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Nathalie Rodriguez

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The Event That *Defied* Putin: The Annexation of Crimea and its Negative Economic Consequences with the European Union (EU)

Nathalie Rodriguez*

Introduction[1]

The 2014 Annexation of Crimea by Russia has been regarded as the most significant event of the post-Soviet political and social order. Such breach of norms of territorial sovereignty and democracy to the international community was met with austere economic sanction policies from the Western powers that ultimately had, and continue to have, negative consequences on the Russian economy and its trade relations.

Putin's militaristic strategy of annexing Crimea presented the Russian Federation with a paradox of unexpected consequences; streaming far from the outcome Putin expected. The ramifications implemented by the Western powers following Putin's intervention in Crimea have inadvertently led to a significant decline in Russian acceptance as a world hegemon, depreciation in the Russian economy, and reduced trade relations with its principal trading partner, the European Union (E.U.).

Keywords: Annexation of Crimea, Post-Soviet, European Union, intervention

I. Moscow's Interests in Crimea

Moscow's interests in Crimea extend far beyond the existing military presence following its annexation. In fact, it has been seen as a region of vital strategic importance for respective generations. Several factors that allow Crimea to be seen as advantageous to the Russian Federation: its geopolitical location in relations to the Middle East and Western Europe, its abundance of hydrocarbon resources, and an attempt to feed the Russian imperialist identity.

Crimea's far-reaching location between the Black Sea and the Sea of Azov contains one of Russia's most strategic military bases, the base of Sevastopol[2]. The base of Sevastopol's tactical position allows Russia to exert military leverage throughout the Black Sea, Mediterranean region, and to one of Russia's closest allies, Syria. There are long-standing ties between Moscow

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* Nathalie Rodriguez is a Senior at the University of Miami studying Political Science and Economics with a minor in International Studies. Nathalie's interests aim at addressing aspects of EU framework and economic policy with an interdisciplinary approach.

[2] AlJazeeraEnglish. *What Has Russia Gained from Annexing Crimea? | Inside Story*. YouTube, 18 Mar. 2019, www.youtube.com/watch?v=7DISoeWEefI.

and Syria, particularly with the Assads, which lend credence to Russia's presence[3]. Furthermore, by aligning themselves with President Bashar al Assad, the officially recognized leader of Syria, there are several benefits to Russia that Putin considers sufficient justification to consider annex Crimea for geographical proximity with Syria.

Also, if we consider Crimea's geopolitical location as an opportunity for increased Western influence in Eastern Europe, this is a significant threat to Moscow and provided additional incentive for Russia to annex Crimea. Ukraine's size, population, and geographic position serves as buffer from and launch-pad to the West, have made it a strategic prize for the Russian imperial project for centuries[4]. Putin's possibility of Ukraine's new government aligning with the Western powers, especially through NATO, as a means of "open enlargement" would be a significant threat for Moscow; and the perception/ identity of Kiev, the center of the Slavic civilization, to be "run by" Europeans.

Furthermore, Crimea's significant amount of hydrocarbon resources was another factor for which Russia annexed it. For most Europeans, when it comes to energy matters, Russia means natural gas. Russia's economy is also fully dependent on its exportation of energy sources. It also holds a quarter of the world's reserves of conventional gas and Gazprom, its national company, supplies EU consumers with 40% of their imports[5]. If Ukraine is considered, this increases significantly, and would thus, mean more profitable energy corporations in Russia. The idea that Moscow was focused on acquiring Crimea's extensive number of hydrocarbons can be seen in Former Ukrainian Energy Minister, Stepan Kubiv's quote that "Ukraine has lost 80% of oil and gas deposits in the Black Sea and a significant part of the port due to infrastructure due to the Annexation of Crimea."

Finally, Crimea serves of strategic influence on Moscow in that it was assist in the Russian imperialist identity that Putin strives to expand. The Annexation of Crimea is the first step in Russia reacquiring its former Soviet satellite states as articulating the Russian expansionist, power character. In annexing Crimea and gradually recapturing former territories it would allow Russia to reassert its influence over former Soviet states, and eventually lead to the renewed growing influence in the region while also feeding the Russian imperialist, hegemon identity.

II. Effects of the Annexation on Ukraine and Russia

For Ukraine, the loss of Crimea – in addition to its geopolitical and military importance, as well as its impact on the internal political scene (more on which in subsequent analyses) – is associated with the economic consequences[6] as well as the recognition as Ukraine as seemingly

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[3] "Understanding the Relationship Between Russia and Syria." *The Aspen Institute*, 1 July 2019, www.aspeninstitute.org/blog-posts/understanding-the-relationship-between-russia-and-syria/.

[4] Grigas, Agnia. "One Year since Crimea's Annexation: Russia's Interests in Ukraine Run Deep." *TheHill*, 4 Feb. 2016, thehill.com/blogs/congress-blog/foreign-policy/236487-one-year-since-crimeas-annexation-russias-interests-in.

[5] "Where Does Russia's Hydrocarbon Industry Stand: Gas and Oil?" *European Energy Forum*, 7 July 2015, www.europeanenergyforum.eu/where-does-russia%E2%80%99s-hydrocarbon-industry-stand-gas-and-oil.

[6] Olszański, Tadeusz, et al. "The Consequences of the Annexation of Crimea." *OSW Centre for Eastern Studies*, 19 Apr. 2018, www.osw.waw.pl/en/publikacje/analyses/2014-03-19/consequences-annexation-crimea.

powerless in the eyes on the international community. Ukraine was left virtually powerless in comparison to the Russian federation, while the Russian government fed its expansionist, power ego. Moreover, the Annexation of Crimea led to further internal controversy and division in Ukraine. Prior to the annexation, and since Soviet times, the Ukrainian population has witnessed an internal divide as to whether it should associate with the Russian federation or maintain its nonalignment. The 2014 annexation has led to a considerably greater amount of domestic political and social unrest: the Ukrainian people have been unable to provide a united and aligned forefront as to whether Russia's intervention is an event that should be admired or objected. For the Russian authorities, the takeover of Crimea was a propagandic success for domestic politics as it fed the interventionist Russian ego; however, the gains of the Annexation of Crimea were minimal and short lived. If we consider the effects on those affected most by Putin's bi-polar militaristic policy, the Russian people, this unnecessary exertion of militaristic power has led to a deterioration of Russian society and economy. The annexation is also associated with significant costs on the international political scene (Russia has acquired the image of a dangerous and unpredictable state), as well as financially (one preliminary estimate puts the total cost of annexation at $82 billion)[7]. Following the illegal Annexation of Crimea, the international community, specifically the West, was quick to reject the Russian intervention and to support Kiev's position; and accordingly reacted with strict economic sanctions against Russia and policies of non-recognition.

III. The Sanctions, specifically the U.S.-E. U. Coordinated Sanctions

Following the Annexation of Crimea, the Western powers utilized an instrument of foreign policy that was distinct from ordinary protectionist barriers[8], the use of economic sanctions. Economic sanctions were an approach that would isolate the Russian economy from the Western markets while acting as an incentive for Moscow to retreat from Crimea. Sanctions were not an end in themselves, but a means to achieve – usually with other instruments – larger political goals[9]. The Western economic sanctions, particularly those by the U.S. and E.U., were met with significant collaboration and support from other international powers. The joint coordination of the U.S., E.U., and additional Western powers demonstrated solidarity and a united Western forefront to the unpredictable Russian hegemon. However, the EU was gradual in adopting similar sanctions to the US. The EU wanted to take a less radical approach due to its proximity to Russia and its extensive investment and trade relations (some EU countries highly dependent on Russian oil and gas supplies also worried about endangering energy sector ties[10]). Russia is the EU's fifth largest trading partner, and the EU is Russia's largest trading partner. A complete cessation of economic relations would mean significant economic damage and an unavailability in obtaining energy sources for the EU, as well as strained political and trade relations. Ultimately, the EU aligned with the rest of the Western powers and passed rigid,

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[7] *Ibid*.

[8] Popovic, Nemanja. "The Energy Relationship Between Russia and the European Union." *E*, 26 Feb. 2020, www.e-ir.info/2020/02/24/the-energy-relationship-between-russia-and-the-european-union/.

[9] Gould-Davies, Nigel. *Economic Effects and Political Impacts: Assessing Western Sanctions on Russia*. Bank of Finland, BOFIT, 2018, helda.helsinki.fi/bof/bitstream/handle/123456789/15832/bpb0818.pdf?sequence=1.

[10] Popovic, Nemanja. "The Energy Relationship Between Russia and the European Union." *E*, 26 Feb. 2020, www.e-ir.info/2020/02/24/the-energy-relationship-between-russia-and-the-european-union/.

structural economic sanctions. If we observe the differences between the US economic sanctions and those of the EU, it can be said that the U.S. sanctions, one can argue, are more general than those of the EU. Designed to change behavior of the Russian government by putting pressure on the Russian economy, U.S. sanctions included asset freezes for specific Russian individuals and entities; restrictions on financial transactions with Russian firms operating in key sectors; restrictions on U.S. exports, services, and technology for specific Russian oil exploration or production projects; and tighter restrictions on U.S. exports of dual-use and military items to Russia[11]. Conversely, the EU sanctions did not affect so much Russian individuals and society, but instead created for a highly asymmetrical relationship in which the EU continues to have access to Russian energy sources while disabling the Russian economy's access to European financial markets. This disparity amongst the EU and US sanctions was meant to protect specific EU interests and to share the economic burden throughout all the 28 EU members[12]. The most important measure agreed was to deny Russian state-owned banks access to European capital markets[13]. Under the agreed sanctions, Europeans will not be permitted to buy debt, equity or other financial instruments with a maturity higher than 90 days in Russian state-owned banks or their subsidiaries[14]. Brokering or other services linked to any such transactions will also be banned. Any trade in arms and "related material" with Russia, both import and export, will be banned, but the embargo will apply to future contracts only[15].

IV. Effects of the Economic Sanctions

The success of the economic sanctions imposed by the Western World is a topic of significant controversy as it is difficult to gauge the effects of the sanctions: does one look at the contribution of peacekeeping policies enacted by Russia towards Ukraine, levels of GDP, or general economic growth or decline. Furthermore, the Russian economy has been on a sharp decline since the fall of the Soviet Union in the 1990s due to adverse demographic and economic trends; so, one cannot attribute the entirety of this economic decline to Western sanctions following the Annexation of Crimea. Additional economic crises that Russia has been witnessing since the collapse of the Soviet Union include a declining working-age population, poor business and investment climate, difficulty diversifying from the angry sectors (making it exceptionally reliant on this unpredictable source), and the declining value of the Russian Ruble, which all contribute to a declining economic growth. Although the Western economic sanctions are not the central cause for the recent decline in the Russian economy, they are responsible for a modest effect on Russian GDP and economic growth. One of Russia's economic crises began in 2014, following Russia's engagement in Ukraine that resulted in international sanctions against Russia

[11] Nelson, Rebecca. "U.S. Sanctions and Russia's Economy." *Congressional Research Service* , International Trade and Finance , 2017.

[12] "EU Restrictive Measures in Response to the Crisis in Ukraine." *Consilium*, 5 Oct. 2020, www.consilium.europa.eu/en/policies/sanctions/ukraine-crisis/.

[13] Borger, Julian, et al. "EU and US Impose Sweeping Economic Sanctions on Russia." *The Guardian*, Guardian News and Media, 29 July 2014, www.theguardian.com/world/2014/jul/29/economic-sanctions-russia-eu-governments.

[14] *Ibid.*

[15] *Ibid.*

and Russian countersanctions. The crisis that started in 2014 caused a two-year recession. Real GDP fell by 2.5 percent in 2015 and additional 0.2 percent in 2016[16]. Additionally, aside from immediate effects on GDP, the effects of the Western economic sanctions, according to the International Monetary Fund (IMF), is estimated to have a long-term, adverse cumulative effect of up to 9 percent of GDP[17]. *Refer to Appendix A for the Annual Percentage Change in the Russian Economy from 1993-2018.* In this graphic, one can observe a modest dip from 2014 to 2015 of 2.5 percent and a preceding dip in 2016 of 0.2; both are immediate effects of the economic sanctions. Also, if we observe the effects of the 2009 economic recession that led to a negative economic growth of 7.8 percent followed by a positive economic growth of 4.5 percent in 2010; it can be said that this apparent economic recovery and resilience of the Russian economy is not something that can be said for the years following the international economic sanctions. The years following the Annexation of Crimea are characterized by minimal economic growth of 1.5 percent and 1.7 percent, respectively. The lack of resilience in the Russian economy also supports the hypothesis from the IMF that the effects of the international sanctions will ultimately cause cumulative effect of up to 9 percent on Russian GDP.

Additionally, the international sanctions triggered large- scale capital outflows from Russia in 2014-15. Capital outflow is defined as the movement of assets out of a country; and is usually a result of political or economic instability. These augmented levels of capital outflow attributed to market panics and the devaluation of the RUR exchange rate[18]; leading to the discouragement of domestic and foreign investment. (*Refer to Appendix B: Private Sector net capital inflows (-) and outflows (+), $ billions, balance of payments data, 2000-17*) Appendix B demonstrates the levels of capital outflow in Russia from 2000-2014; and it can be seen that the highest level of capital outflow was in 2014, following international economic sanctions, at 152.1. Also, the negative effects apply not only to directly sanctioned sectors such the defense and oil industries, but to the entirety of the Russian economy and output.

V. Effects of Sanctions on E.U.-Russia Trade Relationship

In the 1990s and 2000s, the EU's approach to Russia was based on the expectation that economic ties and interaction in various fields would contribute to regional stability and security and possibly even the democratization of Russia[19]. However, despite such expectations the EU-Russia relation is indicative of an asymmetric one in which both sides have a significant number of vulnerabilities. On the European side, the apparent reliance on Russian energy has proven to

[16] Dabrowski, Marek. "Russia's Growth Problem." *Research Gate*, Bruegel, National Research University Higher School of Economics, CASE - Center for Social and Economic Research, 2019, www.researchgate.net/profile/Marek-Dabrowski/publication/330937236_Russia%27s_growth_problem/links/5c5c831745851582c3d58f94/Russias-growth-problem.pdf.

[17] Survey, IMF. "IMF Survey: Cheaper Oil and Sanctions Weigh On Russia's Growth Outlook." *IMF*, 3 Aug. 2015, www.imf.org/en/News/Articles/2015/09/28/04/53/socar080315b.

[18] *Ibid*.

[19] Raik, Kristi, and András Rácz. "Post-Crimea Shift in EU-Russia Relations: From Fostering Interdependence to Managing Vulnerabilities." *ICDS*, 16 May 2019, icds.ee/en/post-crimea-shift-in-eu-russia-relations-from-fostering-interdependence-to-managing-vulnerabilities/.

be destructive for its relations with the West and has unveiled a significant shortage in the European continent. Not only is there an obvious economic rationale for trade between a large producer (Russia) and a nearby consumer (EU), but much of the vast infrastructure for the large-scale transportation of oil and gas is already in place[20]. This is particularly important in the case of the gas trade, as gas requires specific transmission infrastructure. The Annexation of Crimea in 2014 came as a point of realization to Europeans to gradually begin minimizing dependence on Russian energy sources, and to turn to alternative producers.

As for the Russians, they are dependent on European trade and its financial sectors. At best, economic interdependence between states may contribute to security and stability. Russia needs the EU as an export and an import market much more than the EU needs Russia[21]. While part of this asymmetry can simply be put down to the relative size of the economies, the narrow structure of Russia's economy also limits trade possibilities[22].

However, in EU-Russia relations, the preconditions for positive interdependence were always weak and have further weakened since 2014[23] following the Annexation of Crimea. The EU and Russia will probably remain important trading partners for the foreseeable future, but trade relations will continue to be overshadowed by political unease[24].

VI. Conclusion

The Annexation of Crimea has proved a crucial event to the functioning of international order. This illegal exertion of power by the Putin administration to feed the grand Russian imperialist identity led to a number of negative effects, particularly the decline of the Russian economy and weakened relations with the EU, Russia's largest trading partner.

A "grand compromise" between the US, Europeans, and Russia (by means of a regional system of peace and development for the entire Black Sea and Caucasus) will require truly engaged diplomacy in which US, EU and Ukrainian 'vital' interests and those of Moscow are eventually redefined and reconciled[25].

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[20] Tamsaar, Rein. *Post-Crimea Shift in Eu-Russia Relations: from Fostering Interdependence to Managing Vulnerabilities*. International Centre for Defence and Security, 2018, icds.ee/wp-content/uploads/2019/05/EURUS_book_EVI_May_2019-web.pdf. Chapter 7: The EU after 2014: Reducing Vulnerability by Building Resilience

[21] *Ibid*.

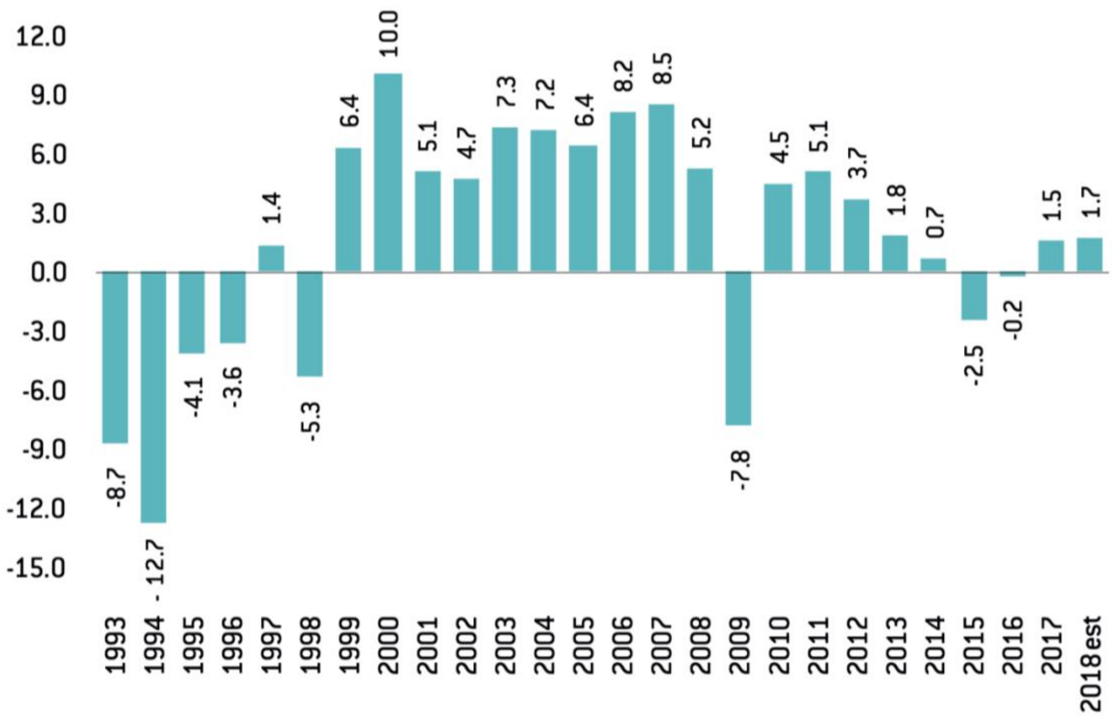
[22] Tamsaar, Rein. *Post-Crimea Shift in Eu-Russia Relations: from Fostering Interdependence to Managing Vulnerabilities*. International Centre for Defence and Security, 2018, icds.ee/wp-content/uploads/2019/05/EURUS_book_EVI_May_2019-web.pdf. Chapter 7: The EU after 2014: Reducing Vulnerability by Building Resilience

[23] *Ibid.*

[24] Tamsaar, Rein. *Post-Crimea Shift in Eu-Russia Relations: from Fostering Interdependence to Managing Vulnerabilities*. International Centre for Defence and Security, 2018, icds.ee/wp-content/uploads/2019/05/EURUS_book_EVI_May_2019-web.pdf. Chapter 7: The EU after 2014: Reducing Vulnerability by Building Resilience

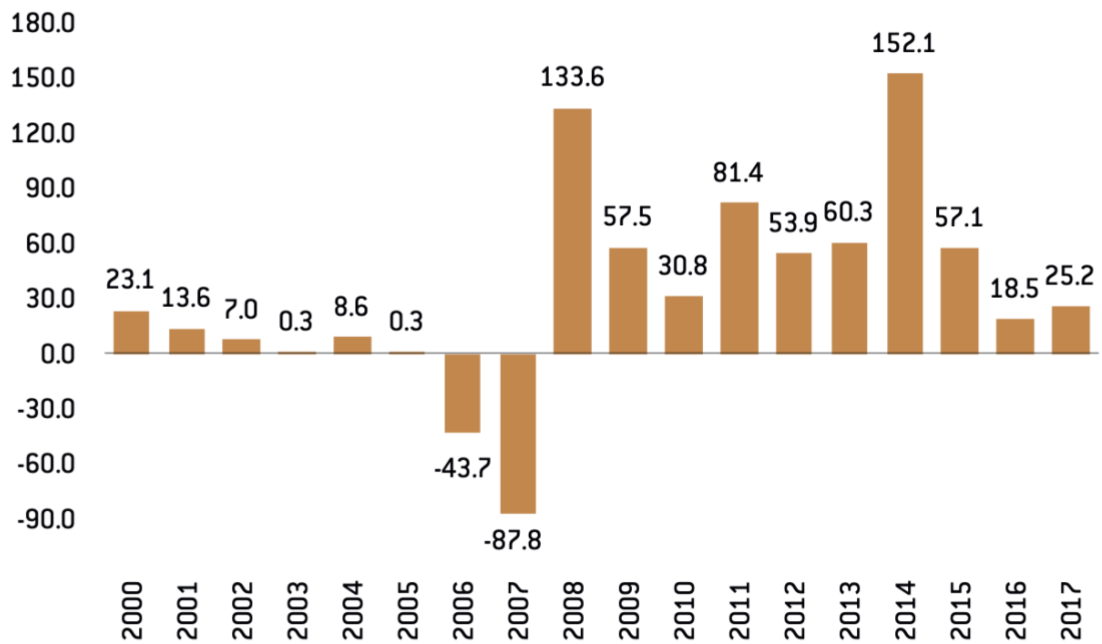
[25] *Ibid.*

Appendix A: Russian GDP, annual percentage change from 1993-2018



Source: Bruegel based on IMF WEO database, October 2018.

Appendix B: Net capital outflows of the Russian Economy (+), $ billions, balance of payments data, 2000-17



Source: Bruegel based on Central Bank of the Russian Federation.

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