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U.S. SANCTIONS ON RUSSIA AND ITS IMPACT ON INDIA

Research Paper No. 14

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— Amit Bhandari, Chaitanya Giri & Kunal Kulkarni

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Executive Summary

The U.S. and its European allies have steadily increased economic sanctions on Russia since first imposing them in March 2014. The stated purpose of sanctions is to penalise Russia for its involvement in Ukraine, as well as its alleged cyber-meddling in the 2016 U.S. elections and its transfer of arms to Syria and alleged human-rights abuses, also in Syria.

While the measures initially prohibited westerners from doing business with Russians who were deemed to have undermined democratic processes in the Ukraine, the reasons given for the sanctions have grown and the list of potentially prohibited Russian partners has increased to include officials and businesses in Russia's defence, energy and finance sectors generally. Washington has applied the sanctions flexibly, imposing them strictly in sectors where U.S. firms are major competitors of Russia and ignoring them in others where the U.S. relies on Russia. For instance, the U.S. has exempted Russian agencies that supply titanium for Boeing's commercial aircraft and rocket engines for the National Aeronautics and Space Administration (NASA), where the U.S. has no indigenous capacity.

This means individuals and businesses outside of the western alliance – including ones from India – now may face sanctions themselves if they don't comply with the new rules.

As the economic battle wages, India is caught in the crossfire. Russia is its long-standing strategic partner and, for the foreseeable future, its irreplaceable supplier of defence equipment and weaponry. The sanctions pose significant risks to this vital relationship. Under the sanctions, Indian companies doing business with critical Russian defense suppliers like Rosoboronexport, United Shipbuilding and Almaz-Antey, could find themselves locked out of the dollar-based global financial system controlled by the U.S. Even the activities of Indian companies in areas not directly covered by sanctions could be affected.

Given the risks, India must make some hard calls in deciding a present and future strategy. First, because the sanctions can block violators from doing business with U.S. banks, India must find ways to circumvent the dominant, dollar-based financial system, similar to the specialist European banks with no exposure to the U.S. market, which are willing to facilitate payments to Russia.

Second, India can deepen its investments in Russian energy and resource assets to generate dividend income in Roubles. This will be used to pay Russia for the defence hardware it sells to India.

Third, there are ample precedents for introducing a dose of economic self-interest into American decision-making on the sanctions issue, taking advantage of the deal-making and transactional nature of the current administration in Washington. India must build its profile in the U.S. market, and Indian companies in the U.S. must actively create local jobs, building a goodwill that can influence policy-makers to consider Indian concerns before imposing sanctions.

I. Introduction

Economic sanctions imposed by the U.S. and European Union on Russia have escalated into a virtual economic war, and India may get caught in the crossfire. They threaten India's access to essential military hardware and technology and to a source of energy security.

As the world's top importer of military hardware, India depends heavily on Russia for its purchases of new equipment, maintenance of existing equipment and joint ventures for manufacturing and technology transfer. Between 2007 and 2017, India's defence imports from Russia were about $24 billion from a total of $34 billion. The U.S. sanctions, which target most of Russia's top arms manufacturers, threaten this vital relationship.

The sanctions also stand to jeopardise another partnership between India and Russia: in the energy sector. Companies from both countries have invested over $20 billion in each other's oil industry in the last ten years, steadily expanding their cooperation.

The threat that the sanctions pose to India comes from provisions contained in legislation passed by the U.S. Congress in August 2017[1]. This law authorises the president of the U.S. to impose "secondary sanctions" on non-U.S. and non-European entities that deal with Russian defence and intelligence partners or engage in

The sanctions also stand to jeopardise another partnership between India and Russia: in the energy sector. Companies from both countries have invested over $20 billion in each other's oil industry in the last ten years, steadily expanding their cooperation in this sector.

Indian Prime Minister Narendra Modi and Russian President Vladimir Putin having an informal discussion in Sochi, Russia in May 2018
Source: Ministry of External Affairs, Government of India

certain transactions in Russia's energy sector. The U.S. has been pushing India to increase its defence procurement from the U.S., and it could use the sanctions to add pressure. In the energy sector, America's ally, the European Union, is a big importer of Russia's oil and gas; perhaps as a result, sanctions on Russia's energy sector have been relatively mild and have not affected India.

So far, the U.S. has not imposed secondary sanctions against non-U.S. or non-European individuals or companies for doing business with a sanctioned Russian entity. The U.S. administration might overlook violations of the sanctions by India to meet its critical defence requirements. The proposed 'John S McCain National Defence Authorization Act for Fiscal 2019'[2] allows the U.S. president to allow waivers to the Countering America's Adversaries Through Sanctions Act (CAATSA) in the 'interests of U.S. National Security' – in a likely reference to India's concerns. However, India's long-term defence policy cannot be predicated on waivers granted by a third party or assumptions about how the U.S. will act in a certain situation. Moreover, by seeking a waiver, India tacitly gives credibility to unilateral sanctions.

This policy research paper analyses the western sanctions on Russia and their implications for India-Russia relations. It argues that India must devise mechanisms to ensure its ability to purchase Russian military hardware and services despite U.S. sanctions. To avoid being sanctioned, it must be able to process payments to Russia via banks in the European Union. It also needs to earn income in Russian Roubles so that it can bypass third-party banks entirely and deal directly with Russia.

Finally, India must leverage its status as a large market for energy and defence hardware to conclude strategic deals which can raise its profile within the U.S., making Washington less inclined to include it in its sanctions regime.

India's long-term defence policy cannot be predicated on waivers granted by a third party and by seeking a waiver, India tacitly gives credibility to unilateral sanctions.

II. Overview of sanctions on Russia

1. Primary sanctions: restricting American dealings with Russia

The U.S. first imposed sanctions on Russia through a Presidential Executive Order in March 2014 following the latter's intervention in Crimea. The sanctions prohibit U.S. individuals and entities from dealing with any sanctioned Russian entity. Initially imposed on individuals and entities deemed to have undermined democratic processes and threatened the security and sovereignty of Ukraine[3], the sanctions were extended to include private and state-owned businesses, government officials and select sectors of the Russian economy, including financial, defence and energy[4].

In December 2016, new sanctions were imposed for alleged cyber-meddling in the 2016 U.S. elections[5]. The Executive Orders will continue to apply unless terminated by the U.S. President. Annex I contains a list of the orders and legislation passed for sanctions against Russia.

Persons and entities sanctioned are on a Specifically Designated Nations (SDN) list maintained by the U.S. Department of Treasury's Office of Foreign Assets Control (OFAC). Under OFAC directives the assets of those on the SDN list are blocked, and no U.S. person is allowed to conduct any transactions with those on that list. A separate Sectoral Sanctions Identification (SSI) List, drawn up pursuant to Executive Order 13662[6], prohibits named persons and entities from carrying out certain transactions. (See Annex II).

The sanctions mentioned above prohibit U.S. persons from dealing with sanctioned Russian entities mentioned on the SDN List and therefore, do not affect Indian companies unless they are registered and have operations in the U.S.

2. Secondary sanctions: power to target foreigners

The Presidential Executive Orders that initially imposed sanctions (primary sanctions) against Russia were codified by the CAATSA, enacted in August 2017. CAATSA, which prevents the president from lifting the sanctions without congressional review, specifically requires the U.S. president to impose sanctions on foreign persons who either purposefully violate the sanctions against Russia or deal with Russia's intelligence, defence and energy sectors. These "secondary sanctions" could affect India. (See table 1 below for a list of sanctions that can be imposed on foreign persons under CAATSA.)

Table 1: Secondary sanctions provision under CAATSA

Section	Cause for imposition of sanction	Impact on India
225	This section amends the Ukraine Freedom Support Act of 2014 which provides as under – Persons making significant investment in crude oil projects that are: 1. in the exclusive economic zone of the Russian Federation in waters more than 500 feet deep; 2. Russian Arctic offshore locations; or 3. shale formations located in the Russian Federation.	Indian energy sector companies may lose out on investment opportunities if they are not allowed to invest in certain energy projects in Russia.
226	Foreign Financial Institutions that facilitate significant investments in Russian crude oil projects, prohibited by the Ukraine Freedom Support Act, will be sanctioned.	Indian banking and financial institutions will be wary of financing Indian companies investing in Russian crude oil projects cited in section 225.
228	The Support for the Sovereignty, Integrity, Democracy, and Economic Stability of Ukraine Act of 2014 was amended to sanction the following: 1. persons who violate any license, order, regulation, or prohibition issued under any Executive order, or the Ukraine Freedom Support Act; 2. persons who facilitate a significant transaction, including deceptive or structured transactions, for or on behalf of any sanctioned person or their child, spouse, parent, or sibling; 3. persons responsible for commission of serious human rights abuses in any territory forcibly occupied or otherwise controlled by the Government of the Russian Federation.	Powers under this are wide and can target any company that deals with a sanctioned Russian person or entity.
231	Persons engaging in a significant transaction with a person who is part of, or operates for or on behalf of, the defense or intelligence sectors of the Government of the Russian Federation, including the Main Intelligence Agency of the General Staff of the Armed Forces of the Russian Federation or the Federal Security Service of the Russian Federation.	Defence procurement and joint ventures of Indian companies with Russia could come under scrutiny and affect India's national interests.

Section	Cause for imposition of sanction	Impact on India
	Any person who makes an investment or sells, leases, or provides to the Russian Federation, for the construction of Russian energy export pipelines any goods, services, technology, information, or support which: (1) has a fair market value of $1 million or more; or (2) during a 12-month period, have an aggregate fair market value of $5 million or more.	At present, no Indian energy company is involved in any Russian pipeline projects.
	Persons making an investment of $10 million or more (aggregate in any 12-month period), or facilitating such an investment, if the investment directly and significantly contributes to the ability of the Russian Federation to privatise state-owned assets in a manner that unjustly benefits – (1) officials of the Government of the Russian Federation; or (2) close associates or family members of those officials.	
	A person who has exported, transferred, or otherwise provided to Syria significant financial, material, or technological support that contributes materially to the ability of the government of Syria to: (1) acquire or develop chemical, biological, or nuclear weapons or related technologies; (2) acquire or develop ballistic or cruise missile capabilities;	
	(3) acquire or develop destabilising numbers and types of advanced conventional weapons; (4) acquire significant defence articles, defence services, or defence information; (5) acquire items designated by the President for purposes of the United States Munitions List under section 38(a)(1) of the Arms Export Control Act.	

India's long-term defence policy cannot be predicated on waivers granted by a third party and by seeking a waiver, India tacitly gives credibility to unilateral sanctions.

Section 231 of CAATSA potentially could affect any dealings India has with Russian defence sector entities. A list of Russian defence sector companies, published by the U.S. Department of State as required by Section 231(d) of CAATSA, includes companies like Rosoboronexport, Almay-Antey, Russian Helicopters and MIC NPO Mashinostroyenia. These are some of India's major Russian defence partners.

Restrictions imposed by Sections 225 and 226 on investments in offshore and shale projects in Russia will curb opportunities for India to secure its energy security. The threat of sanctions will deter Indian private and state-owned energy giants from venturing into any restricted activities.

Indian companies and global businesses will be wary of

dealing with Russia given that the penalties for violation of U.S. sanctions could be substantial. For instance, in 2012, HSBC Holdings and Standard Chartered Bank paid fines amounting to $227 million[7] and $1.25 billion[8] respectively for transactions with persons in sanctioned countries, such as Libya, Iran and Myanmar. Chinese telecom equipment company, ZTE, was fined $1.2 billion in 2017 for violating U.S. sanctions on Iran and North Korea. When ZTE made false statements during the probationary period, U.S. companies were barred from supplying any equipment to it for seven years[9].

3. European Union sanctions against Russia

The European Union on March 17, 2014, imposed travel bans and froze assets of persons deemed responsible for actions that undermine or threaten the territorial integrity, sovereignty and independence of Ukraine[10]. The EU sanctions prohibit its members from dealing with sanctioned Russian individuals and entities. The sanctions were first enacted for six months and have been extended regularly since, with the latest extension due to expire September 15, 2018[11].

On July 29, 2014, the EU adopted a comprehensive package of economic sanctions to:[12]

a) prohibit exports of dual use goods and technology for military use in Russia;

b) restrict export of technology related to deep water oil exploration and production;

c) prevent Arctic oil exploration and production, or shale oil projects in Russia;

d) restrict dealings with transferable securities and money-market instruments.

In 2012, HSBC Holdings and Standard Chartered Bank paid fines amounting to $227 million and $1.25 billion respectively for violating sanctions.

The economic sanctions have been extended regularly, and are set to expire 31 January 2019.

Unlike the U.S., the EU conditioned its sanctions solely on a resolution to the Ukraine conflict.[13] It also did not impose secondary sanctions. Because E.U. sanctions are designed to expire automatically unless renewed, they will be easier to unwind than U.S. ones.

III. Selective enforcement of U.S. sanctions against Russia

The U.S. has sanctioned major military, finance and banking institutions of the Russian Federation. Many of the Russian defence companies are important suppliers of equipment to India and partners in joint ventures with Indian defence entities.

Table 2: Some of the major sanctioned Russian defence companies

Section	Impact on India
Rosoboronexport OAO	partner in manufacture of Kamov Helicopters with India's Hindustan Aeronautics Limited (HAL)
Military-Industrial Corporation NPO Mashinostroyenia	partner of India's Defence Research and Development Organisation (DRDO) in Brahmos Project
Uralvagonzavod	supplier of military hardware like T-90 and T-72 tanks to India
United Shipbuilding Corporation	cooperation in shipbuilding (civil and military) with Hindustan Shipyard Limited

Section	Impact on India
JSC Almaz-Antey	manufactures the S-300 and S-400 air defence systems
Kalashnikov concern	largest manufacturer of small arms in Russia

Energy-sector companies in Russia have not been fully sanctioned, but certain restrictions have been imposed on entities[14], including giants like Gazprom and Rosneft. The restrictions include prohibition on any support for Arctic offshore or shale projects by these entities. Further, these entities cannot obtain debt from U.S. financial institutions with maturity longer than 60 days. These restrictions have so far not affected India or Indian energy companies, but if the U.S. clamps down further on Russia's energy sector, India can be hit.

The partial sanctions on the energy sector seem to favour U.S. allies, such as Germany and Italy, which depend heavily on Russian energy exports, even though the U.S. has been pushing these countries to move away from Russia and source their energy from the U.S. instead. This U.S. interest is further evinced by American opposition to the proposed Nord Stream 2 gas pipeline between Russia and Germany[15].

Sanctions on defence and energy-sector companies do not adversely affect the U.S. Russian energy companies that have strong ties with the EU have not been fully blocked. This shows the selective approach adopted by the U.S. in imposing sanctions against Russia. Further, the U.S. has left out sectors and companies of Russia that are closely tied with its own interests.

The European sanctions are designed to expire automatically unless renewed and will be easier to unwind than the U.S. sanctions.

U.S. DEPENDENCE ON RUSSIAN TITANIUM

Titanium, a strong and light-weight element, has become a vital material for manufacturing aircraft. The Russian titanium producer, Verkhnaya Salda Metallurgical Production Association (VSMPO-AVISMA), is the most major supplier of titanium products to the world's largest aircraft manufacturer, the U.S.-based Boeing Aircraft Company. In 2017, Ural Boeing Manufacturing, a joint venture between Boeing and VSMPO-AVISMA, established a large production unit in the Titanium Valley Special Economic Zone in the Sverdlovsk region of Russia[16].

Boeing is projected to purchase titanium worth $18 billion from Russia for its next generation 787, 737 MAX and 777X commercial aircraft[17]. Anticipating close collaboration and economic commitments, the U.S. did not include VSMPO-AVISMA among companies it has sanctioned. But if the U.S. further tightens its sanctions grip, Russia can leverage its control on titanium exports and look at other interested partners like China.

Commercial Aircraft Corporation of China (COMAC) and United Aircraft Corporation (UAC) of Russia are partnering to build the CR-929 wide-bodied, long-haul aircraft. VSMPO-AVISMA is already exporting titanium components for COMAC's smaller regional jet, the CR-919[18]. Considering China's influence over its Belt and Road Initiative partners in Asia and Africa, which promise to become regional aviation markets, Russian titanium will certainly find profitable markets outside of the West.

U.S. DEPENDENCE ON RUSSIAN ROCKET ENGINES

The United Launch Alliance (ULA) is a leading U.S. satellite and spacecraft launch service provider for commercial, civilian and military agencies. It was formed through a joint venture between Boeing Defense, Space and Security and Lockheed Martin Space Systems. The mainstay of the ULA is the Atlas-V expendable launch system, which is capable of lifting satellites up to 20 tonnes to low-Earth Orbit (about 200 km from the Earth's surface) and nine-tonne ones to geostationary transfer orbit (42,000-35,000 km from the Earth's

surface). At present, the Atlas-V uses Russian-made RD-180 rocket engines supplied by a limited-liability company, RD-AMROSS, a joint venture between Russian manufacturer, NPO Energomash, and the U.S.-based Pratt & Whitney[19].

The U.S. has left out sectors and companies of Russia that are closely tied with its own interests.

The Boeing Company has invested billions in Russia's Titanium Valley Special Economic Zone
Source: Titanium Valley

Recognising its lack of indigenously-built rocket engines, the U.S. categorically exempts NASA and other non-defence agencies and customers from Russia sanctions[20]. Neither the Russian space agency, the Roscosmos State Corporation for Space Activities (ROSCOSMOS) nor RSC Energia, a prominent shareholder in NPO Energomash, have been sanctioned by the U.S.

Titanium and rocket-engines are only two examples where the U.S. has been lax on certain Russian entities on which it is dependent, and hence vulnerable to possible counter-sanctions. The continuing trade and co-operation between the U.S. and Russia in these sectors, critical to both their economies, demonstrate that Moscow-Washington tensions have not reached breaking point yet.

IV. Impact of sanctions on India

India's relationship with Russia is mainly in the defence and energy sectors, and Indian entities in these sectors are potentially in the line of fire. The consequences Indian companies face in dealing with Russia, whether through trade or investment, could be on three fronts:

1. Companies that are not exposed to the western markets may not fear being directly sanctioned for business dealings with Russian companies. But they will still be affected by the restrictions on the access to western financial and banking systems. Further, companies with exposure to the U.S. may not be willing to deal with them.

2. Most Indian multinational companies have a significant exposure to American and European markets. They will not risk irking the U.S. government. This is especially true if their turnover in Russia is less than it is in the western markets.

3. If sanctioned, an Indian company will be unable to receive loans exceeding $10 million or engage in other

banking or foreign-exchange transactions with American financial institutions[21]. They also will be prohibited from receiving investments from a U.S.-based person or entity[22].

Russia can leverage its control on titanium exports and look at other interested partners like China.

The U.S.' Atlas-V rocket, launched with an RD-180 engine, procured from the Russian manufacturer, NPO Energomash
Source: United Launch Alliance

DEFENCE SECTOR

India's engagement with Russia in the defence and energy sectors includes bilateral trade and investment, involving joint ventures and manufacturing. Each of these can be affected in different ways.

a. Procurement of spare parts, sub-systems (existing deals)

India's military imports from Russia for 2017 totalled $1.9 billion. The majority of this went on spare parts for existing military equipment and sub-systems for equipment being built in India.

The Indian Air Force will soon be upgrading its fleet of Sukhoi Su 30-MKI air superiority fighter jets, its front-line aircraft. The Su-30 MKI is currently equipped with N011M passive electronically scanned array (PESA) radar developed by the Tikhomirov Scientific Research Institute of Instrument Design. The IAF intends to upgrade almost 40 of its Su-30 MKI with a highly superior Zhuk Active Electronically Scanned Array (AESA) radar, which is developed by Phazotron, a subsidiary of Concern Radio Electronic Technologies. All these Russian companies are sanctioned by the U.S.

Under a very strict reading of CAATSA, all of this trade could be subject to sanctions. However, the U.S. Department of State, in a briefing on secondary sanctions, said there will be a 'significance threshold to the implementation of the law.'[23] This suggests that such imports relating to existing equipment and sub-systems may not attract sanctions from the U.S.

b. Procurement of new equipment (new deals)

Purchases of major new systems, such as the S-400 ballistic missile defence system developed by Russia's

Recognising its lack of indigenously-built rocket engines, the U.S. categorically exempts NASA and other non-defence agencies and customers from Russia sanctions.

Almaz-Antey, which India proposes to acquire, can cross the significance threshold mentioned in CAATSA. The authority to determine whether a transaction is significant lies with the U.S. Department of State which has stated that it "will consider the totality of the facts and circumstances surrounding the transaction and weigh various factors on a case-by-case basis."[24]

This could lead to sanctions on Indian entities acquiring new equipment. The U.S. effectively could prevent any dollar-based payment for these systems. Admiral Phil Davidson, Commander of the U.S. Indo-Pacific Command, opined that imposing sanctions under CAATSA on partners like India, Vietnam and Indonesia for buying Russian equipment, could have an adverse effect on their relationship with the U.S.[25] It will have to be seen what steps the U.S. president and secretary of state take.

India's purchase of the S-400 system in the future can cause complications, in addition to violation of the sanctions. First, the S-400 is an advanced system which can keep the U.S. air force out of large chunks of global airspace. Second, India uses hardware from multiple sources – Russia, France, the U.S., U.K. and Israel. In the digital world where systems interact with each other and need to be integrated, rival vendors like Russia and the U.S. will not be at ease, sharing top-of-the-line hardware with customers operating competing systems.

c. Joint ventures

India is building a domestic defence industrial base to reduce its dependence on imports. Forming joint ventures with foreign military suppliers for access to technology and knowhow is an important strategy for achieving this goal. Russia, which has developed and manufactures advanced land, water and air systems, is a natural partner. India's Defence Research and Development Organisation and Russia's MIC NPO Mashinostroyenia have already developed a successful partnership to manufacture the Brahmos missile[26]. India's Hindustan Aeronautics Limited (HAL) has formed a joint venture with Rosoboronexport and Russian Helicopters for manufacture of Ka-226T helicopters in India[27]. Mashinostroyenia and Rosoboronexport are both sanctioned by the U.S. Department of Treasury.

So far, there are no reports that the India-Russia joint ventures will be targeted by the U.S. under the secondary sanctions provisions. However, if the sanctions are strictly implemented, the U.S. may sanction these Indian entities. Again, payments for these systems may be difficult if dollar-based transactions are prohibited.

Finally, a long-term issue that India must evaluate for its defence preparedness is the evolution of old and new alliances: deteriorating U.S.-Russia and U.S.-China relations, a simultaneous improvement in Russia-China ties .

ENERGY SECTOR

India is the world's third largest consumer of energy and a major importer of oil and natural gas, and its demand is growing. Russia is the world's second largest exporter of oil and the top exporter of gas.

India's energy imports from Russia are minimal because of logistical issues: Russia has large energy consumers (Western Europe, China, Japan and South Korea) right at its borders, while India finds it cheaper and closer to import oil from West Asia.

Indian companies have invested more than $10 billion in acquiring stakes in Russian oil fields (See Table 1). Russia's oil major, Rosneft, acquired India-based Essar Oil (now Nayara Energy) with its 20-million-tonne petroleum refinery, in 2016 for $13 billion.

If sanctioned, an Indian company will be unable to receive loans exceeding $10 million or engage in other banking or foreign-exchange transactions with American financial institutions.

Table 3: Indian investments in Russia's energy sector

Sr. No.	Russian entity/ gas field	Indian entity (Stake)	Investment	Sanctioned
1	Vankorneft	ONGC Videsh Ltd. (26%);	$2.2 billion (2016)	SSI - Directive
		Oil India Ltd, Indian Oil Corporation Ltd and Bharat PetroResources Ltd (23.9%)	$2.02 billion (2016)	2, Directive 4
2	Tass-Yuriakh	OIL-IOC-BPRL (29.9%)	$1.121 billion (2016)	No
3	Licence 61	Oil India Ltd (50%)	$85 million (2014)	N.A.
4	Imperial Energy	ONGC Videsh Ltd. (100%)	$2.1 billion (2009)	No
5	Sakhalin	ONGC Videsh Ltd. (20%)	$1.7 billion (2001) + $1.1 billion (2004)	N.A.

Source: Collated and analysed by Gateway House from various sources.

Russia's Rosneft is the parent company of two Russian energy companies that have received Indian investment: Vankorneft and Taas-Yuriakh. Rosneft and Vankorneft are both on the SSI list and are subject to restrictions, including prohibition on U.S. persons from extending new debt for a maturity period longer than 60 days and any support in exploration or production for deepwater, Arctic offshore, or shale projects.

India can choose to make further investments in Russia's oil and gas industry to reduce its vulnerability to high oil prices subject to the restrictions under Directives 2 and 4 (See Annex II).

COUNTER SANCTIONS BY RUSSIA

On 4 June 2018, Russian President Vladimir Putin signed the Federal Law No. 127-FZ on Counter-Measures for Hostile Actions of the United States and Other Foreign States[28]. Russia has not enlisted the names of the companies that will be sanctioned, but these counter-sanctions could hit the U.S. in sectors that have not been sanctioned by the U.S. so far, including important metals exports, like titanium, and technology, such as rocket engines. India could be affected in turn, as several Indian companies have partnered with U.S. companies in these sectors. For example, Mahindra Defence Systems and HAL have recently entered into a joint venture with Boeing to build the F/A 18 Super Hornet fighter aircraft in India.[29]

Since India has been vocal in not accepting unilateral sanctions by the U.S. and EU against Russia, it needs to examine whether counter-sanctions implemented by Russia will affect Indian firms and businesses.

V. Navigating the sanctions

ALTERNATE FINANCIAL INTERMEDIARIES

If India, as expected, decides to ignore the U.S. sanctions and proceed with military purchase or collaboration with Russia, the primary problem will be payment to Russian entities outside the dollar-based system. Sanctions make payment in dollars impossible. This is similar to the problem India faced in its energy trade with Iran in the last decade.

India might seek to revive the Rupee-Rouble trade, which it had with the former Soviet Union. But in the absence of significant export products from India to Russia, this is not an option in the short term. Moreover, there were issues relating to calculation of repayment of the amounts due to the Soviet Union. Unless an equitable calculation mechanism is set in advance, this option does not seem viable.

Payment in Euros might be possible. Most leading European banks will not facilitate these transactions for fear of falling foul of U.S. financial regulators. But a number of smaller European banks without a presence in the U.S. can be used to make payments for Russian spare parts and other support until India can put longer term measures in place. Some of them don't deal in dollars, and often, have been set up to facilitate dealings with specific countries. Some examples are:

1. EIH Bank (Europäisch-Iranische Handelsbank AG): a specialist bank with three branches, two in Iran and one in Germany, to facilitate business with Iran.

2. Bank of Cyprus: this bank has three representative offices in Russia apart from its branches in China.

3. RCB Bank: based in Cyprus, this bank is co-promoted by Russia's VTB (46.29%) Bank along with Crendaro Investments Limited (49.9%). It has a representative office in Moscow.

4. Banca Popolare di Sondrio: an Italy-based bank that has facilitated transactions with Iran in the past and has representation in Russia.

In the digital world where systems interact with each other and need to be integrated, rival vendors like Russia and the U.S. will not be at ease, sharing top-of-the-line hardware with customers operating competing systems.

GENERATING ROUBLE INCOME

The long-term option for India is to pay for Russian hardware in Roubles, bypassing the dollar-based system entirely.

Given India's limited exports to Russia, generating the volume of Roubles will be a challenge. This can be partially worked around. India's state-owned oil companies – ONGC Videsh, Bharat Petroleum and Indian Oil – have stakes in several Russian oil and gas fields. Dividends accruing to these three companies will be in Roubles.

India also can set up a specialised bank which will facilitate trade and money transfer with Russia and which has no exposure to the U.S. financial market. The dividends payable to Indian firms could be deposited into this bank and then be remitted to India in Rupees. Simultaneously, payments to Russian weapons manufacturers can be made by this bank in Roubles on behalf of India's defence entities – even though this amount will be limited. OVL's total profit for FY18 was Rs 916 crores ($134 million).

This amount can be increased if the Indian government, through an investment arm, acquires a minority (less than 5%) stake in resource companies such as Rosneft. Rosneft produces more than six million barrels/day of oil – and has committed to paying out 50% of its profits as dividends. In 2017, Rosneft paid out 104 billion Roubles[30] ($1.78 billion at 2017 exchange rates[31]). Income (and dividends) for 2018 will be higher as oil prices have firmed up this year. Rosneft's income is in U.S. dollars, while expenses are in Roubles – so the depreciation of the Rouble against the dollar wouldn't hurt profitability. Since energy investments are not prohibited by U.S. sanctions, these investments can be made freely. An investment in Rosneft will protect India against high oil prices to some extent.

India must invest in other natural resources in addition to the oil industry. With one-sixth of the world's population, India will need almost all types of resources in large quantities as it grows. One other example of a potential investment could be PhosAgro, a manufacturer of phosphate fertilisers, which India imports[32]. Since food products are not covered by sanctions, these investments could help secure resources for the future and guarantee a rouble income to support India-Russia trade.

A long-term issue that India must evaluate for its defence preparedness is the evolution of old and new alliances: deteriorating U.S.-Russia and U.S.-China relations, a simultaneous improvement in Russia-China ties.

Table 4: Potential revenue from Russian investments for payments for Indian defence imports

Potential revenue from Russian investments for payments for Indian defence imports				
	Share Price*	Dividend/ Share **	Dividend Yield	Yield for every $1 billion investment in common stock ($ million)
Gazprom	145.6	8.00[33]	5.50%	55
Rosneft	436	9.80[34]	2.20%	22
Surgutneftgas	28.2	0.65[35]	2.30%	23
Novatek	1,067	14.95[36]	1.40%	14
Phosagro	2,531	81.00[37]	3.20%	32
Tatneft	784.8	39.94[38]	5.10%	51
* As on 28 August 2018				
** Dividend/Share for 2017				
If $1 billion is invested in each of the five Russian companies – Gazprom, Rosneft, Surgutneftgas, Phosagro, Tatneft – it would have yielded an annual dividend to India of $183 million in 2017.				
Given that India's total defence imports from Russia for FY 2017 was $1.9 billion, a $10 billion investment in Russian companies would have yielded an annual dividend of $366 million – enough to cover approximately 20% of annual payments owed to Russia.				

INCREASE INDIA'S PROFILE IN THE U.S.

India needs to raise its profile in the U.S. so that its concerns about defence preparedness and energy security carry more weight in Washington. One way is to create U.S. dependence on India for jobs. The current U.S. administration has shown itself willing to cut 'deals' and is headed by a president who prides himself as a deal-maker. Offering the U.S. tangible gains at home can help India generate the political capital to bypass the sanctions. On a recent visit to the U.S., India's Union Minister of Commerce and Industry and Civil Aviation, Suresh Prabhu, spoke of enhanced trade cooperation with the U.S., especially purchase of civilian aircraft and oil and gas procurement[39]– these will generate jobs on U.S. soil.

India can follow a similar, pragmatic approach in other areas like gas and defence procurement:

1. Source American gas

Increased dealings of Indian energy companies in Russia will surely come in for scrutiny in the U.S. The potential risk on this front can be reduced by linking U.S. energy jobs with Indian energy companies like Indian Oil, ONGC Ltd. and Bharat PetroResources Ltd. The U.S. has become an exporter of Liquefied Natural

Russia's counter-sanctions could hit the U.S. in sectors that have not been sanctioned by the U.S. so far, including important metals exports, like titanium, and technology, such as rocket engines.

India's ONGC Videsh has a large stake in Russia's Sakhalin offshore oil and gas project
Source: PJSC Rosneft Oil Company

Gas (LNG) due to shale gas production. During FY18, India imported merely 300,000 tonnes of U.S. LNG out of total imports of 20 million tonnes. India sourced 5 million tonnes of LNG from Nigeria, Angola, Equatorial Guinea and Australia last year; this volume can be shifted to U.S. suppliers, helping make the U.S. more engaged with India's energy needs.

2. Military procurement

India will have to alter its defence procurement needs, given the reality of CAATSA. An unwritten American objective of CAATSA is to get a larger share of India's defence imports for American manufacturers. India can use this lever strategically to link American defence jobs to Indian defence public sector undertakings (PSUs) as a counterweight against potential U.S. action aimed at Indian companies. This leverage can provide cover for India's dealings with Russia till India is able to develop more permanent bypass mechanisms to facilitate trade with Russia.

The U.S. formed the India Rapid Reaction Cell to expedite bilateral ties with India. It has already cleared the sale of F-16 and F/A-18 fighter jets to the Indian military in an arrangement that includes a proposal to shift production lines to India. Given the Indian Navy's rejection of the Tejas aircraft, India should seriously consider procuring F/A-18 super hornet fighters. HAL, which has joint ventures with Russian defence companies, must partner in any such arrangement. This will give India a cushion and tie HAL into high-tech, export-oriented manufacturing jobs in the U.S., giving it political cover against sanctions. Also, India must consider sourcing non-critical defence equipment from U.S. vendors – and again route these purchases through the PSUs that handle Russian imports.

India also must leverage its partnership with Israel's defence sector. Private Indian companies like Larsen &

India needs to generate a Rouble income to pay for Russian military hardware. India's state-owned oil companies have stakes in several Russian oil and gas fields. Dividends accruing to these three companies will be in Roubles.

Toubro have partnered with Israel Aerospace Industries, Rafael Advanced Defense Systems and Elbit Systems. Israeli backing for India is likely to mitigate the threat of sanctions.

India may face an uphill battle if the economic war between the U.S. and Russia intensifies. Adopting the short-term and long-term strategies recommended in this paper will alleviate some of the pain of possible U.S. actions against India. Insulating private-sector and state-owned entities from U.S. sanctions must be the priority while ensuring the smooth flow of trade in the defence and energy sectors.

Annexure I: U.S. sanctions against Russia

Date	Legal document	Sanctions imposed
6 March 2014	E.O. 13660[40]	Sanctions imposed on persons directly or indirectly involved in any actions that: 1. undermine democratic processes and institutions in Ukraine; 2. threaten peace, security, stability, sovereignty, and territorial integrity of Ukraine; 3. amount to misappropriation of state assets of Ukraine or of an economically significant entity in Ukraine; 4. assert governmental authority over any part or region of Ukraine without the authorisation of the Government of Ukraine; This includes any person or leader or an entity who has materially assisted, sponsored, or provided financial, material, or technological support towards any action mentioned above.
16 March 2014	E.O. 13661[41]	This E.O. expanded the scope of sanctions to include: 1. officials of the government of the Russia Federation 2. persons operating in the arms or related material sector An annex to the E.O. listed the names of seven Russians, including Deputy PM Dmitry Rogozin.
20 March 2014	E.O. 13662[42]	Sectoral sanctions introduced to impose prohibition of certain activities in sectors like financial services, energy, metals and mining, engineering, and defence and related material. The Sectoral Sanctions Indications list includes entities sanctioned under this E.O.

A potential investment for India could be PhosAgro, a manufacturer of phosphate fertilisers, which India imports. Since food products are not covered by sanctions, these investments could help secure resources for the future and guarantee a rouble income to support India-Russia trade.

Date	Legal document	Sanctions imposed
3 April, 2014	Support for the Sovereignty, Integrity, Democracy, and Economic Stability of Ukraine Act[43]	Enacted to provide for cost of loan guarantees and other assistance to Ukraine. Amended by CAATSA to impose sanctions on foreign persons purposefully violating the sanctions against Russia and those who facilitate a significant transaction, including deceptive or structured transactions on behalf of any sanctioned person. Enacted to provide for cost of loan guarantees and other assistance to Ukraine. Amended by CAATSA to impose sanctions on foreign persons purposefully violating the sanctions against Russia and those who facilitate a significant transaction, including deceptive or structured transactions on behalf of any sanctioned person.
8 May 2014	Ukraine-Related Sanctions Regulations[44]	OFAC issued a set of regulations to implement E.O. 13660, E.O. 13661, and E.O. 13662.
19 December 2014	E.O. 13685[45]	Prohibition on export or import of any goods, services or technology to or from the Crimea region of Ukraine; new investment in the Crimea region of Ukraine by a U.S. person, wherever located.
1 April 2015	E.O. 13694[46]	Sanctions imposed on persons engaging in significant malicious cyber-enabled activities. This included: 1. actions that harm the critical infrastructure sector; 2. misappropriation of funds, trade secrets, personal identifiers or financial information.
28 December 2016	E.O. 13757[47]	E.O. 13694 expanded to include misappropriation of information with the intent of undermining election processes or institutions of the U.S.
2 August 2017	Countering America's Adversaries Through Sanctions Act[48]	This Act, passed by the U.S. Congress: 1. codified all previous Executive Orders with respect to Russia; 2. introduced Congressional review mechanisms for waiver or termination of any sanctions imposed against Russia; 3. introduced secondary sanctions to target any foreign person or entity that has dealings with a Russian individual or entity sanctioned by the U.S.

Source: U.S. Treasury website, collated and analysed by Gateway House

India can strategically link American defence jobs to Indian defence public sector undertakings as a counterweight against potential U.S. action aimed at Indian companies.

Annexure II: Prohibition on activities and limitation on transactions under E.O. 13662

Date	Sector	Prohibition/Limitation (as per latest amendment)	Directive
1.	Financial	For new debt or new equity issued on or after 28 November 2017, all transactions, including financing for new debt of longer than 14 days maturity or new equity of persons determined to be subject to this Directive, their property, or their interests in property.	Directive 1
2.	Energy	For new debt issued on or after 28 November 2017, all transactions, including financing for new debt of longer than 60 days maturity of persons determined to be subject to this Directive, their property, or their interests in property.	Directive 2
3.	Defence and related material	All transactions, including financing for new debt of longer than 30 days maturity of persons determined under this Directive, their property, or their interests in property.	Directive 3
4.	Energy	Export or re-export of goods, services (except for financial services), or technology in support of exploration or production for deep-water, Arctic offshore, or shale projects that have: 1. the potential to produce oil in the Russian Federation; 2. the potential to produce oil in any location and where a person sanctioned under this directive has 33% of greater ownership or majority voting rights.	Directive 4

Source: U.S. Treasury website, compiled by Gateway House

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