

## **POSSIBLE POSITIVE AND NEGATIVE CONSEQUENCES FOR RUSSIA AFTER THE ANNEXATION OF THE CRIMEA**

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The result of the Crimean referendum, which was held on March 16, 2014 in the Autonomous Republic of the Crimea and Sevastopol city, is one of the most actual topics worldwide. According to the results of the referendum 96.77 % of people voted for reunification with Russia. Turnout, according to official information, was approximately 83.1 % of the voters. This information doesn't include Sevastopol, which has the status of the city of national importance and is not formally part of the Autonomous Republic of the Crimea. Meanwhile, according to the final results of the referendum, 95.6% people of Sevastopol voted for unification of the Crimea with Russia. Turnout in Sevastopol reached 89.5%. On 18 of March Moscow proclaimed the annexation of the Crimea (both the Republic and Sevastopol) to the Russian Federation as two of its entities. This decision has not been recognized by Kyiv.

After the annexation of the Crimea opinions of people divided: one group of people thinks that the annexation of the Crimea will adversely affect the economy of Russia, another group of people believes that the annexation of the Crimea is extremely advantageous for Russia. In this article we will try to identify some possible positive and negative consequences for Russia after the annexation of the Crimea.

The United States and the EU responded negatively to annexation of the Crimea and Sevastopol to the Russian Federation and immediately after the signing of the affiliation of the two new subjects to the Russian Federation, U.S. Vice - President Joe Biden announced that the United States and the EU will impose additional sanctions against Russia if Moscow continues its policy.

### **What action has been taken so far?**

On 6 March, the European Union and the US agreed a staged approach. It started with the immediate suspension of talks on closer economic cooperation between the EU and Russia, and on preparations for the forthcoming G8 Summit in Sochi. Following the Crimean referendum on 16 March, the EU and the US carried out their threat to target individual Russians and Ukrainians. The US ordered the freezing of assets and travel bans on 11 individuals, while the EU imposed such sanctions on 21 people. The EU later added another 12 individuals to its sanctions list, and the US announced further sanctions on individuals and against the Rossiya bank. The EU's potential sanctions list is thought to include more than 100 people. When the sanctions were first introduced, mainly politicians and officials were targeted by the EU and the US. But the effects of new sanctions on individuals such as Russian businessmen have started to ripple out. Visa and Mastercard are reported to have stopped processing payments to SMP bank after its billionaire co-owners Boris and Arkady Rotenberg were included in US sanctions. And Rossiya bank said the two credit card firms had also stopped processing its payments. US President Barack Obama has signed an order to enable the US to impose sanctions on sectors of the Russian economy.

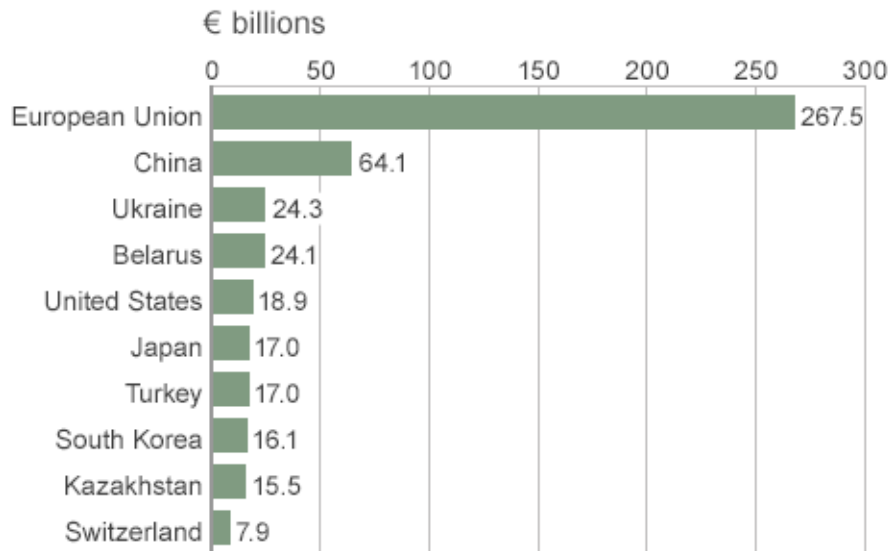
### **Could more sanctions be imposed?**

The EU and the US could seek to isolate Russia by severing diplomatic links. Another option might be to attempt to remove Russia from international bodies such as the World Trade Organization, International Monetary Fund or World Bank. Also, President Vladimir Putin has been very keen to bolster co-operation on investment, research and education. Marginalising him on the international stage could be a blow to Moscow's prestige, although

it is unlikely to damage economics seriously. Nevertheless, the EU and the US don't want to cut off dialogue with Russia.

**Could this dispute develop into a full-blown trade war?**

### Russia's top trading partners 2012



Source: Eurostat

That would certainly ratchet up the pressure on Moscow. As it can be seen in the graph above, the EU is by far Russia's biggest trading partner. Imports to the EU from Russia are dominated by crude oil and gas. According to the Energy Information Administration, European countries import 84% of Russia's oil exports, and about 76% of its natural gas. Germany is the single biggest importer of Russian oil and gas, while the UK buys about 6% of Russia's gas.

But sanctions are not the only negative thing in the annexation of the Crimea and Sevastopol to Russia. The annexation of the peninsula entails a number of costs for the Russian Federation. For the Crimea, the urgent problem is how to finance the huge local budget deficit, estimated at \$1 billion. According to preliminary announcements, Russian economic aid for the Crimea is expected to amount to at least \$2.2 billion annually. This sum does not cover the expectations (aroused during the referendum campaign) that after the peninsula joins the Russian Federation, pay and pensions in the public sector will rise to Russian levels (salaries in Russia are on average more than two and a half times higher than in the Crimea). Subsequent costs will be incurred by adapting the apparatus of state and the economy of the peninsula to Russian requirements, especially the transition to the Russian ruble and the Russian financial and legal systems. Moreover, investments are needed in the peninsula's infrastructure. Government officials estimate the need for Russian investment in the transport and tourism sectors at \$4-5 billion. Just to ensure effective communication with Russia, it will be necessary to build a bridge across the Kerch Strait. The Russian transport minister Maksim Sokolov estimates the cost of such an investment at a minimum of \$1.4 billion. For the Crimea to become independent of the electricity and gas supplies from Ukraine, Moscow will have to bear the costs constructing a power connection through the Kerch Strait, as well as a pipeline (initially there is talk of building a branch of the South Stream pipeline, or even re-routing the whole project to run through the Crimea). According

to the late deputy finance minister Alexander Pochinok, the annexation of the Crimea could cost Russia a total of up to \$82 billion.

Apart from the need for direct financial outlays, Russia's annexation of the Crimea generates administrative and organizational problems. They will need to create a border infrastructure and ensure the defense of the borders; as well as the demarcation of new borders, including maritime borders, and the division of territorial waters to regulate access to and ownership of the shelf. Settling these issues will be more difficult as Ukraine, which should be a party to most of the agreements, does not recognize the annexation of the Crimea, and doesn't want to negotiate to resolve these issues.

In addition to the costs, however, the annexation of the Crimea could also bring Russia some financial benefits. Among them we should first mention the cost of the Black Sea Fleet. So far, Ukraine had been paying Moscow \$97 million a year to station the Fleet on the peninsula (\$30 million of which remained in the Crimea's budget). In accordance with the existing agreement, by 2017 this amount would have risen up to \$100 million. The takeover of the Crimea not only eliminates the need to pay these fees, but Russia gains an opportunity to modernize the Fleet, which so far had been limited by the Russian-Ukrainian agreement. Russia intends to take over the Ukrainian ships which were in the Crimea, as well as the entire Ukrainian military infrastructure and ports. By gaining control over the Crimea, Russia will reduce the cost of the passage of ships through the Kerch-Yenikal Canal. According to the Russian Ministry of Transport, the Russian Federation has paid about \$15 million annually to the Ukrainian budget. Russia and the Crimea will also take over the peninsula's entire infrastructure, along with the property of the Ukrainian state.

Also, Russia gets part of the Ukrainian army (up to 16,000 of 18,000 fighters in the Crimea), part of military equipment. However, most Ukrainian warplanes in the Crimea are inoperative, and the whole Ukrainian military equipment is outdated.

Moreover, Russia takes about 3/4 of the exclusive economic zone of Ukraine in the Black and Azov seas, including oil and gas. Oil reserves are relatively small (up to several million tons), but more significant gas reserves (billions of cubic meters near Kazantip). Also, there are not yet developed and not fully explored oil and gas fields, which are estimated at hundreds of millions tons of oil and hundreds of billions cubic meters of gas.

A significant part of Russian shipbuilding companies are overloaded with orders, so ship-building and ship-repairing enterprises of the Crimea won't be excessive for Russia.

3000 hectares of vineyards and wineries the entire resort and tourist complex of the Crimea, including 2,500 km of coastline with numerous beaches and seaside resorts also become the property of Russia. For such a cold northern country as Russia, the availability of a huge sea resort area is very important. The Crimea easily can be turned into a first-class resort area at the best world standards. Reunification of the Crimea and Russia will lead to the fact that much of the money that Russians spend on vacation, will not go abroad and will remain in the economy. Annexation of the Crimea will fortify a position of ruble among the world's currencies.

Together with the Crimea, Russia's economy will grow and already exceeds the size of the German economy, becoming the first economy in Europe. Although GRP of the Crimea is now only about \$ 12 billion per year, even this is enough for Russia to get over Germany's GDP in the rating according to the World Bank. Moreover, the economy of the Crimea with Russia will have significant growth potential.

As a result of the reunification of the Crimea Russia's population reaches a point of 146 million people. This makes it possible in the coming years due to immigration and natural increase (if it continues) to reach and exceed the historical peak of the population in post-Soviet Russia of 148.5 million people.

In this article, we've tried to highlight just a few pros and cons of the reunification. But we cannot say for sure whether the annexation of the Crimea affects positively or negatively Russia and Russian economy.