THE EU, US, AND RUSSIA: CONSEQUENCES OF FINANCIAL WARFARE

The role of EU and US sanctions against Russia over Ukraine has been the subject of much popular debate, although unfortunately a debate that does not lend itself to easy conclusions. Questions commonly posed are those concerning the intended means of sanctions and how these should be viewed in light of the turmoil currently unfolding in Ukraine. For some, the answer is obvious – sanctions over the Ukrainian crisis are simply symbolic. However, other commentators take the view that they constitute a solid policy response to an alarming geopolitical situation. This article seeks to explain what the West's sanctions consist of, the context in which they should be viewed, and their likely implications.

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In early March 2014, EU leaders agreed to impose progressively harsher restrictive measures ("sanctions") against Russia, should the political turmoil in Ukraine not be resolved peacefully. The sanctions move was directed toward the government of Russia, which many Western officials hold accountable for the political crisis in Ukraine (2013-2014) and for the Crimean crisis in particular (mid-February 2014). The justification for the adoption of sanctions was that Russian actions could be considered a clear breach of the Helsinki process on the stability in Europe in general and the "actions undermining or threatening the territorial integrity, sovereignty and independence" of Ukraine in particular. This breach of a (geo)political order, most Western leaders agreed, had to be met with clear political consequences.

What do the Sanctions Consist of?

As a result of the need for actions against Russia, targeted sanctions measures were put in place with a clear rationale: political and economic measures were to escalate unless Russia reversed its policy towards Ukraine.

The first round of EU restrictive measures came into place on 17 March 2014. It placed 21 government and private individuals on the sanctions list (targeted with an assets freeze and a travel ban). On March 21st, another 12 individuals were subjected to sanctions, many of whom were also on the list of subjects for US sanctions. On March 29th the EU added another 15 individuals to the list (13 Russian politicians and two Ukrainian separatists). A month later, a second round of sanctions came in to place adding another 15 individuals to the travel ban and assets freeze sanctions lists – thus on April 29th bringing the total number of targets to 48. Whereas there were some ambiguities over what the second round of sanctions meant in practice, it became clear that over the course of the summer the EU would follow close attention to every step of the conflict and respond accordingly. Henceforth, the EU decided to expand sanctions on repeated occasions due to rising tensions between Russia and Ukraine (April 28th, May 12th, June 23rd, July 11th, 18th, 25th). On July 29th, the EU adopted its third round of sanctions against Russia thus significantly accelerating its financial warfare.

Responding to what it saw as an illegal annexation of territory, the deliberate destabilization of a neighboring sovereign country, and the spiraling of violence that led to the deaths of a large number of civilians in their flight from the Netherlands to Malaysia, a number of sanctions was put in place. More precisely, the EU decided to target a variety of sectorial cooperation and exchanges with the Russian Federation. These include: "limited access to EU capital markets for Russian State-owned

financial institutions;" a "partial arms embargo on trade in arms;" the "establishment of an export ban for dual use goods – goods, software, and technology normally used for civilian purposes but which may have military applications as well – for military end users;" "restricting Russian access to sensitive technologies particularly in the field of the oil sector;" "expand[ing] the list of persons and entities undermining Ukrainian territorial integrity and sovereignty, including the so-called 'cronies';" the "suspension of European Investment Bank and European Bank for Reconstruction and Development financing;" the "restriction of investment and trade with Crimea and Sevastopol;" and the "reassessment of Russia-EU bilateral cooperation with a view of reducing the level of the cooperation."[1]

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In light of these various listed measures, the EU's sanctions can be understood as having been applied with a staircase rationale, i.e., with increasingly tougher sanctions the more tenacious Russia was deemed to behave in the crisis. Moreover, in the context of the EU's targeted sanctions, its measures should not be considered in isolation, but viewed as a component part of a larger policy response by the EU, including: the suspension of certain bilateral talks between the EU and Russia, cancellation of an EU-Russia summit, suspension of Russia joining the OECD and the IAEA, deployment of NATO forces in Eastern Europe, announcement of military exercises, etc.

In parallel to EU sanctions, the US as well as a number of other global actors have imposed travel bans and financial sanctions. On 6 March 2014, US President Barack Obama signed Executive Order 13660 Blocking Property of Certain Persons Contributing to the Situation in Ukraine, authorizing financial sanctions against those who have violated or assisted in the violation of Ukraine's sovereignty. The motivating reasons were: (1) The deployment of Russian Federation military forces in the Crimea region of Ukraine; (2) the undermining of democratic processes and institutions in Ukraine; (3) the threats to peace, security, stability, sovereignty, and territorial integrity in Ukraine, and (4) the contribution to the misappropriation of Ukrainian assets.

1 "Statement by the President of the European Council Herman Van Rompuy and the President of the European Commission in the name of the European Union on the agreed additional restrictive measures against Russia," *European Council*, 29 July 2014, http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/144158.pdf

"The combination of US and EU sanctions, if coordinated, can cause considerable political and economic damage to Russia."

Taken together, the Obama administration considered these reasons to be posing a severe threat to the national security of the United States. In addition to the initial rounds of sanctions, President Obama signed Executive Order 13661 on March 16th, which expanded the scope of the previous executive order to include the freezing of certain Russian government officials' assets in the US and blocking their entry into the US. This policy was followed by a further round of sanctions-blacklisting on March 20th, when another 16 individuals and one bank were added; on March 28th, with additional seven individuals and 17 companies; and on April 28th when seven individuals and 17 entities – including banks, construction companies, and transportation companies with connections to the Russian government – were added to the list. Moreover, a ban was introduced on the issue of new licenses to export or re-export "high technology" items to Russia or Crimea that could enhance Russia's military capabilities ("placing a hold on all licenses for exports of defense articles and defense services to Russia").

Over the many months that passed with tensions escalating within Ukraine and between Ukraine and Russia, new pockets of emergencies triggered the expansion of sanctions by the US against Russia. With the war in Donbass, the Obama administration escalated its sanctions on July 17th by adding to its financial sanctions list two major Russian energy corporations, Rosneft and Novatek, and two banks, Gazprombank and Vneshekonombank. This round of sanctions escalated US financial warfare against Russia considerably given the type and relevance of the sanctioned entities. With the downing of the Malaysian airline and the limited access to the crash site due to the presence of pro-Russian rebels, the US once more expanded sanctions on July 29 to include VTB, the Russian Agriculture Bank (Rosselkhozbank), and the Bank of Moscow. According to statements by President Obama, this round of sanctions also included widening measures against the Russian economy as well as against the energy, arms, and finance sectors.

Comparing the two sets of sanctions, those imposed by the EU have initially concentrated on individuals, while the US at the outset also included other entities such as businesses. The difference may reflect the fact that Europe is more vulnerable and dependent on certain economic actors than the US. However, as the political

and military situation escalated, both the EU and the US expanded first, second, and third tiers of sanctions with progressively wider and more profound measures. How far both actors were willing to take sanctions seemingly depended on their perception of the severity of the situation. The accepted costs of sanctions closely represent how much of political threat they sense is posed by Russia's ambitions over Ukraine, a perception that progressively grew over the summer of 2014.

A reflection of how seriously Western leaders viewed the situation could be understood also with the increasing costs of imposing sanctions. The longer the sanctions remained in place, the costlier it has become for those European companies engaged in the Russian markets. Similarly, it has become costlier for those European states that benefit from Russian companies operating in their capitals, e.g. through export, investments, and joint ventures. Adding to this, Russia has responded by imposing its own sanctions against Europe and European companies. This in turn has added to the overall costs of sanctions. Yet, sanctions remain in force and could potentially increase. This all suggests that there is a larger political strategy in operation against Russia that looks more at coercion and deterrence through the lens of geopolitical interest rather than through symbolic gestures to signal dissatisfaction with Russia's actions in Ukraine.

Sanctions' Effectiveness

Do the West's sanctions then matter? There is no simple answer to the question of whether sanctions have been effective or not. Most likely any answer will be affected by politicized rhetoric. For some commentators, the first rounds of sanctions over the Ukrainian crisis were more psychological than tangible. The impact of later rounds has seemingly been more profound. Worth noting though is that different commentators, including senior policymakers, have reached a variety of conclusions on sanctions efficacy. For instance, a senior US administration official has stated that sanctions are unlikely to create "an immediate change in Russian policy" but are designed to "steadily show the Russians that there is going to be much more severe economic pain and political isolation."[2] In addition, there are expectations that both the threat of sanctions per se and the actual enforcement of sanctions may deter further negative actions by Russia. Claiming a sanctions bite, some Western governments have pointed to the decline in the value of the Russian ruble and the Moscow stock market as "evidence" of efficacy.

However, there have also been counter-claims suggesting that negative economic impacts of sanctions cannot be corroborated, as some of these economic trends started

2 Geoff Dyer, Jack Farchy, and Guy Chazan, "Ukraine crisis: US extends sanctions on Russia," *Financial Times,* 28 April 2014, http://www.ft.com/intl/cms/s/0/149d5a9c-cead-11e3-8e62-00144feabdc0.html

before the implementation of sanctions.[3] Conflicting with the claims that sanctions have made an impact, there are also claims that sanctions are being used to foster a political narrative rather than scarring business on the ground. For example, according to media sources early on in the sanctions enforcement phase, large companies such as Exxon Mobil, Boeing, Royal Dutch Shell, Siemens, and BP have done nothing to curb their operations in Russia. In fact, several Western companies (and others) have concluded important deals with Russia since the imposition of sanctions. Arguably, EU and US sanctions have given European and American firms little reason to change course on ventures that could yield billions in new resource flows.[4]

While it may be difficult to find causal linkages between sanctions and a negative downturn in the Russian economy, some experts have still argued that the economic statecraft crisis over Ukraine has clearly lowered international confidence in Russia, downgraded its credit standing and decreased investor confidence in Russian markets. With the later rounds of sanctions, investor confidence seemed to decrease further. As explained in the media by David S. Cohen of the US Treasury Department, "One of the purposes of sanctions is to create uncertainty and to create the expectation in the marketplace that worse could be coming… That uncertainty has led the market to punish the Russian economy."[5]

Beyond rhetoric, the question of effectiveness of sanctions could also be considered in light of the strengthening of the sanctions tool in recent years. An important aspect of Western sanctions is that the combination of US and EU sanctions, if coordinated, can cause considerable political and economic damage to Russia. Since the 9/11 attacks, the US in responding militarily has taken economic warfare to a new dimension by galvanizing the international financial system. Working alongside the EU, the US has strengthened the global financial infrastructure to give sanctions more bite by using the trade in US dollars in the global finance system and its central role in financial markets in combination with an enforcement of human intelligence, signals intelligence, and financial intelligence to engage in a powerful public-private governance strategy with considerable influence.[6]

Finally though, when analyzing the effects of sanctions, it is important also to consider the matter counterfactually. What would the situation have looked like without

3 Peter Baker and Andrew Kramermay, "So Far, U.S. Sanctions Over Ukraine May Be Inflicting Only Limited Pain on Russia," *The New York Times*, 2 May 2014.
4 David J. Unger, "EU, US sanctions on Russia: Big Oil stands with Moscow – for now," *The Christian Science Monitor*, 29 April 2014, http://www.csmonitor.com/Environment/Energy-Voices/2014/0429/EU-US-sanctions-on-Russia-Big-Oil-stands-with-Moscow-for-now-video
5 Baker and Kramermay (2014).
6 Geoff Dyer, "Sanctions: War by other means," *Financial Times,* 30 March 2014, http://www.ft.com/intl/cms/s/0/b18d2c74-b59e-11e3-81cb-00144feabdc0.html

targeted sanctions? Would parties to the crisis have turned to violence more immediately or, after some diplomacy, simply returned to the pre-crisis *status quo*?

How to Understand Western Sanctions

As long as the conflict in Ukraine continues and the tension between Russia and Ukraine escalates, there will be further talks of sanctions. Economic sanctions will depend on the price Western leaders are prepared to pay for upholding and maintaining their geopolitical interests and how much they want to invest in support for democratic and liberal values. A sense of how much such investment the West is prepared to make may be disclosed by the use of the sanctions tool itself. Contrary to popular belief, sanctions have a particular history that suggests they are a far more important tool than simply a signaling exercise by the West.

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Economic sanctions are usually applied during conditions in which there is neither peace nor war, but some intermediate situation. A number of international legal scholars contend that economic sanctions are an appropriate response mechanism both in times of peace and in times of war (e.g. for self-defense purposes). In peace time, it is normal and legally permissible for breaches of international law to be met with acts of self-help for corrective behavior. Similarly, in situations of armed conflict, economic sanctions can be acceptable under international conventions on war where two parties are seeking to defeat each other. Put differently, economic sanctions can be considered appropriate both in *jus ad bellum* and *jus in bello*.

In terms of the measures taken against Russia, a starting point is that they are being pursued as a calibrated measure of economic warfare. In fact, economic sanctions against Russia are far from being applied simply as a symbolic gesture, as the popular discourse often seems to indicate. Sanctions differ from other policy and trade relations by being a "calculated" tool, used in a strategic framework for strategic purposes.

There are historical reasons for this. Most notably there is a strong record in the (UK) Anglo-Saxon law tradition of viewing sanctions as part of economic warfare.[7]

7 Fredrik Stenhammar, *Riktade FN-Sanktioner och Rule of Law i Folkrätten* [Targeted UN sanctions and the rule of law in international law] (Stockholm: Jure Förlag AB, 2008).

The historical means of economic warfare can be described as defensive or offensive measures applied to reduce the war potential of another warring party. Based on the laws of sea warfare in the Anglo-Saxon law tradition, private property connected to the enemy state may be subjected to blockades. This in turn has laid the legal ground for banning trading with the enemy, as well as the imposition of targeted financial measures on the enemy. For example, both the US and the UK made considerable use of economic warfare against their enemies during the Second World War, including sea blockades and targeted sanctions against individuals (e.g. freezing of assets).[8] This historical use is further translated into the contemporary activities of the US Department of Treasury's Office of Foreign Assets Control (OFAC), which generally acts on the tradition whereby it is devoted to waging economic warfare, not least in a situation of war. More specifically, the underlying principle is enshrined in the Trading with the Enemy Act.[9] Arguably, much of the EU reasoning takes place on the same grounds (not least given the influence of the Anglo-Saxon law tradition in the field).

Another reason for seeing sanctions as something more than simply a symbolic measure is that, within a United Nations context, they are also considered a tool to deal with situations of aggression (war). Herein, the use of economic sanctions firmly resonates with the principles laid out in Article 16 of the Covenant of the League of Nations, stating that economic sanctions can be allowed in conditions of war, a view later transmitted to the United Nations Charter (Articles 39-42) and the use of smart sanctions (or so-called blacklisting).

Implications

An increasingly important trend in the contemporary use of targeted sanctions is the sender's enhanced sensitivity to the expected costs of sanctions. Early on in the Ukraine-Russia conflict, the imposition of sanctions was considered fairly cheap (i.e. easy to adopt). However, as the tension between the EU and Russia over Ukraine escalated, resulting in more aggressive sanctions, it has become more costly for both sides. In addition to the self-inflicted harm of preventing trade, there is also a cost factor relating to the target's counter-actions. After all, sanctions may backfire**.** For instance, if further and more far-reaching sanctions were to be imposed, there are worries that Russian counter-sanctions would be very costly for European companies. Moreover, if Russia were to use gas exports as a counter-sanctions weapon, gas exports into Europe and Ukraine may come to a halt with considerable consequences. Given that a large amount of Europe's gas imports come from Russia, half of which flow through Ukrainian pipelines, the potential harm to the economic

8 Stenhammar (2008), ch. 4.
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interests of Western states is profound, in particular for the EU. For some member states such as the UK, the costs of sanctions have become an increasingly important factor to consider when voting in favor of or against the use of sanctions. Thus, although recognizing the value of sanctions in various conflict contexts, EU member states are likely to become more cautious and reluctant to widen sanctions if they will likely do harm to their business interests.

With regard to the Ukraine crisis, there are also a number of other states in the EU that take a more skeptical position on sanctions. One of the staunchest critics of sanctions at the outset of the escalating EU-Russia conflict was Germany. Given that around 6,200 German companies (e.g. Siemens, Volkswagen, etc.) are active in Russia (more than for the rest of EU members combined), the domestic lobbying efforts of the German government against adopting far-reaching sanctions were reported to be considerable. Media reports suggest that many German companies have warned that any sanctions affecting trade with Russia could cost thousands of jobs. In fact, according to the German government, if the country's trade relations with Russia were to break down, this could cost as many as 300,000 German jobs. Coupled with the growth and employment dimensions, it is also worth noting that Germany derives one-third of both its gas and oil from Russia.[10]

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Depending on a variety of factors, such as economic and political costs, in combination with actual geopolitical stakes and counter-actions, economic warfare will be waged in different ways. Factors like these shape the contours of Western sanctions, but their use also correlates with the Western interest in upholding democracy and freedom.

Conclusion

Economic sanctions against Russia are a non-violent policy tool. However, as explained in this article, the tradition of using economic sanctions testifies to the fact that it is well intertwined with historical military thinking and practice. It is

10 Matthew Karnitschnig, "German Businesses Urge Halt on Sanctions Against Russia. Vocal Opposition Has Helped Keep Merkel From Endorsing Broader Penalties on Moscow," *The Wall Street Journal*, 1 March 2014, http://online.wsj.com/news/articles/SB10001424052702303948104579535983960826054

misleading to suggest that the sanctions measure the West is enforcing is simply a weak and symbolic measure pursued for the sake of responding short of war. On the contrary, it seeks to change behavior within a larger grand strategy. In fact, so far sanctions have posed a forceful and potent measure. The turn to economic sanctions against Russia suggests that the West is prepared to go rather far in seeking to change Russia's policy behavior. This observation is further strengthened when considering the self-inflicted political and economic costs that have followed, which the West is prepared to accept when seeking to uphold certain geopolitical doctrines.