

## How Russia's Economic Recession Benefits Moscow Politically in its "Near Abroad"

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Over the short run, Russia's acrimonious relations with the West are serving the Kremlin's broader effort of heightening its influence in its "near abroad." In 2014, Russia was hit by a triple whammy of low oil prices, Western sanctions, and Moscow's counter-sanctions. During the following year, Russia's economic problems spread to states that have close economic, demographic, and political ties with it. However, a combination of drivers—risks of political instability and economic volatility in regional states, U.S. disengagement from the region, EU internal divisions, and Chinese regional projects not hiring as many locals as envisioned—has been forcing many post-Soviet states to cooperate more closely with Moscow. The Russian leadership has made it clear that it champions political stability above all and that despite Russia's budgetary problems, it is willing to provide military and security guarantees to regimes in the post-Soviet space.

### **Russia's Economic Crisis**

In March and July 2014, the West implemented a series of coordinated sanctions in response to Russia's annexation of Crimea and support for separatists in Ukraine's Donetsk and Luhansk regions. The sanctioning coincided with the launch of a new regional organization, the Eurasian Economic Union (EEU), which was established in May 2014 and consisted of Russia, Kazakhstan, Kyrgyzstan, Belarus, and Armenia. These states hoped to receive greater economic benefits from the open EEU market, but the declining trade and investment flows from Russia accompanied by the plunge of global commodity prices had a devastating impact on the national and local economies. This was the case even for Armenia and Kyrgyzstan, which joined the EEU more for Russian security guarantees than economic reasons.

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The Western sanctions triggered a large-scale exodus of financial capital from Russia: a \$47 billion reduction in foreign direct investments in 2014 and a further decrease of \$16 billion in 2015. Concurrently, the Organization of Petroleum Exporting Countries (OPEC) decided not to cut oil production and allow global crude oil prices to plummet due to slower demand and market surplus (in order to drive U.S. shale oil producers out of the market). Crude oil prices fell sharply from their peak of \$112 per barrel in June 2014 to \$59 per barrel in December, and declined further to below \$40 per barrel in 2015. This oil price plunge eroded the basis of Russia's economic growth.

Accordingly, Russia's GDP declined to 0.6 percent in 2014 and contracted 2.8 percent the following year (World Bank Group data). Russian counter-sanctions on European and American foods amplified inflationary pressures. As the value of the Russian ruble fell by 76 percent against the U.S. dollar in 2015, the prices for basic consumer goods increased by 30 percent. Although Russia's energy-dependent economy was on the mend in 2016 and 2017 on the backdrop of some recovery in oil prices, its industrial output contracted 3.6 percent in November 2017 year-over-year. Capital flight slowed down in 2016 but foreign investors [withdrew](#) a record \$900 million from Russian markets in 2017. These developments left the Russian economy in a precarious position going into 2018.

### **An Economic Bane for Russia's Post-Soviet Neighbors**

Russia's economic crisis and the decline of global oil and commodity prices has crippled the economies of EEU members and dampened economic growth among its regional non-EEU trading partners. By the end of 2014 and throughout 2015, the national currencies of Russia's neighbors depreciated between 25 percent and 55 percent against the U.S. dollar, despite the intervention of national banks. Belarus, for instance, whose overreliance on Russian capital has long negatively affected the country's economic performance, carried out a redenomination of its currency in 2016 by slicing four zeros off the Belarusian ruble. Armenia, Azerbaijan, Kazakhstan, Georgia, and Turkmenistan had to devalue their national currencies, while Kyrgyzstan and Uzbekistan resorted to big interventions in the currency market to halt the depreciation of the national currency.

These local currencies did not, however, weaken fast enough to avoid strengthening against the ruble. This, in turn, severely undercut the earning power of wages for the millions of labor migrants from Kyrgyzstan, Tajikistan, Uzbekistan, Belarus, Armenia, Moldova, and Ukraine who work in Russia. For the most remittance-dependent countries of the world—Tajikistan, Kyrgyzstan, and Moldova—the issue was particularly crucial. Personal [remittances](#) of Kyrgyz laborers, for example, fell by 26 percent from \$2.278 billion in 2014 (32 percent of Kyrgyzstan's GDP) to \$1.688 billion in 2015 (25 percent of GDP).

Russia's economic recession depressed consumer demand for exports from its neighbors, especially from the EEU states. In 2015, [trade turnover](#) between Kyrgyzstan and Russia declined by 21.7 percent, and this trend continued in 2016. Agricultural producers in Armenia and Belarus had hoped to benefit from Russia's counter-sanctions on food supplies from Europe, but the weak ruble and low customer demand resulted in reduced imports of foodstuffs from EEU states as well as from Tajikistan, Uzbekistan, and Azerbaijan.

Kazakhstan, the largest economy in the region and a country that does considerable trade with the EU, became more dependent on the EEU and Russia. Half of Kazakhstan's trade turnover is with the EU (energy resources are the bulk of its exports to Europe). The plunge in oil and commodities prices affected the European economies and volumes of trade. During the first nine months of 2015, Kazakhstan's [trade turnover](#) with EEU states fell by 25.8 percent, but its trade turnover with Eurozone countries decreased by 41.5 percent. This decline continued in 2016. Kazakhstan's [exports to the EU](#) fell by 21.4 percent and EU imports decreased by 16.1 percent. During this period, Russia continued to dominate Kazakhstan's imports (36.2 percent share) and together with other EEU members it accounted for nearly 41.6 percent of Kazakhstan's [imports](#) in 2017 (January-October).

In an effort to balance state budgets, regional governments were forced to slash spending on infrastructure, health care, education, and even salaries in the government sector. In 2015, Kyrgyzstan's total public debt [reached](#) 64.6 percent of GDP, and many state-owned enterprises were on the brink of bankruptcy. The government of Kazakhstan had to raise utility rates, while Turkmenistan's leader [ordered](#) an end to government subsidies that allowed citizens to receive free water, electricity, and gas since 1993.

### **A Political Boon for Moscow**

Even though Russia's recession and the global oil and commodities crisis had a distressing economic impact on Russia's neighbors, it afforded the Kremlin an opportunity to strengthen its political influence in these states. The crisis robbed the regional authoritarian governments of an important basis of their legitimacy, which is "discursively" connected to political stability and economic growth. Several states in the region that entered a period of austerity saw a rise in local dissent. For example, a wave of protests against new land code laws rippled across Kazakhstan in the spring of 2016. Thousands of Armenians took to the streets in four consecutive summers to protest price increases for public transportation and electricity, and to oppose pension reform. In 2017, Azerbaijanis staged unsanctioned protests in the wake of the central bank's ban on the sale of foreign exchange, and thousands of Belarussians were mobilized for rallies in response to a "parasites" tax levied against the unemployed. In all states of the region,

economic difficulties set in motion destabilizing political processes that threaten the stability of the ruling regimes.

Russia has traditionally played on these post-Soviet governments' concerns about political destabilization. Specifically, it has actively disseminated and profited from the fears of popular discontent fomented from abroad. It has branded itself as the only force to defend these regimes from subversion and coups, and Moscow successfully sold itself as a safe haven for toppled political elites.

Also, despite economic hardships, Moscow sustained or increased investments into the security and military sectors of its neighbors at a time when levels of U.S. security and economic assistance declined. In military terms, Russia [reinforced](#) its bases in Central Asia with new armaments and equipment. It [retained](#) its 7,500-troop presence at its base in Tajikistan. It moved closer toward its goal of creating a CSTO air defense system through the transfer of *gratis* air defense systems to Belarus and Kazakhstan. Special arrangements were made with Minsk and Astana to allow them to [procure](#) new short-range and medium-range surface-to-air-missile systems. Accordingly, Moscow's training of military and security personnel and joint exercises with the militaries of the region have continued unabated, and Russia spearheaded the first military exercises of the Counter-Terrorism Center of the CIS in May 2017. Not only were these the first exercises organized by the Center, but they also [involved](#) military personnel from Uzbekistan, a striking [shift](#) in the dynamics of Tashkent's relations with Moscow (the two have not held joint military exercise since 2005). By now, the membership of the EEU basically overlaps with the membership of the region's military alliance, the Collective Security Treaty Organization (CSTO).<sup>2</sup>

Overall, economic dependency on Russia by the most vulnerable neighboring states has increased. The crisis weakened some levers of Russia's economic influence in the region, but it also strengthened others, such as debt forgiveness and the regulation of labor migration. For example, the lion's share of Kyrgyzstan's GDP was in "shuttle trade" (the re-export of Chinese and Turkish products to former Soviet Republics). While Kyrgyzstan lost multi-million dollar profits from the shuttle business due to the EEU common tariff system (this led to a sharp increase in prices for imports coming from non-EEU states), it was able to re-settle its outstanding debt payments with Russia. The Russian government [decreed](#) the establishment of a \$1 billion Russian-Kyrgyz Development Fund to allow Kyrgyzstan take advantage of opportunities associated with its participation in the EEU. In another example, cash-starved Belarus [received](#) a \$700 million loan from Moscow for repaying its debt to Russia as well as loans from the

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<sup>2</sup> Current CSTO members are Armenia, Belarus, Kazakhstan, Kyrgyzstan, Russia, and Tajikistan (Tajikistan is not a member of the EEU). Afghanistan and Serbia are non-member CSTO observers, and Azerbaijan, Georgia, and Uzbekistan are former members.

Eurasian Fund for Stabilization and Development.<sup>3</sup> In a last example, by pardoning Uzbekistan's outstanding debt to Moscow, Russia had the opportunity to expand trade relations with Tashkent; in 2016, gas giant Gazprom [signed](#) a landmark agreement with UzbekNefteGaz to purchase natural gas from Uzbekistan, filling a void left by a complete suspension of energy trade with Turkmenistan.

From within the EEU, the Kremlin introduced new legal requirements for migrants and increased work permit fees for laborers from non-EEU member states. Roughly half of Tajikistan's working-age males labor in Russia, which gives Moscow leverage to pull Dushanbe into the EEU. Prior to the rollout of the EEU, Tajik laborers [sent home](#) \$3.696 billion in 2013 (49.2 percent of the country's GDP), while in 2016 they sent home \$1.867 billion (26 percent of Tajikistan's GDP), a nearly 50 percent decline in remittances. While so far the region's governments have been spared a labor migrant exodus from Russia, the consequences of their return to their home countries have been disconcerting for the ruling regimes.

### **Where Do We Go from Here?**

Economic crisis triggered by Western sanctions and low global energy prices presented Moscow with an opportunity to bolster its security, economic, and military influence in Eurasia. Whether Russia will be able to continue capitalizing on the economic vulnerability of these states depends on the state of its economy, its approach to the region, and external actors' policies. Historically, Moscow has pursued tactical and symbolic gains in Central Asia, while concentrating its efforts and resources in the European theater, which includes Georgia and Ukraine.<sup>4</sup> This focus has been retained despite the widening divide between Russia and the West triggered by Moscow's annexation of Crimea and support for insurgents in eastern Ukraine.

The new round of sanctions imposed by Washington on Moscow in August 2017 threatened foreign investors who hoped that tensions would ease between Russia and the United States under the Trump Administration. Instead, the pace of withdrawals of foreign funds from Russia increased in December 2017 in anticipation of a new round of U.S. sanctions against Moscow in 2018. The end of 2017 saw a contraction of Russia's industrial output that slowed down the projected GDP growth for 2017 to 1.4-1.8 percent. With crude oil prices expected to hover around \$64 per barrel in 2018, Russia's economy is predicted to grow rather slowly, by 1.8 percent (World Bank data). However, the absence of a coherent economic strategy and lack of investments into technology and innovation pose a risk of economic stagnation. Lastly, Russia's military spending and involvement in Syria have placed a drain on its limited resources.

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<sup>3</sup> This is an international finance institution established in 2009 by Armenia, Belarus, Kazakhstan, Kyrgyzstan, Russia, and Tajikistan to mitigate the negative effects of the global financial crises.

<sup>4</sup> Russia is engaging in information warfare and using other levers to weaken European solidarity and facilitate the decline of the EU.

Russia's economic challenges bear consequences for the economic performance of its neighboring states. More specifically, the countries that are dependent on Russia's energy producers targeted by the round of sanctions imposed in August 2017 will be particularly vulnerable to Moscow's economic slowdown. A rise in these countries' energy prices could generate a new wave of inflationary processes accompanied by public discontent. Whether Moscow decides to engage in negotiations over these energy prices as economic leverage or if it promises support to the ruling elites in case of a political crisis, Russia will be better off than its neighbors as a result of any new economic downturns.

China is the only economic counterweight to Russia for some states in the region, but it has also experienced an economic slowdown that affected external demand for its products and a decline in commodity prices. To be able to capitalize on its economic upper hand, Beijing has to be willing to lend and create joint ventures in the region. So far, the Chinese have been willing to invest in the construction of infrastructure related to their Silk Road economic projects, however Chinese-owned companies in Central Asia have hired mostly Chinese workers. Consequently, Central Asian governments and citizens feel somewhat threatened by the Chinese involvements and would like to see more joint ventures offering jobs for local workers, especially in the regions dealing with, or expecting, returnees from abroad.

## Conclusion

Economic volatility is a destabilizing threat to the region's authoritarian regimes. Their primary concern is with political instability under the shadow of potential high public resentment. Assistance measures from the EU and United States are not in the offing and views in the region toward China are mixed after a period of high hopes. Russia's acrimonious relations with the West are a particular problem for regional states, which are propelled to cooperate more closely with Moscow due to their lack of alternatives and the Kremlin's unabated outreach.

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