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Putin v. Purse Power: Confronting International Laws, Russian Style

In an interview last November about the role of western economic sanctions against Russia, MSNBC host Lawrence O’Donnell confronted my optimistic outlook.

“How could you possibly think the sanctions are working? We want Putin on his knees begging for forgiveness, and so far, he is not doing that,” O’Donnell said.

My reply was simple: “Good luck with that.”

Indeed, anyone who has expected quick results from the sanctions imposed by the United States and European Union over Russian President Vladimir Putin’s annexation of Crimea from Ukraine in March 2014 is suffering from delusion. Contrary to all evidence, Americans often seem to believe that changing the mind of a disagreeable nation can happen overnight. Yet it took 50 years for the Cuban embargo to bring in the opening with the United States (Garcia and Weissenstein 2015). For Iran, it has taken almost the same amount of time to restart the relationship, for now in the form of the antinuclear agreement (Klein 2015). With Russia, however, there is a naive expectation that the sanctions should quickly make the Kremlin obedient and remorseful, with many complaining that the measures were too weak to foster a regime change of sorts—a desired goal, in O’Donnell’s view.

The annexation of the Crimean Peninsula on the Black Sea and the subsequent armed incursions in nearby eastern Ukraine by pro-
Russia separatists in Donetsk and Lugansk have not only challenged Ukrainian territorial integrity but threatened the world order established after World War II. And that, the reasoning went, required a more forceful message from the West: international law violations are a punishable offense. As veteran Moscow reporter Owen Matthews wrote in *Newsweek* on March 25, 2014:

President Barack Obama, who has supposedly taken the toughest line in condemning Russian President Vladimir Putin’s “aggression,” has merely declared banking sanctions on a dozen Russian businessmen personally close to Putin. The European Union’s list of sanctioned Russian officials has been shorter still, prompting an outcry against Europe’s . . . feeble response.

Indeed, the purpose behind Washington’s and Brussels’ “purse power” strategy—as with all sanctions or embargos—was to separate the people and the elites, and also to drive a wedge between Putin’s inner circle, those former military and KGB officials who turned business executives under Putin. The West aspired to also effect the wider Russian middle class, those who have lived better in the Putin years than ever before, who were able to travel and have access to foreign products and jobs. That population, the Western reasoning went, would rather see Russia prosperous than imperious.

Certainly, over the past decade, rising oil and gas prices fueled Russia’s rapid GDP growth (US Energy Information Administration 2015), which secured Putin’s popular standing. In those years the global oil price was at around $100 a barrel, and since natural resources comprise 70 percent of the country’s exports, revenues from Gazprom alone, the giant state-controlled energy conglomerate, accounted for at least 5 percent of the national budget. Yet while Russians have generally benefited both economically and culturally from Russia’s engagement with the world economy, would they really want to follow their president into economic isolation? (Khrushcheva 2015)
After all, taking over territories as a sign of its natural-resources-fueled greatness does not pay bills or feed families.

These calculations of the benefits of engagement with global economy have been largely correct, and critics do have a point: sanctions could have worked quickly, but only if they were “blanket,” drastic measures that would have prevented all Russians from accessing any Western amenities—from businesses to products to lifestyle. Such total isolation, however, would have been a legal challenge in itself, and costly to Western powers, especially those states in the European Union that disagreed on sanctions implementation even in their relatively mild form. Europe could hardly withstand a 30 percent cut in natural gas deliveries if Putin ordered Gazprom to stop doing business there. Therefore, countries that include Italy, Hungary, and the Czech Republic have been hesitant in confronting Russia, while Germany, Poland, and others insisted that the West should be standing firm against the Kremlin’s incursions into other nations’ territory.

For over a decade, Russia’s energy-centric economy used the country’s oil and gas exports as a geopolitical cudgel. For example, Hungarian Prime Minister Victor Orbán is Putin’s staunchest friend in Europe, and therefore Hungary pays Gazprom $260 per 1,000 cubic meters of gas. Poland’s leaders, however—who have consistently warned that Russia could again become a menace to the continent, reverting to its oppressive ways familiar from the Cold War—end up paying $526, the highest price in the EU (One Europe 2014).

For fear of the “Gazprom guns,” the mammoth conglomerate was not the original target of the sanctions. But given that natural resources are Russia’s major currency, the Kremlin can hardly afford the loss of the European market. Russia will suffer more than Europe from Europe’s loss of the supply of Russian gas. Therefore, threatening Europe with cutting exports has become an exceedingly unwise tactic, especially since prices have continued to fall, and now oil is trading at as low as $45 a barrel (Katakey and Rascouet 2015).
ALTHOUGH THE PROCESS BEGAN SLOWLY, THE SANCTIONS WERE NOT AS feeble as they appeared to some, and had seriously increased their reach by the end of 2015. The European Union has 151 individuals on its punishing list. The wide-ranging scope of 37 entities being penalized includes whole regions, such as the Donetsk and Lugansk People’s Republics, established in April 2014 a month after the Crimea annexation, as well as commercial banks, diamond joint stock companies, local airlines, wine producers, spas, and a few oil and gas companies (European Union 2015).

The United States has had an even broader reach. March 2014 sanctions immediately targeted about 130 individuals and businesses, and the following year the number had grown to over 200, including 99 individuals and 109 entities. The United States has also instituted bans on imports and exports from Crimea and surrounding territories, along with bans on all new investments and visa restrictions, effectively increasing the range of both businesses and business sectors that the sanctions now cover (US Office of Foreign Assets Control 2015).

The problem has been less with the measures themselves than with expectations as to what the punishment is supposed to achieve. If the goal is to stop Russia in its tracks or return Crimea to Ukraine, then the efforts have been woefully inadequate. On the other hand, it is important to recognize that even though Putin has not been deterred from his actions in Ukraine completely, in the past year he has certainly curtailed his reach. An ambitious plan to take over the whole area north of the Black Sea, historically known to the Russians as Novorossiya, stalled because it became clear that if Kremlin-supported separatists were to press on with their incursions, the sanctions would only get worse.

The difficulty of changing the mind of the nation, especially from the outside, is best illustrated by the fact that the Russians still cling to an illusion that it is they who call the international shots. Understanding that the West cannot sever all trade relations at once, they take nationalistic pride in showing that while Western values
are under assault, Western goods are still welcome. A common sight in Russia is a shiny German-made car with a bumper sticker recalling the Soviet victory in World War II: “On to Berlin” or “Thank you, grandfather, for the victory, and grandmother for the tough bullets.”

Even though Russia has self-imposed restrictions and bans on certain Western consumable goods, such as Colgate toothpaste and Dutch Gouda cheese (which in a sign of perverse nationalism Putin orders to be destroyed publically), consumption of durable goods, such as German cars and Japanese TVs, is on the rise. This phenomenon proves that consumer confidence continues to plunge, making Putin’s grip on power extremely vulnerable. It also shows that his public support has few roots in reality, and is akin to “negative mobilization” (Levada-Center 2015a), a phenomenon occurring in most countries whereby the population rallies behind the flag when they believe or are told that their nation is in danger.

Since Putin’s ratings remain high at over 80 percent (Levada-Center 2015a), onlookers, including O’Donnell, insist that this means the sanctions have failed and the Kremlin’s campaign in Ukraine has been successful: Crimea remains under Russian control, and although plans for Novorossiya have yet to materialize, eastern Ukraine and the whole country’s sovereignty and territorial integrity have now been destabilized for years to come. Moreover, in the past year, support for the Kremlin notwithstanding, almost 40 percent of the regular Russians seriously worry that the annexation of Crimea, crisis in Ukraine, and Western economic sanctions have been “personally affecting [their] individual lives” (Levada-Center 2015b).

Not only have plunging oil prices wreaked havoc on Russia’s finances, but economic output had already contracted by almost 5 percent in the second quarter of 2015 (Trading Economics 2015a), and the country’s credit ratings have been reduced to “junk” or “near junk” status (Monaghan 2015).

Still, despite such dire conditions, the United States faces a long-term Russia problem. It will take some time for patriotic Russians to tune
out the Kremlin propaganda of World War II and begin to realize that the West is not out to obliterate Russia. When that happens, in order to stay on top, Putin will need a more rational reason than a perpetual war story to keep his people content. But short of his ouster, this kind of change cannot appear immediately or even quickly, and any solution will require at least some partnership between the Russians and the United States.

After all, no recent agreements with Communist Cuba or religious Iran could have been made without their leadership being ready to work on those agreements. When Soviet leader Mikhail Gorbachev initiated his democratizing policies of Soviet glasnost and perestroika in the 1980s, he had to work with Europe and the United States to make these policies sustainable both inside and outside the country. Prime Minister Margaret Thatcher, the British “Iron Lady,” recognized the incoming 54-year-old general secretary of the Communist Party of the USSR as a possible partner (Bowcott 2014), and advised then-US president Ronald Reagan to treat him as such. Reagan agreed, yet his “Star Wars” strategy—formally known as the Strategic Defense Initiative (SDI), an elaborate project to construct a space-based anti-missile system—was on par with the crippling sanctions. The Soviet Union was already weakened by decades of the arms race, and it would have bankrupted the Soviets to introduce another program to counter the SDI.

Reagan’s move, in fact, assisted Gorbachev’s reforms. The Soviet leader was able to argue that if the USSR continued on the path of constructing the military-industrial complex, the country would be brought to ruin soon enough (Kotkin 2008). Thatcher and Reagan considered Gorbachev a “good” adversary for the West—progressive and young compared to his geriatric predecessors. They saw his leadership as capable of democratizing hardline communism. However, no amount of threats would have moved the Soviet Union forward if Gorbachev himself was not ready.

Gorbachev’s example illustrates that any time a policy is imposed from the outside, the West should understand such change can
be helped along only in limited ways. Reagan’s calculation, essentially with Gorbachev’s consent, was to illustrate to the Communist government that aggressive means could turn costly and ineffective, and ultimately embarrass or even destroy Russia.

Even though the Cold War animosities are no more, Putin has proven to be far less accommodating than his Soviet predecessor. Therefore, despite the stringency of Western demands and expectations, sanctions will not achieve the desired reversal in Russian politics unless they are firmly linked to concrete demands. The return of Crimea is seen as a primary condition, but also important is the fulfillment of the Minsk protocols, a set of agreements that establish a timeline for a bilateral ceasefire, withdrawal of weaponry and troops, release of hostages, and ultimately a settlement between the pro-Western Kiev government and Russia-leaning Ukrainian east (BBC 2015a).

It is equally important to face reality: Russia will never renounce its annexation of Crimea. Therefore, the Crimea issue should be treated separately from the rest of Ukraine’s conflict—that is, pro-Russian rebel control of eastern Ukraine villages and towns. Surely the sanctions tied to Crimea must be kept in place, but accepting that there are limits to the concessions Russia will make is also a must.

For example, the Minsk agreements are supposed to be implemented by the end of 2015, so further sanctions should be based on incremental demands, and rewards offered even though they don’t meet the grand expectations of Putin’s “begging for forgiveness.” In short, the first objective is to persuade Russians that there is a benefit to changing their behavior. One way to achieve this is to observe international laws while being willing to lift certain areas of sanctions when appropriate.

As Fiona Hill of the Brookings Institution noted this year,

Right now, the Russians can only conclude that sanctions, particularly US financial sanctions, are forever and so have no incentive to change their behavior. We need to make
clear that the United States and the EU moved to sanction Russia because of its violation of the accords that we all agreed to. If we find a mutually acceptable solution to the current standoff, sanctions would be lifted; and, at some point, economic and trade relations would be restored (Hill 2015).

Hill has a point: During the Cold War, animosity between capitalism and socialism did not prevent the USSR and the United States from engaging in diplomatic give and take, but even then such drastic goals as regime change were hardly effective. Just think of the failure of the 1961 Bay of Pigs invasion, which was supposed to result in young Fidel Castro’s removal from power.

It is not only the diplomatic and political conversation that needs to be maintained. Russia is more likely to have a democratic future if the regime is discredited, not pushed; if it is brought down by Russians themselves, not outsiders. For now, the people believe that the sanctions are part of a Western plot to undermine Russia politically, but the West should not underestimate Russians’ increasing frustration with the failing economy (Nardelli, Rankin, and Arnett 2015).

**ECONOMIC TOOLS SHOULD AND COULD WORK AS LEVERAGE, BUT THEY WILL have an even stronger impact if applied in combination with legal—impartial—mechanisms. Revealing a long stream of underreported legal defeats for the Kremlin is the real force that will eventually have an impact on Putin’s popularity and his political prowess. Last year the European Court of Human Rights (ECHR) in Strasburg delivered 129 judgments against Russia, and in January 2015, the Council of Europe deprived the country of its voting rights for its violations of international law. As the rulings have piled up, they have begun to pose a real threat to Russia’s international standing and its financial and political prospects.**
For years, even before Ukraine’s crisis broke in 2013, Putin wielded Europe’s dependence on his country’s natural gas as a foreign-policy weapon, without fear of the European Union calling his bluff. But earlier this year the EU launched an antitrust case against Gazprom, sending a clear signal that it is ready to end Russia’s natural resources intimidation. In April, the European Commission on Competition issued a Statement of Objections, charging Gazprom with having breached Europe’s antitrust laws by dividing European gas markets. For forbidding resales and hampering pipeline deliveries to third parties (Kanter 2015), Gazprom faces a fine of 10 percent of its revenues, which totaled $177 billion in its last fiscal year. Already struggling with low gas prices (Katakey and Rascouet 2015), increased competition, and falling production, Gazprom will be short on funds for the urgent infrastructure projects that are necessary to stay competitive. The message from the European Commission—that market rules and agreements apply to everyone—is one that Putin will not be able to dismiss for much longer.

In 2003, Putin was still lauded as the leader of “a country at peace within its borders, with its neighbors, and with the world, a country in which democracy and freedom and rule of law thrive” (The White House, Office of the Press Secretary 2003). This was the year that the Kremlin expropriated Yukos Oil, which at the time produced 20 percent of Russia’s output, and jailed its founder, Mikhail Khodorkovsky, for 10 years on trumped-up tax evasion charges after he dared to oppose the Russian president.

In a display of goodwill before the 2014 Sochi Winter Olympics, Putin released Khodorkovsky on the (informal) conditions that the former tycoon stay in Europe and away from Russian politics. But despite the president’s wishes, the Yukos case was brought back into the public view. In July 2014, the Permanent Court of Arbitration in The Hague ruled that Russia must pay $50 billion to the company’s former shareholders for having illegally bankrupted the firm and distributed its assets to Rosneft, a Russian state-owned producer. Shortly before Khodorkovsky’s arrest, Yukos was valued at $30 bil-
lion—hence the lofty sum, which the arbiters argue has nothing to do with politics. So far it has been the largest judgment ever awarded by the court, and some countries like France and Belgium have already begun seizing Russian assets to enforce the ruling. Others are ready to join their ranks (Reuters 2015). This penalty represents about 2.4 percent of Russia’s gross domestic product (GDP), which threatens to further damage the economy. The Ukraine-related sanctions have taken a little over 1 percent off Russian GDP. And if the tougher sanctions are imposed, this will add another 1.5 percent of GDP shrinkage, bringing the total negative to almost 5 percent.

In a separate case last July, the ECHR ordered Russia to pay Yukos’ shareholders $2.5 billion in compensation for “pecuniary damage” (RFE/RL 2014). This judgment was also the largest in that court’s history. After a year of crippling sanctions, Russia cannot really afford legal and financial penalties suddenly popping up here and there.

Then there is the hearing into the murder of Alexander Litvinenko, a dissident former KGB officer turned UK citizen. The case was reopened last year after the original shutdown and is currently under way in London. A legal inquiry into Litvinenko’s 2006 polonium poisoning is trying to identify “where responsibility for the death lies” (Calamur 2014). If the inquiry indeed proves that the evidence for the assassination leads to Putin’s door, it will have very far-reaching consequences. According to the Committee to Protect Journalists, in the 15 years that Putin has been in power, more than 50 journalists and activists have lost their lives. Mostly these were people in opposition to Kremlin politics or the corrupt regional officials appointed by Moscow. The European Parliament has now intensified its calls for an independent international investigation into some of these cases, as well as into the murder of the Russian opposition political leader, former Deputy Prime Minister Boris Nemtsov, who was gunned down steps away from the Red Square in February 2015.

Together with the EU’s antitrust action, the renewed Litvinenko case, and other inquiries, there is an almost coordinated “legal assault” on Putin’s Kremlin. All these decisions send a tough yet impar-
tional message: rules apply to everyone, deaths should be investigated, and stolen property must be returned.

This legal trend will force Putin to become accountable for his actions, even if only to a degree. Sanctions imposed by Europe and America may not be able to return Crimea to Ukraine, but the West’s legal challenges to Russia should put Putin on notice that his strong-arm tactics have failed to work in some, if not all cases.

In fact, it is possible that Russia will soon come under increased pressure not only regarding international business law violations but also for alleged criminal conduct. Russia recently vetoed a United Nations Security Council resolution put forward by Australia, Belgium, Malaysia, Netherlands, and Ukraine to establish a criminal tribunal to prosecute those responsible for the downing of Malaysia Airlines Flight 17 in July 2014 over rebel-occupied territory in eastern Ukraine. These countries insist that they had gathered enough evidence to prove that a fatal missile was fired from a Russian Buk self-propelled system operated by a Russian-trained crew (BBC 2015b). If Russian responsibility for the tragedy—almost 300 people perished in that flight—were to be established, Putin would have a hard time denying that Russia’s military is heavily involved in the Ukrainian conflict.

Clearly, if sanctions alone cannot end Russia’s de facto control of Crimea, Putin will have to deal with further legal challenges related to the country’s presence there. The challenges do not even have to be about its annexation against international laws, they could be as simple as a restitution and the recovery of property rights.

In June 2014, Ukraine presented Russia with a 17-volume estimate of how much the country had lost from Russia’s annexation of Crimea, and according to the study the cost of damages to Ukraine has amounted to almost $90 billion (Bershidsky 2014). The number comes from the value of the peninsula’s territory, over 10,000 square miles, and includes such items as 660 pounds of gold that originally belonged to the Ukrainian state bank. Other countries that do not rec-
Recognize Crimea as a federal subject of Russia but once had properties there will soon begin to put forward their own cases arguing property rights violations, which in Russia’s weakened condition would be the ones to effect the Kremlin’s behavior most.

In fact, most of the infrastructure in southeastern Ukraine is now lying in ruins, including the Ukrainian and foreign properties that once populated the area. If Russia’s denial of involvement in the separatists’ war continues to be challenged, the Kremlin will have to fight many more legal battles—in the ECHR, in the World Bank–affiliated International Center for Settlement of Investment Disputes (ICSID), and other such worldwide organizations (Grant 2015). Russia will not only continue to lose money but, with no foreign investments and with the legal status of these territories perpetually in question, it will have to indefinitely support Crimea, Donetsk and other nearby areas all on its own.

Russia already faces legal penalties nearing 5 percent of its GDP, and in August of this year, the GDP growth rate has already contracted another 5 percent (Trading Economics 2015a). If the trend continues—with Russia remaining vulnerable to international rulings and penalties firmly in place—the Kremlin will start looking for ways out of crisis soon enough. Even though “blanket” sanctions might have brought faster results, the steady international pressure, both financial and legal, is likely to damage Putin’s popularity. It may take just a few months, or the pressure could foster discontent for over a decade. Either way, the strength of “purse power” is that although it cannot always change government behavior, it is definitely successful in influencing it.

REFERENCES


