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The Politics of US and EU Sanctions on Russia's Energy Sector

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On 6 March 2014, the EU and the US agreed on a staged approach to sanctions. In the first instance, plans for closer economic cooperation between the EU and Russia, including talks on the successor to the Partnership and Cooperation Agreement that had lapsed in 2008, were suspended, as were preparations for the G8 summit planned for June in Sochi. Following the Crimean referendum of 16 March and the region's subsequent incorporation into Russia, the threat to target individual Russians and Ukrainians was implemented. America imposed the freezing of assets and travel bans on 11 individuals, and the EU likewise sanctioned 21 people. Soon after, the EU added another 12 individuals, and the US also expanded the list and added Bank Rossiya.

Two more rounds of sanctions in April 2014 in the main targeted individuals who were considered to have been directly involved in Ukrainian policy or the annexation of Crimea, as well companies linked to those individuals. Some technology companies related to Russia's military-industrial complex were targeted, as well as businesses, in particular the natural gas pipeline construction firms Stroigazmontazh, Volga Group, and its Stroitransgaz subsidiaries. There was a grimly personal element, trying to damage people who were personally close to Putin. On 28 April, the Obama administration announced sanctions against seven Russian officials and 17 Russian companies. None of the latter was publicly listed and most were relatively minor. Following the announcement, the American-based payment system MasterCard suspended its services to the latter and SMP, bringing the number of Russian banks with which it had stopped working to four, having already boycotted Sobinbank and Bank Rossiya, while Visa also stopped working with this selection of banks.

The second round of sanctions demonstrated the failure of the Geneva agreement of 17 April, and the new spiral of violence within Ukraine echoed by continued international tension. The western powers insisted that Kiev was abiding by the agreement, including disarming the militias and amnestying protestors who vacated buildings and surrendered their weapons, while Moscow allegedly did nothing to meet its Geneva commitments, hence the new sanctions. In fact, the various 'hundreds' that had defended the Maidan and its analogues were incorporated into the armed forces, into the private militias of the warlord oligarchs, and above all into the National Guard. Far from disarming, they became part of the coercive apparatus of the nationalising state and were unleashed against the pluralists.

Most countries in the EU were reluctant to broaden the sanctions to encompass the energy sector. European countries took 84 per cent of Russia's oil and about 76 per cent of its natural gas exports. Not only were western companies deeply engaged in partnership relationships with Russian companies, but ultimately genuine elements of 'interdependence' had emerged. This is not something to be regretted, as done by the western hawks who lamented the absence of a free fire zone towards Russia, but to be recognised as a salutary fact restraining the warlike and Russophobic proclivities of part of the western public sphere and political society. There is no evidence that the sanctions in any way modified Russian policy, but in fact only impeded the path of dialogue and the emergence of mutually satisfactory outcomes. Even the effect on Russia was minimal, with the rouble regaining some lost ground and the Russian stock market soon bouncing back up to pre-crisis. Of course, the sanctions certainly complicated Russian economic management, with a system that was already slowing down.

It is hardly surprising that those with less exposure to the Russian economy were the keenest on sanctions, accompanied inevitably by high-minded moralising and condemnation of the pusillanimity of those arguing for a more measured response. Trade between the EU and Russia in 2012 reached almost $370bn, while American trade with Russia in that year was a measly $26bn. About a quarter of the EU's gas supplies came from Russia, and about half of Russia's exports went to the Union, while 45 per cent of its imports came from the EU. Countries such as France and Italy had developed ramified economic relationships with Russia, with the former selling two Mistral class amphibious landing ships to Russia, while the Italian energy giant ENI was Gazprom's key partner in building the €17bn South Stream pipeline.

Although America's global engagement in the Russian economy was relatively small, this does not mean that it was insignificant. ExxonMobil in 2011 signed up to a wide-ranging strategic co-operation agreement with Rosneft, which now includes plans for the joint exploration of the Arctic Kara, Chukchi, and Laptev seas, pilot projects in the Bazhenov and Achimov shales of western Siberia, and possibly a liquefied natural gas plant in the Russian Far East. The farm equipment manufacturer John Deere has two factories in Russia, and saw its share price take a severe knock as sanctions began to bite, cutting off credit for purchases in Russia, Ukraine, and other ex-Soviet republics.

The downing of Malaysian Airlines Flight MH17 on 17 July was followed by an accelerated set of sanctions, imposed by the US and then Europe. The Americans appeared 'trigger happy' when it came to sanctions, issuing the ultimatum that Russia should ensure access to independent investigators to the crash site near Snizhne in Donetsk region, but then imposing the sanctions before Russia had a chance to respond or the situation on the ground to be clarified. On 29 July, Obama imposed a broad range of economic sanctions, adding three banks to the list of sectoral sanctions, and sanctioned one shipbuilding company, the United Shipbuilding Corporation of St. Petersburg. The Bank of Moscow, the Russian Agricultural Bank, and VTB Bank were added to the list which American persons and firms were barred from providing financing for more than 90 days or issuing new equity. Restrictions were also placed on export licenses on new technologies for deepwater or Arctic shale drilling in Russia.

As for the EU, on 22 July it considered a range of broader measures, including an arms embargo and financial restrictions on Russian businesses, and on 29 July, eight individuals and three entities were added to the list of 87 individuals and 20 entities who were sanctioned. An arms embargo was imposed, but without retrospective sanction, hence allowing the sale of the two Mistral ships to go ahead. Russia's access to European capital markets was also restricted for Russian state-owned banks, and the export of dual-use goods and technologies, including in the petroleum sector, was restricted. The EU had no desire to see the dense networks of industrial and commercial contracts with Russia suffer excessively, since this would have a negative effect on their economies, which had only just begun to recover after years of recession. More importantly, there remained a group of EU states who doubted the wisdom of piling on the pressure without an accompanying strategy for the resolution of the problems that had given rise to the crisis in the first place.

The crisis once again intensified calls for a common energy policy for the 28 countries in the European Union. Russia produces some 10 million of the world's daily output of some 90 million barrels. Equally, Russia intensified efforts to bypass Ukraine as a transit country. Already it had built North Stream, from the Gulf of Finland to Greifswald in Germany. Russia had just about everything was in place to build South Stream, a 2,446-long pipeline designed to circumvent Ukraine. The plan had been for South Stream to come into operation in 2015, and when running at full capacity, could supply Europe with up to 65 billion cubic meters of natural gas annually. The project had been introduced in 2007 as an alternative to the EU's planned Nabucco pipeline intended to bring Azerbaijani gas to Europe via Turkey. Nabucco had fallen by the wayside, but the EU still sought to find ways to block South Stream. The 'Third Energy Package' (TEP) was a series of legislative acts designed to reduce monopolies in the energy market, including a provision which prohibits gas producers from owning primary gas pipelines. Russia argues that the South Stream agreements had been signed in 2008, a year before TEP came into force, and thus could not have retrospective force, and on that basis, in April 2014, Russia filed an appeal with the WTO claiming discrimination in market access. Thus, the attempt to block South Stream was a type of ersatz sanctions.

On a whole range of issues, attempts were made to isolate Russia and to damage its interests. In particular, the United States put pressure on France to halt the sale of two Mistral assault ships to Russia. Each ship is twice the

length of a football pitch and can carry 700 troops, 60 armoured vehicles, four landing craft, and 16 helicopters. Bought for $1.6 billion, this was Russia's first major arms purchase abroad since the end of the Cold War, and had encountered significant domestic opposition.

There were other creative ways in which Russia could be damaged. As ISIS (Islamic Caliphate) swept in towards Baghdad, America found itself allied with its arch-foe, Iran, in defending the Shia government of Nouri al-Maliki. The future of Iraq came under threat as the militants of the Islamic State of Iraq and Levant (known as ISIS, an al-Qaeda offshoot of Sunni Islamists), headed by Abu Bakr al-Baghdadi, swept in from strongholds in neighbouring war-torn Syria to occupy Mosul, Iraq's second largest city, and drove on to Tikrit. The idea was proposed to give Iran unrestricted access to energy markets, to offset Moscow's position, as well as the right to enrich uranium. As the respected Russian journalist Georgy Bovt noted,

The most absurd part is that the United States and the West continue to portray Russia as its main enemy, an exporter of terrorism in Ukraine. After all, Putin is not some Abu Bakr. And in many respects Ukraine has become part of the 'big chess game' that Brussels and Washington are playing against Moscow. The chessboard spans eastern Europe and the entire post-Soviet space, and the game has continued in defiance of common sense since the end of the Cold War.

The sanctions, while perhaps not punitive in themselves, exacerbated an already worsening economic situation in Russia. Registering only 1.3% growth in 2013, the weakest performance since 1999, the economy was showing signs of 'stagflation': low growth accompanied by high inflation. Instead of the planned 6% inflation, by April, inflation had risen to 7.2%. In the early months of 2014, the rouble lost a fifth of its value against major currencies, while capital flight in the first quarter alone reached $51bn, compared to the average annual outflow of $57bn in the previous five years. Although Russia enjoyed healthy foreign currency reserves, it is estimated that in March 2014, Russian companies had some $653 billion in foreign debt. Over $115bn in foreign debt was due by the end of the year, and companies in response would be forced to reduce their generous dividends and rely on domestic capital markets to tide them over. One positive effect of the great recession after 2008 was that most companies had sufficient liquidity to survive the closure of the refinancing market. The government's macroeconomic probity once again stood it in good stead, with foreign reserves estimated at some $450bn.

Nevertheless, the sanctions could help drive Russia into recession, with an economy that was already slowing down. The sanctions would no doubt deter western business from developing new contracts with Russian firms, even if they were not directly sanctioned. None of the companies targeted had anything to do with the events in Ukraine, demonstrating the political character of the sanctions. The sanctions, moreover, could be used as an excuse to explain declining Russian economic performance. Threats to sanction the export of technology to the Russian oil and gas industry would undoubtedly have a deleterious effect, as would disruptions to access to the Western banks.

On the political front, the regime had long felt threatened by the West, and now the overtly anti-Russian measures, accompanied by the demonization of Putin himself, provoked a further clampdown at home. Although the return of Crimea to Russia boosted Putin's popularity, an extended period of sanctions would undoubtedly damage society and test elite cohesion. Restrictions on the ability to travel to the West affected only a small group of loyal Putin associates, but further sanctions could damage the Russian middle class financially, and it would not take much to turn them against the regime.

There is also the philosophical aspect of the question to be considered. In the post-Cold War era, the west had become 'sanctions happy', applying them with increasing abandon against regimes of which it disapproved, despite the considerable evidence that they are, at best, a blunt instrument to achieve desired outcomes. The idea is to change the behaviour of the target state, and therefore they have to be of sufficient intensity to cause pain. At the same time, they must not be so intense as to provoke a violent reaction from the sanctioned party. A classic case of the latter are the sanctions imposed on Japan in July 1941, following the latter's invasion of Indochina. America froze all Japanese assets, followed by the UK and the Dutch East Indies (today Indonesia). The sanctions were devastatingly effective, cutting off the bulk of Japan's international trade and 90 per cent of its oil imports. Instead of achieving the desired end – withdrawal from Indochina – Japan attacked Pearl Harbour in December 1941.

Acceptance of the terms would effectively have meant acceptance of American hegemony and, in any case, Japan feared that they would have been followed by new demands, hence, although well aware of the risks, Japan felt it had no choice but to go to war.

Sanctions work better when the capacity of the target state to retaliate is weak, as was the case with Iraq, despite the crippling health care and other consequences of the measures. In South Africa, sanctions helped isolate the apartheid regime and prepared the way for the peaceful transfer of power. The efficacy of sanctions against Iran is more finely balanced, but encouraged Iran to step up support for proxy conflicts against the west, as in Syria.

Russia not only has the potential for a devastating military response, and could also retaliate by seizing economic assets in Russia and putting an energy squeeze on Europe. This is the reason why the sanctions were not placed on Russia as a whole, but on certain individuals and a select group of companies. The assumption was that the regime cared more for money than the national interest, a questionable assumption at best. The targeted individuals will most likely only be confirmed in their resolve that Ukraine is an existential matter for Russia, and would not change their behaviour one jot. The deepening of sanctions, moreover, would be problematic because of the economic interdependencies described above.

Sanctions have been practiced against countries such as Cuba for several generations, but have now become generalised. They have become the weapon of choice of the hegemonic powers against regimes they do not like, such as that led by Hugo Chavez and his successors in Venezuela, and above all against Iran. As with so much western policy, it is the selective nature of the countries targeted that renders them less an instrument for the consistent defence of human rights, than a political weapon against obstreperous countries that refuse to buckle down to western leadership.

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