Managing Supply Chain Consequences Of Russian Sanctions

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To combat Russia's war against Ukraine, the resulting humanitarian crisis and evidence of war crimes, President Joe Biden has issued executive orders restricting trade with Russia and taken the rather extraordinary step of revoking Russia's permanent normal trade relations, or PNTR, status with the U.S.

Earlier this month, responding to the emergence of images of atrocities in Bucha, Ukraine, Biden labeled Russian President Vladimir Putin a war criminal, and continued increasing the sanctions imposed on Russian goods and certain sectors of the Russian economy.

The cumulative effect of these actions by the Biden administration uses trade as a weapon to restrict the import and export of goods from Russia. These measures will further negatively affect an already-stressed global supply chain.

U.S. businesses should carefully consider what consequences these additional actions will have from a trade standpoint, and should also be aware of potential avenues to manage continuing supply chain consequences.

Summary of the Recent Sanctions and Congressional Action

In his March 11 executive order, Biden banned U.S. exports to Russia of high-end watches apparel and alcohol, jewelry, and luxury vehicles and other luxury goods frequently purchased by wealthy Russians. The executive order also banned the import into the U.S. of Russian-manufactured seafood, spirits — including vodka — and nonindustrial diamonds.

The White House indicated its goal in issuing this order was to "deny Russia more than $1 billion in export revenues and ensure that U.S. citizens are not underwriting Putin's war."[1] The White House made clear that additional import bans could be imposed as appropriate if the Russian aggression in Ukraine continued.

In addition to issuing the executive order, Biden announced in March that he would work with Congress on legislation to revoke Russia's PNTR trade status, the result of which will mean increased tariffs on all U.S. imports from Russia.

Permanent PNTR status was conferred on Russia in 2012 following Russia's accession to the World Trade Organization.

However, like NATO, the European Union and the G-7, the U.S. is working to remove this most-favored nation designation from Russia, using trade as part of the coordinated effort to sanction Russia's continuing aggression.

On April 7, the U.S. Senate and the U.S. House of Representatives responded to the White House's proposal, with the Senate voting 100-0 in favor of the measure removing Russia's PNTR status, and House approval quickly following along with a 420-3 vote.

Biden signed the bill into law April 8. As a result, imports from Russia and Belarus will now be subject to an additional tariff upon import, though from a practical standpoint, implementation will take some time.

The amount of the additional duty that will be assessed on imported Russian goods will vary depending on the goods at issue, but the average additional duty rate that can be expected is approximately 29% — a purposefully marked increase in price.

The White House has issued more sanctions on Russian banks and targeted certain Russian individuals. Specifically, on April 6, the U.S. Department of the Treasury's Office of Foreign Assets Control took steps in response to the president's executive order imposing full blocking sanctions on Russia's largest state-owned bank and Russia's largest private bank.

In addition, the Treasury targeted Putin's family members and Russian Security Council members who are participating in the war against Ukraine. Further, Biden's April 6 order banned all new investment in the Russian Federation, as well as the provision of certain services to any person located in the Russian Federation.

Those sanctions are not expected to be the last, given the president's continued use of trade as a key weapon in this particular global conflict.

Effects on the Supply Chain and Business Responses

Actions taken within the private sector in connection with the increasing number of sanctions being issued by the U.S., the EU and the G-7 will magnify the effects on the supply chain that will come with increased tariffs — or the outright ban — on Russian goods.

In addition to many companies refusing to do business in or with Russia, including large financial and credit organizations, most ocean carriers have banned all new bookings from Russia and Ukraine. Further, an increasing number of ports throughout the U.S. and Europe have banned Russian-flagged ships.

From a practical standpoint, this means preexisting supply chain congestion will increase as additional shipping vessels and the shipments themselves are diverted back to Russia, delayed or canceled outright.

For U.S. businesses directly affected by the ban of goods imposed through the March 11 executive order, OFAC issued some guidance regarding the scope of the order and how the order must be implemented.

First, in regard to the scope of the ban on Russian imports created by the March 11 order, OFAC clarified that the order encompasses fish and seafood, including preparations thereof, alcohol including vodka and nonindustrial diamonds "produced, manufactured, extracted, or processed in the Russian Federation, excluding any Russian Federation origin good that has been incorporated or substantially transformed into a foreign-made product."[2]

In regard to implementation of import bans established in the order, businesses should be aware that the import ban does not extend to U.S. businesses engaged in transactions to sell goods subject to the ban outside the U.S., even if the goods were originally destined for sale within the U.S. Thus it is possible to redirect shipments of subject goods, provided the goods are sold outside the U.S.

Next, in regard to the ban on exports of designated luxury goods to Russia, the U.S. Department of Commerce acted quickly in establishing a list of the affected U.S.-origin goods.[3]

Along with issuance of this list, Commerce Secretary Gina Raimondo echoed Biden's March 11 sentiment in her separate statement that:

> We will not allow Putin and his cronies to continue living in opulence while causing tremendous suffering throughout Eastern Europe. Today's action takes away another source of comfort and reminds them that Russia is increasingly isolated.[4]

What's Next?

Considering not only the text of the executive orders, but also the statements that have been issued in connection with those orders and the legislation that has followed, it should be clear to U.S. businesses that any trade with Russia in the foreseeable future, if allowed at all, is going to come at a significantly increased price.

Trade is being used as a direct weapon, in an arsenal assembled by the U.S. and its global allies in response to the atrocities being committed in Ukraine. Until the conflict is resolved, businesses — and consumers — can continue to expect more of the same, with continued disruption of the global supply chain in many facets.

To give just a few examples of what we expect to see, the most obvious is that countries affected by the war will continue to face difficulties moving products in and out of their borders. Airspace restrictions over Russia and refusal to grant Russian ships entry in most ports will continue to affect transportation routes.

Looking further, however, refugees from Ukraine seeking replacement work will create unique employment challenges and opportunities. While there may be refugee labor available given the millions of displaced workers who will be looking to make new homes and new lives for themselves, whether companies have the need for the particular types of laborers available is unclear.

Refugee workers could be the answer to certain staffing shortages if companies can find capacity to employ these individuals. Conversely, if transportation bottlenecks for the deliveries of raw materials and finished goods continue, an oversupply of labor may be moot.

Layered atop all of these challenges is continuing significant inflation, as well as oil pricing that continues to be at a record high, and which prompted nearly unprecedented government involvement in the release millions of barrels of oil from the U.S.' Strategic Petroleum Reserve. American businesses and consumers will continue to feel the pinch in their bottom lines and pocketbooks as the conflict in the Ukraine wages on.

Higher interest rates and increases in the price of goods, raw materials, airfare and other transportation costs will undoubtedly continue as a direct result of the stalled post-pandemic economic recovery, increased oil prices from the war in Ukraine and the supply chain issues that still plague all corners of the globe.

However, and somewhat regardless of how long the current supply chain issues last, there is a silver lining for American business. In recent memory, American businesses learned many lessons about how to deal with sustained supply chain issues.

Prior to the COVID-19 pandemic, U.S. entities faced the need to find alternative suppliers when former President Donald Trump imposed Section 301 tariffs against nearly all Chinese-manufactured products. Diversification of supply chains were found to be a further necessity at the onset of the COVID-19 pandemic. Having multiple global supply locations proved to be a sound strategy.

Insightful, proactive companies no longer relied on one manufacturer, in one country. Rather, forward-thinking companies have pivoted, and found alternative suppliers across the globe to satisfy their manufacturing and supply needs.

Further, adept American companies have realized over the past two years that there are also unmoving touchstones for guidance regarding supply chain issues woven into existing U.S. regulations. They have taken advantage of those benefits as well and continue to do so.

Adept U.S. importers should continue to examine their coding of imports under the Harmonized Tariff Schedule; review their imports to determine if any products qualify for tariff exclusions; review use of the first sale rule to properly lower the dutiable price of imports; and review the applicability of establishing a duty-drawback program with U.S. Customs and Border Protection to recover duties paid on goods that are actually never sold within the U.S.

Having learned lessons from recent history, perhaps the impacts of the new — and increasing — sanctions on Russian trade will not be as severe on the supply chain as they might have been five years ago, given that businesses are much more adept and nimble in sourcing and delivery than they once were. However, those same insightful and proactive companies need to maintain their ability to pivot in the face of continuing supply chain impacts.

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[1] White House Statements and Releases, Fact Sheet: United States, European Union, and G7 to Announce Further Economic Costs on Russia (Mar. 11, 2022), https://www.whitehouse.gov/briefing-room/statements-releases/2022/03/11/fact-sheet-united-states-european-union-and-g7-to-announce-further-economic-costs-on-russia/.

[2] OFAC, FAQs #1,019, #1,027.

[3] Imposition of Sanctions on `Luxury Goods' Destined for Russia and Belarus and for Russian and Belorusian Oligarchs and Malign Actors Under the Export Administration Regulations (EAR), 87 FR 14785, https://www.govinfo.gov/content/pkg/FR-2022-03-16/pdf/2022-05604.pdf.

[4] U.S. Department of Commerce Press Release (March 11, 2022): Commerce Restricts the

Export of Luxury Goods to Russia and Belarus and to Russian and Belorusian Oligarchs and Malign Actors in Latest Response to Aggression Against Ukraine: https://www.commerce.gov/news/press-releases/2022/03/commerce-restricts-export-luxury-goods-russia-and-belarus-and-russian.