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SNAPSHOT

How to Sanction Russia

And Why Obama's Current Strategy Won't Work

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After weeks of threatening to do so, on March 17, U.S. President Barack Obama **signed an executive order** **[1]** freezing the assets of Russian officials involved in Moscow's meddling in Ukraine. Economic sanctions and visa bans have been central to the U.S. policy response in Ukraine for two reasons. For one, there aren't any realistic military options for countering Russian adventurism in the former Soviet sphere. But more important, comprehensive economic sanctions have had remarkable success in recent years, including in Iran. Unfortunately for the United States and its allies, Iran-like sanctions are currently neither feasible nor prudent in dealing with the Russian interference in Crimea.

For many good reasons, no one inside or outside of Washington is seriously proposing a U.S. military response to the situation in Ukraine. But buoyed by Iran's decision to come to the negotiating table, many have looked to sanctions. Although Iran's nuclear program unquestionably remains a security threat to the United States and its allies, there is little doubt that the sanctions campaign led by the United States has caused Iran's near total economic collapse and pushed Tehran to enter into negotiations with the West. That sanctions regime has had three components. First, it included prohibitions on oil, tanker fleets, and the insurance industry, which ground the Iranian oil trade to a halt and cost the country many billions of dollars in export revenue. Second, banking sanctions cut off Iran from the international banking system, making it virtually impossible for the country to engage in any form of international commerce. And third, Obama invoked the U.S. International Emergency Economic Powers Act (IEEPA), which allowed him to block Iranian assets subject to U.S. jurisdiction (such as those belonging to the Iranian Revolutionary Guard Corps and its various commercial and logistical affiliates) and made it illegal for U.S. citizens to do business with designated persons or companies.

There has been talk in the U.S. Congress of targeting Russia's energy and banking sectors, in addition to targeting Russian officials under IEEPA. At least for the time being, energy sanctions are likely a nonstarter in Europe, whose cooperation would be necessary for such sanctions to be effective. And banking sanctions are an extreme measure that could cause significant harm to ordinary Russians. So it is only the last type of sanction that is currently on the table, as was made clear by **this week's executive order [2]**, which expanded on Obama's March 6 executive order invoking his powers under IEEPA to block the assets of and restrict the U.S. travel of anyone the administration determines to be violating the territorial integrity and democratic processes of Ukraine.

Until this week, the Obama administration had not actually designated any businesses or individuals under the executive orders, meaning that the United States had not actually seized any money or blacklisted anyone. And those individuals named on Monday are not likely to have any assets in the United States. Call it a warning shot, perhaps, but one of which the Russians (and others) appear to have taken note. Since the announcement, Russians have rushed billions of dollars back to Mother Russia and other perceived safe havens (this includes what appears to have been the transfer last week of some or all of Russia's over $100 billion holdings in U.S. Treasuries at the Federal Reserve). According to Macro Advisory Partners, many billions of dollars more are also moving out of Russia as European financial institutions withdraw to avoid the risks now associated with having money stuck in Russia.

None of this has done much to shake Russian President Vladimir Putin. One reason is that, by all accounts, the country's powerbrokers are not yet in the United States' line of fire. Obama's executive orders, and yesterday's designations, have targeted only Russians who have stirred up trouble in Ukraine. They have not touched the political-economic nexus that helps sustain Putin's power.

That is too bad. Fourteen years ago this month, I warned in *Foreign Affairs* that the **unchecked concentration of power [3]** in the hands of Russia's lawless oligarchs would undermine Russia's successful political and economic transition. The article helped lead to enhanced scrutiny of newly minted Russian billionaire business leaders in London, Washington, and New York and to better business practices from oligarchs craving Western attention and capital.

Russia's business elite still need access to the West. But today's group is different from that of yesterday, when oligarchs could still operate politically. In the last decade or more, Putin has consolidated control over both the Russian state and its business leadership. Russia's oligarchs are now handpicked by the Kremlin or, at a minimum, must hew closely to it. That concentration of economic and political power creates a target-rich environment for U.S. sanctions. And if the United States does not directly go after this political-economic nexus, it cannot expect to have a meaningful effect on Russian behavior.

The United States has imposed so-called elite/leadership sanctions before, albeit on a smaller scale. In the 2000s, for instance, the United States used IEEPA designations to strike at the political and economic leaders of Liberia, who (as in today's Russia) were largely one and the same. These sanctions targeted not only individuals and political leadership around Liberian President Charles Taylor but also the related economic sectors, such as timber exports, that sustained him and his murderous regime.

But Russia is not Liberia, and even comprehensive elite/leadership sanctions would have only a limited effect absent other measures. Putin is an autocrat who will be prepared to accept considerable pain without a flinch. Autocracies can, however, be weakened by transparency. For that reason, any U.S. sanctions program aimed at Russia's political-economic nexus should be accompanied by a public awareness campaign focused on the corruption of the ruling Russian clique. It is widely understood, for example, that massive corruption has accompanied the consolidation of economic and political power in Putin's Kremlin. All told, tens of billions of dollars have likely been diverted from the Russian natural resource sector alone and into the bank accounts of Kremlin insiders, including Putin. Much of that money has been squirreled away outside Russia, and the United States knows where to find a lot of it. The United States could publicize this information to undermine Putin in the eyes of the Russian public. In China, similar disclosures of public corruption, whether by the Western media or as part of internecine battles within the Communist Party, have served to weaken the legitimacy of that country's ruling cliques.

Even with such an information campaign, though, the sanctions against Russia would be missing two components that made the ones on Iran work: energy and banking. Energy accounts for 70 percent of Russia's annual exports, so energy sanctions could, in principle, be a meaningful tool for rebuking Russia. But much of Russia's oil and natural gas (unlike Iran's) goes significantly to Europe, and Europeans have not been willing or eager to change that quickly. And without adequate preparation, such sanctions could cause a shock to world oil markets that could undermine the global economic recovery.

In general, sanctions work best where there is asymmetry, not interdependence. And that is why banking sanctions might look more appealing than energy sanctions in Russia's case. But comprehensive Iran-style banking sanctions are a nuclear option that should be reserved for Russian conduct more egregious than the unfolding Crimean Anschluss. Among other things, comprehensive banking and commercial sanctions, if implemented successfully, will cause real pain to ordinary Russians, just as they have devastated the economic lives of ordinary Iranians. And as a general matter, in this new era of financial warfare, the United States should uphold its longstanding principles of avoiding unnecessary civilian casualties.

The international sanctions on Iran worked for a number of reasons. Not only did they target oil and banking as well as the regime's enablers but they also enjoyed wide support in Europe and the broader international community. Energy sanctions were phased in in a way that reduced their impact on global markets; the sequencing allowed non-Iranian oil producers time to increase their supply and nations dependent on Iranian crude time to wean themselves off it. Further, numerous IEEPA and United Nations designations, and active Treasury Department diplomacy, had already changed outsiders' calculations of the risk associated with doing business in Iran even before comprehensive banking and commercial sanctions were fully in place. In fact, much of the benefit from the sanctions on Iran came as a result of financial institutions' voluntary withdrawal from the country, even in the absence of legal compulsion.

The banking sanctions on Iran also had real, sharp legal teeth, including, among other things, regulatory actions targeting Iran's central bank and secondary sanctions on non-U.S. financial institutions that continued to do business with Iran. These effectively forced international financial institutions to choose between doing business with Iranian banks or with the United States. For banks across Europe and Asia, the choice was easy. As a result, Iran was blocked from nearly all normal economic transactions with the international community. In some cases, Iran, cut off from the international banking system, has resorted to barter deals or payment in commodities such as gold. But when counterparties have concerns about getting paid through banks, they quickly look to other markets rather than engage in eighteenth-century forms of commerce. As a result, real people suffer as currencies depreciate, inflation soars, and basic consumer goods become impossible to find.

The United States could try to do the same thing to Russia, but right now it's not politically feasible. Iran-like sanctions would require considerable international support and considerable time. Energy interdependence with Europe and the hardship that would be inflicted on ordinary Russians as a result of comprehensive banking sanctions preclude the level of international support that would be necessary to make such sanctions effective. Of course, if Putin does not stop at the borders of Crimea, international sentiment, particularly in Europe, will quickly change. Putin should realize that the rules of the game would then change as well -- and the United States should let slip all the dogs of financial war.

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