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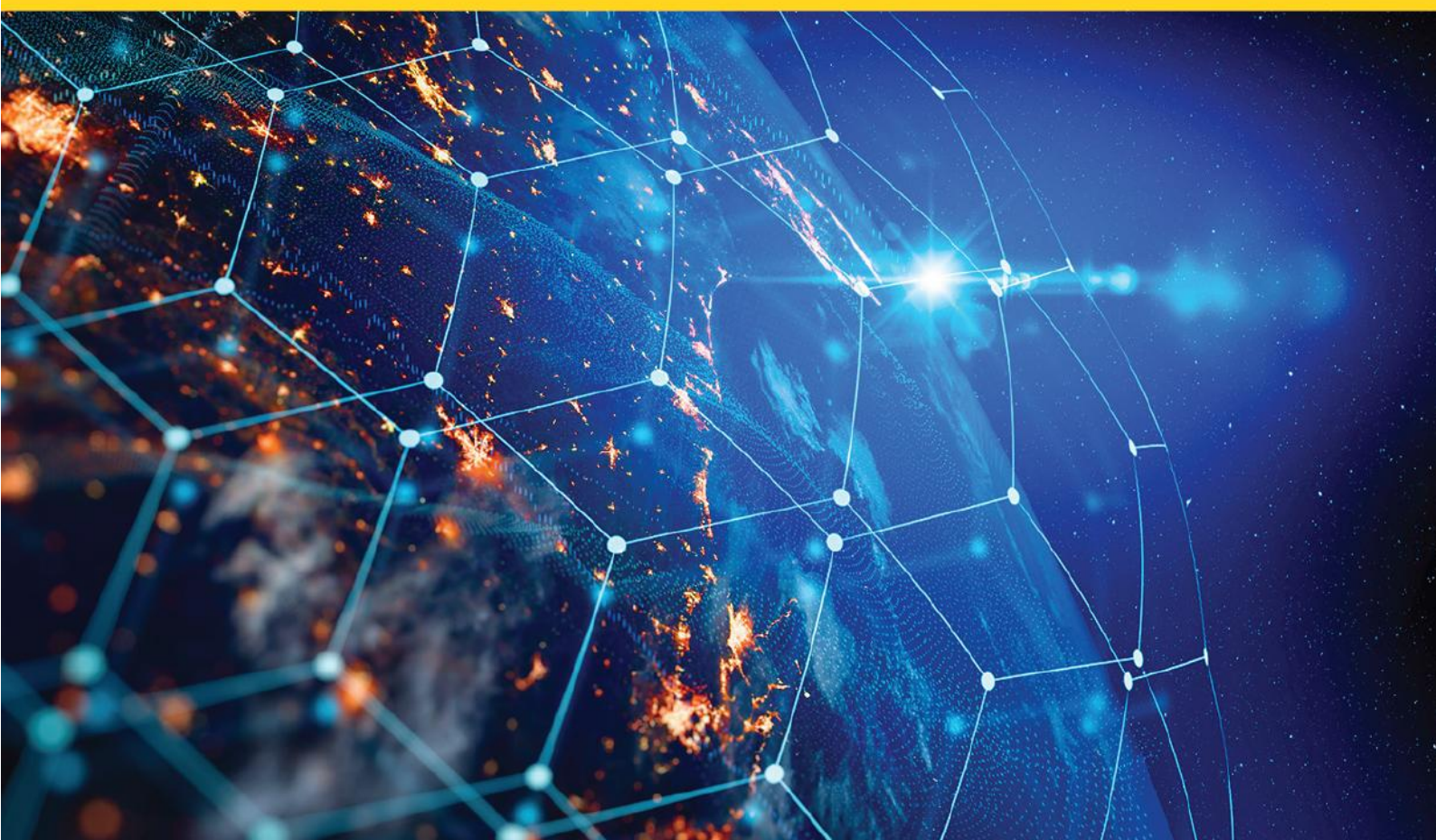

Russia's Business Partnerships Post-Ceasefire. Would Russian business shift back to the West or continue to focus on China?

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Abstract

Sanctions against Russia didn't achieve their goal bringing the Russian economy to heel and stopping the military conflict in Ukraine and will likely never achieve it. However, the sanctions and the countersanction did substantially change the very structure of the Russian economy. To understand the effects of the sanctions and countersanctions, a differentiated, sectoral approach is needed. The sanctions pushed many aspects of Russian business from western to Chinese partnerships, like machinery, machine vehicles or dual-use products. Russian companies also took the places of many leaving western companies. Many of these changes are expected to stay, even in the case of a possible sanction elevation. However, there are sectors, that are still dependent on the West, like healthcare, pharmaceuticals, machinery or energy. Russia has been hit hard by losing the EU as its biggest market for its energy products, and its biggest supplier for critical, high-tech products. Western companies will be welcomed on the Russian market in some sectors, where Chinese or the Russians could not substitute their products or services. Russians are overall skeptical with Chinese products, which creates a favorable environment for Western companies to return to Russia. However, decoupling from the West is in the forefront of Russian political will. Hungary is in a special situation, as the Russian side sees it as the "friendliest from the unfriendly countries". The good political connection gives Hungarian companies exceptional opportunities to enter Russia. A highly lucrative market, that despite the news is not abandoned by Western companies at all. The new situations on the Russian market create unseen opportunities. If conducted well, operating on the Russian market can be highly profitable in these unstable times, as the case of Richter Gedeon and OTP bank shows. Hungary is not seen as a threat, which makes partnerships with Russia possible.

Keywords: Russia, economy, trade, sanctions, EU, China

Introduction

As of 2025. June 05, the EU imposed 17 sanction packages against Russia. Contradicting the mainstream Hungarian media's narrative, these sanctions had severe effects on Russia's economy and changed the very structure of the Russian economy, the country's trade partnerships and internal policies. However, what the sanctions did not achieve was the effect that the collective West aimed to achieve in the first place. The sanctions didn't stop the ongoing conflict by cracking the Russian economy, and will likely never do.

The sanctions targeted both Russian exports and imports, weakening both the Russian and the EU's economy, while changing the trade and economic relations between the two blocks. Since the beginning of the invasion, exports to Europe dropped from USD 265.6 billion to USD 84.9 billion, imports fell by 12 percent. Overall, the sanctions and the Russian counter measurements from export bans to quotas, caused long-lasting disruptions in logistics and the payment system. Trade flows are thus not expected to restart soon. Despite the severity of the sanction's effects, Russia's economy did still not collapse as expected. There are several reasons why. First of all, the weak sanctions after the 2014 annexation of Crimea, were like vaccines to the Russian economy, that had an initially bad effect, but then made Russian economy more resilient against

the same measures. As an effect of these sanctions Russia began with its so-called import substitution politics, started decoupling from the West and grew the state's influence in critical economic segments, that made it possible to give a unified response to the sanctions after 2022, backed by institutional, financial, and diplomatic tools.

Another important factor lies in Russia's internal strength and high tolerance of its people. Sanctions usually serve the purpose to make the lives of the sanctioned country's population worse, pushing them to rebel, and to change the government that is intended to be punished. This is clearly not working in Russia, not only because of the state's strong control, but also because of the population's high tolerance and unity against any attack from outside of the border, be it of economic or military in nature.

Last but not least, the West overestimated its leverage above Russia, by thinking they could isolate the world's biggest country in a world that is moving away from unipolarity. Sanction evasion is an incremental part of this economic conflict, which strengthens third party countries helping Russia to evade the sanctions, at the expense of both the Russian Federation and the sanctioning countries. It is not the cold war anymore, where Western sanctions can totally castrate a country's economy, there is China and the global South as a subsidiary option.

China

Since the beginning of the invasion, exports to Asia grew from USD 290 to USD 306 billion, accounting for 72 percent of total Russian exports. From the perspective of doing business in Russia as a Western company, the fact that Russian trade changed its direction as an effect of the Sanctions, is of highest importance. Till 2022 trade with the EU made up around 40 percent of all Russian imports and exports. After 2022, this figure shrunk to less than 20 percent. China was the biggest trading partner of Russia already till the beginning of the military escalation in Ukraine, but after 2022, the share of China in Russia's trade reached more than 30 percent in Russian exports and more than 50 percent in imports.

Because of Western sanctions, China became Russia's economic lifeline. However, many Chinese companies avoided making lasting commitments to the Russian market, as they don't want to ruin their relationships with the West.

China gains a lot from the sanctions against Russia. The motor vehicle market for example shifted completely from European to Chinese brands. Many European companies left the huge market, because of the sanctions or because of moral reasons. This way many of them gave up on their strong brand reputation, and the profits realized in Russia, and will never be able to return to the market again.

Even though trade figures with China increased, trade became less diversified from Russia's side, focusing more and more on fossil fuel supply. The sanctions pushed Russia into Chinese dependency; the world's biggest country is now regarded as the gas station of China. This is obviously bad news for the West, as this way China gets cheap energy, boosting its competitiveness at the expense of EU countries. However, the good news for European companies is, that Russians feel the dependency from China, and want to diversify their markets. Another point is, that Chinese products and companies are not always trusted by

Russians and are inferior in some cases than western products. Moscow did not plan to replace Western economic dependency with a new dependency on China. In fact, import substitution was the highest policy priority.

Import substitution

Import substitution is achieved using high tariff barriers to enable local production of things that were previously imported. Focusing more on inner capabilities rather than relying fully on trade became a global trend in the past decade, but Russia puts an especially big effort to it. Russia intends to achieve independence from foreign import using a strategy relying on two pillars. First, they develop import substitution in those areas where they can do it, and second, they keep the economy open and reorient their imports from "*unfriendly*" countries to "*friendly*" ones. Russian is doing import substitution from 2008, but that has been intensified in 2014 and 2022 after the sanctions and contra sanctions. Until 2022, import substitution progressed slowly. However, the introduction of economic sanctions, trade restrictions, and the withdrawal or limitation of foreign investors following the "Special Military Operation" significantly accelerated the process. Sanctions make import substitution harder but necessary at the same time.

What did Russia's import substitution achieve in the last 15 years? Overall, Russia's industrial complex today depends on imports by less than 40 percent, which is approximately 2 times lower than in Hungary and is comparable to the imports of the US and India. However, it was in industries where there was healthy competition and these conditions were met that import substitution was easier than others, says Jekaterina Mozharovoj from ACRA rating agency. A complete refusal of imports will be impossible, at least in the near future. As noted in the study by the HSE Center for Strategic Research, more than 60 percent of representatives of industrial enterprises are confident that within two to three years they will be able to only partially not use foreign equipment, components, technologies, raw materials, etc., and only slightly less than 10 percent believe that they will be able to completely refuse imported components. If we can speak about the success import substitution, heavily depends which sector of the Russian economy we are talking about.

Companies leaving Russia

It is also worth examining which companies left the Russian market, what arguments are for and against such a move. According to KSE Institute dataset, since February 2022 a total of 475 companies have totally left Russia, 1346 have temporarily suspended or decreased operations and 2285 companies continue operations as before. Mostly US and European companies have left. European machine manufacturing, engineering, chemical, and pharmaceutical companies have supplied Russia with crucial equipment and services in sectors where Russia heavily depends on Europe. Since these sectors are linked to military capabilities, Western sanctions targeted them to pressure Russia to end the war in Ukraine. However, research by KSE and Yale shows that many Western companies in Energy, Oil, and Manufacturing remain active in Russia. Giants like SLB (the world's largest oilfield operator), Weatherford International, Kleemann, and Wilo SE have not fully withdrawn from the market. The agricultural sector is nearly untouched, very few companies from the sector abandoned Russia, or curtailed their operations

beyond the must. The problems on the Russian market are undeniable, forcing many western companies to scale down or pull out the market, but still many companies seem to pull out of Russia as slow as they can, keeping their presence in the country, while trying to adapt to the fast-changing regulatory environment.

The question arises, why would Western companies stay on the Russian market. First of all, Russia remains a major business market, with a population of 142 million and its 2022 GDP with USD 2.24trillion. Fleeing companies would leave a lot of revenue on the table. For companies who have a big share of their revenue streams coming from Russia, pulling out of the country would simply mean financial insolvency. Other companies may simply not fear the optics of operating in Russia, especially if these firms are small or not publicly well known, or if business interests are simply too great. This notion is corroborated by the fact, that mostly those companies left the market, whose brand is highly valuable and known in the West. These are mostly from the retail sector, franchises like MC Donald's, Adidas, Starbucks etc. These companies had to leave the market, because the revenues coming from Russia would not compensate the losses tied to the damages in their brand reputation. Meanwhile those sectors where the brand name is not widely known by the population, could afford to stay. Most of the western agricultural companies for example, whose brand name is unknown are still present on the Russian market. Another factor is the price that western companies could get out of Russia when leaving. In many cases, management might be able or willing to leave Russia, but aren't keen on selling factories, warehouses, storefronts or other assets in the country. A law, passed by the Kremlin in late 2022, essentially requires all foreign companies wishing to sell assets be assessed by a Russian government agency, then sold at half the agency's valuation.

Why to leave? Sanctions, sectoral and the ones targeting international money transfers made the regulatory environment extremely risky. International pressure, and the risk of damaging brand reputation forced some companies to leave Russia as well. A good example for this is MC Donald's, that did not want to leave the country, but because of boycotts and protests from they were forced to do so. However, the company only left the country temporarily, leaving the doors open to reenter the market when the situation gets better. Issues with money transfers, the surge of insurance costs, and the problems with currency exchange and high volatility make the presence on the Russian market for many companies unprofitable. Another serious risk factor comes from governmental interference, nationalization and confiscation of assets. Some of the companies decide to leave as the aftermath of these factors, while others bare the risks and sometimes even the losses, that come with staying in Russia, so that they would not cut their ties with the market.

In Western media in the past 3 years, the main message was, that companies have to condemn Russia, curtail their activities in the region, so that they would not feed the "Russian war machine". But the reality is more complex than this. Moral considerations may sound good in the media but are often not a primary concern. Many companies left the Russian market because of well calculated rational economic interests, and then used the Western narrative and condemned Russia for the war and claimed they would leave the country because of some moral considerations. Economic calculations come first, after that we can talk about moral

considerations.

Sectors

The new economic environment created by the sanctions did not destroy the Russian economy, but they heavily effected its structure. The era after 2022 is regarded as a separate one in Russian economic studies, because of the huge sectoral changes that happened in this time. There are sectors where import substitution was successful, and where domestic demand is fully supplied from internal sources, like in the case of the food industry. There are sectors, where Western supplies or markets were more or less deposed by friendly countries, making Russia more independent, like the motor vehicle industry. Other sectors became more dependent on one country, like the energy sector, and there are even sectors, that are still dependent on Western supplies, like the healthcare sector. In order to understand the effects of the sanctions and the challenges and opportunities that Western companies have in Russia, we have to differentiate between the sectors and look at them separately. In fact, sanctions and countersanctions changed every sector of the Russian economy differently. Therefore, a segmented approach to the different sectors of the Russian economy is needed.

Agriculture

With its massive agricultural land area and the best quality soil, is Russia historically one of the biggest agricultural producers. In 2024 agricultural exports of Russia was 36 billion, almost 10 percent of all Russian export. Hungary is a historical agricultural partner of Russia, especially when it comes to seed and genetic materials. In 2024 agricultural imports from Hungary were 82,6 million USD, which was 6 percent of the total Hungarian export to Russia. As one of the most prominent sectors of cooperation, it is important to closely examinate the situation of the sector in Russia, the changes that happened from 2022, and the future perspectives.

One of the success stories of the Russian initiative to substitute its imports is in the agricultural sector. A decade of agricultural support from the government made Russia largely self-reliable. Nevertheless, many of these improvements relied on a wide array of imported inputs, which are near impossible to source following Russia's invasion of Ukraine. For example, genetics, seeds or even cows from Hungary have a drastically higher productivity than domestic ones. Western seeds are superior, and of higher quality, boosting agricultural output, which was partly the reason how Russia could become self-sufficient in the past decades. After 2022 western countries sanctioned the agricultural sector, and Moscow decided to push even further away from any dependence from non-friendly countries, and embargoed western food imports to encourage local production. The Russian government applies over-simplistic quantitative metrics based on the outcome to assess self-sufficiency rather than looking at the whole production process and the quality of the outcome. The result is often worse quality but a larger quantity. Several Hungarian and international companies specializing in supplying Russia with high-quality seeds and genetics have to face the problem after 2022 of how they will further collaborate with one of the world's biggest crops producing country. The biggest barrier for planning long-term on the market are the initiated quotas from the Russian government and the will to build the capacity to produce everything domestically. Hungarian companies can either help in the process of transitioning the Russian capabilities, making the country capable of

producing the quality seeds and genetics themselves, or leave the robust market. The first variant is better, as the cooperation can generate considerable profits at least for some of the following years. However, IP rights, technology and knowledge must be kept by the parent company. To ensure the safety of Hungarian businesses an even closer cooperation on the highest level is needed.

Energy sector

The mutual dependency, coming from the energy sector has been historically the backbone of the Russian-EU relations. Russia holds about 20 percent of the world's gas reserves, and a considerable amount of crude oil. The Russian economy is heavily dependent on the export of its natural resources, more than 65 percent of Russian export is crude oil or gas. Europe on the other hand has been always short in energy but positioned itself as the main market for Russian gas and oil, creating a mutual dependency. However, after the annexation of Crimea in 2014 and especially after 2022 and the sanctions, this fundamentally changed, with systematic efforts from the EU's side to abandon Russian energy. The EU has dropped its share of Russian gas imports from 45 percent to 19 percent. Cutting the energy ties with Russia is not an easy task for energy poor Europe, but some countries managed to achieve a relatively high level of independence from Russian oil and gas. However, the Eastern side of the EU struggles to do so. As a rule of thumb, dependency on gas is more common than on oil.

Overall, the 137 bcm of pipeline gas imported to the EU from Russia in 2021 was reduced by 82 percent to 25 bcm in 2023, this way the share of Russian pipeline gas in total EU energy imports has fallen dramatically from 41 percent in 2021 to about 8 percent in 2023. After losing its largest market, Russia was forced to redirect its natural resource exports, primarily to India, China, and Türkiye. China imports Russian energy at significant discounts, while India plays a key role in bypassing Western sanctions by acting as a middleman—relabeling and reselling Russian oil to sanctioning countries. Due to this evasion, India has become a major exporter of refined oil products to the EU. In the 13 months leading up to December 2023, over one-third of India's oil product exports to sanctioning countries came from Russian crude, totaling EUR 6.16 billion.

Russia is also actively countervailing sanctions and imposed price caps on its Ural oil by making use of its so-called shadow fleet. his way Russia is selling its energy to the same Western countries as before 2022, but using a more expensive and complex mechanism. Russia is eager to start its cooperation with the EU in the field of energy again. The EU is still a luring, lucrative market for Russian gas and oil supplies, with existing infrastructure. On the other hand, machinery, supplying the key industry of Russia, namely the energy sector is under western sanctions, hitting Russian gas and oil extraction, refinery and transport.

Overall, sanctions targeting Russia's energy sector have had a severe impact on the industry and the national budget. However, Russia has managed to find partial replacement markets or alternative routes to reach existing ones for its oil and gas exports. These developments highlight the importance of China and the Global South, whose cooperation prevents complete isolation and limits the full effectiveness of sanctions.

Healthcare sector

Beginning from the 90's, Russia's healthcare sector has been dependent on foreign, mostly western ingredients, machines, pharmaceuticals. In return the huge market consisting of more than 140 million people lured western companies with its potentially profitable business opportunities. Among others, Hungarian companies managed to gain a foothold on the market, build lasting relations and reap the fruits of the lucrative cooperations. Cooperation between the West and Russia in the healthcare sector was smooth up until the annexation of Crimea in 2014, and the beginning of the military conflict in 2022. After 2022, western pharmaceutical companies have come under pressure to leave Russia and many of them announced that they have pulled the brake on further expansion in the country but claimed, that they do not intend to exit the Russian market completely. And unlike western companies from other sectors, pharma companies have the legal right to stay in the most sanctioned country, because of the unique nature of the healthcare sector. The reach of the sanctions against the vulnerable Russian healthcare sector -which is heavily dependent on Western imports- is limited, as sanctions against the healthcare sector are very complex and hard to implement without infringing universal human rights.

75 percent of Russian medical equipment was imported in 2021. While many sectors shifted from the West to China for substitutes, this transition is not feasible in healthcare, as Chinese companies cannot fully supply the necessary components or match the required quality. As a result, healthcare remains one of the least affected sectors by sanctions and continues to rely on Western trade, offering significant potential for Western companies. And Hungarian companies are happy to use this potential. The sales volume of Gedeon Richter in Russia in 2019 amounted to 17 percent (267.1 million euros) of total sales in the countries of presence. In 2020 Hungary exported pharmaceutical products in the amount of 300 million USD, then 300, 400 and 486 million USD in 2021, 2022 and 2023 respectively. This way, the pharmaceuticals sector's share in the Hungarian export to Russia grew to more than 40 percent in 2023.

The healthcare sector remains an area where cooperation and trade with Russia is still feasible. The uniqueness of the sector doesn't allow for heavy sanctions, opening the opportunity for western companies to stay on the market. Russia is also welcoming western companies, because of the country's healthcare is still dependent on western machinery, pharmaceuticals, and knowledge, where China failed to replace the west. This leaves the door open for further cooperation. Hungarian companies, especially Richter Gedeon makes huge profits on the Russian market, and is received as a trusted partner from the Russian side.

Conclusions from the Interviews

As part of my research, I conducted interviews with representatives of Hungarian and Russian companies, all operating within the agricultural sector. Therefore, the conclusions drawn are primarily relevant to this field. The interviewed companies are involved in various activities, including livestock trading, feedstock supply, genetics research, and agricultural market analysis.

The start of the military conflict brought problems to every company. It altered logistics routes,

extending them and making transportation more expensive. For Hungarian companies raising capital for operations in Russia became impossible, as the market became too risky for investors. The ban of Russia from the SWIFT system brought serious financial problems connected to money transfer and exchange rates.

The sanctions had a lesser direct effect on the interviewed companies, but had great indirect impact, through the quotas and counter sanctions introduced from the Russian side. The political will for import substitution has risen. This decreased the available market for companies from non-friendly countries. Higher levels in the Russian government decided to create their own genetic stand, which endangers the long-term operations of companies focusing on genetics in Russia. The counter sanctions are incorporated in the Russian legislation; therefore, it is going to be hard to alleviate them even after the possible détente of the international situation. A possible ceasefire therefore doesn't immediately result in a friendlier business environment for foreign companies in Russia.

These factors make the Russian market more and more alienated from foreign business. And still there are a lot of Western companies who operate in the country. Sometimes they change their name, structure or they establish a new entity for Russia, but sometimes they didn't change anything and continued to operate the same way as before 2022.

Hungarian companies need to know that, as many of them are reluctant to enter the Russian market today, because they think Western companies are not doing business in Russia anymore. This is a shame, as Hungarian companies have an advantage in Russia, because of the good diplomatic relations between the two countries. However, big Hungarian multinationals, like Richter Gedeon or OTP bank make huge profits from the Russian market and became top players in their sectors on the market consisting of 142 million people.

The western companies that left the market because of various reasons, created a vacuum in the Russian market, that was quickly filled by Russian and Chinese companies. Many Chinese companies managed to react fast on the changing environment and successfully substituted their Western competitors. However, Russians don't necessarily trust Chinese products, as they count them inferior. Many of the lucrative sectors, which have no impact on the military efforts of Russia were abandoned by Western companies because of moral reason. Russian companies are gaining a lot from the eased competition, often by simply taking over foreign assets by buying it with a considerable discount. Other than that, as an effect of the import substitution, Russian domestic production has been boosted. Many of the dying Russian industries are now on their feet again because of the decreased competition. However, even if in the short term the absence of western companies guaranteed higher demand and profits for the Russian companies, in the long-term the decreased competition can lead to lagging behind from the perspective of technology and competitiveness.

In conclusion, there is no single answer to the question, if Russian business would shift back to the West or continue to focus on China. A sectoral approach is needed, to assess the effects that the situation after 2022 brought to the Russian market. Every sector was hit differently. Some of the sectors definitively shifted to China, some of them shifted, but might return to Western partnerships with a change in the environment, and some of them didn't even shift. Western

companies, Hungarian in particular should examine the changes on the Russian market, as the current situation makes business risky in the market of 142 million people, but potentially highly rewarding. Missing on a chance like that could mean leaving money on the table