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The G7 Summit and the Desperation Stage of Russian Sanctions

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Biden and the other G7 leaders are meeting in the Bavarian Alps this week. Apart from proclaiming they'll never give up supporting Zelensky and Ukraine, it was announced the G7 leaders were planning two new sanctions on Russia.

Like most of the previous phases of sanctions the purpose is to deprive Russia of revenues from exports. So far sanctions haven't been all that successful in that shorter term regard. While the USA has banned Russian oil and gas imports to the USA, those amounts and revenue is insignificant to total Russian exports. And bans on Russian oil exports to Europe do not begin until December 2022, while there's no ban on Russian natural gas imports—or revenues therefrom—at all to speak of.

The sanctions on oil & gas Russian exports to Europe have thus been minimal to date. Meanwhile, Russia's exports to China, India and rest of the world have been rising. More important, with accelerating global prices for oil and gas, Russia's revenues from both have been actually rising—even as the volume of energy exports have been slowing.

This rising revenue despite the G7 sanctions has presented something of a conundrum for Biden and the G7. The whole idea of sanctions is to dramatically reduce Russian revenues, not simply volume of exports! Sanctions thus far have had the opposite effect of what was intended—Russian energy revenues have risen not fallen.

So the G7 in Bavaria have come up with two more schemes to try to reduce Russian revenues. But the thin mountain air must be affecting their thinking. The two new schemes are among the most desperate and economically absurd sanction ideas spawned thus far.

1. Ban Russian Gold Exports to Europe

The first absurd proposal being bandied about in Bavaria is to get Europe to agree to ban Russian gold exports to Europe. The thinking is Russian revenues from gold constitute Russia's second largest export revenue source. Most of the Russian gold goes to the gold exchange in London where it's 'sold' in exchange for other currencies. The G7 thinks denying Russia access to the London gold exchange will result in a big dent in its total export revenues. But there are problems with this amateur proposal.

First, Russia could just as well sell its gold elsewhere in the world. It doesn't have to sell it to the Europeans. Other major global buyers of Russian gold are Turkey, Qatar, and other middle eastern markets. Gold prices have been rising globally, as inflation has driven up oil, gas, and other industrial and agricultural commodities. With rising price trends, other markets will more than gladly buy up the Europeans' share. Some will then no doubt sell it back to the Europeans—at a marked up higher price of course. The Demand for Russian gold will simply shift, from Europe to elsewhere. Russian gold export revenues will thus not fall on net; in fact, may possibly even rise.

Second, gold is an asset that provides a hedge against inflation. It may be that Biden can get the G7 leaders and their governments (and central banks) to boycott buying Russian gold. But what's to stop individual businesses and investors in Europe from buying Russian gold, when it's presently such an attractive asset? Will Biden extend sanctions on all the individual Europeans who simply shift their purchases of Russian gold from the London Gold Exchange to the gold exchanges in Turkey, Qatar and elsewhere?

2. Price Cap Russian Oil Exports to Europe

This is an even sillier proposal. First of all, by the time the cap on Russian oil gets implemented, doesn't Europe supposed to stop buying all Russian oil imports by end of 2022? Who believes the Europeans can agree to put a price cap on Russian oil in three months for just three months more? Europe can't do anything in three months, or even six. But this isn't the most absurd aspect of the 'price cap' proposal.

Here's the logic of how the price cap is supposed to work. Theoretically, Europe would all agree to buy Russian oil exports over the next six months but only at a highly discounted price. That is supposed to cut Russian revenues from the oil exports to Europe—i.e. reduce revenues the prime goal of all sanctions. The idea was first suggested by Janet Yellen, the US Secretary of the Treasury. That's the Janet Yellen who told the world in February 2022 that inflation was temporary, remember!

Assuming Biden could get all the G7 to convince all of Europe's 27 nations on a super discounted price or don't buy any oil (as their economies run dry by December), there's the 'small problem' of what Russia's response might be to all that. The faulty logic is the G7's deep discounted price offer for the oil would be lower than the 30% discount that Russia is now selling volumes of oil to India, China and elsewhere. The G7 presumably would offer to buy Russian oil at 50% of current world prices maybe? That would put pressure, as the G7 argument goes, on Russian oil sales to India etc. The Indians would then demand Russia oil prices at the G7 lower price. Russia would realize reduced revenues from collapsing oil prices to G7 and to India, China etc.

This is so ridiculous it's almost embarrassing. The problem with the G7 'price cap' idea is there's no reason for Russia to want to sell any oil whatsoever to Europe at its deeply discounted G7 price.
First, why should it when Europe says it'll phase out all Russian oil by December anyway? Second, Russia has shown it is not concerned with reducing natural gas export revenues to Europe. It's already cut cubic gas exports to Europe by one-third as part of its own economic response to Europe's agreement with US sanctions on Russia. What's to stop Russia from just cutting off all oil exports to Europe—and well before December? Third, Russia would have to be pretty dumb to agree to Europe's 'price cap' below Russia's already 30% discount oil price sales to India? Finally, Russia knows if it cuts off all oil exports to Europe, it would just change the market flow of global oil, not reduce it. Russia would sell more to other countries, which would then just re-export back to Europe.

In short, the error with the G7 price cap idea is it assumes that buyers (Europe) can set the price for oil in what is a sellers (Russia) market! G7 may think they can stand market fundamentals on their head and make it work, but they are wrong.

Both the proposal to ban Russian gold exports to Europe and the proposal to manipulate oil demand to reduce its global market price—and thereby deprive Russia of revenues—are ideas that reflect more the desperation of the US and G7 to find some way to make sanctions on Russia work in the short run when they aren't working well if at all.

The short run objective of sanctions reducing Russian revenues has not been working and the two latest desperate ideas won't work any better.

Historians will wonder years from now why the US and its most dependent allies in tow—the G7 countries—embarked upon a scope of sanctions on Russia so soon after Covid's deep negative impacts on global supply chains and domestic product and labor markets. Global markets, trade and financial flows were seriously disrupted by the Covid experience of 2020-21. But before they could heal, the US and its G7 allies embarked on sanctions that further disrupted and restructured global supply chains while simultaneously setting off chronic global inflation that ravaged their domestic economies as well. History will show, it was not well thought out.

Even less thought out are the more recent G7 proposals to ban Russian gold—and the fantasy that manipulating a regional (Europe) oil Demand could replace global Supply as the driver of oil price and revenues.

It makes one wonder about the qualifications of the current generation of world leaders playing with the geopolitical world order—but wonder as well about their apparent even less ability to understand the consequences of their economic actions.

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