

Forcing Russia to Respect Minsk Protocols with dollar auction-game model

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Abstract. Four years of active international sanctions against Russia have brought no signs of visible progress, neither in terms of respecting Ukrainian territorial integrity or the agreements of Minsk and Sevastopol, nor in terms of Putin's regime leaving power. The EU-US negative conditionality (sanctions) against Russia seems to be losing its momentum despite new measures taken and prolonged in 2017. Russia's annexation of Crimea as well as the separatist control across the strategically important industrial and resource rich cities of the Eastern Ukraine has not been effectively dealt with. Accordingly, in many aspects the situation meets Russian expectations to retain the occupied territories and wait for the softening of international reactions. Thus, there are good grounds for inquiring into the possibility of the West taking control over the situation in Ukraine and ending the geopolitical power struggle in the region. It is in this context that the game theory, and particularly the "dollar auction game" strategy, offer an intriguing insight into the dynamics of the escalation of the conflict and a dynamic model, thereby showing some future-oriented alternatives of how to get out of the crisis before the costs become excessive for all the "players" involved.

Received:
February, 2018
1st Revision:
May, 2018
Accepted:
July, 2018

DOI:
10.14254/2071-
8330.2018/11-3/1

Keywords: Russia, sanctions, conditionality, interdependence, game theory.

JEL Classification: F1, F5, P4

1. INTRODUCTION

Four years ago, the international community imposed their sanctions on Russia. Yet, there are no visible signs of progress towards a comprehensive settlement of the Russian-Ukrainian conflict, be it in terms of restoration of the territorial integrity of Ukraine, full implementation of the Minsk agreements, or indeed the resignation of (at least some of) the political elite in Russia. No credible solutions have been tabled since the crisis escalated: Russia's annexation of Crimea as well as the separatist control across the strategically important industrial and resource rich cities of Eastern Ukraine has not been effectively dealt with. On the contrary, political and economic pressure on Russia has decreased over time. Even when sanctions are prolonged both by the European Union and the US, the economic situation in Russia is slowly stabilizing after the turbulence in 2015-2016: the economy has contracted at a slower pace from the fourth quarter of 2015 on (The Statistics Portal, 2017), the inflation rate has dropped from 15-16 percent in the second half of 2015 to 2,5 percent in the end of 2017 and the exchange rate of Russian ruble has strengthened from spring 2016 on (Bloomberg Markets, 2016). According to the estimates of the IMF the growth should resume in 2018 and 2019 (IMF, 2016), especially when the prices of oil and gas are growing. Thus, since 2017 Russian economy is showing some signs of adopting to a "new normality", supported by high oil prices and the Asian markets.

It is abundantly clear that the measures taken so far by the Western allies have proved inefficient for achieving the desired effect. Russia will not change its behavior should the West continue to use its existing "toolbox" in the current way (including targeted sanctions) and especially when there is a hope that the sanctions might end in 2018-2019. Hesitation to strengthen the sanctions and the support of Germany and France in particular would be interpreted by Russian political elite as a strategic victory over the West and be exploited locally in a "rally-around-the flag" process to consolidate support to the regime and even further boost nationalist sentiments in Russia. Thus, there are good grounds for inquiring into the possibility of the West taking control and showing initiative over the situation in Ukraine and ending the geopolitical power struggle in the region.

The current study aims not only at analysing the sustainability prospects for each side to survive the effects of conflict and sanctions, but attempts to map and analyse the Russian-Ukrainian conflict in the light of the game theory strategies so that to suggest measures which could be used to stabilize the situation in Ukraine. Additionally, this study aims to deliver new insights into the discussion by exploring the possibilities and thereby making suggestions of how the conflict could be potentially resolved using game theory tools. Thus, the game theory models that best describe the policy choices of the parties to the conflict will be discussed and analysed in the context of strategic interests of the players. More precisely, the study describes "gains" and "losses" of both parties to the conflict, identifies the time horizon of the conflict resolution and makes some suggestions on further measures which should be used to resolve this conflict.

Methodologically speaking, the current article will test the benefits of evaluation and forecasting of the game theory models when adapted to the current circumstances of the EU-Russia sanction standoff. The authors combine qualitative approach with a quantitative analysis of the main macroeconomic indicators for Ukraine and Russia. As regards the contribution of the current study to the debate, the article provides new insights to the discussion by making suggestions of how this conflict could be potentially resolved using appropriate game theory tools.

As the authors see it, earlier studies on this topic such as (Cowen, 2014) and (Ericson and Zeager, 2015) rather focus on the most likely scenario during the conflict, but not on the measures which may contribute to the resolution of the conflict.

2. THE “SANCTIONING WAR” IN THE FRAMEWORK OF GAME THEORY AND STRATEGIC THINKING

In theory, the outcome of mutual sanctions or sanctions answered with countermeasures imposed during the current Ukrainian-Russian conflict could be associated with strategic behaviour and game theory scenarios. In the respective academic debates sanctions as a form of negative conditionality have mostly been associated with the linear “more pain, more gain” logic or the balance between what a country has to gain from its behavior and what it loses from restrictive measures imposed by other countries. However, both of these approaches are relatively useless in the current situation because the West has avoided putting serious economic pressure on Russia, and the returns and costs associated with the conflict are, neither for Russia nor the West, limited solely to financial returns and costs. What’s more, the current situation does not correspond to the traditional logic of bargaining theories where the highest bidder wins, the second one keeps its money and the bids end when the expected real value of the “prize” is reached. Hence, the current conflict should be analyzed in a wider context, applying dynamic game theory models on bargaining between nations. While the game theory also has its limits in explaining the logic of international negotiations, it nevertheless contributes to a better understanding of non-cooperative behavior and conflict escalations between countries or nations.

In the dollar auction game, there are two “bidders” interested in the “prize” which is one dollar. Both players make bids and the highest bidder wins the prize. However, the second highest bidder has to also pay whatever the second highest bid was without getting a prize. What makes the dollar auction game particularly interesting is that there is no neat game theory solution like in the prisoners' dilemma or chicken game. In this sense, the model illustrates a paradoxical situation in which even under complete information leading to rational choices participants nonetheless make ultimately irrational choices. In theory, the critical trespass for the auctioneer is met when one of the players bids 55 cents. As the sum of the two highest bids surpasses one dollar, the auctioneer will receive a profit. The critical zone for the bidders arrives when one player has bid one dollar. Curiously, whereas beyond this point both players will ultimately be losing, they are still motivated to raise the bid. Otherwise they lose money with certainty and indeed become the loser. In practice, the game could lead to completely irrational bids in total amounting to three and five dollars for a one dollar bill (Shubik, 1971, p. 110).

When considering potential game strategies, the most rational behaviour would be if both players do not make any bids in a dollar auction. However, from the perspective of the game theory, this strategy does not represent the equilibrium of the game due to the dynamic nature of the model. More specifically, assuming the second player knows the first player has no intention of making a bid, the second player would still make a bid to win the game. Other reasonable strategies would be to make a binding agreement between both players to bid low and split the prize later, or make it clear to the opponent the player is intending to bid to a maximum amount until their opponent quits the auction (O’Neill 1986, pp. 33-50). In this regard, cooperation, deterrence or even a combination of these two strategies could come into consideration as rational choices to win the “prize”. Even quitting the auction first and losing the prize could be considered as a rational strategy in situations where cooperation is impossible and the opponent continues with irrational and aggressive bids. Whilst the second highest bidder makes losses by quitting, it still allows the player to avoid higher losses in the future due to the escalation of the game.

Game theory models, including dollar auctions are often applied in various fields, from economic relations to diplomacy. For example, an overview of game theory models applied in studies of international relations and security and defence studies is presented by Correa (2001). Similarly to the above-mentioned strategies, in studies of international relations, the choices of players vary from cooperation to confrontation. For example, some authors have argued the conflict should not lead to conflict escalation (O’Neill, 1986, pp. 33-50), whereas others are convinced that “once the contest has been joined, the end will be a disaster

to both” (Shubik, 1971). As stipulated by Shubik (1971, 111), “there is no neat game theoretic solution to apply to the dynamics of the Dollar Auctions, or to the escalation between two nations *in abstracto*”. In a particular context, Poundstone (1992, 1) has suggested that the problem might stem from the difficulties in drawing a line between a rational bid and an irrational one. Moreover, under certain circumstances the balance between cooperation and conflict is possible (the so-called mixed-motive game), after bargaining has reached a stage where each player is locked in place by the other player’s demands.

However, it should be noted that researchers of international relations have been somewhat hesitant in using parlor game models to explain conflict escalations between nations. This is mainly because communication conditions are arguably different in theoretical parlor game models and in practical conflict-resolution between countries. For the latter, there is a possibility to carry out negotiations by fiduciaries, to collect information on the intentions of opponents at any time and to make decisions with large time-lags (Shubik, 1971).

To sum it up, it is most likely that an aggressive and irrational player determines both the dynamics and the outcome of the game and wins the “prize” by forcing their opponent to run out of resources or lose the motivation to carry on. Citing John Kay (2011), “the smaller loser is the person who sticks out longest. That is not usually the rational player” (Kay 2011). The question of how long the player is interested in continuing the game depends not only on the available resources but also their current position (i.e. whether the player has already achieved its objectives or sees a realistic chance to achieve them) and communication (i.e. whether the player succeeds in communicating with the opponent about their intention to keep bidding until the opponent quits the game). If the player has already achieved its aims and has an aggressive bidding record, it is unlikely that the bidder will take a step backwards and consider quitting the game. A salient role in the game can be played by the path-dependence factor: the more the bids rise and distance from the actual value of an auction object, the more the bidders are depending from the already taken costs than from the actual measurable value of an auction object.

Thus, if the choice is between losing everything or raising the bid, irrational choices are likely to be expected. The same logic applies to the abovementioned chicken game model in a situation if one of the players with less negotiating power is still strongly motivated to “drive straight forward”, whereas the more influential player is less motivated to win. The rational choice would be to cooperate and to find a solution which partially satisfies both parties of the conflict. However, in practice the non-cooperative behaviour which follows the dollar auction model is highly likely under these circumstances. However, what makes it difficult to choose between quitting and bidding is the changing nature of the players’ motives as the dollar auction game proceeds (Shubik 1971). At the start of the auction bidders are motivated by a desire to participate, to “have fun”, to gain an easy return or to maximize on it. As the game (or the conflict) escalates, bidders’ motivations change again, focusing on a minimization of their losses and, if possible, maximization of the opponent’s losses. Later on, the aim of the bidders changes again focusing on preserving one’s own identity (by “saving face”) or destroying their opponent.

3. THE SANCTIONS AND COUNTERMEASURES OF OPPOSING SIDES

The political tensions between Russia and Ukraine in 2013 have culminated in the violation of territorial integrity of Ukraine and the annexation of Crimea in March 2014 and military conflicts in the eastern part of Ukraine forced by Russia from 2014 on. To force the conflict towards a peaceful solution, the EU and its partners have decided in March 2014 to use targeted sanctions to put pressure on Russia. The scope of individuals and entities subject to the Western sanctions has been widened in April (Council of the European Union, 2014a), May (Council of the European Union, 2014b and Council of the European Union, 2014c) and July (Council of the European Union, 2014d and Council of the European Union, 2014e) 2014. Russia

responded with introducing retaliatory measures against high-ranked officials of the EU in March 2014. On 30 July 2014, the EU announced new sector-specific sanctions against Russian military industry and its financial and energy sector (Council of the European Union, 2014f), which restricted country's access to the international capital markets and placed an embargo on trade of arms and sector-related materials and technologies. As a countermeasure, on 6th August 2014 the Russian president Vladimir Putin signed a decree "On the use of specific economic measures", which mandated an one-year embargo on the large number of agricultural products from the Western countries (Government of Russia, 2014a and Government of Russia, 2014b). In September 2014, the leaders of the EU and the US have agreed on additional sanctions, forbidding state-controlled Russian oil and defence companies from raising money in the European capital markets and cutting off foreign investments (Council of the European Union, 2014g). Further additions to the list of persons, organizations and companies under sanctions have been made in November 2014 (Council of the European Union, 2014h and Council of the European Union, 2014i). On 22 June 2015, the EU Council extended economic sanctions against Russia until 31 January 2016. On 13 March 2017, the Council prolonged the restrictive measures over actions undermining or threatening the territorial integrity, sovereignty and independence of Ukraine for a further six months, until 15 September 2017. Despite Russian efforts to lift the sanctions the Council decided on 21st of December 2017 to prolong the sanctions against Russia until 31. July 2018 (Council of the European Union, 2018). The measures consist of asset freezes and travel bans. The list was reviewed and the Council removed two deceased persons from the list of persons and entities subject to these restrictive measures, which now apply to 150 persons and 37 entities (Council of the European Union, 2017).

This decision followed the agreement reached at the European Council in March 2015 that the sanctions against Russia should be directly linked to the complete implementation of the Minsk agreements (Council of the European Union, 2015b). The Council of the European Union also stressed that the EU remains ready to reverse its decisions and re-engage with Russia when the country starts to contribute to the solution of the Ukrainian crisis actively and without any ambiguities. Russia responded with additional sanctions in 24 June 2015 and with additional legal and economic measures to integrate Crimea on 15th July 2015 (President of Russia, 2015). In July 2015, both the leaders of the European Union and the US have agreed on additional sector-specific sanctions against Russia (Council of the European Union, 2015c). The European Union has additionally used the normative power concept to call Russia to cooperation and a responsible behaviour in regions which should benefit all the stakeholders. However, Russian leadership has showed very low interest to meet the EU expatiations and follow the proposed norms (Veebel 2018b). In terms of expected policy change and criteria the sides have been less precise. The EU and its allies have stressed the importance to fulfil Sevastopol and Minsk treaties and respect Ukrainian territorial integrity, while Russia has stressed that countermeasures are there because of anti-Russian sanctions and can be ended when the sanctions are lifted. While the sanctions have had changing aims especially from the EU side, the current study evaluates the success based on three scenarios. First, the western sanctions can be rated effective when Russia will respect Minsk and Sevastopol treaties, will withdraw from East-Ukrainian territories and will respect the Ukrainian territorial integrity. Russian approach can be rated successful both in cases when Crimea and Eastern Ukraine will not be returned under Ukrainian governance or when the Ukrainian economy will completely collapse by causing public riots and political instability. Accordingly, when Ukraine and the EU need for success an actual change in terms of territorial integrity, Russia can also be satisfied with the existing status quo (Veebel & Markus, 2015).

4. APPLICABILITY OF THE DOLLAR AUCTION GAME FOR THE RUSSIAN-UKRAINIAN CONFLICT

Since the interplay of reciprocal sanctions can be associated with strategic behaviour, this paper assumes that in order to understand sanctioning wars the game theory could be summoned to help. As mentioned in theoretical part, there are many similarities between the dollar auction game and the current conflict and sanctioning war between Russia, the EU and its allies. There are at least two bidders who have bid against each other (Russia and the Western coalition); there is an object which can be described as a “prize” (Ukraine); both bidders are interested in winning the prize (i.e. both parties in the conflict have made “bids” and imposed sanctions to put pressure on the opponent to force it to withdraw from the conflict); only one of the bidders can win the prize (consider Russia’s ambitions in the region; Ukraine cannot remain divided between Russia’s and the EU’s sphere of influence in the long term); and finally, both parties to the conflict fully pay for everything which means the second bidder will lose everything that has been put on the table but will not receive the prize (resources that were spent during the Ukrainian conflict will not be “compensated”).

Thus, basic conditions of the dollar auction game are met in the case of the Russian-Ukrainian conflict. Both Russia and the Western allies are “bidding” for Ukraine and a cooperative solution is most unlikely. Both parties to the conflict have already made “losses” to stay in the game and these losses (similarly to potential costs that will be made in the future) will not be compensated (Veebel & Markus, 2016a).

However, the application of the parlor game models in explaining the conflict escalation between nations should, as mentioned earlier, be treated with caution. Indeed, this is also partially true in the Russian-Ukrainian conflict, given the Western world has not fully suspended diplomatic relations with Russia (Van Ham 2015, p.4), leaving the platform open for communication and signaling. However, the estrangement of relations between these former “strategic partners” (which became evident in the early 2010s following President Vladimir Putin’s suggested revision of Russia’s foreign policy and revealed an ambition to establish the Eurasian Union) has weakened mutual incentives to cooperate and negotiate. At the beginning of the Russian-Ukrainian conflict, political contact with Russia was interrupted for a short time, when bilateral negotiations with Russia on visa matters were cancelled, the New Agreement between the EU and Russia and the negotiations over Russia’s OECD membership were suspended and the G-7 meeting was held in Brussels instead of the G-8 meeting in Sochi (Veebel & Markus 2016b, p.134). In this sense there are reasonable grounds for analyzing the escalation of the conflict in Ukraine on the basis of this theoretical framework. In addition, both parties to the conflict had to make decisions to impose or extend sanctions in a relatively limited time frame, leaving little room for negotiations or discussions. In this light, the current Russian-Ukrainian conflict in many ways resembles the opposed game theory model.

5. ACHIEVING IMPACT IN THE RUSSIAN-UKRAINIAN CONFLICT

Following the logic of dollar auction, the game is dominated by a bidder who makes highest bids, has an aggressive bidding record and is clearly determined to win the “prize”. Considering that the final outcome of the game is determined by resources, positions and communication, the EU and its allies should actively intervene in the conflict, harm Russia’s bargaining position and push Russia to run out of resources or the motivation to achieve its aims in due course forcing them to withdraw from the conflict in Ukraine. Alas, hitherto the West has not taken the initiative in the Russian-Ukrainian conflict. This concerns both the evaluation of the conflict and measures implemented. Instead of asking of how to resolve the current conflict, the focus of the West has been on the question why things are as they are. Hence, the current situation is mostly assessed on the basis of historical or cultural aspects, or theories of international relations or geopolitical models, instead of analyzing the key elements and dynamics of the conflict itself.

While the benefit of understanding the situation cannot be denied, without understanding the dynamics of the crisis and knowing the critical limits of the opponent it is difficult to design an efficient, pro-active strategy to resolve the conflict. Therefore clear understanding is needed about the motives of the “players” (i.e. what they seek to achieve) and the value of the “bid” (i.e. what they can afford to lose) to change the current situation. However, what makes assessing the motives of opponents complicated in the Russian-Ukrainian conflict is that one needs to understand first who the “bidders” are, and only then can we analyze their motivation to either exert further force in, or to withdraw from, the conflict. As for Russia, is it the Russian political and economic elite controlled by President Putin or the Russian people who should at some point in time lose motivation? Or which key “players” at an EU level should lose motivation when extending sanctions: the European Commission, the Council, Member States, their governments, or somebody else? Furthermore, some EU Member States such as Greece or Cyprus could run out of motivation fairly easily, whilst others such as the Baltic countries could run out of finances but not motivation (Veebel & Markus, 2016b).

Russian political elite on the one hand, and the EU’s foreign policy chief and the head of the European Council together with political leaders of Germany and France, and indeed with the USA, on the other, have a key role to play in determining the outcome of the conflict. These persons or groups have sufficient political power to influence either public opinion and attitudes in Russia or the decision-making process in the EU. So far, the former has actively or even aggressively intervened in the conflict, while the latter have remained largely passive and have sent mixed signals. However, there is a realistic chance that political relations between the EU and Russia, together with the Union’s role in the Russian-Ukrainian conflict will be revised in the nearest future, particularly in light of the forthcoming revision of the EU’s strategy on Russia. Considering the recent re-escalation of military tensions in Ukraine and the forthcoming discussion on the EU’s strategy on Russia, there is every reason to discuss both the ambitions and the limits of the opponents with the aim to understand how the West could take control of the situation in Ukraine.

The dynamic of the motives of the EU and its allies in the Russian-Ukrainian conflict are in line with the theoretical model of how the motives of the “players” are bound to change during the game. At the start of the conflict in spring 2014, the aim of the EU was to influence the situation in Ukraine (i.e. to take part in conflict resolution). This assessment is borne out by the fact that the first-round sanctions constituted of relatively weak measures without specific aims, as only later the extension of sanctions was linked to compliance with the Minsk agreements. However, after the conflict had reached alarming proportions by summer 2014, the motivation of the EU changed from mere “participation” to the goal of increasing the economic costs of the conflict for Russia while decreasing the costs for Ukraine. The following steps taken by the EU, particularly from 2016 on, clearly refer to the Union's ambition to preserve its identity as the major guarantor of peace and stability in Europe (Veebel 2018). This motive came to replace the older one of maximizing Russia’s losses. From the EU’s perspective, the increasing influence of Russia in the region would directly imply a failure of the European Neighborhood Policy and its numerous partnership initiatives.

At the same time, Russia’s motives differ significantly from the theoretical model of the dollar auction game. Since the beginning of the conflict in 2014 up till now, Russia’s “hidden” agenda consists most likely in gaining easy returns while keeping costs for the opponents (particularly Ukraine) as high as possible, despite mutual losses caused by Russia’s countersanctions. This would help Russia to force Ukraine to withdraw from the conflict, i.e. to leave some districts in Eastern Ukraine under the control of Russian-backed separatists and to accept the annexation of Crimea by the Russian Federation. Considering both the relative size of the economy of the EU and its allies and the fact that Russia has avoided imposing sanctions in the energy sector, it is unlikely Russia has ever seriously considered maximizing economic losses for the EU at any cost. The fact that Russia has despite obvious evidence denied its participation in recent regional

conflicts, such as denying shooting down a drone over Abkhazia in April 2008, sending troops to Abkhazia under the guise of railway workers in May 2008, denying their participation in the military conflicts in East Ukraine in 2014-2015 and suggesting that Russian soldiers and military hardware in Ukraine are volunteers, clearly proves Russia has no great motivation to “save face” and remain a credible partner in the international arena. At the same time, the most recent steps taken by the country in the Middle East region as well as in eastern part of Ukraine and Crimea indicate Russia is well aware of the shaky position of the EU in promoting peace in target regions of the EU neighborhood policy (Veebel, Kulu and Tartes 2014).

To sum up, at this stage of the conflict Russia is primarily interested in keeping the costs of the conflict as high as possible for Ukraine, to force Ukraine out of the game first, even when doing harm to itself and its international reputation. The coalition of the EU and the US is foremost interested in saving their reputation and keeping the losses as low as possible, but nevertheless not “losing” Ukraine to Russia. Whereas Russia is clearly aware of the Achilles heel of (especially) the EU and does everything to undermine its reputation, the EU seems to stay rather undecided about which strategy it should use. This could be seen in the recent proposals of several EU Member States of easing the sanctions imposed on Russia. However, drawing on the game theory, this automatically confers an advantage to Russia. Therefore, knowing that unpredictability is of benefit in a dollar auction game, it could be reasonable for the EU to partially backtrack on the current dual-track strategy in putting pressure on Russia due to the aggression in Ukraine, but simultaneously receiving Russia at the negotiating table in regards to fighting jihadist troops or other issues.

6. WHAT CAN RUSSIA AFFORD TO LOSE AND WHEN SHOULD WEST START MAKING HIGHER “BIDS”

Considering the economic supremacy of the Western world, the allies should have sufficient funds and ambitions to put pressure on Russia to convince it that withdrawal from the conflict is the only rational scenario without any other options on the table. However, in real terms it seems that Western allies prefer to continue the game with bids as low as possible. This, however, fully meets Russian expectations. Thus, to avoid remaining the “second bidder in the auction”, the West should take a more active role in current conflict resolution. Hereby, the question about when the West should start making higher “bids” is directly linked to the question of how much could Russia afford to lose to destabilize Ukraine without escalating economic tensions on the domestic front?

Recent economic developments in Russia indicate the country is able to survive and recover under veritably challenging economic conditions. Over last four years, Russia’s modest economic growth in 2013 transformed to a substantial economic decline in 2015, inflation increased from 6-7 percent to 15-16 percent, the Russian ruble lost nearly half of its value (e.g. compare the exchange rate of 1 EUR = 40-45 RUB in 2013 to 1 EUR = 75-88 RUB in 2015), the country’s international reserves decreased from approximately 520 billion USD to 320 billion USD, real wages dropped significantly (e.g. by 9.5 percent in 2015 in annual comparison), and interest rates almost doubled (e.g. the lending rates referring to the bank rates that meet the short- and medium-term financing needs of the private sector increased from 9 percent to nearly 16 percent). In 2016, however the Russian economy started to stabilize, as economic decline decreased to 0.4 percent, inflation reduced to 5,4 percent and ruble strengthened to the level 1 EUR=64 RUB. For the end of 2017 situation looks quite promising for Russian administration: Economic growth is 1,8 percent, inflation 2,5 percent, unemployment 5 percent and budget deficit 3,4 percent. To conclude, in 2013, Russia was one of the eight most powerful industrial countries, belonging to the so-called G-8 (Group of Eight). In 2015 its ranking was substantially lower (12th; based on the GDP) and according to recent data Russia may drop two places further in 2019-2020 (to 14th) (CEIC, 2016).

Thus, one can clearly see the economic costs of the conflict for Russia, whereas the impact of Russian countersanctions has been rather modest to the EU and to the US (Veebel & Markus, 2015, p. 166). The situation becomes even more unbalanced when the economic supremacy of Western allies over Russia is taken into account. In an abstract manner, knowing that in economic terms the EU is ten times “bigger” than Russia, the EU could (in existential terms) “bid” 10 EUR whereas Russia could only “bid” 1 EUR. In other words, should both parties to the conflict “bid” 1 EUR, the relative value of it is much higher for Russia than for the EU. Thus, the EU has a comparatively larger advantage in terms of resources over Russia. On the other hand, the European weakness in this conflict is its fragmented political nature and the need for a consensus to make a bid.

Yet, despite current measures proving to be insufficient in forcing Russia to change its behavior, the “game” is far from finished. As the authors see it, a lot will depend on Russia’s economic outlook in the coming years, particularly with the combination of domestic economic pressure and the overall macroeconomic imbalances, such as the dynamics of oil prices. In 2016, while the Ukrainian economy was already showing growth (+2 percent), the Russian economy was still in decline (-0.4 percent). The deteriorating economic outlook for Russia however did not backfire on Russia’s political elite during parliamentary elections in September 2016. The Russian presidential elections held in conditions of economic growth showed strong support to Vladimir Putin and his political choices. As a result, Russia seems to have resumed the leading role in the conflict with the cost of irrational behaviour. Even when the victory of Donald Trump in US elections offered first some hope to Russian political elite, that Western consensus in terms of sanctions will be lost, the EU and US sanctions will remain in force and impact Russian economic development also in 2018 and 2019.

As referred to above, next to the economic outlook of Russia, the final outcome of the conflict depends to a large extent on the dynamics of oil prices. Since Russia receives about two-thirds of its revenues from taxes on oil and gas, the increase in oil prices could, in principle, alleviate the present economic pressure on Russia and limit room for maneuvers from the West. Best moment to make economic sanctions to have higher impact would be, during next global financial crisis, when investors start to withdraw their capital from less secure countries (like Russia), if to combine this capital outflow effect with sudden additional trade and payment restrictions to Russia, it may result with political surrendering and returning at least some of Ukrainian territories.

7. CONCLUSION

Four years of active international sanctions against Russia have brought no signs of visible progress, neither in terms of respecting Ukrainian territorial integrity or the agreements of Minsk and Sevastopol, nor in terms of Putin’s regime leaving power. The EU-US negative conditionality (sanctions) against Russia seems to be losing its momentum. This meets Russian expectations to retain the occupied territories and wait for the softening of international reactions, especially after the victory of Donald Trump in US elections and the Brexit referenda in the UK. This relatively passive attitude of the EU and US in 2016-2017 may also be understood by the Russian side as a signal of the acceptance of the status quo as a long term outcome.

The time-factor is not working in favor of imposers of sanctions, if the economic shock in Russia has not started during 3 years it will not start also in next year, instead an adaption with “new normality” will appear and the impact of sanctions will decrease in future. Assuming that the oil price is expected to stay above 50 USD per barrel in 2018, which is the level for Russian budgetary balance, the EU and US should not miss this window of opportunity and should increase economic pressure on Russia immediately. There was a hope that presidential elections in Russia in 2018 could potentially leave the West some room for “overbidding” Russia in the short term, however these chances were not used and Putin did not only secure

his seat for the next period but also strengthened his political legitimacy. Against this background the current strategy of the West of waiting and hoping that low oil prices and restricted access to new technologies combined with a deteriorating economic outlook for Russia would lead to a systemic crisis and force Russia to withdraw from the regional conflict appears rather useless. It is certainly not in the interest of Ukraine to wait for many more years. Furthermore, it is difficult to imagine that it will be in the best interests of the West, in terms of global security and welfare, should Russia and Ukraine remain in open conflict over next 3-4 years, and especially if they end up in a systemic economic and social crisis. This does not seem reasonable, even if it turns out to be Russia who is eventually the first to withdraw from the conflict. Thus, an active approach to the Russian-Ukrainian conflict appears to be the only solution that would help Western countries win the second round of a strategic confrontation between East and West. Considering western supremacy in terms of economic resources, the ambition should be to convince Russia to choose early deterrence and withdrawal from the conflict, as no visible or rational scenarios for success should be left.

The most likely scenario today sees the current “status quo” as maintained - at least in the mid-term. There are some noticeable arguments in favor of this, the most prominent among them that Russia has already achieved its core aims (i.e. gained control over some strategically important districts in Eastern Ukraine and taken over Crimea) and is definitely not interested in returning these regions to Ukraine. At the same time, the EU, the US and their allies have constantly avoided exerting sufficient pressure on Russia, thereby lessening their credibility as aggressive “bidders” in the conflict. There is also an option that confrontation and bidding will end due to the lack of motivation and momentum, and both parties to the conflict accept the loss of their earlier bids. Even if this scenario materializes, what remains highly unlikely is the restoration of the territorial integrity of Ukraine. This is due to ethnical factors as the Russian-related population in the region is relatively big.

However, the prerequisite for imposing more advanced targeted sanctions is that the West (and within it the EU) acts unanimously. The EU and the US should show their willingness to raise their bids in terms of Ukraine and give no hope to Russia in terms of softening sanctions and lowering economic pressure. The advantage in terms of economic power should be transferred into initiative and pre-emptive approaches in relations with Russia. Losing initiative and giving breathing space to Russia may lead to a further escalation of the conflict and bring regional instability to Moldova.

Additional efforts are needed to develop Ukrainian ability to support bidding against Russia with their improving economic resources. There should likewise be a realistic basis for developing more extensive cooperation between the EU and Ukraine, and Ukraine should remain the ENP priority country with a clear perspective to future membership. Hereby the importance of financial support provided to these countries by the EU, the IMF and their partners should not be underestimated.

As the authors of the article see it, the “breaking points” for the Russian government to leave the game would be either the moment when the Russia’s ruling elite has lost the public support or when the country is forced to give up the ambitions to restore the former Soviet Union and to lose its sphere of influence in the region. For the EU, the “bid becomes irrational” from the moment on when Ukraine has collapsed economically or returned to the area of Russian political influence. However, for the EU the undesired outcome would be also a situation where no consensus is preserved in the EU anymore and some of the EU member states officially express their disagreement as regards the sanctions against Russia. Thus, any measures and activities which pull Ukraine apart from the Russian sphere of influence or decrease the public support in Russia to the Russia’s political elite should potentially increase the probability that Russia would “swerve out of the way”. Any signs of the de-unification of the EU member states as regards the sanctions against Russia should be rather avoided. The conviction that any measure which helps to pull Ukraine away from the Russian sphere of influence supports the conflict resolution in Ukraine is based on the geopolitical

argument. In the recent years Russia has made significant efforts to integrate Russia, Belarus, and Kazakhstan in the form of the Eurasian Economic Union. At the same time, some of the former Soviet Union republics such as Georgia and Ukraine have been gravitating away from the Russia's sphere of influence (Veebel 2017). Thus, it could be argued that on the one hand, the persistence or the escalation of the conflict in the eastern Ukraine decreases the chances for the EU-membership of Ukraine. On the other hand, Russian sanctions against the EU basically constitute another tool for jeopardizing the position of the EU in the eyes of the former Soviet Union countries like Ukraine, Belarus, Moldova and Georgia.

Based on previous analysis authors are suggest following developments for the EU. Firstly, despite the current Russian-Ukrainian conflict, the EU-accession perspective should be left open for Ukraine. The importance of the clear roadmap to the EU-accession has been also stressed by the Ukrainian political elite. However, in the most recent EU Eastern Partnership Summit in Tallinn in 2018, the leaders of the EU have stressed the "solidarity" with Ukraine, but remained relatively vague as regards the EU-membership perspective for Ukraine. Hereby, citing the President of the European Commission, Jean-Claude Juncker, "They are not ready. We are not ready, but the process is under way". Contrary to Russia's expectations violent conflicts in Ukraine have tended to increase country's support for the European values. As the authors see it, the EU cannot afford any vague statements as regards Ukraine's EU-accession perspective in the current stage of the conflict, without the risk to lose support of the Ukrainians. Finally, Ukraine itself should decisively show initiative and ambition in improving the country's economic situation. This could serve as a guarantee that Ukraine and Western allies will "stay in the game" when overbidding Russia. Hereby, the role of economic stabilization measures should not and cannot be overestimated in order to minimize the potential negative influence of Russia in the region.

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