Economic Whiplash in Russia

An Opportunity to Bolster U.S.-Russia Commercial Ties?

A Report of the CSIS Russia and Eurasia Program

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Executive Summary

Understanding the ramifications of Russia’s economic crisis for its foreign policy is critically important. Since the crisis hit, Russia’s foreign policy moves have largely been characterized by greater assertiveness, as demonstrated by the “gas war” with Ukraine. As a result, some analysts have concluded that Russia is on a path toward confrontation with the West. However, it is too early to make definitive judgments about the direction in which the crisis will push Russian policy. In fact, the crisis has created incentives for the Russians to work with Western partners, in particular on economic issues. Therefore, now is the time for the Obama administration to put a higher priority on commercial ties with Russia. Closer economic relations are in the U.S. national interest, create conditions for cooperation on noneconomic issues, and provide a stronger foundation for the bilateral relationship.

This report recommends 10 steps that the Obama administration can take to bolster commercial ties between the United States and Russia:

1. Promote Russia’s integration into international economic institutions, in particular the World Trade Organization (WTO) and the Organization for Economic Co-operation and Development (OECD).
2. Graduate Russia from the Jackson-Vanik Amendment to the Trade Act of 1974 and grant it permanent normal trade relations.
4. Increase export support and trade facilitation for U.S. companies interested in the Russian market.
5. Reintroduce the Section 123 Agreement governing civilian nuclear activities.

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7. Reform and reinvigorate the U.S.-Russia Energy Dialogue and add energy efficiency and alternatives to the agenda.


10. Continue discussions with the Russians on constructing a new international financial architecture.

Overview

The global economic crisis has hit Russia extremely hard. Its main stock market index, the Russian Trading System (RTS), has lost over 70 percent of its value since its peak in May 2008, the worst performance among emerging markets. After a remarkable decade of robust growth, economic performance is expected to stagnate this year or even decline. Since early August 2008, Russia spent more than a third (more than $200 billion) of its reserves on implementing various stimulus measures and supporting the ruble. Industrial production in December 2008 plunged 10.3 percent year-on-year, while the number of unemployed in Russia increased by 20 percent from October 1 to mid-January. Recent estimates suggest that if the average price of oil is below $35 per barrel this year, the Russian budget, after a decade of surpluses, could run a deficit of more than 10 percent of gross domestic product (GDP). In 2008, capital flight was an astonishing $129.9 billion, which is over five times the previous high recorded in 2000.

The political impact of the downturn has been amplified by the speed and degree of Russia’s economic descent—the crisis hit when Russia’s economy was at its post-Soviet peak. From the economic crisis of 1998 to the summer of 2008, Russia underwent a macroeconomic revolution. Whereas it had defaulted on its external debt in 1998, by 2005 it had become a net creditor in the International Monetary Fund (IMF) and by May 2008 it held around $600 billion in currency reserves.

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7 Interfax, January 17, 2009.
reserves, the third largest in the world. Its nominal dollar GDP had increased by more than eight times from 1999 to 2008. By 2008, Russia’s stock market capitalization was over $1 trillion, the highest among emerging markets. The government’s strategic plan saw Russia becoming the largest economy in Europe and the fifth largest in the world after the United States, China, Japan, and India by 2020. It was from this position of economic might and policymaker confidence that Russia fell into what may be a drawn-out economic downturn.

It is important that U.S. policymakers understand the implications of this unprecedented economic whiplash. The crisis could have a major impact on Russia’s external behavior and therefore on U.S. interests.

As of this writing, many analysts have already concluded that the crisis will spur a new period of aggressiveness in Moscow’s external stance. Most agree with Dimitri Simes’s maxim that “In Russia, hard times normally produce hard lines.” Thus far the crisis has indeed correlated with assertiveness in Russian foreign policy. For example, Russia has engaged in a highly destructive “gas war” with Ukraine, at one point going so far as to completely cut off deliveries to Europe, which caused rationing in some countries, such as Bulgaria, that are completely dependent on Russian gas. The recent announcement that Kyrgyzstan would close the U.S. military base at Manas under apparent Russian pressure would also indicate a more assertive line. Moscow seems at least in part motivated by a revanchist instinct to keep its “near abroad” under tighter political control.

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8 As of this writing, Russia still has the third-largest reserves in the world, despite the $200-billion drop mentioned above.
10 Economists, both in Russia and the West, dispute how long the crisis will last. For example, the Moscow office of Standard & Poor’s, as well as most of the investment houses, argue that the economy will bottom out by the summer of 2009, while German Gref, former minister of economic development and trade and current president of Sberbank, the state-controlled savings bank, recently argued that the crisis will last until 2012. See “Rossiya i krizis: KTO kogo?” February 4, 2009, http://www.k2kapital.com/news/fin/539162.html, and Mariya Privalova, “Rossiya zhdet trekhletnyi krizis,” Finam.ru, February 4, 2009, http://www.finam.ru/analysis/forecasts00D3E/default.asp, respectively.
Despite these assertive moves, it is too early to draw definitive conclusions about the future trajectory of Russian policy. History provides evidence that economic downturns in Russia have often corresponded with periods of greater cooperation. Economic stagnation in the late 1980s was associated with the end of the Cold War, and the contraction of the early 1990s correlated with an accommodating foreign policy under Boris Yeltsin.

Although nothing is predetermined, this historical perspective suggests that the current economic downturn could push Russia toward a more cooperative stance vis-à-vis the West, especially in terms of economic cooperation. Just nine months ago when oil was over $140 per barrel, Moscow had fewer incentives to engage with the West on economic issues. Russia was such an attractive market that it did not need to make an effort to lure Western investors; money flowed into its markets regardless of its policies. Its economy grew at a rapid clip despite the stagnation of the economic reform agenda, and it no longer needed financing from international institutions to ensure fiscal health. In short, Russia’s boom provided little incentive to reach out to the West on economic matters.

With its economy in deep trouble and oil now under $50 per barrel, this situation has changed significantly. Clearly economic troubles are not exclusive to Russia, but the whiplash factor has altered the incentive structure to perhaps a greater degree than in other countries. Recovery from the crisis could require a considerably greater degree of economic engagement with the West than the boom did. In sharp contrast to the pre-crisis period, Russia may now need resources that only international, and particularly Western, investors, institutions, and trading partners can provide. This is a potentially powerful incentive for pursuing greater cooperation. Four examples illustrate the point.

First, since its budget appears likely to run a large deficit this year, Moscow may need to turn to international lenders to shore up its fiscal position, especially if its stabilization funds and foreign currency reserves continue to be depleted at such a rapid clip. After having paid off virtually all its debts to other states and international financial institutions ahead of schedule in the first few years of this decade—a move intended both to prevent incoming oil and gas revenues from spurring inflation and to increase geopolitical freedom of maneuver—Russia could now once again turn to international markets and lenders for credits. According to the World Bank, Russia will be forced to do so if oil prices average below $30 per barrel for the year.\(^\text{13}\)

Second, Russia’s stock market can only recover if foreign, and particularly Western, investors return.\(^\text{14}\) The massive expansion of Russia’s market over the course of the period from 1998 to

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\(^{14}\) If oil prices remain low, domestic investors alone will be too cash poor to return the market to its previous levels. Gaddy and Ickes, “Putin’s Third Way.”
mid-2008 was to a significant extent driven by Western investors. Many Russian firms held initial public offerings (IPOs) in London and New York, some listing directly on Western exchanges. After the “ring fence” that prevented foreigners from trading in its shares on the Russian market was lifted in December 2005 and the government consolidated its 51 percent stake, leaving the remainder to be purchased by private investors, Gazprom rapidly became one of the most desirable stocks in emerging markets. In May 2008, its market value peaked at $315 billion, making it the third-largest company by market capitalization in the world. In this period, Russia was viewed as one of the most attractive emerging markets. Portfolio foreign investment stood at $4.2 billion in 2007, a 31.8 percent increase from the previous year.\(^{15}\)

Russia’s stock market expansion came despite such incidents as the “YUKOS affair,” the term used to refer to the events that began with the arrests of its parent company’s top shareholders, Platon Lebedev and Mikhail Khodorkovsky, in June and October 2003 respectively. At the time, YUKOS was Russia’s largest company and top oil producer. Since the arrests, the company has been gradually dismantled by the authorities and sold off to state-controlled enterprises. In a lawsuit filed in a U.S. court, American holders of YUKOS shares alleged that they lost $6 billion due to the wiping out of YUKOS’s share value and the nationalization of its assets.\(^{16}\) Relations between Russia and the West suffered, and the affair became a regular subject of discussion in high-level government-to-government meetings. Such economic and political uncertainty would usually scare off investors, but Russia was such an attractive market that the attack on YUKOS made little difference. After an initial dip, the RTS recovered in a matter of months.

The economic circumstances that allowed the Russian government to interfere in the market with impunity are long gone. In the context of the current economic crisis and the bottoming out of the RTS at around 500 points (compared to its high of approximately 2,500 points in May 2008), Russia needs to attract foreign, and particularly Western, investors back to the market. Without a return of foreign capital, the Russian market is unlikely to recover in the medium term. Even if oil prices increase significantly, investors have little money to spend, and if Russia remains a risky investment they will be loath to spend it there.

Third, Russian corporations and financial institutions need to refinance loans obtained from Western lenders. Russian firms obtained nearly $500 billion in private credits in the years of plenty leading up to the crisis.\(^{17}\) UBS estimates that around 40 percent of that went to the energy sector, mostly to Gazprom and Rosneft.\(^{18}\) Western lenders competed fiercely with one another to finance Russian companies’ rapid expansion, tempted by the impressive cash flows on their balance sheets.

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\(^{15}\) Interfax, February 2, 2008.
\(^{17}\) Gaddy and Ickes, “Putin’s Third Way.”
When the value of collateralized assets sank as investors fled the Russian stock market over the summer of 2008, Russian companies scrambled to make their (dollar-denominated) repayment schedules. Credit dried up fast and margin calls on 10 of the 25 wealthiest owners of large private companies forced even more asset sell-offs. As one brokerage house put it, “Russia has a solvency problem. Simply put, in August Moscow was flooded with international bankers competing to provide funding to Russian entities. By October, the only financiers visiting were those trying to get their money back.” In addition to cash shortage problems, Russian corporations will face difficulties refinancing as a result of the global credit crunch.

Russian firms have about $100 billion in debt coming due in 2009, double the total owed by the governments and companies of Brazil, India, and China combined. So far, they have survived the initial wave of debt payments, in part thanks to a $50-billion government aid package specifically targeted for refinancing of foreign loans. Some analysts argue that Russia has weathered the worst of the corporate debt-repayment storm.

However, debt transactions in Russia, which often involve off-shore entities, tend to be nontransparent; the $100-billion figure could be a vast underestimate. There is a significant probability that Russian firms will face serious difficulties repaying their debts. As Clifford Gaddy and Barry Ickes put it, “With no Western financial intermediation to roll over old corporate debts, Russia is itself in an acute crisis without any way out on its own.” Russia may well have few alternatives to Western lending sources if it wants to resolve its “solvency problem.”

Fourth, as Russia’s leaders themselves have argued, the path out of the crisis depends to some degree on economic reform and, in the long term, diversification of the economy. President Dmitry Medvedev has repeatedly and publicly argued that “the only way to stabilize the economy and sustain growth…is through transparency, competition, accountability, and protection of property rights.” In a recent interview, Prime Minister Vladimir Putin maintained that the crisis will force the government to return to the reform agenda: “The global financial crisis is even helpful to us, since it makes us act in a more rational way. It makes us apply new technologies, like in energy saving. It makes us think of optimizing production and providing additional personnel training and re-training. All this makes us think about leaving this time of crisis as a more mature

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23 Gaddy and Ickes, “Putin’s Third Way.”
country with better prospects for development.”

In other words, there are indications that the Russian leadership has recognized that a return to the structural reform agenda—largely neglected for the past five years—can be a key component of a recovery plan.

While greater integration and economic cooperation with the West may not be necessary for Russia to push ahead with such reforms, closer ties can create conditions consistent with their implementation. Measures such as WTO membership will bring increased competition to the Russian market, force firms to restructure and produce higher-quality goods, and reinforce norms of transparency and protection of property rights. Increased Western foreign direct investment (FDI) can provide the know-how and technology transfer necessary for modernization and the resources to upgrade Russia’s aging infrastructure. In other words, economic integration is likely to facilitate reform. Further, as the government acknowledged in its recent strategic economic policy plan, deeper economic integration will be crucial for Russia to achieve optimal growth rates and diversify the sources of growth in the long term.

In short, the crisis has created significant incentives for Russia to work with Western partners on economic issues; Russia may need the economic resources that Western investors, financial institutions, and trading partners can provide in order to facilitate its recovery from the crisis. As a result, there could well be a greater emphasis on economic cooperation as opposed to confrontation and assertive geopolitics in Russian foreign policy. Incentives clearly do not translate directly into policies; the key issue is whether the Russian leadership will react to the incentives or to their often conservative, anti-Western instincts. If the Russians respond to the incentives, they are likely to seek cooperation with the West on economic issues.

This presents a valuable opportunity for the administration of President Barack Obama to expand the role of commercial ties in its broader strategy of engagement with Russia. Currently such ties are extremely weak. Despite significant increases following 1998, Russia accounted for only 1.1 percent of U.S. imports and 0.4 percent of U.S. exports in 2006. In the same year, the United States accounted for 3.1 percent of Russian exports and 4.4 percent of Russian imports. In 2007, trade turnover between the two countries totaled $27 billion, versus almost $387 billion between the United States and China. In 2007, U.S. FDI in Russia accounted for 5 percent of the total.

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26 That said, they have taken few steps toward this end as of this writing. Indeed, several policy decisions, such as the move to impose tariffs on used foreign car imports, have contradicted reform goals.
28 See “Kontseptsiya dolgosrochnogo sotsial’no-ekonomicheskogo razvitiia,” and Kuchins, Beavin, and Bryndza, Russia’s 2020 Strategic Economic Goals.
These numbers are proportionally quite low. In terms of FDI, the 5 percent number should be four times as high if it were to reflect the proportion of U.S. FDI in the total global FDI stock.\(^\text{32}\)

Despite this considerable potential to increase trade and investment, the economic aspect of U.S.-Russia policy has long been underemphasized in favor of such issues as arms control, nonproliferation, and counterterrorism. The Obama administration should respond to possible overtures from Moscow on economic cooperation and seek to strengthen commercial ties in the bilateral relationship. Even though arms control and other security issues will rightly remain the main priorities, there should be much more focus on economic measures than in the past.

**Policy Recommendations**

The following are suggestions for concrete steps that the administration can take to solidify the economic relationship with Moscow.

**First,** the United States should continue to promote Russia’s integration into international economic institutions. By bringing Russia into structures such as the OECD and the WTO, the United States can foster rules-based international norms of economic behavior that can shape Russian policy and increase bilateral trade. Participation in these institutions carries with it obligations such as observance of international standards relating to rule of law, transparency, and property rights that are key to improving the investment climate and thus boosting bilateral commercial ties over the medium term.

In the U.S.-Russia Strategic Framework Declaration (the so-called Sochi Declaration) signed by Presidents George W. Bush and Vladimir Putin in April 2008, the United States pledged to push for WTO accession and OECD membership.\(^\text{33}\) However, these efforts were derailed by the August war in Georgia, when most bilateral initiatives were shelved.

Subsequently Russia reversed itself on several obligations it had taken on in bilateral WTO negotiations, by, for example, increasing quotas on chicken imports. Recently its top WTO negotiator issued an ultimatum stating that Russia would no longer observe any such obligations if it does not become a member of the organization by 2010.\(^\text{34}\) Despite these setbacks, Prime Minister Putin still maintains that WTO membership is a priority and seeks to push forward with it “on standard and acceptable terms.”\(^\text{35}\) He singled out the United States as the key actor in furthering WTO accession: “Joining the WTO is still on our agenda. We will continue talks with


\(^{32}\) Ibid.


\(^{35}\) Putin, interview with Bloomberg.
our American partners, and we hope they will support Russia in joining the WTO.\textsuperscript{36} Although the two countries took a major step forward in November 2006 when they signed a bilateral agreement for Russia’s accession to the WTO, the United States still must play a role as an advocate for Russian membership in the organization, both publicly and in the multilateral negotiating process.

Despite the recent hiccups, relatively few technical issues remain in the multilateral negotiations. It appears that the main impediment to moving forward is Georgia, which in 2006 pulled out of a bilateral agreement on WTO accession it had previously signed with Russia. Given the current climate of relations between the two countries, there is little chance that such an agreement can be worked out without intervention from the United States and other Western nations. Although Russia’s actions in Georgia and its recognition of South Ossetia and Abkhazia should not be excused, the United States, together with European allies, should work with Georgia and Russia to help the two sides overcome the present stalemate.

\textbf{Second}, the United States should graduate Russia from the Jackson-Vanik Amendment to the Trade Act of 1974 and grant it permanent normal trade relations (PNTR). The amendment is an anachronistic Cold War relic that no longer serves any purpose other than to antagonize the Russians.\textsuperscript{37} It forces the executive to certify annually to Congress that there are no restrictions on freedom-of-emigration from Russia in order to grant Moscow most-favored-nation status.\textsuperscript{38} The original intention was to compel the Soviet Union to lift limits on the emigration of minority groups, in particular Jews.\textsuperscript{39} Today, Russia imposes no such limits. Several other post-Soviet countries—Georgia, Ukraine, Kyrgyzstan, and Armenia—have already been graduated from the amendment’s provisions.

Presidents Bill Clinton and George W. Bush both promised to graduate Russia from the Jackson-Vanik Amendment but did not follow through on their pledges. Repealing Jackson-Vanik would send a clear message that the United States is serious about strengthening commercial ties between the two countries and would create general goodwill by removing an irritant in the relationship. For U.S. companies, PNTR would add stability to the investment environment. The Obama administration should encourage congressional leaders to reintroduce relevant legislation and should publicly push for its passage.

\textbf{Third}, the United States should pursue a new bilateral investment treaty (BIT) with Russia. A BIT was signed by both countries in 1992 and ratified by the Senate in 1993. However, Russia never

\textsuperscript{36} Ibid.


\textsuperscript{38} If Jackson-Vanik were invoked, prohibitive Smoot-Hawley tariffs would apply to all Russian imports into the United States.

\textsuperscript{39} In recent years, many American-Jewish groups, acknowledging the lack of restrictions on emigration in Russia, have expressed support for “graduating” Russia. See Cooper, “Permanent Normal Trade Relations (PNTR) Status for Russia and U.S.-Russian Economic Ties.”
ratified it, and the document is now dated. U.S. FDI in the Russian economy remains low in part because the countries do not have a BIT, while 38 other nations, including most major global economies and members of the European Union, do. The BITs provide many legal protections for investors, such as requiring fair and equitable treatment of investments and prohibiting nationalization or expropriation without compensation. Further, investors have legal recourse against the government signatories. Investors from the United Kingdom, for example, can turn to the Institute of Arbitration of the Chamber of Commerce of Stockholm or to an international arbitrator.40

According to its leadership, Russia welcomes such an agreement with the United States. The April 2008 Sochi Declaration declared the creation of a new BIT a major priority in the relationship, but the Bush administration did little to realize this objective.41

Fourth, the United States should increase export support and trade facilitation for U.S. companies interested in Russian markets. The Export-Import Bank, the Trade and Development Agency, and the Overseas Private Investment Corporation should be provided with resources to strengthen their existing financing programs and launch new initiatives for Russia. Such measures are now all the more important in the context of the global credit crunch because there are far fewer private-sector alternatives to these institutions. U.S. companies’ activities in Russia receive a relatively small portion of government financing; in 2008, for example, the Ex-Im Bank had over twice as much exposure in Singapore as it did in Russia.42 Other financing mechanisms such as enterprise funds and small loan programs can be used to expand trade credits and allow more private-sector lending to smaller U.S. companies.

Fifth, the Obama administration should reintroduce the U.S.-Russia Agreement for Cooperation in the Field of Peaceful Uses of Nuclear Energy (the so-called 123 Agreement) into the Congress for ratification. According to Section 123 of the Atomic Energy Act of 1954, the United States must conclude a formal agreement with Russia before firms in the two countries can engage in commercial nuclear activities. In addition to providing the United States with an instrument for strengthening nuclear nonproliferation practices, for example by creating incentives for improving safeguards for the handling of nuclear materials in Russia, the agreement would facilitate commercial deals among U.S. and Russian companies. Current bilateral projects operate under exemptions from the rule, but they are severely restricted in terms of the transfer of nuclear materials and know-how. If the agreement were ratified, it could open up the vast Russian market to U.S. suppliers and provide opportunities for Russian firms to supply the U.S. market with nuclear fuel in the future.

40 See the full text of the UK-Russia BIT at http://www.yukosshareholdercoalition.com/pdfs/BIT_UK.pdf.
41 It should be noted that the Russian side did not make an effort either.
The United States and Russia signed the 123 Agreement in May 2008 and it was ready for ratification in the fall, but the Bush administration chose to withdraw it after Russia’s invasion of Georgia. The agreement offers the United States and Russia the potential for significant commercial benefits in peaceful nuclear cooperation. It should be reintroduced and ratified as soon as is feasible.

Sixth, the Obama administration should maintain an open environment for Russian investment in the U.S. economy. Inward FDI creates jobs for American workers, and Russian investment is no exception. For example, the Russian steel concern Severstal has invested $3.4 billion, $1 billion of which went to build a steel plant in Mississippi that created over 500 new jobs. The United Steel Workers have supported several Russian acquisitions of U.S. firms, such as Evraz’s purchase of Oregon Steel Mills. They argue that these investments will preserve American jobs.

Not only does foreign investment provide jobs for Americans, but, as Aleh Tsyvinski writes, “By investing in [U.S.] assets, Russia’s government and business elites are buying a stake in the global economy. This should bring better mutual understanding and a more rational and accountable foreign policy.” Economic interdependence provided by increased FDI could help stabilize the relations between the United States and Russia.

In 2007, Congress passed the Foreign Investment and National Security Act (FINSA), which altered the procedures governing the activities of the Committee on Foreign Investment in the United States (CFIUS). FINSA broadens the range of foreign investment projects that are subject to review on national security grounds, increases congressional oversight, requires investigations of transactions involving foreign state-owned or controlled firms, mandates greater oversight of investments related to U.S. “critical infrastructure” (e.g., energy projects), and forces CFIUS to negotiate binding agreements to alleviate national security concerns.

The Obama administration should work within the confines of FINSA to facilitate Russian investment in the U.S. economy. According to market participants, Russian investors on several occasions have shied away from new projects because of the new procedures. While technically there are no greater structural impediments to Russian investment than there are for investment from other countries, the administration should make it known that U.S. law does not

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43 Åslund and Kuchins, The Russia Balance Sheet.
45 Akin Gump Strauss Hauer & Feld LLP, “International Trade Alert: New CFIUS Reform Act Presents Challenges to Foreign Investment in the United States,” July 18, 2007, http://www.akingump.com/files/Publication/2b9d0d2c-b0ae-4e14-b23b-43b3d3186b7e/Presentation/PublicationAttachment/36255edfcac-4a90-84e90361524ce328/070717%20NEW%20CFIUS%20REFORM%20ACT%20PRESENTS%20CHALLENGES%20(2).pdf, p. 1. According to this report, “[FINSA] will necessarily increase the complexity of a CFIUS proceeding, as well as demand that parties navigating it employ more sophisticated and coordinated strategies to anticipate and deal with the full range of regulatory, policy and political issues that can be expected to arise.”
discriminate against Russian enterprises that are prepared to abide by American laws and regulatory requirements. A political climate of openness could significantly increase opportunities for mutually beneficial investment in the U.S. economy. The United States must also work with Russia to ensure that openness to foreign investment is reciprocal and monitor the practices and policies of state-influenced companies and state-controlled sovereign wealth funds.

Seventh, the U.S.-Russia Energy Dialogue, a body consisting of officials from both countries, should be reformed. It came to be viewed as an unproductive talk shop or a forum for voicing complaints about Russian treatment of American companies. Instead, the Dialogue should focus on fundamental policy choices that the Russians face, such as open access to pipelines and fair tariffs for their usage. The Obama administration needs to engage with the Russians on policy, including lessons learned, good and bad, from reforms in the United States. If used for this purpose, the Dialogue has the potential in the future to bring some improvement to the investment environment in this key sector. While it is important for the United States to take the first steps, the ultimate effectiveness of the Dialogue will depend on the Russian side’s willingness to cooperate.

Although the Sochi Declaration called for an intensification of the U.S.-Russia Energy Dialogue, the group has not met since the signing of the document; the last meeting was in March 2007. Political will from high-level policymakers is required to institutionalize the Dialogue. It should meet regularly and produce concrete policy recommendations. The Dialogue should be expanded to include representatives of private companies and independent experts, or a parallel structure should be created to foster a nongovernmental Dialogue.

A top agenda item for the renewed Dialogue should be energy efficiency. There is a new interest in Russia in environmentally friendly and energy-efficient technologies and renewable energy sources. President Medvedev has called for halving Russia’s energy intensity by 2020 and on several occasions has identified inefficient energy use as one of the most pressing problems facing the country. Russia would certainly benefit from a comprehensive energy efficiency policy: according to the World Bank, with the right policies, Russia could save 45 percent of its total primary consumption and gain $120 billion to $150 billion per year from cost savings and additional gas revenues.

The Dialogue should capitalize on this interest, which has never been present in the past, and facilitate discussions on efficiency policy and on development of new commercially attractive alternative and renewable energy projects and technologies. This would create the possibilities for commercial benefits for U.S. companies working in this sphere and, in the future, enhance U.S.

47 Ibid., p. 5.
48 Ibid.
energy security by increasing efficiency in Russia (the third-largest energy consumer in the world). According to participants in bilateral meetings on these subjects, initial discussions have been productive.49

Eighth, the Obama administration should strengthen government-to-government mechanisms for dealing with economic issues. There is an extant foundation for such efforts: the U.S.-Russia Economic Dialogue, which resulted from the Sochi Declaration. The Dialogue includes officials from the U.S. National Security Council, the Council of Economic Advisers, the Office of the U.S. Trade Representative, the Departments of Energy, Commerce, Treasury, and State, and the Russian Ministries of Foreign Affairs, Finance, and Economic Development. While its stated objectives—"to identify areas where our laws and regulations impede trade and investment, improve the transparency of the business and investment environment, and strengthen the rule of law"—are laudable, the body has only met once since its inception.50 The group should meet quarterly to facilitate discussions on these key issues and draw up a concrete policy agenda. Once again, political will from the executive branch is necessary if the Dialogue is to become a functioning institution. As Ed Verona, the president of the U.S.-Russia Business Council, has put it, "Experience has demonstrated that progress on economic and commercial negotiations between the two countries depends on the engagement of senior government officials."51

One way of bringing high-level political pressure to bear on these issues is to recreate a bilateral body along the lines of the Gore-Chernomyrdin Commission (named for U.S. vice president Al Gore and Russian prime minister Viktor Chernomyrdin), which operated from 1993 to 1999. The commission included eight cabinet members and agency heads from the U.S. side. It allowed for "a broad range of contacts with senior Russian officials that has not been duplicated since."52 A Biden-Putin Commission could be even more useful, given their shared interest and experience in foreign affairs and Putin’s clout within the Russian political system.53

Ninth, the United States should support partnerships among U.S. firms and business associations and their Russian counterparts. Such cooperation provides the United States with another opportunity to promote norms of transparency and good corporate governance within Russia,

50 U.S.-Russia Strategic Framework Declaration.
52 Pifer, “Reversing the Decline,” p. 22.
thus potentially improving the investment environment. A business-to-business economic dialogue was proposed in the Sochi Declaration, but the idea was never realized.

Tenth, the United States should continue and intensify discussions with the Russians on constructing a new international financial architecture. The Russian leadership has demonstrated a clear interest in pursuing this issue. In his October 2008 speech to the World Policy Conference in Evian, France, President Medvedev said: “Russia has launched its call for change in the global financial architecture, a revision of the role played by today’s institutions and the creation of new international institutions, institutions that can ensure genuine stability… We need to use this opportunity to clean out our systems and prolong and maximize the growth periods in our economies.”

Prime Minister Putin in a recent interview put forth a broad spectrum of issues to be discussed and brought up the matter again in his address at the January 2009 Davos conference. While some argue that these proposals represent attempts to undermine Western institutions, this seems an unlikely explanation. Instead, Russia appears to be making repeated, serious overtures on a critical issue, and the United States stands to lose little from responding in kind. Although it is unclear where this discussion will lead, it can be the starting point for renewed economic relations. The Obama administration can engage the Russians on a whole host of issues connected to the crisis, both within the G-20 format and bilaterally, and use this forum as a method of broadening the overall dialogue, on both economic concerns and other aspects of the bilateral relationship. The April 2009 G-20 meeting, during which Obama and Medvedev will hold their first talks, will be an ideal forum for pushing ahead with these discussions.

All of these proposals build on existing ideas, institutions, or practices; there is no need to reinvent the wheel to strengthen U.S.-Russia commercial ties. Such steps require minimal policy innovation or radical change in U.S. priorities. Political will is the key factor needed to solidify the economic aspect of the United States’ relationship with Russia.

If these policies are implemented, the United States potentially stands to reap substantial economic benefits. These measures could create new investment opportunities for U.S. firms, facilitate bilateral trade, in particular in the nuclear and alternative energy spheres, and increase investment in the U.S. economy. Given the current crisis, the Obama administration should not overlook this opportunity.

In addition to the direct benefits for the U.S. economy that will result from increased commercial ties, economic integration also could forge space for dialogue on other issues in the bilateral

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relationship. By using the aforementioned policy measures to boost economic cooperation, the overall climate of relations could improve. These conditions could facilitate discussion of more sensitive issues, such as Iran’s nuclear program. Even if the United States and Russia do not see eye-to-eye on such issues, a climate of goodwill created by closer economic ties will increase the chances of a productive discussion.

Further, more robust economic relations create, as former U.S. ambassador Steven Pifer puts it, a “ballast that could cushion the overall relationship against differences on other issues.” When compared to U.S.-China ties, there are remarkably few domestic stakeholders in the U.S.-Russia relationship. In the case of China, such stakeholders, especially in the private sector, help prevent radical swings in relations. In the case of Russia, all too often relations have rested on flimsy foundations such as the personal relationship between presidents. Increased commercial ties would create a core group of private actors in both countries who could provide an anchor to the bilateral relationship. The example of China has shown that such a group can play a major role in stabilizing relations and keeping open lines of dialogue.

Finally, if the Obama administration seizes this opportunity to strengthen commercial ties, it could prevent economic links from deteriorating if Russia’s eventual recovery reduces the current incentives for cooperation. Indeed, the premise that incentives now point to cooperation appears to imply that any gains in the relationship made now would be undone if and when oil prices increase and Russia returns to a period of rapid economic growth. However, implementation of the policies outlined above will help institutionalize and deepen the bilateral economic relationship, thus decreasing the chances that economic cooperation will deteriorate in the future, even if the incentive structure changes.

**Conclusion**

The question of how the economic crisis will affect Russia’s foreign policy remains open. The signs from Moscow are distinctly mixed, and Russia’s external posture in the medium term is far from predetermined. Recent assertiveness notwithstanding, the crisis has created incentives that would appear to lead the Russians toward increased cooperation with the West, especially on economic issues.

If the Russians respond to the incentives and show signs of willingness to cooperate on these issues, the Obama administration should use the opportunity to put economic cooperation higher on the bilateral agenda. Improved commercial ties are intrinsically in the United States’ interest, open up space for dialogue on more sensitive issues, and provide a stronger foundation for the bilateral relationship.

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57 Pifer, “Reversing the Decline,” p. 2.