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Some recommendations for policymakers

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CENTRUM BALTICUM

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Summary

In assessing Moscow's drivers on the Ukrainian track and prospects for dialogue with Kyiv it would be more considerate to identify some rather sensitive challenges for Russia in terms of economic and financial burdens. They are apparently less scrutinized, though bearing a long time imprint on Russian strategic movements. It could assist to evaluate possible no returns in bilateral relations within a variety of probable scenarios, including gradual defrosting the temperature between Moscow and Kyiv. These challenges stem from already made decisions to at least minimize dependence from Ukraine in a number of economic cooperation areas. The decisions have already resulted in substantial financial and economic costs. This is valid in particular for the defense industrial complex and a number of civil industries. Russia would try its best to shrink supply channels of some strategic commodities. Russian business would stay caught in an unexpected cold shower of the conflict calculating damages and without bright hopes for returning to Ukrainian market. With cutting ties in economic cooperation Moscow with Kyiv offer themselves larger maneuverability for their decisions and moves – but with bleak views about possible warming up relations.

Keywords

Russia, Ukraine, economic costs, import substitution, sanctions, foreign direct investments, defense-industrial complex

Experts' evaluations of economic and financial costs for Russia brought about by the conflict with Ukraine are mainly limited with sanctions and Moscow's retaliatory initiatives. Both have produced a negative impact on Russian economic resources, living standards, financial potential and other internal difficulties. Illusions to lift sanctions in the nearest future are dispelled, keeping alive reciprocity trend.

But real value springs from many more factors. All of them have become directly or indirectly interwoven and crammed in a short period of time. That makes the load for Russia more onerous.

A highly intense information collision vs. Ukraine and the West has led to a substantial re-allocation of national resources to the engaged mass-media leverages. The conflict might have already requested at least hundreds of millions of USD.

Just a dynamics of budgetary flows to state-controlled off-line media assets and enhanced on-line activities invite for having a clearer view of supply costs on this front. Plus state donations for different "soft power" endeavors and numerous public activities borne by the conflict. Among "dividends" from these investments is the unprecedented rise of anti-Ukrainian and anti-Western sentiments. They do a favorable turn for advocates of "Fortress Russia", bold ill for a turnaround in relations along the Western borders and have a longer-term effect inside the country.

Though the relations with the West and NATO have started to evidently deteriorate since 2012, the conflict itself has substantially contributed to opening the floodgates to a speedy revision spiral up of the Russian military budget to more than 4% of GDP with additional financial gifts to other security-related structures. It has together complicated meeting financial obligations and priorities set before, including social commitments, as well as regular budget planning process.

Despite high oil prices, the symptoms of economic stagnation were also traced before the conflict. Prices' slump in 2014 along with sanctions and further economic deterioration could logically have presented a serious deterrent remedy against military appetites even on the way to cooling off environment with the Western partners. But the flames of the Ukrainian conflict have weakened Kremlin's potential to curb growing military and security appetites at the expense of health care, education, scientific and many other national programs and in the longer term – of the economic development.

These are just two examples of longer-term consequences both for domestic and foreign policies sustained by substantial financial injections. The list can be supplemented again and again.

In assessing Moscow's drivers on the Ukrainian track and prospects for dialogue with Kyiv it would be more considerate to identify some rather sensitive challenges for Russia in terms of economic and financial burdens. They are apparently less scrutinized, though bearing a long time imprint on Russian strategic movements. It could assist to evaluate possible no returns in bilateral relations within a variety of probable scenarios, including gradual defrosting the temperature between Moscow and Kyiv.

Defense-industrial complex

The breakup of cooperation between the defense industry complexes (DIC) seems to be one of the most painful blows for Russian interests and costs. High sensitivity is indicated by a very dynamic and scale up reaction to abdicate dependence from Ukraine particularly on this track, supplemented by mutual embargoes on interaction.

On the first wave of sanctions Moscow announced a national prompt plan of “import substitution”, i.e. to replace import products from involved countries with national ones by developing Russia’s own capabilities where possible.

With certain successes in agricultural sector, civil industries, like machinery, still face high barriers to fill the gap in the domestic market. Russia keeps its stance as an import-addicted country in a vast list of the developed world’s output.

So far, Kremlin can praise itself with a certain break-through exactly in dumping Ukrainian DIC for Russian needs. In autumn 2016 the Defense Ministry assured about completion of substitution programs for 70-80% and their fully expected implementation by the early 2018[1]. Though later the Russian government changed a timetable for complete independence in military components to the end-2018 and 2019. Besides in early 2017 Ministry for Industry and Trade assessed the level of substitution at more than 50% - vividly less than the assurances of their military colleagues.[2]

Nevertheless, a comparison even of “more than 50%” with other efforts alike beyond DIC shows more fortune in Moscow’s efforts in substitution for the military needs. It also indicates that the driving motive behind the overall import-substitution policy has been a mobilization of resources to develop alternative supply chains for replacing exactly Ukrainian military products. This has been perceived as one of the most urgent tasks in reacting to the conflict.

Given several specialized or unique supplies from Ukraine to the Russian DIC together with a high degree of their sensitiveness it is presumed that these chains must be cut and mainly replaced by Russian own products without any major outside sources. This has driven to additional and substantial costs for creating or modernizing an adequate research and industrial infrastructure and within a limited time span.

Indeed, such a speed-up and encompassing program has had to be strongly resourced. While no hopes for other outside sources with an inability to have adequate replacements might lead to cancelling or postponing certain Russian armament programs as well. Due to a high dependence on the Ukrainian products and know-how a new challenge for Russia on this track has been among the most significant.

Before the conflict the cooperation involved 859 Russian and 79 Ukrainian arms producers. Russia accounted for 80% of Ukraine’s military-technological cooperation with the annual amount of USD 200 million[3]. Though these figures didn’t cover the whole width of cooperation because of many secret contracts it indicated a high degree of coherence anyway.

In 2013 the Ukraine’s share in Russian DIC was 3.5% (non-Russian sources estimate it at 4.4%)[4]. But Kyiv supplied several products vital for Russian needs. Already in 2014 Ukraine’s embargo on cooperation with the Russia’s DIC affected every fifth arms deal for Russian navy and air forces.

Moreover, about one third of Ukrainian exports included key components for Russian Intercontinental Ballistic Missiles (ICBMs). The guidance systems for two other types of ICBMs were developed and produced in Ukrainian Kharkov. So far these three types of missiles comprise over a half of all Russia’s strategic nuclear arsenal.

1 www.ria.ru/defense_safety/20160929/1478145245.htlm
2 www.geo-politica.info/razryv-s-vpk-ukrainy-tochka-nevozvrata-pro…
3 www.ng.ru/economics/2014-06-18/1_oboronka.htlm?print=Y
4 Ibid

Until 2014 the mutual military supplies comprised 7,000-8,000 items (final products and components) that were usually not disclosed in open databases of export/import flows. Russia accounted for 70% of components exported for Ukrainian DIC.

In turn about 400 Russian arms producers depended on component's supplies from Ukraine. There were about 3000-4000 thousand Ukrainian components for Russian arms. For full replacement of these supplies with its own Russia would need to allocate approximately USD 10 billion or more to revise some procurement plans.[5]

The above mentioned and varied official assessments of substitution indicate at least two options. Such plans could be practically met by delayed timetables and by additional resources. Where it is not possible, some military procurement programs should be aborted. But in any option the priority to neutralize the dependence from Ukraine is the Moscow's strategic choice regardless of the turn of events. Positive trends could only assist to keep just a very limited list of products and without complete cuts in cooperation.

In better times this cooperation, besides energy supplies and transits, was one of the strongest binding requisite to keep bilateral relations firmly afloat. Now and in the foreseeable future this requisite does not and would not work.

Moreover, there are other demanding consequences for Russia. First, Moscow has decided to get rid of cooperation for its DIC not only with Ukraine, but together with many other countries. Russia has developed close ties with several NATO and EU members in importing components for military hardware. Now this honeymoon seems to be over – in Kremlin's plans a divorce is oriented to 2020-2021, i.e. slightly later than with Ukraine. But that would be also touchy for financial re-allocations to substitute the gap whether from other sources or by developing own capabilities. These options raise additional and burdensome repercussions and cost-effectiveness' challenges.

Second, with its bleak analysis of the deterioration of the Ukrainian DIC Moscow might anyway calculate its recovering and developing ties with the West and NATO in order to adjust to their standards. This provides another strong deterrent against restoring wide cooperation with the Russian DIC – again, in any situation, including a possible way out from the conflict. Certainly, except a scenario of Kyiv's choice to be under Russian umbrella, what seems hardly realistic so far.

Breaking up cooperation in research and production

The speedy shrinking of cooperation in civil research and production projects closer to a complete halt seems to be another painful implication of the conflict for Russia.

It has demanded large-scale and dynamic corrections in production schemes and financial re-allocations. In order to at least mitigate unforeseen transformations and to meet updated pronounced plans to lessen or completely neutralize weighty interdependence with Ukraine. Moreover, many tracks of cooperation were dual-oriented – also to the needs of the Russian DIC.

Bilateral dependence featured a very high level of cooperation among enterprises, companies, ministries and research institutes. In a whole range of key and strategically important products it was beyond ties that Russia had with other Commonwealth of Independent States' (CIS) members, not to say about other partners.

5 www.rbc.ru/newspaper/2014/06/18/56be74729a7947299f72ceef

Like with DIC, already on the first wave of the conflict and sanctions Moscow initiated a strategic turn over from Ukraine in civil research, technological and production interactions. This shift has already indicated some advantages for developing Russia's own capabilities. But with obvious higher costs than in the course of sustainable cooperation or in case of gradual cutting ties in more selective areas and projects. A frontal reaction in a swift replacement of Ukrainian-made products and know-how along with some of Ukraine's unique specialization has also brought about problems for fast adequate replacements in terms of quality and cost-effectiveness.

In spring 2014 Russian Ministry for Industry and Trade estimated the overall portfolio of Russian orders already placed with Ukrainian enterprises at USD 15 billion.[6] As the result of the conflict and Kiev's sanctions, this portfolio huddled very rapidly and substantially. The difficulties for implementing plans pronounced in Moscow to offset these losses have been accompanied by serious complications in finding other partners in CIS and outside the Commonwealth, aggravated by Western sanctions. It could not but affect to fulfill plans for replacing imports with Russian products.

In the *aviation industry* Russian cooperation with Antonov State Corporation has been stopped. "AN" aircraft were assembled in Ukraine and in Russian Ulyanovsk, Samara and Voronezh. But as the intellectual property rights on most of the designs belong to "Antonov", Russia is hardly able to produce these airplanes on its own. The country has to allocate at a very short notice additional funds to upgrade and produce its own "IL" airplanes as an adequate replacement for "AN" airplanes. The estimated sum of costs for the period of 2016-2020 is about USD 160 million.

In *helicopters' production* Russian enterprises used to heavily rely on Ukrainian engines and some other components. By 2014 an approved contract prescribed for importing 400 engines from Ukrainian "Motor-Sich" Company, but the Kyiv's ban abrogated it. The suspension of cooperation with "Motor-Sich" is fraught with a reduction of the number of helicopters produced in Russia and take years to find alternative sources for components, taking into account highly qualitative versions of the Company's new engines.

In *rocket-building* the Ukrainian plant "Yuzhmash" accounted for 80% of orders from Russia. But already in 2014 the volume of contracts was reduced more than 60 times (from USD 106 million to USD 1.75 million). Afterwards the cooperation has virtually stopped and Russia's faced a need to find ways to compensate this loss with prompt development of its own capabilities.

In *space industry* a task to neutralize the dependence on Ukraine requires additional costs in the current and planned federal programs – approximately up to about USD 150 million. It could take at least 5 years only to replace Ukrainian supplies with Russian electronic components.

In *shipbuilding* the break-up in the cooperation made Russia face a risk of failing the contract of 17 navy vessels with the amount of USD 4 billion because they needed Ukrainian engines. Kyiv placed an embargo on these supplies. These engines are planned to be produced in Russia what requires considerable additional costs. [7]

6 www.government.ru/news/16118

7 It should be noted here that Russia before the conflict accumulated stockpiles of Ukrainian products, components in particular, and can maintain final production for a certain period of time. But later further shrinking of available stockpiles could additionally affect production processes in Russia, if no measures for their replacements are taken. The above figures in: www.bgsience.ru/lib/34711;www.w82.ranepa.ru/rnp/wpaper/1854.pdf

Along with pure military research and production fundamental shifts in the civil industrial cooperation have forced Russia to make changes in its production infrastructure, again supported by substantial financial donations. In April 2017 President Putin stressed that these shifts vis-a-vis Ukraine had led to creating "the whole new industrial sector."[8]

Also for producing it's own items Russia has had to buy a number of needed equipment from other countries (like machine tools) to produce components or final products what has made it more autonomous from Ukraine but with additional costs.

Nuclear industry

Cooperation in nuclear energy sector is particularly sensitive for Russia as one of the key and most delicate areas of cooperation where Ukraine accounted for 25% of all Russian exports of nuclear fuel and 20% of natural uranium for the Russian industry came from Ukraine by 2014. Before the conflict the annual volume of exports by Russian monopolist Corporation "Rosatom" was at USD 600 million[9] with a slight increase in 2015 to USD 610 million and decrease to USD 450 million in 2016. i.e. down to less than 30% of the overall earnings of "Rosatom's" subsidiary – "TVEL" Corporation - from almost 50% before.[10]

With 95% of the Russian share in the Ukrainian market before the conflict, in 2016 Kyiv decided to get 5 out of 15 active power generating units of fuel from the Western company "Westinghouse". Before this decision Russia's officially agreed future share was set to 12 out of 15 active power generating units of Ukrainian nuclear power plants.

In 2017, it further increased to 40% for "Westinghouse". Moreover, last December the Ukrainian government tightened its plans vis-à-vis Russia by sharing a vision to buy 55% of nuclear fuel from "Westinghouse" in 2018. This is fraught with violating a long-term contract with "Rosatom".

In November 2016 Kyiv also adopted a Concept for the Development of Nuclear Energy Sector until 2020 that revisited former plans for establishing independent production of nuclear fuel for domestic nuclear power plants. The program aims at dealing with the problem of complete dependence of nuclear power plants on imported nuclear fuel. The plan is to increase the production of concentrated uranium until Ukraine is self-sufficient by 2020. It seems to be very ambitious and hardly implementable, but the official guideline for continuous offensive moves against "Rosatom" is obvious.

The Russian costs also include the revenues that Russia could lose starting from 2017 for nuclear waste management (though Kyiv was constantly behind in payments, and in May 2016 it made "Rosatom" refuse to take spent nuclear fuel from the territory of Ukraine). The price of these services provided by Russia was in the range of USD 150-200 million a year.[11]

Another victim are interests in modernizing infrastructure in Ukraine. The contract under which "Rosatom" was to construct two new energy blocs at Khmelnytska Nuclear Power Plant in Ukraine with the amount of USD 3 billion was terminated. Controlled by "Rosatom" the Russian company "Atomenergomash" lost about USD 10 million because of the suspension in the supply of equipment to upgrade Starobeshivska electricity generation station in Donetsk Oblast.

In its turn Ukraine sold a number of equipment items, primarily turbines, for Russian nuclear power plants (USD 2.2 billion in 2013). The plan to reduce this dependence will also require considerable expenses.

8 www. Gazeta.ru/army/2017/08/09/10825502
9 www.kommersant.ru/doc/3000690
10 Kommersant, December 22,2017
11 www.minprom.ua/page2/news174393

In the short run the risks for Russian enterprises encompass the termination of cooperation in the production of nuclear reactors, boilers and power units for nuclear power plants. In the longer perspectives the risk is that Ukraine would completely or partially stop buying Russian fuel.

Strategic commodities

Moscow's course to reduce dependence from Ukrainian supply of some strategic commodities has affected and will continue to have effect on additional costs incurred. Though with less challenges and urgency compared with DIC.

There could be a need for allocations in the development of mining sites inside the country as well as securing supplies from other markets that may add costs in terms of prices, logistics, etc. For example, Ukraine provided manganese products with 17% discount from market prices what made it a leader among other competitors for Russia. Ferroalloys were imported also with dumping prices.

Russia showed a high dependence on the supply of zirconium, an important commodity for nuclear energy sector. It raised this issue to the highest level in Moscow at the end-2016 to initiate a dynamic development of the site in the Tambov region with planned investments about USD 200 million for 4-5 years.[12]

It is not surprising that already in May 2014 Russia adopted The Strategy for the Development of Steel Industry providing for the reduction of raw materials imports, including manganese ore. However, the low quality of this ore's resource base in Russia requires considerable investments, including the development of Usinskoe deposit.

In order to reduce the dependence on Ukraine Russia has already started designing or reviving old plans to develop own deposits. This means addition burden on Russian finances and investment priorities.

Financial risks

The conflict has made it very problematic meeting a number of obligations stated by the Ukrainian government prior to it. The risks still valid comprise:

1. Risks for payments (in any form) of Ukraine's public debt owed to Russia and Russian legal entities under the "compensation of losses" clause because of the conflict (Crimea, crisis in the Eastern Ukraine, etc.). As of April 30th, 2014, Kyiv's obligations included: the national loan given by Russia – USD 606 million; Eurobonds owed to Russia (issued in December 2013) – USD 3 billion; publicly guaranteed debt owed to Russian banks – "VTB" (USD 257 million), "Gazprombank" – USD 500 million, "Sberbank Rossii" – USD 529 million (the total USD 1.29 billion).[13]

Overall the sum of the Ukrainian state and state-guaranteed debt to Russia by the first stages of the conflict reached almost USD 4.9 billion. Taking into account an increasing burden for Kyiv's payments (overall for 2018-2020 at USD 64.2 billion, including almost USD 30 billion for foreign debt)[14], it is highly problematic for Russia to hope for a full compensation even of these debts. Even despite the Western pressure, Ukraine is still reluctant to return USD 3 billion from Eurobonds.

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12 www.wtcmoscow.ru/pressroom/eksperty-informiruyut…tonkoy-nastryki-torgovoy-politiki-i-importozamescheniya-mater/

13 Russian official data

14 www.tass.ru/ekonomika/4560118

2. Risks for the Russian property. It is extremely difficult, if not possible, to calculate the value of the Russian property under risks. Before the conflict most of it comprised investment coming directly from Russia or via third countries without combined reflections in statistics.

3. Risks for direct investments. By the beginning of 2014 Russia accounted for USD 17 billion of accumulated direct investments in Ukraine (though the Central Bank of Russia limited this amount at USD 6.0 billion).[15] But then the tempo of the FDI withdrawals accelerated: by the end of that year the amount dropped to USD 8.6 billion and in 2015 to USD 8.2 billion. Thus, the period of 2014-2015 saw the reduction in the accumulated Russian direct investments in Ukraine by USD 8.8 billion, or almost by half from USD17 billion before the conflict.[16]

Despite some recent reports about slight increases of Russian FDI, besides certain activities in the banking sector the real trend indicates another direction. According to Statistical Office of Ukraine, as of July 1, 2017 the amount of these FDI was USD 4.4 billion.[17]

It should be noted that the lion's share of Russian FDI was not in the Crimea, but in other regions of Ukraine (the value of Russian assets in Crimea– over USD 1 billion before the peninsula joined Russia).[18] A rapid shrinking of Russian FDI in a non-comfortable business environment from the waves of conflict and in a deteriorating economic situation in Ukraine shows definite losses in this process.

The list of largest FDI contributions is now limited only to VS Energy, while before the conflict it comprised several wealthy corporations (Vympelcom, Rosneft, Evraz, etc.). VS Energy controls assets in almost half of the Ukrainian regional power companies.

The great majority of Russian companies assess the Ukrainian market with a high degree of prudence for the foreseeable future. It drives them from increasing their asset base, which, in turn due to continuous devaluation of the local currency, is tantamount to their impairment. This is valid for retail trade companies with a permanent process of shrinking their assets. They are accompanied by oil, petrochemical and metallurgical companies, which have been withdrawing their assets as well.

Russian companies with a few exceptions restrict themselves from public analysis of their losses in Donbas and Lugansk. While Mechel has recognized complete losses of the value of its large plant in Donbas, many others have not opened fresh assessments.

In turn, Ukrainian investments in Russia have continued to shrink. Some of their companies (Milkiland, Armavir Rolling Mill, etc.) have lost their assets or gone bankrupt. There is no bright horizon for a slight increase of Ukrainian FDI in Russia. Even some economically promising projects face uncertain future.[19]

4. Risks for payment of debts incurred by Ukrainians legal entities (besides the state and state-guaranteed debts) owed to Russian legal entities under the same "compensation of losses" clause. The amount of this debt is impossible to evaluate since there is no detailed statistics for that. Open claims involved only the debt of "Naftogaz" to "Gazprom".

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15 Calculations of FDI made by Eurasian Development bank with the Institute of World Economy and International Relations (IMEMO) which are, in our view, the most reliable.

16 "Monitoring of Mutual Investments in the CIS, 2016", Eurasian Development Bank, Report No 9, 2016, p. 20.

17 Kommersant, October 4,2017

18 "Monitoring of Mutual Investments in the CIS, 2015", Eurasian Development Bank, Report No 32, 2015, p. 10.

19 Monitoring of Mutual Investments in CIS Countries. 2017. Eurasian Development Bank, Report No.45, pp.30-31

For evaluating amounts under some of the above groups of risks it is better to refer to the assessments made by Russian Prime Minister D. Medvedev in mid-2014: Ukraine's public and corporate debt to Russia was USD 16 billion including 3 billion in Eurobonds and about 2 bln of debt owed to "Gazprom".[20] But even taken for granted, this assessment did not include the legal penalties demanded by "Gazprom" for 2012 – 2013 contracts, what increased the Ukrainian debt to USD 18 billion, plus its claims for additional USD 4.4 billion made after the Prime Minister's statement. Thus, taking into account the absence of the necessary statistics about some groups of risks, by mid-2014 the total amount of just Ukraine's public and corporate debt might have reached at least USD 36 billion.

Nevertheless, only open claims from the fourth group indicate that their amount and risks of possible losses for Russia have been increasing, despite some sporadic Kyiv's positive moves by transferring US$ 3.1 billion in Autumn 2014 to "Gazprom". By December 2017 the sum of "Gazprom" claims to Ukrainian "Naftogaz" reached 37 billion USD.

In turn, the latter's counter-claims make up 26.6 billion USD. This means that in case of a compromise, "Gazprom" can hardly reach its claims entirely. Even a decision of the Stockholm Arbitrary Court at the end - 2017 can provide only slightly more than 2 USD billion from "Naftogaz".

Overall, without the conflict the chances to have at least a large share of these debts compensated would have been much higher. In the current situation they are in fact miserable, apart from the debt in Eurobonds and partial compensations to "Gazprom".

Russian banks' assets

The conflict has exposed Russia's banks to serious risks for their financial and property assets in Ukraine. These risks involve Kyiv's claims seeking damages, default on contractual obligations, the operation of banks with Russian capital in Ukraine, nationalization (expropriation) of assets and the property of companies with Russian capital, growing discomfort for Russian business activities, etc. Some of the risks have already resulted in substantial costs.

It is impossible to define a preside amount of Russian deposits in Ukraine even on the verge of the conflict. There is no detailed available statistics from both sides.

As an approximate guideline, the National Bank of Ukraine provided its data as of December 30th, 2013. "Foreign currency and deposits" liabilities (obligations) consisted of deposits of non-residents in Ukrainian depositary institutions in the amount of USD 15.1 billion (no assets in the National bank and USD 12.3 billion in interbank transactions). If to rely on these figures the hypothetical maximum ceiling of Russian deposits could not have been above it.

Russian bankers prefer broader calculations. In the late 2014 during the closed meeting with Prime Minister D. Medvedev they estimated that the conflict and the growing risks might eventuate in losses in Ukraine around USD 25 billion.[21] The net assets of Ukrainian subsidiaries of the Russian banks accounted for about half of this total. Assets of "Prominvestbank" (owned by the Russian state's Vnesheconombank) – USD 4 billion, Sberbank-Ukraina – USD 3.4 billion, Alfa-Bank Ukraina – USD 2.4 billion, VTB-Ukraina – USD 2.4 billion, BM-Bank – USD 250 million. Another half consisted of their investments in businesses of Ukrainian subsidiary companies (investments in real estate, offices and branches, purchase and lease of land, etc.).

20 www.nv-online.info/by/462/world/80108/Медведев-Долг-У….
21 www.rbcdaily.ru/finance/562949992792670

According to FitchRatings in early 2014, the risks for Russian banks in Ukraine amounted to USD 28 billion what was slightly more than the amount announced by bankers. But "Fitch", for example, included into this amount a debt of USD 500 million to "Gazprombank".[22]

The above figures provide a guideline for evaluating possible portioned or complete losses of the Russian subsidiaries in Ukraine. They also address possible costs for foreign direct investments from Russia. The prime channel of FDI flows from Russia has been traditionally occupied mainly by the bank community. Vnesheconombank, VTB Group, Sberbank and Alpha-bank provided substantial capital support for their subsidiaries. Nevertheless, the latter have been with permanent losses.

Even with the financial support they have failed to increase their equity. In general, large Russian banks, let alone medium-sized (which have been disappearing from the market), found themselves in a very uncomfortable position aggravated by the Ukrainian economic crisis.

First, some of them have come under Western sanctions that have limited or barred their access to foreign loans and refinancing. That has led to substantial difficulties in supporting their subsidiaries in Ukraine and to appeals to the government for assistance from the federal budget. It's worth mentioning that many Russian banking institutions, for various reasons, including sanctions, have refused to meet the Kremlin's recommendations and closed their operations in Crimea. That has deprived them from additional dividends in the Crimean market.

Second, even if they are ready to get rid of their assets in Ukraine the selling price would be significantly below the price than four years ago. Taking this into account, in 2017 the VTB Group (16th rank in the Ukrainian banking system) has assessed possible losses from closing its Ukrainian branch for more than USD 400 million. Almost the same amount is predicted by Sberbank for it's assets.[23]

Third, due to the economic situation in Ukraine Russian banks have sacrificed substantial operational losses. Only in 2015 VTB, Alfa-Bank and Prominvestbank accounted for 40% suffered by the whole Ukrainian banking system.[24]This trend is still alive. For example, VTB Ukraina has been out of pocket for more than USD 40 million in the first two quarters of 2017.

Also the banks have had serious difficulties in the lending segment, obtaining a high share of individually impaired and overdue loans. In addition, by the end-2015 they lost their licenses at the Ukrainian stock market aggravated by Kyiv's sanctions against them in September 2015. These sanctions are more severe than Western sanctions and demand from the banks to conceal their Russian origins.

Besides banks with Russian capital the payment systems also come to suffer significant losses. In October 2016 Kyiv introduced new sanctions that barred Russian payment systems from working in Ukraine. According to the Bank of Russia, in 2015 alone the amount of money transfers from Ukraine to Russia was USD 157 million and from Russia to Ukraine the amount reached USD 988 million. In these transactions Russian payment systems accounted for a considerable part.

Until recently Ukraine has been the third largest recipient for money transactions from Russia. That is why Kyiv's decision can make Russia lose channels, clients and incomes. Experts estimate that these Russian companies could have to cede their operations in Ukraine with the total amount of USD 1 billion a year to their competitors.[25]

22 Ibidem
23 Kommersant, May 30,2017
24 www.kommersant.ru/doc/3071227
25 www.rbc.ru/newspaper/2016/11/09/5821c68a9a79478612744d8a

There are ways for them to continue their operations through subsidiaries that are not affected by sanctions by involving foreign companies, but that would require additional expenses. In any case Russian operators would inevitably experience an increase in the costs of doing business by about 15-20% what undermines their competitiveness compared to other foreign companies.

Concluding remarks

The evaluation of Russia's economic costs triggered by the conflict with Ukraine should be linked with a wide variety of the conflict's consequences. Among those are above mentioned sanctions against Russia and retaliation, deterioration of the outside environment being harmful for the country's development, spiking tension in relationships with the outside world, curtailing political, economic, commercial and many other ties with Ukraine, large-scale expenses for new "acquisitions" (Crimea) and for treating severe "headaches" (Donbas).

The fallout for Moscow is not limited exclusively by the unexpected turn of events and the tough conflict with its high waves. It has been enhanced with the shock from the slump in oil prices which Russian economic and financial muscles are mostly dependent on. With the significant depreciation of RUR this shock has had a significant effect on the adjustments in a long list of plans set before the conflict – starting from domestic priorities to foreign policy behavior.

In this fallout economic considerations and hardships have only quite recently started to influence and gradually press on popular slogans in Russia that Crimea and the conflict with Ukraine must be dealt with "at all costs". Nevertheless, there is still the inertia of "political expediency" in the decision-making mechanisms and in budget planning. That makes an obvious impact on disregarding the economic and financial burden, including costs stemmed from the strategic choice to neutralize dependence from Ukraine where possible. The key stake seems to have been made and has already eaten substantial resources.

Some prospects provide clearer view for Russia vis-à-vis Ukraine. Even in case of warming up relations there will be no return to past relations between defense-industrial complexes – one of the corner stones of stability. It is hardly possible to return to previously closer ties in civil industries and research communities. Moscow would continue its line to lessen dependence from Ukrainian in strategic commodities.

Kremlin would fight hard to make Kyiv meet its financial obligations, but without hoped bright perspectives in the foreseeable future. At the same time with the continuous energy it will try to defend interests of "Rosatom" and nuclear cooperation as a certain "island of stability" of interdependence. But, again, with substantial losses compared with better times.

Finally, Russian business is hardly to return massively to Ukrainian market along shrinking the presence of the "last warriors" (large banks and very few corporations) that are still fighting to stay in Ukraine. And this trend would be more realistic to be maintained in the nearest future.

One should not be charmed with the latest statistics about a slight trade revival between Russia and Ukraine starting in 2017. The results are incomparable with pre-conflict times and seem to be of a tactical nature. The same impression stems from information about increases of FDI what is just an indicator of activities of the "last warriors" to save their subsidiaries.

The above sensitive areas of former interdependence are more robust indicators for the fact that the river has been almost crossed. A Russian "ferry" has been approaching to another bank from where there is no easy way back. Also, a price for tickets has been very high.

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