The West’s Dilemma of Sanctioning Russian Aggression in Ukraine

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The flags of NATO member countries are seen on a billboard in Riga, Latvia, on Nov. 28, 2021, two days before the start of meetings to discuss Russia’s military buildup near Ukraine. (AFP via Getty Images)

Less than a month after the United Kingdom’s 1939 declaration of war against Nazi Germany, Winston Churchill famously described Russia’s actions as "a riddle, wrapped in a mystery, inside an enigma." Churchill’s quote likely still rings true today in how Western leaders view their Russian counterparts — especially regarding Moscow’s aggression in Ukraine. But it is probably an even more accurate description of the trillion-dollar question North American and European governments are facing if Russia invades Ukraine — that is, how to sanction the Russian economy in a way that maximizes pressure while minimizing blowback.

This dilemma is exposing Western Europe’s incredible dependence on Russian energy supplies, as well as NATO allies’ divergent positions on how far to go in sanctioning Russia. Canada and the United States’ geographic distance from Ukraine and relative independence from Russian energy exports give them the space to take more antagonistic positions with fewer consequences compared with European countries like Germany, which receives more than half of its natural gas from Russia.

As the specter of a Russian invasion grows, Western leaders risk backing themselves into a corner where they are forced to implement sanctions just for the sake of doing something that goes beyond a diplomatic response but falls short of a military intervention. This strategy, however, could backfire as sanctions have proven to be limited in their ability to deter behavior — let alone Russia’s — and are also politically challenging to remove once they’re in place.

The Dilemma of Russian Energy Exports

Since the collapse of the Soviet Union, Russia has focused on exporting natural gas, oil, defense and minerals to countries around the world, as well as deeply intertwining its economy with those in Europe. This makes carving out the Russian economy — which is the world's 11th largest — from the global economy via robust and sweeping sanctions a disruptive procedure, particularly at a time when Western countries are dealing with energy price-fueled inflation.

Over the years, the United States has also placed substantial sanctions on Cuba, Iran, North Korea and Venezuela designed to significantly disrupt their economic activity. But compared with Russia, these countries' economies are far smaller and less interconnected with global markets, which have limited the blowback of such sanctions. Iran and Venezuela, for example, are also two major oil exporters. But Russia alone exported 4.3 million barrels per day in 2021 — a level that neither Iranian nor Venezuelan oil production has reached in 40 years.

In February 2021, a colleague of mine wrote that sanctions are more effective when they "[focus] on the greatest point(s) of leverage." There's little disagreement that Russia's dependence on oil and gas revenue is its Achilles' heel and where Western sanctions could inflict the most pain. In 2021, the oil and gas industry accounted for 36% of the Russian budget and 49% of Russian exports. But there's just as little disagreement that Europe's dependence on Russian energy exports is also its Achilles' heel and serves as Moscow's primary leverage point against the West. Russia exported a whopping 185 billion cubic meters of natural gas to Europe in 2020 — equivalent to 38% of all global LNG trade that year.

Sanctioning Russian energy exports (particularly natural gas, due to the difficulty in securing alternatives given infrastructure constraints) would thus have immediate repercussions for Europe, as would imposing other measures (like severing Russia's access to the SWIFT global financial messaging system) that prompt Russia to cut off its natural gas exports to the Continent. The loss of Russian energy exports — whether through direct sanctions or indirect Russian retaliation — would lead to substantial natural gas shortages in Europe due to the lack of alternatives to replace Russian shipments, causing significant social and economic unrest across the Continent as natural gas (and other) prices rise.

This, in turn, makes targeting Russia's energy exports a terrible option for Western leaders as they seek to find a strategy designed to maximize economic pressure on Moscow and minimize blowback on European countries.

- **Central and Eastern European countries are incredibly dependent on Russian natural gas.** In 2020, Russian natural gas exports accounted for 34% of natural gas consumed in Europe (including Turkey). Many Western European countries, like Spain and France, import very little Russian natural gas. But countries in Central and Eastern Europe, like Slovakia and Austria, are highly dependent on Russian natural gas. In 2020, Germany imported 56.3 billion cubic meters of natural gas from Russia, or approximately 63% percent of its overall consumption.
- **There is no immediate alternative to Russian natural gas.** U.S. and European leaders have approached other large exporters of liquified natural gas (LNG) — including Qatar,

whose emir visited Washington earlier this month — about increasing exports to Europe in the event of a gas cut-off or sanctions. But excess gas production is limited. Unlike the global oil market, the LNG market lacks a swing producer like Saudi Arabia that can quickly surge exports in the event of a major disruption of supplies. Russia's 185 billion cubic meters of natural gas exports to Europe in 2020 was equivalent to a whopping 38% of the globally traded LNG market.

- **Europe will need to refill gas storage during the summer.** Although European countries are coming out of the 2021-22 winter season when natural gas demand peaks due to demand for heating, European natural gas storage levels are just 35% full, and will probably further decline to around 30% by March. This means European countries will need to refill gas storage levels before the 2022-23 winter season, which will require Russian natural gas. Typically, European gas storage levels reach around 100 billion cubic meters when they peak at the start of the winter.

The West's Options for Retaliation

The United States and Europe have refrained from outlining the specific sanctions that they are considering amid the escalating Ukraine crisis in lieu of broader sanctions that could affect Russian energy exports to Europe. But leaks cited in recent reports suggest the West is considering a host of sanctions that would have a significant medium- and long-term impact on the Russian economy, including barring investment into strategic industries like oil and gas. Western countries have allegedly sparred over the precise details of the sanctions — like which Russian financial institutions, companies or oligarchs would be targeted, or what projects or sectors would be exempted.

- The United States can more quickly enact sanctions compared with the European Union, where adopting sanctions requires unanimous approval from member sanctions. Washington is thus likely to take the most aggressive action when it comes to sanctioning Russia over its actions in Ukraine. Home to the world's largest economy, the United States is also able to leverage its importance in the international financial system to force its sanctions on other countries in a way that no other government can.
- Differences between Western countries' views on Russia will also make sustaining any sanctions policy difficult. While the United States can maintain its sanction policy indefinitely without other countries vetoing it, the EU foreign policy requirement for unanimity means that Russia will try to pick off more vulnerable European countries to vote against European sanctions and any extensions of them.

As evidenced by the long-running split between Berlin and Washington over sanctioning Nord Stream 2 natural gas pipeline between Russia and Germany, there is unlikely to be full alignment between all Western governments on what a final sanctions package entails in response to a potential Russian invasion of Ukraine. But in addition to less impactful sanctions like asset freezes and travel bans targeting Russian government officials, the final package will likely include a combination of the following measures:

- **Expanded sanctions on Russia's financial sector.** The United States, United Kingdom and European Union will likely blacklist more Russian financial institutions and impose restrictions designed to limit Russia's ability to convert rubles to hard currencies, like the U.S. dollar, euro or British pound. One bill proposed in the U.S. Congress would sanction Russia's three largest banks, including VTB and Sberbank, which are essential to Russian households, pension funds and workers.

- **Expanded sanctions on Russia's energy sector designed to reduce long-term investment.** The United States and European Union appear likely to place restrictions on financing, technology transfers and other related activities to new Russian oil and gas projects, particularly more technologically challenging that Western companies are participating in. Washington and Brussels could also expand some of the restrictions on Russian Arctic and shale projects they imposed in response to Russia's 2014 annexation of Crimea. In addition, the United States and (less likely) Europe could impose broad sanctions on Russia's newer pipeline projects, including Nord Stream 2, and potential future ones as well.
- **Expansive controls on exports of high-tech products to Russia.** Despite having a large economy, Russia lacks an expansive tech sector that produces and develops the products that will be strategically important in the coming decades, like high-end electronics, biotechnology, semiconductors and green technology. U.S. export controls on Chinese smartphone manufacturer Huawei have shown how effective such measures can be in cutting off a company or country's access to technology in these key fields. Russia's small market and the limited direct impact on Russia's oil and gas exports make export controls an attractive option for retaliating against Moscow's actions in Ukraine, particularly amid the West's policy of increasing similar restrictions against China. Sanctions limiting access to foreign-made chips would also hit Russia's two most popular processors for military and government applications, Elbrus and Baikal, as they are currently manufactured by Taiwan Semiconductor Manufacturing Company and would likely fall under sanctions.
- **Expanded sanctions on Russian oligarchs viewed as being close to the Kremlin, Russian President Vladimir Putin and other key Russian officials.** The United States and European Union relied heavily on sanctioning Russian oligarchs as a part of their response to Russia's 2014 annexation of Crimea in hopes of causing enough economic pain on Putin's inner circle to informally pressure him to change his policy. While an expansion of this strategy is likely, there are constraints as many of the obvious oligarchs have already been targeted in some fashion. Sanctions on key oligarchs can also lead to significant repercussions across the global economy. U.S. Treasury sanctions targeting Oleg Deripaska and Rusal (the Russian aluminum giant he controlled) led to a 20% spike in aluminum prices in 2018, and remained elevated until Washington eventually reached a deal to reduce sanctions on the company less than a year later.

Russia's Vulnerability

The sanctions that are being proposed by Western leaders in the case of a Russian invasion of Ukraine are designed to limit the impact on Russia's oil and gas exports to Europe and do not reach for the proverbial "nuclear option" of SWIFT sanctions. But it is likely that the level of sanctions the West is considering — even if not immediately impactful — will still have dire consequences for Russia by 2030 if they remain in place.

Russia's economic model is already undergoing significant structural changes. The country is entering a period of prolonged demographic decline and its economic dependence on emissions-intensive natural resources will struggle to maintain relevance in a greener economy. Russia's technological capabilities continue to wane amid its struggles to shift toward a digital economy that manufactures high technology goods. The technology areas where Russian companies are still globally competitive are chiefly in Soviet-era legacy industries like aerospace and defense. But in even these sectors, Russian firms are falling behind their competitors in the West and, increasingly, China. Simply put, it is likely that the level of sanctions the West is considering — even if not immediately impactful — will still have dire consequences for Russia by 2030 if they remain in place. These economic weaknesses mean the sanctions measures the West is considering would likely still have a significant impact over the medium- and long-term for Russia.

Nonetheless, Russia has been able to weather Western sanctions put into place since 2014 over Crimea and other issues without a visible impact thus far, which could make Moscow overconfident in its ability to withstand additional economic pressure. Russia has spent the last decade making their economy more insulated from Western sanctions. As a result, the Kremlin may feel it has taken enough steps to weather new Ukraine-related sanctions from the United States and Europe. However, Western sanctions may be far more aggressive than anything Russia's stopgap measures are designed to protect against — thus creating the possibility of a miscalculation on Russia's part if it decides to invade Ukraine.

The Issue of 'Sticky' Sanctions

Without a dramatic turn of events in Russia, Ukraine or Europe, it is difficult to imagine a series of events that would prompt the West to relax whatever sanctions it imposes over the current Ukraine crisis. It has been proven to be politically difficult for Western governments to actually remove sanctions against non-democratic countries without a significant change in policy, as acutely illustrated by the United States' 60-year-old sanctions on Cuba. Clearly, Cuba is no longer the same national security threat it was back when the sanctions were first enacted in 1962 — when the island nation hosted Soviet ballistic missiles and served as a central part of the Cold War. But the inertia of U.S. sanctions policy has never really made it politically feasible for the United States to relax and suspend the embargo on Cuba, as there has not been a change of government in Cuba, even though the United States does not have sanctions on at least a dozen countries that have worse human rights and rule of law records.

More recently, the political inertia behind the U.S. sanctions policy on Iran showed how, even if a country negotiated a deal with the United States to relax sanctions, that deal may not be permanent if there's a change of U.S. administration, even though Iran was following through with its end the bargain. Given the current political environment in the United States (and parts of Europe), such challenges will likely also plague any new U.S. sanctions placed on Russia over the Ukraine crisis – making the sanctions policy "sticky."

An effective sanctions strategy will include clear and concrete strategic objectives in their design and attach conditions for their removal to those objectives. If the United States and European Union place sanctions on Russia for invading Ukraine, those concrete objectives could either be:

- **Entering negotiations for a cease-fire and the end of the Russian invasion.** Russia will almost certainly have the upper hand in any invasion of Ukraine and it is hard to imagine the Russian military getting bogged down to the point where it would want to enter negotiations to end the conflict. That would be tantamount to Russia admitting defeat and allowing a pro-Western government to remain in Ukraine.
- **Deterring Russia from broader military action beyond Ukraine.** The problem with using sanctions as a form of deterrence is that deterrence needs a level of permanence. Sanctions as a form of deterrence, in this case, would be problematic because if Russia "wins" in Ukraine and installs a pro-Russian government, Moscow risks seeing the cost of sanctions as worthwhile and is less likely to change its future behavior beyond Ukraine. Moreover, in the case of such a Russian "victory" in Ukraine, there would also not be a clear point where the Western governments could politically justify suspending or removing sanctions on Russia like they could if Russia's invasion of Ukraine failed and sanctions removal was a part of a peace settlement.

A High-Stakes Situation

Western leaders are more likely to design a sanctions policy with domestic political objectives in mind and the need to punish Russia for invading Ukraine in the first place. The most realistic way for sanctions to be removed would either involve Russia making significant concessions (and it remains unclear what those would be) or a significant mea culpa by the West to end the sanctions due to them being ineffective or, worse, causing more significant harm.

A scenario in which Western sanctions make matters worse could transpire if the Kremlin feels that, in order for sanctions to be removed, it must escalate tensions elsewhere in Europe — whether through saber-rattling in the Baltics or threatening to cut off gas to European markets. Regardless of veracity, Russian leaders may perceive that further destabilizing behavior elsewhere in Europe may ironically give Moscow the leverage it needs to force the West to remove sanctions once a pro-Russia government is set up in Kyiv or the conflict in Ukraine becomes even more deadlocked than it already is.

If the new sanctions persist indefinitely, there could be long-term strategic repercussions, as it would represent a significant first step in isolating the Russian economy from that of the West. This would thereby result in Moscow, Beijing, and other non-Western countries accelerating efforts to create alternatives to the Western-led and developed financial system that can give Western sanctions so much bite. Such an outcome risks Russia becoming more insular and resulting in a turn to neo-Cold War dynamics where economic relations between Russia and the West are reduced substantially, leading to more hostility on numerous friction points.

It will also force Russia to become more dependent on China as a partner. Although recent media attention has focused on Moscow and Beijing's apparently budding ties, China has incentives to not fully embrace Russia. Given that Russia needs China more than the reverse, China may initially respond by keeping Russia at an arm's length in order to avoid disrupting its own economic relationship with Western countries. But even if it doesn't more closely align with Russia, China could still view an aggressive sanctions package from the West as a sign of possible risks in the event of future conflict in Taiwan or the South China Sea. As a result, Beijing would likely only increase its efforts to create international financial mechanisms globally that could operate regardless of U.S. sanctions policy and limit the extraterritorial impact of Western sanctions on its non-Western trading partners.

As questions remain about the long-term impact of new sanctions on China and Russia's relationships with each other and with the West, so will the strategic risk that Western countries incur by going down the sanctions path. Western sanctions strategies have long been criticized for being strategically ineffective in achieving their objectives. And that strategy will face the most significant test yet if Russia invades Ukraine.