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Harshest Sanctions Yet Won't Force Moscow to Change Its Way

U.S. threatens new round of sanctions but Russia is prepared.

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Sanctions are back. In 2018, there were four rounds of sanctions which clearly did a lot of damage to Russia's business and investment case. Ultimately, however, they failed to produce the intended result — force the Kremlin to change its aggressive ways.

As last year closed, the U.S. midterms interrupted the introduction of a new round of "crushing" sanctions. However, on Wednesday five U.S. senators from both parties published a bill called the Defending American Security from Kremlin Aggression Act (DASKA).

The aim is to increase economic, political and diplomatic pressure on Russia "in response to its interference in democratic processes abroad, its disastrous influence in Syria and aggression against Ukraine, including the recent incident in the Kerch Strait," the Senate

Foreign Policy Committee said in a press release.

According to Republican Senator Lindsay Graham, these are the toughest sanctions of all proposed so far. In response to the Kremlin's aggression in Ukraine, the proposed sanctions target 24 FSB agents implicated in the Kerch Strait attack, the Russian shipbuilding industry, oil research and development, and Russian state-owned oil projects abroad.

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Additionally, the bill aims to accelerate the transfer of weapons to NATO countries that on depend on Russian weapons, as well as creating centers that would help fight Russia in areas such as hybrid and cyber threats.

There has been speculation as to whether the "crushing sanctions" will target Russian sovereign and domestic debt. International investors believe that placing a ban on holding these bonds would make them unsellable and drive their value to zero.

However, more sober observers don't believe the U.S. government will go that far as too many big U.S. institutional investors already hold this paper thanks to the rock solid macroeconomic backing of the Russian government set against the high yields they pay.

The ruble is likely to weaken further due to the political uncertainty. Others say that the currency has already priced in some of the threat of sanctions as the Central Bank of Russia (CBR) prophylactically ended its easing cycle and hiked rates to the current 7.75% despite low inflationary pressure in anticipation of more currency volatility.

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Despite the drama, a new round of sanctions will have a limited effect on Russia's economy. The first sanctions were imposed in 2014 following Russia's annexation of the Crimea and since then the government has been earnestly trying to sanction-proof the economy.

Among other measures it undertook were a ban on EU food imports that have spurred massive investment into the agricultural sector to make Russia increasingly self-sufficient in food production.

Additionally, last year the CBR sold off two thirds of its U.S. treasury bond holds to put the bulk of Russia's currency reserves out of the reach of the U.S. authorities. It has also successfully launched and deployed its own payment system to counter the threat of being denied use of the SWIFT system.

And only recently, the government introduced a bill to set up an internal internet in case Russia is cut off from the worldwide web. The government intends to test the system on April 1 by artificially cutting the lines to the internet to see what happens.

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But of all the changes imposed in the last four years, probably the most significant is the sustained campaign to crack down on waste and corruption. It resulted in some long overdue deep structural reforms that have seen the breakeven price of oil needed to balance the budget tumble from $115 in 2008 to $56 now — well below the average price of oil last year (hence the record large budget surplus).

With an external debt of only 15% of GDP – one of the lowest of any government in the world – and the federal budget in profit, even at reduced oil prices, there is actually very little that the U.S. can do to wound the Russian economy.

But new sanctions will inflame an already tense situation. Some Duma deputies have begun to talk about "economic war" and new "crushing sanctions" would definitely be taken as an escalation in that conflict. But the Kremlin must feel that it is ready for the fight.

The bottom line is that sanctions are designed to force a government to change its ways, and in that sense new and even harsher sanctions are almost certainly going to fail. All they will do is encourage the Kremlin to dig an even deeper trench.

This opinion piece *was first published by bne Intellinews.*

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