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Russia and the Global Meltdown:  
Domestic and Foreign Policy Responses to the  
International Financial Crisis

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## 1. INTRODUCTION

This paper has its origins in the observation that government responses to the global financial crisis are as much political phenomena as they are economic. The current global financial crisis, among its many consequences, has on a very high level shaken up the world political order. And while the crisis is international in origin—its roots lie in the breadth and the degree of the dispersal of risk associated with mortgage-backed securities, as well as the growing imbalance in international capital flows—its resolution is necessarily being carried out first and foremost on a domestic level. This is not least of all because, in the decade since the Asian financial crises, states have begun to play a dramatically increased role in international finance in relation to both multilateral financial institutions such as the IMF and traditional private actors.<sup>1</sup> In an age where global economic ties are integral to domestic economies and where states themselves are becoming some of the biggest players in international capital markets, a state's global financial standing will more than ever determine its political clout on the world stage. With states acting as market makers, lenders of last resort, and regulators of last resort,<sup>2</sup> the key to understanding the future of individual states in the global economic order can be found only by analyzing states' domestic and foreign policy decisions within the context of the specific constraints facing those states at home and abroad.

This paper will focus specifically on Russia, a country whose political and economic development in the 17 years since the fall of the Soviet Union has run the spectrum from the extremely liberal, pro-Western policies of the early and mid-1990s to the increasingly authoritarian consolidation of power under Putin and now Medvedev. Russia's international financial and political power rose with the surge in revenues from high oil and gas prices from approximately 2003-2008, as did its ambitions to become a leader in both arenas. Meanwhile, the Kremlin's extremely successful consolidation of power at home under Putin was to a large extent enabled by the existence of a tacit social contract between Russian leadership and its people: You give us a good standard of living, said the people, and we won't question your governance. The financial crisis has brought into question both the attainability of Russia's international ambitions, and the sustainability of the current authoritarian trend in domestic governance. An unstable domestic landscape will only further complicate an ambitious foreign policy, making stable domestic policy of primary concern to the Kremlin. Thus, the broad goal of this paper is to examine the concrete steps taken by Russia in response to the financial crisis both at home and abroad, in order to gain insight into Russia's current place in the world political and economic order, as well as the current trajectory of its

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<sup>1</sup> For a discussion of the increasingly dominant role of states in international finance, see Brad Setser, (2008). "A Neo-Westphalian International Financial System?" in *Columbia University Journal of International Affairs*. 62:1, Fall/Winter. pp. 17-34.

<sup>2</sup> The private sector, in the form of the now-notoriously inept rating agencies, wildly failed to self-regulate; indeed, in what is a cruelly ironic misalignment of incentives they instead managed to massively amplify risk in the market of opaquely packaged asset-backed securities. See Gretchen Morgenson, (2008-12-06). "Debt Watchdogs: Tamed or Caught Napping?" *New York Times*.

rule at home. A key assumption throughout is that the country's domestic- and foreign-policy trajectories are inextricably and closely linked; the exact mechanism by which they are linked is discussed in sections three and four.

More narrowly, in examining Russia's foreign policy the paper seeks to challenge the widely held "multipolar thesis" as an adequate model by which to explain Russia's place in the 21st century world order. Specifically, it challenges the frequently proposed argument that Russia will regain "great-power" status in the near to mid term, and cites the financial crisis and subsequent recession as the chief—but not the only—impediment to realizing this goal. After presenting the facts of Russia's response to the financial crisis, this paper, in its final section, will attempt to explain why the international financial crisis has rendered the multipolar thesis invalid and Russia's aspirations to be a regional leader in a multipolar world unlikely in the near future.

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This paper is divided into five sections. The first section gives a brief overview of the origins of the financial crisis and what it has meant for Russia, and briefly outlines Russia's relations with the U.S. and EU pre-crisis; understanding the context of the Russian response to the U.S.-driven financial crisis will help us understand the rationale for its response, and correspondingly, its political trajectory. Second, I examine Russia's domestic response to the crisis, and why the crisis will very likely undermine its hold on power at home; in doing so it will further drain the Kremlin's resources, adding constraints to Russia's leverage in world affairs. Third, I examine Russia's foreign-policy response to the crisis, which I explain as a three-prong strategy to solidify Russia's place among the great nations in the 21st century: it is at once trying to marginalize the U.S., move closer to Europe, and consolidate its control over the former Soviet space. Finally, I argue that the financial crisis has effectively invalidated the widely held multipolar thesis underlying its foreign-policy aspirations and suggest an alternate theory about how, given what we know now, Russia's domestic and foreign policy strategies might play out.

In his November 17 presentation before the Council on Foreign Relations, President Medvedev offered the following commentary:

*In the current situation many countries are directing their efforts toward overcoming the crisis. Maybe this isn't such a bad thing. This creates the opportunity to forget about any divergences because, when you have a common enemy, and this enemy is clear—it's the crisis—then other motives, other issues, recede. I, by the way, see in this a good opportunity to reestablish a number of lost issues in Russian-American relations. [...] Every cloud has a silver lining.<sup>3</sup>*

One hopes that Medvedev is being sincere, and that the Americans and Europeans agree with his sentiment. The crisis does, in fact, present an opportunity to build a more mutually beneficial world order. Whether our politicians will use that opportunity to the common advantage will be the test of 2009.

<sup>3</sup> Volkova, Marina, (2008-11-17). "Na sovete bez kupyur." *Rossiiskaya Gazeta*. <<http://www.rg.ru/2008/11/17/medvedev-sovet.html>>

## 2. THE BACKGROUND

### 2.1 Russia and the U.S. – Political Background

Politically, Russia's relations with the West—and with the U.S. in particular—had been deteriorating since their recent apex in the aftermath of the September 2001 terrorist attacks. From the Russian perspective, the attacks had a silver lining—they opened the door to a new era in U.S.-Russian relations, one based upon cooperation to defeat common enemies. Facing its own domestic terrorist threat, Russia welcomed the United States to the cause of fighting terrorism and extended a hand, both symbolically and materially.

President Putin had been the first to call Bush after the attacks, offer his condolences, and offer Russian assistance in finding and bringing to justice the perpetrators of the attacks. Both sides had much to gain in the sharing of terrorism-related military intelligence, and Putin welcomed the backing-down of the Bush team's harsh rhetoric against his war in Chechnya as the U.S. itself joined the fight against fundamentalist Islamic terrorism. Putin immediately stepped forward with material assistance as well, proposing a five-point plan on September 24, 2001, to support the U.S. war on terror, including “‘active international cooperation’ of [Russia's] intelligence services and supply of ‘weapons and military equipment’ to the coalition of forces aligned against the radical Islamic Taliban government in Afghanistan.”<sup>4</sup> In a very surprising move, Putin also gave the U.S. an open door to station military bases in Central Asia (where admittedly, Russia also sought to fight the threat of fundamentalist Islamic terrorism). He opened Russian airspace to flights carrying humanitarian aid and offered support to the Northern Alliance, the main domestic Afghani opposition to the Taliban. In short, Putin offered the U.S. cooperation on a scale rarely seen in Russian-American relations.

The question remains about what, if anything, Putin expected in return for these favors either in the short term or the long term. Clearly he saw value in enfolded the war in Chechnya within the larger, global “war on terror,” as the latter was garnering international support and taking some of the international pressure off Russian domestic policy.<sup>5</sup> And it is likely that he expected, if nothing else, at least American goodwill toward Russia and flexibility in the U.S. response to Russian domestic policy and its foreign policy in its strategic “near abroad.” On the other hand, at the time Putin, in regard to his post-September 11th assistance to the U.S., explicitly stated that “We do not want to, and will not, get involved in any horsetrading. [...] For us, the issue of uniting forces in the fight against terrorism is a separate theme of our cooperation.”<sup>6</sup> This is a pretty clear-cut statement that Russia was not expecting a quid pro quo; if it was, then U.S. behavior in the

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<sup>4</sup> Wines, Michael, (2001-09-25). “A Nation Challenged: Moscow; Aligning with U.S.” *New York Times*.

<sup>5</sup> Erlanger, Steven, (2001-09-26). “A Nation Challenged: The Russians; Schroder Urges Milder View of Moscow Role in Chechnya.” *New York Times*.

<sup>6</sup> *BBC News*, (2001-09-25). “Putin: 'We are all to blame.'”

following months would show that the Russian strategy, in retrospect, should be regarded as a miscalculation at best.<sup>7</sup>

Already by November 2001, the U.S. announced that they would go ahead with the second round of NATO expansion, which would include the three Baltic states. On December 13, Bush expressed U.S. intentions to leave the anti-ballistic missile treaty,<sup>8</sup> long the cornerstone of U.S.-Russian nuclear arms control. With the creation later of the U.S. Missile Defense Agency and plans to build missile and radar systems in Poland and the Czech Republic, it looked as though Ronald Reagan's Strategic Defense Initiative was finally being realized in earnest, to the astonishment of Russian leaders. Furthermore, Russia's hoped-for "fast track" to the WTO has been painfully slow, and the U.S. has inexplicably still not gotten around to removing the anachronistic Jackson-Vanik amendment limiting U.S.-Russian trade (the amendment is based on historical emigration restrictions on Soviet Jews that have long been irrelevant).<sup>9</sup> Add to that U.S. non-ratification of the Treaty on Conventional Forces in Europe, NATO military intervention in the Balkans, Western recognition of Kosovo as a sovereign state, vehement Western opposition to Russia's intervention in Georgia the previous summer, the West's subsequent denial of Abkhaz and South Ossetian sovereignty, and NATO's proposed push eastward into Georgia and Ukraine. However unlikely its prospects,<sup>10</sup> the U.S. push for NATO expansion into Georgia and Ukraine is extremely offensive diplomatically to the Russian leading elite who, among other things, were under the impression that early Russian concessions on nuclear disarmament in the 1990s would be met with a tacit pledge that NATO would not expand into Eastern Europe and the former Soviet Union.

In the eyes of Russia's ruling elite, it is difficult to find an instance of gracious diplomacy coming from the U.S. in the past eight years (and for that matter, many would argue that the Clinton policy toward Russia—the genesis of renewed efforts to establish anti-ballistic missile systems and push NATO expansion—was equally

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<sup>7</sup> See the comments of Dr. Leon Aron in: Partnership for Global Security. (2002-04-19). "Russian American Nuclear Security Advisory Council. Congressional Strategic Stability and Security Seminar Series. Seminar 1: U.S.-Russian Relations in the post-September 11 World." Remarks prepared by Ingrid Staudenmeyer. This, however, did not stop many from seeing Putin's moves exactly as a *quid pro quo*. See Paul Starobin and Catherine Belton, Stan Crock, (2001-10-08). "Vladimir Putin, Washington's Pal?" *Business Week*.

<sup>8</sup> Office of the Press Secretary, (2001-12-13). "Announcement of Withdrawal from the ABM Treaty." The White House.

<sup>9</sup> Antipova, Natalia and Ekaterina Grigorieva, Nadezhda Popova, (2007-10-04). "Ni Dzheksona nam, ni Venika." *Izvestia*. <<http://www.izvestia.ru/politic/article3103036/>>  
See also Office of the Press Secretary, (2001-11-13). "Jackson-Vanik and Russia Fact Sheet." The White House Office of the Press Secretary. <<http://www.whitehouse.gov/news/releases/2001/11/20011113-16.html>>. Russia has been subject to annual reviews stating that it is in compliance with emigration requirements and consequently has received annual waivers from the Jackson-Vanik trade penalties. However, as is apparent from the *Izvestia* article cited above and many, many other articles in the Russian press, Russians are understandably unhappy with the persistence of the amendment.

<sup>10</sup> Frolov, Vladimir and Stephen Blank, Ethan Burger, James Jatras, Edward Lozansky, (2008-12-05). "Russia Profile Weekly Experts Panel: No MAP for Georgia and Ukraine?" *Russia Profile*. <<http://www.russiaprofile.org/page.php?pageid=Experts%27+Panel&articleid=a1228495742&print=yes>>

dismissive of Russian interests). Most recently, Obama's choice of Hillary Clinton as Secretary of State has only increased Russian fears that the next four to eight years of U.S. diplomacy will be nothing more than a continuation of U.S. hardline tactics, unilateralism, and disregard for Russian interests<sup>11</sup> (although despite some minor setbacks, Clinton and Lavrov's first meeting on March 6, 2009, seems to have set a tentatively optimistic tone for the coming year).

The tensions have spilled over from the diplomatic arena into the financial: international lack of confidence in the direction of Russian foreign policy was expressed, among other ways, in \$7 billion of capital flight from Russia in the days following the outbreak of war.<sup>12,13</sup>

## 2.2 Russia and the EU – Political Background

On the other hand, Russian relations with the EU have been more positive. Though no European country has recognized Abkhazia and South Ossetia as sovereign nations and many European nations harshly criticized the Russian response to the Georgian attack in South Ossetia, the post-conflict negotiations between Medvedev and Sarkozy represented a diplomatic breakthrough between Russia and the EU. Russia–EU cooperation, especially in light of the November 14th Russia–EU summit in Nice, represents a significant step forward in Russia's ties with the EU.

The success of the EU-Russian negotiations regarding the Caucasus war and Russia's timely fulfillment of its obligations under Sarkozy's six-point plan reassured Europe. While Sarkozy had to tell both the U.S. and Russia to step back on U.S. missile defense plans and Russia's proposed Kaliningrad-based Iskander missile system until negotiations could be held later in 2009, he greeted favorably Medvedev's proposal for a new European security architecture. France sided with Germany against the inclusion of Georgia and Ukraine in NATO, and France and Germany have been leading the way to a heightened, more productive partnership with Russia. Early on, Sarkozy also commented favorably on the Russian response to the financial crisis and on its proposals for a new financial architecture, to be discussed in the April G20 meeting.

On the other hand, the European Commission has announced 350 million euros of support to Ukraine, Georgia, Azerbaijan, Armenia, Moldova, and Belarus, in addition "to the almost 1.2 billion euros already pledged to these countries by 2020

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<sup>11</sup> See AFP, (2008-12-06). "No warming in U.S.-Russia ties under 'tough' Clinton: analysts." <[http://www.google.com/hostednews/afp/article/ALeqM5gikn0In36lELxfI9\\_Ip9zx6kWGA](http://www.google.com/hostednews/afp/article/ALeqM5gikn0In36lELxfI9_Ip9zx6kWGA)>.

<sup>12</sup> BBC Russian, (2008-08-17). "Kudrin: Za vremya voyny Rossiya poteryala 7 mlrd. dollarov." <[http://news.bbc.co.uk/hi/russian/russia/newsid\\_7566000/7566577.stm](http://news.bbc.co.uk/hi/russian/russia/newsid_7566000/7566577.stm)>.. Accessed 2008-11-15.

<sup>13</sup> Later substantial capital flight, including \$28.4 billion in September alone, is difficult to attribute specifically to one cause or another—it is clear that much of the September figure was due to the September 15 fall of Lehman Brothers and Merrill Lynch, as well as the corresponding plunge in world stock markets in connection with the onset of the U.S. banking crisis.

in the framework of the so-called Eastern Partnership.”<sup>14</sup> While Russia has not seemed to have taken this as harshly as it has the U.S.-backed plans for NATO expansion—partly because it is an offer of economic, and not military support—any direct support to countries of the former Soviet Union is likely to be viewed suspiciously by Russian leadership. This is especially true when some, such as Ukraine’s ambassador to the EU Andriy Veselovsky, believe that the EU’s financial support “is definitely a step toward Ukraine’s membership in the European Union. Why go through the trouble otherwise?”<sup>15</sup> While the Kremlin may not yet be paying the Eastern Partnership much serious attention, it is a sign that Russian-EU relations will remain complex for some time to come.

The Russia-EU trade relationship is quite significant, which has historically kept the two closer despite foreign policy disagreements. The EU accounted for 51.5% of Russia’s trade in 2007, and approximately 75 percent of FDI stocks in Russia come from EU states.<sup>16</sup> Germany, Italy, and France rely heavily on Russian gas, and the EU as a whole imports over 40 percent of its gas from Russia (though this is down from 75 percent in 1990).<sup>17</sup> Central and Eastern Europe’s gas markets are smaller on an absolute scale, but relative to those countries’ needs make them “highly dependent on Russia. [...] Russian gas supplies a particularly high share of total energy in only four countries—Lithuania, Latvia, Hungary, and Slovakia—each of which is reliant on Russian gas for around a third of its energy use.”<sup>18</sup> This leads to a feeling of insecurity among those countries and to tensions between the EU and Russia on issues regarding the diversification of energy supply. Such fears were heightened in the aftermath of the January 2006 gas disputes with Ukraine; though the argument to make Ukraine pay market prices was economically fair, Europe regarded Russia’s response to Ukrainian non-payment as overly harsh and unreasonable.

The recent Russia-Ukraine-EU gas dispute-redux brought the conflict to an even finer point, as Europeans now see the issue as a trend, not an anomaly. Gazprom had warned Ukraine’s Naftogaz that it was responsible for paying the gas distribution intermediary RosUkrEnergo, by January 1, 2009, \$1.67 billion in arrears and \$450 million in fines for the gas Ukraine used in the autumn of 2008.<sup>19</sup> Additionally, the two parties were not able to agree on the price Ukraine would pay for gas in 2009. The conflict eventually led Moscow, which argued that Ukraine had been stealing

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<sup>14</sup> Bigg, Claire, (2008-12-06). “EU Enhances 'Eastern Partnership'—But Is There Less Than Meets The Eye?” Radio Free Europe/Radio Liberty. <[http://www.rferl.org/Content/EU\\_Enhances\\_Eastern\\_Partnership\\_But\\_Is\\_There\\_Less\\_Than\\_Meets\\_The\\_Eye/1356313.html](http://www.rferl.org/Content/EU_Enhances_Eastern_Partnership_But_Is_There_Less_Than_Meets_The_Eye/1356313.html)>.

<sup>15</sup> Quoted from *ibid*.

<sup>16</sup> European Commission. “Bilateral Trade Relations: Russia.” <[http://ec.europa.eu/trade/issues/bilateral/countries/russia/index\\_en.htm](http://ec.europa.eu/trade/issues/bilateral/countries/russia/index_en.htm)> accessed on 2008-12-06.

<sup>17</sup> Noel, Pierre, (2008-11-21). “The EU and Russia’s Gas.” *The European Council on Foreign Relations*. <[http://ecfr.eu/content/entry/commentary\\_the\\_eu\\_and\\_russias\\_gas/](http://ecfr.eu/content/entry/commentary_the_eu_and_russias_gas/)>.

<sup>18</sup> *Ibid*.

<sup>19</sup> BBC News, (2008-12-30). “Ukraine 'paid gas debt in full.'” <<http://news.bbc.co.uk/2/hi/business/7804336.stm>>



gas destined for Europe, to shut off all gas to Europe from January 7 through January 19, 2009 at the expense of European consumers, many of whom went without gas for a period.

While Russia and Ukraine finally reached an agreement for 2009 on January 19 and gas began to reach Eastern Europe once again on January 21, the situation is far from stable. The “10-year agreement” reached between Prime Ministers Putin and Tymoshenko has already been called into question; by early February Ukraine had yet to pay back RosUkrEnergo for the fines from the previous autumn; and the Czech-led EU has been insisting on diversifying their sources for gas supply. Among the pipeline options are three possibilities that bypass Ukraine: the Caspian-based Nabucco pipeline in the south that would also skirt Russia entirely; the competing Russian-based South Stream pipeline that would reach Eastern Europe and Italy from the south; and the Russian-based North Stream pipeline that would skirt Ukraine and deliver gas to Europe in the north. Which of these projects the EU will eventually favor remains uncertain, but the outcome will necessarily be a compromise between the EU’s heightened fear of Russian (and Ukrainian) instability, the reality of European disunity, and leverage that Russia commands in the region because of its monopoly on gas production.

In any event, whatever the objective reality regarding the fairness of Russian energy policy toward Ukraine, such events leave a bad taste in the mouths of European diplomats and add an additional barrier to increased Russian-EU cooperation.

### 2.3 Roots of the Financial Crisis in the U.S. Housing Bust and the Worldwide Fallout

The substantial developments in world finance since Bretton Woods and the increased volume and interconnectedness of international capital flows in recent years have created massive global trade imbalances. As emerging economies have increasingly subsidized the spending of the major post-industrial economies—most dramatically the United States’—a handful of the emerging economies have recently been able to accumulate fiscal and current account surpluses on a scale never before seen, and have dumped tens and hundreds of billions of dollars into hard currency reserves and sovereign wealth funds. They represent a new class of super-investors. Meanwhile, financial engineers in the U.S. have developed increasingly complex financial instruments allowing for the securitization and packaging of a wide range of assets, which they saw as a triple boon: investors would have an immense amount of new investment possibilities (there were a lot of assets to securitize!), liquidity could increase so domestic consumers could get cheap credit, and risk would be dispersed so widely that it would be negligible. Unfortunately for the world, the first two propositions were very true, and the third all too false.

Lenders, mortgage originators, and investment banks churned out new mortgages, securitized them and packaged them as fast as possible, with few or no checks on quality. Foreign investors bought the high-yield, AAA-rated structured financial instruments known as collateralized debt obligations (CDOs) at increasing

rates, allowing them to earn even more money from U.S. spending. On the American side, the constant inflow of liquidity and resulting cheap credit allowed consumers to spend well above their means, in reality creating little value for the goods they were receiving; when housing prices fell in the U.S. and it came time to pay, the world looked to American consumers, and then to American banks, who were left empty-handed. Like the theatergoers in Bulgakov's *Master and Margarita*, the bankers upon whom fortunes so recently rained down were astounded when their money—or, in this case, AAA-rated CDOs—turned to junk before their very eyes.

Less happy still were the investors, both domestic and foreign, when the cheap credit supplied by the securitization boom dried up overnight and the value of investments around the world plummeted; faced with billions of dollars of debt, margin calls they could not meet, and no sources of credit, investors worldwide were forced to either give up their collateral or turn to their governments for credit, setting off a round of nationalization on a tremendous scale. Governments such as Russia's, indignant at being forced into a corner as a result of America's failure to govern its own financial sector, saw the crisis as one more example of American arrogance coupled with ineptitude that has characterized Russia's perception of America since the Yeltsin years. When added to the list of Russia's grievances against the U.S., the financial crisis added fuel to the already substantial anti-American sentiment pervasive among the ruling elite.<sup>20</sup>

### 3. RUSSIA'S DOMESTIC RESPONSE TO THE FINANCIAL CRISIS

Russia's domestic response to the financial crisis was notably strong in the early fall—a fact that Russian leadership did not hesitate to mention, both to maintain public confidence in Russian banks and the Russian ruble, and seemingly to point out the ineptitude of the uncoordinated, shot-in-the-dark responses of Russia's G8 partners (a point I will return to in the discussion of foreign policy). Russia's strong initial response was made possible by extraordinary levels of foreign reserves and a sovereign wealth fund<sup>21</sup> that allowed the government to cushion the impact of the

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<sup>20</sup> See Levada-Center, (2008-11-27). "Izmenenie otnosheniia rossiian k SShA, ES, Ukraine i Gruzii." <<http://www.levada.ru/press/2008112704.html>>. According to their survey, in September 2008 67% of Russians said that their attitude toward America was either "bad" or "very bad." Results for November improved slightly, with 51% responding that they regarded America "badly" or "very badly". This paper will address the question of the attitudes of the political elite in greater detail below.

<sup>21</sup> After gaining \$157 billion only four years after its creation under the direction of Aleksei Kudrin, Russia's original sovereign wealth fund, called the Stabilization Fund, was split into two parts as of February, 2008: the National Welfare Fund (containing \$142.6 billion as of September 1, 2008) and the Reserve Fund (\$31.92 billion as of September 1, 2008). Oil revenues gained from prices over \$70 per barrel were funneled into the Reserve Fund until it grew to 10% of the GDP, which occurred in August; additional money from high oil prices has gone to the Welfare Fund. The Welfare Fund was established to help refinance Russia's pension system by investing in high-yield securities abroad, while the Reserve Fund was to be maintained as before in order to fill gaps in the Russian budget in the event of a fall in oil prices and would be invested in lower-yield government securities abroad.

crisis early on. As the crisis has continued with no end in sight, however, the Ministry of Finance's initial strategy—which seemingly consisted of throwing large amounts of rubles at the nation's banks to increase liquidity and credit, and even larger amounts of dollars at the foreign exchange markets to support Russian consumers at home—began to look increasingly hopeless. The ruble tumbled in January as support for it stopped. Meanwhile, reserves have fallen more than a third in value since their peak of \$598 billion in August 2008.<sup>22</sup>

### 3.1 The Pressure on the Russian Economy

Since August 2008, the Russian economy has suffered blows from three main fronts: 1) a series of foreign policy missteps set off by Russia's participation in the war in Georgia, which lowered international public confidence in Russia and caused immediate high levels of capital flight, coupled with later, unprecedented levels of capital flight as private investors exited the Russian market; 2) the falling price of oil, which wiped out 75% of Russia's two main stock indices practically overnight, put the most pressure on the ruble (which greatly encouraged the aforementioned capital flight, further increasing pressure on the ruble), and resulted in an attempted, and ultimately ineffective, "bailout of the ruble" by the Central Bank; and 3) loss of liquidity as the stock market was wiped out and international banks were both unwilling to lend to Russia, and generally unwilling to refinance Russian loans. Here we will explore each of these factors in a bit more depth.

The first factor is recent Russian foreign policy moves—specifically, as of August, the Russian-Georgian war in South Ossetia and the consequent diplomatic fallout. In the week after the war broke out on August 8, Russia's currency reserves fell \$16.4 billion, approximately half of which could be attributed directly to reactions to Russia's role in the war.<sup>23</sup> In addition to the immediate capital flight in August, Russia's role in the war with Georgia has encouraged Western investors—some of whom might have been wooed by Medvedev's more liberal tone earlier in his term—to remain cautious of Russia and wary of the control a strong Kremlin would exert over the country's business sector.

The West's ensuing criticism of Russian actions led to a diplomatic tit-for-tat that has only further alienated Russia politically and financially from the West. Medvedev's November 5th harangue at the United States<sup>24</sup>—justified as it may have been—may have only aggravated the situation; Medvedev, by presenting Russia to the world as a powerful, independent state that would sooner go it alone than cede authority in its backyard, reinforced the impression that Russia was too unpredictable to be considered a safe environment for investment. This, in part, might also explain why foreign banks have been largely unwilling to roll over Russian commercial

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<sup>22</sup> As of February 13, 2009, the gold and currency reserves totaled \$386.6 billion.

<sup>23</sup> Shcheglov, Aleksei and Mikhail Sergeev, (2008-08-22). "Tsentrбанк neset voennye poteri." *Nezavisimaya Gazeta*. <[http://www.ng.ru/economics/2008-08-22/5\\_centrobank.html](http://www.ng.ru/economics/2008-08-22/5_centrobank.html)>

<sup>24</sup> Medvedev, Dmitry, (2008-11-05). "Poslanie Federal'nomu Sobraniuu Rossijskoj Federatsii." <<http://kremlin.ru/text/appears/2008/11/208749.shtml>>

debt, while they have in most cases remained willing to do so for other developing economies (including Russia's BRIC "partners"—Brazil, India and China).<sup>25</sup> While it is impossible to quantify exactly the degree to which Russian foreign policy played a part in capital flight and forestalled prospective foreign investment, foreign perceptions of the Kremlin's shift toward unilateralism and significant influence in private-sector decision-making have undoubtedly hurt the ruble.

New and unprecedented levels of capital flight soon followed, spurred less by Russia's foreign policy moves than by international investors' assessments of the doubtful resilience of the Russian economy. In total, in the last three months of 2008, Russia experienced more than \$130 billion of capital flight.<sup>26</sup> When compared with the more than \$83 billion capital inflow the country attracted in 2007, this number signals both the large degree to which the Russian private sector had participated in the international capital boom—and subsequently suffered as a result of that participation—and an extremely pessimistic prediction of the direction the Russian economy will take in the short to medium term as it faces the global recession. Such high levels of capital flight are without a doubt in part due to a general move of investors worldwide to "safe," liquid investments—largely to U.S. treasuries—but they also represent, to a degree, a vote of no-confidence on the Russian leadership's ability to steer the country's economy back to health in the short to medium term.

The second, but perhaps most immediate cause of the immense downward pressure on the ruble, was the plummeting price of oil and the corresponding collapse of the Russian stock markets. As of February 2009, the price of oil hovered at about \$40 per barrel—more than \$100 lower than its peak in mid-July 2008. Demand for oil had skyrocketed in the first three quarters of 2008 with the high consumption fueled by the cheap-credit boom of the past five years; as a result, oil-rich states such as Russia were able to heavily tax oil profits and use the revenues to both fund domestic development and fill sovereign wealth funds at unprecedented rates. Although the management of Russia's sovereign wealth funds was handled extremely well—at least until September, when the government began an ill-fated attempt to support the ruble—the commodity-dependent nature of the Russian economy means that it has effectively ceded control over its budget revenues to external consumption. And as of October 2008, the level of that consumption was low.

Among its many effects, this fall in the price of oil tipped off a sharp drop in the value of country's stock markets and erased vast amounts of wealth from private hands. Both the RTS and MICEX stock indices fell with the price of oil this fall. As of February 2009, the value of Russia's RTS index was down almost 80% since June 2008, while the MICEX index was down approximately 65% from that period—far

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<sup>25</sup> For example, when the Russian aluminum company RusAl attempted to secure investment from the Chinese state-owned aluminum holding company Chinalco in September, Chinalco passed it over in favor of investing \$9 billion in the British-Australian jointly listed Rio Tinto aluminum giant. RusAl was later forced to accept a loan from the Russian state-managed bank VEB, on extremely poor terms that amounted to at least a "quasi" nationalization of the firm. See below for further discussion.

<sup>26</sup> EurasiaNet, (2009-01-13). "Russia: A Record Year for Capital Flight." <<http://www.eurasianet.org/departments/briefs/eav011309e.shtml>>

out-pacing the declines experienced both by other BRIC markets and by the OPEC countries. This, in part, has put pressure on Russia's wealthy elite (the "oligarchs") to turn to the Russian government for bailouts or face ceding their assets—generally major companies that the state considers "strategic industries"—to the foreign banks from which they acquired loans.

Meanwhile, liquidity in the Russian banking sector dried up almost overnight as U.S. and other banks around the world stopped lending, ultimately leading the Russian Central Bank to inject massive amounts of liquidity into Russian banks. Much of the Central Bank money, however, was never transferred to the real economy as intended, but rather fueled the capital flight discussed above; banks knew that the Central Bank was massively supporting the ruble at the time, and that it could not withstand the downward pressure on the ruble forever. The banks increased this downward pressure by selling the rubles they had received in bailout money for dollars, which effectively: A) squandered the Central Bank money that was supposed to loosen up credit in Russia domestically, which would have lowered the rates at which banks would loan to ordinary Russians and restart the stalled economy, and B) forced the Central Bank to dump even more of its gold and currency reserves into supporting the ruble. The Central Bank essentially had to buy back the rubles it had just given out with dollars it had saved in its reserves, which further perverted its response to the banking crisis and exacerbated the very problem it had set out to fix.

### 3.2 The Rise and Fall of Russia's Gold and Currency Reserves (and Monetary Policy)

The hero in the fall of 2008 was Russia's Minister of Finance Aleksei Kudrin, who was largely responsible for the enormous amount of wealth the country accumulated during the years of high commodities prices. By August 2008 Kudrin had managed to build up \$598 billion in gold and foreign currency reserves since becoming Minister of Finance in 2000, making Russia the third largest holder of foreign currency in the world (following only China and Japan). By December 1 the country's Stabilization Fund—in the short time since Kudrin had established it four years prior—had accumulated a total value of \$209 billion. With increases in value of \$3.2 billion in the Reserve Fund and \$16 billion in the National Welfare Fund in November 2008 alone,<sup>27</sup> government optimism remained high; officials used the opportunity to underscore the safety of their investments from the fallout of what they persistently referred to in the media as the "U.S. and European financial crisis." Premised on the understanding that oil and gas prices could rise and fall dramatically, and that consequently Russia would need protection from inflation during times of peak prices and a steady flow of income to fill the gaps in its budget in years of low prices, the fund has indeed served its purpose extremely well as Russia has seen oil fall 73% from its peak in July 2008.<sup>28</sup> Standing up against opponents of the Stabilization Fund, who were convinced the money would be

<sup>27</sup> RIA Novosti, (2008-12-01). "Russia's Reserve, National Prosperity Funds show growth in Nov." <<http://en.rian.ru/russia/20081201/118635038.html>>

<sup>28</sup> As of December 8, 2008

better spent immediately before it could be eroded by the ruble's high rate of inflation, Kudrin and others such as Kremlin economic advisor Andrei Illarionov remained confident that the fund was necessary in an oil- and gas-driven economy such as Russia's. In this they have been vindicated, as the substantial reserves and stabilization funds have perhaps been Russia's only saving grace since the crisis hit in the fall of 2008.

With these numbers in mind, the government's response to the crisis at home was very optimistic well into October, remaining overly positive all the way up until the end of January. The crisis was the problem of the U.S. and the EU, government officials proclaimed relentlessly on television and in the press, and Russia could overcome any financial bumps that came their way. Flush with oil money, a strong ruble, and 8.1% GDP growth in the first half of 2008, Russian leaders saw themselves in a strong position to respond to the crisis. Moreover, they did not see Russia as being overly exposed to the toxic mortgage-based "collateralized debt obligations" that were pulling down the U.S. economy. "It appears that all the 'hot, short money' has already left the country," said Deputy Minister of Finance Dmitri Pankin on September 13. "One should note that serious amounts of money were taken from our markets by non-residents," he continued, referring to the \$4.6 billion of capital outflow the Central Bank had calculated for August 2008 (once total figures were calculated, the amount later turned out to be almost four times greater).<sup>29</sup> The Central Bank still maintained their prognosis of a net \$40 billion capital inflow for 2008, while Pankin noted that the fall in the Russian market was natural given similar declines in U.S., European, and Asian markets recently, and that in any case Russia could weather the decline in oil prices to \$95 per barrel.

Apparently anticipating further declines, however, two days later Kudrin expanded the placement of temporarily free budgetary funds into bank deposits from 668 billion rubles (approximately \$26.7 billion at the exchange rate at the time) to 1,232 billion rubles (approximately \$49.2 billion) and on September 17 extended the term of credit to three months. The money was disbursed to Sberbank, VTB, and Gazprombank<sup>30</sup> in the hope that these three "system-making" banks would continually supply credit to other banks,<sup>31</sup> which would in turn be offered to small and medium-sized business at affordable rates. Most of that money, including an additional 282 billion rubles freed from available budgetary funds (bringing the total dollar amount to about \$60 billion), was taken up by the "big three" banks at Ministry of Finance auctions by the end of September; the Ministry of Finance predicted that the situation would stabilize and that the worst was behind them.<sup>32</sup>

As discussed above, though, much of the money that went to banks to increase liquidity only served to increase capital flight; the Ministry of Finance was effectively

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<sup>29</sup> Nikolaev, Yurii, (2008-09-13). "Vse 'goryachie' dengi uzhe vyvedeny iz Rossii." *RIA Novosti*.

<sup>30</sup> The money was disbursed as follows: Sberbank received 754.2 billion rubles; VTB received 268.5 billion rubles; Gazprombank received 103.9 billion rubles.

<sup>31</sup> RBC, (2008-09-17). "Prinyatykh Minfinom i TsB mer poka dostatochno dlya udovletvoreniya potrebnostei rynka."

<sup>32</sup> RIA Novosti, (2008-09-25). "Situatsiya s likvidnostyu v RF stabiliziruetsya i budet uluchshatsya."

defeating its own monetary policy by signaling to investors that it was massively supporting the ruble. Investors, knowing full well that the Central Bank could not support the ruble forever and that the downward pressure from non-speculative sources (namely the falling price of oil) demanded a weaker ruble in the medium term, put all of their money in dollars and euros to wait out the ruble's fall and make a quick profit. This had the effect of freezing lending within Russia; interest rates skyrocketed, exacerbating the problems for domestic businesses. Meanwhile, the government only increased the amount of money it threw at supporting the ruble and "increasing liquidity," while extending its media campaign to reassure the public.

But when in September \$28.4 billion of capital left Russia and October saw another \$50 billion of capital flight, Russian leadership began to show signs of concern beneath their otherwise relentlessly confident public pronouncements. If the total outflow of capital during Russia's 1998 financial crisis amounted to \$22 billion, this time \$83 billion had left the country in only three months. Still, on November 10 Kudrin announced that regardless of the level of capital flight and the fall in oil prices the government was not going to try to limit the movement of capital or abandon the convertibility of the ruble, and that those who sold their rubles would be sorry. Indeed, the government expended much effort throughout the fall reassuring Russian businesses and citizens that it was not interested in nationalizing private enterprise or getting the government involved in the private sector, that the Russian economy was fundamentally stable, and that the ruble would remain strong. Thus the media campaign soldiered on through the New Year's holidays.

In retrospect, the cruel irony of the government's anti-crisis media campaign is that the only thing that was ultimately reliable was that any given official pronouncement would be turned on its head within three weeks. When the December statistics came in, they showed an additional \$50 billion of capital flight. The ruble's loss of more than 20% in value against the dollar in the last weeks of January alone—topped by Vice President Igor Shuvalov's statement on January 30th that the crisis could very likely "last three years"—rather clearly put an end to the authorities' public anti-crisis pronouncements. Propaganda was by this time too far at odds with reality.

The nonchalance with which the Kremlin had brushed off the "American" financial crisis has been replaced in the best case by resignation that, given that the country is beholden to high external demand for oil, the most viable option for Russia is to simply wait it out. Little more than a year after Putin proposed his ambitious long-term program of modernization (formalized in the "Conception for Development through 2020" that he proposed on February 8, 2008), the country is facing the reality that it will need to spend its entire savings—and go into debt—to save jobs and support basic social-welfare programs. Aggressive modernization is decidedly off the agenda.

### 3.3 The Reality of the Fallout on the Russian Economy

The blows to Russia's economy have affected three principal groups: 1) Russian firms and business elite; 2) the Russian working classes (i.e. the Russian lower class and recently emerging middle class); and 3) Russian executive authority. We will examine each of them in turn.

### 3.3.1 Russian Firms and Business Elite

Russian firms have been hit hard, with far-reaching implications both for the Russian workforce and for the arrangement of ownership of the country's key industries. The immediate fallout from the U.S. credit crunch—the extremely rapid drying-up of liquidity—affected Russian firms severely. The torrent of inexpensive credit that fed immense amounts of spending by Russian small, medium, and large enterprises was cut off; not only could these businesses not afford to continue their plans for development, but they could no longer even borrow enough overnight to pay their employees. Construction has halted throughout the country. Many firms are laying off employees they can no longer pay, or, alternatively, holding their wages in arrears in the hope that credit will begin to flow once again.

The fall in oil prices has meant that oil companies themselves have gotten hit hard, and they have passed the impact on to the rest of the economy. The fall in oil prices has meant a loss in government revenues, as the government's "tax on natural resource production" (NDPI)—the source of much of the government's extraordinary growth since 2000—brings in substantially less revenue. The government, as a result, has been hesitant to lower the taxes significantly and thereby give up what little revenue it is able to collect (though the government did reduce the export duty on oil on November 1, 2008, from \$372/ton to \$287.30/ton, which carries an expected negative fiscal impact of about 50 billion rubles on the Russian budget.<sup>33</sup>). Thus, since the price of oil plummeted, the oil industry has complained that the government has not lowered the taxes enough; to compensate, the oil companies, which also own the chains of gas stations around the country, have kept prices for gasoline artificially high.<sup>34</sup> This has put additional pressure not only on consumers—who have less disposable income due to the falling value of the ruble, layoffs, and salary arrears—but also on other, non-resource-based businesses, as they fight plummeting demand for their products but are still forced to pay a high price for fuel costs for transportation. At the same time, the plummeting ruble and credit crunch makes it difficult for Russian firms to continue to invest in their business and improve productivity, as the many foreign-made products necessary for resource drilling and production, agriculture, and manufacturing are increasingly out of reach. Formerly feasible investment projects have been taken off the agenda.

Additionally, the falling value of the ruble has meant that existing Russian foreign commercial debt—\$117.1 billion of which needs to be paid back this year, \$73.2 billion in 2010, \$233.4 billion in 2011 and after, and \$13.6 billion without schedule<sup>35</sup>—will be even more difficult to pay off. As of November 2008, total

<sup>33</sup> See World Bank Russia Country Office, (2008-11-17). "Russia Economic Report No. 17." *World Bank*. p. 32.

<sup>34</sup> The Federal Anti-Monopoly Service (FAS) has brought a case against *Rosneft*, *LUKOil*, *Gazprom Neft*, and *TNK-BP* for artificially inflating prices. The head of FAS, Igor Artemiev, blamed those companies for not setting aside reserves during the boom in oil prices, noting that only the company *Surgutneftegaz* had the foresight to do so. See "Artemiev: neftyaniki provodyat tsinichnuyu tsenovuyu politiku." (2009-02-17). *Vesti*. <<http://www.vesti.ru/doc.html?id=254492&cid=1>>

<sup>35</sup> Central Bank of Russia, (2009-01-30). "Payment Schedule of External Debt of the Russian Federation. As at Q3, 2008."



Russian external debt stock amounted to \$527.1 billion, while the share of debt flows as a percent of total capital inflows had risen to 85.2%.<sup>36</sup> The cheap credit underwritten by the toxic CDOs was spread throughout the world economy; many Russian corporations capitalized on the opportunity for cheap credit, forgoing the foreign direct investment favored by many developing economies in favor of borrowing cheaply abroad from foreign banks. This trend, heightened in 2008, led to explosive short-term growth but long-term vulnerability, the extent of which is now becoming visible.

While the Russian state-run bank Vneshekonombank (VEB) has disbursed approximately \$11 billion of the \$50 billion it was entrusted to use to help Russian businesses refinance their foreign debt, Russian companies recently placed bids for approximately \$90 billion of assistance from VEB to restructure their foreign debt.<sup>37</sup> Crunched between the plummeting ruble, which has lost about 25% of its value against the dollar and euro since its peak during the summer, and the massive amount of debt from ostensibly “cheap” credit it took out from foreign banks in the economic boom of the past few years, Russian big business is facing possibly insurmountable problems.

What tipped the balance for many Russian firms was that when the price of oil fell and took the Russian stock markets with it, the value of those companies listed on the markets—many of which were used by Russian businessmen as collateral for massive investments and takeovers in recent years—plummeted as well. This triggered margin calls by the foreign banks from which these firms took loans, leaving the Russian firms with three options: scramble for additional private money in order to refinance their original loans; give up their collateral—Russian strategic industries—to foreign control; or accept Russian government loans, managed via VEB, to pay off the foreign bank and transfer the collateral to VEB.

The best option—refinancing debt through additional loans from other foreign banks or private investment—has been rendered impossible for two reasons. First, the international credit crunch has made securing credit at reasonable prices all but impossible for all but the most well secured, government-backed firms. Second, because of the instability of the Russian economy and all-too-flexible boundary between public and private ownership of Russian strategic firms, foreign banks and private investors are unwilling to take on the risk of losing their investment to devaluation or a state takeover. Fitch Ratings downgraded Russian debt to the second-lowest investment-grade rating, BBB, on February 4, 2009, while S&P did so earlier, on December 8, 2008, reflecting worldwide skepticism about the state of the Russian economy.

The next option, then—ceding to foreign banks the Russian company used as collateral, as per their contract in the case that the borrower cannot meet a margin call—is equally unacceptable to both the Russian owners in question, and the Russian government.

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<sup>36</sup> World Bank Russia Country Office, (2008-11-17). “Russia Economic Report No. 17.” *World Bank*.

<sup>37</sup> *Ibid.*

Thus, firms have been forced to turn unenthusiastically to the third option, resulting in a wave of quasi-renationalization that has transferred strategic industries from the oligarchs back into the government's hands—a dramatic upset of the oligarch's initial victory in the infamous loans-for-shares scheme of the mid 1990s. The government got a great deal on at least two major assets, Norilsk Nickel and Vimpelcom. And that is just fair business practice: the government—and Kudrin in particular—acted very wisely, and against popular sentiment, in accumulating its reserves and sovereign wealth funds. By October, hard currency had arguably become the most valuable commodity, and those who had a lot of it could gain substantial leverage. Not hesitating to use the opportunity, in a sharp policy turnaround on October 11 the government announced that it would move \$50 billion from the Central Bank into VEB deposits for the purpose of “refinancing Russian companies.”<sup>38</sup> The announcement took the form of one line in the middle of a more general series of measures the government was taking to address the crisis, but its weight was perhaps disproportional to the attention it garnered at the time.

Former Duma Deputy Aleksei Mikhailov discusses the process in detail in relation to two corporate deals with Vneshekonombank (VEB):<sup>39</sup> that of Mikhail Freidman's Alfa Group and Oleg Deripaska's RusAl. In 2007 Alfa had put up its 44% share in Vimpelcom to Deutsche Bank as collateral for a loan; at the time the shares were valued at around \$20 billion.<sup>40</sup> By the end of October 2008 the shares had plummeted to just over \$5 billion, and Deutsche Bank called in the loan.<sup>41</sup> With nowhere else to go, Alfa Group put up the shares as collateral with VEB in exchange for a \$2 billion loan, leaving the company with a one-year 90% loss on its investment and a slew of restrictions on its future actions. A similar story occurred with RusAl, which borrowed \$4.5 billion in syndicated credit from Western banks earlier this year to finance a purchase of more than \$14 billion of shares in Prokhorov's Norilsk Nickel. When shares in Norilsk plummeted over 50% and the Western banks called in their loans, Deripaska had nowhere to turn but VEB. VEB soon gave Deripaska the required \$4.5 billion in exchange for the shares of Norilsk Nickel that had previously been worth \$14 billion, and as with Alfa Group, attached to the loan a list of conditions that for all intents and purposes gives VEB control over RusAl's future business decisions.

The problem with these deals is not simply the immense value that the government, via VEB, has been able to accumulate. The bigger story is the deal that VEB got in terms of control. Given the state of RusAl and Alfa Group finances and their remaining outstanding debt, they will be unlikely to regain their shares from VEB, much less at favorable prices, says Mikhailov. Mikhailov notes a handful of VEB's

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<sup>38</sup> RIA Novosti, (2008-10-12). “Kudrin schitaet printsipial'nym raskhodovat' rezervy v RF v usloviyakh krizisa.”

<sup>39</sup> Mikhailov, Aleksei, (2008-12-2). “Putinskij peredel.” *Gazeta.ru*.  
<[http://www.gazeta.ru/comments/2008/12/02\\_a\\_2901938.shtml](http://www.gazeta.ru/comments/2008/12/02_a_2901938.shtml)>

<sup>40</sup> “VEB pomozhet 'Alfa-grupp' pogasit' kredit pered Deutsche Bank.” (2008-10-30). *Lenta.ru*.  
<<http://lenta.ru/news/2008/10/30/help/>>

<sup>41</sup> *Ibid.*

conditions upon granting its loans. I excerpt his original commentary below in full for the insightful issues he raises:

- *the collateral is transferred to VEB (an entirely natural proposition);*
- *VEB can demand practically any increase in the collateral (including of the collateral of the borrower's export earnings) and the accordance of additional guarantees all the way up to guarantees of individual people (it would be interesting to know what they had in mind here);*
- *the total size of the credit available to an individual borrower (and related borrowers) should not exceed \$2.5 billion (this maximum amount has its source in banking criteria and the size of VEB's capital, and was raised immediately when it came time to credit Oleg Deripaska's companies \$4.5 billion. How did the oversight committee allow this and why did the Central Bank of Russia (CBR) close their eyes to this?);*
- *VEB acquires the right to make an acceptance-free write-off of funds used to repay the credit of any of the borrower's accounts (a completely fantastic proposition—no bank ever has that right without a court decision);*
- *without VEB's agreement a borrower cannot acquire credit or issue securities (including in order to repurchase their collateral from VEB—and would VEB give their agreement to do that?);*
- *without VEB's agreement it is not possible to sell (or put up for collateral, etc.) property valued at more than 10% of the borrower's assets;*
- *the mandatory inclusion of VEB's representatives, as well as candidates whom VEB recommends, in the borrower's management units (in the case of the loan for Norilsk Nickel the government representative is placed not within the borrower's management, but in Norilsk Nickel's. Moreover, in a high position. That is what VEB decided, and the borrower had to agree.)<sup>42</sup>*

In this light, it seems that the government strategy, despite many outspoken announcements to the contrary, can best be defined as one of renationalization. Or perhaps it should be qualified as quasi-renationalization, as the government does not appear overly anxious to formally take control of its strategic industries. It is likely more advantageous for them to technically keep a degree of distance from the companies it “bails out,” but maintain *de facto* control over the companies' decisions, including the final word on the companies' management and on their future investment decisions. That way the government enjoys the best of both worlds: control, on the one hand, and the outward appearance of a budding and internationally competitive private sector on the other. The latter is especially important given its aspirations to finally accede to the WTO, and to turn Moscow into a world financial center, however much both of those goals may currently be off the agenda. And the former is no less important if Russia is going to maintain control over its major companies and strategic industries, some of which account for a substantial proportion of its budget; Alfa Group's and RusAl's dangerous investments could have left Vimpelcom and Norilsk Nickel in foreign hands, something no one in Russia wants to see.

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<sup>42</sup> Mikhailov, *op. cit.*

### 3.3.2 Impact on the Russian Working Classes

If the plight of Russian firms—many of which accumulated their wealth and power through arguably unscrupulous means in the mid 1990s—does not evoke much sympathy, the fact that these firms will necessarily pass on their troubles to the Russian worker and consumer should. The most obvious consequence of the firms' inability to secure credit, together with plummeting consumer demand across the board, is an increase in layoffs and wage arrears for the Russian working classes.

According to Natalia Zubarevich,<sup>43</sup> in Russia the crisis has been spreading—and will most likely continue to spread—from the centers of recent fast-paced economic growth to the peripheries. That is, the regions that have benefited the most from growth since 2000 will also experience the greatest declines in the coming years. She cites banking, development, and the retail sectors as the most prone to decline, as well as single-industry cities. Among these single-industry cities, she points out that particularly vulnerable are cities that rely on ferrous and non-ferrous metallurgy, an inherently labor-intensive industry that has not optimized employment (that is, they have not yet gone through a period of massive layoffs similar that of other industries). The author notes that despite the dropping worldwide demand for oil, the oil industry has a slight advantage over metallurgy, coke-coal mining, paper production, and some other industries, as it has already gone through a round of such “optimizations” in the beginning of the 2000s and is therefore operating relatively efficiently. Additionally, she notes that big cities such as Moscow and St. Petersburg have an advantage over the regions because the very nature of those cities—the massive concentration of employment opportunities in a small area, and the relatively high level of education of those cities' citizens—means that residents there will be more adaptable to the crisis than their regional counterparts and more able to be retrained to work in another industry.

The scale of layoffs and wage arrears is substantial.<sup>44</sup> Approximately 500,000 workers were laid off in December, bringing the total number of unemployed to six million, with fears that the number could rise to 11 million by the end of 2009.<sup>45</sup> About two million people have lost their jobs in Russia since the beginning of the summer.<sup>46</sup> As of February 18, 2009, the Health and Social Development Ministry had recorded an additional 496,600 workers who are slated to lose their jobs but have not yet been laid off.<sup>47</sup> In addition to those who have lost their jobs already or are soon to be laid off, 690,100 are working partial days at the decision of their employer, 248,100 have

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<sup>43</sup> See Natalia Zubarevich, “Regionalnaya proektsiya krizisa.” *Pro et Contra*. Carnegie Moscow Center. Volume 12, No. 5-6, September-December, 2008.

<sup>44</sup> See Marina Krasilnikova, (2009-02-09). “Situatsiya na rynke truda po dannym oprosov obschestvennogo mneniya.” *Levada Center*. <<http://www.levada.ru/press/2009020907.html>>

<sup>45</sup> Baranova, Nadezhda, (2009-01-29). “Epidemiya sokrashchenii.” *Vesti*. <<http://www.vesti.ru/doc.html?id=247134>>

<sup>46</sup> *Ibid.*

<sup>47</sup> *The Moscow Times*. (2009-02-26). “500,000 Workers to Lose Jobs.” <<http://www.moscowtimes.ru/article/1009/42/374813.htm>>

not been technically laid off but are not getting paid or going to work, and 88,400 are on “unpaid vacation.”<sup>48</sup>

Indeed, Zubarevich notes that firms’ cost cutting measures will, to a large extent, be carried out in the form of wage cuts, wage arrears, transitioning employees to shift work, and related cuts in working hours. She points out that massive wage cuts were the norm in Russia in dealing with the economic instability of the 1990s, with legal wages in 1999 reaching only a third of their 1991 level, after having fallen substantially in the interim. However, this time, the most inefficient firms that did not carry out employment optimization during the 1990s will almost certainly be forced to cut additional jobs in a number of single-industry cities; the current “crisis” gives them an opportunity to carry out fundamental, necessary reforms in their business model that would be difficult to justify to the population in ordinary times.<sup>49</sup> This will not be popular with the regional leaders who want to keep a lid on social unrest, notes Zubarevich, and there will likely be increased tensions between businesses and regional elites as they strive to reach the optimal balance between efficiency, commercial sustainability, and social stability.

As many firms themselves are crunched between the lack of credit availability, the dropping value of their exports, and the rising cost of imports, so ordinary Russians—the working class as well as the so-called “rising middle class” that was to be the driving force of a new generation—are seeing their quality of life curtailed by three main factors. First, as noted above, they are losing their jobs or having their wages cut or withheld in record numbers, putting an end to the trend that saw average wages in Russia rise faster than the country’s GDP (which itself was rising extremely quickly at an average of 7% per year from 2000-2007<sup>50</sup>). Among other things, this will likely have the effect of pulling many people back into poverty who had been able to escape it and find good-paying work during the past eight years of economic boom. The World Bank estimates that from 2000 to 2007 the poverty headcount rate dropped from 29% to 13.4%, implying that roughly 30 million people in Russia escaped poverty during that period of increasing wealth.<sup>51</sup>

The rising middle class, of course, will also be affected by falling wages and curtailed salaries, especially as the retail sector in Russia’s big cities takes a hit from falling consumer demand and many are forced to find new jobs or be retrained. In addition, however, they will also be affected by the second factor: the fall of the ruble. During the past eight years the achievement of the rising middle class has not been to escape poverty, but to afford a whole new level of comfort. Their rising salaries, together with the increasingly strong ruble that was the result of high oil prices, allowed them to refurbish their apartments, buy foreign cars with cheap credit, buy foreign clothes, and travel on a scale they had not previously been able to afford.

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<sup>48</sup> Demyanenko, Vlasta, (2009-02-24). “Polmilliona rossiyan na grani uvolneniya.” *Reuters*.  
<<http://ru.reuters.com/article/topNews/idRUMSE51N1JM20090224?sp=true>>

<sup>49</sup> *Ibid.*

<sup>50</sup> World Bank Russia Country Office, (2008-11-17). “Russia Economic Report No. 17.” *World Bank*.

<sup>51</sup> *Ibid.*, p. 33.

Now that the ruble has lost a quarter of its value since earlier in 2008, imports and the lifestyle that they make possible are increasingly out of reach for much of the population.

The third factor, affecting both the Russian population and the country's businesses, is the continual problem of extreme inflation. While in the months leading up to the current financial crisis many countries around the world were facing the prospect of inflation—due in part to the immense amount of liquidity flooding markets worldwide—Russia is the only country of the G20 currently facing inflation in the double-digits, and the only country for which the financial crisis has not affected inflation.<sup>52</sup> The fact that inflation plummeted along with both consumer demand and expectations for current and future GDP growth in countries around the world was natural and to be expected in such a serious global recession. The fact that inflation did not fall in Russia—and is expected, on the contrary, to even increase in 2009 to above 13% (the annual inflation rate in January rose to 13.9%)<sup>53</sup>—is cause for alarm. In addition to the direct, negative impact of such high levels of inflation on consumer spending and investment, Russia's "decoupling" from the rest of the world's economies signals to potential investors that Russia stands out as an extremely undesirable investment for fundamental reasons other than the current financial crisis. This means that once the crisis subsides, Russia will still be viewed warily compared to other emerging economies if its Central Bank does not quickly take decisive action to curb inflation. Raising interest rates and bringing inflation under control would not only restore buying power to consumers, but would also help support the falling ruble and lay the groundwork for investment in Russia once the crisis subsides.<sup>54</sup>

While the government has ostensibly tried to help the population weather the immediate effects of the crisis, its measures have arguably fallen far short of those necessary—and in the minds of many, far short of the more visible bailout it has offered banks and businesses. In mid-October, for example, the Ministry of Finance raised the insurance level of individual deposit accounts in banks from 400,000 to 700,000 rubles (equivalent to almost \$26,000 at the time, but just under \$20,000 at February's average exchange rate of 36 rubles to the dollar). While the amount insured should technically cover most people's accounts—and may have been effective enough to stave off a run on banks in the short term (though this, of course, cannot be verified)—there is no clear mechanism for how one's savings would be recovered in the event of a run on banks, inspiring little confidence that the measure would in fact work if tested. Russians have seen their savings wiped out two times in the last two decades, and have a correspondingly low level of trust in the Russian banking system.

More recent state promises have failed to hold up as well. The government's massive promotion of the "people's IPOs" of Sberbank and VTB in 2007 is fresh in

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<sup>52</sup> Gilman, Martin, (2009-02-11). "Fighting Inflation Needs to be a Top Priority." *Moscow Times*.  
<<http://www.moscowtimes.ru/article/1016/42/374442.htm>>

<sup>53</sup> According to the Russian Economic Development Ministry, as quoted in *ibid*.

<sup>54</sup> *Ibid*.

the minds of many Russians who invested their savings only to see them wiped out soon thereafter as the banks' values tumbled after the IPOs. Most recently, those same leaders relentlessly encouraged Russians to keep their money in rubles, even as billions and billions more rubles left the country, falling oil prices pushed the value down, and the Central Bank waged a losing war against the falling ruble. While speculators knew what was happening and changed their rubles to dollars as quickly as possible, many ordinary Russians did heed the government's call, unaware of the inevitability of the ruble's fall. Many are now furious.<sup>55</sup> In this light, many Russians have made a lifestyle choice to spend immediately rather than save, viewing goods as substantially safer than currency—especially currency held in a bank. This is further encouraged by the negative real interest rates they earn at banks as their money is eroded by high inflation. In all, the measure, while better than nothing, does not address the deeper problems facing the Russian banking system.

In December, when social tensions had risen further, Kudrin announced an additional measure: monthly unemployment payments would be raised to 4,900 rubles, or roughly \$136 at February's exchange rate. It need hardly be stated that this money is a pittance, especially in St. Petersburg and in Moscow, the world's most expensive city. Furthermore, the length of the lines and complexity of the bureaucracy necessary to collect one's unemployment money means that relatively few people who were not signed up previously will actually take advantage of their unemployment payments. In an additional measure, the government set up a website to help laid-off workers find jobs. However, the site is not only very difficult to find, but once you do find it, the listings include the lowest-paying jobs, below poverty level for one person; the numerous commercial job-hunting sites offer the same service, but the quality of the offerings are much higher.

In an additional measure, Putin's United Russia party has "asked" some of the country's biggest retail chains to place visible advertising all over Moscow inviting people to work.<sup>56</sup> The advertisements prominently display the logo of United Russia's anti-crisis project "Together" ("Vместе"), as well as an active telephone number where callers can hear descriptions of vacancies. Interestingly, the companies involved—Perekrestok, Karusel, Pyatyerokha, and Sedmoy Kontinent—all received bailouts from the government when they were on the brink of bankruptcy, allowing them to keep their doors open and continue selling a limited assortment of food and basic goods. Now the party has asked them to "show social responsibility" by keeping hiring open and advertising prominently.<sup>57</sup> Vladimir Medinsky, the Duma deputy who heads the project, noted that "[we] are helping not only to find work, but to

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<sup>55</sup> See, among others, the articles in *Nezavisimaya Gazeta*, "If You're Not Sure, Don't Promise," and "The Cost of a Ruble – a Kopeck": *Nezavisimaya Gazeta*, (2009-01-23). "Ne uveren – ne obeschai." <[http://www.ng.ru/editorial/2009-01-23/2\\_red.html](http://www.ng.ru/editorial/2009-01-23/2_red.html)>. and Igor Naumov and Miroslav Limansky, (2009-01-30). "Tsena rublyu – kopeika." *Nezavisimaya Gazeta*. . <[http://www.ng.ru/economics/2009-01-30/1\\_rubl.html](http://www.ng.ru/economics/2009-01-30/1_rubl.html)>

<sup>56</sup> Vedenskaya, Alisa, (2009-03-16). "Edinaya Rossiya' priglashaet na rabotu." *Nezavisimaya Gazeta*. <[http://www.ng.ru/politics/2009-03-16/1\\_edro.html](http://www.ng.ru/politics/2009-03-16/1_edro.html)>

<sup>57</sup> *Ibid.*

create a psychological effect. A person is walking down the street, sees the poster, and understands that hope is not lost, that somewhere there are vacancies.”<sup>58</sup>

It remains to be seen whether these measures will prove sufficient to stave off mass anti-government protests in the event that the current deep recession continues for the next three years, as Vice President Shuvalov predicts. The public’s confidence in their leaders has already been eroded, albeit not yet enough to pose a serious threat to the government. Much is at stake. That “tacit contract” between the people and the Kremlin risks being broken; if it is, then those who rode to power on the wave of high oil prices will come crashing down as they realize that, along with the price of oil, public support has fallen out from under them.

### 3.3.3 *Impact on Executive Authority*

For the time being, it does not seem like this threat is immediate. Putin and Medvedev still maintain high public-opinion ratings while those around them take the fall for individual mistakes. As of January 2009, Putin’s rating remains stable in the low 60s, while Medvedev’s has risen in the past year from the mid 30s to the mid 40s.<sup>59</sup> The ratings for the office of the prime minister and the president remain even higher, respectively.<sup>60</sup> Neither seems to have suffered unduly from direct public criticism; while public discontent has risen in step with layoffs, salary arrears, and the devaluation of the ruble, relatively little of this “negative news” has been attributed directly to the country’s top leaders. Russians are well aware that the current recession is the result not of Russian financial mismanagement, but primarily of the irresponsibility of the American financial sector and regulators. If anything, the fallout on the Russian economy was tempered by sound financial planning in the form of Kudrin’s stabilization fund and the country’s currency reserve. While some argue that the country’s finances could have been managed even more smartly and to greater advantage, the Russian public, like any public, is generally not splitting hairs over the government’s financial and monetary policies. The positive media coverage—both domestic and international—of the stabilization fund, together with the mention of statistics such as “third largest gold and currency reserves in the world” leave the public with confidence that their leadership did what it could to manage the country’s wealth.<sup>61</sup> The most important variable, perhaps, is how well Russia weathers the crisis relative to other emerging economies and developed economies. Ukraine is on the brink of collapse, and Iceland and Ireland—Europe’s “tigers” of recent years—are in a shambles. When viewed in this light, Russia has been holding

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<sup>58</sup> *Ibid.*

<sup>59</sup> VTsIOM. “Reiting doveriya politikam.”  
<<http://wciom.ru/novosti/reitingi/reiting-doverija-politikam.html>> Accessed 2009-03-03.

<sup>60</sup> VTsIOM. “Reiting Gosudarstvennykh Institutov.”  
<<http://wciom.ru/novosti/reitingi/reiting-gosudarstvennykh-institutov.html>> Accessed 2008-03-03.

<sup>61</sup> That the reserves have since dropped below those of the Eurozone to take fourth place—and risk falling even further as demand for anti-crisis measures increases—might be disquieting. But now, of course, the country’s currency reserves occupy increasingly less space in Russian mainstream media.



its own; any hardship the population experiences will be blamed on the “crisis” and its propagators (on America, first of all) rather than on Russia’s leaders, and public anger will be directed accordingly.

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That being said, it is interesting to note that Russia’s presidential politics have largely been defined by economic events that are, to a great degree, outside the control of the president himself. While Yeltsin arguably did have a significant amount of control over the direction of economic reform in the country, he did not have control of the low oil prices that set the background to his reforms, arguably undermining a number of them and leaving the Russian population with a strong distaste for the newly experienced “democracy” and “capitalism.” In a similarly unpredictable turn of fate, oil prices began to take off soon after Putin took the presidency in 2000 and have carried his policies ever since, arguably lending his policies a legitimacy they might otherwise not enjoy. Now, eight years later, Medvedev has taken the presidency as oil prices have plummeted once again. True, Russia is better prepared now than it was under Yeltsin for such a crisis; 17 years of capitalism, enormous current account and fiscal surpluses thanks to the recent oil boom, and a newly consolidated central authority all give Medvedev big advantages that Yeltsin did not enjoy. Still, the case has often be made that popular support for the government in Russia is closely correlated with oil prices—and those prices have returned to new lows in the face of plummeting global demand that seem likely to continue for the foreseeable future.

It is worth stepping back for a moment and briefly charting the rise and fall of oil prices and executive power. Although Russia’s political and economic trajectory since the fall of the Soviet Union has not been along a single vector, in broad strokes the 1990s represented a period of decentralization and privatization, with most of Russia’s prized industrial assets falling into the hands of a select few oligarchs. The 2000s, on the other hand, saw a rise of executive power on the wave of high oil prices; increased demand for Russian national resources, driven by the intense growth of the 2000s—which in turn was increasingly fueled by the cheap credit underwritten to a large extent by the securitization boom in the United States and the savings glut in a number of emerging economies—allowed Russian firms to prosper, and the wealth did trickle down to the population in the form of higher salaries, with a consequent rise in national pride.

Thus, in the 2000s, a prospering but resource-dependent economy provided the support necessary for Putin and his administration to remain popular despite increasing executive consolidation—the appointment of governors, consolidation of districts, consolidation of the media, and the fast-paced takeover of the Duma by United Russia, to name a few—as well as rising ratings of official corruption. Now it appears that the financial crisis has given the government the opportunity to both strengthen its control over the private sector and further consolidate the current administration’s grip on the levers of power. This has included, among other things, the president’s justification of the necessity of 6-year presidential terms and 5-year

Duma terms, and the passing of a law to that effect by the Duma in record time. The crisis is allowing the government to reclaim the assets it lost through privatization by means of the aforementioned “bailouts” (read: renationalization of strategic industries) by the state-run VEB, finalizing the country’s return to the pre-1991 national order.

This time, there are three main differences. First, who is in charge: the strong “tandem” of Putin and Medvedev, with Putin obviously calling the shots, instead of Yeltsin. Second, the ideology: the current consolidation of power is driven not by capitalism or communism—though the former might be a means to an end in some instances—but by statism focused on the raw desire of Russia’s leaders to once again turn Russia into a full-fledged “great power.” Third, the image of Russia that the country’s leaders are trying to project onto the international stage: if Yeltsin tried too hard to befriend the West at the cost of pursuing more independent development, then Putin—now together with Medvedev—has for the past five years consistently been pushing the hard line. And despite the constraints imposed by the crisis, they show no signs of relenting.

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Returning to the effects on the state, then, we should ask how precisely executive power—the only real source of state power to speak of—will be affected. More specifically, we can ask how the relationship between the country’s rulers and the ruled will change. As mentioned earlier, I suggest that this dynamic will be influenced more than anything by the subjective perception of the people about the competence and authority of its leaders. This subjective perception can be traced along two vectors: first, the competence of the authorities in dealing with the crisis domestically, including effectively and visibly supporting the population during the prolonged recession; and second, continuing to project an image of a “strong Russia” on the international stage. We will continue the discussion of domestic policy in the remainder of this section and examine the impact of Russia’s foreign policy in the next section.

If, as proposed earlier, the public will judge the competence of its leaders based on certain factors that are to a certain degree out of the state’s hands—namely, factors relating to the performance of Russia during the crisis relative to that of other countries—then there also remain a number of measures that are clearly within the government’s control, and will be judged as such by the public. Three main candidates stand out (though the categories are by no means clear-cut). First, the consistently overoptimistic forecasts about the Russian economy, together with a misinformation campaign about the devaluation of the ruble (possibly due as much to unwarranted optimism as to willful deception), displayed very poor judgment on the government’s part. It also demonstrated that the control of the media by the government and the corresponding use of the media as a policy tool can backfire if government pronouncements contradict reality to a great enough degree on issues

of importance to the public.<sup>62</sup> While shouting something loudly enough can often make it truth, the authorities will have to be more careful in the future about what it is they shout.

Second, highly visible anti-crisis measures that risk alienating or angering certain segments of the population—especially those in the working class who have been severely affected by the crisis—risk setting off a wave of resentment against the government, possibly escalating into protests. This was seen in December when Putin raised tariffs on foreign automobiles; the import cars in question both support a substantial number of Russian jobs and are bought in large numbers in Russia's Far East, since used imports were affordable and are seen as more reliable than Russian cars. In response to a December 21st riot over the tariffs in Vladivostok, the Kremlin flew special riot police the 3,750-mile distance from Moscow, and they harshly suppressed the protests,<sup>63</sup> making the front pages of some print media and garnering attention in the West. Protests are continuing regularly in the Far East and resentment remains strong, though it remains unclear to what extent unrest in the Far East could spread to other regions and to the population at large. Although Putin himself still drives a Mercedes (to the dismay of many in the domestic auto industry), the tariffs he imposed on imports were part of a \$5 billion package to bail out and support the Russian auto sector—a step that some call a handout to the oligarchs, but which Putin defends by proclaiming that buying imports during the crisis is “inadmissible.”<sup>64</sup> In the Far East, Russians have flocked to the auto industry for jobs as other industries have crumbled. Many see the imposition of tariffs as a direct affront to their livelihood and to their freedom to buy imports, which is widely viewed as a status symbol. It is precisely this type of policy move that threatens to undermine public support for executive power in the future.

The third measure within the government's ability to control is inflation. While certainly more insidious than the imposition of tariffs and less likely to be judged by the public as a positive or negative indicator of the government's response to the crisis, inflation continues to eat away at the population's spending power at an annual average of 13%, as discussed previously. If rapidly growing wages and a strong ruble previously compensated for such skyrocketing inflation, both of these factors have now been turned on their heads. With wages slashed or in arrears, layoffs rising at an astounding rate, and a very weak ruble, inflation will increasingly tip the balance between whether a family is able to survive or not. While average Russians will not connect rising prices with government mismanagement as quickly as they did a clear policy like the imposition of tariffs, their continually decreasing buying power will make them more acutely sensitive to the efficacy of government support in general.

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<sup>62</sup> See note 55.

<sup>63</sup> See Isabel Gorst, (2008-12-21). “Car import curbs have Russians on streets.” *Financial Times*. <http://www.ft.com/cms/s/0/41daa16e-cf70-11dd-abf9-000077b07658.html>> and Clifford J. Levy, (2009-02-15). “Tariff Protests in Eastern Port Rattle Kremlin.” *New York Times*. <[http://www.nytimes.com/2009/02/16/world/europe/16russia.html?\\_r=2](http://www.nytimes.com/2009/02/16/world/europe/16russia.html?_r=2)>

<sup>64</sup> See Gorst, above.

Just as the population has generally been content with their government during a time of growing wealth across the board, so they will likely grow discontented with their government during a time of diminishing wealth.

In this case, the objective measures a government takes—especially if such measures are not highly visible or easy to understand—are much less important than people’s subjective perception of their own well being in general. It is unimportant that external factors—the fluctuating price of oil and the onset of the financial crisis—and not government policies are overwhelmingly responsible for the rise and fall of Russians’ standard of living. Most people will still hold their government accountable, in the final instance, for ensuring their survival, even in the face of severe external shocks. If the government cannot continue to deliver on its side of the social contract, the people will not hold to theirs, either.

## 4. THE CRISIS AND RUSSIAN FOREIGN POLICY

### 4.1 The Russian Public and Russian Foreign Policy

The Russian response to the global financial crisis embodies an interesting paradox, arising from three observations. First, the government’s domestic response to the crisis has by many measures been insufficient, as discussed above. Their one saving grace has been their reserves and sovereign wealth fund, though even this has not been optimally managed—especially since September. Second, the government’s foreign policy, especially since 2003, has become increasingly aggressive and ambitious, aiming for no less than to become a major world power in a “multipolar” world. We add to these two observations the supposition that, should executive authority in Russia be undermined on a domestic level, the country would no longer be able to conduct a coherent foreign policy on the world stage and would be forced to abandon its ambitious foreign policy for the foreseeable future. Finally, we note that as Russia’s anti-West (and particularly anti-American) foreign-policy rhetoric has grown stronger, and as it has made increasingly greater demands to other countries to be accepted and has threatened to “go it alone,” Russia has at once become isolated and resented on the world stage, but embraced domestically—the result of the country’s increasing global isolationism and internal nationalism even as it aspires to global leadership. This leads to a strange system in which, as Russia’s domestic policy increasingly falters and its foreign policy leaves it isolated on the world stage, the very fact that many Russians approve of the country’s strong-arm stance abroad bolsters the authorities’ ratings at home.

Indeed, Russians seem to approve of their leaders’ recently assertive foreign policy. A Levada-Center poll taken on September 10 shows that 80% of respondents felt that Russia’s role in the war with Georgia was “completely right” or “most likely right,” while a whopping 64% said that Russia’s recognition of Abkhazia and South Ossetia as independent states was either “timely” (34%) or “overdue” (30%).<sup>65</sup> According to

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<sup>65</sup> Levada Center, (2008-09-10). “Rossiyane o situatsii vokrug Abkhazii i Yuzhnoj Osetii.” <<http://www.levada.ru/press/2008091001.html>>

other polls taken by the Levada Center, Medvedev's approval rating shot up from 73% in August to a stellar 83% in September (reflecting public opinion on Medvedev's actions in August—namely, regarding Russia's role in the war with Georgia in South Ossetia).<sup>66</sup> Similarly, "trust in Putin" went up from 83% to 88% in the same period. Both leaders' ratings returned to their previous levels in October, signaling that the temporary increase was due to the internationally criticized but domestically popular role of Russia in the war in the Caucasus.<sup>67</sup> Additionally, in July and August, 55% of respondents approved of the country's direction; in September that number rose to 66%, before returning to 54% in October.<sup>68</sup>

The public held similarly positive attitudes regarding Medvedev's proposal, in his November 5th address to the Federation Council, to position an Iskander missile complex in Kaliningrad to face Eastern Europe and counterbalance the threat of the proposed U.S. radar and ABM systems in the Czech Republic and Poland. 62% of Russians polled by the Public Opinion Foundation approved of the step.<sup>69</sup>

Later, in the highly politicized gas dispute between Gazprom and Naftogaz, 77% of Russians polled said that entirely cutting off gas delivery to Ukraine was the "correct" step, and 84% said that Russia's allegation that Ukraine was stealing gas was "justified."<sup>70</sup> When asked in the same poll which country was to blame for the fact that gas was cut off to parts of Europe, 76% of respondents blamed Ukraine, 2% blamed Russia, 13% blamed both sides, and 10% had difficulty answering.<sup>71</sup> Interestingly, a plurality of respondents (37%) answered that as a result of the gas conflict, Russia's position in the world would be strengthened, while only 10% responded that Russia's position would be weakened.<sup>72</sup> 79% responded that the Russian authorities acted correctly in the gas dispute with Ukraine.<sup>73</sup> According to additional polls by the Public Opinion Foundation, public approval (voiced as "trust") for Putin and Medvedev has remained steady and high in recent months—around 70% for Putin, and in the mid 50% range for Medvedev.<sup>74</sup>

But if Russians continue to approve of their leaders' aggressive foreign-policy stance, the view from abroad is very different. A recent BBC World Service poll of world public opinion across 21 countries found that, while last year world public opinion of

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<sup>66</sup> See Ilya Zinenko, (2008-10-17). "Tandem Medvedev-Putin teryayet sentyabrskuyu populyarnost." *RB.ru*. <<http://www.rb.ru/topstory/politics/2008/10/17/095119.html>>

<sup>67</sup> *Ibid.*

<sup>68</sup> *Ibid.*

<sup>69</sup> Fond Obschestvennogo Mneniya, (2008-11-20). "Otnoshenie k razmescheniyu raketnogo kompleksa 'Iskander.'" <<http://bd.fom.ru/report/map/projects/dominant/dom0846/d084623>>

<sup>70</sup> Fond Obschestvennogo Mneniya, (2009-01-22). "Rossiya i Ukraina: gazovyy konflikt." <<http://bd.fom.ru/report/map/d090311>>

<sup>71</sup> *Ibid.*

<sup>72</sup> *Ibid.*

<sup>73</sup> *Ibid.*

<sup>74</sup> Fond Obschestvennogo Mneniya, (2009-01-15). "Politicheskie indikatory." <[http://bd.fom.ru/report/cat/polit/rat\\_good/confidence\\_politician\\_08/d090102](http://bd.fom.ru/report/cat/polit/rat_good/confidence_politician_08/d090102)>

Russia was slightly positive, the negative perception of Russia in the countries polled has grown by 8% in the past year; as of February 2009, 42% of respondents currently view Russia negatively, while only 30% view it positively.<sup>75</sup> At the same time, views of America and Europe from Russia have grown increasingly grim. As of August 31, 2008, a stunning 75% of Russians viewed America as an “unfriendly” country; only 4% said America played a positive role in the world, compared with 71% who held that America played a negative role.<sup>76</sup> Russian public opinion of the EU countries is more complex, as Russia, among other things, requires more of the EU countries than of the U.S., including a continuing strong trade relationship and security of energy demand. As of September 7, 2008, 40% of Russians had trouble evaluating the current state of Russia-EU relations; 39% said that relations were bad, and only 21% said they were good.<sup>77</sup>

What does all this mean? In short, it shows that polarization between Russia and the U.S. is at a post-Cold War high, and suggests that Russia-EU relations are still rocky and will require substantial work before mutual trust is fully reestablished. Most importantly, this brief view of Russian public opinion shows the stark divergence between domestic and foreign views of the same policies, signaling both the increased isolationism of Russia on the world stage, and increasing opposition to the West among the Russian public. The fact that Russians support their leaders’ hardline policies abroad might yet prove to be the authorities’ saving grace in the short to mid-term, as leaders who can no longer deliver a constantly improving standard of living to fulfill the “social contract” might instead be able to rely on traditional nationalism to maintain order domestically. As long as ordinary Russians continue to blame the U.S. and the EU for the global recession and their declining standard of living—and not blame their leaders for mismanaging the fallout from the crisis—the current Russian authorities should be able to keep a lid on isolated incidents of domestic unrest and remain largely unchallenged at home.

## 4.2 Russian Foreign Policy and the Crisis

If the Kremlin’s foreign policy response to the crisis has made some Russians proud that their leaders are standing up to the West, it has not necessarily been to Russia’s benefit, immediately or in the long term.

As Russia’s fortunes turned under Putin and the country’s natural resources brought in increasingly more wealth, its foreign policy grew more

<sup>75</sup> BBC, (2009-02-06). “Russia and China 'approval down.'” <<http://news.bbc.co.uk/2/hi/7873050.stm>>

<sup>76</sup> Fond Obschestvennogo Mneniya, (2008-09-04). “Otnosheniya Rossiyan k Amerike (avgust 2008g.)” <[http://bd.fom.ru/report/cat/inter\\_pol/\\_west\\_rel/Russia\\_USA/d083523](http://bd.fom.ru/report/cat/inter_pol/_west_rel/Russia_USA/d083523)>. Unfortunately this author was not able to find updated, equally detailed data concerning Russian public opinion about America; thus, it should be noted that this data, having been collected during a time of unusually high anti-American sentiment in the media and on the street, is likely exaggerated over normal levels (including above those leading up to the August numbers—anti-American sentiment was at 58% before jumping to 75% after the war in the Caucasus). While the conclusion of the war and the start of the financial crisis will have had an effect of Russian public opinion of America, we can fairly safely surmise that, given continuing anti-American rhetoric in the media, it remains highly negative into March 2009.

<sup>77</sup> Fond Obschestvennogo Mneniya, (2008-09-11). “Rossiya i Evrosoyuz.” <[http://bd.fom.ru/report/cat/inter\\_pol/\\_west\\_rel/eurosoc/d083622](http://bd.fom.ru/report/cat/inter_pol/_west_rel/eurosoc/d083622)>

and more aggressive in step. Putin's early years in office saw a final attempt at rapprochement with the West, albeit from a position of greater strength than Yeltsin had enjoyed. As discussed in section 2.1, from the Russian perspective, the Russians were offering the United States an olive branch and a helping hand after September 11, 2001, and were hoping for a closer alliance based on mutual respect and cooperation in return—including respect for Russia's "sphere of interests"—i.e., the noninterference of the West in the former Soviet Union. After the U.S. decision to pursue a unilateral war in Iraq, Russia decided to follow suit and follow its own course, spurning the unilateralism of the United States but increasingly confident in its own ability to successfully go it alone. This feeling, of course, was bolstered in the following years by the extraordinary growth of the state's reserves. The new foreign-policy position was first formalized in Putin's now-notorious 2007 Munich speech and later codified in the 2008 Conception of the Foreign Policy of the Russian Federation. As the U.S. was increasingly bogged down in two wars, its unilateralism began to look like a failed strategy. Oil prices skyrocketed in the summer of 2008, and the U.S. economy got hit hard at the same time that Russian coffers were filled at unprecedented rates.

August and September marked the apex of Russian confidence in the correctness of its foreign policy. It carried out a successful war in the Caucasus, and while international opinion concerning Russia plummeted, as discussed above, Russian leaders' popularity at home was higher than ever. They had, after all, effectively annexed two regions from Georgia, made Saakashvili an international laughing-stock, embarrassed the United States, which was unable to come to the aid of its "ally," and successfully put a wrench in the works of Georgia receiving a Membership Action Plan to NATO. Moreover, with almost \$600 billion in their reserves and a strong ruble, the Kremlin could afford to spurn international public opinion and take comfort in the popular saying that "Russia has two allies—its army and its navy."

When Lehman Brothers fell in mid-September, it looked like the icing on the cake to foreign-policy makers in the Kremlin. Russia was thriving, and the decadent Americans were finally getting a taste of their own medicine—that is, the extreme-liberal, anti-regulatory prescription known as the "Washington Consensus" that the U.S. and the IMF had fed Russia in the early 1990s, and which was responsible for much of the instability in Russia during that time. Russian consolidation of power in the executive and financial conservatism under Putin had obviously paid off. After all, its National Welfare Fund was the only one of its kind in the world to not lose money in the past year due to the crisis, and in fact earned money at a time when others were losing heavily.<sup>78</sup> Apparently genuinely filled with optimism, the Russian authorities used up more than a third of the country's reserves in the following months in an attempt to support its currency, as discussed earlier; among other things, this move showed the country's economic policy was perhaps not as much uniquely enlightened as it had been lucky in the previous months (with a number of very smart decisions still justly attributable to Kudrin).

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<sup>78</sup> RIA Novosti, (2008-10-12). "*Vlasti RF mogut ogranichit vlozheniya natsfonda v aktsii odnoj kompanii primerno 5% - Kudrin.*" <<http://www1.minfin.ru/ru/press/speech/>>

This early unbridled optimism also led the Kremlin to not only continue, but to ratchet up its anti-American, go-it-alone rhetoric. That Medvedev did not congratulate President-elect Obama on his November 5th victory (he later explained that he “forgot” that the U.S. presidential election results came in that day), but instead greeted him with an ultimatum to either revoke Bush’s ABM missiles and radar systems in Eastern Europe or face a Russian Iskander missile system in Kaliningrad, cannot be considered graceful. Perhaps he did not want to risk offering an olive branch to America when the situation would ordinarily call for such a gesture, as Putin had admirably done seven years earlier only to see Russia’s interests largely disregarded.

In any event, Medvedev’s November 5th address to the Federation Council emphasized a number of points that had become characteristic of the Russian foreign policy approach during the crisis, and which remain staples of the current foreign policy doctrine. First, the doctrine holds that NATO expansion past its current borders is unacceptable, as is interference within the former Soviet space; Russia alone has the final word within its sphere of privileged interests. The first of these assertions has conveniently fallen off the map for the time being, as Germany and France were both against or hesitant about offering Ukraine or Georgia a MAP in the first place; now that the Ukrainian government is on the brink of collapse and Georgia is clearly far from stable and far from peaceful, it will be a long time before anyone raises that question again. In this sense, the Russian objective was met, if not entirely as a result of Russian actions (Georgia would likely still be out of consideration for a MAP after August, even if Russia had not intervened in South Ossetia, and Ukraine is failing largely due to internal factors).

Second, it asserts that Russia plays a unique role in its near abroad and should have special privileges and control in the region. This has been supported by a number of concrete instances: the August war in South Ossetia (Medvedev: “We really proved ... that we are able to protect our citizens”); the January Gazprom-Naftogaz dispute; and the Russian influence asserted in Kyrgyzstan in order to close the U.S. military base, Manas, thereby reversing its 2001 decision and extracting concessions from the U.S..<sup>79</sup> These moves have demonstrated that Russia does indeed still hold some trump cards, and that if the West has interests in the Russian near abroad, it will have to, for better or worse, deal with Russia as well. It seems that this policy is not completely in vain: that the U.S. qualified its plans for ABM in Poland and the Czech Republic soon after the Manas incident speaks to Russia’s ability to back the United States into a corner politically when the U.S. has interests involving former Soviet states. Even if the U.S. would have eventually backed down on its plans for ABM for technical or cost reasons, it is fair to suppose that Russia’s interests played a large role in U.S. considerations about further steps to take on ABM. In other words, Russia is not by any means off the map.

A third point made in the November 5th address was that Russia is moving forward on plans to solidify a sort of Eurasian bloc (of which Russia would, of course, be the natural hegemon). Medvedev mentioned the CSTO and EvrAzES as focal

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<sup>79</sup> See Ellen Barry and Michael Schwartz, (2009-02-04). “Dispute Mounts over Kyrgyz Base.” *New York Times*.



points for military/political and economic cooperation respectively. Assertions such as these—of which there have been many in recent years—seek to make the point that if Russia won't be allowed to join the "Western clubs" such as the WTO, NATO, or the EU, then it will lead its own legitimate interregional organizations and the world will have to play by Russian rules within Russian-dominated territory. If you don't accept us as an equal in your organizations, then you will face us as an opponent as we strengthen our own coalitions. This is similar to the "sphere of privileged interests" doctrine discussed in the previous point but goes further by codifying these interests in formal institutions that Russia will lead.<sup>80</sup>

In forming this 21st century Eurasian regional bloc, the Kremlin seems to have turned Lord Ismay's often-quoted prescription for NATO on its head, adopting a foreign-policy mantra that might be described as "Keep Europe close, the U.S. down, and the CIS under control." The financial crisis—as well as the August war in the Caucasus—has helped Russia's leaders to do exactly this.

### 4.3 The Multipolar Thesis

This Russian "regionalism" goes hand in hand with other assertions Russian leaders have been making since the financial crisis really took hold in September—namely, in favor of promoting multiple regional powers throughout the world instead of relying on the United States to supply the world's public goods. The mainstream Russian position (espoused regularly by Putin, Medvedev, Lavrov, Kudrin, Shuvalov, and others) emphasizes the failure of U.S. foreign policy, monetary policy, and fiscal policy, and the corresponding need for the rest of the world to step forward and rebuild a new world legal order, security architecture, and financial architecture. It underscores the failure of U.S. unipolarity, both for the U.S. and for the world, and stresses the need to build new institutions for the 21st century that will not be U.S.-centric, but will instead revolve around what more or less amount to the new "great powers" in a multipolar world. Not surprisingly, Russia plans to become one of those powers.

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The multipolar thesis posits that America's period of unipolar dominance in the world is over, having lasted roughly from the decline of the Soviet Union in the 1980s (i.e. the fall of the bipolar world order) until mid 2003, when the Bush administration began undertaking a series of internationally unpopular and eventually unsuccessful

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<sup>80</sup> It is interesting that Medvedev did not mention the Shanghai Cooperation Organization in this connection, with which it has conducted military exercises and which would prove a formidable Eastern alliance were it to be strengthened; one gets the feeling that Russia has shied away from the SCO, where China would likely be the natural hegemon (or at least there would be substantial dispute as to who would really "lead" the organization), in favor of the CSTO and EvrAzES, where Russia's dominance is undisputed.

measures that have eroded its standing in the world.<sup>81</sup> In this vein, the current financial crisis has only further brought the failure of American unipolarity into relief. The multipolar thesis in its most basic form envisions a post-American world order in which power is dispersed, but in which there is also a substantial emphasis on the new centers of regional power—the new “great powers.”

As multipolarity gained traction and popularity in Russia and elsewhere, President of the Council of Foreign Relations Richard Haass tweaked the theory, suggesting that a post-American, “nonpolar” world order will define the 21st century.<sup>82</sup> His theory pictures a world in which regional state leaders together with a diffuse network of non-state actors will dominate international relations. However, Haass writes of his own theory that “In contrast to multipolarity—which involves several distinct poles or concentrations of power—a nonpolar international system is characterized by numerous centers with meaningful power.”<sup>83</sup> Haass emphasizes the power of non-state actors and the diffusion of power among many actors. But if for Haass individual states no longer wield the power they once did, then multipolarism asserts that a given group of regional state actors still has the upper hand.

This explains why, since Putin took office, the multipolar thesis has increasingly enjoyed the strong support of Russian politicians and leaders in their foreign policy speeches and writings. The theory conveniently explains both American decline in international affairs, and offers Russia a place in world leadership in the 21st century (Haass’s nonpolarity provides only for the former).

Thus, despite Medvedev’s mention of Russia’s development of Eurasian political, military, and economic alliances, Russia would still strongly prefer to further develop and emphasize its participation in common institutions with the U.S. and Europe rather than build up alliances of developing states such as the CSTO, which has substantially less influence in world affairs than its transatlantic counterpart. To this end, the Kremlin has long pushed for an alternative to NATO and the OSCE, from which they at best feel alienated, and which they otherwise despise. While they cherish their membership in the UN Security Council, where they command veto power and their interests are necessarily considered, the UN lacks the power and specificity of action of the transatlantic security organizations. When Medvedev mentioned the necessity of a new treaty on European security (“which I have drafted,” he added) in his November 5th address, the world listened more seriously than ever. Sarkozy, among others, seconded the need for a new European security architecture during his shuttle diplomacy in August. The Russian multipolar agenda is beginning to gain attention throughout Europe, as the necessity for a new world order has become clear.

The Kremlin, for its part, sees hope in the new political climate. It is extremely tired of being rejected from or marginalized in the world’s most prominent

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<sup>81</sup> See Thierry de Montbrial, (2007-12-15). “Mnogopolyarnost' i mnogoobrazie.” *Rossia v Global'noj Politike*. November/December 2007.

<sup>82</sup> See Richard Haass, (2008). “The Age of Nonpolarity.” *Foreign Affairs*. May/June 2008.

<sup>83</sup> *Ibid.*

international organizations, at best pulling a seat up to the table but rarely if ever having its interests exclusively considered on the agenda. As a long-time opponent of American exceptionalism, it is taking the opportunity to lead the movement—at least rhetorically, so far—to construct the new 21st century world order.

Thus, while the financial crisis has severely hurt Russia economically, it has given it some political leverage to carry out—or at least try to carry out—its goal of keeping Europe close, the U.S. down, and the CIS under control. Putin is correct in saying that the American unipolar moment is over. Its debt is enormous, it is far overstretched in two wars with no obvious way out, the financial crisis is taking a tremendous toll on the country's economy, it has numerous domestic problems including long-term education and health-care issues that are not readily solvable, and it has lost much of the world's confidence. If it is still indisputably a major player in world affairs, it is no longer the only one;<sup>84</sup> once the world emerges from the current recession, it is extremely unlikely that the U.S. will hold the position of unquestioned dominance that it did a decade previous. As Russian Minister of Foreign Affairs Sergey Lavrov wrote on the eve of the war in the Caucasus the previous summer, "This isn't a 'world after the U.S.' or even more 'without the U.S.' This is a world where, as a result of the rise of other global 'centers of power' and the strengthening of their influence, the relative significance of America's role [...] has declined."<sup>85</sup>

If Lavrov's observation is measured and subtle, Medvedev's address to the Federation Council only a few months later is anything but: "We need to put in place mechanisms that can block the mistaken, selfish and at times simply dangerous decisions made by some members of the international community."<sup>86</sup> While Russia's financial capital has decreased substantially in the months since the crisis broke out, it has tried to salvage political capital by positioning itself as a righteous force that, together with the rest of the world, will rebuild the world from the ashes left by the United States. Later in his speech, Medvedev continued:

*I think that this idea that emerged in the United States after the Soviet Union collapsed that its view is the only indisputably correct view led the U.S. authorities also into making serious economic miscalculations. They let this currency bubble grow in the interests of stimulating domestic growth but did not bother coordinating their decisions with the other players on the global markets and neglected even the most basic sense of measure. They did not listen to the numerous warnings from their partners (including from us). As a result they have caused damage to themselves and to others.*

This type of logic deliberately portrays the independent financial decisions of a multitude of investors—many of whom acted from outside the United States—as if they constituted a coordinated plan by the United States government to undermine

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<sup>84</sup> For an excellent analysis of the changing U.S. position in world affairs, see Robert C. Altman, (2009). "The Great Crash." *Foreign Affairs*. January/February 2009.

<sup>85</sup> Lavrov, Sergey, (2008-07-20). "Rossiya i mir v XXI veke." *Rossiia v globalnoj politike*.

<sup>86</sup> Medvedev, *op. cit.*

the world financial system. That the U.S. financial system is responsible for much of the financial crisis is without a doubt, and U.S. government regulators carry a lot of responsibility for not regulating the extremely dangerous financial products and the excessively risky lending that led to the crisis. But as the United States has not suffered alone as a result of the financial crisis, it also by no means benefited alone during the boom of recent years; much of the demand for the very financial products in question was fueled by emerging-market growth and the savings glut that accumulated in China, Singapore, and a number of Persian Gulf states (as well as in Russia). The U.S. financial markets attracted the massive amounts of new liquidity and gave it an outlet in high-yield, overly high-risk CDOs, but they did not force anyone to make those investments. The Russian strategic companies that VEB has been forced to bail out failed precisely because of their own investment decisions; if they had seriously been warning the U.S. about the impending “burst of the bubble,” they clearly would not have been taking out increasing amounts of cheap credit from the very foreign banks they thought would fail and leveraging to the degree that they did. The truth is, Russians were as hopeful about the boom as were Americans, and Japanese, and Icelanders.

Still, one cannot call U.S. financial regulators’ “non-regulation” anything but poor governance, and the entire world would be unwise not to reconfigure the current global financial system. Russia sought to lead the way on this front in the November 2008 G20 meeting. It has called for creating a new international regulatory regime and reforming the system of financial ratings to return to a strict rating of value. It has also called for reforming the IMF and, along with the three other BRIC countries, has refused to contribute funding to the IMF until the rules are changed to transfer voting rights more fairly among emerging economies. These proposals are perfectly reasonable and will definitely be considered, and possibly accepted, at the upcoming G20 meeting in London.

Russia has proposed a few additional steps that are substantially less likely to be universally agreed upon and implemented, as many of these steps concern individual countries’ decision-making on matters of financial and monetary policy. One, as Putin mentioned in his recent speech at the Davos economic forum, focuses on “the objective process of creating several strong reserve currencies in the future,” as “excessive dependence on a single reserve currency is dangerous for the global economy. I think it is clear to everyone now.”<sup>87</sup> China has also been pushing the move to new reserve currencies, including the idea that the IMF’s Special Drawing Rights (SDRs) should be expanded. But while individual central banks may choose to diversify their reserves, it is unclear, to say the least, that widespread agreement on any multilateral basis would be reached regarding a move to diversify reserve currencies. If anything, the last few months have shown that the dollar, with a certain amount of cruel irony, has only strengthened as a result of the crisis (the general assumption driving that trend being that the U.S. will never default on its debt). International currencies outside the G10, meanwhile, have grown even weaker and less stable in

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<sup>87</sup> Putin, Vladimir, (2009-01-28). “Transcript of Speech at the Davos Economic Forum.” *Office of the Russian Prime Minister*.

recent months. If international reserve currencies are to be diversified, it is unlikely that this will occur in the near future.<sup>88</sup>

In the same speech, Putin also suggested that, in order to instill confidence in reserve currencies, the countries that issue those currencies (read: the U.S., in first order, the European Central Bank, and other G10 countries) “must implement more open monetary policies. Moreover, these nations must pledge to abide by internationally recognised rules of macroeconomic and financial discipline. In our opinion, this demand is not excessive.”<sup>89</sup> The United States, the European Central Bank, and other reserve-currency issuers will certainly not agree to external constraints on their monetary policy. If anything, it is in the interest of those banks to maintain a stable currency and strong reserves and they can be trusted to do so for that reason alone. It is clearly in no country’s interest to maintain an irresponsible monetary policy, but it is also in no country’s interest to voluntarily cede control of those policies.

Putin went on to the thrust of his argument—that the world cannot continue to rely on the United States to drive the world economy—proposing that:

A system based on cooperation between several major centres must replace the obsolete uni-polar world concept. We must strengthen the system of global regulators based on international law and a system of multilateral agreements in order to prevent chaos and unpredictability in such a multi-polar world. Consequently, it is very important that we reassess the role of leading international organisations and institutions.<sup>90</sup>

In addition to this broadly worded proposal that an international financial system replace the current U.S.-centric one—complete with an international regulatory system and binding multilateral agreements—Russian leaders have suggested many times in recent months that the use of the ruble be expanded (ostensibly with the aim of becoming the main regional currency in the region between the euro and the renminbi, as well as in trade in Russian-produced oil and gas), and have expressed a desire to turn Moscow into a competitive international financial center in the years to come.<sup>91</sup> Without yet considering the viability of these proposals we can say that, taken together, these plans clearly represent the strong desire of Russia’s leaders not only to reform the current world financial system to make it more balanced, but for Russia to be one of the heavyweights in that balance.

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<sup>88</sup> Interestingly, Russia seems to have been one of the few countries to diversify its reserves away from the dollar, largely in the first half of 2006, while other emerging economies seem to have increased their dollar holdings during the same period. See Brad Setser, (2007-06-27). “Reserve Diversification—What Does the IMF Tell Us?” *Brad Setser: Follow the Money*. <<http://blogs.cfr.org/setser/2007/06/27/reserve-diversification-what-does-the-imf-data-tell-us/>> Accessed 2009-03-08.

<sup>89</sup> *Ibid.*

<sup>90</sup> *Ibid.*

<sup>91</sup> RIA Novosti, (2008-10-01). “Kontseptsiya sozdaniya v RF mezhdunarodnogo fintsentra vskore postupit v kabmin – Kudrin.” <<http://www1.minfin.ru/ru/press/speech/>>

Netreba, Petr and Dmitri Butrin, (2008-12-02). “ASV vyvodyat na rynek tsennykh bumag.” *Kommersant*. <<http://m.kommersant.ru/?f=4&n=1000051170&s=>>>

The Kremlin's foreign-policy response to the world financial crisis has been characterized first and foremost by its attempts to marginalize the United States rhetorically and position itself as a more responsible, trustworthy regional leader that will develop a new, stable, transparent financial architecture for the common international good. First of all, it is clear that these claims are a thinly veiled attempt to increase Russia's power in international affairs and to have a say in designing the new world order that will coalesce in the short to mid term, as national economies and the global economy emerge from the current deep recession. As for any state, that is a perfectly legitimate and expected aspiration; it is undermined in Russia's case, however, by a second factor—that Russia's desire for and ability to produce a stable, robust, and transparent international financial architecture is belied by its inability to do so at home.

In recent years, the Russian state has consistently been given low ratings for corruption, lack of government transparency, and lack of open and unbiased media. Furthermore, the state of its own financial system—if only to look at the highly volatile performance of the RTS and MICEX stock indices over the past months, the relative lack of volume and liquidity on those markets, and uncontrolled inflation during the past years—hardly makes it a desirable candidate for a world financial center. Furthermore, foreign investors are increasingly hesitant to enter the Russian market in the wake of Shell's ousting from Sakhalin-2 and BP's fiasco with the TNK-BP joint venture. The ongoing Khodorkovsky-Lebedev show trial does even less to instill confidence in the transparency and stability of public-private relations. Given the government's unwillingness (or inability) to address the problems of its own domestic legal and financial infrastructure, it seems highly unlikely that other countries will give Russia a great deal of influence in building the new financial architecture.

The prospects for expanding the use of the ruble to make it a regional currency are also weak, as well as generally unimportant. As with Russia's campaign to increase the country's birth rate and reverse population decline, the goal of using the ruble in foreign trade transactions is more politically than economically salient; in the end using rubles instead of dollars or euros in a given spot transaction makes little difference, only adding an extra layer of complication to a transaction. And in long-term investment projects, denominating the deal in rubles would provide no advantage, but instead only expose both transacting parties to currency-fluctuation risk. For these reasons, it is highly unlikely that the use of the ruble will be expanded; if it is, it will be on a bilateral basis between two contracting parties. So far, Russia has only succeeded in expanding the role of the ruble with Belarus, which it achieved by offering the latter a \$2 billion loan in the wake of the financial crisis.

In the end, Russia will be able to gain influence in 21st century global financial decision-making only to the extent that it has value to offer the world economy. While along with the other BRIC countries and smaller emerging economies Russia should be able to win greater voting rights in the IMF as it is reformed, as well as influence in the Financial Stability Forum as G20 members are integrated into that body's decision-making process, it is unlikely that Russia will attract either substantial external investment or interest in turning Moscow into an international financial center in the coming years.

## 5. CONCLUSIONS

As discussed earlier, in February 2008, Putin unveiled the comprehensive plan for the country's economic development through 2020. The plan outlined an ambitious vision of modernization that would reorganize and revitalize Russia's economy, completing the transition from an industrial, emerging economy to a fully developed, "innovative" economy. GDP growth was to average 6.6% per year and the inflation rate was to be pushed down to and controlled at 3% per year. Importantly, much of the funding for such development was premised on high oil prices—if not at \$147 per barrel, than at least closer to \$90. The crisis, of course, has decidedly put an end to these plans for the time being. What foreign investment the country enjoyed has also left the country and is unlikely to return until high commodities prices can once again justify the expense of expanding resource extraction and production.

In light of all this, the multipolar thesis expounded by Russian scholars and politicians in recent years, in which a "resurgent" Russia is once again a great power among an elite few, is increasingly unlikely. In a recent article, expert on Russian policy in the regions Nikolay Petrov agrees that Russia's modernization project is distinctly out of the question, and that the most probable scenarios for the country's near- and mid-term development include increased layoffs and the failure of key industries, including in single-industry cities.<sup>92</sup> He predicts that this will inevitably lead to domestic unrest—in some scenarios, it will lead to serious upheaval, including the possibility of renewed war in the Caucasus and increased protests in a number of Russian regions.

Any scenario in which Russia's domestic stability is seriously threatened would necessarily derail remaining great-power aspirations, as the country's dwindling resources would have to be diverted to quelling domestic unrest, and its legitimacy on the world stage would only be further questioned by public and private investors and foreign policymakers alike. And as the choice for Russian policymakers increasingly appears to be a zero-sum decision between allowing key industries to fail or fall into foreign control on the one hand, or spending the remainder of the country's prized reserves on the other, the authorities seem to be reluctantly siding with the former. According to Arkady Dvorkovich, Medvedev's top economic aide, earlier bailouts were "individual cases that won't be repeated."<sup>93</sup> The oligarchs are being given the sign that they will either need to find foreign financing in the next year or be prepared to hand over their assets; the state's resources—and much of its confidence—have dried up.

Thus, whether one believes that de Montbrial's multipolarity or Haass's more dispersed nonpolarity more aptly describes the coalescing world order, it is almost certain that the "resurgent Russia" vision of Putin's and Medvedev's multipolar world—where Russia becomes a leading decision-maker in shaping new international

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<sup>92</sup> See Nikolay Petrov, (2008). "Vremya divergentsii." *Pro et Contra*, No. 12:5-6, sentyabr-dekabr. <<http://www.carnegie.ru/ru/pubs/procontra/80597.htm>>

<sup>93</sup> Quoted from Gregory White, (2009-03-09). "No Lifeline Guarantee for Russian Tycoons." *Wall Street Journal*.

institutions and defining the terms of the 21st century world order—will be out of reach in the short to mid term. For the time being, however, the Russian rhetoric remains high on the international stage. As the NATO-Russia Council resumed operations once again in early March after a six-month forced hiatus, Russian permanent envoy to NATO Dmitri Rogozin started things off by commenting that “our Western colleagues saw in Russia a partner that one cannot wipe one’s feet on. We are strong. [...] We are restoring co-operation, including on our terms.”<sup>94</sup> Lavrov was no less insistent—if he was, perhaps, more diplomatic—in his March 6th meeting with Clinton. However, Dvorkovich’s attitude after returning from the G20 preparatory meetings in England in mid-March was reportedly less optimistic; there may yet be a lag between the country’s economists and its foreign-policy decision-makers.

While Russia is likely to assert itself at the G20 meeting in London, it will have its interests and proposals considered only inasmuch as they correspond to the greater interests of emerging economies—first and foremost, of Brazil, India, and China, who together with Russia have refused to fund the IMF until its voting structure is changed. Nevertheless, the state-controlled Russian media will almost certainly spin the coverage of the G20 meeting in Russia’s favor, much as it did coverage of the dismal Davos Economic Forum earlier this year, displaying a righteous Russian delegation as it stands up to the U.S. and gains concessions for the more fiscally responsible emerging economies. In doing so, it may be able to successfully portray Russia as a lead decision-maker at the G20, holding its own against a dethroned United States and an EU that is still heavily dependent on Russian energy resources.

If it is successful in this and future domestic media campaigns, the Kremlin may be able to maintain an image of strength in relation to other countries, thereby prolonging the subjective perception of the public that, yes, the crisis is bad in Russia, but it’s no worse than elsewhere. This, in turn, would allow the authorities to deflect public resentment away from themselves and onto a common enemy, and in doing so maintain their hold on power at home. Such a scenario, unfortunately, would almost certainly result in increased nationalism within Russia and increased isolationism without.

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<sup>94</sup> Elder, Miriam, (2009-03-06). “Nato agrees to re-establish ties with Russia.” *Telegraf.co.uk*.  
<<http://www.telegraph.co.uk/news/worldnews/europe/russia/4943881/Nato-agrees-to-re-establish-ties-with-Russia.html>>



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