

New US sanctions against Russia

Position paper of the German Committee on Eastern European Economic Relations

On 6 April 2018, the US Treasury Department published details of new sanctions against seven Russian oligarchs (and their close relatives), twelve companies controlled by them, 17 Russian government officials, a state-owned arms manufacturer and a bank. Non-US citizens, and hence European companies, could also become the target of sanctions if they have knowingly facilitated “significant transactions” on behalf of the individuals or companies on the sanctions list. The German Committee on Eastern European Economic Relations has produced a position paper describing the possible impact of the new US sanctions legislation on German companies. It was drawn up on the basis of a survey of members of the Committee and the Eastern Europe Business Association.

Target of the new sanctions

The new package of US measures (Executive Orders 13661, 13662 and 13582) refers to Section 241 of the “Countering America’s Adversaries Through Sanctions Act (CAATSA)” from August 2017. The new sanctions are being imposed on individuals and companies that have profited from the policies of the Kremlin and that greatly facilitate “Russia’s malign activities” internationally. But in addition to the twelve new companies on the list, which have direct links to the oligarchs subject to sanctions, the measures clearly state that all other companies in which the listed persons (or their close relatives) have shares of 50 percent or more, will also be subject to sanctions. Regarding the impact of the new package of measures, the stated aim is to freeze the assets of individuals and companies on the list and prohibit US citizens from having business relations with them.

Non-US citizens can also become the target of sanctions (secondary or extraterritorial sanctions) if they have knowingly supported “significant transactions” on behalf of the Russian individuals, their close relatives and companies on the sanctions list. However, the measures do not define at what point a transaction becomes “significant”.

Impact on German companies

A number of the Russian individuals and companies on the sanctions list have active business relations with German companies that have US business interests. According to first estimates, there are over 60 German companies that have extensive business relations with individuals on the sanctions list, and who would thus be affected both by direct and “secondary sanctions”.

These German companies now have to face the questions of whether to break off such business relations, most of which date back many years. On this point the US administration has already set two deadlines in May and the beginning of June. A grandfather policy is not planned. The question of how contracts could be terminated at very short notice in a legally watertight way, and whether in such cases Euler Hermes credit insurances would take effect, remains unanswered. This is evidently decided on a case-by-case basis.

German companies fear short-term the loss of ongoing business operations worth hundreds of millions of euros. Furthermore, the short-term termination of contracts with suppliers, for example, could lead to production losses along the entire production chain, since a replacement (of equal quality) has to be found first. A company can also be affected by direct sanctions if it sells, as an intermediary, the products of a company on the sanctions list to a US company or citizen.

Since international banks are among the most threatened by sanctions, it is safe to assume that further problems will arise with the financing of business transactions with Russian partners, even if they are not currently subject to sanctions. This would have a negative impact on possible future business and also diminishes the chance of German companies being awarded contracts for major orders in Russia in future. The fear is that rivals from China, Japan and South Korea could gain additional market share.

The negative consequences for the operations of German and European aluminium processing companies are already becoming alarmingly clear: one Russian company on the sanctions list, Rusal, has to date covered 30 to 40 percent of European demand and also runs factories within the EU. If entire factories suffer production shutdowns, it will bring the risk of price hikes and follow-up costs worth hundreds of millions of euros. Aluminium is particularly important in the automobile and aviation industries.

Indirect consequences of the US sanctions

The new US sanctions will certainly increase the burden of checking whether business dealings are affected, and they are becoming an ever greater obstacle to new business relations. The US sanctions imposed on Russia already take up 138 pages on the list of the Special Designated Nationals (SDN). According to initial estimates, the Russian business men targeted by the sanctions at the beginning of April alone have interests in around 8,000 companies worldwide, although Western business partners are now compelled to check that the people on the sanctions list do not collectively own more than 50 percent of the shares in any of these companies.

German companies that are active on the Russian market – overall there are about 5,000 – are under pressure on two fronts: firstly, banks in particular are increasingly taking a critical view of business with Russian partners. Continuing to cultivate business contacts with people on the sanctions list, even when their companies are not directly targeted by sanctions, risks damaging one's reputation. Secondly, Russian government authorities have announced that they will punish compliance with the US sanctions. Sanctions against US companies have been announced, and US suppliers are increasingly not even being considered as suppliers. Complying with Western sanctions is punishable in Russia.

Overall, the economic outlook for Russia looks increasingly bleak because of the new US sanctions, which will spill over into international trade and affect the business prospects of German and European companies in Russia.

Positions of the Committee in brief

- The German federal government and the EU should make their opposition to the extraterritorial application of US sanctions clear and protect EU companies from sanctions as required.
- It is necessary to clarify how the US administration defines the term "significant transaction". There are no clear indications of the volume of business covered by this term.

- For German companies whose activities also fall under US law via their subsidiaries, exemptions, or at least longer-term transition arrangements, on the legally watertight handling of contracts should be agreed. The best solution in this regard would be a clear grandfather clause.
- It is necessary to clarify whether the loss of business caused by the sanctions is covered by Euler Hermes federal export credit guarantees. According to information from the German Federal Economics Ministry, this is decided on a case-by-case basis. US sanctions represent a political risk, which in our opinion should generally be covered.
- There are reports that there are factories in neighbouring states of Russia and Europe belonging to the corporations on the sanction lists, and thus that European jobs will also be affected. In particular, developments on the aluminium market must be closely monitored to prevent supply shortages and massive price hikes for European producers along the production chains owing to lost supplies from Rusal.
- The bureaucratic workload arising from compliance with US sanctions, as well as other existing global sanctions, has ballooned in recent years. The US list of individuals worldwide upon whom sanctions have been imposed is over 1,000 pages long and includes an estimated 25,000 names of individuals and companies. In addition, sanctions are being used against companies that themselves are not on the list, but in which companies that are on the list have significant shares. This drastically increases the workload involved in checking business dealings. Small and medium sized enterprises in particular can barely cope financially with these obligations and are thus increasingly limited in their business opportunities. In the case of doubt, banks tend to retreat from business transactions, which is further curbing international trade (see also Iran)
- The international regulations for introducing economic sanctions urgently have to be clarified. In their current form, the sanctions are driving forward global protectionism in a dangerous manner. It should be strength of the law that prevails, not the law of the strongest. The WTO must be maintained and strengthened as the body entrusted with preserving international trade regulations.
- Continuing to pull the sanctions lever is taking us further and further away from a political solution to the conflicts that exist with Russia. The need for a political de-escalation strategy is blatantly clear. There are enough politicians who cause conflicts or take a confrontational approach. We need people to build bridges, people who have the courage to deploy their political capital for the benefit of mutual understanding. In our view the German federal government still has a crucial role to play as mediator.

The full-length, 15-page position paper (German only) by the Committee on “New US Sanctions against Russia – Impact on the German Economy” is available online at www.ost-ausschuss.de

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