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The High Price of Crimea

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How much will Crimea cost Russia? The costs of annexation are only gradually becoming clear, and it is impossible to determine a specific figure yet. This alone shows that the whole idea of annexing Crimea was an impromptu response to Ukrainian President Viktor Yanukovych's unexpected ouster rather than the implementation of a carefully prepared plan.

Economists offer varying estimates as to the degree of Crimea's energy and technological dependence on Russia, as well as to the financial burden the peninsula will place on the national budget. Prior to annexation, experts most frequently put the price tag for maintaining and supporting Crimea at $3 billion a year. But that did not factor in the impact Western sanctions would have on the Russian economy.

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The first legislative measures for integrating Crimea into the Russian system will cost the state budget almost $1.5 billion alone. In addition, plans call for granting Crimea at least 80 billion rubles ($2.2 billion) in annual subsidies. That figures includes payments to offset the peninsula's budget deficit as well as social benefits for Crimean residents.

What's more, that figure could rise to as much as 150 billion rubles ($4.5 billion) in the near future. Russia might also have to spend another $5 billion soon for construction and repairs to the peninsula's dilapidated infrastructure. In recent years, Crimea was only about 35 percent financially self-sufficient and depended on the rest of Ukraine for assistance, although Kiev never fully fulfilled its financial obligations to Crimea given the sad state of Ukraine's economy.

Russian payments of social benefits for Crimea alone could range from 50 billion to 100 billion rubles ($1.5 billion to $2.9 billion). Ukraine finances pensions from payments that the current workforce makes to the country's Pension Fund. Obviously, the payouts previously allocated for Crimean residents will now remain in Ukraine, and the Russian budget will have to directly finance the pensions for Crimea's 677,000 retirees. Monthly pensions in Crimea average about 6,000 rubles ($168), but Moscow plans to raise them to match the average monthly Russian pension of more than 10,000 rubles ($281). Russia's Defense Ministry is now responsible for paying the pensions of Crimea's 32,400 military retirees. Moscow is additionally saddled with supporting the peninsula's 200,000 state employees and with bringing their monthly salaries up from the current 12,500 rubles ($351) to the Russian average of 30,000 rubles ($842) — at an annual cost of another 42 billion rubles ($1.2 billion) more.

Crimea earns up to $2.5 billion dollars annually from tourism, with 70 percent of those tourists coming from Ukraine. Now that Crimea has been annexed, many of these Ukrainian tourists will probably find other spots to take vacation. Meanwhile, it is unlikely that Russian tourists, who typically demand higher-quality products and services in tourism and other sectors, will fill this gap.

Then, there are the transportation problems. Automobiles and trains must go through Ukraine to reach Crimea, and transportation complications could be an additional barrier to tourism if the political situation within Ukraine remains unstable.

Until now, Crimea received 80 percent of its electricity and 65 percent of its gas from nearby Ukrainian regions, and a large percentage of its water is piped in from the Dnieper River though the North Crimean Canal. Ukraine has already announced its decision to charge market prices for these supplies — that is, if it doesn't decide to blockade Crimea entirely. If Ukraine cuts off electricity, Russia will have to build power lines across the Kerch Strait at a cost of up to $300 million. The needed reconstruction of sea ports would cost an estimated $2 billion to $2.5 billion, and the roads in Crimea require $1.5 billion in upgrades. Airports and train stations also stand in need of repair or reconstruction, and Moscow will have to put up another $1.5 billion to build a bridge across the Kerch Strait to bypass Ukraine. In total, Crimea could end up costing Russia even more than the $50 billion it spent staging the Winter Olympics in Sochi.

If Moscow does not intend to destroy its own economy in a protracted standoff with the outside world, it should seriously consider turning Crimea into a large free economic zone. It could become a testing ground to attract investment and provide a secure legal environment. If successful, Crimea could become for Russia what Hong Kong and Macau are for China. Even with sanctions, Crimea could become an economic haven freed from bureaucratic restrictions — something that is unimaginable in the rest of Russia.

The Russian economy has already fallen into stagnation, with forecasts for this year ranging from a meager 1 percent growth to a 6 percent contraction. But the government has taken no steps to spur business. Instead, the authorities have effectively eliminated the simplified tax system for small businesses.

Rather than implementing measures to stimulate the economy and create free enterprise zones, starting with Crimea, Russian lawmakers spend their days dreaming up absurd bans and restrictions. State Duma deputies are now preparing to equate the organization of illegal rallies with terrorism and to punish offenders with prison terms similar to those given to convicted murderers. They also want to introduce requirements that at least half of all films shown in movie theaters are Russian-made. In addition, lawmakers want to prohibit "false information" against banks.

If that weren't enough, Liberal Democratic Party leader Vladimir Zhirinovsky and others are calling to close all McDonald's in Russia and want to open a second front against Coca-Cola. Politicians are outdoing each other with proposals to ban the dollar and to carry out all foreign trade in rubles to deliberately spite the U.S.

It is now obvious that the Kremlin is incapable of coping adequately with the challenges arising from the confrontation with the outside world over the Crimean annexation. At this point, it is impossible to predict just how deep or widespread Russia's political and economic problems will become. If leaders fail to improve the economy by stimulating growth or to strengthen the legal system by reducing corruption and government bureaucracy, the only thing Russians can expect from Putin's great Crimean conquest is disaster.

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