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Russia Will Pay Dearly for Putin's Anschluss

By Anders Åslund

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President Vladimir Putin overplayed his hand when he invaded Crimea. This unprovoked and illegal aggression was a throwback to the Soviet combination of megalomania and inferiority complex. It was reminiscent of the Kremlin's decision in December 1979 to invade Afghanistan, which in hindsight marked the beginning of the end of the Soviet Union.

Putin has demolished the post-Cold War order in an attempt to serve his own political interests. But Russia will suffer from his shortsighted blitzkrieg.

According to Russian opinion polls, Putin's popularity has skyrocketed in the wake of his military Anschluss of Crimea. This is common when a war breaks out. But as the Levada Center pointed out, the surging popularity of Russia's 2008 war in Georgia lasted a mere three months. In the end, wars are rarely popular.

Ukraine's democratic breakthrough and criticism of kleptocrats presented a challenge to -

Putin's authoritarian kleptocracy. Presumably, Putin's response is drawing on the oft-quoted 1904 statement by the tsarist Interior Minister Vyacheslav von Plehve, "What this country needs is a short, victorious war to stem the tide of revolution." But Plehve's words led to the Russo-Japanese War, which unleashed the revolution of 1905. It is unlikely that Putin will be more successful.

The first victim of war is truth. In attempting to justify his Anschluss of Crimea, Putin and his aggressive propangandists have become lost in a Soviet-style sea of lies. They have lost all credibility. The U.S. State Department even issued a statement with 10 false statements made by Putin.

The second victim of war is diplomacy. By invading Crimea, Putin violated many important international treaties in which Russia has guaranteed territorial integrity, sovereignty and inviolability of borders, thereby showing that any agreements made with Russia's current regime are meaningless.

The Western powers are responding quickly by kicking Russia out of the Group of Eight, blocking its entry to the Organization for Economic Cooperation and Development, halting all trade negotiations and military cooperation. This is only the beginning. In one month, Putin has managed to squander the diplomatic achievements of Soviet leader Mikhail Gorbachev and President Boris Yeltsin and turn Russia into an international pariah similar to Iran, Belarus or Venezuela.

Putin's Russia has no allies. Most countries respect existing borders and national integrity to safeguard their own security. For Belarus and Kazakhstan, few things are scarier than Russian ethnic separatism. China is also frightened by secessionist movements in its far-away territories.

Russia truly stands alone. If Putin were to create an alliance with the occupied territories — Crimea, the self-proclaimed republic of Transdnestr, Abkhazia and South Ossetia — he might scare Belarus and Kazakhstan to leave the Eurasian Union, which is already stillborn without Ukraine.

Putin has not only alienated his potential allies but inadvertently reinforced the transatlantic alliance. The North Atlantic Treaty Organization has found a new purpose — to contain Russia. Europe will rearm after two decades of disarmament, and NATO will focus on defending East European states bordering Russia. Putin has also given a strong impetus to a new transatlantic free-trade agreement.

Putin seems to disregard Russia's numerous and significant vulnerabilities. When Nazi Germany launched its aggression in 1938, it accounted for more than one-third of Europe's gross domestic product, or GDP, while Russia's GDP is only one-tenth of the EU's. Meanwhile, the Western economies are now recovering, while Russia's is stagnating.

Moreover, Russia is highly dependent on international financial markets because its dysfunctional legal system makes it impossible to develop a reasonable domestic financial system. Russia's financial center is the City of London, rendering it vulnerable to financial sanctions. Putin's seizure of Crimea caused the Russian RTS index to slump 12 percent on March 3, which JP Morgan and the Bank of Finland estimated had cost Russia 1 percent

of its economic growth this year. Russian companies cannot launch initial public offerings now because stock prices are too low.

The sanctions that U.S. President Barack Obama announced on March 20 forced Gennady Timchenko to sell his share of the oil-trading company Gunvor, and Yury Kovalchuk's Bank Rossia lost access to the international payments system. Sanctions are likely to expand to all Russian state banks. Like Iran, Russia could be shut out of the international financial system. Meanwhile, Russian and foreign investors are likely to continue withdrawing funds from Russia. Putin would do well to end his Anschluss and return Crimea to Ukraine before severe financial sanctions kick in.

Russia is also vulnerable because of its resource-dependent economy. Last year, three-quarters of Russia's exports consisted of oil and gas. In the medium term, Europe and Ukraine can manage without Russian gas thanks to U.S. shale gas production. If Gazprom cuts its exports, Russia would lose 15 percent of its export earnings. Although Obama has not yet done so, his recent executive order allows him to prevent U.S. firms from exporting advanced oil and natural gas extraction technology to Russia, preventing them from efficiently exploiting their far east reserves.

An overlooked fact is that 40 percent of Ukraine's exports to Russia consist of machinery and armaments. Motor Sich in Zaporozhe produces all of Russia's helicopter engines, Yuzhmash in Dnipropetrovsk manufactures carrier rockets and missiles and Antonov makes planes in Kiev. The Russian military-industrial complex will be in great trouble without these imports. Meanwhile, Western countries are quickly cutting arms deliveries to Russia as part of their sanctions.

Potentially, Russia's greatest weakness is its legal system. The West is likely to treat the Kremlin, Putin's cronies and large state corporations as a law enforcement problem suspected of corruption and money laundering. The international exposure of the gross enrichment of the Kremlin and its cronies could have quite an illuminating effect on Russians.

War and sanctions usually reinforce state control and repression, rendering economic reforms virtually impossible. Downgraded forecasts indicate that the Anschluss has already cost the Russian economy from 1 to 2 percent of GDP for 2014. Greater uncertainty and more sanctions are expected, which will push the Russian economy into significant decline this year.

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