



Policy Brief

July 2006

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Russia on the eve of the G8 summit

By Fraser Cameron

Background

This weekend, the leaders of the world's most advanced industrial democracies will meet at the G8 summit in St Petersburg, the home city of Russian President Vladimir Putin.

Some might ask why Russia is a member of this exclusive club, given that its economy is way behind that of China, India or Spain. Others have called for a boycott of the summit because of rising concerns about democratic practices in Russia. There will be no boycott, but the spotlight will shine brightly on Russian foreign and domestic policies. So how does it look today, 15 years after the collapse of communism?

Few states have been through the trauma Russia has experienced in recent years. It lost its empire, ideology and superpower status almost overnight. Its political, security and economic elites became completely disorientated.

In the Klondike years under President Boris Yeltsin, the economy suffered from mismanagement and lack of direction. In 1999, GDP was 40% below the level of a decade earlier. Some oligarchs became massively

rich overnight, but for many it was a period of hardship and suffering.

Western attempts to promote quasi-instant democracy and a market economy had little success, and the failure to bring prosperity in the 1990s became increasingly synonymous with the failure of democracy and liberal values. The West tried to prop up President Yeltsin, mainly out of fear that the extremist Vladimir Zhirinovskiy would gain power. Four years later, Russia was admitted to the full G8 meetings, covering economic as well as political issues.

Domestic stability restored

When President Putin took over in 2000, in a carefully stage-managed election, he inherited many difficult problems. The largest country in the world seemed to be going backwards, with its economy almost in free fall. He swiftly established himself as a strong leader capable of taking tough decisions and restoring some pride to the country. His background in the FSB (formerly KGB) was seen as positive by most people.

He prioritised the economy and, helped by a boom in energy prices, oversaw a period of steady growth (6-7% annually during 2000-2005) that brought increased benefits to most Russians.

While it was no surprise that he was re-elected by such a large margin in 2004, President Putin's second term has seen a worrying move away from democratic practices, with increasing controls on the media and NGOs, and little effort to promote the separation of powers. He has also sought to limit the independence of Russia's 88 regions by moving to a system of Kremlin appointees rather than elected governors.

Too uncritical?

Several Western leaders have sought a special relationship with President Putin. George W. Bush famously looked into his soul at their first meeting in 2001 and declared that this was a man with whom he could do business. After 9/11, Washington basically gave him a free hand in dealing with 'terrorists' in Chechnya, while Italian Prime Minister Silvio

Berlusconi refused to allow journalists to ask questions about Chechnya during a press conference after an EU-Russia summit.

Germany's former Chancellor Gerhard Schröder forged the closest ties of any European leader and, on leaving office, took up a position with the Russian gas company, Gazprom.

Many are now questioning whether this uncritical approach is the right policy towards Russia.

The EU has a strategic partnership with Russia which is notable for its lack of content. The Partnership

and Cooperation Agreement is up for renewal next year, and there is a lively debate about the future EU-Russian relationship. So far, the Union has failed to make much of an impact in Russia because Member States are divided. Some, such as France and Germany, do not want to rock the boat; others, such as Poland and the Baltic States, seek a much tougher EU line towards their big neighbour.

Meanwhile, Russia has become an energy superpower, not afraid to flex its energy muscles to promote its own interests. The EU is heavily dependent on Russian energy and

this dependence is likely to grow. As a result, it is attempting to develop an energy security policy, but this will be very difficult unless there is a minimum of agreement on an internal EU energy policy.

At this May's EU-Russia summit in Sochi, President Putin sought to allay EU fears, stating that Russia "was, is, and always will be, a reliable supplier".

But he warned that any opening of Russia's own energy market, including pipelines, had to be matched by reciprocal arrangements for Russian companies in Europe.

State of play

When G8 leaders gather in St Petersburg, they will experience a newly self-confident Russia. The economy is growing three times faster than the EU average. Foreign debts have been largely repaid and foreign exchange reserves stand at over \$185 billion, the fifth largest in the world. The rouble has just become convertible. The stock market is booming, the streets of Moscow are clogged with new cars, and millions of Russians take foreign holidays.

The boom is mainly, but not exclusively, tied to the rapid rise in energy prices. Today, the country ranks 12th in the world and just marginally ahead of the Netherlands in terms of GDP (just under \$1 trillion in 2005), with Goldman Sachs predicting that it could become the globe's fifth largest economy by 2025.

Understandably after decades of drab communism, Russians want to enjoy their new-found prosperity and freedom. Both the state and consumers seem intent on 'spend, spend, spend'. There is no thought for the longer term: investment is lacking and major problems

are either ignored or tackled with insufficient resources.

In the early years of President Putin, a number of reforms designed to strengthen the market economy were introduced – notably the tax reform and provisions for the freehold ownership of property. But, more recently, there has been a trend towards greater state control of the economy, especially in the energy sector, which has led to a distortion of fair competition.

Russia's leading gas company, Gazprom, alone accounts for nearly 10% of its GDP. The oil company Rosneft, which snapped up most of the assets of Yukos (one of the world's largest oil companies before it fell from grace) for next to nothing, is also growing in size and power.

The other side of the (gold) coin

Despite the healthy state of public finances, investment in education, health and transport is lacking. Russia has one of the worst HIV/AIDS infection rates in the world, and alcoholism continues to be a problem,

along with other social ills such as racism and bullying in the military. The gap between rich and poor continues to widen. Corruption is rampant, with a resurgent bureaucracy able to block reforms.

Russia also faces a major demographic challenge. On current trends, the working-age population will decline by 18 million over the next 20 years, but economic growth at the current rate will require an additional seven million workers by 2015.

The big problem is male mortality, which, at 58, is way below the European average of 77. Unless something can be done to raise this rate or produce a sharp rise in productivity – which requires investment, restructuring, education and training – the labour deficit will become a serious constraint on economic growth.

The combination of easy oil money and intolerance of criticism, verging at times on paranoia and a persecution complex, is leading the Kremlin to disregard the negative effects of its behaviour on Russia's image in the world.

Moscow has defended President Alexander Lukashenko's Belarus and other authoritarian regimes in Central Asia; openly backed the candidacy of Viktor Yanukovich in the rigged 2005 Ukrainian elections; and is dragging its feet on the frozen conflicts in the Southern Caucasus and Transnistria. The Russian foreign and security elite appear to treat all issues as an old-fashioned zero-sum game.

Belarus, Georgia and Ukraine are thus pawns in a new struggle for influence. In January, Sergei Ivanov, Russia's defence minister and a possible successor to President Putin, stated that the chief threat to Russia's security was possible "interference in Russia's internal affairs by foreign states, either directly or through structures they support". This statement followed a clampdown on NGOs, which were portrayed by the Kremlin as tools of foreign intelligence services.

It is not so much that Moscow wishes to re-create the Soviet Union, but that it seems to resent its former satellites breaking free

and going their own way without paying homage to Russia. Despite recent negative trends towards greater state control of the media and restrictions on NGOs, most Russians enjoy far more freedom than at any time in their history. They can choose where to live and work, travel abroad, access the Internet, and read and watch what they want.

A 'Russian' democracy

But there are limits on the freedom of the media and it can be dangerous to openly challenge those in power, as former Yukos head Mikhail Khodorkovsky and former oil tycoon Boris Berezovsky discovered to their cost. As former President Mikhail Gorbachev said recently, it is an imperfect democracy but a Russian democracy, and he was confident that there could be no going back to Stalinism or communism.

One of the main problems, however, is that Russia's present stability depends almost exclusively on the Presidency, and there is

no real system of checks and balances. Too much power is concentrated in the Kremlin and the lack of control over the executive means corruption can flourish unchecked. There is no system in place for the orderly transfer of power, as most opposition groups are viewed as disloyal. This is not the mark of a healthy society.

At the same time, President Putin regularly reaffirms his belief in the importance of democracy and has actively promoted the concept of Russia as a multinational and multicultural state.

Meanwhile, Russia has taken over as chair of the Council of Europe. This caused some raised eyebrows, but Moscow's involvement in this human rights body has helped modernise Russian laws and enabled many Russians to take their cases to Strasbourg. It has also led to a moratorium on the death penalty, and the Russian authorities now have to submit to regular and often critical reporting resulting from the Council's monitoring mechanisms. Acting on these reports, however, is another matter.

Prospects

After the sudden collapse of empire and a decade of humiliation, with European and American consultants queuing up to tell them how to run their country, it is hardly surprising that the newly-wealthy Russians are luxuriating in their new energy superpower status.

The inevitable end of the oil boom will, however, bring some formidable problems to the surface, and renewed instability and extreme nationalism cannot be ruled out. Meanwhile, present riches have led to a new Russian arrogance in the way it treats its neighbours. Most Russians also seem content with their new 'managed democracy', as polls show that if they had to choose

between prosperity and democracy, most would opt the former.

The political class in Russia is now focused on who will succeed President Putin, with parliamentary elections due in December 2007 and presidential elections in February 2008.

There is no real opposition to United Russia and the composition of the Duma is unlikely to change significantly. There was some speculation that President Putin might try to change the constitution to allow himself a third term, but this now looks unlikely. There is little doubt, however, that he will have a decisive say in the choice of successor, who is more than

likely to be someone in his current entourage. Speculation largely centres on Sergei Ivanov and Dmitri Medvedev, both deputy prime ministers. It thus seems fair to predict that post-2008, we are likely to see a continuation of present policies.

How President Putin's successor governs will depend on a number of factors, including the state of the economy, the nation's social fabric and whether there are further terrorist attacks inside Russia. The President has at least openly addressed Russia's main social problems and has announced four national projects designed to raise the human development index: in education,

healthcare, agriculture and access to quality housing. But the 2006 budget for these four sectors is just \$4 billion, rising to \$5.5 billion in 2007 – quite inadequate for a country the size of Russia.

Russia at the crossroads

It is also clear that Russia is approaching an economic crossroads. There are strong protectionist forces who would like to build a 'Fortress Russia', using earnings from energy exports to prop up unreformed, non-competitive industries. But there are others who argue that Russia must become a dynamic, outward-looking economy to survive in global markets. This would involve continuing economic reforms, re-invigorating privatisation, streamlining the bureaucracy, enhancing the rule of law and rooting out corruption.

This struggle will continue for some time, but there are certain encouraging trends. Many Russian companies are seeking public listings and this should have positive implications for corporate standards. Russia's accession to the World Trade Organization, scheduled for later this year, will force it to follow agreed international rules on intellectual property rights and other issues.

President Putin also seems to recognise that without a proper legal structure, foreign companies will not invest in Russia. The rise of the first post-Soviet generation to the top in politics and economics should help mark a new approach.

EU Russian relations

Today, Russia ranks as the EU's fourth largest trading partner, and the Union is number one

for Russia. Trade is growing fast (over €124 billion in 2005) and the relationship is complementary: Russia is the EU's most important supplier of energy, iron and steel, while the EU is among Russia's most important suppliers of telecoms equipment, machinery and chemicals. In addition to these strong trading links, the stock of foreign direct investment (FDI) had grown to around €21.9 billion in 2003, with €17.1 billion of this accounted for by EU investments in Russia.

However, while trade is booming, there has been less progress on other issues, including the shared neighbourhood, energy security, Chechnyna and human rights.

The EU is unable to agree on whether or not to apply conditionality in its relations with Russia. While the EU-Russia Partnership and Cooperation Agreement and the strategic partnership are based on alleged shared values, including democracy and the rule of law, it seems that there is no agreement on defining these values.

In the circumstances, some argue that the EU should drop the pretence of shared values and concentrate on shared interests. It should cooperate on specific issues (Iran, energy, Kaliningrad), but not attempt to hold Russia to account for what it does internally. The trouble with this argument is that it muddles short-term tactical gains with long-term strategic interests.

Dealing with an emerging super power

The EU cannot be indifferent to what is happening in Russia, by far its biggest neighbour. It has more than 10% of the earth's landmass and shares borders

with 14 countries. It has vast natural resources in minerals, forestry and energy. It is a permanent member of the United Nations Security Council, and belongs to the G8 and the nuclear club. But more important, the EU has a long-term interest in a stable, prosperous, democratic Russia.

What the Union needs above all is a united approach towards Russia; not blind Russia-bashing as some advocate, nor supine acquiescence as others seem to prefer, but a sustained commitment to a relationship based on values and interests, with the right balance of rapprochement and distance. The successful negotiations on Kaliningrad were a good example of how a united EU can secure a deal favourable to all.

The summit on 15-17 July could be an embarrassing occasion. Indeed, some Western governments have sent representatives to participate in an alternative meeting of NGOs organised by Gary Kasparov, the chess champion and an outspoken critic of President Putin, in Moscow just before the G8 summit.

This will displease President Putin, but as he welcomes his G8 guests, he will also be able to portray himself as the man who brought Russia back onto the world stage. Western leaders should recognise his achievements, but also remind him that G8 membership is open to advanced, industrial, democracies. On all three counts, Russia still has much to do.

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