



Treasury Committee

Oral evidence: Cost and Effectiveness of Economic and Financial Sanctions, HC 1242 [Tuesday 6 May 2014]

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Members present: Mr Andrew Tyrie (Chair); Mark Garnier, Stewart Hosie, Mr Andrew Love, Mr Pat McFadden, Mr Brooks Newmark, Jesse Norman.

Questions 1-133

Witnesses: Raoul Ruparel and Gary Campkin and John Lough, Roger Munnings and Dr Chi Kong Chyong gave evidence.

Chair: Good morning. Thank you very much for coming in to help us examine this possibly very important subject on which there has been a great deal of public interest and interest among colleagues in the House. Could I begin with you, Mr Ruparel? You have described the impact on the UK of possible sanctions on using the financial sector as a vehicle as overblown. Why?

Raoul Ruparel: In the early part of this debate, a narrative had taken hold that the City of London was heavily exposed to Russia and heavily involved in Russian finance and in the Russian economy. However, looking deeper into the data, I just do not believe that is the case, and I will provide a few estimates to back up my comments. For example, the real estate market: there is obviously a lot of talk about the level of Russian money purchasing properties in the UK and particularly the London real estate market. According to Savills, around 2% of high-end home buyers are from Russia. Knight Frank estimates that it could be as high as 9% for properties over £1 million. However, when you look at individuals based and living in Russia, that falls to 5%. While these figures are probably substantial in absolute terms, given the size of the residential and commercial market in London, I do not think they represent an unusually large proportion. The way that the market is

going, it would probably be able to withstand a loss of such business, although it would be far from ideal, of course.

Looking at the international investment position of the UK, again there has been a significant amount of talk that Russia invests a huge amount of money into the City of London. However, when we look at the data, the stock of Russian investment held in the UK is £27 billion, which again sounds like a large figure and it is a large figure, but given the size of the City of London, it represents only 0.5% of total European international investment into the UK. Again, it is a large absolute figure, but in the context of the City of London, it is probably not prohibitively large if it came to discussing financial sanctions.

Equally, if we look at the exposure of UK banks to Russia, it is around \$19 billion. Again, a reasonably large figure but compared to some other European countries—France \$51 billion, Italy \$28.5 billion and Germany \$24 billion—the City of London in terms of its banking exposure ranks lower than all of these countries, which personally I found to be quite a surprising statistic and I think one that not many people are inherently aware of.

For these reasons, then, I believe that this discussion and narrative that had taken hold that the City would be massively damaged by financial sanctions on Russia is, as I said, overblown.

Chair: In order to find a single adjective to describe this, are we talking about small, very small, negligible, in your view? Listening to what you have just provided, it sounds to me somewhere between small and negligible.

Raoul Ruparel: I think small would be the right adjective. Maybe comparing it to other countries could give a bit of perspective as well. Significantly more international investment comes from all other European countries in the EU for the UK, so Russia ranks fairly low on that perspective. One aspect I did not mention was obviously the number of Russian firms on the London Stock Exchange, which may be of interest to some of the Members. There are currently 29 Russian-incorporated firms listed on the London Stock Exchange out of a total of, I think, 2,455 firms. They represent 1% of the total number of firms listed on the London Stock Exchange.

Chair: The listing business is not going to be badly hit. That is what you are saying?

Raoul Ruparel: I would not think so. In terms of their market capitalisation of the overall market, it is only around 6% of the whole market, so slightly larger but again not huge.

Chair: Okay. On the housing market, is it more likely that we will find a flight to safety net is a flight to London in the event of a further deterioration in relations or a flight from London?

Raoul Ruparel: Given what we have seen during the previous financial crisis and previous uncertainty in global financial markets, London has fared well as a safe haven and I think that we could see such flows. If we also look at the fact that interest rates are at record lows around the world, the return on assets is very low, so the demand for safe assets with a reasonable return is significantly higher than one might consider normal. Therefore, I think the London property market would still fare fairly well even if sanctions were imposed on Russia.

Chair: What is your response to the view that imposing financial sanctions would undermine the legal certainty and consistency that makes the UK such a good place to do financial business?

Raoul Ruparel: This is certainly probably the most valid question about whether to proceed with financial sanctions. I do not believe it would be a prohibition. I think the case is quite particular if we look at what has happened between Russia and the UK and the EU. Obviously, Russia has continued to attempt to expand its influence on its neighbourhood and this has bumped up against the EU's approach to its European neighbourhood. Such a conflict I would say is quite rare and it is quite rare for two significantly large blocs to come into contact and produce these kinds of financial sanctions. Therefore, I do not believe there would be a general interpretation that this would be the modus operandi for the financial sector or that such sanctions would be any more likely because they have been taken in this case.

Chair: Okay. Mr Campkin, thank you very much for coming. You have been listening quietly to all of that. I would be grateful if you would comment and mention anything that you particularly strongly agree with or from which you dissent.

Gary Campkin: Thank you, Chairman, and thank you for the invitation. I think we need to start by looking at the fact that Russia is about the ninth or 10th largest economy globally and up until the 2008 crisis was exhibiting some quite significant growth rates. It was hard hit by the recovery, but until recently we had seen a rebound in those growth rates. It is the case that for financial services and related professional services engagement in Russia in all its forms is an important part of a global strategy. Part and parcel of that is—

Chair: You are talking about foreign policy strategy here, are you?

Gary Campkin: No, in terms of business strategy in the way that they look at emerging markets and the way that corporate—

Chair: So Russia's strategy? Sorry, I am just trying to be clear. Whose strategy?

Gary Campkin: Excuse me, Chairman; I am talking about the importance of Russia and Russian business opportunities to corporate strategy.

Chair: UK corporate strategy?

Gary Campkin: Yes, so I am trying to put it into the context of a kick-off question.

Chair: Okay, I am sorry.

Gary Campkin: The way in which business assesses opportunity, of course, has something to do with the facts and the scale of the market but also about the way that businesses expect opportunities to develop. If you look at opportunities for UK business in the sector that I represent in financial services and related professional services, we believe that there are significant opportunities in banking, insurance, pensions, legal services, capital markets and accountancy. It is one of the reasons why The City UK has been the private sector lead in the UK on the "Moscow is an International Financial Centre" project. This is a long-term project, as members may know, led by the private sector that brings benefits to both the UK and the Russian economies by developing opportunities for business in the industry in both countries.

Chair: If I could summarise what you have just said, you disagree with Mr Ruparel. You think that there are significant, possibly quite big opportunities that we are going to put at risk if this ends up with financial sanctions. Is that correct?

Gary Campkin: I think that is a fair summary, Chairman.

Chair: Okay. I do not know whether I did interrupt you there, but if I did are there some further points you want to make?

Gary Campkin: No, that is fine. Thank you.

Mr Newmark: I guess we need to separate out the politics from the economics of what is going on. I, for one, am not interested in pursuing Russians. The idea is to put pressure on specific people. At the moment, the EU's current sanctions regime merely denies 48 individuals access to their EU assets. Is it fair to say, then, that the direct economic impact at the moment is fairly minimal?

Raoul Ruparel: Yes, I would agree with that. I think the direct impact at the moment has been minimal and that also shows in the knock-on effects on the policy side. There has been some indirect effect. We have seen the capital outflows from the Russian economy picking up substantially in the first quarter of this year totalling \$51 billion, which I believe is around the average yearly outflow over the past five years. It is a significant increase in the first quarter, but I would say that is more of an indirect economic impact, a knock-on from the uncertainty of the potential threat of sanctions rather than the direct impact of the current sanctions.

Mr Newmark: Those outflows from Russia are going to where, though? Where is the main destination for that money?

Raoul Ruparel: The latest data from the Russian central bank is for 2012, so it is a bit outdated, but 37% of Russian FDI went to Cyprus, 16% to the Netherlands and 12% to the British Virgin Islands.

Mr Newmark: It is going to Cyprus?

Raoul Ruparel: Yes, but it also flows back from Cyprus to Russia. Equally, 31% of FDI in Russia is from Cyprus. There is a big cycling of this money that outflows from Russia through offshore centres and often back into Russia itself. While the outflows are problematic for the economy and they do hamper investment and capital, particularly for the financial services, a lot of it does end up back in Russia in some form or another, I believe.

Mr Newmark: Gary, do you see this as having much of an impact or not?

Gary Campkin: I think you have to look at it at a number of levels. The first thing I would say about sanctions, and it is important to kick off with this point, is it is for Governments to decide the appropriate level of political response to actions in the Ukraine and business should, of course, comply with any legal restrictions or sanctions that Governments impose on Russia.

That said, I recognise the figures of capital flight that have just been quoted. I would add to that the decline in the rouble has been fairly dramatic—between 8% to 10%—over the time period. The stock market is off about 20%. Interest rates have recently risen to 7.5%. Ratings agencies have been downgrading.

Mr Newmark: I am less worried about what is going on for Russia and the Russians. I am more interested in the UK and the impact on the UK.

Gary Campkin: The picture that I am trying to lead to is the fact that, for business, this uncertainty therefore leads to some inevitable recalibration and the indirect impacts of sanctions as a result of increased geopolitical risk. All of those things that I have said will mean that corporates are looking again at their exposure to Russia and their links, and there are a number of concerns that we would have in terms of corporate due diligence, the need for increased screening of contracts and contacts, increased compliance costs. A lot of corporates are, from contacts with our members, reviewing their contracts—

Mr Newmark: Okay, because we do not have too much time to go into all this. What you are saying is it is the other way round: it is people looking at risk of putting capital to work in Russia as opposed to what my question is about, which is Russian money coming back into the UK and whether that is going to have an impact. You have not really answered

my question as to that side of the equation rather than UK businesses, let us say, investing in Russia.

Gary Campkin: The anecdotal evidence from our membership is that, because obviously businesses should comply with sanctions, the main impact that we are focused in on is, in fact, the increased compliance costs and the need for business to comply and to make sure that they do not fall foul of any legal requirements placed upon them.

Mr Newmark: Okay. What about the perception issue of further sanctions, then? Is that then going to have an impact on Russian money coming into the UK? I am interested in that side of things, not the other way round.

Gary Campkin: I cannot really comment for Russian perceptions.

Mr Newmark: Okay. Raoul?

Raoul Ruparel: Anecdotally again, there has been talk of—

Mr Newmark: Would that have any impact?

Raoul Ruparel: There has been talk of the Russian Government encouraging firms to delist from the London Stock Exchange, for them to enhance their relationships with China and other countries, and particularly from the energy sector looking to move towards other countries. This is a shift that will take a long time and, again, any impact on the ground I think would be small, because the overall links are fairly small, and the time it would take to shift this kind of business would take some time as well.

Mr Newmark: Do you think, then, that if the regulatory regime tightens up—for example, there was a perception, and I am not saying it is real or not, Mr Chairman, that London was the biggest laundromat for laundering money out of anywhere in Europe—maybe there will be a flight of capital, as the regulatory environment perhaps tightens up on following Russian money and Russian assets, particularly of those close to Putin? You mentioned Cyprus. Obviously, Cyprus now seems to be the destination of choice for laundering Russian money. I am curious as to what your view is on the flight of capital, perhaps, as regulators tighten up here.

Raoul Ruparel: That is a possibility, but again it would require a very co-ordinated EU response to tackle the offshore centres that are located within the European Union, notably Cyprus and the Netherlands. That is a possibility, but again we have seen the regulatory environment tightening up since the financial crisis. That does not yet seem to have had a huge impact on the likes of Cyprus and the Netherlands in terms of their foreign direct investment flows. It is all very hypothetical, but it could have an impact. It would be hard to say.

Mr Newmark: It is probably for a separate discussion, Mr Chairman, on laundering of Russian money.

Chair: Mr Campkin, you said something that surprised me a lot. You said that the main concern of firms was not the direct business impact, but that they might accidentally fall foul of new legal requirements on sanctions and be damaged reputationally as a consequence of investigations by a regulator. That is the point you made, isn't it?

Gary Campkin: The point, Chairman, I was trying to make was that, as businesses look at trying to comply with the sanctions regimes and legal restrictions, there are a number of things that they will need to do, which will include enhanced compliance costs, a deep dive into reviewing—

Chair: I think you said that was the main concern.

Gary Campkin: It is a major concern, certainly, Chairman.

Chair: Okay, so it is not the main concern, but it is a concern.

Gary Campkin: Well, if you are a responsible business, the most important part of a responsible business is complying with the law.

Chair: Okay, but it does not sound as if the loss of business is so huge if the main concern is the regulatory and reputational risk associated with compliance with new rules.

Gary Campkin: Well, there are some issues, Chairman, in terms of transactions already entered into, for example, but not completed, which could then become part of sanctions regimes.

Chair: All right. We are going to come on to that in a moment. Andy Love wants to come in and then Mark Garnier.

Mr Love: Mr Campkin, following up on your earlier response, I want to know how much of the impact that you talked about on the Russian economy was attributable to the sanctions regime and how much was attributable to economic circumstances that the Russian economy finds itself in.

Gary Campkin: If you are looking at the sorts of figures I was talking about—the rouble, the stock market and so on—there is a fair argument to link the heightened risk, the geopolitical dynamics and sanctions regimes imposed on Russia and those dynamics. The Russian economy has been going through a difficult time of late. There was some evidence of rebound, but if you talk to businesses on the ground and analysts, the most important thing that they would feel is important in terms of the Russian economy's reform is to embed some structural reform. The oil and gas revenues give them a cushion. In our view, it is probably the reason why Russia cancelled its bond auction recently. It did not need to go to the market at the pricing that was offered because of the oil and gas revenues. The oil and gas revenues give it a background, but reform is important. Certainly, we think that one of the things that is important in terms of Russian reform is financial services and related professional services. We believe that UK companies through engagement can help with the reform, which will benefit both economies.

Mr Love: Can I ask you to focus more directly? There is some talk about capital flight reaching \$100 billion by the end of the year. Would you demur from that figure? There is some discussion about the rouble declining 78%; is it likely to continue its decline?

Gary Campkin: It is highly speculative and I am not an economist. If one accepts the fact that 60 billion has already left, the sort of figure that you quote is perfectly possible.

Mark Garnier: Thank you, Mr Campkin. Perhaps we will stick with the extra burden that is going to be placed on the City by instilling these sanctions. From any sort of practical point of view, how easy is it going to be for any bank or any institution to try to determine what constitutes a Russian asset and what is something that has got through some sort of byzantine labyrinth of control ownership? Is it going to be possible to work out what is Russian and what is not?

Gary Campkin: Well, if I could answer that question, if you would allow me, by putting out three important points about sanctions, which are the points that we put to Government when we discuss sanctions and their operation, because we feel these are quite important. First of all, any sanctions should be very, very carefully considered, and if Government deems them to be necessary, they should be given the full force of law. There should be clarity there as to the legal intent. They should be multilateral and consistent, which means that in our case UK companies are not disadvantaged vis-à-vis their competitors. Then, lastly, sanctions should be targeted, smart and thought through for all of their implications. We have been in dialogue with Government throughout this process to make sure—

Chair: I think we could have guessed that those points might have been on the agenda, but what we would really like is an answer to Mark Garnier's question, which is: are we going to find that the labyrinthine structure of many of these deals makes it impossible or very difficult to make sanctions effective?

Gary Campkin: There are some difficulties. If I could give you a difference between the way that US sanctions operate and the way that EU sanctions operate, in the US, OFAC, which is the Office of Foreign Assets Control, is part of the US Treasury, and what happens there is that property is automatically blocked if an individual or an entity owns more than 50% of the equity.

Mark Garnier: Yes, but how do you know? This is my point. If you have a nice shareholder register with lots of Russian institutions on it, then you can get that, or a land registry gets that. But very few of these organisations presumably use those simple mechanisms. They have all sorts of offshore accounts through Cyprus or whatever, we have heard.

How do you know who owns what? More importantly, what happens to an institution that unwittingly finds itself working for what has an ultimate Russian beneficiary ownership when, in fact, they think they are simply dealing with, for example, a Cypriot company?

Gary Campkin: I go back to heightened due diligence, which is what corporates do in these circumstances. Where they are faced with heightened due diligence, they do as much compliance as is possible to do, but they also need guidance—

Mark Garnier: What is the cost of that?

Chair: What we are asking is: is it possible to do?

Mark Garnier: Yes, first, is it possible; secondly, what is the cost?

Gary Campkin: I cannot make a hard and fast response in terms of is it possible—

Mark Garnier: Okay. Let me ask the question a slightly different way. How many representations have you had from City institutions that have come to you saying this is impossible or it is too difficult or it is going to be too expensive?

Gary Campkin: We have had a lot of dialogue with our members and our members tell us that this is a major challenge. Obviously, they do the best they can because they need to comply. One of the most important things that we believe that Government can do is to provide some sort of guidance to the private sector to help them through the process. Compliance costs, I do not have a figure for you at this point. I can certainly go away and look and see whether we could put some sort of estimated figure on that for you if that would be helpful.

Mark Garnier: Raoul, do you have any thoughts on this?

Raoul Ruparel: I would be inclined to agree that this could be an issue. Obviously, I mentioned the FDI flows going through many of these offshore centres and, as you suggested in your question, a lot of the structures in these corporations are quite opaque and it is not entirely clear who the end owner is. Often, if there are joint ownerships, possibly between a Russian and a non-Russian individual, could they switch the ownership and things like that? There are problems one could imagine. I think in the case of Cyprus and the Netherlands, being EU countries, they can get help from the European Commission and from other countries. I am sure the US would be willing to share its expertise in this area, and that would certainly help. If we look maybe at somewhere like the British Virgin Islands, a very small country, a very small Government infrastructure, yet it receives huge flows in and out from Russia totalling I think close to \$50 billion. For that Government and the regulatory infrastructure there to try to pin down who is really behind all these flows, in that case we can see it being quite an issue. There would possibly be a

desire for the UK Government to get more involved and lend its expertise there. I think that could be a problem.

Mark Garnier: What happens to an institution that does breach these sanctions and does find itself doing trade? Gary, perhaps you have some thoughts on that since you talk to the Government a lot.

Gary Campkin: At this point, we are not aware of any situation or circumstance where that has arisen.

Mark Garnier: Yes, but what are you being told is going to happen to them if they do?

Gary Campkin: The penalties are put out in broad terms under the orders either in the EU, the US or the other Governments that put in place sanctions regimes.

Mark Garnier: Okay. My final question, Chairman, is this is going to be slightly disproportionate to different institutions. For example, there are some legal firms that specialise in doing legal advice for Russian banks looking to come into the UK. Have you done an assessment on which firms are going to be particularly affected within the City and have you made any representations to Government to try to support them or not?

Gary Campkin: We have not made any specific studies. As I say, the anecdotal context that we have with our members on a day-to-day basis is our basic bread and butter, and what those contacts tell us on a day-to-day basis is that for those corporates with exposure either directly as foreign direct investors in Russia or who have Russian clients or involved in Russian deals or in giving advice or, indeed, for those professional services companies who use people within their global networks based in Russia as part of global project teams, these are all big challenges that they need to think through. I cannot put a hard and fast figure answer to the question, but it is a major part of corporate thinking at the moment how to respond to these issues and to comply with the legal requirements.

Mark Garnier: Just a very quick answer to my supplementary last question, if I may, do you think there is any firm in the City that may go bust as a result of this?

Gary Campkin: I cannot comment on that.

Chair: Can you, Mr Ruparel? You can say no if you want to say no.

Raoul Ruparel: No, but maybe just providing a bit more colour to the previous question, for example, when I was looking into the listings on the London Stock Exchange, all of the Russian-incorporated companies are listed through depositary receipts. The point of contact for these receipts tends to be a few large banks. Some examples would be BNY Mellon, JP Morgan, Deutsche Bank, and they are the points of contact and

hold the shares for these companies. That could be an impact. That just gives you a bit of a flavour of the types of companies that are involved.

Chair: Yes, that is very helpful.

Jesse Norman: Mr Ruparel, there has been a lot of talk about so-called tier 3 sanctions. Do you know what those are?

Raoul Ruparel: Well, it has been very vaguely described by the EU at the moment in terms of deeper economic and financial sanctions, possibly including firms and sectors of the economy. At the moment, from my understanding, there is no clear consensus within the EU.

Jesse Norman: It is a catch-all that did not fit into one and two; everything else is three?

Raoul Ruparel: The next stage further on, yes, I believe.

Jesse Norman: Okay, thanks. Do you think the European Union has the capacity to impose tier 3 sanctions, given that it requires the sign-off of all nations?

Raoul Ruparel: At the moment, the EU is quite far from unanimity on this issue and there are a number of facets to that.

Jesse Norman: Far from unanimity?

Raoul Ruparel: Yes, there is no unanimous support for tier 3 sanctions. Going even deeper than that, there is not even unanimous agreement on the role Russia is playing in the current instability in Ukraine, which I think is a fundamental precondition for further sanctions. The divisions really are quite substantial within the EU at the moment and the factors behind these divisions are also very varied. It is not simply the countries that have significant trade links with Russia or significant exposure to Russia not wanting to push further sanctions. In fact, we see countries such as Lithuania, the Baltics, Poland quite in favour of tier 3 sanctions, even though their economies are very heavily exposed, I imagine mostly due to security and political concerns, whereas we see some other countries, notably the Mediterranean countries such as Spain, Italy, Greece, who are a bit more dovish, who are not as keen on taking tier 3 sanctions. The reasons behind this are not entirely clear, I would say, possibly due to some broad view of economic and financial uncertainty and fears about stoking up the Eurozone crisis once again. There is a huge level of divisions in the EU and a huge number of reasons behind those divisions is what I am getting at.

Jesse Norman: Okay, so paradoxically or not, the states that know what it is like to get close to Russia or to have to deal with Russia are rather keen on tier 3 sanctions and the ones that are not are less keen on tier 3 sanctions? You can just say yes if that is true.

Raoul Ruparel: It is a generalisation, but there are countries such as Bulgaria, which is obviously close but is not so in favour of sanctions, so it

is split, but quite a few of the countries that are close are in favour of sanctions.

Jesse Norman: Sure. Okay, so what is to stop Russia just leaning on one of these countries? All it has to do is get one and that prevents unanimity and therefore stops them from being imposed.

Raoul Ruparel: I completely agree. That is a fundamental problem, as we have seen in many cases with EU collective action. Countries such as Russia—it has also been adopted by China in terms of their trade disputes—can take a divide-and-conquer approach. If you can pick off one or two countries when unanimity is required, it can severely hamper the progress.

Jesse Norman: Right, so cutting through it all, do you think the EU is actually going to impose tier 3 sanctions, given those concerns, the obvious conflicts, the disagreements about fundamental motivations and the potential for being lent on by Russia directly?

Raoul Ruparel: I would not say never, but at the stage we are now, it certainly has not reached a threshold as a collective.

Jesse Norman: Highly unlikely. That is right, is it?

Raoul Ruparel: I would say highly unlikely to take significant sanctions.

Jesse Norman: Okay, thanks. If the decision was taken to freeze all Russian assets held in the EU, what direct impact would that have on UK banks and would it be material?

Raoul Ruparel: I think all Russian assets in the EU would have a severe knock-on effect on the wider economy. Obviously, this would involve freezing the assets of numerous energy firms such as Gazprom, and the knock-on effects of that would possibly be halting of supply and things of this nature. I think that the exposure for UK banks is not huge and as a percentage of assets is very small, so there might be some material losses, but again, not prohibitive.

Jesse Norman: Right, so secondary impact, but not much direct impact?

Raoul Ruparel: Agreed, and I think also we have to consider in all of these cases the possibility of retaliation from Russia, which would be a complete unknown and could potentially have another secondary round of impacts.

Jesse Norman: Right, because we have \$20 billion-odd worth of UK bank claims or assets held in Russia. Are those going to be influenced in some way?

Raoul Ruparel: The UK international investment in Russia totals £46 billion, which is 0.87% of total UK investment in the whole of Europe, including Russia.

Jesse Norman: It is how much?

Raoul Ruparel: 0.87% of total UK investment in the whole of Europe, including Russia. It is not a sizeable amount, but it is more than Russia has invested in us, according to the ONS figures.

Jesse Norman: Right, but then there are also, presumably, derivative-type contracts, contracts on contracts, things like that, that could then be a further source of instability?

Raoul Ruparel: There are quite sizeable derivative contracts. That does increase the bank exposure. Again, these are listed off in notional terms, rather than net terms, which does confuse judging the exact impacts. Also, we have to consider whether this would constitute a default event and whether these sorts of swaps would be triggered, so it is a lot of unknowns there. I would not expect the credit default swap and the derivative exposure to be a massive problem in this instance, but again, it is quite an unknown.

Jesse Norman: Just looking down the list, France has vastly more exposure than almost anyone else specifically to the banks, it appears. There is potentially a risk then from collateral damage if there was some effect on their banking system, which is already in some difficulty.

Raoul Ruparel: Indeed. Again, these links are complex, and given the links between European countries, the knock-on effects that, as you said, freezing all Russian assets in Europe would have on the European economy and then on to the UK could be sizeable. Again, charting all of these links is very difficult to know exactly how it would flow.

Jesse Norman: A net positive or a net negative for the UK's reputation as the home of the rule of law and a place of financial stability and probity?

Raoul Ruparel: I think this leads on to a question about who we decide to sanction and why we decide to sanction them. If we provide substantial and sufficient evidence about why we decide to sanction them, then I think it could be seen as positive, but again, it is a number of unknowns there, and it is hard to see how different groups would interpret it.

Mr McFadden: The point of these sanctions is to limit Russia's actions in the Ukraine. The evidence would appear to be that that is not happening so far and that a policy of organised chaos against the Ukraine is continuing unaffected by these sanctions. I would like to ask you one or two questions about what more might be done. Mr Campkin, a number of Iranian banks were denied access to the SWIFT system, the international payment system, which has limited that country's ability to get payment for its oil and gas sales. Russia is highly dependent on oil and gas sales. Is it technically possible to deny Russian banks access to the international

payment system in the same way as has been done with the Iranian banks?

Gary Campkin: I suppose it would be technically possible. I understand that Russia is thinking, and has been thinking for some time, about setting up its own payments system internally. Indeed, because of the way that the sanctions are working in the US, that has probably been brought a little bit forward in terms of their own thinking. Technically, yes, I suppose it would be possible.

Mr McFadden: In the same way, is it possible for the United States, given that oil and gas sales are denominated in dollars, to deny the clearing facilities for such contracts?

Gary Campkin: I believe technically it would be, and, indeed, US sanctions as they are currently constituted include US persons or anyone with a nexus in the US, so technically US sanctions already cover anything that includes US reach.

Mr McFadden: What is your view of the potential impact on the Russians' ability to be paid for their oil and gas contracts if the US stepped up the difficulty of doing this in dollars?

Gary Campkin: It is not an issue I have thought anything about to date, so it would only be an immediate reaction. Obviously, if you are talking about restricting Russian access to dollar clearance and access to the US dollar, that would have a pretty significant impact globally.

Mr McFadden: Mr Andrey Kostin, who is the Chief Executive of the state bank, VTB, said a few days ago, "To a certain degree"—this is payment in roubles rather than dollars he was referring to—"this would be a guarantee that if at some point someone decided to impose Iran-style sanctions on us, we would have a level of protection from it." We could not have a situation—could we?—where the Americans decided to try to limit Russian payment by denying the use of dollar clearance facilities and then the City stepping up to the plate and offering to replace that with euro-denominated sales. That would leave British, European and American foreign policy pulling in completely different directions on this question, wouldn't it?

Gary Campkin: It is a very hypothetical set of circumstances, and I do not have a view on that at this time.

Mr McFadden: The Foreign Secretary has said that some damage to the UK economy through the use of sanctions is a price worth paying. Do you think all parts of the Government are united in that view from what you know?

Gary Campkin: Obviously, within any Government, and you have been in Government and you know that there are interdepartmental discussions, but the Government has a view when it is expressed. The

Government has decided on the appropriate level of political response at this moment and that is what business will comply with.

Mr McFadden: Mr Ruparel, do you have a view on stepping these sanctions up in terms of the payments system and particularly how it affects oil and gas contracts?

Raoul Ruparel: I would like to touch upon your initial question: what is the goal or the aim of these sanctions? I think that really remains quite unclear at the moment, particularly from the broader EU perspective. It is not entirely clear to me what the EU wants to achieve from its relationship with the Ukraine. Does it see the Ukraine as a future EU member? Does it see it as a NATO member? What sort of association partnership does it really want with the Ukraine? Is it willing to go as far as continuing to bail out Ukraine and continuing to possibly provide military support for Ukraine if it came to that? These are all unanswered questions, and for that reason, I think the goals and the aims of the potential sanctions are quite unclear. That makes their possible use quite hard to judge, as it is difficult to say whether they would be effective in achieving some unknown goals.

I would like to point out, with relation to the payment system and the foreign exchange issue, Russia does have quite sizeable foreign exchange reserves, currently around \$486 billion in international reserves—not all in dollar denominated, I would add—but that does allow them some leeway, even if they were shut off from international markets, to still use the dollar and utilise these reserves. Clearly, that is not an indefinite path, and I think eventually it would certainly have some impact.

Mr McFadden: I think the aim of the sanctions is not really that hard to define. It is to try to preserve the territorial integrity of the Ukraine. I do not think it is that difficult to see what the aim is. My point is that, given Russian actions so far, they have not been particularly effective, but I think we will leave it there for today.

Stewart Hosie: Mr Campkin, what sort of Russian businesses list in London on the stock exchange?

Gary Campkin: I am afraid I do not have an answer to that here, but I am certainly happy to give you a written answer.

Stewart Hosie: Mr Ruparel, do you know of the sort of businesses that list in London?

Raoul Ruparel: From my research, there is a wide variety. Again, I do not have a list of the full names. It is quite dominated by the energy sector, oil, metals, gas, I believe. There are some very large firms listed. I believe Lukoil and Rosneft and Gazprom have listings here. Again, I would be happy to provide a full breakdown, but that is a general feel.

Stewart Hosie: That is all right. It is just to get an idea for that. What advantages does listing in London provide, and how would those advantages be undermined by sanctions?

Raoul Ruparel: The main advantages from the Russian perspective are access to broad capital markets located in London, and that includes, therefore, access to the European capital markets and the US capital markets, and also the skills base and the experience and the level of services available in London, particularly prevalent for Russia given that these services and these capital markets are not as developed in Russia as maybe in some other European countries. We again come back to the capital outflows. A lot of money, rather than being reinvested in these sorts of businesses in Russia, flows out of the economy, and therefore, these firms are forced to turn maybe to listing elsewhere to access these other capital markets. I would say that is the main logic.

Stewart Hosie: Okay. Is there any evidence so far that the Russian companies are following their Government's advice to delist or to seek to delist from the stock exchange here?

Gary Campkin: I am not aware of any company that has currently delisted. I am aware—and this happened before the sanctions regimes were put in place—in 2012 the largest new listing on the stock exchange was from a Russian bank, and as a result of that, President Putin said that in future privatisations or part privatisations should be launched from the Moscow exchange. There was already a mentality in place there, but I am not aware of any current plans to delist.

Stewart Hosie: So, right now, you are not aware of any Russian firms who are currently listed who plan to delist as a result of the sanctions currently in place?

Gary Campkin: I have not heard anything to that effect, but I do not have full knowledge.

Stewart Hosie: Okay. Mr Ruparel, a final question for you. It might be in a couple of parts. You obviously described the sanctions or the impact of the sanctions on the City as overblown and in your earlier answers described the Russian firms that were listed here. You said 28 or 29. That is valued, you said, at 6% of the market, £260 billion, a quarter of a trillion, plus the 15 Russian-focused firms on AIM, plus the dozens more with depositary receipts, the overseas traded shares. Were you not rather underplaying the potential impact when you described it as overblown in that sense? These are big numbers.

Raoul Ruparel: They are big numbers, but in the context of London as a global financial centre, as a proportion, they are not huge. More important is the question: what impact would these have on the UK economy, and how much business and revenue does listing on the London Stock Exchange and do these companies being present on the London Stock

Exchange generate for the UK? Would them leaving really have a material knock-on impact on revenues and services in London? In that sense, I do not believe it would be particularly large. That is the context in which I was framing it.

Stewart Hosie: When you say not particularly large, do you think, for example, that the underwriters alone could have afforded to forgo the 300 million in fees on the back of Russian firms over the last couple of years, for example?

Raoul Ruparel: If we look at the total level of financial services, business services and insurance exports to Russia in 2012, they were £1.2 billion, which is sizeable, but that is only 1% of our total exports in this area. Again, these numbers are large, but the City is large and I think that it could withstand that. There are obviously specific firms that are very Russian-focused or focused on that business and they would be hit hard, but I think as a collective the City would be able to stomach it because it is so large and diverse.

Chair: Thank you very much for coming to give evidence to us this morning. It has been extremely interesting. If there are substantial points that you feel we have not covered and should, we would be very grateful if you could put something down in writing to us. We will be receptive to taking that in evidence as well.

Raoul Ruparel: I just want to add I am happy to provide a package of all the data I have cited here for the Committee if that would be of interest.

Chair: That would be extremely helpful. Thank you very much, Mr Ruparel. Thank you both for giving evidence. We will move straight on to the next session.

Examination of Witnesses

Witnesses: **John Lough**, Associate Fellow, Russia and Eurasia Programme, Chatham House, **Roger Munnings**, Chairman, Russo-British Chamber of Commerce, and **Dr Chi Kong Chyong**, Director, Energy Policy Forum, University of Cambridge, gave evidence.

Chair: Thank you very much for coming to give evidence to us this morning. I am grateful to you for coming in time to have heard a good deal of the evidence that we have taken in the first session, too, which will be helpful to us. We will perhaps be able to avoid some repetition. Could I begin by asking all three of you in a sentence or two to characterise the EU's response to this crisis so far? Perhaps to assist, would you consider the response vigorous and effective at one extreme, or pusillanimous and ineffective at the other extreme, to give us a feel? I will go left to right. Mr Munnings.

Roger Munnings: I think slow and uninformed.

Chair: We have heard “slow” this morning. Can you just develop “uninformed”?

Roger Munnings: Yes. One of the issues, looking on from the outside, for me has been the fact that both sides have been very slow to talk to each other and very slow to appreciate the other side’s position. I spend quite a lot of time in Russia, and Russia has some solid logic to its approach, as you will appreciate. One of the problems that we have seen of late certainly is—

Chair: The solid logic being that they feel Ukraine should remain within their sphere of influence?

Roger Munnings: That it is part of their sphere of influence; that the Russian-speaking large minority in the east—and this is from Russian friends—has been disadvantaged by the actions of the Kiev Government, certainly in terms of language. The way it was put to me was if you are a Russian speaker in the east and you are faced with Ukrainian-speaking policemen, Ukrainian-speaking judges, then you are at a disadvantage. That was the basis of the use of the word.

Chair: I am just trying to clarify. I know I have interrupted you twice in response to explain the question on “uninformed”.

Roger Munnings: That is fine, yes.

Chair: Just to be clear, when you say the logic of the Russian position is clear, is it a logic that involves retention of Ukraine in the Russian sphere of influence or a part of the Ukraine? Which is it?

Roger Munnings: I think they would see Ukraine as their sphere of influence.

Chair: Okay. Therefore, their purpose is to retain territorial integrity and independence, but an independence that was within their sphere of influence?

Roger Munnings: All of the Russian rhetoric has been that they will not cross Ukraine’s border unless there is incitement to do so.

Chair: Isn’t that the other way round? Doesn’t that argument point in exactly the opposite direction, that they will if there is incitement, of which there appears to have been a good amount?

Roger Munnings: Well, other than in Crimea, they haven’t so far.

Chair: Okay. Well, that is a fairly big “other than”.

Roger Munnings: Of course.

Chair: I apologise, particularly since it is the first round of questioning, but you have said some very interesting things in your opening few remarks. Let us just go back to “uninformed” because I broke your train of thought on that.

Roger Munnings: Yes. For me, there just does not seem to have been enough dialogue between Russia and the EU and the US on how to solve the core problem. The core problem is how you assist Ukraine to be governable and to govern itself.

Chair: Okay. Mr Lough?

John Lough: I would characterise the EU's policy so far as weak, ineffective, betraying a significant degree of division. Russia knows how to handle the EU, and it does that through bilateral relationships. It does it pretty effectively. I think what we have seen from the EU so far is just a series of pinpricks. The Russians are much more worried about what is coming down the line from the US.

Chair: Dr Chyong?

Dr Chyong: I would characterise the EU response—and particularly the response in terms of energy response because that is my sphere of expertise—as uninformed. The energy policy of EU towards Russia in the Ukrainian crisis as uninformed in the sense that portraying Russia as using energy and particularly natural gas as a weapon to achieve its goal in Ukraine particularly, I do agree that there is some pressure—

Chair: I have not understood that point. Could you just explain that point again?

Dr Chyong: There is widespread opinion that Russia is using its energy resources as a weapon against Ukraine and Europe particularly in this.

Chair: That is uninformed?

Dr Chyong: Yes, and that is uninformed in the sense that what is happening between Russia and Ukraine at the moment is that Russia has a legal basis to act in the sphere of natural gas exports to Ukraine because it based its behaviour on the contract that has been signed in 2009 and is asking for the price, which is high but has been agreed between Russia and Ukraine back in 2009. I think that most of the public opinion at the moment that Russia is using gas prices against Ukraine to pressure Ukraine is somewhat uninformed in that sense.

Chair: I am perplexed by that piece of evidence, but no doubt colleagues will come back to it in a moment. I want to ask one further question before passing the questioning over to Brooks Newmark, which I will ask initially to Mr Lough and then if others want to chip in please do. It is widely reported that President Putin has extensive holdings of foreign assets personally abroad and has accumulated these over many years. What is your understanding of that, and what is your best estimate of the scale of that? Is this a card that can or should be deployed, and if it has not been deployed, why not?

John Lough: Mr Chairman, this is all in the realm of speculation. I do not believe anybody has any information about what Mr Putin is worth outside a very, very small number of people in Russia.

Chair: We have these WikiLeaks via the US. I do not know what store you place on those.

John Lough: Where is the evidence? I am certainly prepared to believe that he is not a poor man and there is a certain amount of evidence to suggest that he started earning a good deal of money when he was the deputy mayor in St Petersburg in the 1990s, but to attempt to put a figure on it—

Chair: And placing it abroad?

John Lough: Very possibly. Given that Russia was a rather unstable place at the time, I think that is quite likely.

Chair: And that it has not been repatriated?

John Lough: Who knows? He has been calling on his associates to repatriate their assets. There is widespread belief that the US authorities have targeted a certain Mr Timchenko and his company Gunvor, in the belief that Mr Putin has a stake in that company, but I cannot comment on that. That is speculation.

Chair: Before I hand the questioning over, on the basis of what you know about Russia and President Putin, would targeting it be likely to have any effect should this speculation be correct?

John Lough: It is very hard to say. I think Mr Putin has an intention to remain in office for some time. I am not sure that his living expenses are particularly considerable, so we can assume that he may need to have access to a level of cash. I would hazard a guess that he has a good deal of money accessible in Russia and believes that he is going to hold on to it.

Chair: Okay. Before I pass the questioning to one of my colleagues, is there anything else that any of you would like to add on that point?

Roger Munnings: Perhaps I could comment on the question of Putin's wealth. It is a comment you hear often. It is possible, may even be likely, but every time somebody makes it to me and I say, "Have you seen any proof of this?" because it would be interesting to know if proof existed, then the answer is always, "No, but don't you think it is likely?" That would be the only comment I could put forward.

Mr Newmark: Gosh, I do not know where to start, Mr Chairman.

Chair: That is not like you, Brooks.

Mr Newmark: No, I am trying to not delve into the sphere of the political, Mr Chairman. I will stay focused for a little bit, how about that?

Dr Chyong, besides your very obtuse response to the fact that Russia is not using gas or energy as a weapon, which I am not sure what parallel universe you came to that conclusion in, which they are—

Chair: Steady on, give Dr Chyong a further opportunity.

Mr Newmark: I am just going to focus on the UK.

Chair: We are not going to abuse the witnesses here.

Mr Newmark: Okay. The UK does not import any gas from Russia. Does that mean that sanctions then are less concerning from the UK perspective, as opposed to if you were German or Eastern Europe?

Dr Chyong: I think, yes, you are right, the United Kingdom does not import any gas from Russia, but it does import gas from continental Europe. It is about 10% to 15% of our annual gas consumption. If there were some energy sanctions against Russia that could lead to some sort of disruption to the European gas customers, then that might have some indirect effect on the UK for which those effects are going to be very limited in scale.

Mr Newmark: Okay. Focusing on the eurozone itself, given that Europe relies more on energy than the UK, is there a risk that the eurozone itself could be tripped into some form of recession as a result? Even though you say energy is not going to be used as a weapon at all, on the hypothetical circumstance that energy is and that they do turn off the gas supplies for whatever reason, could that trip the eurozone into a recession again and then that in turn could be a risk to the UK?

Dr Chyong: The macro-economic effects of energy disruptions and effects of those disruptions on European economies I cannot comment, but I do think that there will be some effects on the national economies of European countries.

Mr Newmark: Just because we are ultimately concerned about our constituents with high energy bills, which they have suffered a lot lately before this crisis happened, is there a risk that if we go and look at it from our constituents' perspective, even though we are not reliant, their energy bills nonetheless could be tripped higher?

Dr Chyong: Certainly, I do not possess any information with regard to the possible effect of those sanctions on the retail bills.

Mr Newmark: Okay. I saw John nodding there. Do you see an impact on energy bills if sanctions have an impact on Europe? Forget the UK, because we do not rely that much on them.

John Lough: I think if there were to be a restriction of Russian gas supplies to Europe through perhaps a chaotic situation in Ukraine, the 50% supply of Russian exports coming through Ukraine—it is 20% of Europe's consumption—that would have a significant effect. Obviously, spot prices would be affected, and in turn I think my colleague would agree that the British consumer would feel the knock-on effect from that.

Mr Newmark: Do you think then that the Ukraine crisis will be a wake-up call to the EU that having an energy partnership with Russia perhaps was a mistake because they are not necessarily a stable partner it looks like? Despite what Dr Chyong says, they could use it as a weapon. They have done it before. I am just curious if Dr Chyong would agree with this. They have used gas as a weapon before in terms of turning the gas off. No, yes, in Ukraine? You cannot say that they have not done because they have done.

Dr Chyong: I do disagree on this. The 2009 crisis was due to the fact that Ukraine has not paid its bill and Russia has legitimate cause to cut off gas supplies to Ukraine. In turn, Ukraine took the gas that was destined for European customers.

Mr Newmark: Okay. Then again, sorry, going back to Mr Lough, do you see that the impact of what is going on now, maybe the Europeans will look for alternatives and an alternative supply relationship for energy rather than Russia? Is that something in the calculus of the Russians today, or do they feel at the end of the day, when push comes to shove, that relationship will remain?

John Lough: I think experience shows that in 2008 when Russia went to war with Georgia, the Five-Day War, there was horror in European capitals at what the Russians were doing, a sense that we cannot just stand by and watch this, we have to act, we should not let them get away with it longer term, but within a matter of months the Russians felt the business relationship was back to normal. What I am saying is from where the Russian stance started out, they think, "The Europeans need us. They need our gas. They cannot readily find substitutes, at least not at favourable prices, so the relationship will remain in place." Now, we said in 2006, 2009, during the previous Ukrainian gas crisis, that the EU finally needed to do something, and I think 2009 was a really big wake-up call. Some things have happened since then. Interconnections have been built. Countries have looked more seriously at the issue of energy security. The EU is implementing its third energy package, forcing Russian companies like Gazprom to unbundle. In the European market, that is having an effect and the Russians do not like it, but you could argue that we have not gone nearly far enough yet to create the diversity of supply we need in order to manage the relationship with Russia. I would say at the same time it is a relationship that by and large has worked extremely well for Europe over a long period, because—

Mr Newmark: It has worked for Russia as well.

John Lough: It has worked for Russia, so—

Mr Newmark: A huge amount of their GDP depends on—

John Lough: So it may have been a stabilising factor in the relationship, but my view is it became unstable at a certain point when Russia began

to use gas—I disagree with my colleague here, in fact—as a political tool and Europe found in some cases it was very exposed to the Russian market. I think German dependence particularly on Russian energy sources, the fact that Germany is now closing its nuclear power plants, in fact increases the need for alternatives. Russian gas is one of them.

Mr Newmark: Right, but given they are trying to reverse their nuclear policy—I am not going to ask if they are going to reverse it once again—

John Lough: Unlikely.

Mr Newmark: But the lesson in the past couple of months clearly is that Europe is exposed to some form of risk of supply. On the flipside of that coin obviously Russia sees itself as vulnerable, I am assuming, because a huge amount of its GDP relies on exporting that energy. Do you see them switching where they are supplying energy to sources other than Europe? Is there a risk that the Russians themselves will look elsewhere to find outlets for their energy?

John Lough: I think the best way to answer that question is to draw attention to the importance of oil exports for Russia. Russia earns vastly more money from exporting oil than gas. Putin used some figures, which I believe are correct, just a couple of weeks ago to say that oil sales brought—if I remember correctly—\$191 billion per annum to the Russian state budget, whereas gas he said the figure was \$28 billion. He said, “Do you sense the difference?” I think what he was saying was the Europeans might be able to try to reduce their gas dependency on Russia over time, but it is not going to hurt us an awful lot. Russia can try to redirect some of its gas exports to China. It has been in negotiation with the Chinese for at least 10 years, as far as I am aware, and still no price has been agreed. It is something that will happen over time. Logically, Russia should be exporting more, in my view, to the Asia Pacific markets, so they will seek, I think, to create that optionality.

Mr Newmark: So in the game of three-dimensional chess, my final question, of which Putin seems to be three steps ahead of everybody else and we are playing a game of draughts, it would seem. Do you feel, Mr Munnings, that in his calculus, it is exactly this: he has seen that talk is cheap in the West and their memories are short, and at the end of the day somehow this will be history, and in five years’ time business will be back as usual with the west, particularly Europe, in terms of energy supply, and that if we fast-forward to 2019, this will be a dim and distant memory and gas and oil will have been going back and forth?

Roger Munnings: Yes, I think that is an element in his thinking, certainly. I think they will diversify, too; I think they will build. I was in Ufa, where there is quite a large oil production, a couple of weeks ago and the talk already there was of contracts with China and pipelines to China, although nothing had started beyond that. I think they will diversify; I think they will look to the far eastern market as has been said. Russia

supplied gas to Europe for 50 years without interruption throughout the cold war. I rather agree with Dr Chyong about using it as a weapon. Certainly, they had the excuse that Ukraine owed them a huge amount of money for gas, and although turning it off in mid-winter was absolutely brutal and rather in line with Russian negotiation, then I think, rather than using it as a weapon, it was just being done to get the cash.

Mr Newmark: To get their money back.

Roger Munnings: Yes. Russia does produce, I think, 9 million barrels of oil a day, which is about 10% of the world's production. If for some reason that flow was to be switched off, then it would have a really marked effect on economies around the world, because I do not think Saudi has the capability of anywhere near filling in that gap. The cost of oil would rocket really significantly, would be my view. So I think there is a concern there, but of course, as you have already said, that is a very painful thing for Russia to do with whatever the number was—\$196 billion a year coming in. But it is always worth remembering that if they have 9 million barrels—

Mr Newmark: Yes, it goes back to Putin's calculus, I am assuming, short-term pain for long-term gain, "If I can keep Crimea and maybe get a bit of Moldova, who cares, because in five years' time, it will be back to business as usual."

Roger Munnings: Yes, I think that may well be the way he thinks.

Mr Newmark: Okay, thank you.

Chair: I just want to clarify one point, possibly with Mr Munnings, but initially Dr Chyong. Your argument is they turned the supplies off in 2009, but that is because they were not getting their bill paid. Correct?

Dr Chyong: Yes.

Chair: Therefore, if they do get their money, they are not going to, also perhaps for the reason that Mr Munnings just gave. Correct? Yes. Is it therefore your view that the Russians are motivated partly by a desire to demonstrate compliance with legal norms and with treaties and agreements, once signed, as well as wanting the cash?

Dr Chyong: I think with respect to the commercial relations between Russia and Ukraine and particularly in the gas trade, it is the case that they have signed a very good deal in 2009, which has a base price substantially higher than the price was at the time in Germany, for example. Ukraine, perhaps because of its inability to diversify away from Russia, and particularly from Russian gas, had to sign that agreement. Of course, this is the commercial interest of Gazprom.

Chair: I have understood that, but I was asking a different question. I'll have one more go. I will give it to Mr Munnings. Is it part of what Brooks Newmark calls Russia's calculus that they need to continue to

demonstrate compliance with contracts, once signed, or is this about the money?

Roger Munnings: It is part of the way Russians do business. Once there is a legal contract, they will abide by it almost without exception. Having run a business there for 12 years, I never had one instance where a contract was broken or not honoured in any form at all. For example, if you have a series of—

Chair: The BP contract there some years ago?

Roger Munnings: Unless it is something that is absolutely of huge—

Chair: It looked a pretty big breach from the outside, but you were a little bit closer to it than me.

Roger Munnings: Yes, and of course in 1998 there were contracts broken relating to financial instruments and those sorts of areas, but unless it is absolutely critical, I think in routine day-to-day business, they will not break a contract.

Chair: But this is not routine day-to-day business we are talking about here.

Roger Munnings: No, it is not. No, it is not.

Chair: So I go back to the question: do they have the same view as some say the Chinese have that they want to build credibility by demonstrating adherence?

Roger Munnings: I would say that has been part of their tactic in internationalising themselves, yes.

Mr Love: The effect of sanctions imposed so far has been variously described as symbolic and cosmetic. Is that a fair description, Mr Munnings?

Roger Munnings: Yes, I think so.

Mr Love: Any others would disagree? So you think that we have just been playing at this so far. How about indirect effects? We heard earlier on from witnesses that there has been a substantial impact, although disaggregating what is happening to the economy generally and what has happened as a result of sanctions. What is your view, Mr Lough?

John Lough: We have certainly seen some chilling of the Russian market and the threat of sanctions is still there. Russian business appears to think that this is still a problem and could go further, and looking at the situation in Ukraine now, which is steadily deteriorating, and seeing that President Obama and Chancellor Merkel have both said that, if the presidential election on 25 May is disrupted, that would be—and I do not like using this term, but just as shorthand—a red line and then we would see a next stage of sanctions, although they have not been specific. So there could be more coming down the line, and as previous witnesses

have pointed out, the underlying condition of the Russian economy is not as strong as it was, let us say, in 2006, 2007.

One of the biggest problems is investment, and if FDI is now adversely affected, we are going to see knock-on effects in the Russian economy that are going to be negative, so we are already seeing the Russian authorities lowering their growth forecasts. The World Bank put out a very, very pessimistic growth forecast last week, I believe. The economy, they said, could be contracting by 1.8%. This is going to make itself felt.

Mr Love: Mr Munnings, you were nodding your head there. Do you agree with that analysis that the indirect impact has been much more substantial?

Roger Munnings: I think there is a significant impact and there is significant fear, but I am not sure that that will enable the EU and the US to achieve the goals of sanctions, because they have some very strongly held views about what they would like to see in Ukraine. Once again, Putin has become pretty popular in Russia. His popularity, I think, was on the wane because economic performance—you asked the question earlier about how much was due to sanctions and how much was happening anyway. Economic performance was really poor. Growth was probably under 1%, whereas the population's expectations had been ramped to 5% to 8% up until 2008, so the issue was the so-called middle class were no longer comfortable with the advance in their standard of living. That lack of growth has now been overshadowed by something that wins him support from Russian people.

Mr Love: But the inference is that as the economy declines, assuming it does continue to decline, that will then become a factor in his popularity. Does he have limited room for manoeuvre popularity at the moment, as a result of the strong way in which he has defended so-called Russian interests in Ukraine?

Roger Munnings: Yes. This is not my sphere of even competence necessarily, but I would say there was real danger of Russia becoming fortified and very supportive of its leader for the reasons they believe to be good ones.

Mr Love: There has been quite a lot of talk, Mr Lough, carrying on that comment about a fortified Russia, of a return to doing it all themselves, but what impact would that be likely to have? It would have a very negative impact on Russia in economic terms, but what impact would that be likely to have on the west?

John Lough: We could first of all see Russia becoming a more unstable place. Secondly, it would have effects on Russia's periphery. Russia is engaged in a quite ambitious project called the Eurasian Economic Union, so that is a union of three countries at present, Russia, Belarus and Kazakhstan, the biggest Central Asian economy, with Armenia set to join.

I believe this would impact quite heavily that project. It would, I think, have an adverse effect on some of the Central Asian economies, so we could see quite a complicated cycle there of, let's say, negative trends. The question would then arise to what extent are these manageable? We are not even talking about the situation in Ukraine, and nobody has given any indication so far about who is going to prop up the industrial heartland of Ukraine, where there are a lot of loss-making coal mines around, where Russia is engaged at the moment in south-east Ukraine. So I think Mr Putin is going to face, sooner or later, a problem of resources. Yes, he has very healthy international currency reserves, but a lot of economists agree on the fact that those could be actually used up very quickly. If, for example, financial sanctions were imposed against Russia and the country was effectively cut off from international financial markets, then there is a great deal of Russian corporate debt that would have to be refinanced, and I believe the Russian state would have to do that.

Mr Love: Let me come to that, and I will start with Mr Munnings. There has been a lot of talk about third-tier sanctions, whatever that means. President Obama is, if you like, taking a lead on this in terms of suggesting that further sanctions need to be imposed. You mentioned about financial sanctions, what type of sanctions would have the effect that the west is looking for in terms of a change in Russian attitude towards Ukraine, Mr Munnings?

Roger Munnings: I think it is an incredibly difficult question. I just do not know the answer to it. There is very strong Russian feeling in support of what they seem to be doing at the moment, at least what the Russian media are showing them as doing at the moment. That would be represented not as anything to do with NATO, which there must be some pieces missing, but as supporting a Russian minority that they see as being dangerously oppressed by, for want of a better word, an illegal Government. The elections are critical, and the response to the elections are critical.

Mr Love: That was probably an unreasonable question I just asked, so I will not repeat it, Mr Lough, but let me ask you what is politically possible in terms of further sanctions that will not expose the weaknesses and differences either in the EU or between the EU and the United States. What is politically possible in these circumstances if the decision is taken that more action needs to occur to try to influence Russia in terms of Ukraine? What would be the options that would be available?

John Lough: I see two options, neither of them particularly attractive. The first one is restrictions on Russian companies expanding abroad. There is a case at the moment of the Russian state nuclear company is looking at opportunities in the UK, I believe, together with Rolls-Royce. I

imagine that there might be measures put in place that would make that sort of deal, if it were ever to come to fruition, impossible.

Coming from the United States, which is less exposed to the Russian economy and is in perhaps a much stronger position to act, in principle, the issue of financial sanctions, I imagine, will be discussed quite seriously because this would be a way of having immediate impact on the Russian economy. I am informed that it is the sort of thing that would tip it into recession immediately and it would have a long-lasting effect, but that is something of a nuclear option, and you then have to model how the Russians would respond to that. But I imagine if the US went ahead with those sorts of measures effectively Europe would be obliged to follow.

If there is a big division across the Atlantic in terms of how we manage Russia or how we even read this crisis in Ukraine, then that could be very, very risky for the transatlantic relationship just at a time when we feel the need to reinvigorate NATO. So it is a complicated issue.

Mark Garnier: Mr Munnings, can I direct most of my questions—in fact, all my questions—to you? Looking at UK businesses, what difficulties do you think they are going to face in complying with these sanctions?

Roger Munnings: The practical ones have already been mentioned. We tried to circulate with the members of the RBCC after hearing that this hearing was taking place and we had about a 10% response. About 5% or 6% of those mentioned that just carrying out the due diligence to understand who they were dealing with might be an issue for them, so I think there is a practical problem. Sorry, could you repeat the whole question again?

Mark Garnier: It was to do with the complexities of the problems that UK businesses face, and while we are thinking about that, do you think the Government understands what they are asking of businesses who are going to have to comply with these sanctions?

Roger Munnings: It is difficult to say whether the Government understands it or not, but it is a complex issue for businesses whenever they go into a contractual relationship, understanding all of the strands of ownership, including beneficial ownership, which is the difficult step. You can carry out due diligence on registered ownership, but beneficial ownership is difficult. But we have had to deal with that issue for a long time. If I can, I have three areas of concern.

Mark Garnier: Yes, please.

Roger Munnings: The first is the City, and we have talked a lot about the City. Now, I think “minimal” was used or some expression was used. I would say there is a manageable effect on the City now, but the danger is if Russian companies stop coming for the longer term or London is seen as no longer a friendly place for companies to list, so there is that area. It is not a huge financial impact as is, but it is prospectively not good. Oil of

course is the other area, and specifically I think BP and Shell and oil majors. The worst possible thing to happen would be that BP's shareholding in Rosneft was somehow affected, so BP's value is fatally undermined for whatever reason. I think that is the danger. The probability is low-ish, I would think, but nevertheless it is there.

The next thing is just the long term. We are only 20 years into a kind of thawing of relationships from cold war times and the UK has been behind other European countries in terms of building relationships with Russia, for understandable political reasons, but nevertheless behind. We were making a bit of—

Chair: You are talking about alleged murder in the streets of London?

Roger Munnings: Yes, exactly, exactly. We are in the process of catching up, but I think this is going to set all of those developments back, but it will do it for the rest of the Europe as well.

Mark Garnier: This is part of an EU-wide thing, isn't it? This is not just London—

Roger Munnings: Yes. It will be the same for the rest of Europe too, but somehow the Germans seem to have a good way of speaking to the Russians.

Mark Garnier: Better diplomatic relations?

Roger Munnings: They have a better high-level political relationship, for sure. A point I have continuously made is to win big infrastructure projects in Russia, you need those high-level political relationships. That is where the Germans I think are very good. The Italians have been quite good. The French have been fairly good.

Mark Garnier: Our Foreign Office has been slightly lacking in comparison?

Roger Munnings: Not entirely lacking, but we have had reasons not to and we have not been able, probably for political reasons, to park those issues.

Mark Garnier: To a certain extent, part of my question is when we are talking about BP and we are talking about some of the big banks and all the rest of it, they have pretty substantial resources at their disposal in order to be able to invest more money into this compliance function in order to make sure they do not stray across the line with these sanctions, but what about the smaller businesses? Presumably, for some smaller businesses, trying to comply with this is going to be quite technically difficult for them to try to understand it. Do you think the Government understands the problems that they face? Maybe I will ask that question in a slightly different way: are you getting many representations about this?

Roger Munnings: Talking about third-level sanctions, and who knows what they are, I would say that it probably means that the Russian market closes for British companies. It certainly gives British boards the opportunity to say, "Much too risky. We are not going to go there."

Mark Garnier: This is the over-complexity response, if you like. It is far safer to turn around and say, "Forget it. Let's go and do something else in another part of the world."

Roger Munnings: Absolutely, so we are going to lose a potentially good market for a number of our services. I would not say a fantastic market. It is not China.

Mark Garnier: It is a good opportunity and it is growing, isn't it?

Roger Munnings: It is a good opportunity, 140 million people compared with China's, what, 1.4 billion—I am not sure—so it is not China, it is not India, but there are areas where British companies can do very well, not least in the City. In financial services, Russia is looking to establish decent pension funds, those sorts of areas; oil, obviously, and oil services. So it is much more looking into the future and saying, "Is that going to retard us still more?" that I would be worried about.

Stewart Hosie: Mr Munnings, can I just carry on from the questions that you have had there? Is it your view that in terms of compliance now with sanctions businesses are being over-zealous in the sense they are over-complying because they are not quite sure where the lines are?

Roger Munnings: I think there is a danger, isn't there? What is really interesting is that you see a complete disconnect between companies that are invested in Russia, UK companies, and UK companies who are not, but are looking at it. Those who are invested in Russia find it relatively straightforward to do business in accordance with their international values largely and do well. Those who are not, I think there is still a kind of residual cold war issue, corruption gets very, very high profile and so they are very resistant to doing it. The companies that are there will, I think, fight their boards to stay there and find ways to do it. Those who are not there will just say, "We always understood that that was going to be a problem so we will not take what we now see as enhanced risk," and it will be enhanced risk, "of infringing sanctions."

Stewart Hosie: In terms of an enhanced risk of infringing sanctions then, is the fear of reputational damage as strong as the actual practical impact of accidentally breaching a sanction? How big is reputational damage risk playing on the minds of boards?

Roger Munnings: I think if your Government makes a law, you want to comply with it. That is a business requirement, so you have to do it. Reputational damage, for those companies already there, a lot of them have lived with talk of operating in a corrupt environment yet have not

been operating corruptly for a number of years, so they would be likely to find ways to live with it, I would say, because it is a good market for most companies that are already invested there. Not a huge number of British companies, by the way, but nevertheless a good market for those that are.

Stewart Hosie: Okay. Mark Garnier asked you some questions about the Government's view on things, but let me ask from the business point of view. Do you feel that the Government have given enough reassurances or clarity to businesses on how to comply with the sanctions regime that is in place?

Roger Munnings: Again, I am not sure I am equipped to answer that, but my guess is you can never give enough, so the more you give, the better—the more you set out your stall, the better—and if you are already slow reacting with your European partners and there is some disagreement with your European partners, then the information that is going to feed to business is going to be slow.

Stewart Hosie: In that case, to all of the panel, if the businesses you are interacting with tell you, "We need more information in this area, that area," that would be useful for us to have to get a clear understanding of where businesses think there is a lack of specific detail in terms of compliance.

Roger Munnings: Yes. The RBCC has run sessions in Russia and in the UK on the current state of affairs and we have asked the embassy and UKTI to come and talk to those. My view would still be you can never give too much information in these circumstances, so if you are going down the route of stage 3 sanctions, please publicise and share what compliance requires.

Stewart Hosie: That is helpful.

Jesse Norman: Just a couple of quick questions. Mr Munnings, both Mr Putin and the Russian Deputy Foreign Minister have pointed to potentially painful consequences for people working in key sections of the Russian economy from any current or escalated round of sanctions. Obviously, you spend a lot of time advising foreign investors on investments in Russia in your own career. Can you tell us a bit about what that might involve, how you grade that, what you think the consequences might be of that and what advice you give businesses that are looking at investing in Russia?

Roger Munnings: Clearly, the first piece of advice is try to understand what the sanctions involve now, what they are likely to involve in the future, and that is a bit of a guess, but if you put that aside—

Jesse Norman: You were hinting that you shared Open Europe's view that EU tier 3 sanctions were highly unlikely.

Roger Munnings: No, I didn't say that.

Jesse Norman: I was getting that from your earlier—

Roger Munnings: Yes, it has been said, but I did not say it.

Jesse Norman: But is that a position you would support?

Roger Munnings: Again, it is not my area of competence. I do not know where the EU is in discussing it—I do not know how close it is to agreement on it—but my advice to companies has always been the same, which is find a Russian partner you can trust, and that takes time to get to know the person or the company, see if you can have meetings with the local governor so that you can access the local governor or his administration whenever you have concerns. It is possible to do business there without corruption.

Jesse Norman: You were suggesting, I think it is true to say, earlier that ideally—or, in fact, perhaps as a necessity—one needed high-level support for investment in Russia to give a kind of political backdrop or backstop to ensure—

Roger Munnings: If you are looking at major infrastructural projects, then you would do well to have full Government support and vociferous Government support.

Jesse Norman: But do you think companies with existing investments should think about disinvesting, given the way that the climate is going?

Roger Munnings: I think if sanctions require you to disinvest, you are going to have to disinvest. That is a very unattractive move to make, but if that is what sanctions require, you have no choice.

Jesse Norman: Right, so they should perhaps be at least making contingency plans against that possibility?

Roger Munnings: I dare say they are, yes.

Jesse Norman: Yes, okay. That is interesting. Mr Lough, can you just pick up the point we were discussing about where you read or where Chatham House reads the possibility of tier 3 sanctions from the EU? Do you think that is a possibility, or do you think that the EU is in too much disagreement over motives and vulnerable to pressure?

John Lough: Let me put it this way: I think we are in disarray at the moment, for the simple reason that our leaders are having great difficulty understanding Russia's logic in Ukraine, how far it wishes to go and what the end result is going to be. If the end result is effectively the destruction of a country's independence and sovereignty in Europe, a major country that impacts on our security, then I believe we will take further measures and some form of stage 3 sanctions. The Germans have effectively said this, not in quite those words, but they said, "We will go, if there is further destabilisation, to the next stage," and I think, coming

from Berlin, that is quite a significant statement. Sooner or later, we in Europe and we in western countries need to make up our minds about what we want to do about Ukraine and the extent to which this country matters to us. That will then determine our response.

Jesse Norman: So the EU is in disarray at the moment—

John Lough: On this issue.

Jesse Norman: Germany is giving some leadership, but it is unclear at the moment, okay.

Perhaps I can go back again to you, Mr Munnings. We see at BP Bob Dudley said that his company was unaffected by sanctions, and similar things have been said by senior Russians at the moment, even those who have been specifically targeted as named individuals. Do you think that, in fact, it is true that BP can be unaffected even by the current levels of sanctions?

Roger Munnings: That BP are unaffected by sanctions?

Jesse Norman: Even by the current level of sanctions.

Roger Munnings: I think the ultimate worry is the one I have already referred to, which is that some kind of reciprocal action be taken and BP's shareholding in Rosneft be somehow frozen or removed. Bob himself may have an issue, given that he is an American citizen, so quite how that relates to him sitting on a board, the chairman of which is one of the people who say sanctions do affect them, I am not sure, but clearly that is for BP and his personal lawyers to advise on.

Jesse Norman: Mr Lough, it appears to many outside observers that there has been a staggering lack of US leadership on this issue. Would that be your view?

John Lough: I think there has been an absence of leadership. There have been sporadic signs of life from Washington, but I think the problem arose because the US had largely outsourced the issue of Ukraine to the EU.

Jesse Norman: Although its own sanctions are stricter, in fact.

John Lough: Indeed, but I am talking about the origins of this crisis. The United States has not been heavily engaged, and the problem has been that this whole issue around the association agreement, whether Ukraine would sign or not, then triggered political destabilisation in Ukraine. The EU is not by any stretch of the imagination a geopolitical actor, so finds, by definition, this sort of thing very difficult to deal with. When you have to get, as we have mentioned before, the consensus of 28 countries, some of which have vastly differing degrees of relations with Moscow, this is well-nigh impossible. I think in Europe we are looking for leadership from the United States, and we have to see whether it is going to arrive or not.

Jesse Norman: Okay, so let us just be clear about that. The US has outsourced leadership on this major foreign policy issue to the EU. The EU is in no way a geopolitical actor and its policy is in disarray. That is just summarising your view.

John Lough: If I may clarify—

Jesse Norman: It is quite an interesting combination of claims; that was all.

John Lough: The US had outsourced the Ukraine problem and it woke up late to a problem with Ukraine that was of course then impacting hugely on its own deteriorating relationship with Moscow. We are in a situation now where the EU finds it, for understandable reasons, difficult to act. We are all trying to, I think, digest the consequences of this crisis. In particular, one of the questions is what is this going to do to Russia? Russia seems to have just shifted gear over the last three or four months, and it feels as though we are dealing with a country that does not care two hoots about its relationship with the west. It is prepared to take enormous risks to pursue its goals, and as Roger said, Mr Putin appears to have the people behind him at this stage. So we are dealing with a different actor and it is fair to say that the United States is also struggling with this. From what we know, there is a view among the analysts, the desk officers in the State Department, the Pentagon and elsewhere, they read this in pretty clear terms, and their advice has gone to the political level, but so far not much has come out of it. John Kerry was part of that Geneva process on 17 April, which delivered an agreement that, in my view, just was not worth the paper it was written on, because it could not be implemented.

Mr Newmark: It sounds like Syria.

Chair: Did you want to come in? Sorry, Mr Munnings.

Roger Munnings: Yes, just talking to businesses, and I have talked to the CBI a little bit about it, the thing that businesses are having difficulty understanding is why Geneva is not in permanent session. The core issue here is the governability of the Ukraine and how to govern it for the future, and nobody seems to be working on that at the moment. Therein lies the solution, and business is asking, "Well, why aren't people working on this? Why are we making escalating statements on one side, or aggressive, belligerent statements on the other? Why don't we attack the core issue, which is how do you govern Ukraine?" or "How does Ukraine govern Ukraine?"—sorry.

Chair: Thank you for that. Mr Lough wants to come in and then I am going to ask Dr Chyong, who has been very quiet and patient, whether he has anything he wants to add to any of the areas that he has heard since he last had the opportunity to speak. Mr Lough on this point and then Dr Chyong, and then it will be Pat McFadden.

John Lough: Thank you, Chairman. I just wish to state perhaps the obvious here, that the reason why there is not a permanent process at the moment in Geneva is that we have no common ground to discuss with Russia, because western countries wish to give Ukrainians, broadly speaking, the choice of how they wish to govern themselves and it seems that Russia wishes to restrict that choice. So this has become a chasm between Europe and the US on the one hand and Russia on the other, and I just do not believe we are able to deal with this right now, regrettable as that is.

Chair: Dr Chyong.

Dr Chyong: I do not have anything to add and I mostly agree with what has been said by my colleagues in those questions.

Mr McFadden: Mr Lough, I would like to take you back to a comment you made at the beginning of this session, where when all three of you were saying that the sanctions so far have been pretty symbolic, pretty cosmetic, have not had much effect and so on, that what Russia was worried about was what America might do next. Could you expand on this a little bit and what kind of further sanctions from the United States might make Russia think differently about what has been done so far?

John Lough: I am not inside Mr Putin's head and I cannot tell you exactly the calculations he is making, but he and those around him and senior figures in Russian business must be aware of what western sanctions did to Iran and they finally brought Iran to the table after a long period. They know that sanctions take a long time to work, that they take a high degree of political will, and it seems, as far as we can tell to be their calculation, that the game they are playing at the moment in Ukraine comes almost certainly with costs, but to them the costs of doing nothing in Ukraine are far greater.

Mr McFadden: To them, the United States, or the—

John Lough: To Russia, of doing nothing at all, because they believe that somebody else will fill the vacuum.

Mr McFadden: Right, okay, to Russia.

Going back to the Iranian parallel you mentioned, what was it about the sanctions against Iran that brought them to the table, what type of sanction really bit hardest?

John Lough: I am not an expert on sanctions against Iran, but it seems to me that the combination of the oil embargo and then locking them out of the international financial system were very powerful forces that finally had a political impact. So if you look at an economy such as Russia's, which is well-integrated with the west and Russia being a major energy supplier, I completely agree with the view that if you were to put Rosneft, Russia's largest oil company, on a sanctions list, you would be taking 2.5 million barrels of oil out of the picture immediately. Some of that of course could be redirected, but it would have a catastrophic effect on the

oil price, so the Russians know that, they know that the Saudis cannot pump that much oil, they know the Saudis have to live at a certain level of oil price, so they do not believe that we can deflate the oil price in any way, which would be a way, of course, of hitting them.

The global economy is recovering. This crisis might not have happened three or four years ago. The aftermath of the global financial crisis, Russia took a big hit and I think there was a bit of a wobble in Moscow as the oil price plummeted. They seem to think that, from what we can tell, they are sitting pretty, that sanctions are not going to have a huge impact, and we are talking about the way the decision makers are communicating at the moment, but from what I hear elsewhere in Russian business, there are concerns about this is going to be a sort of drip, drip effect and if investment dries up in Russia, this is just going to exacerbate the country's problems. So this is probably going to be a long march.

Mr McFadden: Again, sorry to keep going back to the parallel with Iran, but one of the things that was done there was the removal of access of a number of Iranian banks to the SWIFT—I do not know if you were in the earlier session when I asked the witnesses the same thing—international payments system. Given that the oil sales, which you earlier said were worth far more than gas sales, are denominated in dollars, is that kind of action in the thinking of people in the United States, and if it was, might it have an effect?

John Lough: The answer is that I do not know what people in the US are thinking. I imagine a whole range of scenarios are being looked at. Certainly, there has been discussion in Russian circles about potential de-dollarisation of the economy, although I do not take that very seriously, given the source it is coming from, at least the main source. It is certainly a factor, but I think you need to talk to a technical specialist to understand how the Russians would be able to cope with that, because I suspect they would find a way of coping.

Mr McFadden: Dr Chyong, you are an energy expert. This is Russia's key export. What is your view of the potential for the United States to step up sanctions, especially on the payments side of this energy contracts business?

Dr Chyong: As far as I know, when we embargoed Iranian oil, for example, some of the Chinese importers transferred the imports of oil and payment into the Iranian business in Chinese currency, as well as some of the Indian customers who also imported oil from Iran transferred that from dollars to rupees. So I think there will be some complicated schemes where Russia would find a way to still trade oil, but probably that would raise the transactional costs as well as the oil prices.

On the potential sanctions, I would like to mention particularly in the gas sector in Russia, as you may know, the gas is mainly transported through pipelines to Europe. In December 2013, Russia liberalised the export of

gas through the means of seaborne ships, the liquefied natural gas ships, to take it to markets other than the European markets, the traditional markets for Russian gas. So the technology that is used to liquefy this gas is all coming from the western companies, and if we were to put sanctions on those specific technologies, that could somehow, I imagine, shift the internal dynamics between Putin's inner circle, because the LNG export is mostly supported by Rosneft and Novatek. They are the companies that are competitors to Gazprom and that could potentially put some cost to Russia in the sense of not allowing Russia to diversify away from Europe, but on the other hand, we would then still keep the Russian gas exit to Europe secure, in the sense of not touching the Gazprom export contracts to Europe, so that is my point.

Mr McFadden: Do you think there is an appetite in the United States to go significantly further than we have seen so far?

Dr Chyong: I don't know.

Mr McFadden: Do you think there is an appetite, Mr Munnings?

Roger Munnings: I have no idea. There is some belligerent comments coming from the United States, but I have no idea of the underlying reality.

Chair: Thank you very much for coming to give evidence to us this morning. I am pleased to say we have been able to end this session in the morning rather than the afternoon, which I thought might not be the case half an hour or so ago. Can I end by saying we all found the evidence that you provided of considerable interest and if you have further points that you feel should be made, on reflection, please do put them down in written form? We will be glad to receive them. Thank you very much indeed.

