The Economics Of Deterring Russia

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When it comes to the prospects of war in Europe, perhaps we simply aren't asking the right questions. For months now, Russia watchers within the Beltway and in European capitals have been preoccupied with anticipating the next moves of Russian President Vladimir Putin in the year-old conflict taking place in Ukraine.

But achieving a satisfactory answer to the question of what Russia might do has proven maddeningly elusive. This is because much of Moscow's policies to date have been opportunistic in nature - driven by perceived Western weakness and divisions within the NATO alliance, rather than by a clearly defined end state on the part of the Russian government. Given this state of affairs, Western capitals should focus less on possible Russian actions, and more on how to constrain its potential for aggression.

The United States and Europe have already begun to do so. Three formal rounds of sanctions to date - and subsequent expansions of existing restrictions by both Washington and Brussels - have taken aim at obvious targets of opportunity within Putin's regime. These are threefold: state-owned enterprises (like natural gas giant Gazprom and its oil analogue, Rosneft), members of Putin's inner circle (including influential oligarchs and power brokers Igor Sechin and Gennady Timchenko), and high-ranking government officials (such as Deputy Prime Minister Dmitry Rogozin). In this way, Western nations have begun to drive up the marginal costs to Russian decision makers of their Ukrainian misadventure.

The world oil market has arguably done much more. Saudi Arabia's active and ongoing attempts to depress the global price of oil through increased production - a reaction to both the unfolding rapprochement between the United States and Iran, as well as America's unfolding fracking "revolution" - has had a pronounced collateral effect on Russia's energy-heavy economy.

Yet this trendline, like Western sanctions themselves, is perceived in Moscow as fleeting in nature and unsustainable in the long run. Which is why Putin himself recently argued that the Russian economy has now weathered the worst of the resulting economic downturn.

It is also why Russia appears to be preparing for a wider war in Europe. According to former Kremlin economic adviser Andrei Illarionov , Russian military spending - which long averaged between 2.5 and 3.2 percent of national GDP - is today rising to levels analogous to the period immediately preceding last spring's incursion into Ukraine. The amount of money now being spent by Moscow, Illarionov notes, rivals the initial mobilization that accompanied the start of hostilities in Ukraine (in excess of 10 percent of GDP), suggesting that Russia is preparing for escalation, in Ukraine and perhaps even beyond.

In crafting their response, policymakers in the United States and Europe can learn from the financial markets. In the world of venture capital, the operative figure used by potential investors to calculate the solvency and profitability of a company is its "burn rate" - the amount of capital that itexpends monthly on its operations. A venture with an unsustainable "burn rate" is seen as inefficient and a bad investment bet, and potential funders stay away. The message to those companies is clear: improve, or perish.

This lesson is applicable to Russia as well. By all indications, the Kremlin's current "burn rate" is already significant. According to authoritative estimates, Russia is now spending some $105 million monthly on hardware and personnel deployed in Ukraine's east. The attendant military mobilization now taking place within the Russian Federation itself is believed to be considerably more expensive. These costs have been compounded by the added drag on the Russian economy imposed by last year's annexation of Crimea (some $4.5 billion or more annually), as well as reduced governmental revenue from artificially low world oil prices.

Nevertheless, the size of Russia's foreign exchange reserves (currently estimated at upward of $353 billion) suggests that Moscow can keep up its present rate of expenditure for some time yet. But not if the West drives up the marginal costs of the Kremlin's war effort.

Doing so requires targeting not high-profile public figures in Moscow, but the cogs in the Kremlin's war machinery: the foreign suppliers, domestic factories and associated industries that help provide the critical components of the mechanized divisions, artillery and hardware that Russia will use if and when it again goes on the march. The logic is simple. The more it costs Russia to build a tank or submarine, to fuel a long-range bomber, or to properly outfit a warfighter, the quicker it will end up depleting its savings. And once it does, Moscow will find its potential for aggression profoundly constrained.

In this way, Western nations can help change the terms of the debate surrounding Russia, from parsing the specifics of Putin's policies to actually limiting his ability to mobilize. That would be a sound investment indeed.