Five Reasons Obama Won't Push Harsher Russia Sanctions—Yet

By Matthew Philips April 16, 2014

Things are getting worse in Ukraine. The government’s counterassault against pro-Russian militants has hit road blocks—literally. Ukrainian troops are defecting. Military convoys sporting Russian flags are still driving into town squares and doing victory laps as Ukrainian military helicopters hover above. NATO, meanwhile, is upping its presence as satellite photos show Russian forces building up just across the border.

While Europe’s leaders edge closer to imposing strict economic sanctions against Russia, the U.S. finds itself in a bind. It has been three weeks since President Barack Obama signed an executive order granting authority to go beyond slapping travel bans and asset freezes on Putin’s inner circle and actually sanction “key sectors of the Russian economy.”

Five things stand in the way of quicker action:

1. The U.S. lacks the hard evidence it needs to escalate to tougher sanctions. After Russia annexed Crimea, the thought was that if its forces moved into eastern Ukraine, a red line of sorts would’ve been crossed that would justify the use of broader, more painful sanctions. But the situation has reached a gray area: The Obama administration clearly believes the Kremlin is directing the pro-Russian protests without so far mustering much evidence to prove it. With reports that certain pro-Russian militants are introducing themselves as Russian army officers and the State Department churning out press releases aimed at proving Russian support for destabilizing Ukraine, however, we seem to be inching closer. But for now, lacking any firmer evidence of direct Russian involvement, as long as Putin is making phone calls to Obama and those Russian forces stay massed on the other side of the Ukrainian border, it’s hard to see the U.S. upping the ante and going to full-blown, sectorwide sanctions.

2. The Europeans still need to get on board. Until German Chancellor Angela Merkel can persuade her fellow Europeans to take a firmer stand against Russia, the U.S. probably has to wait. “The U.S. is boxed in right now,” says Julianne Smith, Vice President Biden’s former deputy national security adviser. “If we can’t garner the cooperation of Europe, the bigger sanctions won’t have teeth. They won’t have enough impact unless the Europeans join us.”

3. There’s risk in acting alone, and it’s not clear the risk is worth the limited rewards on offer. Although the Obama administration is emboldened by the success of the harsh sanctions levied against Iran, Russia’s an entirely different animal. Iran was already fairly isolated, and the crushing sanctions that went into effect in 2012 were a combination of presidential executive orders, United Nations resolutions, and acts of Congress. Russia is
the eighth-largest economy in the world.

4. The Americans don’t even have the biggest stick to wield. Europe is much more economically entangled with Russia, and European Union sanctions against broad swaths of the Russian economy would be much more effective than American ones. Trade between the U.S. and Russia amounted to just $40 billion last year, or about 1 percent of total U.S. trade, according to U.S. Commerce Department data.

5. There is also blowback to consider. If the U.S. targeted Russia’s energy sector, cut off trade, or prohibited American companies from doing business there, that would inflict a certain amount of collateral damage on a handful of large U.S. corporations. Boeing (BA), for example, relies on titanium from Siberia and has invested $7 billion in Russia since the early 1990s; the company plans to buy $18 billion of Russian titanium over the coming decades. Exxon Mobil (XOM) also has a deep partnership with Rosneft, Russia’s state-owned oil giant.

Of course, there are those who think the U.S. should stop waiting for the Europeans and go ahead and act right now on harsher sanctions. Last month the Treasury Department targeted Russia’s 17th-largest bank, Bank Rossiya, which is said to be a favorite of top Kremlin officials. “Why not target the 10th-largest bank?” asks Dov Zakheim, formerly a foreign-policy adviser to George W. Bush’s 2000 presidential campaign and a former Undersecretary of Defense. “We’re working up the ladder too slowly, and it’s hurting our credibility.”

John Herbst, who was U.S. ambassador to Ukraine from 2003 to 2006, says it’s “shameful” that the U.S. hasn’t imposed tougher financial sanctions on Russia—banning certain energy companies from tapping U.S. capital markets, for example, or working with the British to bar large Russian banks from doing business in London. Zhakeim suggests preventing commercial flights leaving Russia from landing in the U.S. as well as placing two U.S. military brigades in Poland. “That would get their attention,” he says.

William Taylor, the U.S. ambassador to Ukraine from 2006 to 2009, believes cutting off Russia’s energy sector from U.S. capital markets would have a devastating impact. “The oil and gas industry in Russia is hugely capital intensive,” says Taylor. “Cutting them off from U.S. sources of investment would have a big punch, it would stop them in their tracks.” He acknowledges that these sectorwide sanctions would be more effective if the Europeans joined in, but he doesn’t think that should stop the U.S. from acting alone. “The president has the authority to do this himself and to target certain pieces of the Russian economy,” Taylor says.

Perhaps the most effective weapon the U.S. could deploy against Russia is one that ended up being key to bringing the Iranians to the negotiating table last year. In March 2012, the U.S. and Europeans persuaded the Society for Worldwide Interbank Financial Telecommunications (Swift) to suspend service to all Iranian financial institutions, making it all but impossible to transfer money between banks. Doing the same against the Russians would require the coordination of the Europeans, since Swift is based in Belgium. The U.S. doesn’t have direct control over Swift. It would also more than likely require an act of Congress. The Senate Banking Committee had to approve sanctions against Swift to get the organization to target Iran in 2012.

“Enacting Swift sanctions are like the financial equivalent of the nuclear option,” says Campbell Harvey, a professor of international finance at Duke University’s Fuqua School of Business. “You use it as a deterrent. And in this case, that’s particularly so, because using Swift against the Russians would cause obvious collateral damage.”

http://www.businessweek.com/printer/articles/195045-five-reasons-obama-wont-push-harsher-russia-sanctions-yet
Philips is an associate editor for *Bloomberg Businessweek* in New York. Follow him on Twitter @matthewaphilips.

©2014 Bloomberg L.P. All Rights Reserved. Made in NYC