In response to Russian interference in the U.S. 2016 election, cyberespionage, and Russia’s continued aggression in Ukraine and Eurasia more widely, on August 2 President Trump signed into law the Countering Americas Adversaries Through Sanctions Act. Title II of the new law, the Countering Russian Influence in Europe and Eurasia Act of 2017, codifies existing sanctions, adopted in 2014 and 2016 in response to Russia’s intervention in Ukraine and cyberespionage in the U.S.; expands sanctions in certain key domains; and restricts Trump’s ability to lift sanctions unilaterally. This move is not severe enough to have much chance of compelling a near-term change in Russia’s behavior, and it is already causing a concerning rift with Europe, a fact that plays into Russia’s hand. But the expanded sanctions will hurt Russia at a time when Moscow needs to get its economy back on track following two years of low energy prices and ahead of a presidential election scheduled for March 2018.

THE RUSSIAN TARGETS AND REACTION

The expanded sanctions target Russian cyber threats, crude oil projects, financial institutions, corrupt individuals, pipeline maintenance and construction, known evaders of sanctions, weapons exportation, and participation in the privatization of state-owned assets at over a $10,000,000 stake. The sanctions restrict Russia’s access to capital markets, reducing the maturity period of lending for five leading Russian banks, including state-owned Sberbank and Gazprombank. In a significant departure from prior practice, the new sanctions target any oil project in which a sanctioned person holds an interest of at least 33%. The previous threshold applied by Treasury was 50%. In addition, the sanctions expand the scope of persons potentially subject to penalties by targeting “foreign persons who cause a violation” by a U.S. person. Lastly, the new law constrains the president’s ability to lift or reduce sanctions by imposing a congressional review of any sanctions relief.
Russia responded angrily, but counter-measures have been cautious so far. Following the House and Senate votes, Russia ordered a cut of 755 staffers at the US Embassy (approximately 50%) and the seizure of two U.S. embassy compounds. The Kremlin's actions mirrored those taken by President Obama in December 2016 in response to the revelation of Russian interference in the 2016 election. President Putin made his announcement right after the Senate vote but before the President Trump signed the bill into law, thus the Russians were at least symbolically aiming at Congress and not the administration. Furthermore, in making the announcement, Putin noted several areas for broader US-Russia cooperation.

Trade retaliation will not necessarily benefit Russia. The U.S. is a minor economic partner (5% of Russia’s total export-import market share) and American trade focuses on goods that are not necessarily easy to quickly replace (machinery, automobiles, and commercial aircraft). However, Russia may seek to undermine the U.S. without resorting to countersanctions, such as suing in international courts, capitalizing on the growing divergence between Europe and the U.S., stepping-up cyberattacks, or further undermining U.S. efforts in the Middle East and Asia.

Finally, in some areas Russia can afford to take a wait-and-see approach or undertake preemptive mitigation measures. The language of the law is vague, many new proposed sanctions are discretionary, and the Office of Foreign Asset Control (OFAC) and agencies have to draw implementation guidelines. At present, Russian firms have shown no indication of backing out of international energy projects, or from foreign weapons deals with Turkey and Iran. Additionally, Russia is reevaluating domestic competition between energy suppliers, which could allow for greater Russian economic engagement in energy projects while remaining under the 33% stake threshold.

THE EUROPEAN REACTION

The new sanctions are straining already tense relations with the Europe. European allies view these new US sanctions as a unilateral action responding to domestic concerns, and an uncoordinated interference in European energy policy that render European economic interests collateral damage. Both the EU and member states lobbied Congress to diminish the impact of the new sanctions on European companies. At their behest, the House amended the bill to prohibit US and non-US companies from partnering in energy projects where Russian firms have a 33% or more ownership stake. Congress also inserted a clause ensuring sanctions could be imposed only in consultation with Washington’s allies. As a result, projects such as Azerbaijan’s Shah Deniz 2 gas field and Egypt’s offshore Zohr gas field will be exempted. The $9.5 Billion Nord Stream-2 project, of which Engie, OMV, Royal Dutch Shell, Uniper, and Wintershall Holding share 50% ownership with Russian state-owned Gazprom’s 50% will not.

Still, initial reactions to the final bill were stern. In a joint statement, Austria’s Chancellor Christian Kern and Germany’s Foreign Minister Sigmar Gabriel accused the US of trying to help American natural gas suppliers at the expense of their Russian rivals and said the possibility of fining European companies participating in the Nord Stream 2 project “introduces a completely new, very negative dimension into European-American relations.” EU Commission President Jean-Claude Juncker warned that Brussels was ready to retaliate “within days” if the measures hurt EU economic interests.
SHORT TERM IMPACT OF EXPANDED SANCTIONS

For Western companies and investors, the sanctions are likely to negatively impact investor and business operator confidence in the Russian market just as the economy returns to economic growth. Increased uncertainty surrounding ‘sanctionable’ entities will make doing business in Russia more complicated and costlier. Furthermore, complying with the 33% rule could be challenging for Western companies as they try to ascertain who exactly their Russian partners are. At the very least, companies will incur increased due diligence costs.

Expanded sectoral sanctions could significantly disrupt business strategies. For example, cyber-related sanctions increase the risk of liability for US tech firms operating in Russia. If a cyber-attack were instigated by a Russian firm using the popular IBM Websphere of Microsoft’s ASP.net, for example, Microsoft and IBM could be accused of inadvertently providing technological support to a Russian entity responsible for undermining U.S. cybersecurity and face possible punitive measures. The flexible language of the law means the U.S. could indict any firm considered to be have deliberately or even inadvertently abetted Russia’s cyber effort against the West.

EU companies expect significant disruption to investment and trade with Russia. “Russian customers have begun looking for suppliers outside of Europe,” says Ulrich Ackermann, a foreign trade expert with the German engineering association VEDA. “They are concerned that European companies, because of the threat of increased sanctions, won’t be able to deliver.”

THE GEOPOLITICAL REALITY

European leaders will most certainly maintain as much pressure as they can on the Trump administration to minimize the impact to their businesses. They will, no doubt, highlight that Europe has paid a far heavier commercial price of the sanctions. They may also explore retaliatory measures, including taking the case to the World Trade Organization, reviving a 1980s European statute prohibiting European companies from submitting to US sanctions, and (although more unlikely) trade retaliation.

In addition, expanded sanctions could embolden those in Europe who think it’s time to reset relations with Russia. That sentiment has been growing in key European countries (France, Germany, Italy) as mainstream parties are more vocal about the sanctions’ lack of effectiveness. In the coming months, this will make it more difficult for the U.S. and the Europeans to manage the Ukraine conflict in a coordinated and effective way.

As with any foreign policy move to exact consequences on an adversary, the expanded sanctions come with a cost. Given the current political climate in the U.S., they were unavoidable. But whether the cost will be worth the gain will take some time to determine.

The authors would like to thank James Gregg for providing research, writing, and editing assistance on this article.

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