The Man Puup Nuor Rock Formations at the Northern Urals, also known as Seven Strong Man or Little Mountain of the God in the local tribe (Mansi) language.
U.S.-Russia Economic Relations
Myths and Realities

AUTHOR
Vadim Grishin

A REPORT OF THE CSIS RUSSIA AND EURASIA PROGRAM
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Introduction

A friend of mine, a devoted connoisseur of bilateral economic relations with 30 years of experience in the field, once noted that the hottest discussions about U.S.-Russia ties occur at a time when mutual trade is compressed into the value of a mathematical error. This is exactly what is happening now. According to official statistics, the value of U.S.-Russia trade is about $20 billion and is rolling back to the level of 2005.¹ There is no doubt that a new set of sanctions, recently signed into law by the U.S. president and currently being implemented, will further hurt economic interaction by reducing financial inflows, limiting the transfer of technology and expertise, and dampening business confidence. Many policymakers and experts have agreed that H.R. 3364 (Countering America’s Adversaries through Sanctions Act²), by expanding and codifying U.S. sanctions targeting Russia, opens a new cycle in bilateral relations. This legislation, which received overwhelming bipartisan support, creates a new economic and political framework on a bilateral track. Strong concerns, expressed by President Donald Trump in his special statement about “unconstitutional provisions of the “flawed bill,”³ cannot significantly limit its intended and unintended consequences. In its implementation, it could have relatively broad margins of flexibility and leverage, but requires the president to seek congressional approval before easing or terminating sanctions against Russia or undertaking actions that would significantly modify U.S. policy toward Russia. Additional observations regarding H.R. 3364’s possible impact on U.S.-Russia interaction in particular industries can be found throughout this report, but suffice it to say that it will contribute to a broader curtailment of many pillars of economic cooperation for years ahead.

Escalating geopolitical tensions have continued to significantly define Russia’s economic prospects; however, the country’s economic model exhausted itself long before the dramatic deterioration of relations with the West. Structural bottlenecks have seriously limited Russia’s growth capacity, even during the previous period of high oil prices.4

The purpose of this report is to assess what has gone wrong with the U.S.-Russia equation by analyzing it through the prism of a bilateral economic and political trajectory, while keeping in mind the structural constraints of the Russian economy. It will attempt to answer the following questions:

- Do bilateral economic relations matter?
- Are the United States and Russia “natural” or “unnatural” trading partners?
- What future scenarios can we expect?

In the vast literature on U.S.-Russia economic relations, analysis of developing trends in bilateral commerce has always been accompanied by discussions around important political and economic matters, particularly regarding U.S. legislation and regulation.5 Over several decades, the most controversial issues concerned the granting of permanent normal trading status to Russia through legislation that eliminated the Jackson-Vanik Amendment, and Russia’s accession to the World Trade Organization (WTO). The Magnitsky Act, signed into law in 2012, repealed the Jackson-Vanik provisions but added legislation providing authority for the U.S. government to withhold visas and freeze assets of Russians thought to have been involved with human rights violations, and later imposed sanctions on Russia because of its involvement in the Ukrainian and Syrian crises and its cyber-enabled activities.6

Some have observed deficiencies in Russia’s participation in the international division of labor (reliance on the export of energy and metals), which “can’t serve any more as a basis for further expansion of the country’s position in world markets, including the U.S. market.”7 Unfortunately, such observations have not been accompanied by quantitative and qualitative analysis of structural constraints in the Russian foreign trade model. Many authors limit their policy recommendations for fostering bilateral economic relations to a requirement for a strong initial push from respective governments, the creation of business working groups, and the extension of bilateral and multilateral legal grounds for economic cooperation. Such instruments proved to be useful in facilitating

7. Глущенко Ю.Н., "Состояние, проблемы и перспективы сотрудничества России и США в экономической сфере" [Status, problems and prospects of Russia-U.S. economic cooperation], Проблемы Национальной Стратегии 21, no. 6 (2013): 148–164.
trade and investment during several reset cycles in bilateral relations, starting in the 1990s, but they were only partially successful.

Several papers and books, although focused primarily on bilateral political agendas or sectorial analysis, underline the importance of Russian domestic realities. Dr. Angela Stent in her “Limits of Partnership” notes that state control of the commanding heights in the Russian economy creates significant deterrents for U.S. private-sector entrance into the market.8 Thane Gustafson in the “Wheel of Fortune” asserts that Russia’s growing dependence on revenue from oil exports, along with its inefficient and often-corrupt management of industry, is unsustainable.9 Andrew Kuchins in his “Elevation and Calibration: A New Russia Policy for America,” has quoted some experts who believe that the weakened Russian economic position may over time contribute to some rapprochement with the West, and emphasized lack of reforms as “a key obstacle not only for Russian economic recovery but also for improving ties with the West.”10

In a recent joint task force report, Eugene Rumer, Andrew S. Weiss, and Richard Sokolsky argue that the concept of developing stronger economic ties with Russia as a foundation for improved diplomatic relations has not worked. “Clinton, Bush, and Obama all placed high hope on trade as an engine of better relations with Russia. All were frustrated by the fact that the two countries are, for the most part, not natural trading partners.”11 On a different note, the former U.S. envoy to Russia, Michael McFaul, has defended the achievements of a reset policy under the Barack Obama administration, emphasizing that bilateral trade reached a record level in 2011. Nevertheless, he also stresses that it was a one-time accomplishment, unlikely to be repeated.12

Voices of those who believe that extensive economic ties can provide stability to broader political interaction are weaker than ever in an environment of growing protectionism and adversarial rivalry.

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Does Bilateral Economic Interaction Matter?

Economic relations do not emerge out of a vacuum. There are many variables that define the final configuration of economic interactions, such as a particular country’s level of economic development, its business environment, legal framework, political climate (regime), culture and religion, history and tradition, demography and geography, as well as global and national economic cycles. An important driver of trade relations for many economies has become participation in global and regional trade agreements.

As many studies and anecdotal evidence show, bilateral economic cooperation should be sizable and should relate to the economic growth of two countries in a way that affects their policy interests. Let us take as a reference point the BRICS countries, a community of large emerging economies, which Russia belongs to. Table 2.1 presents official data on U.S. trade and investments with BRICS states. U.S.-Russia trade in goods is disproportionately low—23.5 times less than U.S. trade with China, 3.3 times smaller than U.S. trade with India, and 2.8 times less than U.S. trade with Brazil. The size of the U.S.-Russia trade balance is comparable to the size of the U.S. trade balance with South Africa, whose economy is almost four times smaller than Russia’s. If we add trade in services to the trade of goods, the gaps increase significantly (Figures 2.1 and 2.2). The difference is not only quantitative, but also qualitative.

The quality of trade relations can be measured by its diversity, its share of high-tech components, resilience to economic shocks and its contribution to GDP growth. On average, a 10 percent increase in a nation’s two-way trade relative to GDP increases GDP through a variety of channels by at least 1.6 percent.

Bilateral trade and real GDP growth in the United States and Russia are practically uncorrelated, as shown in the summary output of multifactorial regression. The coefficient of multiple determination (R Square) is close to 0 (Table 2.2). At the same time, the correlation of U.S. exports to India

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1. BRICS is the acronym for a select group of five developing economies: Brazil, Russia, India, China and South Africa.
Table 2.1. U.S. Trade and Foreign Direct Investments (FDI) with China, India, Brazil, South Africa, and Russia, 2016

<table>
<thead>
<tr>
<th></th>
<th>China</th>
<th>India</th>
<th>Brazil</th>
<th>South Africa</th>
<th>Russia</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Goods Trade</td>
<td>578.6</td>
<td>67.7</td>
<td>56.5</td>
<td>13*</td>
<td>20.3</td>
</tr>
<tr>
<td>Imports</td>
<td>462.8</td>
<td>46.0</td>
<td>26.2</td>
<td>7.3*</td>
<td>14.5</td>
</tr>
<tr>
<td>Exports</td>
<td>115.8</td>
<td>21.7</td>
<td>30.3</td>
<td>5.5*</td>
<td>5.8</td>
</tr>
<tr>
<td>Trade in Services</td>
<td>69.6</td>
<td>47.2</td>
<td>31.7</td>
<td>4.7*</td>
<td>n.a.</td>
</tr>
<tr>
<td>Imports</td>
<td>16.1</td>
<td>26.8</td>
<td>6.8</td>
<td>1.7*</td>
<td>n.a.</td>
</tr>
<tr>
<td>Exports</td>
<td>53.5</td>
<td>20.3</td>
<td>24.9</td>
<td>3.0*</td>
<td>n.a.</td>
</tr>
<tr>
<td>U.S. FDI</td>
<td>74.6*</td>
<td>28.3</td>
<td>65.3*</td>
<td>6.2**</td>
<td>14.1**</td>
</tr>
<tr>
<td>BRICS FDI in the United States</td>
<td>14.8*</td>
<td>9.3</td>
<td>0.43</td>
<td>0.76**</td>
<td>6.3***</td>
</tr>
<tr>
<td>Supported Jobs in the United States (thousand)</td>
<td>911*</td>
<td>197</td>
<td>308*</td>
<td>50**</td>
<td>8.4***</td>
</tr>
</tbody>
</table>


*2015
**2014
***2013

and China with the real GDP growth of these big Asian economies is significant (0.5). In the case of Brazil, the correlation is even higher (0.7). By contrast, South Africa’s small, open economy is quite sensitive to U.S. imports from South Africa (0.43).³

In marked contrast to other BRICS countries, Russia is a poor choice for export-oriented operations. As a recent International Monetary Fund (IMF) study highlights, Russia is an outlier, a rare exception among emerging market (EM) economies, with virtually no preferential access to major markets and little meaningful change over three decades.⁴ This complicates Russia’s integration into the global value chain (GVC), which became a significant driving force toward economic development and trade for certain BRICS economies.

³. IMF statistics, author’s computation.
Trade is closely connected with foreign direct investment (FDI), and both are parts of a complex interaction known as international production sharing. According to publicly available official data, U.S. FDI in Russia was about $13.1 billion for 2013 and $2.95 billion for 2016, with the top industrial sectors being software and IT services; financial services; chemicals; metals; coal, oil, and gas; and business services.\(^5\) If we take into account U.S. investments made through European branches of U.S. companies and offshore firms, this number would easily triple. Another component that usually is not tracked by official statistics is reinvestments. The American Chamber of Commerce surveys in 2016 and 2017, which include this component, draw a completely different picture: accumulated U.S. corporate FDI in 90 large U.S. companies working in Russia reached

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$82.44 billion in 2017. The real level from our perspective is usually between official and private estimations, around $40 billion. But even this cumulative figure is less than the U.S. FDI in Brazil and China.

The American Chamber of Commerce surveys have also revealed other important data. Eighty-five percent of U.S. companies doing business in Russia entered its market 10 or more years ago, while 60 percent of them “landed” there 20 years ago or earlier. Only one percent have started operations over the last five years, confirming an obvious fact: entry into the Russian market is challenging because of growing monopolism, risks associated with the business climate, and a stagnating economy.

6. American Chamber of Commerce in Russia, “Investment and Import to Russia. 2nd Survey” (Prepared by GfK for the American Chamber of Commerce in Russia, Moscow, May 2017), 12.
7. Ibid., 4.
Russian direct investment position toward the United States declined from $21.5 billion in 2013 to $8.3 billion in 2015 (Figure 2.3). Taking into account different channels and instruments, the actual volume of Russian investments in the United States made through offshore, European, Canadian, and U.S. companies may be several times greater than the available official data.

Foreign investment in financial assets or foreign portfolio investment (FPI), should be included, even though Central Bank of Russia statistics indicate they were also quite low: U.S. investments in equity were $345 million and in debt instruments were about $65 million in the fourth quarter of 2016.8 However, these numbers do not reflect the real level of FPI. Russia’s stocks are incredibly inexpensive, while there has been impressive growth of U.S. investments in short-term securities and in foreign exchange (FX) operations (cash-and-carry trade). Russia was among the top performing emerging markets in 2016, gaining 47.44 percent in U.S. dollars.9 Nevertheless, the general capitalization of the stock exchange is tiny (less than 20 percent of GDP), comparable to the capitalization of just one large U.S. company such as Coca-Cola. Many private sources believe that the U.S. FPI in Russia could be as high as several billion U.S. dollars, but a new set of sanctions approved by President Trump on August 2, 2017, if implemented, could reverse those flows. It is still not clear whether the secretary of treasury will prohibit participation in the offerings of Russia’s sovereign debt and the full range of derivative products. A report on this subject should be submitted no later than 180 days after enactment of the law, which means no later than February 2018. New legislation tightens prohibition on Russian financial companies already under sanctions by limiting any new equity or debt with a maturity greater than 14 days (a provision that

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Table 2.2. Summary Output of Regression Statistics (U.S. Real GDP, Russia Real GDP, U.S.-Russia Exports, Imports, and Total Trade)

<table>
<thead>
<tr>
<th>Regression Statistics</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Multiple R</td>
<td>0.056445768</td>
</tr>
<tr>
<td>R Square</td>
<td>0.003186125</td>
</tr>
<tr>
<td>Adjusted R Square</td>
<td>−0.042123597</td>
</tr>
<tr>
<td>Standard Error</td>
<td>26.16043923</td>
</tr>
<tr>
<td>Observations</td>
<td>24</td>
</tr>
</tbody>
</table>

Sources: IMF statistics, author’s computation.

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previously allowed for 30 days). Similarly, U.S. persons are prohibited from taking on any new debt that has a maturity greater than 60 days (previously, it was 90 days), with Russian energy companies currently under sanctions.10

According to the Treasury Department, Russia held $102.9 billion in U.S. Treasury securities in June 2017.11 Could Russia withdraw all its reserves from the United States and use this action as a retaliatory measure? Such a scenario is unlikely, since there is no comparable safe-haven alternative to U.S. dollars. When Russia’s U.S. Treasury holdings dropped 50 percent from $176 billion (October 2010) to $90 billion (November 2011), the market did not notice.12 Nevertheless, Russian authorities have announced they will decrease dependence on assets and payments in U.S. dollars.13

Figure 2.3. Russia: Outward FDI Position, United States, Equities and Debt, Million US$, 2009–2016


12. Ibid.
Officially, the country does not invest in the U.S. stock exchange, although some Russian oligarchs have bought U.S. corporate bonds and equities in large amounts. The new sanctions law requires the secretary of treasury, in consultation with the director of national intelligence and the secretary of state, to issue reports on Russian senior political figures and oligarchs, based on their closeness to the Russian regime and their net worth, as well as the exposure of key economic sectors of the United States to Russian politically exposed persons and parastatal entities, including, at a minimum, the banking, securities, insurance, and real estate sectors.\textsuperscript{14}

Only three Russian companies are listed in the U.S. exchanges.

Overall, the scale and scope of U.S.-Russia economic interaction and business activity is much greater than officially appreciated, but not significant enough to be taken into consideration by policymakers.

\textsuperscript{14} Countering America’s Adversaries through Sanctions Act, H.R. 3364.
Politics in the Driver’s Seat

Bilateral economic relations depend to a great extent on global and national economic cycles. After the recent global financial crisis, the U.S. economy has shown surprisingly sustainable GDP growth, while the Russian economy was the most affected among BRICS countries by the turbulence of a worldwide economic downturn in 2008–2009 and, after a short-term rebound, slipped into stagnation (2012–2013) and then into full-scale recession (2014–2016). The country’s economic cycle, however, appears to be changing once again, with the economy returning to a pattern of growth, albeit uneven and gradual (Figures 3.1 and 3.2). Even with sanctions still in place, conditions have improved as a result of the stabilization of Urals oil to an average annual price of $41.9 per barrel in 2016. The gains were sparked in part by major crude producers agreeing to cut production, after hefty price drops in 2014 and 2015. Supported by easier financial conditions, higher oil prices and growing macro-stability, Russia is heading toward a moderate growth rate that is expected to reach 1.4 percent this year, according to forecasts of the World Bank Group (WBG) and the IMF.¹

Because of the significant role that politics plays in any bilateral interaction, it is important to combine economic and political cycles, applying a “reset” to bilateral economic cooperation in addition to the political relationship. I have compared political cycles and trade dynamics using the following graphs (Table 3.1 and Figure 3.3). These charts do not pretend to reflect with mathematical precision all shifts in the bilateral political relationship, but rather attempt to visually align important economic and political moments to detect the effects of political events on the size of bilateral trade.

Figure 3.3 shows all possible combinations: economic trends at the intersection of political developments oppose or support each other in synchronization. It is evident that political interference

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In bilateral business affairs in the early 2000s was less significant than in later years. As result, growing political tensions from 2003 to 2008 did not dramatically affect bilateral economic interaction. It is also easier to explain why 2011–2012 resulted in record trade and investment—a consequence of very high oil prices, GDP growth in both countries, improved legislation after Russia’s accession to the WTO, and the Obama–Medvedev political reset. From 2014 to 2016, a perfect storm of developments added efficiency to Western sanctions and augmented the damaging consequences of counter-sanction measures.

Figure 3.3 also confirms that in times of reduced economic cooperation, political pressures can easily change bilateral economic trends. Moreover, business interests, along with economic interactions, have a limited capacity to reverse the political mainstream.
Table 3.1. Political Cycles in Bilateral U.S.-Russia Relations, 1999–2016

<table>
<thead>
<tr>
<th>Year</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>2001–2002</td>
<td>The George W. Bush–Vladimir Putin Reset: Russia supported “global war on terrorism,” launched by the United States after 9/11; the SORT nuclear arms reduction treaty was signed by the United States and Russia and a successful business dialogue was developed that created the current structure of economic relations.</td>
</tr>
<tr>
<td>2009–2010</td>
<td>The Barack Obama–Dmitry Medvedev Reset: Russia served as a logistical hub for transportation and supply of U.S. forces in Afghanistan; United States and Russia signed the new START nuclear arms reduction treaty; Russia backed tighter economic sanctions on Iran; Russia gained access to the WTO after 18 years of negotiations.</td>
</tr>
<tr>
<td>2011–2016</td>
<td>Deterioration in bilateral relations caused by the Ukrainian crisis, which were followed by sanctions and counter-sanctions, along with the Syrian crises and cyber-enabled activities.</td>
</tr>
</tbody>
</table>

Source: Author’s evaluation of political and economic data.
Note: SORT=Strategic Offensive Reductions Treaty; START=Strategic Arms Reduction Treaty.
Figure 3.3. U.S.-Russia Trade, Million US$ vs. Political Cycle, 2000–2016

Are the United States and Russia “Natural” Trading Partners? A Little Bit of History

The current structure of U.S.-Russia economic relations emerged in the early 2000s, when the model of trade and investment interaction took on a character similar to that which existed between the United States and developing economies. U.S. imports from Russia centered on commodities, while technology, along with food products, lead American exports. The primary exception was that Russia supplied nuclear fuel, including highly enriched uranium extracted from nuclear weapons, for U.S. power plants and provided services to the aerospace industry, primarily in satellite launches. However, both these exceptions can be explained as a legacy of the Soviet past and not a harbinger of the future economic relationship (Figure 4.1).

In the last 15 years, this trade structure has not changed significantly. The only noticeable shift in trade was a dramatic drop (to practically nothing) in exports of U.S. agricultural products, a result of Russia’s policy of import substitution and so-called counter-sanction measures it took in response to U.S. sanctions over the Ukraine crisis (Figure 4.2).

Promising new directions of cooperation in the IT sector and in engineering services for the aerospace industry, appeared in the early 2000s, but did not spill into other sectors and consequently did little to renew economic cooperation on the whole. The integration of Russian high-tech services into large-scale global production and value chains was constrained by the usual culprits: a lack of financial resources, managerial experience, skilled labor, modern infrastructure, R&D investments, and an adequate business environment. High commodity prices incentivized the restoration of an economic system centered on resource rents. The leading role of oil and gas extraction and transportation discouraged the development of a nonenergy sector that might have created advanced and complex production and services. An import substitution policy could not work efficiently in an economic environment plagued by the Dutch disease, where currency

inflows (oil money) lead to ruble appreciation and render a country’s production less competitive. During that time Russia’s industry did not receive preferential access to larger markets and could not expand its share in the global economy, particularly because of its self-isolation from the regional trade agreements (except for its participation in the Eurasian Economic Union with some neighboring countries of the former Soviet Union). As a result, neither import substitution nor export-led strategy promoted growth and specialization in nonoil production. A long-awaited modernization and reallocation of resources from an inefficient nontrade sector to a trade sector did not materialize.

These limits were later augmented with sanctions and an extension of domestic restrictions on cooperation with Western partners. Importantly, the rapid growth of state-monopoly structures in the Russian economy over the past 15 years has created additional obstacles to the development and diversification of U.S.-Russia economic ties.

**Figure 4.1. U.S. Imports from Russia, US$, 2016**

Source: U.S. Census Bureau, “Trade in Goods with Russia” (see data for 2016).
Figure 4.2. U.S. Exports to Russia, US$, 2016

Source: U.S. Census Bureau, “Trade in Goods with Russia” (see data for 2016).
No doubt, political ups and downs add volatility to U.S.-Russia trade. Nevertheless, Russia’s economic structure exhausted itself before the Ukrainian crisis and the recent Russian recession. Its limitations are not only due to some mistakes in policy or negative coincidences of circumstances, but rather to deeply rooted properties in the current bilateral trade model related to structural issues in the Russian economy. Structural constraints such as the weak enforcement of property rights, poor business regulation, and nondiversified exports weighed on Russian trade with the United States. From this perspective, the term “natural/unnatural trading partners” does not address the unused capacity of bilateral interaction or the real challenges that kind of interaction faces. It just adds metaphysical flavor to the very specific economic and political factors that determine the U.S.-Russia trajectory.

Overall, the outlines of bilateral trade (Figure 4.3) resemble the famous “Russian Mountains” that were a predecessor of the modern roller coaster: icy hills supported by wooden constructions—a rigid and immobile structure that sooner or later would melt. This, unfortunately, is what is happening to U.S.-Russia trade cooperation now.
ARE LITTLE FISH REALLY SWEET?

Low U.S.–Russia economic interaction has at least two consequences. First, it limits the capacity of policymakers to exploit trade as an instrument for geopolitical combat. Even the question of a U.S. trade deficit, which used to be a headache for many U.S. trading partners, has become so insignificant in absolute terms (about $8.7 billion in 2016) that it seems hardly worth caring about. When the volume of trade between two countries becomes very small in absolute terms, whether a country is running a surplus or deficit is no longer relevant. But it also renders another type of confrontations (sometimes more dangerous) more likely, since the two traders have little to lose.

Second, in an environment marked by low levels of bilateral trade both sides could incentivize (if and when a desire for political rapprochement exists) the signing of new trade deals, which are elevated symbolically as a turning point in bilateral political relations (i.e., the sale of Boeings to Russia, or the delivery, via tankers, of Russian oil to U.S. refineries). Sometimes markets themselves present “gifts” that can be capitalized on politically. U.S.–USSR grain trade in the 1970s was one such “gift”: large sales of American grain to the Soviet Union helped U.S. policymakers win favor with the politically important American farming sector and permitted Soviet leaders to maintain access to a dietary staple for the Soviet population.

The strong 32 percent growth in value of U.S. imports from Russia from January to May 2017 versus January to May 2016 (Table 5.1) is an example of a development that has tempted officials to present it as a sign of positive change due to “growing business activities” (this kind of statement was heard before the bilateral summit in Germany in July 2017), although the reason for that leap was evidently an increase in commodity prices (mainly of oil—see Table 5.2) and not a rise in entrepreneurial interactions. The primary beneficiaries of that upside rally have been two other petro-economies: Saudi Arabia and Venezuela (Tables 5.3 and 5.4).
Table 5.1. U.S. Imports from Russia, Million US$, January–May 2016 vs. January–May 2017

<table>
<thead>
<tr>
<th>Year</th>
<th>January</th>
<th>February</th>
<th>March</th>
<th>April</th>
<th>May</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>2016</td>
<td>960.3</td>
<td>687.1</td>
<td>1,109.7</td>
<td>1,225.7</td>
<td>1,097.7</td>
<td>5,080.5</td>
</tr>
<tr>
<td>2017</td>
<td>1,221.5</td>
<td>1,022.0</td>
<td>1,697.9</td>
<td>1,347.1</td>
<td>1,414.7</td>
<td>6,703.2</td>
</tr>
<tr>
<td>Change</td>
<td>27.1%</td>
<td>48.7%</td>
<td>53.0%</td>
<td>9.9%</td>
<td>28.9%</td>
<td>31.9%</td>
</tr>
</tbody>
</table>


Table 5.2. Change in Urals Crude Oil Prices, US$ per Barrel, January–May 2016 vs. January–May 2017

<table>
<thead>
<tr>
<th>Month</th>
<th>January–May 2016</th>
<th>January–May 2017</th>
<th>Change ($)</th>
<th>Change (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>36.01</td>
<td>51.29</td>
<td>15.28</td>
<td>42.4</td>
<td></td>
</tr>
</tbody>
</table>

Source: Ministry of Finance of the Russian Federation, https://www.minfin.ru/ru/#ixzz4mMIZ7XtC.


<table>
<thead>
<tr>
<th>Year</th>
<th>January</th>
<th>February</th>
<th>March</th>
<th>April</th>
<th>May</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>2016</td>
<td>1,511.4</td>
<td>903.6</td>
<td>1,355.5</td>
<td>1,084.4</td>
<td>1,467.9</td>
<td>6,322.8</td>
</tr>
<tr>
<td>2017</td>
<td>1,980.2</td>
<td>2,029.8</td>
<td>2,165.0</td>
<td>1,621.1</td>
<td>1,954.2</td>
<td>9,750.3</td>
</tr>
<tr>
<td>Change</td>
<td>31.01%</td>
<td>124.63%</td>
<td>59.72%</td>
<td>49.5%</td>
<td>33.1%</td>
<td>54.2%</td>
</tr>
</tbody>
</table>

Table 5.4. U.S. Imports from Venezuela, Million US$, January–May 2016 vs. January–May 2017

<table>
<thead>
<tr>
<th>Year</th>
<th>January</th>
<th>February</th>
<th>March</th>
<th>April</th>
<th>May</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>2016</td>
<td>665.7</td>
<td>556.0</td>
<td>714.0</td>
<td>800.7</td>
<td>792.2</td>
<td>3,528.6</td>
</tr>
<tr>
<td>2017</td>
<td>1,304.1</td>
<td>1,086.4</td>
<td>1,235.00</td>
<td>1,114.8</td>
<td>1,224.3</td>
<td>5,964.6</td>
</tr>
<tr>
<td>Change</td>
<td>95.90%</td>
<td>95.40%</td>
<td>72.97%</td>
<td>39.23%</td>
<td>54.54%</td>
<td>69.03%</td>
</tr>
</tbody>
</table>


Table 5.5. U.S. Exports to Russia, Million US$, January–May 2016 vs. January–May 2017

<table>
<thead>
<tr>
<th>Year</th>
<th>January</th>
<th>February</th>
<th>March</th>
<th>April</th>
<th>May</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>2016</td>
<td>362.8</td>
<td>357.7</td>
<td>729.8</td>
<td>465.7</td>
<td>494.7</td>
<td>2,410.7</td>
</tr>
<tr>
<td>2017</td>
<td>314.4</td>
<td>427.7</td>
<td>538.6</td>
<td>667.0</td>
<td>480.6</td>
<td>2,428.3</td>
</tr>
<tr>
<td>Change</td>
<td>−13.3%</td>
<td>19.6%</td>
<td>−26.2%</td>
<td>43.2%</td>
<td>−2.9%</td>
<td>−0.7%</td>
</tr>
</tbody>
</table>


At the same time, U.S. exports to Russia continue to stagnate (Table 5.5) due to low levels of consumption during a two-and-a-half-year economic crisis, a deep ruble devaluation, sanctions, and counter-sanctions.

Given the very different economic structures and resource endowments of Russia and the United States, it is not surprising that U.S.–Russia trade is asymmetric and oil driven (Figure 5.1). A 3 percent increase in Urals oil prices translates into a one percent increase in U.S. import growth from Russia. Thus, in 2016, every $10 increase in Urals crude oil added $1.5 billion to the value of U.S. imports, or 11 percent to the total value of imports from Russia.

**OIL ADDICTION**

Oil is a core pillar of U.S.–Russia bilateral trade. A bumpy ride in oil markets affects commerce. Nevertheless, Russian oil exports to the United States in physical terms have been rather
sustainable. Starting from 2005, average annual deliveries have been above 150 million barrels (Figure 5.2). Crude and heating oil have dominated, while petroleum products and liquefied petroleum gases have not (Figure 5.3). In 2011, oil exports peaked at 228 million barrels but declined to 159 million barrels in 2016—a drop of 30 percent. Record high shipments of Russian oil to the United States coincided with an elevation in oil prices, which made the subsequent decline in oil shipment value between 2011 and 2016 (by about 72 percent, as shown in Figure 5.4) seem more stark. The increase in price also raised the share of oil in Russian exports by 74 percent in 2011 (Figure 5.5).

The Russian share in total U.S. oil imports was around 5.5 percent in 2011 and 4.3 percent in 2016 (Table 5.6). In the last five years, the United States has relied exclusively on consumption of Russian oil for the rough equivalent of one week out of the year (Figure 5.6).

It is unlikely that Russia can significantly increase its share of the U.S. oil market, and there is a real possibility for a downward trend. There are several reasons the historically high Russian hydrocarbon export threshold of 2011 will not soon, if ever, be surpassed.

First, U.S. energy consumption will likely be flat. According to the U.S. Energy Information Administration (EIA), demand for petroleum and other liquids in the United States will be about 35–36 quadrillion British thermal units (BTUs) with minimal variation over the next 25 years.¹

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Second, the United States will become a net energy exporter between 2020 and 2030, in most cases under different combinations of oil and natural gas prices, GDP growth, technological breakthroughs, and the availability of energy resources. The role of oil imports will dramatically fall.2

Third, oil price scenarios, as described by the International Energy Agency (IEA), international financial organizations (IFIs), and many national agencies, are very cautious and assume that even by 2035 to 2040, oil prices will not to recover to the levels of 2011–2012.3

Fourth, Russian oil production and export growth will be modest and driven by Asian economic expansion, and will comprise a decreasing share of Western markets.4 According to forecasts from

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2. Ibid., 15–18.
the Organization of the Petroleum Exporting Countries (OPEC), crude oil exports from Russia and the Caspian region to the United States will disappear by 2025.  

So why does the Russian Urals blend continue to be attractive for oil traders and U.S. refineries, which could process greater volumes of domestically produced lighter crude? There are two main reasons. One is related to the preference of U.S. high conversion refineries (the most sophisticated in the world) to work with heavy oil blends produced by Canada, Mexico, Iraq, Venezuela, and Russia. Processing heavy crude now is as profitable as processing lighter crude. The so-called crack spread—the difference between the cost of relatively cheap heavy crude oil and the final price of value-added consumer products (diesel, gasoline, jet fuel, and heating oil)—has become the same as the refinery margins of light, sweet crude. This has primarily affected light oil producing countries such as Angola, Algeria, and Nigeria.

Another factor affecting purchase of Russian oil is a new trend among oil companies for further consolidation of scale and for integrating operations of upstream and downstream business. There have been several waves of separation and unification of production, transportation, and processing in the last 50 years. The current business cycle can be seen as an adaptation to a period of low prices and oversupply. Companies that buy and/or produce oil in Russia most likely prefer to transport and process this oil in their own modern refineries in the United States. At the same time, some of the newest refinery designs, specifically for processing heavy oils, have been built in Asia, thus extending the choices of heavy oil producing countries.

We should also consider that leading U.S. and international oil traders, along with oil producing companies, working with or owning U.S. refineries, frequently buy Russian oil on the open market and have long-term contracts on Russian crude oil delivery. Many Russian oil companies prefer to pay for purchases or services with their future production, instead of cash, creating situations of “sticky” oil imports that are difficult to replace. The best-known example is an interaction between

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Figure 5.5. U.S. Imports from Russia: Share of Crude Oil and Petroleum Products, Million US$, 2007–2016


Table 5.6. U.S. Oil Imports: All Countries vs. Russia, Thousand Barrels per Day, 2011–2016

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>All Countries</td>
<td>11,436</td>
<td>10,598</td>
<td>9,859</td>
<td>9,241</td>
<td>9,449</td>
<td>10,058</td>
</tr>
<tr>
<td>Russia</td>
<td>624</td>
<td>477</td>
<td>460</td>
<td>330</td>
<td>371</td>
<td>433</td>
</tr>
<tr>
<td>Share</td>
<td>5.46%</td>
<td>4.50%</td>
<td>4.67%</td>
<td>3.57%</td>
<td>3.93%</td>
<td>4.31%</td>
</tr>
</tbody>
</table>

the Russian state monopoly Rosneft and commodity trading and mining giant Glencore, which, along with energy and commodities company Vitol, participated in a $10 billion prepayment deal with Rosneft for crude supplies in 2013.

There have been a number of ongoing transactions between the Russian oil industry and international oil companies, including several that top the list of importers of Russian oil to the United States (Table 5.7). In December 2016, Glencore participated in a controversial privatization operation, purchasing in tandem with the Qatar sovereign wealth fund a 19.5 percent stake in Rosneft, which was on the U.S. and EU list of sanctioned firms. Glencore has also taken a blocking stake in midsize oil producer RussNeft. BP owns a 19.75 percent stake in Rosneft. Chevron holds a 15 percent interest in the 935-mile-long CPC pipeline, which transports an average of 959,000 barrels of crude oil per day, including 76,000 barrels daily from Russia. ExxonMobil has formed

9. CPC=Caspian Pipeline Consortium.
**Table 5.7. Top Importers of Russian Oil to the United States, Thousands of Barrels, 2016**

<table>
<thead>
<tr>
<th>Importer</th>
<th>Barrels</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>VALERO MARKETING &amp; SUPPLY CO</td>
<td>54,590</td>
<td>36.16%</td>
</tr>
<tr>
<td>EXXONMOBIL OIL CORP</td>
<td>17,087</td>
<td>11.30%</td>
</tr>
<tr>
<td>CHEVRON USA INC</td>
<td>15,217</td>
<td>10.08%</td>
</tr>
<tr>
<td>BP WEST COAST PRODUCTS LLC</td>
<td>10,130</td>
<td>6.71%</td>
</tr>
<tr>
<td>GEORGE E. WARREN CORP</td>
<td>7,272</td>
<td>4.8%</td>
</tr>
<tr>
<td>PAULSBORO REFINING CO LLC</td>
<td>6,838</td>
<td>4.53%</td>
</tr>
<tr>
<td>TESORO CORP</td>
<td>5,097</td>
<td>3.38%</td>
</tr>
<tr>
<td>VITOL INC</td>
<td>5,084</td>
<td>3.37%</td>
</tr>
<tr>
<td>PHILLIPS 66 CO</td>
<td>4,726</td>
<td>3.13%</td>
</tr>
<tr>
<td>TRAFIGURA AG</td>
<td>4,360</td>
<td>2.89%</td>
</tr>
<tr>
<td>PAR HAWAII REFINING LLC</td>
<td>3,893</td>
<td>2.58%</td>
</tr>
<tr>
<td>MOTIVA ENTERPRISES LLC</td>
<td>3,041</td>
<td>2.05%</td>
</tr>
<tr>
<td>SHELL US TRADING CO</td>
<td>2,863</td>
<td>1.9%</td>
</tr>
<tr>
<td>MARATHON PETROLEUM CO LLC</td>
<td>2,475</td>
<td>1.6%</td>
</tr>
<tr>
<td>ATLANTIC TRADING &amp; MARKETING</td>
<td>2,099</td>
<td>1.4%</td>
</tr>
<tr>
<td>FREEPOINT COMMODITIES LLC</td>
<td>1,439</td>
<td>1%</td>
</tr>
<tr>
<td>GLENCORE LTD</td>
<td>1,284</td>
<td>.85%</td>
</tr>
<tr>
<td>BEST PETROLEUM CORP</td>
<td>967</td>
<td>.64%</td>
</tr>
<tr>
<td>ROLYMPUS US COMMODITIES GROUP LLC</td>
<td>822</td>
<td>.6%</td>
</tr>
<tr>
<td>HUNT CRUDE OIL SUPPLY CO</td>
<td>666</td>
<td>.4%</td>
</tr>
<tr>
<td>GULF OIL LP</td>
<td>658</td>
<td>.4%</td>
</tr>
</tbody>
</table>

several joint ventures with Rosneft to undertake offshore exploration in the Black Sea and the Kara Sea in Siberia.11

According to the Sanctions Act, U.S. persons are prohibited from exporting or reexporting goods, services (except financial services), and technology in support of exploration or production of new deep-water, Arctic offshore, or shale oil projects that involve designated Russian entities or other entities in which such sanctioned persons have a controlling interest or a substantial noncontrolling ownership interest, defined as not less than 33 percent (previously it was 50 percent). The new law also authorizes—but does not require—the imposition of so-called secondary sanctions against non-U.S. entities that engage in activities involving the construction, maintenance, or expansion of Russian energy export pipelines with a fair market value of $1 million or more, or an aggregate fair market value during a 12-month period of $5 million.12 This provision has raised the concerns of some European countries, particularly Germany. As result, the final language of the law included wording about coordination of this issue with allies of the United States.

Shipments of Russian oil to the United States could be affected by activity in the U.S. refinery industry. In early 2017, Saudi Aramco bought the United States’ largest oil refinery in Port Arthur (Texas), and it announced plans to send more of its own crude to that refinery.13 Serious concerns exist, however, regarding the future of three refineries and nine pipelines owned by Citgo, a U.S. branch of the Venezuelan state company PdVSA, which is balancing precariously on the edge of default. Under certain conditions in the event of PdVSA bankruptcy, Rosneft could claim a stake of up to 49.9 percent in Citgo. Such a possibility has raised concerns among politicians and U.S. government officials, with Treasury Secretary Steven Mnuchin calling it a “national security issue.”14

Tables 5.8, 5.9, and 5.10 show allocations of Russian oil imports to major U.S. refineries, some of which work exclusively on Russian crude a total of two to three months per year. In total, 150,940 thousand barrels of Russian oil were refined in 2016.

Figure 5.7 confirms a leading position of Texas and Louisiana among the U.S. states receiving Russian crude, followed by New Jersey, California, Mississippi, Washington, Hawaii, and Delaware. In a paradoxical way Texas has disappeared from the list of states as a main destination of U.S. imports from Russia (Figure 5.8) because Russian crude is mostly delivered to Louisiana ports and registered there by U.S. Customs as an import from Russia. After that, it transports to refineries in Louisiana and Texas.

Overall, the short-term business rationale behind the sustainability of U.S oil imports from Russia cannot overcome strong headwinds in the U.S. energy sector, facing all oil importers, which will inevitably lead to a contraction of Russian oil exports to the United States in the foreseeable future.

11. Exxon efforts to receive a special U.S. Treasury waiver to drill in sanctioned Russia failed in 2017.
Table 5.8. Valero’s Refineries Processing Russian Oil, Thousands of Barrels, 2016

<table>
<thead>
<tr>
<th>Location</th>
<th>State</th>
<th>Quantity</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Saint Charles</td>
<td>Louisiana</td>
<td>29,206</td>
<td>53.5%</td>
</tr>
<tr>
<td>Corpus Christi</td>
<td>Texas</td>
<td>20,626</td>
<td>37.8%</td>
</tr>
<tr>
<td>Wilmington</td>
<td>California</td>
<td>4,250</td>
<td>7.8%</td>
</tr>
<tr>
<td>Total</td>
<td>USA</td>
<td>54,590</td>
<td>100%</td>
</tr>
</tbody>
</table>


Table 5.9. ExxonMobil Refineries Processing Russian Oil, Thousands of Barrels, 2016

<table>
<thead>
<tr>
<th>Location</th>
<th>State</th>
<th>Quantity</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Baytown</td>
<td>Texas</td>
<td>15,037</td>
<td>88%</td>
</tr>
<tr>
<td>Baton Rouge</td>
<td>Louisiana</td>
<td>2,046</td>
<td>12%</td>
</tr>
<tr>
<td>Total</td>
<td>USA</td>
<td>17,083</td>
<td>100%</td>
</tr>
</tbody>
</table>


Table 5.10. Chevron’s Refineries Processing Russian Oil, Thousands of Barrels, 2016

<table>
<thead>
<tr>
<th>Location</th>
<th>State</th>
<th>Quantity</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pascagoula</td>
<td>Mississippi</td>
<td>12,767</td>
<td>84.0%</td>
</tr>
<tr>
<td>El Segundo</td>
<td>California</td>
<td>2,372</td>
<td>15.5%</td>
</tr>
<tr>
<td>Saint Rose</td>
<td>Louisiana</td>
<td>78</td>
<td>0.5%</td>
</tr>
<tr>
<td>Total</td>
<td>USA</td>
<td>15,217</td>
<td>100%</td>
</tr>
</tbody>
</table>

HEAVY METAL

Taken together, U.S. imports of metals and U.S. imports of oil compose about 80 percent of U.S. total imports from Russia (Figure 5.9). Trade of metals, like other commodities, is strongly affected by market price fluctuations. Nevertheless, metal imports from Russia have been fairly resilient to market volatility, and their average annual value has hovered at about $4 billion in the last five years (Figure 5.10). This market resilience was forged at the end of the 1990s/early 2000s, when Russian metal producers gradually modernized their plants, adjusting quality of production to Western standards and enhancing integration into global value and supply chains. Some of them conquered their share of the highly competitive U.S. market, struggling with peers from Canada and certain BRICS countries (China, India, and Brazil). To attract additional resources, all Russian large metal-producing companies became public and were listed on stock exchanges, chiefly the London Stock Exchange (Severstal’ PAO, Evraz, MMK OAO, Novolipetsk Steel, Norilsk Nickel, and TMK PAO); one on the New York Stock Exchange (Mechel); and one on the Hong Kong Stock Exchange (Rusal). Business logic pushed some of them to invest in the U.S. metal-making industry, which was hit hard by crisis. Later on, some of those assets were sold (e.g., two U.S. steel mills acquired by Severstal in 2004 were purchased 10 years later by Steel Dynamics Inc. and AK Steel Corp.).
Figure 5.8. U.S. Imports from Russia by State, Million US$, 2013–2016


Figure 5.9. U.S. Imports from Russia: Share of Oil and Metals, Million US$, 2007–2016

Obviously, the market dynamic of different metals varies (e.g., iron, steel, aluminum, platinum, and nickel). Caps to increase their trade and production in a "red ocean" global environment with anemic demand is rather limited, despite Figure 5.10 showing a spike of iron and steel imports from Russia in 2014 and aluminum in 2016. Some opportunities may exist for Russian-owned steel plants in the United States (such as NLMK) to participate in energy projects resumed under President Trump, who has required that new pipelines use only American-made steel.15

Russia occupies a special niche in the U.S. market for titanium products, a high-end metal industry. Twenty years ago a long-term contract was signed between Russian titanium producer VSMPO-AVISMA and Boeing. The Russian company entered the selective club of Boeing suppliers for the manufacture of components and semi-finished products. Since the signing of this contract, VSMPO has delivered more than 35 percent of all titanium placed on Boeing civil aircraft.16 They are hidden in the trade data in an import category for Civilian Aircrafts and Parts (Figure 5.11). At the end of 2016, Boeing announced an extension of its framework agreement with AVISMA.


through 2022 and additional investments in the construction of a new robotic plant in Titanium Valley, a special economic zone located in the Sverdlovsk region that will open in 2018. The processing of titanium forgings in all Boeing civil aircraft will be performed there, including 787s, 737 MAXs, and 777Xs. The contract extension with AVISMA may add several hundred million dollars in value to annual U.S. imports from Russia. How can such heavy reliance on imports of Russian titanium exist during a period of rising geopolitical tensions? The answer is straightforward: VSMPO-AVISMA is a highly specialized natural monopoly, producing 45 percent of the world’s aerospace titanium. Only four other countries smelt high-grade titanium in industrial quantities: the United States, Germany, Japan, and China. Overall, global production capacity is limited, while demand is growing. The United States currently imports around 79 percent of all the titanium it consumes each year. 

The Sanctions Act authorizes the secretary of the treasury (in a nonmandatory way) to impose restrictions (without specifying them) against Russian state-owned entities operating in the railway, metals, and mining sectors of the Russian economy. Despite the commanding heights of Russia’s state sector ownership in its economy (70 percent of GDP), the metal-producing companies have remained mostly in private hands.

NUCLEAR AFFAIRS

Historically, owners and operators of the 104 commercial nuclear power reactors in the United States have purchased more than 80 percent of their uranium from foreign countries. Uranium shipping from Russia accounted for about 13 percent of the 58 million pounds of uranium purchased overseas in 2012. At the same time, the Russian state-owned monopoly Rosatom accounts for 20 percent of Kazakhstan’s uranium production (which, in turn, comprises 11 percent of all U.S. uranium imports) and 20 percent of U.S. domestic uranium production capacity (with ownership of exploration tracts in Wyoming).

Nuclear fuel and nuclear power continue to be politically sensitive topics both in the United States and Russia. Bilateral cooperation in this sector (being surprisingly stable, with imports of nuclear fuel from Russia at a level of $1 billion annually in the last five years [Figure 5.12 and 5.13]) is under constant political and lobbying pressure and has been a source of several political scandals. Consequently, upside risks in this area of interaction are minimal, and downside risks are much higher, especially when we are seeing more decommissioning of nuclear plants in the United States than new constructions. The U.S. EIA’s 2017 Annual Energy Outlook assumes that about 25 percent of the nuclear capacity now operating will be removed from service by 2050.

WHY IS THE GRASS GREENER ON THE OTHER SIDE?

The United States continues to significantly reduce imports of chemical fertilizers as domestic production increases. In 2016, the United States imported 13 percent less ammonia and 11 percent less urea and UAN, which is a liquid urea and ammonium nitrate fertilizer. Russia accounts for around 40 percent of UAN imported by the United States. The United States canceled antidumping duties on imports of ammonium nitrate and urea from Russia in 2016, but it did not prevent import

Figure 5.12. U.S. Imports from Russia: Share of Oil, Metals, and Nuclear Fuel, Million US$, 2007–2016


drops twice last year (Figures 5.14 and 5.15). According to forecasts, UAN imports are expected to decline further to 1.5 million tons this year, down over 46 percent from 2.8 million tons imported last year. The downside trend in imports of fertilizers will likely continue because of oversupply.

BIG FISH

U.S. imports of fish and shellfish from Russia are best understood in comparison with U.S. fish exports to the Russian market, which slipped to zero in August 2014, after Russia issued an order banning certain agricultural imports from the United States (Figure 5.16). While the volume of U.S. supply was not very large, it was important because it broke up the monopolistic dominance of a few vertically integrated Russian companies that have kept prices high by restricting the entry of new producers. Seeking to implement import substitution policies, Russia has tried to reduce exports as well as imports of fish and seafood products in the last couple of years. This symmetrical approach was intended to “compensate” for a decrease of fish products in the domestic market.

**Figure 5.15. U.S. Imports from Russia: Chemical-Fertilizers, US$, 2007–2016**


**Figure 5.16. U.S. Exports to Russia: Fish and Shellfish, US$, 2007–2016**

consumer market caused by Russia’s import ban, but it has failed. As result, the group most affected by the self-imposed counter-sanctions were Russian consumers.

With a significant drop in fish imports, a devaluation of the ruble, and inflationary pressures on seafood prices, yearly consumption of fish in Russia has declined precipitously. In 2015 alone, fish prices increased 20 percent and consumption dropped to 14 kilograms per person from 22 kilograms in 2014. In 2016, food rose to 35.5 percent of household expenditure as a result of increases in food prices. This has pushed vertically integrated fishing monopolies to sell even more of their catch abroad, rather than deliver to the Russian Federation (Figure 5.17). Thus, we cannot exclude the possibility of further growth in U.S. fish and shellfish imports from Russia on a marginal scale.

Figure 5.17. U.S. Imports from Russia: Fish and Shellfish, US$, 2007–2016


SPACE ODYSSEY

Among high-end products beyond the top five groups of goods imported from Russia, cheap and efficient Russian engines have been used to launch U.S. rockets into space for about 16 years (Figure 5.18). There was a serious political struggle around a 2014 ban on the purchase of Russian RD-180 rocket engines, revealing the conflicting business interests of powerful high-tech companies. This restrictive measure was temporary and was quickly lifted because of significant cost impacts and risks of disruption to launch schedules. For the same reason, the Sanctions Act does not authorize “the imposition of any sanction or other condition, limitation, restriction, or prohibition, that directly or indirectly impedes the supply by any entity of the Russian Federation of any product or service, or the procurement of such product or service by any contractor or subcontractor of the United States or any other entity, relating to or in connection with any space launch conducted for the National Aeronautics and Space Administration; or any other non-Department of Defense customer.”

Nevertheless, many experts believe that U.S. domestic alternatives to replace Russian engines will be viable in five to eight years.


Figure 5.18. Spacecraft, Excluding Military, US$, 2007–2016

Diversity and technological complexity are the most visible advantages supporting U.S. exports to Russia. Three major groups of export goods include civilian aircraft, engines, and parts (Figure 6.1); drilling and oil field equipment (Figure 6.2); and industrial machines and engines (Figure 6.3). Despite sanctions against the transfer of advanced oil producing and processing technologies, the realization of U.S. drilling and oil field equipment in Russia is sustainable, although some bilateral projects have been frozen.

Another category of goods that has demonstrated resilience is the pharmaceutical industry (Figure 6.4), because most drugs in Russia are imported (about 70 percent of the Russian pharmaceutical market in value). Import substitution policies have had only modest results in this industry.

As confirmed by American Chamber of Commerce surveys, U.S. exports to Russia are closely connected to U.S. FDI. 30 percent of total imports of U.S. companies working in the Russian market come from the United States (more than $2 billion in 2016). In other words, about 40 percent of all U.S. exports to Russia are related to a U.S. corporate-sector business process in the country. The major sectors of activity of these companies are energy and natural resources (52 percent); manufacturing (17 percent); information and communications technology, or ICT (13 percent); retail (7 percent); automotive industry (6 percent); pharmaceutical production (1 percent); professional services (0.5 percent); and other (2 percent).1

Some obvious constraints on U.S. exports to Russia have resulted from a reduction in demand. A deterioration of bilateral relations and implementation of sanctions and counter-sanctions have, directly or indirectly, affected all businesses. Figures 6.5 and 6.6 provide data regarding a dramatic drop in the sale of U.S. agricultural production in Russia, with all other categories of exports in goods showing big cuts as well (see Figures 6.7–6.9).

Exports of civilian aircraft, engines, and parts put the state of Washington in first place among other states as a leading exporter to the Russian market (Figure 6.10).

1. American Chamber of Commerce in Russia, “Investment and Import to Russia, 2nd Survey,” 13.
Figure 6.1. U.S. Exports of Civilian Aircraft, Engines, Equipment, and Parts to Russia, US$, 2007–2016


Figure 6.2. U.S. Exports of Drilling and Oil Field Equipment, US$, 2007–2016

**Figure 6.3. U.S. Exports of Industrial Engines to Russia, US$, 2007–2016**


**Figure 6.4. U.S. Exports of Pharmaceutical Preparations to Russia, US$, 2007–2016**

Figure 6.5. U.S. Exports of Meat and Poultry to Russia, US$, 2007–2016


Figure 6.6. U.S. Exports of Soybeans to Russia, US$, 2007–2016

Figure 6.7. U.S. Exports of Vehicles, Engines, and Parts to Russia, US$, 2007–2016

Source: U.S. Census Bureau, "Trade in Goods with Russia" (see data for 2007–2016).

Figure 6.8. U.S. Exports of Medicinal Equipment to Russia, US$, 2007–2016

Source: U.S. Census Bureau, "Trade in Goods with Russia" (see data for 2007–2016).
Figure 6.9. U.S. Exports of Excavating Machinery to Russia, US$, 2007–2016


Figure 6.10. U.S. Exports to Russia by States (2016 US$ Value), Million US$, 2013–2016

Source: U.S. Census Bureau, “State and Metropolitan Area Trade Data.”
Upon reviewing the current trend in U.S.-Russia economic relations, we must acknowledge that the existing trade model is obsolete and exhausted. Imports are resource-oriented and reflect constraints of the Russian economic structure, while five groups of goods—oil, metals, nuclear fuels, fertilizers, and fish—make up more than 90 percent of total imports from Russia (Figure 7.1). Each of these industries has a limited capacity for growth in the foreseeable future.

Russia’s core export to the United States—oil—will inevitably decrease in the mid-term under any scenario. The value and volume of Russian exports to the United States are open to global market volatility and political pressures, with limited hedging mechanisms.

Overall, U.S. exports to Russia are unsustainable due to bilateral political tensions, the whims of commodity markets, and changing domestic policies. Sanctions and counter-sanctions have created additional barriers, particularly in finance, banking, high-tech, energy, and agro-business. According to the American Chamber of Commerce, 69 percent of U.S. companies working in the country consider the impact of U.S. sanctions against Russia on their business as negative. At the same time, 60 percent of companies do not expect big changes in business relations between Russia and the United States under Trump, as the new law codifies existing sanctions, fortifies them, and extends them to new sectors.

Current U.S. investments are low due to the weak rule of law in Russia, a lack of property right protections and proper contract enforcement, high levels of statization and monopolization in the economy, a poor business climate, outdated capital stock, dependence on natural-resource sectors, and of course, sanction and counter-sanction measures. Bloated administrative components, created as risk mitigation instruments, have also served as impediments. The country’s institutional weakness, low level of productivity, budget constraints, and a declining, inflexible workforce will restrain future economic growth, even if commodity prices recover. Russian economic policy will likely continue to be statist and protectionist, relying mostly on import substitutions.

1. Ibid., 11.
What scenarios can be expected in such a challenging environment?

One probability (no peace, no war) is based on the assumption that matters will not deteriorate further and implementation of the Sanctions Act will be cursory. This will cause relatively slow degradation in the economic field, with occasional flashes of activity in selected areas (e.g., closer cooperation against Islamist terrorist groups in Syria).

A second, worse case or critical scenario is the intensive and full-scale execution of current sanction legislation, and even the imposition of new economic punitive and restrictive measures, which could incite asymmetric retaliatory actions and lead to the introduction of additional protectionist policies. This, in turn, could trigger a further escalation of mutual confrontation, and could eventually destroy the fundamentals of the current bilateral trade system. Russian leadership has characterized the Sanctions Act as a declaration of a trade war that ends all hope for improving bilateral relations.2

2. Дмитрий Медведев, “Подписание президентом США нового санкционного закона против России создает несколько последствий” [The U.S. President’s signing of the package of new sanctions against Russia will have a few consequences], Facebook, August 2, 2017, https://www.facebook.com/Dmitry.Medvedev/posts/10154587161801851.
The best case and most favorable scenario looks less probable now. It assumes the realization of structural reforms in Russia in such a way that would adapt Russia’s foreign policy to national economic needs, reduce confrontations with the West and make a concerted effort to integrate Russian businesses into global supply and value chains. A revitalization of the structural reform agenda—including efforts to diversify economic activities through de-monopolization and support for SMEs, a restructuring of the banking sector, the creation of a vibrant business climate to foster entrepreneurships and innovation, the implementation of administrative and judicial reforms to tackle red tape and endemic corruption, and the reduction of state control over key sectors of the economy via wide-spread privatization could kick-start the development of a nonoil economy and improve long-term growth prospects. Despite ongoing discussion of reform strategies, deep economic and political changes are extremely complicated over the next political/electoral cycle (2018–2024), particularly because of resistance of vested interests and growing commodity prices. The urgency to tackle structural shortcomings in natural resource-dependent economies usually correlates with the price of those resources and the degree to which resource rents drive economic activity. However, there may be marginal improvements in the efficiency of the current economic system.

Future U.S.-Russia relations can be thought of through three pillars: one pillar focuses on areas where both countries maintain a competitive rivalry; another looks at potential areas of interaction under present conditions; a third pillar, and one that has evaporated from the current bilateral agenda, concentrates on future cooperation. Stronger economic ties could not only be a kind of political shock absorber, but contribute to the building of this future (particularly business contacts aim to support future structural reforms), although political factors are depressing the prospects for cooperation. To escape deadlock, it will be important to establish the right balance between politics and economics, and create a model of collaboration within the framework of contention.
About the Author

Vadim Grishin, PhD, MBA, has been involved in the reform process in Russia as adviser to the deputy prime minister of Russia in 1992–1993 and 2006–2010. He has extensive experience working with the Bretton Woods Institutions. He was the board member of the World Bank Group and served as senior adviser at the International Monetary Fund. Currently, he is a consultant to the chief economist’s office of the International Finance Corporation and teaches the economics of transition at Georgetown University in Washington, DC.
The Man Pupu Nyor Rock Formations at the Northern Urals, also known as Seven Strong Man or Little Mountain of the God in the local tribe (Mansi) language.