



The Russia Balance Sheet

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Russia's 1,000-year history is replete with revolutions, global and continental wars, economic crises, colorful leaders, and a brilliant cultural heritage. Its journey since the fall of the Soviet Union has been tumultuous. Russia rose from the ashes of a collapsed empire and nearly failed state in the 1990s to become an energy superpower during the past eight years. Its remarkable oil-fueled economic recovery boosted its GDP almost nine times from \$200 billion in 1999 to nearly \$1.7 trillion in 2008, making it the eighth largest economy in the world. The stock exchange reached an all-time high in mid-2008 after 10 years of remarkable economic growth. But as so often happens in Russian history, shocking events in the form of a war followed by economic crisis intervened in the second half of 2008.

The August 2008 Russia-Georgia war and the January 2009 natural gas conflict with Ukraine battered Russia's international reputation, and the global economic and financial crisis, which reached dizzying heights in September 2008, hit Russia hard. Growth slowed in 2008 to 5.6 percent and even started falling in December. Foreign exchange reserves, which had peaked at \$598 billion in early August 2008 thanks to soaring world oil prices, fell to \$386 billion at the end of February 2009 as oil prices plunged. Unemployment has spiraled, the ruble has plummeted, and industrial production has sharply declined. The country now suffers a severe downturn in an astounding reversal of nearly a decade of robust economic growth fueled by high oil prices and a consumer boom.

The economic crisis is putting a lot of pressure on the Putin-Medvedev regime. Vladimir Putin's presidency occurred during Russia's most felicitous conditions for economic growth, the dramatic increase in world oil prices and the "global money party" that occurred during his tenure. Especially from 2003 on, the Russian government needed to do little but float on the high oil prices to maintain robust growth, and the structural economic reform agenda went into hibernation. Since Dmitri Medvedev took over as president in May 2008 and Putin moved to the position of prime minister, however, those beneficial economic circumstances have dramatically changed. The commodity price cycle has peaked and credit markets have become very tight around the world. Public discontent with the devastated economy has spilled onto the streets, prompting the leadership—which was in denial—to finally admit that the crisis is seriously affecting Russia. Sustaining economic growth for the country's population will have a direct influence on popular support for the government.

As impressive as Russia's economic recovery has been over the last decade, if the country wants to rejoin the ranks of the world's great powers, it has a long way to go. The Russian government's "Russia 2020" economic growth plan, unveiled in February 2008, has set ambitious goals including raising the per capita income from \$12,000 in 2008 to \$30,000 in 2020 and making Russia the fifth largest economy in the world. But the leadership has thus far ignored the need for critical reforms, and the economy remains highly vulnerable to external circumstances beyond its control, primarily the oil price. Russia cannot continue to depend to such an extent on its resource wealth, which is prone to booms and busts. The lower oil prices are, the more difficult it will be for Russia to achieve its ambitious Russia 2020 goals by maintaining the status quo and the more vital new reforms become. For the country to reemerge as an economic power, it will have to swiftly implement substantial and comprehensive economic reforms. First,

Russia should accede to the World Trade Organization (WTO) to secure its successful international integration and an improvement of its legal standards. Russia suspended its application to join the WTO in anticipation of Western sanctions against its war in Georgia, which never materialized. Hopefully, it will reinstate its application soon. Second, to ease infrastructure bottlenecks, the Kremlin needs to introduce transparent procurement procedures for major investments. Third, property rights must be reinforced and renationalization stopped to ease the problems in banking and energy production.

The impact of the financial crisis on the domestic economy has also compelled Russian leaders to reconsider Russia's foreign policy. Historically, Russian governments have often seriously compromised optimal growth in favor of political control at home and domination abroad. The drastic deterioration in Russia's economic situation at the end of 2008 and the uncertainty about its duration have radically altered the assumption of a relatively high oil price on which the Kremlin has operated for the last several years. If the current oil prices endure and history is a guide, the substance and tone of Russian foreign policy should change toward greater accommodation to the West. The nature and goals of future Russian foreign policy will depend primarily on how the country develops domestically.

The extraordinary decade-long economic recovery in Russia has fueled its change from a reluctant follower in the 1990s to an obstructionist with aspirations to revise the world from a unipolar to multipolar order. The United States and its European allies have conflicting ideas about how to deal with Russia. Not only in Europe but around the world, interests are more fluid and cross-cutting in this era of rapid globalization. Perhaps most worrisome is that the understanding among American and Russian political elites about US and Russian roles in the world was never as diametrically opposed in the last 20 years as it is today. Channels of communication between Washington and Moscow are thin and fraught with hostility and distrust.

The security challenges are obvious: Russia maintains the largest stockpiles of nuclear weapons and fissile materials; its military-industrial complex is second only to that of the United States; and its client list features countries such as China, Iran, Syria, and Venezuela, whose interests diverge in important ways from those of the United States. Russia is a regional power in many respects. It is the largest country in the world and borders Europe, East Asia, and the Greater Middle East, theaters of greatest concern to US foreign policy, making its role as either a partner or a troublemaker most significant. Russia is important also in regional politics, energy, and the world economy. The inherent difficulties in anticipating what will happen in Russia make the stakes in getting it right all the higher for the United States.

In the near term Washington needs to gain a sense of how the new Russian regime is shaping up and the broad outlines of the Kremlin's policies and of its ability to drive policy. In the longer term the administration will need to consider other questions, such as: What kind of power is Russia likely to be in the world? How will it define its interests? What capacities will it have to pursue those interests? How compatible will those interests be with US interests?

The current situation has several advantages for US-Russia relations. One is that these relations have deteriorated so badly so that there is a strong feeling in both Washington and Moscow that something has to be done to improve them. Another advantage is that both the United States and Russia have new, young presidents who aspire to do better than their predecessors. A third precondition is that the global financial crisis offers all world leaders an opportunity to think big and effectively cooperate with each other.

Åslund and Kuchins identify six key areas of desired cooperation between Russia and the United States: Iran and missile defense, European and regional security including Afghanistan, arms control, commercial relations, energy policy, and democracy and human rights. Arms control is the area where the United States and Russia have the longest history of cooperation. It is the easiest place to renew the bilateral relationship, which is exactly what happened when Presidents Barack Obama and Medvedev met for the first time in London on the eve of the G-20 summit on April 2, 2009. They agreed to start negotiations on a new arms control treaty. The proposed deal would go beyond the 2002 Strategic Offensive Reductions Treaty (SORT), which committed both sides to cutting arsenals to between 1,700 and 2,200 warheads by 2012. It would replace the 1991 Strategic Arms Reduction Treaty (START I), which will expire in December 2009.

At the same time, the two leaders acknowledged that differences remain over US plans to deploy a missile-defense shield in Eastern Europe, Russia's war with Georgia in 2008, and the North Atlantic Treaty Organization's (NATO) plan to expand deeper into what Russia considers its traditional sphere of influence. The war in Georgia showed how brittle security remains in Europe and made plain that the issue is much more important than at any time since 1991. Because the United States has broad global security responsibilities, the onus is on Washington to take the lead in recasting European security. A prime goal of the United States must be to guarantee the sovereignty and territorial integrity of other states in Europe. President Obama stressed this goal in his remarks at NATO's 60th anniversary summit in Strasbourg on April 4, 2009, saying that it is important for NATO allies to reengage with Russia, while understanding that the independence of neighboring states had to be respected.

President Obama appears to have created a new atmosphere with Medvedev after the strained Bush-Putin years, and his administration must seize the initiative to define both its policy toward Russia and the agenda for the many multilateral meetings already planned, especially as unanticipated events will inevitably affect any agenda. Åslund and Kuchins propose the following next steps for the Obama administration:

- It is imperative that the Obama administration establish an explicit Russia policy rather than subordinating it to other issues in order to enable the administration to make necessary tradeoffs and follow up on promises. President Obama's intention is to lead Russian policy from the National Security Council (NSC). An interagency group for Russia has been created under the leadership of the NSC's senior director for Russia. Determination of a Russia policy should be the task of this group and should take the form of an NSC directive.
- Some time in May–June 2009, the new Russia policy should be ready and an NSC directive on Russia adopted. At this time, President Obama himself should make a public statement on his policy on Russia. If the circumstances are appropriate, the president should have something positive to offer. Ideally, President Obama would declare his determination to finally persuade the US Congress to graduate Russia from the Jackson-Vanik Amendment to the Trade Act of 1974 and really do so. This amendment requires the executive branch to certify to Congress annually that there are no restrictions on the emigration of Jews from Russia; if it were invoked, prohibitive Smoot-Hawley tariffs would apply to all Russian imports to the United States. Another offer could be to have the mutually beneficial US-Russia Agreement for Peaceful Nuclear Cooperation (also called the 123 Agreement) reintroduced in the US Senate.
- The first full-scale summit between Presidents Obama and Medvedev will take place in connection with the G-8 meeting in Italy in July 2009. The two presidents should recommit to fulfilling the April 2008 Sochi Declaration and to reestablishing a broader organized cooperation mechanism between the two countries, like that of the Gore-Chernomyrdin Commission, to promote action and accountability.

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