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**Research Report**

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# A Permanent State of Sanctions?

## Proposal for a More Flexible EU Sanctions Policy toward Russia

*Sabine Fischer*

**Sanctions seem to have become a permanent element in relations between the EU and Russia. They have contributed to curbing the war in Donbas but are not capable of forcing Russia to return Crimea to Ukraine and implement the Minsk agreements. In 2017, consensus within the EU on sanctions against Russia is more fragile than it has been previously. As a result, therefore, the EU needs to consider now what strategic steps it should take next.**

In recent years, sanctions have profoundly affected relations between the EU and Russia. They are an expression of the worst crisis in Russia's relationship with the West since the end of the East-West conflict and reveal the extent to which the European security order has broken down. They are also part of the blocked peace process in Ukraine.

The EU closely coordinated its sanctions policy with the Obama administration. The election of Donald Trump has raised concerns among the US's European allies that Washington could withdraw from the Western sanction mechanism and allow it to collapse. There are currently no signs that the Trump administration is planning to withdraw any punitive measures. However, the sanction mechanism could unravel at the European level, too, as a result of parliamentary and presidential elections in some EU Member States.

### EU sanctions against Russia

The restrictive measures imposed by the EU on Russia are based on a three-stage sanction mechanism which heads of state and government adopted in early March 2014. It includes diplomatic sanctions (Level 1), measures, such as visa bans and asset freezes targeting specific individuals or legal entities and organisations, (Level 2) and economic sanctions targeting specific economic sectors (Level 3).

The EU can adopt such restrictive measures based on a Common Foreign and Security Policy (CFSP) decision by the Council which occurs at the behest of the High Representative for Foreign and Security Policy. A Council regulation, prepared by the EU's External Action Service and the Commission, is required if assets are to be frozen and economic and/or financial sanctions imposed. Council Decisions and Council Regulations come into force once they are published in the Official Journal of the

European Union. The EU officially informs individuals and organisations affected by sanctions about which steps it has taken and why. Restrictive measures are reviewed at least every 12 months and extended by Council Decision. The Council may at any time decide to amend, extend, suspend or repeal the sanctions.

The diplomatic measures against Russia (Level 1) came into force on 6 March 2014 through the decision of the heads of state and government to adopt the three-stage plan. Since then, negotiations on a new partnership agreement between the EU and Russia have been suspended. Visa liberalization and visa freedom are no longer being negotiated and EU-Russia summits are no longer taking place. Many thematic working groups have been suspended as well.

In response to the annexation of Crimea, the EU adopted the second stage of its sanction mechanism and initially imposed visa bans and asset freezes on a very limited number of actors who were directly involved in the events. By December 2014, it had suspended all forms of economic interaction with Crimea and Sevastopol. Since then, the two annexed territorial units have been both economically and politically isolated from the EU.

The EU also imposed restrictive measures on individuals and organisations involved in the destabilization of Eastern Ukraine from April 2014. The list of affected actors has since grown to a total of 150 individuals and 37 organisations and includes a number of high-ranking Russian government representatives and confidants of the Russian president. The EU finally activated the third stage of its sanction mechanism in response to the escalation of the war in Donbas during the summer of 2014 (the shooting down of passenger aircraft MH17 in July and the invasion of regular Russian troops in August). It imposed an arms embargo and restrictions on the trade in dual-use goods and equipment needed for crude oil exploration and production. It also restricted access to the EU's capital market for a group of Russian banks and compa-

nies. At the same time, it refrained from imposing more disruptive measures, for instance, excluding Russia from international payment transactions (SWIFT). The EU reacted to a renewed escalation of the armed conflict in January 2015 by extending the list of sanctioned individuals but did not adopt new economic sanctions. The restrictive measures it imposed as a result of the war in Donbas have also been gradually adapted in the past two years, but have not been tightened. They were extended every six months. In March 2015, the European Council decided to bundle the sanctions imposed on Donbas and agreed to make their suspension conditional upon the full implementation of the Minsk agreements from February 2015. The next decision on the Donbas sanctions is due on 31 July 2017.

The EU coordinated closely with Washington on the form and content of its restrictive measures. The US list of sanctions includes more and more prominent individuals from Putin's inner circle. US financial sanctions – unlike those of the EU – also have an impact outside its borders. The suspension of US coercive measures would reduce the broad impact of Western sanctions. It would be a strong incentive for political and economic actors within the EU who are critical of sanctions to further question the already fragile consensus in favour of sanctions.

### **Russian sanctions against the EU**

In response to Western sanctions, Russian President Vladimir Putin ordered an import ban on many agricultural products from the EU and the US on 6 August 2014 (decree no. 560). For this purpose, a federal law from 2006 authorizes 'special economic measures' to ensure the security of the Russian Federation (e.g. breaches of international law or hostile acts by other states against Russia). The import ban concerns a number of meat and sausage products, dairy products, varieties of fruit and vegetable as well as fish and crustaceans. Other products, such as baby food, certain animal products and live animals or lactose-free milk and

dairy products, were exempt from the embargo. These Russian sanctions have been extended several times since August 2014 and also extended to third countries that had signed up to the EU and US sanctions. The list of countries affected now includes Canada, Australia, Norway, Albania, Montenegro, Iceland, the Grand Duchy of Liechtenstein and Ukraine, in addition to the US and EU Member States. In May 2016, Moscow eased the ban on imports of beef and poultry meat as well as some vegetable varieties because these products are needed for the production of baby food. The Russian sanctions were last extended in June 2016 for the period up until 31 December 2017. They are a reaction to the sanctions imposed by Western states. As a result, their suspension depends on the future sanctions policy of the EU, the US and the third-party countries involved – without it being explicitly stated in the relevant legal documents.

Furthermore, since March 2014, Russia has kept a list of 89 political actors from various EU Member States who are refused entry into the Russian Federation. Unlike the EU, the Russian list has neither been officially adopted nor published, nor has any reason been given as to why the politicians on the list are affected by the measure. Instead, the list was leaked to Western media in May 2015 after the Russian government had unofficially sent it to the EU.

Whether and when the travel bans for those affected are cancelled is, therefore, even more dependent on the political will of leaders in Moscow than is the case with the Russian food embargo.

### **The impact of sanctions**

The ‘impact of sanctions’ in the following means the overall implications of the sanctions on both sides as well as on their relationship to each other. In the three years they have been imposed, the punitive measures have had a broad impact. The impact of the sanctions is not, however, identical with their effectiveness in the narrower

sense, i.e. the question as to whether the sanctions have achieved their intended objectives.

**The impact of sanctions and counter-sanctions on the Russian economy:** The impact of EU sanctions corresponds to the intention of targeting individuals, organisations or sectors. As a result, sanctioned actors had to accept financial losses, such as the Rotenberg brothers or Gennady Timchenko, three influential oligarchs in Putin’s inner circle. Most sanctions on economic sectors have largely had a medium to long-term impact: the export ban on dual-use goods excludes the Russian armaments industry from long-term access to high-technologies from industrialized countries which could have a negative impact on Russia’s ambitions to modernize its armed forces. The export ban on technologies in the area of oil exploration and production is limiting Russia’s ability to develop new oil fields and keep production levels stable. The sanctions have also made cooperation with Western energy companies more complicated. However, this is not the case for all cooperation projects, since contracts already concluded may still be implemented despite EU sanctions (e.g. Nord Stream 2, Statoil cooperation). The impact of these sectoral economic sanctions is, therefore, indirect and dependent on the development of other factors. Consequently, some experts are questioning whether they will ever have an impact at all.

Restrictive measures in the financial sector have the most direct influence, limiting access to Western financial markets for the affected Russian banks and companies. The Russian government has, therefore, had to give financial support to several companies hit hard by the sanctions.

In 2014 and 2015, the Russian economy experienced an acute recession but has stabilized since 2016 albeit at a lower level. Western and Russian experts agree that sanctions are only one, and by no means the most important, reason for the recession. The oil price decline in 2014/15 had

a much stronger impact on the resource-dependent Russian economy. Both Russian and non-Russian experts estimate the impact of sanctions on the entire economy at 0.5 to 1 percent of gross domestic product (GDP). Beyond these specific implications, the mere existence of the sanctions and the political crisis in Moscow's relationship with the EU and the US have led to a general deterioration in the business climate and increased risk for foreign investors. In the medium to long term, these trends will adversely affect the urgent need to modernize the Russian economy.

The consequences of the import ban on food from the EU, the US and other third-party countries were ambiguous for the Russian economy. On the one hand, in 2014/15, this measure led to a massive increase in food prices (up to 50 percent for some product groups) and pushed up inflation. This, and the disappearance of coveted goods from supermarket shelves, had a direct negative effect on Russian consumers. On the other hand, the Russian agricultural sector benefited from the absence of often higher-quality Western goods and was the only economic sector to grow in the 2014/15 recession.

The Russian political leadership countered the impact of sanctions with a package of measures. As mentioned previously, companies approaching insolvency were given support in the form of financial aid and large-scale public contracts enabling them to compensate for losses incurred due to the sanctions. From 2014 onwards, Russia also tried to rapidly intensify its economic relations with China – with moderate success. Moscow is now working even more resolutely to strengthen the role of the state in its economy and is yet more relentless in its drive for protectionism and import substitution.

**Impact of sanctions on the economic situation in the EU:** The economies of EU Member States are affected by the mutual sanctions in three respects. Firstly, the EU's restrictive measures prevent certain inter-

actions in the armaments industry, in high technology and the energy sector. Secondly, some Member States have suffered declines in their agricultural exports due to the Russian import ban. And thirdly, the recession and the concomitant weakening of Russian purchasing power had a negative impact on EU companies active in Russia. Calculations by economists conclude that the sanctions will have only a very limited long-term impact on the EU economy as a whole (considerably below 0.5 percent of GDP). However, the effects are distributed very unevenly due to varying degrees of economic interdependency. As Russia's most important European trading partner, the Federal Republic of Germany, for example, is hardest hit by the EU sanctions. France had to halt the sale of two Mistral-class helicopter carriers. The French banking sector is exposed to risks from particularly high lending to Russian companies. Others, mostly Eastern Central European countries and Finland, are strongly affected by the Russian agricultural embargo.

The negative consequences of sanctions are not existential for EU Member States, but they cannot be ignored in view of the already tense economic situation in the EU. Back in 2014, the Commission launched a series of steps to counter the negative effects. These included measures to stabilize the EU's agricultural market and attempts to open up new markets within the EU or in third countries. Therefore, re-focussing on other markets, such as Belarus, could largely offset Russian market losses.

In 2014, the EU sanctions were deliberately designed in such a way as to not endanger its close energy relations with Russia in the medium to long term, especially in the natural gas sector. However, efforts to diversify EU natural gas imports were in place long before the outbreak of the Ukraine crisis. The primary and secondary implications of the sanctions imposed in 2014 have led to unbundling tendencies in various sectors on the EU side.

## **The effectiveness of sanctions in the EU-Russia relationship**

When international actors impose sanctions they usually want to punish the action of another actor and make it change its policies. They can use sanctions in a variety of ways to either coerce their counterpart to change their course of action against their explicit will or convince them of the meaningfulness of political reorientation. They can also use sanctions to send a signal to a counterpart, but also to other target groups, such as their own citizens or the international community. The harshness of the punitive measure depends on the intention (to coerce, convince or send a signal). However, the relative strength of the sanctioned actor also determines which of the three options the sanctioning party chooses.

The EU restrictive measures were adopted against Russia in 2014 “with a view to increasing the costs of Russia’s actions to undermine Ukraine’s territorial integrity, sovereignty and independence and to promoting a peaceful settlement of the crisis”. The decisions to establish the sanction mechanism and to activate the three levels were each taken in phases as the conflict escalated. Their aim was to de-escalate the war but also to create a political environment in which it would be possible to peacefully resolve the conflict and restore the territorial integrity and sovereignty of Ukraine.

The EU responded to the annexation of Crimea with weak sanctions. EU decision-makers were surprised by the rapid speed of developments there. In the spring of 2014, a number of Member States, including Germany, were still rejecting full implementation of the three-tier sanctions mechanism. As a result, the EU’s response was to signal their disapproval of Russian (and also Ukrainian) policy. The additional costs incurred by the sanctions had no impact on Moscow’s decision to annex Crimea and to persist with this action.

A different assessment can be made of the effectiveness of Western sanctions with

regard to the escalation of the war in Eastern Ukraine. The decision to fully activate the sanctions mechanism and impose sectoral economic measures may well have influenced the course of the armed conflict in Donbas. After September 2014, it did not expand much beyond the conflict line established during the Minsk negotiations. Russia re-calibrated its support for the separatists and disempowered the most radical actors among them. The chronology of the conflict suggests that the imposition of painful economic measures, which made the threat of more serious measures credible, restricted Moscow’s actions and curbed further escalation of the war. The simultaneous debate taking place in the West on possible military support for the Ukrainian army may have played a role here. The sanctions were, therefore, quite effective. They convinced Russia of the necessity to moderate their acts of war, without having been able to force them to end the conflict completely.

The sanctions have not changed the basic orientation of Russia’s policy on Ukraine which is to maintain influence through controlled instability. The annexation of Crimea has become such an important part of the Russian identity discourse that the political leadership cannot reverse it without endangering itself. A large majority of the Russian population continue to support the government’s position on Ukraine. In addition, hopes that targeted restrictive measures could lead to dissent and resistance in the ranks of the political and economic elite have not come to fruition. The EU has not had access to Russian society and its elite for some years which would be a requirement for exerting any influence of this kind. The majority of Russians still believe the West bears full responsibility for the crisis; approval ratings for foreign policy and for the president remain high.

The European Council has ‘misappropriated’ the sanctions in its package solution from March 2015. Their goal is no longer restricted to de-escalation but is aimed at fully implementing the military and politi-

cal provisions negotiated in Minsk. The Minsk process, on the other hand, has been blocked since 2015 because the parties are calling for contrary sequencing of the Minsk agreements. Russia (with the separatists) insists that the political provisions must be implemented before the military provisions, while Kiev is demanding security and control over its borders before it can or will implement the political provisions. The sanctions have become part of this blockade. They do not offer Moscow any incentive to change their policies. Furthermore, the 'package solution' makes the lifting of sanctions also dependent on Kiev's policies. Russia has repeatedly complained that while it suffers from the sanctions, it is actually Ukraine that is not fulfilling its obligations under the Minsk agreements.

Russia has hitherto been less successful with its sanctions than the EU and/or Western actors. EU Member States have decided to continue the sanctions at regular intervals since 2014. It should be pointed out that there is no causal link between the extent to which a Member State is affected by the mutual sanctions and its critical attitude to sanctions: of those Member States in favour of a severe course of sanctions, Poland, the three Baltic republics and the Federal Republic of Germany are the hardest hit economically.

The debate on punitive measures against Russia has already taken several turns. The consensus on sanctions was first put to the test when Russia broke out of its international isolation for the first time in the autumn of 2015 with its military intervention in Syria and the EU was, simultaneously, under pressure from the increasing number of refugees. One year later, on the other hand, it was the Russian-Syrian bombardment of Aleppo that prevented a critical discussion of sanctions at EU level.

While the impact of the 'Trump factor' is as yet unknown, shifting forces in favour of populist and anti-EU movements in important elections in European countries could jeopardize the consensus on sanctions

throughout the course of the year. Given the key role that cooperation between Berlin and Paris has played and still plays in both negotiating sanctions and in the Minsk Process, the acid test in this context could be the presidential election in France.

Contrary to reducing Western opportunities to influence Russian opinion-shaping and decision-making processes, Russia, for its part, is currently influencing political developments in EU Member States through various means. If, in the upcoming elections, political forces succeed in removing the basis for the sanctions mechanism by withdrawing their consent, Russia's overall strategy (counter-sanctions and political influence) will have proved successful at a stroke.

### What next?

EU sanctions against Russia were not ineffective as is repeatedly claimed. In view of Western efforts to end the crisis in Ukraine, they should be viewed as a partial success because they have

- ▶ expressed the EU's protest at Russia's violations of international law;
- ▶ helped curb armed conflict in Eastern Ukraine in the summer/autumn of 2014 and spring of 2015;
- ▶ helped prevent Russia and the separatists from expanding the war.

However, the sanctions did not

- ▶ reverse the annexation of Crimea;
- ▶ end the war in Donbas;
- ▶ lead to full implementation of the Minsk agreements.

They also had some unintended effects. For example, processed accordingly by the Russian state media propaganda machine, they contributed to consolidating the authoritarian Russian regime. The coincidental timing of sanctions and the decline of the oil price and the economic crisis in 2014/15 reinforced the impression among the Russian population that the sanctions were aimed at worsening their socio-economic situation. In addition, compensa-

tion, the reorientation of foreign trade and, in part, efforts to circumvent the sanctions on both sides, have led to a certain habituation effect in bilateral economic relations. In view of the general weakness of the Russian economy, it is also questionable whether an end to the sanctions would rapidly restore economic relations to levels before 2014. In turn, this reduces the already low incentive capacity of the sanctions.

The Western consensus on sanctions appears to be less stable in early 2017 than in previous years. The worst conceivable scenario is an uncontrolled collapse because EU Member States can no longer agree on the sanctions and transatlantic cooperation fails. This course of events is very likely if Marine Le Pen wins the French presidential election. However, even if the Front National does not win elections in France, a development of this nature cannot be ruled out. It should be prevented in all circumstances because it would

- ▶ revive uncertainty and the risk of escalation in Eastern Ukraine;
- ▶ confirm to Russia that there is sufficient scope for a policy of military influence in its neighbourhood;
- ▶ signal to all parties that the EU is incapable of taking action.

To date, Russia has not given the West any reason to consider lifting sanctions. No change to Russia's Crimean policy is expected under the current political leadership in Moscow. The Crimea sanctions should, therefore, be maintained in any event.

With regard to Donbas, consideration should be given to unbundling the sanctions package and linking the gradual lifting of sanctions to the implementation of security provisions. This applies in particular to the ceasefire (item 1), the withdrawal of heavy weapons (item 2), effective monitoring and verification of the ceasefire regime by the OSCE (item 3), guaranteeing access for humanitarian aid (item 7) and the withdrawal of foreign armed groups (item 10). The EU could provide additional incentives for implementation alongside

the gradual lifting of sanctions, including the European Bank for Reconstruction and Development (EBRD) resuming its activities in Russia.

At the same time, pressure on the Ukrainian side would have to be increased considerably in order for it to meet its security provisions. The EU would have to make it more clear to Ukraine than it has in the past that it should also expect negative consequences if it were to contravene these provisions or even escalate the conflict. The EU should urge the Ukrainian leadership to set up a coherent reconstruction programme for the destroyed parts of the Donbas, and also support it generously. In addition, Kiev urgently needs to abandon its current policy of socio-economically isolating separatist-controlled areas.

This last point is particularly important. Unresolved conflicts over Transnistria, Abkhazia, South Ossetia and Nagorno-Karabakh in the last 25 years have shown that implementing ceasefires and, at the same time, politically, economically and socially partitioning the conflict parties leads to the formation of de facto states and decades-long blockades of peace processes. It is only now that attempts are being made to break down the isolation of the conflict areas and counteract this highly advanced development through a policy of engagement and non-recognition. The EU should now insist that this mistake is not repeated in Donbas.

From a Russian perspective and from the perspective of critics of moderate sanctions in the EU, the proposed flexibility would make an end to the sanctions more tangible and this end would no longer depend on Kiev implementing the political provisions. At the same time, Ukraine's comprehensible need for greater security could be taken into account before political obligations are met. The Minsk negotiations and the accompanying international process (Normandy format) should certainly continue and be used to discuss further political steps.

The sanctions have proved to be an effective means of curbing the war in Donbas.



They should be linked to this objective again. The prospects of this approach being successful also depend on the political will of the conflict parties. This will is not currently present on either side. Sanctions will, therefore, have to remain a permanent condition for the time being. However, with the step proposed here, the EU would be proactively demonstrating its willingness to be more flexible in its approach. It would, therefore, be better prepared for a future turning point where the conflict parties signal genuine interest in a sustainable solution to the conflict.

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