Putin will not budge to the West’s demands

It should come as no surprise to anyone that Russia has formally entered a recession for the first time after 2009; this time, though, the prospects of recovery are bleaker. Russian President Vladimir Putin appears to be worried, while the average Russian is feeling anguished by Deputy Economy Minister Alexei Vedev’s unpleasant announcement that GDP growth for 2015 might be -0.8%, worse still than 2014, which is predicted to close at 0.5%.

Sanctions, the collapse of oil and the depreciation of the ruble have combined to give Russia and Putin the biggest blow since the start of the Ukrainian pro-Western European, ‘Euromaidan’ revolt in December 2013. Putin has retaliated, declaring the closure of the South Stream gas pipeline, which had a major European partner in Saipem with his back to the wall. The gas pipeline, could be re-directed to run via Turkey rather than Bulgaria and Poland and it stands as a symbol of the growing diplomatic distance between Moscow and the European Union (EU): the 23.5 billion dollar worth ‘Pipeline of Discord’. A few months ago, the oil giant Rosneft had to give up prospecting in the Arctic with its Texas-based partner Exxon, and now it is Gazprom’s turn to ‘feel the heat’.

The Government’s admission pf recession has come at a very difficult time, when the collapse of the ruble seems unstoppable and consumer prices are growing by the day. The causes of the disaster are obviously attributable mainly to the Western sanctions and Russia’s predictable annexation of the Crimea region. The drop in oil prices, last week, has merely served to highlight Russia’s worsening international relations. For years, Putin had urged experts and oligarchs to diversify the economy; manufacturing and agriculture in particular. The latter was negated and even regressed compared to the Soviet era, forcing Russia to become dependent on imported goods, which now cost much more as Russia relies. Until last summer, a Euro was worth 40 Rubles; yesterday, the currency price shifted to 67 Rubles, a new record low. The government needs top tale some control over worsening the situation even as the spiral of the crisis seems to have just begun.

Yesterday morning Putin had signed a decree suspending pay increases for all public officials. All Russians to have to prepare for tough times. The associations of travel agents, to cite one example, have indicated that the number of Russian tourists abroad next year will be less than half. Meanwhile, the closure of the South Stream pipeline may serve as a way to further alienate the EU. If Putin wants to close the South Stream pipeline, Europe has a lesson to learn, said the Vice-President of the European Commission pointing out that the EU imports acco8nt for more than 30% of its gas needs from Russia. The South Stream project was supposed to bring Russian gas to Europe through a pipeline under the Black Sea that would arrive in Bulgaria and then in the Balkans, bypassing Ukraine. Yet, Putin’s government shows no signs of gasping, nor has it indicated any halting of its ongoing involvement in neighboring Ukraine, largely because such policies have proven wildly popular with the Russian public. Until that changes, the Russian government will likely maintain its course despite growing economic pressures. Nevertheless, the rhetoric of not bowing to foreign pressure contrasts with requests for negotiations to end the conflict, which means that at some level Putin is worried.

Putin remains popular with Russians, receiving approval ratings of 85% last week (it was 88% last September). Russia has appealed to the Western powers to abandon the sanctions policy in the interests of the world economy – requests that have resonated with many European citizens and officials, who worry that more sanctions would only add to their economic woes. That said, Putin will not budge because to abide by the Western demands is implausible in Putin's personal leadership 'vocabulary'. The 80% plus approval ratings are a reflection of his 'defiance' against those who have 'ganged up' against Russia. Only if he were he to give up the nationalist principles that have guided his actions vis-à-vis Ukraine, would he then incur the people's wrath. To ensure popularity remains high, Putin will likely continue to shore up support for Ukrainian rebels rather than abandon his ambitions.

While Russia is vulnerable, Putin will encourage Russian businesses to diversify, resume industrialization while continuing to develop its resource sector even as it invests in replacing imports from the West with local goods. Shifting the import focus away from Europe to China; in doing so, however, Russia must avoid the temptation to base that relationship on the familiar pattern of 'oil and gas in exchange for finished products' that has been a signature of the recent past. Moreover, Putin will challenge the rentier capitalists that have dubiously earned billions of dollars in the past two decades. The so-called, 'oligarchs', will be targeted such that their assets, privatized at ridiculously low prices in the roaring 1990's of the Boris Yeltsin era, will be re-nationalized. This will include banks, the foreign trade and strategic industries. In the anti-Russia rhetoric that has characterized the coverage of the former 'superpower', the media and western leaders have often failed to recognized that after the humiliation of the immediate post-Soviet era, Putin has raised Russia from the abyss and has instilled in Russians dignity and self-worth, which is why he is so popular and why the 'oligarchs' seen as pariahs. President Putin has the support of the vast majority of the Russian people; has allies in China and among the BRICS (Brazil, Russia, India, China, South Africa) and has the will and the power to "do the right thing. It remains to be seen if he can fulfill this historic challenge. Of course, in its campaign to consider their responsibilities towards the country, the Kremlin will have aroused the oligarchs' anger, generating what is, for the time being, an unspoken fear of a coup sponsored by the new wealthy elites.

President Putin has urged his government to adopt new legislation to prevent the use of offshore tax havens making Russian citizens subject to taxes at home no matter where they come from their income. The measures are targeted towards the very wealthy Russians, who systematically try to move their goods and families abroad, fueling capital flight, one of the problems that Putin is no longer willing to tolerate especially when, for both factors cyclical and structural, the Russian economy started to slow down for the first time since he became president 14 years ago. Estimates suggest that capital flight from Russia reached over USD$ 100 billion pounds. It is indeed a measure that meets the favor of the most popular classes, as well as the middle class Russians whose welfare unlike the oligarchs is the fruit of labor and the economic growth of the past few years.

Ukraine crisis pushing Russia to form rare earths alliance with China

In 1986, Deng Xiaoping, launched the "863 program", aimed to gain control of the rare earths market in the sector saying: "The Arab countries have oil, China has rare earths." The 15 "rare elements" along with yttrium, scandium ('15+2'), have the characteristic of retaining a strong magnetic property, resistant even at high temperatures. They are essential for the production of hard drives, satellites, lasers, digital cameras, wind turbines, fluorescent lights, electric motors, hybrid, mobile phones, guided projectiles, new generation radar and many other items that are of special military interest. In truth, these elements are not as “rare” as the name would suggest, but, their extraction and treatment requires expensive technology, because these elements are not found in nature in its pure state and they must be refined. Their abundance betrays the fact that most are found in deposits at low concentration, making it economically unwise to extract. China is the country with the largest reserves of rare metals (between 35 and 45%) and, since 1986, has made the greatest effort to support technological research in the field. Taking advantage of the significant economies of scale, low labor costs and minimal regulatory impediments, it has been able to optimize the supply chain in order to offer prices that have eliminated all competitors. Russia has the largest reserves after China – about 20% of the world’s known reserves – but recently there have been new discoveries in the region of Murmansk and the Kola Peninsula. In addition, while the known North American, South African, Australians, Indian and Brazilian rare earth deposits do not ensure a supply of the full range of “15 + 2”, it is virtually certain that the Russian deposits would be able to provide the entire series.

Russia has every incentive to exploit these resources and the recent tensions with the West and NATO over Ukraine, have generated even more interest, given their demand in industrialized countries and their importance to military technology. And, in fact, the fall in the supply of China (which has been discussed extensively in InvestorIntel) has left Russia a serendipitous opportunity to enter the rare earths market. In late 2013, the IST group, founded by Aleksandr Nesis, has formed a joint venture with the state-owned company Rostekh, and a large investment fund in order to invest at least a billion dollars, by 2018, to exploit of an area of about 250 square kilometers in the Yacuzia region in hopes of expectation of extracting 154 million tons of elements such as yttrium, niobium, scandium and terbium. The plant is expected to be finished by 2017, to enter into full swing only in the following year. ICT's plans have gained stronger momentum as a result of the tensions resulting from the political and military crisis in Ukraine. The United States has never quite warmed up to the EU's reliance on Russia for gas supplies (and for capital), always finding ways to disrupt the South Stream project – a pipeline bringing Russian to Europe via Bulgaria, avoiding Ukraine).

The IST rare earths supply from Russia would clearly tempt the EU in the same way that Russian gas has been doing with South Stream, promoting closer ties between many existing and potential NATO members and Russia – a perspective that most American foreign policy makers, especially on the neo-conservative side, regard with concern if not horror. If Russia cannot consider the EU as a reliable market because of geopolitics (European industrial powers needing rare earths will be hard pressed to promote sanctions against Russia), Moscow can still such outlets as Japan and the BRICS (Brazil, Russia, India, China, South Africa). Taking a page from the potash industry, where Russia had an alliance and pricing cartel mechanism with neighbor Belarus, Russian rare earth producers could establish a rare earths cartel of convenience with China. Last May, Russia and China (which are already linked by the "Shanghai Pact") decided to increase their gas trade. A Sino-Russian rare earths cartel would be far more powerful than the gas one, being able to dictate world prices. Secondly, Russia could obtain the technology required to undertake a cost-effective exploitation of its resources. China, would gain deeper trade penetration toward Western Europe linking it to Germany more directly, potentially weakening the links with the United States. China and Russia would also have all the materials needed to expand their military, thanks to the materials to advance new generation weapons from lasers to drones.

The Ukraine crisis – and China's rare earths industrial consolidation and reform – has given Russia an unprecedented incentive to develop a rare earths mining industry, which, in addition to its hydrocarbons, would give it further huge bargaining power on the world economy. It does not have the know-how, technology, refining plants yet but China can offer these. Rare earths are essential to the production of directed energy weapons: absolutely innovative systems that, instead of hitting a target with a bullet, invade it with electromagnetic radiation, plasma or high energy laser beams. They are weapons of power, precision and speed, offering much lower operating costs than conventional weapons. Now, the United States is at the forefront in the development of these systems, but for some years now, it has suffered projects delays, due to the difficulty of overcoming the supply problem. The US Department of Defense has launched some inquires and legislative proposals to address the rare earths supply issue and the findings were discouraging.

Sanctions against Russia over Ukrainian crisis are counterproductive

The tension and the ongoing civil war in Ukraine's increasingly bloody battles will be expensive for the West and will damage what had been an already precarious relationship between the West and the former Soviet bloc. The West has embarked on an inexplicable 'crusade' against Moscow, which has reacted in an entirely predictable manner to the political crisis in Ukraine and then to the civil war involving the largely pro-Russian population in eastern the eastern part of the country and the more pro-EU population in the western regions. Ukraine never existed as such and the struggle now is over border solutions adopted in the fallout of the Soviet Union under pressure from NATO. There was no actual State of Ukraine before the October 1917 Revolution that led the path to the formation of the Soviet Union.

Historical arguments aside, Russia has sufficient historical and diplomatic claims over Ukraine that its involvement is understandable and its concerns of Western interference entirely warranted if not downright justified. Nevertheless, the West, NATO, Canada and the United States in particular (though Canada playing an especially and comical role as part of Prime Minister Harper's 'hawkish' foreign policy) have put pressure on Russian President Putin to relinquish Russian interests in Ukraine. This policy is rather more ridiculous than it sounds. It is akin to having Russia and its allies (including China and the BRICS countries) demand that The United States and Canada relinquish interests in Mexico or the Caribbean.

The West's economic (and military) isolation and encirclement maneuver aims to weaken Russia in an effort to cut ties with the separatists Eastern Ukraine. However, the related sanctions will have a boomerang effect as they are counterproductive for the West. Apart from a predictable series of Russian responses – some of which have already been adopted – major Russian state-owned banks will no longer issue bonds and shares in the European markets and European companies are worried. Exports from food to arms, cars and luxury goods will be prohibited, causing major damage to the EU's economy; indeed, Europe will undoubtedly pay the highest price of this renewed "Cold War" and such countries as Poland, which on paper should be a Kiev supporter, stands to lose the most. Russian sanctions will slow down its economic growth to the point of threatening a recession.

Moscow wants to block the import of fruits and vegetables from

Poland. In fact, Moscow has decided to ban for a year, imports of meat, fish, dairy products, fruits and vegetables from the United States, European Union, Norway, Canada and Australia. The main effect of the sanctions against Russia will be to harm bilateral cooperation and international stability. Russia is a strategic market for Europe from the viewpoint of trade and energy and small, medium and large enterprises will suffer alike. Italian and German companies, which are among Russia's major trading partners, will suffer considerably. As an example, Adidas, the German sports apparel manufacturer, has been forced to cut their estimates of the net profit for 2014, having been forced to reduce expansion plans in Russia. In the first half of this year, Volkswagen sold in 8% fewer cars in Russia than a year ago. And the CEO of Siemens, Joe Kaeser, warned – according to the Financial Times – of the "serious risks" of growth for Europe for this year and next. The sanctions will be felt even by Erste Group, VDMA, Shell, Total and BP. Some American companies such as Visa, MasterCard and ExxonMobil will also feel the sting.

Russia is a strategic market for Europe in terms of trade and energy. However, it is not so much that the EU risks being cut off from Russian gas this winter; it is that the EU exports much of the oil and gas extraction and delivery technology and infrastructure to Russia. The effects will be delays to major infrastructure projects such as the construction of the South Stream gas pipeline, which affects the Eni and Saipem groups directly. Steel companies such as the Danieli Group will see losses as it has significant interests in Russia. As for the military sector, it is likely that Finmeccanica will have to review some strategies, given its cooperation in various civilian and military aerospace projects. A spirit of dialogue between Russia and the West is preferable by far. Europe and Russia are forced to integrate by history and geography and now by the globalization of markets.

The economic war, the resurgence of armed conflicts and confrontation between Obama and Putin is a worrying sign for the international community. Sometimes compromises are considered petty gestures, but mediation is the only remedy to a conflict or a civil war. Canadian Prime Minister Harper and his unlikely and entirely inadequate foreign affairs minister John Baird have steered foreign policy away from diplomacy to adolescent threats that solve nothing, having forgotten (or possibly they are ignorant of history) that stomping on Russia's feet is a feat that ended the careers of many deluded conquerors from the Teutonic Knights (defeated by the legendary folk hero Alexander Nevsky) in the Middle Ages to Napoleon and Hitler in more recent times. The West has backed some rather ridiculous 'revolutions' lately with terrible consequences: think of Syria, Iraq or even Egypt. Ukraine appears headed in the same direction. It is for posterity to deliver the ultimate evaluation but from the present standpoint, Washington, Ottawa, Bruxelles and all of NATO are pursuing a fruitless and self defeating path by sanctioning Russia.

Global economic consequences of the Malaysian MH17 crash still to come

The crash of Malaysian Airlines MH 17 in Ukraine, beyond the all too human tragedy, has also raised market risks worldwide especially as far as the energy and banking sectors are concerned. Stocks dropped some 2-3% in worldwide trading on the day of the crash, July 17, only to recover – somewhat cynically – on the next day; however, as might have been expected, the Russian markets reacted differently. The Ruble dropped 5% and stocks some 2%. Meanwhile, the conditions for improvement do not exist. The crash of MH 17, regardless of who is ultimately found responsible, has only served to increase tensions. Even if the crash may offer Russian President Vladimir Putin reasons to reduce Russian support for the separatist rebels, the crash has only served to emphasize the deep differences that exist between the pro and anti Russian populations in Ukraine. This means the war in Ukraine has become even more intense. The crash has done nothing to resolve the underlying reasons for the conflict, adding only more motives to deepen them. Russian companies and Western ones that have business with them will have some difficult days ahead. Gazprom is the largest Russian company and the biggest extractor of natural gas in the world and Chinese demand may not be enough to protect it from potential new sanctions.

The US announced more sanctions against Russia on the very day of the MH 17 crash. Those will certainly deepen if it turns out that the missile that hit MH17 was, in fact, launched by pro-Russian separatists using Russian supplied weapons (even if the government forces have the same equipment). In that case, the U.S. and Europe would be forced to expand sanctions against Moscow, affecting such companies as the oil giant Rosneft, which owns sizeable portions of important European companies like the tire maker Pirelli. Gazprom, Gazprombank, the principal shareholder of the South Stream pipeline would also be blacklisted. For its part, in the event of additional sanctions, and given that Russia has more than a ‘few dogs in the Ukraine fight’, Putin will not hesitate to retaliate with no less harsh measures. For the time being, the Kremlin has advised the White House that “the door remains open to negotiations to get out of this situation. But if our partners will continue with sanctions, measures will be taken against persons and foreign companies.”

Moscow has an agreement with Beijing to supply gas worth up to

USD$ 300 billion over the next 30 years; however, the Russian economy, over the past two decades – and ironically especially in the 15 years of Putin’s leadership, Russia has become well integrated in the Western economic system, more than Washington, Berlin or Moscow would care to admit. Russians have invested heavily in the West, as much as USD$ 230 billion in foreign investments. Some companies rely on Western financial institutions and because of US sanctions, such companies will not be able to re-negotiate refinancing or other mechanisms, meaning that they will incur more interest on their loans, damaging the entire Russian economy. One of the first to suffer will be Rosneft itself. Then there is the issue of oil and interdependence with Europe.

Russia addresses half of European oil demand using about a third of its production (10.51 million barrels), collecting some USD$ 160 billion a year at current prices. Even if it switches some of this oil in China’s direction, facing more sanctions, it would not be able to secure the same prices. Moreover, Russia relies on Western companies to obtain most of the oil and gas industry hardware. Then again, many European companies are not eager to see more sanctions pouring on Russia. Western European companies deliver goods and services to Russia in the tens of billions. Some companies like United Technologies, FIAT Autos, GM or even BMW have joint ventures in Russia not to mention energy sector companies like ENI – a South Stream partner. Italy and Germany would be among the greatest ‘losers’ in this situation. Former German chancellor Gerhard Schröder is at the head of the supervisory board of the North Stream gas pipeline. Without Russian gas, the industrial region of the Rhine valley may well come to a stop. The Ukraine crisis presents diplomatic challenges on both sides of the former ‘Iron Curtain’, are the leaders prepares to manage it?

The EU risks a very frosty winter as tensions in Ukraine rise

Oil prices rose again in Asia because of the crisis in Ukraine, where fighting between government forces with pro-Russian rebels have left dozens dead in the east, which is a key transit route for gas. A barrel of ‘sweet light crude’ (WTI) for July delivery gained 7 cents to reach USD$ 104.18 a barrel while the Brent price hit USD$ 110.3. The increases were prompted by the tensions in Donetsk following the results of Sunday’s presidential election, won by candy magnate Petro Poroshenko. Donetsk is the bastion of Ukraine’s pro-Russian population, resulting in dozens of dead combatants on both side and two civilians between Monday and Tuesday. Poroshenko has dismissed plans to visit Moscow to discuss the standoff with President Vladimir Putin, who, in turn called for an end to the government forces’ ‘punitive’ operation in the East.

The situation in Ukraine has added to the oil and gas risk resulting from recent developments in Libya, where there is a high risk of a resumption of fighting on a large scale. The oil and gas markets are reacting to concerns that a prolonged civil war in Ukraine, a transit country for Russian gas exported to Europe, disrupting exports and causing a surge in energy prices. The crisis in Ukraine has served as a reminder of the extent to which the European Union, where many of its member States are struggling to recover from recession, relies on Russian gas for survival: over 50 % of needs.

Today, the European Commission, therefore, presented a new strategy for energy security, aimed at diversifying sources of external energy supply, modernizing the energy infrastructure and stimulating savings in energy consumption. Of these, however, diversification will be the main target. The EU plans to accelerate the diversification of external energy suppliers, especially for gas. Russia supplies 39% of the gas consumed in the EU, Norway 33% and the remaining 22% is imported 22 from North Africa (Algeria and Libya – which is wrought with its own supply risks. The EU could seek new supply routes, for example in the basin of the Caspian Sea, through the extension of the Southern Gas Corridor, the development of Mediterranean gas hub and more LNG supply sources.

The EU also plans to strengthen its energy independence through renewable energy and fossil fuels. Energy efficiency should be strengthened. However, the EU has little time and it must find short term as well as long term solutions. In the short term, the EU will have to carry out comprehensive risk assessments ahead of next winter in order to anticipate and provide mechanisms for relief, given that the scale of the tensions in Ukraine and Libya are more likely to intensify than to resolve. The EU may consider such options as increasing gas stocks this summer, reduce demand through the use of alternative fuels (a return to coal or nuclear in Germany…?), or releasing some of the current emergency stocks.

The energy risk emanating from Ukraine to Western Europe is high. Should, Russia shut off the gas taps to Europe, due to its concerns in Ukraine – especially concerns that Ukraine will be offered a fast track into NATO – almost the whole of the EU, except the Iberian Peninsula and the South of France (which is supplied from Algeria), would be affected in a direct way. Europe risks a very frosty winter 2014-2015, especially South-Eastern Europe where over 60-80% of gas supplies are Russian. Former Soviet Republics or Warsaw pact members – and current NATO and EU members – such as Poland and Romania may need to compensate as much as an 80% supply disruption.

Adding ‘fuel to the fire’, Gazprom President Alexei Miller has insinuated that China and other Asian countries are willing to pay a higher price for Russian liquefied natural gas, meaning that Europeans will have to adapt if they want to keep their LNG terminals full. Gazprom plans to squeeze every possible dollar out of the crisis in Ukraine, which has been exacerbated by Sunday’s elections – despite the defeat of the extreme right. Miller suggested that the significant differences in tariffs gas between Europe and the Asian markets has resulted in a shift of gas originally destined for EU export to be shifted toward the Asian market. Miller’s statements were delivered in a delicate geopolitical context; however, his warnings have some ‘bite’ because Gazprom and China’s CNPC have just signed a thirty year LNG supply deal that will surely herald a competition for Russian gas between China and the EU, which will ultimately have an impact on gas supplies in Europe. The suggestion, from the White House, that the US will be able to compensate for the loss of Russian gas remains rather fanciful, which further strengthens Moscow’s stance.

Putin launches the ‘Gas Wars’

The Ukrainian armed forces’ offensive in eastern Ukraine Kiev continues, but with considerable difficulty. Meanwhile, on the eve of a summit between USA, Russia, Ukraine and the EU – and just as NATO is has announced its own military buildup in Eastern Europe – pro-Russian Ukrainian insurgents have effectively halted the Ukrainian army. The insurgents are maintaining control of most of Donetsk. The situation is very similar in Sloviansk where official

Ukrianian soldiers have been forced to surrender to pro-Russian insurgents. The message here is that the Ukrainian government army is in poor shape and its troops lost and insecure. Certainly, the fact that the largely young recruits are forced to confront fellow nationals is not contributing to raising military fervor. The operation, in fact, was launched largely instigated by the more right-wing and nationalist Maidan party (a member in the current coalition that replaced the Yanukovich government) under the guise of “anti-terrorism’. The operation has resulted in all but an admission of defeat, especially considering that Russia has 35-40,000 combat ready troops massed at the border. The Russian government will uphold its policy of defending Russians and Russian speakers in Ukraine; that was the same motivation that prompted the invasion of Georgia in 2008.

Ukrainian security has accused Moscow of fomenting the insurgents, claiming that some Russian soldiers wearing unmarked uniforms have taken part in the actions in Donetsk. But, what is more interesting is that several Ukrainian soldiers, officers, security staff have switched side in support of the pro-Russian insurgents. Meanwhile, the Party of Regions, ousted former President Viktor Yanukovich’s political group, has appealed for the Government to cease military operations in the East. Washington has apparently taken no notice of the very complex and far from ‘black and white’ situation that is developing, limiting its reaction to threatening more sanctions against Moscow. This is not wise, because Russia has economic weapons at its disposal.

Russia is ready to unleash the ‘gas war’, cutting off supplies to Europe and sending the bill to Washington over its clash with the new Ukrainian government. Vladimir Putin has officially asked the EU to compensate Ukraine’s USD$ 2.2 billion gas import debt with Russia. Putin has warned EU leaders that if Kiev does not will pay its debt – the payment deadline for which expired on 31 March – Gazprom will be forced to ask for advance payment for supplies (current and future), and in the event of further violations of payment terms, it “will fully or partially suspend supplies”, cutting off the EU. Washington accused Moscow of using energy as a “tool of blackmail” in the dispute over Ukraine. The USA has promised to support Ukraine through emergency funds and technical assistance in the areas of energy security/sector reform; however, so far no such aid has arrived and the pressure on the EU is real. Putin has also deployed a carrot and stick plan to help in efforts to stabilize and reorganize the Ukrainian economy but only on “an equal footing” with the EU, namely committing the same sums of aid. Putin, in addition, has also used the crisis to shore up the price of gas. He warned that to ensure the uninterrupted transit of gas to Europe, 11.5 billion cubic meters of gas will be added to Ukrainian deposits at the new price of USD$ 485.5/thousand cubic meters against the USD$ 285 of the Yanukovich era. This means a payment of USD$ 5.5 billion in addition to the aforementioned USD$ 2.2 billion.

Putin’s ‘gas diplomacy’ give Russia strong clout over the EU and US at the April 17 talks in Geneva, even if NATO has demanded that the talks cannot have any effect unless Moscow withdraws its approximately 40,000 soldiers at the eastern border. Russia has denied such a deployment, saying the satellite images that allegedly demonstrate this presence, were taken in August of 2013 rather than between late March and early April. As expected, the U.S. military will boost its presence in Eastern Europe in response to the persisting tensions in Ukraine. Nevertheless, this sort of action will not be effective and most EU countries are very concerned about economic sanctions against Russia – they are not willing to take the hit on behalf of Ukraine. If sanctions cost nothing for the USA, they carry a big price for Europe risks. Indeed, for the United States sanctions even represent an opportunity, because in the future they could increase arms exports to Europe, and eventually launch a new market for

American gas.

Putin is drawing much of his political and military advantage from the fact that Western Europe suffers from energy weakness and action. Europe’s position of weakness derives from the fact that gas only flows from east to west, rather than also from west to east. The result is that some countries rely 80 to 100 % on Russian supplies. The crisis has brought to light the importance of energy independence. This is a concept that China has learned well; it has refused to switch to from coal to imported gas, preferring the domestic production of coal, despite the huge levels of pollution that it produces. Yet the images of masked Beijing residents masked making their way through the smog are evidence of how crucial decisions relating to security of gas supply are. If the EU thinks it can get away by snubbing Mosco, then it must quickly adopt a shale gas policy while also securing new supplies and building new pipelines to alternative production sources – perhaps North Africa? Otherwise, it will have to play Putin’s game.

Putin can afford to cut off the gas; the EU cannot afford to be left without it

Yesterday, Italy’s Saipem, the gas division of the energy giant ENI, signed a 2 billion Euro contract to build the first line of the offshore section of SouthStream, the gas mega-pipeline, which Russia’s Gazprom has planned specifically to export natural gas to Europe bypassing Ukraine. On an ordinary day, this would be interesting business news; however, yesterday, the EU and the United

States and other NATO countries (including Canada) announced a series of sanctions against key figures in the government of Russian President Vladimir Putin. The sanctions were slapped because Russia was accused of holding the region of Crimea (since 1954 formally part of Ukraine but largely Russian in ethnicity) under military occupation during a referendum that resulted in an overwhelming approval of joining the Russian Federation. Western governments – with varying degrees of enthusiasm – rejected the referendum (whose vote was 93% in favor of joining Russia), pushing for economic sanctions. For his part, Putin retorted that the referendum "complied with international law".

Far from weak, Putin has emerged from the Crimean situation as the strong leader, who understands and plays the 'realpolitik' game better than any of his western counterparts. Putin has been nationalistic but decisive, while those Crimeans who voted in favor of a union with Russia, perhaps observed what has become of Egypt, Libya or Syria, whose people followed western encouragements to 'freedom'. Putin's Crimean claims did not emerge from a sudden whim. Russia has had real and historic interests in Crimea for over two centuries; he was defending Moscow's access to its Black Sea fleet in Sebastopol (the birthplace of the last Soviet leader, Mikhail Gorbachev). Not surprisingly, the West has acted erratically in the crisis; indeed, it had no horse in this race and the sanctions being mulled in Washington, London or Paris (less so in Berlin and Rome) are being motivated by idealism rather than realism. Certainly, while Putin is pursuing Russia's genuine national interests, the West is not. Russia for historic reasons has always pushed its western border as 'far west' as possible. In the 1990's, the Soviet Union, collapsed releasing the buffer zone states of Latvia, Lithuania, Estonia and Ukraine from Moscow. The first three have joined NATO, which contributed to tensions in other Russian republics such as Chechnya. Now, Putin is worried that the breakaway Ukraine, will inspire or revive more secessionist movements in Russia itself from

Chechnya to, Karelia and the regions in the far east.

What are the West’s interests?

For starters, key NATO countries need Russian gas. The ENI/Saipem deal with Gazprom has come as an ironic reminder, on the day that the White House announced sanctions, that Russia is a global energy powerhouse. Saipem and Gazprom have agreed to start construction of the first submarine pipeline linking to the SouthStream pipeline’s four mainland lines – each over 931 km long – from Russia to Bulgaria as well as Austria, Croatia, Greece, Slovenia, Hungary and Serbia. Ukraine would no longer be involved. This means that whatever the issues between Russia and Ukraine over gas supplies (which has been the major trigger of Russo-Ukrainian crises such as in 2006 and 2009); the pipelines to Western Europe would not be affected. Just a few days ago, the European Commission tried to stall the South Stream pipeline consortium, freezing talks with Gazprom. Yet the consortium, controlled 50% by Gazprom (the rest being Eni 20% and 15 % each by France’s EDF and Germany’s Wintershall) had announced plans to sign a number of contracts before the end of March to start work on the project. Alexey Miller, Gazprom’s CEO, reiterated that “the South Stream project will be completed on time. There is no doubt that the gas will start to flow in December 2015”. Moreover, the blocked GreenStream pipeline from Libya to Italy – Libya being near collapse and wrought with risks that have driven away oil and gas explorer – and the continuing economic difficulties in Europe have emphasized Russia’s importance and Russia’s energy giants have the economic power to keep western Europe in check.

Russia is the EU’s main gas supplier yet the international community still dares to threaten the Kremlin with an economic embargo. This leaves more political risk for Europe than it does for Russia. So far, Europe plans a three-step sanctions program. 1. The EU will suspend talks to ease visas for Russian visitors; 2. The EU will block the accounts and issue travel bans for key figures close to the Putin governments; 3. Should Moscow pursue the Crimean crisis into eastern Ukraine, the EU plans an economic embargo. Yet, the three-step program may well be a mask or a bluff from NATO, which is actually rather powerless.

Europe’s energy transition away from nuclear power and the as yet limited reach of alternative or clean energy sources have created an ever greater reliance on Russian gas. Gas generated electricity is more acceptable than coal and Chinese pollution levels are a warning sign of the relationship between economic growth and pollution and of the need to find alternatives. So, alternatives to gas are very limited while alternatives to Russian gas are also limited. The Nabucco project – an attempt to transfer gas from the Caspian Sea region, bypassing Russia, to Western Europe – failed last year. That idea has been supplanted by the South Stream gas pipeline from Russia to Italy. Two years ago, the EU blocked the North Stream pipeline, which runs from Russia to Germany. In other EU countries, although there are LNG terminals, the price of gas varies greatly while availability is limited and the infrastructure is insufficient.

Could Norway take over? Perhaps, but it lacks the sheer amount of gas available from Russia. Surely, the spring has arrived in Europe and if Moscow were to turn off the gas to retaliate against EU sanctions, it would not have a dramatic effect – now. In the long term, EU member states would have to make heavy investments to obtain sufficient gas from other States or increase expenditure to promote a faster energy transition but the period required to achieve such shifts would cripple Europe economically. In sum, of Russia wanted to hurt the EU and keep it in economic recession – if not depression – all it has to do is stop the gas flow, Putin can afford it, even if this will leave Russian coffers empty.