, December 14, 2020, accessed March 10, 2022.

¹³ The Print, "India expects West sanctions on Russia to impact key sectors, defence, engg could take big hit", <https://theprint.in/economy/india-expects-west-sanctions-on-russia-to-impact-key-sectors-defence-engg-could-take-big-hit/853792/>, March 2, 2022, accessed March 9, 2022.

only to be reinstated in 2018, when the deal fell through.¹⁴ Given that Russia was already facing various sanctions following the Crimea conflict, and the controversy relating to alleged interference in US elections the Ukraine conflict has compounded its problems, by making it the “world’s most sanctioned nation”.¹⁵

While India has not been sanctioned in any way, it needs to adapt and mitigate, with the object of maintaining a stable, rules-based financial and legal order.

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¹⁴ BBC News, “Six charts that show how hard US sanctions have hit Iran”, <https://www.bbc.com/news/world-middle-east-48119109>, December 9, 2019, accessed March 10, 2022.

¹⁵ Bloomberg News. “Russia Is Now the World's Most- Sanctioned Nation”, <https://www.bloomberg.com/news/articles/2022-03-07/russia-surges-past-iran-to-become-world-s-most-sanctioned-nation>, March 7, 2022, accessed March 10, 2022.