



The taming of the shrew: How the West could make the Kremlin listen

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Abstract

The regime that has emerged in Russia under President Vladimir Putin is no longer only Russia's problem. By promoting corruption, kleptocratic practices and the violation of democratic norms in Western societies, and by using chemical weapons on their territories and carrying out assassinations abroad, Putin's regime has become a significant domestic problem for the EU and the US. However, the preventative measures put in place by the West fall short of fundamentally influencing the regime's behaviour. This article offers some suggestions on how to adjust existing European policy to enable it to more effectively influence the actions of the Kremlin on the international stage.

Keywords

Russia, Putin, EU, US, Neopatrimonialism, Sanctions

Introduction

From a political science perspective, the ruling regime in Russia today can best be described as neopatrimonial. In such regimes personalistic rulers (usually presidents) hold power through a personal patronage system based on informal relations of loyalty and personal connections, rather than formal institutions (Snegovaya 2013; Gel'man 2016). Such regimes, most frequently encountered in African and post-Soviet countries, tend to draw legitimacy primarily from pay-offs to elites and the broader population.

To ensure the loyalty of the elites, the leaders of neopatrimonial regimes allow their elite members access to various forms of illicit rents, patronage and corruption (Bratton and Van de Walle 1997). Neopatrimonial presidents make 'little distinction between the public and

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private coffers, routinely and extensively dipping into the state treasury for their own political need' (Bratton and Van de Walle 1997, 66). In accordance with that logic, the regime of Russian President Vladimir Putin has established a system of enrichment for Putin's cronies that is based on extracting resources for his closest circles from the public coffers through a system of privileged public procurement, stock manipulation, asset stripping and privileged trade (Goldman 2010; Robinson 2013; Åslund 2019).

Similarly, neopatrimonial regimes ensure the loyalty of the broader population through the redistribution of payments and benefits (mass clientelism) (Van de Walle 2007). In Russia, Kremlin politicians allocate resources to the population to secure political support and mobilise voters through payments from the state coffers in the form of pensions, allowances and wages (Kvartiuk and Herzfeld 2020).

The sustainability of such systems is hence ensured through a constant flow of rents (from taxes, natural resources and state-owned companies' revenues) to the rulers. These rents are then partly redistributed to various population groups to ensure their continuous loyalty. External shocks to rent flows might threaten such regimes, and lead to growing dissatisfaction among the elites and the broader population (Bratton and Van de Walle 1997; Snegovaya 2013). In an effort to seek additional sources of revenue when suffering from external shocks, neopatrimonial rulers might be more inclined to agree to concessions with the West. Any successful sanctions policy targeting regimes of this type should therefore incorporate efforts to target the flow of rent that is at the disposal of such regimes.

Existing sanctions policy

Western sanctions have so far done very little to seriously threaten the stream of revenues to Putin's regime. Two policies have had a serious effect to date. The first was the Obama administration's and the EU's de facto freeze of Russian companies' access to Western financial markets in 2014, which also deterred Western companies from investing in Russia. The second was the US Office of Foreign Assets Control's April 2018 addition of Oleg Deripaska and six other oligarchs to the Specially Designated Nationals and Blocked Persons (SDN) list, which resulted in the sanctioning of his companies, including Rusal and En+, the world's second-largest aluminium company. The first of these policies, a ban on trading bonds and equities and a ban on loans with maturity periods exceeding 30 days for several of Russia's biggest banks and companies, ensured that Western creditors avoided entering into long-term operations with multiple Russian counterparts. Consequently, until around mid-2016, few Russian banks and companies were able to raise funds in the Western capital market, which had a painful impact on Russia's economy and put pressure on the Russian Central Bank to provide the missing liquidity. The coinciding drop in oil prices further strained the Russian budget and suppressed the value of the rouble. However, by autumn 2016, the de facto freeze on Russian credit operations had dissipated as Western creditors had adjusted their approach, avoiding cooperation with only those companies directly targeted by sanctions. Since September 2016, the Russian government and companies have de facto regained (limited) access to the Western financial markets (Snegovaya 2018). Similarly, while the

2018 sanctioning of Rusal had a seriously destabilising effect on Russia's economy by rattling Russian financial markets (Harrell 2019), it was eventually removed from the list following a 10-month lobbying campaign in the US and Deripaska's divestment of the majority of the company's shares (Zengerle and Ivanova 2019).¹

The sanctions that remain in effect have a much lesser impact on Russia's economy. They have two main effects. First, they somewhat limit economic growth by shaving off 1%–2% of Russia's economic output (Congressional Research Service 2020, 46). Second, they are deepening the country's technological backwardness by prohibiting Western companies from investing in next-generation oil projects in the Russian Arctic, deep-water and shale fields (Aleksashenko 2016; Fishman 2020).

These effects are moderate at best, and the design of the existing sanctions limits the West's diplomatic leverage over the Kremlin in two ways. First, the existing sanctions do not seriously threaten the revenues accumulated by the Russian regime. If anything, they have had the opposite effect as, to give itself a buffer against threats such as new Western sanctions, over recent years the Kremlin has dramatically increased national reserves (Korsunskaya 2018). Second, the existing sanctions are almost impossible to lift given that there is a lack of clarity about the specific conditions that need to be achieved before their removal. While the 2014 sectoral sanctions were fairly clearly linked to implementation of the Minsk agreements and withdrawal from eastern Ukraine (but not Crimea), the sanctions imposed since then have not been tied to particular benchmarks. Moreover, in the US the Countering America's Adversaries Through Sanctions Act has made it much harder to lift sanctions without notifying Congress and thus giving it the ability to veto the changes. These qualities of the existing sanctions regime led a recent report by the Russian International Affairs Council to conclude that announcements of new sanctions do not seriously affect the macroeconomic situation in Russia, nor have they led to noticeable market fluctuations (Timofeev 2021).

How to make it work

There are two ways in which the design of the existing sanctions could be modified to make the West's diplomatic leverage over the Kremlin more impactful. Both, however, would require a significant commitment by Europe and the US, one which has yet to become manifest.

First, existing individual-level sanctions should be combined with the freezing of these individuals' assets that are located in the West. Thus far individual-level sanctions that penalise selected Kremlin-associated individuals who have committed particularly heinous crimes by banning them from entering the EU and the US have not created a serious challenge for the regime. While such sanctions may have consequences for the individuals concerned, they are unlikely to have broader effects on Russia's economy (Congressional Research Service 2020, 50). These sanctions are also unlikely to create splits among Putin's cronies because the Kremlin spends significant resources on directly compensating Russian elites for their financial losses, compels them to repatriate their

capital and brutally represses any suspected dissent (Szakonyi 2018; Ahn and Ludema 2020).

Therefore individual-level sanctions are unlikely to be effective unless accompanied by a systematic effort to fight money laundering, particularly by collecting information about and freezing the assets of targeted Putin allies. For example, the beneficial ownership reporting requirements in the National Defense Authorization Act (NDAA) might help, should they be rigorously implemented and enforced by the US Department of the Treasury's Financial Crimes Enforcement Network. Despite the fact that sanctions against Russians have been in place since 2014, systematic efforts to identify the assets held by Putin's cronies in Western democracies have only begun recently (Åslund and Friedlander 2020).

Moreover, unless any such effort differentiates between the assets of Putin's cronies and the assets of Russians unconnected to the regime who keep their assets abroad, the effects of such policies may prove counterproductive. Because of a lack of domestic institutional protection, Russians commonly keep their assets outside of their country, which allows them some independence from the regime (Åslund 2019) and serves as one of the main sources of funding for resistance to Putin domestically. Yet so far Western anti-money-laundering initiatives have had an opposite and rather deleterious effect on Russian citizens. For example, the automated exchange of financial account information, introduced as part of the West's anti-money-laundering initiatives in recent years, has exposed data on the foreign assets of Russians in 58 jurisdictions to Russia's federal tax service. This has provided the Kremlin with an opportunity to increase budget revenues by raising additional tax income from the accounts held by Russian citizens abroad (Vikulov 2017). The Kremlin has also actively used these and related anti-money-laundering laws to prosecute domestic opposition (Volkov 2020). At the same time, these practices have done little to expose the assets of Putin's cronies in the West, who tend to legalise assets in Russia before taking them out of the country.

Second, broader sectoral sanctions should target the Kremlin's rent revenues that come primarily from the sale of oil, gas, weapons and/or metals. So far little has been done in this regard.

In 2014 the US and the EU adopted export controls against Russian defence industries, and in 2017 the US Congress passed a law sanctioning foreign companies and governments that engage in 'significant transactions' with the Russian defence sector (Harrell 2019). However, Russia remains the world's second largest arms exporter (*RFE/RL* 2019). In recent years even Turkey, a NATO member, has purchased Russia's S-400 surface-to-air missile batteries, reportedly worth \$2.5 billion (Macias 2020). The West should put more pressure on Russia's defence industry by blocking Russia's access to technologies with major military applications and withholding resources from Russia's military (Harrell 2019).

Under the existing sanctions policy, no major Russian state-owned enterprise has been put under a full asset freeze. The Congressional Research Service estimates that as of early 2020, of the 100 largest firms in Russia only 5 were subject to full blocking sanctions (Congressional Research Service 2020, 49). Sectoral sanction identifications (SSIs) affected 7 of Russia's 10 largest companies, but these were limited to specific sets of transactions relating to debt, equity and/or certain long-term oil projects (Congressional Research Service 2020, 50). Sanctions against Rosneft and Sberbank were limited to banning them from issuing certain types of debt on the US and European markets (Fishman 2020). SDN sanctions on entities were primarily limited to businesses controlled by designated individuals, companies that operate in Crimea, and several defence and arms firms.

The gas industry is particularly immune to sanctions, probably because of the EU's dependence on Russia's gas. The US and the EU have refrained from imposing sanctions targeting gas production or trade in Russia's gas sector (with the exception of Novatek, Russia's private liquefied natural gas producer, sanctioned by the US in January 2020) or Russia's state-controlled gas company, Gazprom (Congressional Research Service 2020, 12, 42). Germany's and other member states' eagerness to preserve their energy ties to Russia led to the EU decision to apply lending and investment restrictions only to the oil sector, not to Gazprom or other companies in the Russian gas sector. Similarly, the EU applied restrictions on the sale of energy exploration equipment, technology and services only to oil, not gas, development projects (Congressional Research Service 2020, 39).

If targeting Russia's gas industry appears too problematic for the EU, companies in other sectors, such as major state-controlled banks, including VEB (formerly Vnesheconombank), and/or Russia's defence industry, should become its priority. Without applying more focus to these policies, sanctions on the Putin regime are unlikely to have any meaningful effect because they will fail to target the regime's ability to sustain the loyalty of its supporters through neopatrimonial networks.

Conclusion

Western analysts often wonder why the sanctions imposed on Putin's Russia have failed to fundamentally alter the regime's actions on the world stage. This is the wrong question. Most policies introduced by the West were not intended to impose serious economic hardship on Putin's regime but were designed to put long-term pressure on the Russian economy. The sanctions on Russia have a light touch, particularly when compared with Western sanctions against Iran or Venezuela (Fishman 2020). Only a stricter and more comprehensive sanctions regime could change Putin's calculus (Aleksashenko 2016).

This article has discussed several ways to reinforce the design of the existing sanctions. However, a more relevant question might be whether the West is ready to seriously constrain Russia. Despite unprecedented levels of interference by the Kremlin in domestic processes in Western societies (Snegovaya and Watanabe 2021) and the use

of banned chemical weapons on their territories (France, Ministry of Foreign Affairs 2018), Western countries remain remarkably reluctant to impose serious economic costs on Putin's regime. A more applicable question, then, is what possible actions on the world stage might the Kremlin commit before the West introduces more meaningful policies.

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Note

1. Recently, it has become known that the US and Britain are also exploring the possibility of additional sanctions against Russia, from restrictions against oligarchs to more serious measures possibly targeting Russia's sovereign debt market, especially if Russia is again found to have committed a major transgression of the international ban on chemical weapons. However, even in the latter case negative effects could be smaller than previously anticipated given that over the last years the Kremlin has moved away from issuing dollar-denominated debt towards the euro (Mohsin et al. 2021).

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