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A test of strength The escalation of the crisis in Russian-American relations

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On 6 April, the Trump administration introduced additional, more severe sanctions against Russia, covering 24 people and 14 companies: Russian oligarchs, the businesses they run, senior government officials and heads of state corporations, and (again) the Russian state arms company Rosoboroneksport. The immediate consequence of the new sanctions has been a downturn on the Russian stock market and the weakening of the rouble, as well as financial problems for the companies sanctioned, especially those belonging to the oligarch Oleg Deripaska. In the longer term the Russian oligarchs and their companies which conduct extensive activity abroad will find that the sanctions hamper their operations, and as a result, their dependence on the Kremlin will increase. On the other hand, the Kremlin will have increasing difficulty in recouping the affected oligarchs' losses, which will lead to an increase in tensions within the elite, as well as a rise in social discontent, which will make the functioning of Putin's regime more costly.

The US sanctions represent the next stage of the crisis in Russian-American relations. They were imposed just after the expulsion from Russia of 60 American diplomats in retaliation for a similar decision by the US regarding Russian diplomats. The crisis may deepen further as a result of the military response which the US has announced in response to a chemical attack in Duma, Syria on 7 April, most likely by the Assad regime's forces. An escalation of the crisis does not suit the Kremlin, which still seems to nurture hope that the recently announced further Putin-Trump meeting could initiate the process of normalisation of Russian-American relations. On the other hand, for reasons concerning its image, the Kremlin will probably undertake some kind of limited retaliation against the US, in order to demonstrate to Washington its potential to cause harm. All this means a long-lasting crisis in Russian-American relations.

The new US sanctions

The expansion of the designation list of sanctions against Russia, introduced on 6 April by a decision of the US Treasury Department, has been justified by the hostile (from the point of view of the US's interests) activities Moscow has undertaken in recent years and which are still continuing: attempts at hostile interference in the internal affairs of Western countries (including the US), the aggression against Ukraine and

the occupation of Crimea, and its support for the Assad regime in Syria. Four categories of Russian entities have been included:

1. Seven people from a larger group of Russian oligarchs belonging to the Russian elite, including Oleg Deripaska, Suleiman Kerimov and Kirill Shamalov (the President's former son-in-law; for more, see the Appendix). These individuals have benefited from profitable public procurement contracts, and have sometimes received

state support for their foreign economic activity; in return they have funded political and economic projects on behalf of the Kremlin, as well as the luxurious lifestyle of some members of the ruling elite's inner circle.

2. Twelve companies whose principal owners are the individuals mentioned above; seven of these companies are controlled by Oleg Deripaska (see Appendix). These entities generally conduct a wide range of foreign activities, including on the US market.

3. Seventeen Russian high officials and heads of public companies, including Viktor Zolotov (Commander of the National Guard), Nikolai Patrushev (Secretary of the Security Council) and Aleksei Miller (head of Gazprom) (see Appendix). These individuals belong to the ruling elite, and/or are suspected of personal involvement in lobbying and implementing Russia's aggressive actions.

4. Others have been included on the sanctions list for their support of the regime in Syria: once again, the Russian state arms company Rosoboroneksport (which was placed under sanctions in 2014 for its role in the aggression against Ukraine) and the Russian Financial Corporation Bank (RFK) which provides its services to it.

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The sanctions against the physical persons include a ban on their entry onto the territory of the US, the freezing of their assets in US financial institutions, and a ban on transactions with US entities. The sanctions against legal persons also include freezing their assets on the territory of the US, a ban on transactions with US entities, and an order to dispose of any shares

in these companies. By the decision of the US authorities, the sanctions can also be extended to cover companies from other countries which fail to dispose of their significant shares and/or continue to conduct significant transactions with those firms affected by the sanctions, which poses a risk to some European companies, among others.

The sanctions have been severely criticised by the Russian authorities. While Premier Dmitry Medvedev has warned that Russia "reserves the right" to take retaliation, a spokesman for President Dmitri Peskov responded more temperately when asked about the Russian response, and stressed that Russia would be guided by its own interests; this could suggest that the Russian response will be limited.

The consequences of the sanctions for Russia

The new US sanctions have both economic as well as political consequences for Russia both in the short and the long term.

With regard to the short-term economic consequences, the most seriously affected are the Russian oligarchs affected by sanctions, as well as other members of the richest Russians. According to calculations by Forbes, as a result of the fall in the value of the stock in their companies on 9 April alone, Deripaska lost US\$1.3 billion, Viktor Vekselberg more than US\$900 million, and Suleiman Kerimov more than US\$800 million. In total the 50 richest Russians (including both those covered by US sanctions and those not) lost a total of US\$12 billion on that day.

The Russian stock market has been seriously affected, losing between 9% and 11% of its main indices on 9 April. Many Russian companies saw significant declines in their share prices, both on the stock markets in Moscow (as examples: Rusal lost around 46%, Mechel around 30%, Norilsky Nickel around 17%, Polyus around 13%, the VTB bank 11%) and London. Earlier in Hong Kong, shares in Rusal fell by around 50%.

There was also a sudden weakening of the Russian rouble, which by the morning of 11 April had lost around 15% of its value against the US dollar and the euro.

Further economic consequences will depend on both how the Russian authorities respond to the sanctions and on the subsequent moves by Washington, as well as the reactions of Russia's other important economic partners (the EU, China). Above all Moscow fears the indirect effects of sanctions: deterring foreign entities (mainly, but not only, from the West) from any cooperation with major Russian companies (primarily, but not only, those already covered by the sanctions) for fear of negative reactions from the United States. Representatives of the Russian government (Prime Minister Dmitry Medvedev, Deputy Prime Minister Arkady Dvorkovich, the minister of industry and trade Denis Manturov) declared the government's (undefined) support for the companies affected. The Russian government is also meeting in session to discuss the matter. From leaks emerging in the Russian media, it appears that various forms of assistance are being considered:

First, big state corporations may partially purchase shares in the private companies affected. This would fit in with the government's existing policy of increasing the state's participation and control in the economy, and also with the ambitions of the individual heads of the state-owned corporations (in particular Rosneft's president Igor Sechin, who has been trying to consolidate the country's energy assets). However, the problem lies in acquiring the funds for such transactions, which could potentially prove very expensive. This is particularly true for the heavily indebted state-owned companies; in one way or another they would need support from the State Treasury, which itself also has limited financial capabilities.

Second, tax breaks (as was previously arranged for companies hit by Western sanctions and belonged to President Putin's friends, notably Gennady Timchenko, the Rotenberg brothers

and Yuri Kovalchuk). However, this would be quite costly for the budget (which would receive less tax revenue); and the measure was previously applied to members of Putin's inner circle, which most of those covered by the new sanctions are not part of.

On the other hand, the Kremlin will have increasing difficulty in recouping the affected oligarchs' losses, which will lead to an increase in tensions within the elite, as well as a rise in social discontent, which will make the functioning of Putin's regime more costly.

Thirdly, the creation of tax havens on Russian territory, and the transfer to these places of the registered head offices of Russian global companies, which would somehow retain their previous legal form. According to reports in *Vedomosti*, the Russian government has accelerated the preparation of legal acts (which has already been underway for some months) to set up such special zones on Oktyabrsky island in the Kaliningrad oblast, and on Russky island near Vladivostok in the Primorsky krai. Entities belonging to Russian oligarchs and located in such places would be treated as foreign entities, and would pay taxes only on that part of their business which is carried out on Russian territory. This solution, although legally complex and fairly time-consuming, would be quite beneficial for the Russian government, as it would substantially increase its control over the larger Russian private businesses and limit the financial costs of supporting them. However, it is doubtful whether this arrangement would be sufficiently attractive and secure from the point of view of any oligarchs who might be interested. It seems that they would only agree to such a plan if they had no other choice (if their companies were threatened with bankruptcy and the loss of the vast majority of their assets).

The Russian authorities' decision on the question of possible forms of aid, and the attitude of the oligarchs towards them, could significantly affect the political consequences of the current (and any possible future) sanctions. This could lead to the further evolution of the relationship between government and big business in Russia.

The US government has struck at people and companies which conduct a broad range of economic activity abroad. This is part of a chain of events demonstrating the escalation of the crisis in Russian-American relations, something which does not suit the Kremlin.

On the one hand, the current situation presents a major challenge for the Kremlin. In the stagnant Russian economy, which needs to finance both an intensive rearmament programme and increasing social security obligations, Russia is unable to bear the further burden of significant, systematic financial aid for Russian private business. However, some form of support is essential, for reasons of Russia's public image – as a demonstration that the country is not bowing under the pressure of Western sanctions, and is ready and able to resist them. The Kremlin also cannot afford to let the Russian oligarchs hit by sanctions fall into bankruptcy because it itself is sponging off them (the oligarchs fund the luxurious lifestyle of members of the ruling elite), and also uses their support in domestic politics (as they finance political and business projects) and as a tool of foreign policy (through the creation of foreign lobbies or by financing infrastructure investments).

In turn, granting the oligarchs even limited financial support will inevitably increase the costs of maintaining the Putin system and generate additional tension, both within the elite and in society at large. Because the govern-

ment's support will probably be selective, it will lead to competition among the oligarchs. This could also – despite the oligarchs' resistance – result in part of their estates being taken over by state structures and other private entities closer to the Kremlin. Meanwhile, social tensions will arise from the fact that in a situation of progressive pauperisation, the public will look upon the aid which the state grants to the privileged caste with increasing resentment.

On the other hand, the current situation presents an opportunity to the Kremlin. The Russian economy is suffering from a rising deficit of investment capital, for reasons including the Western sanctions. In this situation, the Kremlin is struggling to find ways to encourage or compel those Russian oligarchs who have invested a significant part of their assets abroad to repatriate them and make investments in Russia. The sanctions restrict the Russian oligarchs' access to lucrative Western markets; and as they often have a raw-materials base in Russia, they cannot break their ties to the country. This increases their dependence on the Russian government, which can dictate the conditions for doing business with them and offering possible state support. In this way – despite the bad investment climate prevalent in Russia – the Kremlin gains the opportunity to repatriate at least some of the capital, and thus keep the ailing Putin system afloat. However, the operation of this mechanism will depend on how far the United States goes in its sanctions policy, what the attitude of the European Union on this issue will be, as well as the reaction of Russia's non-European partners (especially China and India).

Sanctions and crisis in Russian-American relations

The expansion of the US sanctions on 6 April is the most serious punitive action of this type taken by the US against Russia since July 2014 (which saw the introduction of economic sanc-

tions in response to Russia's aggression against Ukraine). For the first time, the US authorities have struck at the people and companies belonging to the Russian elite who conduct a broad range of economic activity abroad. At the same time, this is part of a chain of events demonstrating the escalation of the crisis in Russian-American relations.

These latest sanctions were introduced the day after the forced departure from Russia of 60 US diplomats from the embassy in Moscow and the consulate in Yekaterinburg (and a week after the forced closure of the American consulate in St. Petersburg); this was Russia's retaliation for the expulsion from the US on 26 March of the same number of Russian diplomats, and the closure of the Russian consulate in Seattle (decisions taken after the Russian chemical attack in Britain on 4 March). This was the largest such 'exchange' in the history of Russian-American relations. These moves have worsened what was already the poorest state of relations between the two countries since the mid-1980s.

On the one hand, these latest US actions seem to confirm the Russian assessment of the Trump administration's policy as unpredictable and dictated by an American establishment which is hungry for retaliation against Russia (for its interference in the US presidential elections of 2016). Russia's conviction, that both the ruling Republicans and the opposition Democrats (through their accusations of an alleged conspiracy by Trump and his people with the Kremlin in the 2016 campaign) have pushed the US President to take further steps against Russia, has probably been exacerbated by the recent personnel changes in the US government. The resignations of Secretary of State Rex Tillerson and national security adviser Gen. H. R. McMaster, who had been seen as fairly critical towards Russia but favouring a moderate foreign policy, and their replacement by the notoriously more radical (also on the issue of Russia) Mike Pompeo and John Bolton, may suggest a further sharpening of the US's approach to Moscow.

On the other hand, this is happening at a quite unfavourable moment for Moscow, as the Russian side is working intensively to bring about another meeting between Presidents Putin and Trump, apparently still hoping that this could lead to some psychological, then political breakthrough in bilateral relations. Some statements by the American President, suggesting his respect for Putin and a willingness to cooperate with Russia in resolving regional problems (such as in North Korea, Syria or even Ukraine), seem to have fuelled the belief that a personal dialogue between Putin and Trump could get the latter to take some non-standard decisions, possibly starting a process of normalising relations.

Washington's introduction of new and more severe sanctions, and possible American military action in Syria, will be seen by the Kremlin as a means of strengthening Trump's position before his summit with Putin, and thus as a bargaining chip. We are dealing, then, with a test of strength between the United States and Russia.

However, this does not mean that Russia intends to cease its hostile activities towards the US; it will continue to demonstrate its potential to cause damage, trying in this way to induce Washington to hold a serious discussion about the demarcation of the two countries' interests, especially as the dynamics of events rather suggests an escalation of the Russian-American crisis.

The Russian-American conflict may be further aggravated against the background of the conflict in Syria. On 7 April the Syrian opposition accused the Syrian army, which is besieging the suburbs of Damascus (the town of Duma), of using chemical weapons against the civilian population there, apparently resulting in the deaths of about 70 people, including children. On 8 April, President Trump for the first time publicly accused President Putin of personal

responsibility for the use of chemical weapons in Syria, and suggested that retaliatory measures could be taken. The next day, a 'strong, unified response' to the chemical attack by Assad's forces was announced jointly by President Trump and France's President Emmanuel Macron. On 11 April, Trump announced outright that there would be missile attacks on Syria. In Washington, preparations are underway for the military response, which according to media leaks may be coordinated with France, the United Kingdom and selected Arab countries, and could include air attacks on military targets in Syria as well as further sanctions.

When taking decisions about possible military action in Syria, the US must consider how Russia will respond. On 13 March, the Chief of the General Staff of the Russian Armed Forces, Gen. Valery Gerasimov, had already warned that in view of the fact that there are Russian military personnel in Syria, the Russian armed forces will respond to any American attack on the forces of President Assad, not only by striking at American missiles, but also at the 'platforms' (i.e. the aircraft and ships) from which they will be fired. This increases the risk of direct clashes between the armed forces of both states, although a Russian attack on American ships seem unlikely.

On the other hand, in connection with the intentions expressed by the Kremlin and the White House (including a statement by the US President's spokeswoman on 6 April) to arrange

a summit meeting between Trump and Putin, Washington's introduction of new and more severe sanctions, and even possible American military action against Assad's forces in Syria, will be seen by the Kremlin above all as a means of strengthening Trump's position before the summit, and thus as a bargaining chip. We are dealing, then, with a test of strength between the United States and Russia. For the time being, the Russian side is not signalling any readiness to make real compromises on the most difficult questions (Ukraine, Syria, disarmament issues), which would be a condition for the US withdrawing its sanctions policy. On the other hand, Moscow's hope of creating a 'special relationship' between Trump and Putin still appears to be holding the Kremlin back from trying to break the stalemate by undertaking any further radical escalation of the situation, especially in the military sphere. In this context, Russia's more heated rhetoric (e.g. warning that a major military conflict is approaching, using the analogy of the Cuban missile crisis) seems to be being used as an instrument of psychological warfare before the talks expected at the summit. The situation points to a continued stalemate in Russian-American relations and the continuation of the current state of tension, interrupted by an exchange of diplomatic and economic 'strikes', albeit without any further radical escalations.

The text was finalised on 11 April at 1.30pm

APPENDIX

Russian citizens and companies added to the US sanction lists on 6 April

1. People

Name	Position/principal assets	Notes
Vladimir Bogdanov	director-general of the oil company Surgutneftegas	49 th on the list of Forbes' richest Russians in 2017 (US\$1.9 billion); Surgutneftegas (covered by US sanctions) is the most opaque of the Russian oil companies, and it is suspected that President Putin holds shares in it
Oleg Deripaska	main owner of the Rusal, En+, BazEl companies and others	23 rd on the list of Forbes' richest Russians in 2017 (US\$5.1 billion); suspected of links with organised crime
Suleiman Kerimov	member of the Federation Council; main owner of the Polimetal, Polyus Gold, Ural-kaliy companies and others	22 nd on the list of Forbes' richest Russians in 2017 (US\$6.3 billion); accused in France of tax evasion
Igor Rotenberg	head of the board of directors of NPV Engineering	son of Arkady Rotenberg, oligarch and friend of Putin; the father (who is on the sanctions list) has made part of his estate over to him. According to Forbes, his assets were worth US\$700 million in 2017
Andrei Skoch	deputy of the State Duma; co-owner of Vnukovo airport in Moscow and the Metaloinvest holding (Alisher Usmanov)	17 th on the list of Forbes' richest Russians in 2017 (US\$6.9 billion); suspected of links with organised crime and of having run the Solntsevo mafia in the past; friend and business partner of the oligarch Alisher Usmanov
Kirill Shamalov	co-owner of the Sibur gas and petrochemical company	74 th on the list of Forbes' richest Russians in 2017 (US\$1.3 billion); probably President Putin's former son-in-law (married his daughter Katerina Tikhonova in 2013; their alleged separation in January 2018 may have been used to conceal part of his income); the son of Nikolai Shamalov, a friend of Putin's and a shareholder in Bank Rossiya
Viktor Vekselberg	owner of Renova	10 th on the list of Forbes' richest Russians in 2017 (US\$ 12.4 billion)
Andrei Akimov	head of the board of Gazprombank	In the 1980s and 1990s he worked at Russian banks and companies in Switzerland and Austria, while probably serving as a KGB/SVR officer; from 2004 to 2007, member of the senior management of the Rusukrenergo company, an intermediary in trading Russian gas in Ukraine; member of the board of directors of the Novatek gas company. Member of Gazprom's board of directors

Aleksei Diumin	governor of Tula oblast	colonel-general; former FSB and FSO officer; former deputy head of GRU (military intelligence); former chief of staff of Russian Land Forces; former commander of Special Operations Forces (participating in the annexation of Crimea); former deputy minister of defence; enjoys the confidence of President Putin and has been mentioned as a candidate for the highest position of state
Mikhail Fradkov	director of the Russian Institute for Strategic Studies (RISI)	former Prime Minister of Russia; former head of the Foreign Intelligence Service (SVR)
Sergei Fursienko	president of the Zenit St. Petersburg football club	an old friend of President Putin; in the 1990s participated (with Putin) in the Ozero summer housing cooperative; former president of the Russian Football Association
Oleg Govorun	head of the board for socio-economic cooperation with the CIS countries, Abkhazia and South Ossetia in the Russian President's administration	former head of the internal policy board of the Russian President Administration; former representative of the President in the Central Federal District; former minister for regional development; since 2013, one of the coordinators of Russian policy towards Ukraine; subordinate and friend to the President's assistant Vladislav Surkov
Vladimir Kolokoltsev	Minister of the Interior	general of the police; former chief of police in Moscow
Konstantin Kosachov	the chairman of the International Committee for the Federation Council	former long-time Chairman of the International Affairs Committee of the State Duma; mentioned among the candidates to head the Foreign Ministry
Andrei Kostin	the head of the board of directors of the state bank VTB (Vneshtorgbank)	enjoys the confidence of President Putin; former member of Rosneft's board of directors. The VTB Bank is used to finance a variety of projects at the behest of the Kremlin. Another member of the board of the VTB is Matthias Warning (a former Stasi agent and friend of Putin)
Aleksei Miller	the head of the board of directors of Gazprom	former friend and subordinate of Putin in the St. Petersburg mayor's office (in the 1990s); head of the state-owned Gazprom company since 2001
Nikolai Patrushev	Secretary of the Security Council of the Russian Federation	former officer of the KGB and FSB; long-time head of the FSB; since 2008, Secretary of the Security Council of the Russian Federation; enjoys the confidence of Putin
Vladislav Reznik	deputy of the State Duma	businessman (in the insurance sector) during the 1990s; since 1999 a deputy of the State Duma; accused of links with organised crime (the Tambov mafia); fugitive in Spain from an international arrest warrant for mafia and money laundering activities
Yevgeny Shkolov	assistant to the Russian President for human resources policy	former KGB officer; an old friend of Putin (served with him in the KGB in Dresden); former Deputy Minister of Internal Affairs; enjoys the confidence of Putin; oversees the Directorate for State Services and the Personnel of the President's Administration

Aleksandr Torshin	vice-president of the Central Bank of Russia	long-time member of the Federation Council (representative of the Mari-El Republic); accused in Spain of links to organized crime (the Tambov mafia); alleged boss of the Tambov mafia
Vladimir Ustinov	representative of the President in the Southern Federal District	former Russian Attorney General (supervised the Yukos case, among others); former Minister of Justice; his son is married to the daughter of Igor Sechin, President of Rosneft
Timur Valyulin	head of the Interior Ministry's main board for counter-extremism	colonel in the militia; former head of the board for the fight against organised crime in Moscow
Viktor Zolotov	director of the Federal Service of the National Guard Troops; Commander of the National Guard Troops	general of the army; an old friend of Putin (1990s), previously linked to organised crime (Tambov mafia, Malishev's group); former long-time head of the Security Service of the President; former Deputy Minister of Internal Affairs, former Commander of Internal Troops; enjoys the confidence of Putin
Aleksandr Zharov	head of Roskomnadzor (Federal Services for the Inspection of Communications, Information Technology and Mass Media)	Roskomnadzor plays an important role in the repressive activities of the state against independent media and limiting freedom of information on the Internet

2. Russian companies

Name	main owner	attention
Agroholding Kuban	Oleg Deripaska	subsidiary of the Bazovy Element holding company; agri-food sector
Bazovy Element (BazEl)	Oleg Deripaska	diversified holding for companies in the energy, mining, metallurgical, construction, aviation & agricultural insurance sectors; global activities on six continents; owns 25% of shares in Austrian construction group Strabag, among others; owner of mines and aluminium smelters in Montenegro
B-Finance	Oleg Deripaska	financial company; the formal principal owner of En+
Gazprom Burenie	Igor Rotenberg	drilling company, until 2011 a subsidiary of Gazprom, then completely taken over by Arkady Rotenberg; since 2014, owned by his son Igor
GAZ Group	Oleg Deripaska	automotive company, the group that controls a network of factories, cars and trucks, part of the holding company Russkie Mashiny; cooperates with Volkswagen, Daimler and General Motors companies
En+ Group	Oleg Deripaska	part of the Bazovy Element holding company, coordinates its energy and extractive divisions
EuroSibEnergo	Oleg Deripaska	electricity company which controls the hydro-electric plant in Bratsk, part of the En+ group
Ladoga Management	Kirill Shamalov	financial company engaged in managerial services in the petrochemical sector
NPV Engineering	Igor Rotenberg	financial company, manages the assets of Gazprom Burenie, Mosenergo, Mostotrest among others

Renova Group	Viktor Vekselberg	diversified holding, controlling companies in the extractive sector (mainly aluminium), petroleum, telecommunications in Russia and the former USSR, Switzerland, South Africa and the US
RUSAL	Oleg Deripaska	aluminium company which controls a network of mines and aluminium works, belonging to the En+ group; the head of the board of directors is a friend of Putin's, the former Stasi agent Matthias Warning
Russian Machines	Oleg Deripaska	holding in the automotive sector (production of cars and wagons), part of the Bazovy Element holding company
Rosoboronexport	Rostec	holds the state monopoly on arms trade with foreign countries; part of state corporation/ holding Rostec, headed by an old friend of Putin, Sergei Chemezov
Russian Financial Corporation (RFC-Bank)		in 2013 the bank was taken over by Sergei Chemezov's Rostec holding; from 1993 to 2013, President of the Bank was the economist Andrei Nechayev, who since 2013 has headed the moderate oppositional party Citizens' Initiative, which stood Ksenia Sobchak as its candidate in the presidential elections in 2018 (she later took control of the party)

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