



Russia's Business Diplomacy

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Summary points

- In Russia, as elsewhere, state power is founded in part on the nature and degree of the country's economic involvement with the rest of the world. However, Russia is conflicted in its attitudes towards integration into the global economy, as shown by its slow progress towards entry into the World Trade Organization.
- The poor business environment has placed limits on long-term foreign investment in Russia and holds back the country's integration into the global economy. This restricts the scope of Russia's soft power as a pole of economic attraction, as does its tendency to employ coercion rather than persuasion.
- President Dmitry Medvedev has put forward an ambitious but generalized modernization agenda, which if enacted would require close cooperation with the West and much greater foreign investment. However, this conflicts with entrenched economic and political interests.
- There are several possible scenarios for Russia's future development. It may continue to rely on oil and gas revenues to prop up the current economic and political model. Investment is required to make the most of hydrocarbon reserves. At present, however, the government has returned to budget deficits to cover social spending, rather than seeking to boost growth through reform.

Introduction

This briefing paper looks at the way in which the international interactions of Russia's businesses are used for political purposes by the Russian state. It is intended as a companion piece to John Lough's paper *Russia's Energy Diplomacy* in the same series.¹ Much of the business elite in Russia has become dependent on the political elite. In some of the key sectors of the economy, energy above all, political and business elites have become inseparable.

The return of high oil prices makes a review of Russia's business as well as energy diplomacy timely. The correlation between prosperity, or at least economic security for the ruling elite, and a truculent attitude to the rest of the world was evident in Soviet times, and has been clear since the establishment of the Russian state.² The oil price is of course the critical factor in determining Russia's GDP. Russia's attraction for neighbouring states, which might have sustained its ability to deploy a broader system of soft power, has been limited – even in states governed by similarly constituted and centralized regimes. None of them wants to be controlled by Moscow. Russia's illiberal internal attitudes, and its self-centred approach to the wider world, have also limited its soft-power potential. In principle, that makes Russia's ability to deploy business influence all the more important to its ambitions.

In Russia, as elsewhere, state power is founded among other things on the nature and degree of the country's economic involvement with the rest of the world. If the already fuzzy concept of soft power is to be useful for the analysis of policies and practices, however, it cannot be left at that. The notion of 'business diplomacy' embraces the conscious and deliberate exercise of influence abroad through business channels, building on a country's particular advantages. However, power projection is not the only driver of Russia's integration into the global economy. It would be perverse to suggest, for example, that Prime Minister Vladimir Putin's ban on grain exports in 2010 in response to the drought in Russia was a political move

against the government of Egypt, one of Russia's principal markets, even though this contributed to bringing the Egyptian people out onto the streets against President Hosni Mubarak.

The political structure of Russia has been reduced to what Putin described on assuming office as president as a 'vertical of power'. The legislative and judicial branches have been drained of autonomy by the executive, as have the regional structures headed by governors appointed by the president. The mass media have also been brought under central control. The state and state-related share of Russian business has risen significantly in recent years and is now around 50%.³ Russian and foreign businesses must therefore work in an environment where property rights are conditional on the right political patronage, and where judicial recourse is uncertain.

It does not follow, however, that the central authorities can direct economic activity because they have this hold. The 'vertical of power' has been proclaimed by Putin as the necessary framework for stability. A number of foreign investors have accepted that proposition, along with the assumption that it has provided relief from the uncertainties of the Boris Yeltsin years. But the 'vertical of power' is arguably more a form of restraint of anarchy than an effective instrument of rule. The machinery of government at the vertical's command is ineffective, and thoroughly corrupted. In his 30 November 2010 report to the National Assembly President Dmitry Medvedev remarked on how law enforcement overlapped criminal structures.⁴ Foreign and Russian businesses are affected as those who should be their protectors, regulators or enablers have become predators.

Russia is also conflicted in its attitudes towards economic and business relationships with the rest of the world. An instinct towards economic autonomy encourages protectionism and a belief in zones of special interest. Yet the reality of Russia's growing integration into the world economy cuts across such attitudes; hence, for

1 John Lough, *Russia's Energy Diplomacy*, Chatham House Briefing Paper, May 2011. For other papers in the series, see p. 12.

2 For a succinct account, see Dmitri Kamyshev's article in *Vlast*, 29 November 2010, <http://www.kommersant.ru/doc.aspx?DocID=1545978>.

3 Sergei Aleksashenko, 'Suverennyi Kapitalizm s Nechelovecheskim Liitsom', *Novaya Gazeta*, 13 October 2010, <http://www.novayagazeta.ru/data/2010/114/12.html>.

4 *Poslaniye Prezidenta Federal'nomu Sobraniyu*, 30 November 2010. <http://www.kremlin.ru/transcripts/9637/work>.

example, Russia's ambiguity and slow progress towards entry into the World Trade Organization (WTO). Russian soft power is as often about resentment as about strategic purpose. Russia's policies, lastly, are deeply affected by the weight of the country's dependence on exports of hydrocarbon and other natural resources. This feeds the instinct towards autonomy and state control, but the realization that it is not enough for a vibrant economy also fuels a desire for greater and more balanced interaction with other countries.

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The dearth of long-term investment is Russia's abiding problem. The country is still living largely off its Soviet inheritance. Russia responded to the global economic crisis with support for existing enterprises, viable or not, and by preventing unemployment, whether the workforce was well deployed or not. Russia was not alone in that of course, but in its case this reflected a consistently conservative outlook rather than a temporary solution to a crisis. Individual businesses had to follow government objectives, and the spirit was protectionist.

Russia's natural resources have made all this possible – despite the lack of investment in that sector too. Russia's return to growth in the latter part of 2009 tracked the recovery of oil prices. Revenues from natural resources fuel Russian imports, domestic demand, spending on foreign ambitions and its state budget, just as they did for much of the Soviet period.

It follows that Russia's international business relationships, including in the energy sphere, are different from those pictured by Western observers, and that they fit into a general Russian perception of the country's rightful but unrealized place in the world. This background, which includes the declining status of the Russian language in regional affairs and the international claims of the Russian Orthodox Church, needs to be borne in mind in considering the pattern of Russia's business relationships and the way in which their weight is used, the future of these factors in the absence of substantive change in Russia itself, and what changes might lead to the greater integration of Russia into the international system.

Russia's business relationships with its neighbours and the West

Russia and China

There is no strategic partnership between Russia and China, declarations to the contrary notwithstanding. Russia's natural resources marry well with China's needs in principle, but linking is difficult in practice. China's rapid growth, which has seen it acknowledged as an emerging great power, is in marked, and to Russian minds disquieting, contrast to what has happened to Russia. The Chinese state is also far more effectively organized than its Russian counterpart. Moscow can pick and choose its relations within the European Union, but Beijing confronts the EU with a unitary approach that is more competent, methodical and long-term in its policies than anything that Moscow can bring to bear. The population of Eastern Siberia has declined more significantly than that of the rest of the country, feeding Russia's concerns as to its ability to compensate for the disparity in wealth and for the demographic pressures on its Chinese southern flank. Procuring Russian military hardware is still important to Beijing, but less than it has been, and Russian manufacturers have to face increasing competition. China does not turn to Russia for innovative technology. The Moscow and Beijing leaderships have a common interest in maintaining a polite working relationship, and Moscow has been active in this regard. But Russia's economic leverage over China is not significant, and personal relationships, even in the military sphere, are of limited value.⁵ Given

⁵ See, for instance, Bobo Lo, *Axis of Convenience: Moscow, Beijing and the New Geopolitics*, (London and Washington, DC: Royal Institute of International Affairs/Brookings Institution Press, 2008).

the weakness of Moscow's influence on Beijing, Russia has limited possibilities of using business-related soft power to affect Chinese ambitions.

In balancing the rise of China, Russia has no significant business levers to operate with Japan or India. Hopes of building up its Sakhalin energy resources to increase its influence in Japan are vitiated by Moscow's rejection of Japanese claims to the Northern Territories/Kurile Islands. Russia has inherited from the USSR a useful economic and political relationship with India, including a defence procurement element. The relationship also has energy potential. Russia has tried to build up the Brazil-Russia-India-China (BRIC) forum, but its comparative economic rating is questionable and trade relations with Brazil, Central and South America in general (except Venezuela) are underdeveloped, as they are with the Middle East and Africa – although here Iraq and Nigeria have been targeted with hydrocarbon interests particularly in mind.⁶

Central Asia and the Caucasus

Russia has more leverage in the formerly Soviet parts of Central Asia, but Moscow is not as well positioned as it has sometimes supposed to act as it pleases. Central Asian states export as much of their surplus labour as they can to Russia, and the resulting remittances are important to countries such as Uzbekistan or Tajikistan. Remittances from Russia to Tajikistan came to \$1.74bn in 2009, or some 35% of the latter's GDP.⁷ Soviet-inherited enterprises in Central Asia are oriented towards the former metropolitan power. Personal networks are influential. The Russian and Central Asian leaderships still share the same ex-Soviet background, and Moscow cultivates its counterparts accordingly. Most gas pipelines in Central Asia go north.

China is the rival in Central Asia that Moscow would rather not confront or acknowledge. Russia has until recently been able to treat Central Asian energy producers as Gazprom's 'reserve army'. Kazakhstan has been a partial exception to this, principally as an oil producer.

President Nursultan Nazarbayev has been able to establish his country as a regional actor while retaining effective working links with Russia, and his own network with Western business interests, in a way that other Central Asian leaders have been unable to emulate. China's investment in gas supply from the region has further complicated Central Asian relationships with Russia, and done so in a way that illustrates Beijing's growing involvement as a major political and economic factor in implicit rivalry to Russia. Turkmenistan's steps towards Iran are a portent too.

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Russia's assets in Central Asia are in relative decline. The Central Asian states have all understood the advantage to them of both working with Russia and also establishing other relationships. Personal links inherited from the Soviet era are fading. Russian attempts to buttress and even develop this inheritance by means of a variety of institutional structures have not so far had enduring success even though Russia remains for many in Central Asia a genuine centre of attraction. Familiarity, similarly personalized regimes, economic ties, the relative absence of Western powers or organizations, and the risks of the wider area all build on that. But Russia vitiates its message by reaching when it can for instruments of necessity, and treating economic ties as political obligations, in effect as tests of loyalty. The Central Asian countries

⁶ Moscow has commercially backed relationships with individual countries beyond those of the OECD, often with a significant energy or weapons component. Venezuela, Nigeria and Guinea are instances. But these do not amount to a concerted effort compared with that of China, or the exercise of significant soft power. I have therefore not included them in this paper, which focuses primarily on the Russia/CIS/OECD nexus.

⁷ <http://siteresources.worldbank.org/INTPROSPECTS/Resources/334934-1199807908806/Tajikistan.pdf>.

also have good reason, including through their citizens working in Russia, to know what weight the Russians give to their interests where they clash with Moscow's. Russia's economic or political potential is not enough to induce them to throw in their lot with Moscow.

The South Caucasus affords a number of object lessons in the realities of relationships with Moscow. Armenia is dependent on Russia, given its conflict with Azerbaijan over Nagorno-Karabakh and the frustration so far of its prospective opening to Turkey. Azerbaijan has achieved a degree of freedom for manoeuvre thanks to its access to Western oil and gas markets through the Baku–Tbilisi–Ceyhan pipeline system. Georgia was punished first by economic sanctions and then by force for its defiance of Moscow's will. In the South Caucasus, Russia's motivation has been political as much as economic, in the interests of what it has seen as its right to control neighbouring countries. Its ability to deploy soft power has been limited accordingly.

Ukraine, Belarus and the West

The lesson Russia has learned from its traumatic experience over the past quarter of a century is profoundly conservative: restoration not reinvention. That has generally suited entrenched interests in Russia and in Central Asia, and to some extent in the Caucasus countries with their comparatively unsophisticated economies. Ukraine and Belarus are a different case. Ukraine, in particular, is a natural partner and rival to Russia. Like Russia, it depends heavily on its Soviet legacy. Its inheritance is still interlocked with Russia's in aviation, military production, nuclear industry, railways, and oil and gas, and both countries are major steel and coal producers.

Belarus too is reliant on its Soviet inheritance, which also meshes with Russian structures. Like Ukraine, it is a principal transit corridor for Russia's (formerly Soviet) gas pipelines to Europe.

There is a constituency in all three countries with a vested interest in exploiting what exists rather than developing new categories of enterprise. Ukraine is an important

export market for Russia. Russian capital would be seeking an outlet in both Ukraine and Belarus, even if the Russian government were not urging Russian companies to harness Ukrainian enterprises to Russia's national purposes.⁸

But all three are divided by politics and interests, and the West is a more pressing factor for Ukraine and Belarus than it is to the countries of Central Asia or the South Caucasus. Ukraine and Belarus are not major investors in Russia, but fear the Russian ability to buy them out at home. Russian military, intelligence and political resources in both these countries remain grounded on personal links formed over many years, buttressed by common interests. It was noteworthy that the advent of Viktor Yanukovich to the Ukrainian presidency was swiftly followed by proposals from Moscow for business mergers, such as between Gazprom and Naftohaz, coupled with encouragement of Russian entrepreneurs to take enhanced holdings in Ukrainian enterprises. The aim was clearly to secure Russian control, not to promote equal partnership. The result was overreach. Both Belarus and Ukraine have endured pressure from Moscow, extending in the latter's case to an apparent attempt to poison Victor Yushchenko when he was a leading presidential candidate. Russian politicians have explicitly or implicitly called Ukraine's borders into question. None of these three countries can plead naivety about the other two.

Russia has not been able to make good on its 'union' with Belarus, or to overcome the difficulties of its relationship with Ukraine. For every trend and 'narrative' in Ukraine there is always a counter-trend that frustrates Russian ambitions. Half the country is anti-Russian and, whatever the economic arguments, a majority of the political elite remains wary of Moscow. Whether pro- or anti-Russian, all Ukrainians insist that they are European, not in any sense Eurasian. They may often be Sovietized in their values, but the difference in political culture between Russia and Ukraine is tangible. History has taught Ukrainians to distrust power – perhaps particularly power coming from Moscow. They have a tradition

⁸ See, for instance, the report of the Russian Ministry of Foreign Affairs to President Medvedev on the ways in which external factors can assist Russia's modernization, published in *Russian Newsweek*, 'Programme for the Effective Utilization of Foreign Political Factors on a Systematic Basis for the Long-Term Development of the Russian Federation', 11 May 2010, <http://www.government.ru/smi/press/1849/>.

of pluralism and, although set back by the failures of the previous government and now the advent of Yanukovich, the trend has been towards civic consciousness and action rather than an acceptance of centralized and personalized rule on the Russian model. These factors militate against undue pressure from Moscow, including pressure exercised through business and energy channels.

Western business in Russia

The EU is Russia's principal trading partner, with North America playing a lesser but still influential role. The basic trade pattern between them is simple, long-standing, and complementary. Russia sells oil, gas and other raw materials; and it imports technology, consumer goods and high-quality services. The higher the price of oil and gas, the more Russia can import. Military equipment is not a significant part of the relationship between Russia and the West. The hope is that imports of Western technology should make Russian goods more competitive, as happened in China, reducing the need for imports and enabling Russian companies to compete internationally. Success in this has been limited, however, not least because Russia's infrastructure is obsolescent and its intellectual heritage in decay.

This pattern has suited the ruling elite of Russia. The country has profited hugely from income from its natural resources without going through the difficulties of renewing its wider economy. And those at the top have lived well off the proceeds while directly or indirectly controlling the assets. The attraction for Western companies of Russian raw materials, particularly in hydrocarbons, is obvious, even compelling. Western investment in what Russia sees as its strategic sectors is restricted, however, and the authorities change the rules when it suits them. In most cases, the rough treatment accorded to major Western companies has not blunted their zeal in the energy sector, and returns on capital have often been considerable, though Western mining interests have sometimes been less successful. But by and large, Western business has learned that Russia intends to keep its natural

resource wealth under its own, usually state, control. This means that foreign companies have to work with the authorities.

As for the rest of the Russian economy, the country's growth between 2000 and 2008 made it an attractive market for Western companies, and growth has resumed, though less strongly, over the past year or so. There has been Western investment in local production (cars, cigarettes, beer, processed food), retail, and technical, legal, financial and telecommunications services. Companies such as BMW, Toyota, Renault, Unilever, Nestlé, Mars, Air Liquide, Halliburton, Boeing, Coca-Cola and Auchan all have major presences in Russia. Pepsico has purchased Wimm-Bill-Dann, one of Russia's most successful 1990s start-ups. Russia's cities are showcases for foreign luxury goods. But overall, the country has attracted significantly less foreign direct investment than its BRIC colleagues, particularly in its basic economic structures. Russian entrepreneurs have also been hesitant about committing to longer-term projects.

Western business experience beyond the 'strategic' sectors has been mixed, but with the right local political and economic connections there is money to be made. Without them, foreign firms can fall prey to powerful and better-connected competitors or rapacious officials. Visits from tax inspectors, troubles with customs, requests for bids to be increased before they are accepted, and so on are part of the Western experience, as well as the constant reality for Russian enterprises. For those not directly affected, extra-legal pressures on businesses are usually seen as a reason to be cautious, if not servile. Although Russia has consistently slipped down the ratings of, for instance, Transparency International or the World Bank's Ease of Doing Business Index, this is more of a deterrent to prospective investors than it is to existing ones.⁹ Russia would secure far more FDI if it performed better on such indicators and if its strategic sectors were less constrained. The Russian political elite seems to have found it difficult to accept, however, that its determination to exercise central control over the economy comes at a cost.

⁹ See, for example, *Transparency International Corruption Perception Index 2010*, http://www.transparency.org/policy_research/surveys_indices/cpi/2010/results; *World Bank Ease of Doing Business Rankings*, <http://www.doingbusiness.org/reports/doing-business/doing-business-2011>.

The supposition that increasing the Western business presence in Russia is about more than just profit is widespread, and reasonable. Western business practices have had a beneficial effect on Russian companies. There is an impulse in Russia towards greater integration into the world market. Bilateral government commissions, a dialogue with the United States and the EU covering business interests as well as wider societal and development issues, business interchanges such as the Foreign Investment Advisory Council, the St Petersburg Economic Forum or the Yaroslavl gathering all have their place in this effort. But there is also an impulse for Russia to impose its own story, and these occasions are useful opportunities for the authorities to put it across through a sympathetic audience. Western participants know that too much questioning or criticism can be harmful.

Prime Minister Vladimir Putin has been skilful in dealing with Western businesses, and many have been impressed. President Medvedev has been less successful, but he has been instrumental in maintaining the hope that Russia's evolution will be in a liberal direction. Putin has also been active in using political pressure or encouragement as appropriate in pursuit of what he sees as Russia's economic/mercantilist advantage. Western figures have been recruited to the boards of directors of Russian companies and Western experts have been employed too. Western accounting firms have also played a considerable role in giving such enterprises credibility. The greater the distance between the Russian state and the enterprise in question, the more effective Western participation has proved. But it is hard to sit on a board, let alone work for a company, and be too outspoken. Even in the best of circumstances, it is not easy to learn the details of how decisions are taken; most Russian companies are run by a very limited number of decision-makers or owners and their structures are often imaginatively opaque.

In sum, therefore, the state is a constant presence for Western businesses in Russia. It can directly bend foreign as well as Russian companies to its will. For example, PwC came under considerable, even threatening, pressure to revisit its audits of Yukos as the authorities were building a case

for a second trial of former owner Mikhail Khodorkovsky. Actions against Shell and BP have been taken on a deniable but nonetheless transparent basis by state organs in pursuit of unadmitted ends. The destruction of Hermitage Capital, once a major investment fund, was engineered by raiders from the Ministry of the Interior, or at least so the evidence strongly suggests, probably with encouragement from other parts of the Russian state or quasi-state body.¹⁰ President Medvedev promised that the death in custody of Hermitage's lawyer, Sergei Magnitsky, in November 2009, would be rigorously pursued, but there has been no tangible result so far. Western companies like Siemens, Hewlett Packard, IKEA and Commerzbank have been affected by bribery cases involving officials of one level or another. Getting goods through customs is an art. Due diligence on prospective partners, or distributors, is impossible to secure with assurance.

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But the game is still worth the candle for many foreign investors, and Russian enterprises have it worse. Western business figures are quick to express the fear that political difficulties between Russia and their countries or the EU will harm commercial interests. It is a common view in business circles to expect gradual improvement in the underlying political obstacles towards a more diverse and balanced pattern of growth. That would imply greater interaction between Russian and Western companies and individuals. In the meantime, there is money to be made by some Western enterprises, fuelled by Russian raw material exports.

¹⁰ See, for example, Sergei Guriev and Oleg Tsyvinskii, 'Ratio economica: Modernizatsiya-37', *Vedomosti*, 24 November 2011, <http://www.vedomosti.ru/newspaper/article/2009/11/24/219585>

Russian business activities in the West

Prudent budgetary policies from 1998 to 2008 and high oil prices built up Russia's foreign currency reserves, allowing the country to ride out the global economic crisis without having to implement fundamental structural changes in the economy. In the process, the banking system has become state-dominated. As the former senior IMF representative in Russia, Martin Gilman, has pointed out, the years of low and unproductive investment in the non-oil economy, coupled with loose monetary policy, fuelled a massive increase in imports.¹¹ The relative unattractiveness of Russian capital markets to investors meant that much of Russia's savings has been held offshore, and recycled when required to Russian borrowers. Western stock exchanges along with Western banks have played a disproportionate role in financing Russian enterprises and domestic credit. Their requirements for listing Russian companies have also had a significant impact in improving their corporate governance.

President Medvedev has repeatedly set out the objective of transforming Moscow into a world financial centre, without much effect so far. There have been improvements in the banking system over the past decade, but progress is slow. Russians with the opportunity and the means still prefer to keep their savings outside the country. Capital flight took on renewed vigour as 2010 ended. Almost \$40bn left the country. More has gone in the early part of 2011. The reasons for capital flight are not entirely clear, according to the Governor of the Central Bank and others. However, the phenomenon reflects institutional weaknesses and corruption in Russia, together with political uncertainty in the run-up to the Duma and presidential elections in December 2011 and March 2012 respectively.

With the encouragement of Western partners, Russian interests have also outsourced judicial business to foreign courts. Russians have in parallel become increasingly adept at using Western legal systems to their advantage both at a personal level (in divorce or libel cases, for example) and at a corporate level. The nature of Russia's

legal system encourages them to do so, since the courts have to adjudicate laws that are so loosely drafted as to permit selective judgments. The two Khodorkovsky trials in 2003 and 2010 were plainly instances of selective enforcement of improbable judicial interpretations. Persons or companies would not want to put themselves at comparable risk in a Russian court if foreign courts were an alternative.

Western law firms are well represented in Moscow and St Petersburg, working with both Russian and Western clients. There have been improvements in the Russian judicial system, not least in arbitration. But significant numbers of Russian enterprises are registered in foreign jurisdictions, and agreements between them, and also between Russian and Western firms, are still regularly designated for adjudication in Stockholm, London, Bermuda or the British Virgin Islands, for example. There is nothing illegitimate about that, but it is worth noting that it too creates a mutual interest and dependency.

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There has been some direct investment by Russian enterprises in Western companies beyond the energy sector. Those that have acquired stakes in the US steel sector have operated there on normal commercial principles. Bids by Russian companies closer to the Russian state, such as the car-making firm owned by Oleg Deripaska's Basic Element, have raised suspicions

¹¹ See his comments to the *Moscow Times*, 9 December 2010, <http://www.themoscowtimes.com/opinion/article/golden-days-of-being-a-net-saver-are-over/425910.html>.

as to their real purposes. When Basic Element tried to buy into GM, with the Canadian automobile-part company Magna and Russia's Sberbank as partners, it was supposed by some that the real Russian interest was to acquire sensitive technology. The bid was not successful, in part because of these suspicions. Russians are not alone, of course, in seeking to buy into technological and intellectual property, but it is not surprising that the owners of such property object to it. Nor is Russia alone in using its intelligence services to seek out data that others would prefer to keep secret. Putin accused the West of double standards in the GM case, with reference to US fears about technological transfers. He has been even more outspoken about Gazprom's difficulties in meeting EU legal standards.

The role of the government

The Russian government has used trade embargoes on varying premises to put pressure on several states, including Georgia, Moldova, Belarus, Poland and the United States. The country's progress towards joining the WTO has been fitful, and accompanied by repeated use of protectionist measures. Moscow has played assiduously, however, on the argument that the West has tried to keep Russia out. The Russian diplomatic service has not been effective in trade promotion. The submission to President Medvedev by the Ministry of Foreign Affairs, published in *Russian Newsweek* on 11 May 2010, was long on the need for Russia to take advantage of the waning dominance of the West by working with the G20, the BRIC countries and other groupings, and on the desirability of buying into Western firms so as to ensure their attachment to Russian interests, but it was unconvincing as a contribution to practical trade promotion and modernization.

Russia's competitive trade advantage remains predominantly in oil and gas, and, to a lesser degree, in metals and chemicals. Its efforts to get beyond this have been hampered by unaddressed domestic structural faults, but also by its reputation for corruption and violence, as well as manipulation and outright coercion. Russia's

attempts to counter its unfavourable reputation have been extensive, including through the state-funded English-language news channel Russia Today. Established in 2007, and describing itself as 'a joint project of the Ministry of Foreign Affairs and the Ministry of Education and Science and supported by both public and private funds', the Russkiy Mir (Russian World) Foundation has been generous with financial support to academic and other interests, and operated some 50 centres in 29 countries in 2010.¹² There are rumours, too, about Russian money supporting particular political figures and newspapers. The Russian state and Russian firms are extensive users of public relations agencies. Gazprom alone is reported to spend a quarter of a million dollars a month on public relations efforts in Washington. Moscow also makes a particular effort to reach out to Russian speakers, particularly in neighbouring countries.

The direct returns for such efforts are perhaps unclear, but they do appear to have paid off in some instances. Russia has also been successful by dint of repetition in setting a good proportion of the diplomatic agenda. Its portrayal of Russia as prevented from joining the WTO for political reasons is one instance, fitting as it does into a wider narrative of Russia having been obstructed and humiliated since the collapse of the USSR.

Western governments are committed to the idea of broadening and deepening their countries' business relationship with Russia. Germany, which has the most varied of such relationships, has a highly developed system of cooperation between its firms abroad, and between those firms and its foreign ministry. One result is to give prominence to those who argue that restraint in criticizing Russia is necessary for engagement and longer-term progress towards the integration of Russia into a Europe based on common values. Others with considerable investments and interests in Russia take this view more strongly, however. The EU as a whole has a hopeful approach towards Russia, with broad ambitions to create a common economic space, but little to show by way of concrete achievement. Russia has no difficulty in dealing with its members on an individual basis.

¹² For details, see <http://www.russkiymir.ru/russkiymir/en/fund/about>.

Future prospects

Russia, it has been said, has been at a crossroads for the last 300 years: does it, or does it not, want to be part of the wider European or rather Atlantic Community? The hopeful answer is the common-sense one – yes. But the last decade suggests that the answer for now is no.

What might change that? Three possibilities, and one variable:

- First, Russia has come to depend not merely on raw materials resources, but on their increasing worth. Gazprom is creaking and the world energy market is changing. Investment is needed, and on a huge scale – in oil too. And that does not begin to cover Russia's wider investment needs. In 2005 the budget would have been in balance with crude oil at \$35 per barrel. In 2011 it is \$100 plus. The IMF report of 9 December 2010 was blunt: Russia has to cut back on its non-oil budget deficit. The variable: in an election year? And why would it be easier after 2011/12, with a new Duma and a president now elected for a six-year term? So far, Russia's leaders have taken the option of returning to deficit budgets to fund increasing social expenditure, with higher taxes an imminent prospect. The basic model of paying for imports, social peace and enhanced domestic demand by exporting raw materials is under threat.
- Second, modernization. Both Putin and Medvedev have urged the need for Russia to diversify its economy.¹³ Medvedev has gone further than Putin by recognizing, in principle, the link between diversification and political and social liberalization. That liberalization is not on the regime agenda, as the verdict in the second Khodorkovsky

trial demonstrated at the end of 2010. Current plans for modernization are limited to the hope of stimulating technological imports and investment from the West. That need and hope are part of the reason for the fitful rapprochement with the West. Tracking both Soviet and Russian versions of détente and rivalry with the West with domestic economic difficulties or success remains quite exact. A three-figure oil price points to tightening, not reform. The problem for the present ruling cabal is that genuine diversification and modernization would threaten their positions, but that a technological fix will not work by itself. It will be difficult, in any case, to attract larger scale Western investment if Russia is unable to stimulate demanded growth in the way it managed at the end of the 1990s, and particularly during the boom years between 2000 and 2008.

- Third, the WTO – and the same political variable. The gains from Russian entry would be considerable, as membership (always assuming that Russia lived up to its commitments) moved the country towards an open trade and investment model of development. But the competitive pressures on Russian enterprises would also be considerable, and particular interests, some of them close to the ruling elite, would be hurt. Adjustment to greater integration into the world economy and acceptance of its norms would not be easy. The ability of Moscow to bring in protectionist measures would be constrained, as Putin noted when increasing tariffs on automobile imports in 2010 and threatening to raise them again in 2011: 'We could not do this if we were in the WTO.'¹⁴ Russia's decision in the second half of 2011 on WTO entry will be

13 There have been all too many prescriptions over the years for the modernization of Russia, starting in this century with the Gref proposals which were prepared for Putin's election to the presidency in 2000 (see <http://www.kommersant.ru/documents/Strat1.htm>); continuing with 'Putin's Plan' (see e.g. http://www.twq.com/08spring/docs/08spring_gaddy.pdf) which ushered in Medvedev's succession and is generally supposed to have been the '2020 Strategy' then under discussion; a subset of documents covering Russia's Energy Future (<http://www.rg.ru/2003/10/07/energetika.html>); the aspirations recorded in a 2008 internet document by Medvedev, 'Forward Russia' (see <http://www.kremlin.ru/news/5413>); and now ideas being discussed with Putin about how to shape the economy from 2012 – after the coming election cycle is over. These prescriptions have worthy aspirations in common, and are often heralded in the West as harbingers of real change. But they consistently disappoint in practice. They will be forgotten quickly without clear priorities being set, and without the long-term, highly motivated political will to implement them.

14 http://www.vedomosti.ru/newspaper/article/244700/poshliny_ot_putina.

important. If it does at last join, its ability to exert pressure on neighbours by economic sanctions will be diminished.

There are two final points. Western soft power is a determinant too. Although the Russians often see it as a threat – and as often see the West as an aspiration – the West is a constant preoccupation for them. Western business figures prefer to avoid anything that smacks of politics, which they understandably see as interfering with the normality of profitable exchange. But they and their domestic political supporters could with advantage be less tolerant of the stream of repetitive sloganising that comes from Russia: is the Madoff analogy really with Khodorkovsky? A better comparison would be Sergei Mavrodi, who got a light sentence for his massive Russian pyramid scheme – but did anyone snort when at Davos in 2011 Medvedev defended the persecution of Khodorkovsky? Has Gazprom really been the victim of double standards in the EU? The West has a stronger voice in Russia than it knows, and should use it to understand, criticize and publicize Russian shortcomings, and Russian exploitation of Western weaknesses too. That would be part of an adult dialogue, not an attack on Russia, and needs to go beyond its present dimensions. Such a process would also be an inherent part of the most effective lever the rest of the world has to encourage Russia to move beyond its present restricting paradigm: WTO membership.¹⁵ WTO entry is often presented as being in the gift of the West, and the United States in particular. The truth is that it is up to Russia to negotiate its entry seriously and to obey the rules once it has joined. The prospects for that – once more – look reasonably encouraging.

‘The West has a stronger voice in Russia than it knows, and should use it to understand, criticize and publicize Russian shortcomings, and Russian exploitation of Western weaknesses too’

Secondly it is the combination of relatively easily acquired energy wealth and imperial nostalgia that has led Russia towards the coercive end of the soft power spectrum, and this governs Russian business and energy diplomacy no less than its more traditional approach to international affairs. The point was made at the beginning of this paper that the state and business in Russia have become inseparable. That will not always be so. Others too have thought that wider society would keep out of politics in exchange for the rulers nurturing prosperity. The longer Russia's rulers remain the prisoners of their great-power delusions the longer it will take Russia to develop its full business potential and its soft power influence. The last word should go to the Director of IMEMO, Aleksandr Dynkin, who said on 10 February 2010:

It seems to me that the longer Russia lulls itself in conservative romanticism [of being an energy superpower], dabbling at its imperialist tears, then the worse it will be for our competitiveness, and our security ... the idea of modernization ... should not be a modish slogan but a concrete project requiring a move to a different path of development altogether.¹⁶

15 See, for instance, the analysis 'Foreign Economic Policy at a Crossroads', in David G. Tarr and Natalya Volchkova, *Russia after the Global Economic Crisis* (Peterson Institute/Center for Strategic and International Studies of the New Economic School, June 2010).

16 Proceedings of INSOR conference to discuss the Institute's report on a 'Desirable Future for Tomorrow's Russia', p. 15, http://iph.ras.ru/upfile/root/prensa/russ_xxi/Stenogr.pdf.

The Means and Ends of Russian Influence Abroad

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