

## Washington's game of 'sanctions poker' Russia awaits America's decisions

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On 29 January, the administration of President Donald Trump sent Congress a batch of documents which provide the basis for a possible further expansion of sanctions against Russia: a report on the Russian business and political elite, and a report on the consequences of selected financial sanctions. At the same time, the authorisation for the possible introduction of extraterritorial sanctions against entities from the Russian security sector and arms industry came into effect. This was in line with the requirements of the Countering America's Adversaries Through Sanctions Act, No. 3364 from 2 August 2017. This Act covers US sanctions against Iran, Russia and North Korea. As of now, President Trump's administration has not decided to implement any new sanctions against Russia, although it has the ability to do so at any time.

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The absence of new sanctions and the publication of an extensive and purely formal list of members of the Russian business and political elites by the US administration has, on the one hand, been received in Russia with some relief. The Kremlin's decisions and the actions taken by Russian businessmen have demonstrated that Russia had been preparing itself for a 'black scenario' of new, severe, and precisely targeted US sanctions. On the other hand, the Russian reactions reveal their continuing uncertainty regarding Washington's intentions. The Kremlin is clearly unsure whether the US decisions represent a step back and a desire for a limited normalisation of relations with Russia (thus revealing the relative weakness of the American government), or a sophisticated strategy of keeping a constant threat over Russia's head of increasingly tough sanctions that could be triggered at a time convenient for Washington. The Kremlin is obsessively worried that such sanctions might be introduced right before the presidential elections in March, with the aim of destabilising the domestic political situation.

Therefore, even though no new sanctions have been introduced, they have partly achieved the desired effects by creating an atmosphere of uncertainty and unpredictability for the Kremlin. Russia's future behaviour will depend on whether and what kind of new sanctions the US government will impose during the coming weeks and months. If Washington fails to impose significant new sanctions, or imposes merely symbolic ones, it will encourage Moscow to harden its stance and become more assertive. Comprehensive and very painful sanctions, especially if introduced before the elections, could spur the Kremlin to respond aggressively and asymmetrically. In turn, painful but selective sanctions are likely to incline Moscow to make concessions, especially with regard to regional conflicts.

### The US's sanctions against Russia

Act No. 3364<sup>1</sup>, adopted at the initiative of Congress, confirms all the previously introduced

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<sup>1</sup> For the full text of Act No. 3364, see <https://www.congress.gov/bill/115th-congress/house-bill/3364>

sanctions against Russia and imposes new ones; this not only makes it more difficult for President Donald Trump to lift them, should he wish to, but also requires him to monitor and make periodic assessments of Russia's behaviour, in order to consider imposing tougher sanctions if the Kremlin perseveres with policies harmful for American interests<sup>2</sup>. In accordance with the requirements of this Act:

- On 29 January 2018 (180 days after the act comes into force), the US President sent Congress a report on Russian parastatal entities (companies partially or entirely controlled by the state) and members of the Russian business and political elite (Russian politicians and oligarchs with close ties to Vladimir Putin, the Russian ruling elite, and members of their families). This report consists of two parts. The public part lists 210 individuals, including 114 Russian state officials: functionaries of the President's Administration, ministers, heads of government agencies, the speakers of both chambers of Parliament, members of the Security Council, and the heads of the largest state-owned companies; as well as the 96 richest Russians with fortunes that are valued at \$1 billion or more<sup>3</sup>. 22 people from this list have already been covered by individual sanctions (i.e. a freeze of their assets in the United States, a ban on American entities concluding any transactions with such persons or the companies they control, and a ban on them entering the United States). The second part of the report – which is confidential – allegedly (in accordance with the requirements of Act No. 3364) details the involvement of these persons in corrupt transactions, as well as the size and origins of their assets, including the financial status of their spouses, children, parents

<sup>2</sup> For more on Act No. 3364, see I. Wiśniewska, S. Kardaś, 'Ustawa o amerykańskich sankcjach przeciwko Rosji', *OSW Analizy*, 4 August 2017, <https://www.osw.waw.pl/pl/publikacje/analizy/2017-08-04/ustawa-o-amerykanskich-sankcjach-przeciwko-rosji>

<sup>3</sup> For a complete list of the names listed in the public portion of the report: <http://prod-upp-image-read.ft.com/40911a30-057c-11e8-9650-9c0ad2d7c5b5>

and siblings. This part of the report is also said to include assessments of Russian parastatal entities, information about their management structure and beneficial ownership and their international ties, as well as their significance for the Russian economy. The document also allegedly presents the exposure of key sectors of US economy (in particular in banking, insurance, securities and real estate) to Russian political and business figures, and the parastatal entities enumerated in the report. As suggested by the US administration, the confidential part may also contain the names of more Russian citizens. The presentation of this report to Congress did not mean the introduction of any new sanctions against the Russian business and political elite, as underlined in the report itself.

### **So far, President Trump's administration has not decided to introduce any new restrictions against Russia.**

- Another report submitted to Congress on 29 January included an analysis of the potential effects banning American entities from dealing in any new Russian sovereign debt. The report concludes that this type of restriction would not only be a blow to the Russian economy, but would also affect American entities and have negative consequences for the global financial market. For the time being, the US administration has decided not to take such steps.

- Act No. 3364 also obliged the President – at any time starting on 29 January (i.e. 180 days after the act comes into force) – to impose sanctions against persons engaging in 'significant' transactions with the Russian intelligence, military and arms industry. In October 2017 the administration had already specified 39 entities in these sectors (of which 30 had already been covered by US sanctions)<sup>4</sup>. The criteria under

<sup>4</sup> For a complete list of entities: <https://www.state.gov/t/isn/caatsa/275116.htm>

which these transactions will be considered 'significant' have not been revealed. For the time being, the US administration has decided not to exercise this option.

In parallel with the sanctions against Russia arising from Act No. 3364, the US Government is regularly updating the specially designated nationals and blocked persons list. For example, on 26 January 2018 these lists were expanded to include Russian companies and individuals associated with the delivery of Siemens turbines to occupied Crimea, as well as entities involved in trade (mainly steel and coal) between the occupied Donbas region & Russia and other countries.

### Russia's preventive actions

Act No. 3364, which obliges the US administration to closely monitor the situation in Russia, and encourages it to implement successive sanctions against that country, sparked huge concern among the Russian business and political elite, as demonstrated by the actions subsequently taken by the Kremlin and Russian oligarchs. The Kremlin has been clearly obsessively worried that sanctions would be imposed right before the presidential elections in March, which in their opinion would constitute a destabilisation of the domestic political situation.

In view of the above, the Kremlin has first of all tried to convince Washington of the need to normalise Russian/American relations, and of its readiness for constructive cooperation with the US, especially in the area of international security (particularly with regard to Syria, North Korea and Ukraine), if Washington withholds further sanctions. As far as we can discern, the proposals Russia submitted were purely declaratory and did not include any specific promises to discontinue the activities Washington perceives as being harmful to the United States and its allies. Moscow's proposals included the reactivation of the three regular communications channels between Russia & the USA:

political, military and special services (in March 2017); starting bilateral consultations concerning cyber-security; and an exchange of declarations between the two countries about not interfering in the other's domestic affairs (in July 2017). These proposals were rejected by Washington as insufficient.

### **The Kremlin is obsessively worried that the US might introduce sanctions to destabilise the situation in Russia before the presidential elections.**

However, Russian and US intelligence services and the military continued to maintain contacts in order to the fight against terrorism and to avoid incidents in Syria (the so-called 'deconfliction agreement'). In December 2017 Russia announced that it had been able to prevent a terrorist attack in St. Petersburg with the aid of information obtained from the CIA.

It should be assumed that another element of Russian policy aimed at persuading the United States not to introduce new sanctions, especially against the Russian secret services and enterprises in the armaments sector, was the unprecedented visit to Washington at the end of January 2018 by three heads of the Russian special services: Sergei Naryshkin, the head of the Foreign Intelligence Service; Aleksandr Bortnikov, the head of the Federal Security Service; and Igor Korobov, the head of military intelligence (GRU). Both Naryshkin and Korobov are covered by US sanctions, including a travel ban to the United States. Naryshkin's visit was revealed on 30 January by Anatoly Antonov, Russia's ambassador in the United States; the others' visit was reported by the *Washington Post*, according to which Bortnikov and Naryshkin met Mike Pompeo, the head of the CIA, among others. The meeting supposedly concerned the fight against terrorism.

It is most likely that the heads of the Russian intelligence services came to Washington to persuade the US administration that the introduction of new sanctions would have a very negative impact on their ongoing cooperation. Presumably they offered enhanced consultation and cooperation with the US on issues relating to the fight against terrorism, as well as cooperation on regional conflicts affecting American interests (North Korea, the Middle East and Afghanistan).

**The Russian government has undertaken a series of actions aimed at limiting the negative effects of introduction of new sanctions by Washington to the Russian economy.**

At the same time, the Russian authorities have been taking steps to shield the Russian security sector and arms industry from future sanctions. First of all (by a regulation of November 2017), the Russian government permitted state corporations and the Defence Ministry, the Federal Security Service and the Foreign Intelligence Service not to disclose information about their transactions, including information about their business partners (vendors, contractors, etc.) until 1 July 2018. According to unofficial reports, Russian companies had complained that they were having difficulty finding foreign counterparties because of the American sanctions (this allegedly applied to Roskosmos and Rostech, among others, especially after the scandal concerning the supply of Siemens turbines to occupied Crimea).

Secondly, the Ministry of Finance decided to concentrate the financial servicing of the arms companies and the Ministry of Defence in a single state bank. Russian media have speculated that this role was granted to Promsviazbank, which until December 2017 had been one of the largest private banks in Russia, although due to fi-

nancial problems it underwent restructuring and passed under the control of the central bank. At the same time, the central bank ceased publishing information about which Russian banks were authorised to process transactions concerning public procurement in the defence sector. These two decisions were related to Russian banks' concerns over the next round of American sanctions. For example, in December the private Alpha Bank reported that it was ceasing cooperation with Russian armaments companies for fear of reprisals from the United States.

Thirdly, within the military-industrial committee (a key body assigning military contracts) a special team was created with the specific task of ensuring a smooth fulfilment of military contracts by the arms sector in conditions of the anticipated expansion of the sanctions (the Deputy Prime Minister Dmitri Rogozin revealed this fact in January 2018).

The Russian authorities have also undertaken activities aimed at creating favourable conditions for Russian oligarchs (especially those at risk of US sanctions) to move their capital to Russian jurisdiction. First of all, Vladimir Putin has declared that in 2018 the Russian government will issue special anonymous sovereign bonds denominated in foreign exchange. According to the Russian Ministry of Finance, these Eurobonds (worth around US\$3 billion) will be issued within the framework of the domestic Russian financial infrastructure; these instruments will not trade on the secondary market, and their owners will not appear on the international lists of depositaries.

Secondly, an amnesty on capital repatriated to Russia by individuals and legal entities will be introduced by the end of 2018. The assets and foreign accounts which individuals have declared will be exempt in Russia from responsibility for tax infringements and taxation for previous years. Russian residents liquidating their companies in tax havens will be able to move their assets to Russia without suffering any tax consequences.

In recent months, Russian businessmen have also taken a number of actions which can be interpreted as attempts to avoid US sanctions, or minimise their losses should they be imposed. These have primarily focused on lobbying against being included on the list of people associated with the Kremlin, through American law firms and experts in Washington.

### **Russian business is trying to minimise the losses which would be caused by potential sanctions.**

The last year has also seen Russian businessmen making a number of financial transactions which will limit their losses if the sanctions are extended; in particular this involves reducing the assets they hold abroad. To list some examples: at the end of 2017 Viktor Vekselberg (owner of the Renova Group) sold his shares in the Petropavlovsk gold mining company (registered in the UK); in May 2017 Kirill Shamalov (the youngest billionaire in Russia, and probably President Putin's ex-son-in-law) sold 17% of the shares (he still retains 3.9%) in the chemical company Sibur to Leonid Mikhelson, the chairman and largest shareholder in the gas company Novatek (which is subject to US sanctions), who in December 2017 handed over 14.4% of the shares to the board of Gazprombank, reducing his stake in Sibur to 34%. As a result, the share in Sibur held by businessmen potentially vulnerable to American sanctions has fallen below 50%, which means that if they are subjected to individual sanctions, the restrictions will not be automatically extended to Sibur as a company. Meanwhile in August 2017 Mikhail Prokhorov sold 7% of shares in Rusal (a company registered on the Channel Island of Jersey), and in December 2017 he sold 49% of shares in the US basketball club the Brooklyn Nets (31% of which he retains). Alfa Bank (the biggest private bank in Russia) initially announced it would

cease its cooperation with the Russian armament industry in December 2017, and in January 2018 it closed its branch office in New York. In October 2017 Polina Deripaska (since 2001 the wife of Oleg Deripaska, although Russian media have recently rumoured that the couple have divorced) became the owner of almost 7% of the shares of the En+ Group (a vertically integrated aluminium-energy company controlled by Oleg Deripaska); these shares were worth around US\$500 million, thus making her one of the richest women in Russia.

As the Russian media have speculated, divorces may be one of the ways in which Russian oligarchs can minimise their losses from potential sanctions. In this way, their spouses and children (who often live outside Russia) could be protected from restrictions (in particular concerning visas), and some of their assets can be transferred as a result of the division of property. Recently, the media have reported on the divorces of Yekaterina Tikhonova (probably the daughter of President Putin) and Kirill Shamalov (January 2018); Roman Abramovich and Daria Zhukova (reports about their separation appeared on 7 August 2017); and Igor Sechin (who is covered by individual US sanctions) and his wife Olga (in May 2017).

### **Russian reactions to the reports submitted to Congress**

For months the Kremlin had been preparing for a 'black scenario': the introduction of further restrictions, especially on the armaments sector. It feared that the US administration, with the cooperation of intelligence services, would select a narrow group of people from the president's 'inner circle' and hit them with new sanctions. In spite of these fears, the list automatically named Russian government officials, the presidents of the largest state companies (most likely based on the Russian consulting firm RBK's top 500 ranking in 2017) and the country's richest businessmen according to

the 2017 Forbes ranking. Premier Dmitri Medvedev even joked that any officials who had not been named on the list should consider resigning from their posts. Since the list does not differentiate the members of the Russian political and especially business elite according to the degree of their proximity to the president, and omits entirely some of its members who belong to the president's 'inner circle', it does not pose a serious threat to the Kremlin. That is why, on the one hand, the Russian government reacted with positive surprise, in particular at the American administration's decision not to introduce new sanctions.

On the other hand, the Russian authorities' reactions revealed that they still lacked a clear and unambiguous interpretation of the US administration's intentions and were uncertain what to expect in terms of future sanctions policy. Moscow is aware that the risk of the US introducing further sanctions has not passed, and the US administration may take such a step at any time. In particular, the report also includes a confidential section which may include information much more detrimental to Russia's government. This is why Moscow also has a problem with interpreting the signal sent it by the Trump administration, which for the time being has not expanded the sanctions, but has drawn up a very superficial list of members of the political-business elite. The Kremlin is unsure whether this signifies weakness on the part of the American government and a desire for a limited normalisation of relations and cooperation, or whether it is a sophisticated strategy for harassing Russia with continuous threats and preparations for imposing harsher sanctions on the country at the US's convenience. Commenting on the publication of the American report, President Putin admitted that Russia had been waiting for its publication, and was preparing to respond to it by taking real actions that would "reduce relations with the United States to zero". Nevertheless, he stated that for now, such steps were deemed unneces-

sary. On the contrary, he stressed that Russia is ready to patiently build up its relationship with America to the extent that the latter was ready to do the same.

**On the one hand, the Kremlin was positively surprised by the US's decision not to introduce new sanctions, but on the other, it is afraid that Washington may be planning a sharp increase in their restrictiveness in the near future.**

Putin's reaction to the published list seems to have been addressed primarily to Trump himself, and is aimed at continuing to play off the differences between Trump on the one hand and Congress and the American establishment (the 'deep state') on the other. Putin's statement is based on the assumption that Trump – in contrast to the political establishment – is looking for ways to improve relations with Russia. His reaction is a signal to Trump that the Russian president appreciates the fact that the announcement was not accompanied by any additional sanctions, and that therefore he is not going to complicate matters for Trump by taking any retaliatory steps. At the same time, Putin has indicated that if the US escalates its sanctions policy significantly, he will be forced to respond, thereby further hindering Trump in his declared goal of improving relations with Russia and exposing him to attacks from Congress and his political opponents.

The Kremlin list which the US published was met with surprise by Russian analysts and experts. They faulted the American administration for its lack of professionalism and its ignorance of the situation in Russia. They pointed out that the list, while supposedly naming persons closely associated with President Putin, also includes businessmen who have little connection with the Kremlin, such as the Ananyev brothers (who have just had Promsviazbank

taken from them) and Yuri Shefler (a producer of alcoholic beverages who has been living outside Russia for 15 years). At the same time, it omits many of the people (like Sergei Roldugin) whose close ties to the President (including financially) have been reported in journalistic investigations based on the disclosed documents about tax havens (such as the Panama Papers and the Paradise Papers). The Russian experts were also surprised at the list of government officials, which omitted many high-ranking people who have cooperated with the Kremlin such as Elvira Nabiullina, the President of the Central Bank, and the Chechen leader Ramzan Kadyrov.

**The US administration has great freedom and flexibility in imposing sanctions on Russia, which is an important instrument of pressure on the Kremlin.**

Experts have pointed out that, on the one hand, the effect of publishing this list could be counterproductive for the US. Persons who have found themselves on the list 'unfairly' could close ranks behind President Putin in the current situation, resulting in greater consolidation of the business and political elite. On the other hand, absence from the list could 'stigmatise' other members of the political elite, who may be forced to prove their loyalty to the Kremlin. In contrast, being named on the list is a serious problem for Russian businessmen who operate on international markets, as this would make conducting business with them more risky. For example, most likely due to potential sanctions in January 2018, the buyout for US\$1 billion by the American company Halliburton (which offers its services to petroleum extraction projects) of 100% of the shares in the Novomet Oil Services Holding (based in Perm) will have to be cancelled.

## Summary

- The US government has intentionally increased the ambiguity and unpredictability of its process for extending sanctions against Russia. The American administration has obtained great freedom and flexibility in applying them. For example, in the case of the sanctions against the armaments sector – apart from information about the 39 Russian entities which are potentially vulnerable to restrictions – the criteria for 'essential' transactions detrimental to the interests of the United States or its allies have not been specified. The US government's clear aim was to create a range of flexible tools for use against Russia, in order to deter the Kremlin from taking any action which could be aggressive and/or harmful to the United States, its allies and partners.
- One important feature of the potential new US sanctions against the Russian defence sector is their extraterritorial nature. Cooperating with Russian entities can also lead to sanctions against their foreign partners from third countries (both natural & legal persons and state institutions), even those allied with the United States. For example, in a situation when Russian armaments contractors are also involved in transactions on the American market, the introduction of sanctions against them could lead to the cancellation of some Russian export contracts in the defence and industry sector. In this sense, another aim of the sanctions is to narrow Russia's room for cooperation in sensitive areas, and to deter other states from undertaking such cooperation.
- The preparation of the report concerning the members of the Russian elite did not result in an automatic expansion of US sanctions, although it has created a potential threat to those individuals and entities. However, this list presents an incentive for the United States and international organisations to monitor transactions

by the Russian entities named on the list. This document also gives American authorities the option of launching unexpected, targeted responses and undermining contracts signed with Russian entities.

- As a result, the American list could cause further tensions within the Russian political and business elite, especially since it is not known what is contained in the report's confidential part, or whether any sanctions will be imposed against the persons named therein. The mere announcement that new US sanctions might be imposed caused visible concern in the Kremlin and among the Russian oligarchs. The latter had already lobbied for months in the United States against being added to the list of those cooperating with the Kremlin. Meanwhile, the Russian government has tried to make it easier to repatriate capital to Russia, which shows that the Kremlin sees the risk of rising dissatisfaction among the business community, and is trying to calm unsteady nerves. At the same time, in recent months the Kremlin has tried to create a semblance of readiness for the normalisation of relations with the United States (including by undertaking 'peaceful initiatives' in Syria and Ukraine). The above demonstrates that even without further sanctions, their desired effect has to some extent been achieved.

- What shape Russian-American relations and Moscow's policy towards Washington assume depends to a large extent on whether and to what degree the Trump administration will introduce new sanctions. Three main scenarios are possible:

1. Withholding new sanctions in the coming weeks/months, or the introduction of merely symbolic sanctions, will be read by the Kremlin as a signal of the US's weakness, and strengthen the Russian leadership in its belief that it should continue its aggressive foreign policy. This will most likely increase Moscow's assertiveness and discourage it from making any concessions.

2. If the US introduces comprehensive, deep and very painful sanctions, especially in the run-up to the presidential elections in Russia (18 March 2018), this will put the Russian authorities in a difficult position, as Russia has a relatively limited potential to respond adequately to the US in the sphere of economics. The Kremlin would deem such a move to be a direct attempt to remove Putin's team from power, and would thus move the conflict with the US into areas where it has better instruments than in the economic sphere (military, cyberspace, hybrid actions), and can undertake actions intended to show Washington the cost of further deepening the conflict with Russia. These could include striking at American interests through the escalation of regional conflicts, the implicit support of attacks on US forces, or a series of cyber-attacks against the United States and its allies.

3. The introduction by the United States of severe but precisely targeted sanctions may prompt Moscow to intensify its attempts to alleviate the conflict with Washington by making real concessions on contentious issues (such as Ukraine, North Korea or the Middle East), including by limiting its actions in these regions which are damaging to US interests, and possibly by providing limited support for Washington in the resolution of regional problems.

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