

Policy Bulletin

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The full report
from this event,
*"China, Russia,
and the United
States: Partners
or Competitors?"*
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online at

<http://reports.stanleyfdn.org>

The United States and Russia: Partners or Competitors?

It has been nearly nine years since Russia embarked on ambitious reforms to establish a democratic political system and free-market economy. The road to these goals has not been easy, nor has the task of building relations with the United States following the Cold War. After nine years, what is Russia today and what will it be in the future—a partner or a competitor?

To answer this question, the Stanley Foundation convened two roundtables to examine economic and security relations between the United States and Russia. Participants came from US government departments and agencies, nongovernmental institutions, and academia. This diverse group of policymakers and policy watchers spent several days assessing the nature of US-Russia relations, the impact of Russia's troubled domestic politics and its foreign and security policy, and what the United States can do to improve relations with Russia.

Policy Recommendations

- The Bush administration should raise the profile of Russia with Congress and work closely with them to broaden the definition of US national security interests.
- The United States should undertake a thorough assessment of national missile defense deployment and its potential effect on relations with Russia, and likely Russian responses.
- The United States should clearly articulate to Russia its interests in the Eurasia region, especially in the Caspian region, to avoid potential confusion and conflict.
- US policymakers should increase coordination among their Russia assistance programs. To date, there has been little strategy, measurement, or accountability of US government programs to Russia.
- NATO (North Atlantic Treaty Organization) expansion should not be a high profile issue or focus of US policy.
- US policy should be middle-range, programmatic, targeted, and synchronized. Grand policies of "building democracy" or "developing capitalism" are too abstract.
- The United States should target policies to areas where Russia has an interest in engaging and for which there is genuine Russian domestic support. More focus should be put on achieving objectives that may not be clearly related to security (information, cultural exchanges, etc.) and entail economic benefit to Russia.
- The United States should devote democratic and economic assistance programs to Russian societal actors where possible and direct assistance to the Russian state only when increasing Russian capacity is in the immediate national interest of the United States; e.g., Cooperative Threat Reduction program's support for creating systems for safe storage and disposal of nuclear, chemical, and biological weapons.
- The United States should increase funding for economic and military training programs. For example, funding should be increased to the New Economic School in Moscow and other new economic institutes and public policy programs to train Russian economists and public policy analysts.

This Policy Bulletin summarizes the primary findings of the conference as interpreted by the chair and rapporteur. Participants neither reviewed nor approved this Bulletin. Therefore, it should not be assumed that every participant subscribes to all of its recommendations, observations, and conclusions. The findings in this Bulletin do not necessarily represent the views of the Stanley Foundation or its staff.

Perspectives on Russia's Economy: A "Virtual" or Real Recovery?

What are the current prospects of the Russian economy? Do the Russian reform plans have the potential to usher in a functioning market economy in Russia? What principles should guide the next US administration in its policy toward Russia? As a starting point, the group discussed Barry Ickes and Clifford Gaddy's "virtual economy" model, evaluated the reform agenda of President Vladimir Putin's government, and explored the political economy of Russian economic reform.

There is controversy surrounding the Russian economic trajectory....

Whither Russian Economy?

In recent months most economic indicators have signaled an economic recovery in Russia. Yet there is controversy surrounding the Russian economic trajectory—are we witnessing a fundamental improvement in the Russian economy or merely the expected effects of devaluation and high oil prices?

Participants who argued for the presence of real improvement pointed to the following considerations to support their optimism:

- While last year's exports fueled growth, this year's growth is led by consumption and investment. If we were only witnessing the effects of devaluation and oil prices, the subsequent increase in external competitiveness would have resulted in export-led growth.
- Domestic investment levels have risen, especially in recent months. The Russian business magnates are investing from retained earnings. This demonstrates increased

confidence in the Russian economy.

- The Russian economy grew by over 7 percent in 2000, the largest increase in decades.
- Consumer spending has grown by 10 percent in recent months.

The pessimists questioned these trends as indicators of improvement, and they suggested that these are merely elements of a "virtual recovery."

- The decline in barter and the increase in monetary transactions can be attributed to devaluation. Because the choices entrepreneurs make are influenced by circumstances, there is nothing irreversible about the new preference for monetary transactions.
- Gross domestic product growth can be explained by rising oil prices and does not necessarily indicate an increase in the value of production.
- The increase in consumption is due to the partial payment of wage and benefit arrears. In fact, household incomes decreased because of the real wage decreases triggered by devaluation.
- What is happening now is the transfer of value from the value-destroying sectors back to the value-producing sectors. However, this value transfer does not prove that restructuring is taking place—the incentives to restructure are still too weak. High oil prices and the effects of the 1998 devaluation merely opened a window of opportunity for reform and restructuring, but there is

little evidence that it is indeed happening.

- No other country that has experienced so much currency depreciation has exhibited so little boom as a result.

Problems of the Russian Economy

In the course of discussion about the direction of the Russian economy, participants compiled a list of trends feeding the virtual economy—problems that require attention if Russia is to make real sustainable progress.

- **Relational Capital.** Relational capital—the heavy use of informal connections—perpetuates the barter system, enabling enterprises that would otherwise go bankrupt to pay rents and taxes to the state "in kind." As a result, success in many sectors is dictated by whom the entrepreneurs are connected with rather than how robust and efficient the enterprise is. Small businesses unconnected to government or the established magnates are being smothered.
- **Misuse of Subsidies.** Energy subsidies, in particular, were singled out as a problem. Because Russia enjoys an energy excess, it can afford to subsidize bankrupt and insolvent enterprises. Necessary restructuring is thus stalled in the subsidized sectors.
- **Lack of Incentives to Reform.** The prospect of joining the European Union and other Western institutions motivated Eastern European nations to make the necessary sacrifices for future gains; there are little factors of equal value to push Russia toward painful restructuring.

The Stanley Foundation convened two roundtables on US security and economic policies toward Russia. Participants were asked to both assess the current situation and analyze the possibilities for policy review or revisions in the next administration. This Policy Bulletin summarizes the discussion on security policy.

An End to the Virtual Economy?

Although most in the group displayed distrust of statistical indicators, the discussion did generate several trends that would indicate successful economic restructuring and an end to the virtual economy:

- The heavy industry sector is perceived as the greatest value-destroyer. The shrinking or restructuring of heavy industrial producers and the flowering of smaller, newer firms could be one such indicator of restructuring.
- If energy prices increase, exploitation of relational capital to obtain lower energy prices would decrease and, therefore, value-reducing enterprises would find it harder to continue operating without restructuring.
- A higher number of bankruptcies would mean bankrupt entities are not able to use relational capital and subsidies to stay in operation. (Although bankrupt businesses that reopen under different names and the political use of bankruptcies render this indicator somewhat ambiguous).
- Increased level of direct foreign investment is a straightforward indicator of real recovery.

Reform Proposals of the Putin Government

The panel overwhelmingly agreed that the "Gref Plan"—the package of economic reforms proposed by German Gref, Minister of Economic Development and Trade—is a good one. However, consensus that a greater part of the Plan will not be implemented in the near future was just as overwhelming. Most agreed that a

sufficient pro-reform political constituency does not exist.

With respect to changes the Putin administration undertook, opinions were mixed. On Putin's tax reform, which sets a 13 percent flat tax on individual incomes, both positive and negative aspects were mentioned. On one hand, redistributing tax revenues from the regions toward the center has the potential to reduce corruption. On the other hand, several panelists pointed out that regions retain the prerogative over distribution of social benefits; with less revenue available and less control over the expenditures, an increase in public welfare is not to be expected.

With respect to banking reform, Putin's move toward reducing the independent powers of the Central Bank elicited an uncertain reaction from the discussion panel. Putin's proposed amendments to the law on the Central Bank would put a stop to its commercial activities and transform it into a state-controlled agency for financial banking control. Whereas one participant argued that an independent Central Bank is conventionally thought to be good for the economy, another pointed out that in Russia today the banking sector is not investing in the economy. In this case, the proposed reform would mean a move from no investment to state-directed investment, and the effects of such a move are not necessarily beneficial or harmful.

The Russian Political Economy: Prospects for Reform

There was consensus regarding the indeterminacy of Putin's personal reform agenda—his

precise aims and through what kinds of policies these would be achieved are uncertain.

Opinions differed on the likelihood of any further reforms. Those who doubted the possibility of real reform under Putin pointed to the absence of a real pro-reform coalition. The Russian people are suffering from "reform fatigue." They are tired of a decade of failed trials. They elected Putin to bring stability, not create more unimplemented rules. Putin's main allies are "fundamentally illiberal" and are likely to push Putin away from the economic liberals in his support coalition. One participant added that market reform in the post-communist context has to be a part of a broad political agenda and that Putin is proving to be uncomfortable with political liberalism, stating openly that Russia has a genetic predisposition toward a super-centralized state.

Several participants offered considerations that brighten the gloomy prospects of reform painted by the more pessimistic panelists. One participant asserted that although there is no apparent great alliance for reform, Putin currently faces an unusual opportunity to push his initiatives through. The Duma is compliant, his economic team is rather competent, and there is still a chance that he can set off a virtuous cycle of growth and reform.

Prospects for US-Russia Security Relations

In assessing the condition of US-Russia relations, optimism has given way to cynicism. With the collapse of the Soviet Union, expectations were raised that Russia and the United States would now be able to work as partners in an

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international arena no longer dominated by the threat and suspicion that characterized the Cold War. The marked deterioration in US-Russia relations has sparked widespread concern and debate over "who lost Russia." Russia's attitude toward the West has clearly shifted in a direction that many in the United States find alarming. Why? Is the negative turn in US-Russia relations a result of Russia turning away from democratization and economic reform? Has US policy unintentionally exacerbated the situation? Does Russia have a consistent and coherent set of security interests and policy priorities? Does the United States have a consistent and coherent set of security interests and policy priorities with regard to Russia?

Trends in Russian Policy
Conference participants first looked at trends in Russian foreign and security policy. They agreed there is a crucial connection between Russia's domestic politics and Russia's foreign policy and security interests. This stands in marked contrast to the Soviet era when national security policy was, for the most part, separate from domestic politics. Consensus existed that US policymakers have failed to recognize that domestic concerns largely drive Russian foreign policy, and this failure has had negative consequences for US-Russia relations. Participants also agreed that it is crucial for policymakers to take into account Russia's domestic situation when responding to or formulating policy decisions.

The roundtable discussion then turned to specific foreign and security policy trends that were of considerable significance for US policymakers. Military

issues quickly came to the fore, as well as Russia's relations with the states of the former Soviet Union (FSU) and Russia's national security concept.

Military Issues. Russian military issues are closely tied to domestic political and economic considerations. Issues such as Russia's new military doctrine, military reform, arms control, and Cooperative Threat Reduction (CTR) were discussed. Russia's military doctrine, participants agreed, represented a serious setback for US-Russia relations due to a much greater reliance on nuclear rather than conventional forces. Domestic considerations have played a role in the formation of this doctrine. Participants said the shift reflects the weakness of conventional forces due in large part to Russia's continued economic difficulties.

Military reform was of particular interest, and the inherent difficulties with reforming Russia's military structure was noted by most participants. Economic difficulties, as well as issues of political patronage, are hampering Putin's ability to reform the military. There was widespread agreement among the participants that it is highly unlikely that Putin will be able to achieve all three goals and will be forced, sooner rather than later, to choose among military reform, strengthening the state, or modernizing the economy.

Policy Toward the Former Soviet Union. Russia's policies toward the FSU vary considerably. Russian policy in the FSU depends to a large degree on what other significant powers or interests are involved and how serious the conflicts of

interest are in different regions. The Baltic States of Latvia, Lithuania, and Estonia have been largely left alone in comparison to Russian intervention elsewhere in the FSU. The United States has drawn a clear line in the sand toward Russian actions in the Baltics, but failed to do so with other Soviet successor states. In Armenia, Azerbaijan, Georgia, and Moldova, Russia has intervened without risking confrontation with significant outside interests. Although the United States has declared its commitment to democracy-building in the region, it has failed to follow up with significant material support. In Central Asia, Russia and China have begun to consult closely because of a mutual interest in preventing the rise of Islamic fundamentalism. Russia appears to be finding accommodation with the Central Asian states based on Russia's locally predominant power. In the Caspian region, however, the United States and Russia may have competing interests. Participants saw the Caspian as having the potential to draw in the United States, Russia, Turkey, and Iran over competing pipeline projects if zero-sum geopolitical strategies prevail.

National Security Doctrine. Russia's national security doctrine has been revised under Putin, and the participants agreed that, in terms of US interests, those revisions were not for the better. On the positive side, economic reform is a top priority for Russian national security as is Russia's relations with the FSU. Although Russia declares that no one state is considered an enemy of Russia, it now states that the actions and policies of certain states or groupings (NATO)

US policymakers have failed to recognize that domestic concerns largely drive Russian foreign policy.

could potentially pose threats to Russia's interests. Some participants observed that there was a clear anti-US line in the national security concept; others argued that anti-Americanism is a by-product of a less cooperative security policy rather than its objective.

NATO Expansion

NATO expansion has consistently been one of the more contentious issues in US-Russia relations. There was no consensus about the advisability of NATO expansion. There was general agreement that NATO enlargement would further undermine US-Russia relations, but views varied considerably on exactly how relations would suffer if further NATO expansion was pursued. There was also disagreement about whether NATO enlargement would be in the United States' national security interest; although there was general consensus that US-Russia relations would benefit by keeping NATO a low profile issue.

The Russian Perspective

After the collapse of the Soviet Union, Russia declared itself a state committed to democratizing and to developing a capitalist economy. Enthusiasm flowed from the West, but the expected aid to Russia did not. Many reforms were not implemented, resulting in a belief by many Russians that the West had failed them and was trying to keep Russia weak. What initially was extensive pro-Western sentiment in Russia has been replaced by suspicion and even hostility. This will likely continue to feed misperception and miscommunication, which seem to be increasingly common characteristics of US-Russia interactions. Participants also noted that both sides have, at least to

some degree, failed to move out of a Cold War mindset. National security is still seen as a zero-sum game, where any gain for one side is a loss for the other. Additionally, neither Russia nor the United States seem to have reassessed their post-Cold War strategic needs, and old assumptions are slowly being replaced.

The Putin Factor

The emergence of Putin as Russia's prime minister and then president has also contributed to the deterioration of US-Russia relations. Participants in the roundtable discussions were not optimistic that relations would improve under Putin. One of the fundamental differences between Putin and Yeltsin is which interest groups and institutions dominate policy. Putin has turned to the Federal Security Service, one of the successor organizations to the KGB, and the army. These institutions have consistently proven themselves to be less willing to accommodate Western concerns and are more confrontational with the West. This institutional shift could lead to a Russia that is less willing to be deterred. Additionally, participants thought that Putin seemed to value good US-Russia relations less than Yeltsin. Putin seems much more uncomfortable than Yeltsin with Russia's second-rate status and believes the West is ignoring Russian concerns on many international issues. Another significant difference between the two leaders is that Putin is seen as more willing to do something about Russia's apparent international irrelevance.

Participants also agreed that Putin is trying to bring coherence and consistency to foreign and national security policy.

While Yeltsin had an interest in keeping foreign policy and national security institutions divided, Putin's reliance upon the security agencies will likely reduce the fragmentation of policymaking in Russia and give it the coherence and consistency that it has lacked. This may bring a greater clarity to relations between Russia and the United States, although those relations may be decidedly cooler.

The Role of the United States

Participants agreed that US policy toward Russia has not had the intended results. There was general consensus that the new US administration's policy assessment must go beyond the content of foreign policy to examine how policy toward Russia is formulated and implemented. There was no disagreement when one participant observed, "the United States is institutionally set up to fail in foreign policy." That is because discord between the executive branch and Congress has significant foreign policy implications that the new administration is going to have to address to achieve effective foreign policy outcomes.

Economic and Security Relation Linkages

Russian economy experts and Russian security experts pooled their intellectual resources to address "linkage" issues and attempted to draw up a list of policy recommendations for the next US administration. Three linkage issues were explored; however, not many concrete policy proposals were agreed upon.

- Is there a real contradiction with Putin's support coalition, and how will it affect prospects for Russia's reform? Opinions were split. Several participants suggested that there isn't a

Putin is trying to bring coherence and consistency to foreign and national security policy.

necessary contradiction between reformers and "men with guns" in Putin's coalition because the latter do not automatically side against the market economy. Others felt that the inconsistencies among Putin's backers were certainly among the factors precluding true economic reform.

- How much does Putin need Western economic assistance, and can it be used as leverage in security issues? There was not much confidence in the efficacy of the economic aid lever. One participant suggested that any provisions the United States can attach to International Monetary Fund (IMF) loans or other forms of assistance are merely short-term gains that will not be important in the longer term. Several panelists indicated that a future IMF agreement may, in fact, be used as a lever in negotiations to restructure the Russian debt; however, since debt restructuring is more important to Germany than to the United States, this task is probably better left to the Germans.

- What is the role of energy as a resource for Russian participation in the international economy? It was a prevalent opinion that American economic and military involvement in Central Asia is threatening to the Russians, leading them to use Gazprom and Transneft as implements of their foreign policy instead of promoting a proper integration of Russia in the international market economy. Although most participants agreed that US actions were perceived as threatening by Russia, the conclusions they drew from this assessment differed. Many expressed the

thought that justifications for US involvement in Central Asia are not convincing enough to bear the cost of antagonizing Russia. Others suggested that Russians would feel threatened no matter what the United States does; Russian perceptions of threat, therefore, are not necessarily a good basis for altering behavior.

Conclusion

After nine years, Russia is still a state in transition—a theme that was repeated again and again. Ultimately, the type of state Russia becomes, both domestically and in the global arena, will depend on what course it charts in its reform efforts. If the United States is concerned about the direction and tone of Russia's foreign and domestic policies, its best strategy is to try to influence the domestic debates over reform in Russia. This will require the US executive branch and legislature working together—broadly but clearly defining US security interests—and developing a coordinated, consistent, and synchronized Russia policy. The United States does not have the capacity to transform Russia, but it can influence the path Russia takes.ⁿ

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Strategy for Peace, the Stanley Foundation's US foreign policy conference, annually assembles a panel of experts from the public and private sectors to assess specific policy issues and to recommend future direction.

The seventy-five participants who met at Airlie Center were drawn together in four concurrent roundtable discussions to examine the current state of relations and recommend elements of a strategy for peace.

All sessions were informal and off the record. In preparing this document following the conference, the chairs and rapporteurs tried to convey the areas of consensus and disagreement and the conclusions of the discussion. It contains their interpretation of the proceeding and is not merely a descriptive, chronological account.

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