

# Sanctions against Russia ignore the real politik of the markets

✘ The crisis in Ukraine, which started around last November, has intensified and exacerbated tensions between Russia and NATO to a degree unknown since the pre-Gorbachev Soviet Union. On September 30, The European Union decided to renew and add new sanctions against Russia, claiming that the peace plan in Ukraine has not yet been respected. Brussels had hinted that it would consider revoking the sanctions had there been progress by September 30 toward a ceasefire. The EU will continue to “closely monitor developments on the ground,” but failed to issue another deadline. Should the EU consider the ‘situation on the ground’ to have stabilized, it will consider amending or revoking the sanctions, in whole or in part. The EU, in effect, is looking for any possible excuse to scrap the sanctions as even the most critical EU member states were reluctant to enforce sanctions while others continue to demand a softer approach toward Moscow.

Russia, meanwhile, has taken the first steps to comply with the EU demands, agreeing to a ceasefire with Ukraine, even as it has enforced its own, ongoing, retaliatory embargo against a number of European agriculture-food sector products. The ceasefire is holding tenuously but there is great uncertainty and fear because Ukraine aspires to join NATO and the European Union within the next six years. There is very little chance Russia would allow this to happen without its own retaliation, especially about the issue of NATO membership. The Russian Foreign Ministry has been controversially referring to Ukraine’s ‘restive east’ as Novorossiia, the territory that once consisted of what in today’s terms would be Odessa, Mykolaiv, Kirovograd, Dnepropetrovsk, Kherson, Zaporizhya, Donetsk, and Luhansk.

The EU's sanctions Russia concern companies operating in the energy, finance and defense sectors, including the oil giant Rosneft and the weapons manufacturer Kalashnikov. The EU has also imposed assets freeze and a ban on granting visas to travel to a number of officials and business personalities considered to have close ties to President Vladimir Putin and pro-Russian rebels in eastern Ukraine and in Crimea, annexed to Russia. NATO military command said that while the first phase of the ceasefire saw a significant withdrawal of Russian forces in Ukraine, there are still hundreds of troops, including special forces, in Ukraine. The conflict between pro-Russia rebels and Kiev's own troops has now claimed more than 3,000 lives.

The crisis worsened last July 18, when (still unconfirmed) pro-Russia rebels accidentally shot down a Malaysian Airlines Boeing 777 airliner, (Flight MH-17) sparking a slew of allegations against Russia and its reckless arming of the rebels. Evidence suggesting that the rebels had Russian 'Buk' surface to air missiles, which were deployed against Ukrainian fighter jets and helicopters, amounted to a "massive escalation" of the crisis said Jonathan Eyal, director of the UK's Royal United Services Institute. It should be noted that while Flight MH-17 served as the premise to bolster Western resolve against Putin, the Ukrainian government holds the actual technical fault because it failed to shut down its airspace at a time of aerial warfare. In fact, the families of that flight's German victims plan to sue the government of Ukraine, rather than Russia's, in accordance with that failure.

The international response was to boost sanctions against Russia that had been rather tepid until that point. However, the US State Department, and the neo-conservatives that still have influence there, primarily one Ms. Victoria Nuland, the US Assistant Secretary of State in charge of Europe and Eurasian Affairs, played a rather important role in fomenting

the crisis. Nuland was secretly filmed as she addressed Ukrainian business and political leaders at a Washington meeting that the United States had spent "USD\$ 5 billion to develop Ukrainian Democratic Institutions". Nuland was evidently rather involved, then also in the successful coup (and it was a coup, regardless of one's feelings about the previous Ukrainian leadership) against the democratically elected, but pro-Russian President Viktor Yanukovich. Indeed, the situation in Ukraine is not at all as clear as the Western media and diplomacy hawks have presented it; that is, one where Russia is bullying a 'democratic' neighbor, trying to improve its fortune by looking toward alliances with the 'West' rather than staying 'East'. Many commentators have ignored the huge role played by the United States and its allies in prompting the Ukrainian crisis in the first place, ignoring, in the process, the very real risk of it escalating into a more wide reaching war.

The crisis has actually been rather less about Russian aggression in Ukraine than a Western attempt to lure Ukraine into NATO and the European Union, while weakening the political future of Russia's President Putin. Victoria Nuland's previously mentioned meeting proves that Washington invested many US tax payers' dollars to finance Kiev's Maidan public protests and the coup against President Yanukovich, who had been democratically elected. Russia sees NATO's creeping into Eastern Europe as a challenge to Russia, which had been assured of its continued influence – free of NATO troops – in a formal agreement signed by Presidents Mikhail Gorbachev and the George H. Bush at the time of German reunification in 1990. NATO, meanwhile, has announced it will build five new bases in Eastern Europe last August. This cannot but deepen tensions between the Kremlin and the West. Meanwhile, Ukraine has gained nothing since its new 'democracy' started. Kiev needed, says the IMF, some USD\$ 35 billion in aid last May; the IMF has revised that amount to USD\$ 55 billion, while economist Desmond Lachman says it now needs "closer to USD\$

100 billion". Moscow has not done so, but it could shut off supplies of its gas to Ukraine as winter approaches. The fact is that the most democratic solution would be to allow a referendum in the pro-Russian Ukrainian provinces to vote whether to stay in Ukraine or join Russia.

Many of the opinions heard so far, enforced by sanctions and materialized through the deceptive use of campaigns costing billions of dollars, have come from people living far beyond the borders of Russia or Ukraine. Meanwhile the sanctions continue; are they effective? The last package of sanctions Treasury USA and the EU takes aim at Russian banks, the energy industry and the military. Sberbank, the largest bank in Russia, will not have to Western long-term capital (that is any loan lasting over 30 days). The USA and the EU want to cease the development of exploration projects in Siberia and the Russian Arctic, preventing the West's oil majors from selling equipment and technology for deepwater shale gas projects. Exxon and Shell, therefore, can no longer do business – building pipelines for instance – with such energy sector giants as Gazprom, Gazprom Neft, Lukoil, Rosneft and Surgutneftegaz.

The United States Secretary of the Treasury, David Cohen, has insisted that the sanctions package "isolate" Russia further from the global financial system. Interestingly, nationalist Russian shareholders have seen to it that the shares of the companies on the list of sanctions go up rather than down while the shares of the oil majors in the United States have gone down! Oh, and because Russia has been isolated from Western capital, Russia will simply not be importing goods and services both from the USA and the EU – finding alternatives through its BRICS (Brazil Russia, India, China, South Africa) partners and beyond. Moscow is simply dealing in local currencies with its other business partners and this could hurt the West and its currencies in the long term, because other developing countries might start to do the same.

Russia may sell its energy resource in any currency except USD and EUR while importing clothes, technology, hi-tech electronics, computers, agricultural goods and raw materials it needs from Asia and South America. There are serious doubts, moreover, as to how long the EU member states, in absence of a shared energy policy, will last without Russian gas even if they manage to secure alternative supplies from other countries (Azerbaijan, Qatar, Libya?). The West is still banned by another set of, rather counterproductive, sanctions against Iran, which means that it cannot import oil or gas from there to meet the Russian shortfall. The markets are less 'irrational' than they are motivated by profit and profit is based in reality. The current intentional politics practiced by the West against Russia express very little 'reality' and much ideology. Russia has a huge surplus of foreign capital – and can protect itself from the economic storm. The EU is still in austerity mode and failing to recover; even Germany, the Union's strongest economy, is hurting with recent growth rates noted at -0.2%. Markets respond to realpolitik and the economic wars launched by Washington and Brussels against Moscow will hurt the markets of the former rather than the latter.

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## **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?