

Tense Ukraine Situation and Its Impact on Energy Market (3)

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In a manner to attract global attention on March 18, Russian President Vladimir Putin decided to annex Crimea into Russia. Before Russian upper and lower house lawmakers, government officials, the prime minister of the Crimean Autonomous Republic and the mayor of Sevastopol, who gathered at the Kremlin, Putin declared the annexation of the autonomous republic into Russia, noting that the March 16 Crimean referendum was lawful and that Russia and Crimea have maintained close relations. Putin and Crimean representatives immediately signed a treaty on the annexation.

The international community including Western industrial nations, Japan and Ukraine has criticized the referendum as invalid and raised opposition to Russia's annexation of Crimea. Putin's decision to brush off the international criticism has shaken the world and international order. Russia, one of the five permanent members of the United Nations Security Council, has implemented a regime change by force and a challenge to post-Cold War international order. The Russian action represents a problem expected to seriously affect stability in the world. Some people believe that the development could be an epoch-making turning point.

In response to the Russian action, Western industrial countries as well as Japan have further toughened their anti-Russia attitude which had grown severer since the Ukraine situation's destabilization. The United States threatened to take measures in addition to earlier-announced sanctions including the suspension of visa issuance and assets for 11 Russian nationals such as government officials and noted that it was convening an emergency Group of Seven summit excluding Russia on the occasion of the Nuclear Security Summit opening next week in The Hague.

The European Union, which has closer economic, trade and investment relations with Russia than the United States, is also expected to toughen economic sanctions on Russia. After announcing the present sanctions including the suspension of visa issuance and assets for 21 Russians, the EU is considering expanding and toughening these measures. The United States and

Europe are likely to consider far tougher economic sanctions if Russia indicates any move to expand its control into eastern Ukraine beyond Crimea.

Economic sanctions on Russia have so far remained in a predictable range, falling short of causing any great market turmoil. In Russia, the stock market and the ruble have plunged since Ukraine's destabilization. Other markets in the world have grown nervous about the Russian and Ukrainian situation. Nevertheless, economic sanctions within expectations have not affected global markets so seriously.

But the growing possibility of tougher economic sanctions after the Russian decision to annex Crimea has increased market uncertainties and fears. Details of the tougher sanctions are naturally attracting attention now. In this sense, great matters of concern include how the energy sector as the backbone of the Russian economy would be treated, how Russia-Ukraine-Europe energy relations would change and how the world and Asia would be affected.

Europe, which has close relations with Russia's energy sector, is expected to refrain from imposing any severe sanctions on the sector. Sanctions on the most important sector of the Russian economy would be useful for increasing pressure on Russia. Once such sanctions are imposed, however, Europe and Russia may be locked in a serious dispute. Although the winter energy demand season has ended, Europe that depends heavily on Russian energy supply may see sanctions on the Russian energy sector as too risky unless substitute energy suppliers are secured. Europe still suffers from an economic slump despite long-awaited signs of recovery and seriously fears that sanctions on the Russian energy sector could boomerang. In a sense, Europe will find it difficult to impose sanctions on the Russian energy sector without a grave decision to tolerate any boomerang effect.

As argued by the Financial Times on March 19, however, opinions are growing for resolute actions against Russia after the Russian action brought about serious concerns in the Western world. Recently, I have had opportunities to exchange views with Russian and European energy experts. We reaffirmed that the chance is slim for Europe to subject the Russian energy sector to sanctions, though it cannot be denied flatly, and that sanctions on the energy section would have an impact that would be very great and dangerous. We may have to regard such sanctions as one of the tail risks and closely watch relevant future developments.

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