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Promises to Keep: U.S.-Russia Relations and the Reemergence of Possibilities

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Russia's reaction to the September 11 terrorism challenge and the positive tone of the November Bush-Putin summit have once again put Russia center stage in U.S. foreign policy calculations. Having reemerged as an essential participant in the anti-terrorist coalition, President Putin's government is now perceived—and portrayed—as a stable, reliable partner, if not friend, of the United States.

This surprisingly rapid warming of Russia-U.S. relations followed a period in which both Washington and Moscow sought to demonstrate their independence from each other and their ability to define and pursue national goals without any special reference to the other's international standing or interests. Moreover, the Bush administration clearly intended to reduce the U.S. role in Russia's internal political and economic transformation. This hands-off posture had begun to erode during the first two encounters between Presidents Bush and Putin at Ljubljana and Genoa, but aligning American and Russian foreign policy agendas became a national and personal pursuit of both Presidents only after the terrorist attacks in New York and Washington, D.C.

The Crawford summit showcased the sea change in perceptions of the U.S.-Russia relationship, even if fundamental issues, such as the development of a new strategic relationship and the future of the ABM Treaty, will have to be resolved at a future time. In the past, both Presidents would have publicly "agreed to disagree" on contentious issues such as missile defense, the sanctions regime against Iraq, and Russia's support for Iran's nuclear program. This time, however, both were determined to minimize the remaining difficulties in the relationship. Thus, at Crawford they "agreed to agree" that the Unite States and Russia could and would work out remaining differences on strategic issues and pledged to strengthen both economic and political links between the two countries.

At present, the rhetoric is clearly out in front of substantive policy changes. But, a significant degree of real new cooperation has emerged in pursuing the military campaign in Afghanistan and in combating global terrorism. The lack of an agreement on the big strategic issues, continuing differences on regional issues, and questions regarding Russia's role with NATO will continue to be a drag on the relationship. In Russia, a lack of tangible progress on such issues will be a lightning rod for those in the Russian security and foreign policy establishment uneasy that the new relationship with the United States could undermine or detract from Russia's independent global role. Likewise, some critics on both sides of the aisle in Washington have already expressed concern that President Bush "gave up" some key U.S. interests in return for Russian cooperation in the war against terrorism.

Nevertheless, the swift turnaround in the atmosphere surrounding bilateral relations has reverberated throughout the American and Russian business communities. There is new interest in seizing what many on each side portray as a "second chance" to bring a modernizing Russia into the family of industrial democracies as a respected member of the Western-Euro-Atlantic "Club." The core of the new economic relationship between Russia and the United States and Western Europe is a Russian commitment to a market-based economy. Both Russia and the United States have indicated they will take tangible, practical steps to improve the context for economic relations, and both are now thinking about how to do so.

Looking ahead, the most important question for both the United States and Russia is whether we are truly on the verge of creating a new set of strategic and commercial possibilities. Much will depend on actions taken by both sides in the next few months.

- Will Putin's economic team make effective use of the economic and political window of opportunity to push through comprehensive structural reforms?

- Will the cumulative effect of the economic and political reforms be sufficient to fundamentally improve the investment climate in Russia on a sustainable basis?

- What role will the United States and other G-7 powers play to promote Russia's internal reforms and its global integration in this phase of the country's transformation?

Russia's Future Prospects

President Putin appears determined to modernize Russia and he wants to integrate it fully with the global community of industrialized, democratic nations. He has soberly assessed Russia's weaknesses and strengths, both at home and abroad, and designed policies accordingly. Domestically, Russia's economy is performing better than at any time in post-Soviet history, political life has remained calm, and there is no doubt about who is in charge. Putin has promised that the Kremlin's reform agenda will be a priority, and for the first time in a very long while Russia's population is guardedly optimistic about the future. Much of this recent prosperity and growth is tied to the effects of ruble devaluation and high oil prices. The current struggle between OPEC and Russia over production cuts is moderating some forecasts for Russia's economic growth in 2002. Yet, barring another steep downturn in oil prices, Russia's economy should continue to expand and diversify as the domestic market strengthens. Internationally, Putin has positioned Russia as a reliable ally in the war on terrorism, and, perhaps most important, as a committed partner of the United States and President Bush personally in the present struggle against Al-Qaeda in Afghanistan.

Putin has presided over the development of unprecedented cooperation between United States and Russian special services and militaries in the war on terrorism. More broadly, he has also declared openly and forcefully his intent to carry Russia into the Euro-Atlantic world as an integrated player. He has taken significant further steps to overcome the remaining post-Kosovo frostiness and to improve further Russia's relations with NATO. He has also made World Trade Organization (WTO) membership a priority.

At the same time, some issues on the Russian foreign policy agenda run counter to this direction. Russia has blocked any changes in the U.N. Oil for Food sanctions program against Iraq, and the possibility of U.S. military action against Baghdad could become a major focus of disagreement. The continuing Russian-Iranian nuclear and missile-technology relationship, the "strategic partnership" signed this summer with China, along with Russian arms sales to other countries that may threaten U.S. interests, will also test the emerging U.S.-Russia partnership.

At home, Russia may be getting a real second chance to create a stable, prosperous economy. Since the financial shock of August 1998, Russia's macroeconomic situation has improved substantially, and, indeed, Russia's medium-term economic outlook looks promising. In 2000, Russia's real GDP grew by 8 percent, and is projected to grow another 5 percent this year. The federal budget is roughly in balance. Central Bank reserves, nearly depleted three years ago, will stand at nearly $40 billion by the end of the year. Russia has a massive balance of payments surplus, and is currently meeting its external debt service requirements. On November 27, Russia paid back $1 billion to 2001 Eurobond holders, a significant step representing the first full and timely commercial external bond payment since the 1917 revolution.

The Kremlin's economic management team, headed by Prime Minister Mikhail Kasyanov, Finance Minister Alexei Kudrin, and Minister for Economic Development and Trade German Gref has been able to pass legislation and implement a variety of policies to strengthen Russia's markets. Conditions are slowly being created to attract foreign investment which, although growing, is still meager compared with many other emerging markets, both in absolute terms and as a share of GDP. (For example, total FDI in Russia since 1992 is about $12 billion, compared with $25 billion annually for China in the 1990s.)

The shift in domestic priorities is also evident in other indicators. For example, the published Russian 2002 federal budget, for the first time in Russia's history, allocates more spending to education than for defense. In addition, a growing number of Russian companies are following the example of some leading Russian firms and seizing upon the advantages of adopting generally accepted business practices, accounting standards, and the necessity of good corporate governance. While there are still entrepreneurs and companies looking for ways to make a fast buck, well established Russian companies are adopting a more long-term perspective devoted to attracting capital, increasing their share value, and corporate growth. In addition, Russian companies are going into capital markets in growing numbers and are being well received by international investors.

Russia is still fraught with inconsistencies, saddled by the economic legacy of the Soviet Union, burdened by domestic ills such as corruption and poverty, and underdeveloped in key areas. This is underscored by Russia's recent ranking of 79th (between the Ivory Coast and Tanzania) on the Corruption Perceptions Index published by Transparency International. But President Putin appears to have the necessary political support as well as the personal commitment to continue to tackle Russia's problems.

Putin's Priorities

During the past two years, much has emerged about President Putin's character, leadership style, and intentions. While there are still Yeltsin holdovers in some key government positions, Putin has moved to shape his own team. He has been very deliberate in picking replacements for Yeltsin appointees, relying heavily on former St. Petersburg colleagues, many with a background in the security services. At the same time, Putin has effectively isolated those who are perceived to oppose the interests and policies of the Kremlin and sought to limit the oligarchs' ability to manipulate political life in furtherance of their own economic interests. Putin has been very frank in his public assessments of Russia's domestic difficulties. He has spoken often about the need to root out corruption and increase the transparency of government bureaucracy and private business. Much, of course, remains to be done, and not everyone is convinced that the required laws will be passed, and, if passed, that they will be implemented and implemented fairly.

Unlike many of his countrymen, Putin also appears to have a realistic appreciation for Russia's ability to influence and shape events abroad. Putin has from the very outset of his presidency made it a priority to husband his power and avoid the erosion of authority that so weakened the ability of his predecessor to govern. With a mandate based on popular support, the perception of effective leadership, and the authority to get results, he has taken strong action against any that have openly contested his leadership or sought to undercut this image. And he has been exceptionally successful in doing so.

However, this very success also sets certain constraints on Putin's choice of options. Most important, his success is hostage to his inability to sustain a significant failure. This has made him cautious in the face of opposition and careful in facing issues he cannot control, but it has also contributed to sustaining his high popularity among the Russian public. Some polls place his approval rating near 75 percent—and his team is determined to protect this asset.

Putin is clearly growing into his position, and has been able to dispel doubts, both in Russia and the West, about his ability to govern. He now wields authority at home with little effective institutionalized opposition in the Duma or among regional governors. While this has enabled him to undertake much needed changes, there are still some serious doubts about the Putin team's commitment to values and institutions essential to democratic society—a pluralistic media, a strong civil society, and the rule of law. The ongoing bloody campaign in Chechnya is a reminder of the distance Russia still has to cover with regards to human rights. But Putin's actions after September 11 have eased many of the earlier fears that Putin seeks to develop a place for Russia apart from, or incompatible with, the norms of the global community.

In fact, Putin's recent statements of solidarity with the United States may well signal the end of a period of distrust of the U.S. government by ordinary Russians, fed by disappointments with the U.S.-backed reform programs of the 1990s and alarm about NATO's bombing of Yugoslavia. A recent poll found that 55 percent of Russians believe that U.S. official support of Moscow means a radical turn to the better in Russian-American relations, 52 percent express sympathy and compassion with the American people in connection with the September 11 tragedy, and 43 percent call the United States a friendly state. Other polls have yielded similar results.

During the next year, Putin must keep up momentum on new reform legislation and convince skeptical elites in Moscow and the regions that new laws will be implemented in a transparent manner. Areas likely to be addressed are: pension reform, restructuring natural monopolies and the banking sector, judicial reforms, and anti-corruption. The goals of the next stage of economic reforms appear to be to bring Russia closer to the way business is done in the West and meet the requirements for entry into the World Trade Organization (WTO.)

U.S. Moves Towards Russia

The positive momentum in Russia is being met with enthusiasm from U.S. leaders. President Bush has praised Putin, remarking at Crawford that "the more I get to know President Putin... the more I know that we can work together in a positive way." The American public appears to be mirroring this upbeat tone. In a recent CBS poll, 80 percent of Americans agreed that Russia was a "friendly" government, as compared with a similar poll two and a half years ago, when 44 percent thought Russia was "friendly." Commerce Secretary Donald Evans, Treasury Secretary Paul O'Neill, and U.S. Trade Representative Robert Zoellick have all traveled to Moscow in the past few months and have praised Russia's economic plan and prospects.

The Bush administration is also seeking to reinvigorate the existing trade financing mechanisms, such as ExIm, OPIC, and TDA. These were substantially cut back after August 1998 (for some prudent reasons) but they are rightly regarded as indicators of the direction in which the U.S. government believes political and economic relations are headed. The Russian-American Business Dialogue, announced by Presidents Bush and Putin at the Genoa summit in July, is progressing with the encouragement of both governments and has identified six issue areas (market access, investment policies, high-tech support, growth of small and medium enterprises, rule of law, and administrative procedures) to guide the initial stages of its work. Secretary Evans and Minister Gref have met with the group on three separate occasions and both plan to continue their active involvement with the Dialogue. We have also seen calls in Congress for more imaginative and creative initiatives to address the security issues lingering from Russia's Cold War arsenal.

The Bush administration is also moving to reduce the irritants in the economic relationship. It is therefore urging Congress to remove Jackson-Vanik restrictions and undertaking a review to determine if Russia can be declared a "market economy" for purposes of anti-dumping cases.

These steps are integral to the Bush administration's declared goal of helping Russia accede to the WTO. WTO accession will be the driver and shaper of Russia's reform and modernizing efforts during the next few years, and will provide the basis for much of Russia's commercial relationship with the United States. More important for business, Russia's desire to join the WTO, and the essential role the United States and the European Union will have in that effort, will encourage Russian leaders to adhere to international standards and practices. As in the case of China, there will be difficult negotiations on the precise terms of accession, and, in addition, Putin may face even more domestic opposition from protectionist interests than China's leaders have.

The United States is also examining possible avenues for helping Russia deal with its external debt, particularly with respect to Soviet-era obligations. Any deal would depend on a complex matrix of financial need and political factors. There is a certain logic to forgiving at least some Cold War obligations. Despite public statements by Russian policymakers that they will be able to make all future payments, the numbers are substantial: next year, the Russian government is obligated to pay $14 billion in debt payments (including to the IMF) and in 2003, the burden will total $19 billion. (Russia's initial 2002 budget forecasts total government spending at $57 billion.) This burden is probably manageable, absent a collapse in oil prices and depending on Russia's ability to access capital markets.

Putin's economic team is counting on robust growth and relatively high oil prices in order to make debt payments on time and keep pension and other public sector disbursements current. In recent weeks, however, the Duma has been recalculating its figures for the 2002 budget. In the third reading of the budget, Deputies reduced their forecast for the average price of oil to $14 per barrel (down from $18.50), the result of which would be reduced government revenues. Minister Gref has announced that, despite the downturn in oil prices, he is confident that Russia will meet the original target of 4.3 percent growth next year. It is noteworthy that President Putin, speaking recently at a World Economic Forum meeting in Moscow, did not rule out that Russia would need external assistance, saying “We will not become arrogant and will stay in contact with international financial organizations,” and he added that “We may resort to their help if necessary.” In the United States, Senators Joseph Biden and Richard Lugar are introducing a bill that would ease Russia’s debts to the United States in exchange for Russian action to destroy, secure, or prevent the spread of its weapons of mass destruction.

Some of the progress made recently in the bilateral agenda clearly reflects the consequences of Putin’s support in the war on terrorism. But they are by no means concessions that benefit only one side. Russia should be encouraged to continue with economic reforms, and the overall long-term goal—Russia’s meaningful integration with the world economy—is in the interest of both the United States and Russia.

Russia as Potential Oil Supplier

Continued volatility in the Middle East will prompt the United States and America’s allies to seek alternative oil supplies and lessen dependence on energy from that region. President Putin, sensing the new opportunity for Russia since September 11, said in Germany, “In case of regional conflicts breaking out, Russia is prepared to supply more oil, and I say this loud and clear.” Although any actual changes in global oil flows would require billions of dollars of investment and years to implement, such a change—in perceptions and investments—would have seismic consequences for the U.S.-Russia relationship, for U.S. investment priorities, for Western oil companies, and for the global system as a whole. Energy export is Russia’s main economic engine and its most highly developed and integrated industry. Energy is also a tool of leverage, as many of Russia’s immediate neighbors know too well. President Putin recognizes Russia’s great potential in this area, and has been quick to take advantage of opportunities to try and bolster Russia’s presence in the global energy market. In recent weeks, the Russian government has been playing the role of spoiler in OPEC’s bid to decrease production and raise prices. It is a gambit that is producing very low gasoline prices in the United States and could spur further market gain for Russian oil companies.

A New Bottom Line?

President Bush told President Putin that he wished to “establish a relationship between our countries strong enough that will endure beyond our presidencies.” The long-term view of the relationship will help get over the many rough patches likely to develop in the years ahead. Certainly until the issue of missile defense and the ABM Treaty is resolved, it will be difficult for Presidents Bush and Putin to fully capitalize on the friendship that they announced at Crawford.

One of the strongest “glues” in this relationship can come from the private sector. The creation of an environment in Russia that is attractive to business and investment will help further that goal. Both countries are looking for business to take a prominent role in strengthening ties and recognize the need to develop private “stakeholders” in the relationship. There are opportunities to move ahead on both sides and the business prospects for the next three to five years are better than would have been expected just a few months ago, particularly if Putin’s team is able to implement the reform agenda.

The more positive perception of Russia in the United States, combined with the economic changes in Russia, has changed the way we think about U.S.-Russia relations. The long-term goal must be to create links at all levels between the two countries, links that can develop and thrive beyond the new realities created by September 11 and the coalition against terrorism. Presidents Bush and Putin have reshaped the contours of the relationship, but there are still many miles, and much work ahead, in order to fully capitalize on this newfound positive momentum.

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