

# Russia and Multilateral Institutions

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Russia's current leadership recognizes the instrumental value of multilateral institutions and has adapted its foreign and economic policies to exploit them. This represents an important opportunity for the United States, whose major foreign policy objective toward Russia has been to promote its integration into the world economy. An integrated Russia is a more stable and less belligerent, more profitable and less unpredictable Russia. Russia's domestic institutions and international integration are developing in tandem, and it is not too late for Russia to develop along more democratic and market-oriented lines, or to slide deeper into authoritarianism and autarky. The best chance for the former is for multilateral institutions to present Russia with credible constraints and opportunities.

Unfortunately for Russia, however, U.S. foreign policy often finds reasons to use whatever leverage multilateral institutions afford to buy influence in Moscow. This undermines the incentives that these institutions provide for Russia to integrate its economy with the West. Long-term developments in Russia are far from the top of the Bush administration's foreign policy agenda, and other priorities may be more urgent. However, the habits of thought of the immediate post-Cold War era, which depended on a relatively cooperative and very weak Russia, will become increasingly inappropriate as Russia's economic potential emerges from its depression in the 1990s. Russia is becoming stronger and, within a decade, it will return to its former role as a major world power. U.S. interests will be best served over the next ten years if the opportunities that are available now are used to promote Russia's integration into the global economy.

### Russia's Economic Potential

Russia has enormous economic potential. It presides over the largest undeveloped territory on the planet with vast reserves of every natural resource. It has a highly educated, technically developed workforce, and a population large enough to support diversified industry and a powerful military establishment. Russia has suffered a catastrophic economic collapse in the last decade, comparable in economic terms to the destruction of World War II. GDP declined by 40 percent between 1991 and 1997, with the steepest declines in industry and construction; it grew for most of 1998 and then collapsed with the financial crisis. However, with the consolidation of appropriate institutions, Russia is poised to stage an equally dramatic recovery. In many respects, Russia's institutions have a long way to go: the weakness of the central tax authority, the uneven application of federal law across the widely scattered regions, the insecurity of basic property rights, and the tenuous influence of democratic institutions. Nevertheless,

under Vladimir Putin the first steps have been taken to consolidate the power of the central state and rationalize economic management. Last year, Putin finally succeeded in passing important legislation that had been bottled up for years: a reform that streamlined the tax system and established a new Labor Code and a new Land Code, a package of measures to reduce Russia's excessive regulatory burden on business, and a new pension system. In June 2002, the U.S. Department of Commerce changed Russia's classification to "market economy."

The results are beginning to be apparent. Russia's economy grew at annual rates of 8 percent in 2000 and 2001, and is expected to finish 2002 with 4 percent growth in spite of a global downturn. Russia's GDP in 2001 was \$350 billion, compared to \$280 billion in 1998. Russia continues to boast a strong current account surplus in spite of a 40 percent real exchange rate appreciation since 1998. Some of this is attributable to high oil prices, but not all of it. The Russian economy has begun to show signs that the long, painful transition has created the basis for international competitiveness in some sectors.

## The International Monetary Fund

Because of its current account surpluses and the fact that net capital drain abroad has slowed, Russia finds itself in the enviable position that its largest macroeconomic policy challenge is how to sterilize all the capital flowing into the country. In the process, the Central Bank of Russia has built up reserves of \$45 billion, and the government has run budget surpluses in excess of 2 percent of GDP for three years in a row, amassing substantial deposits at the Central Bank. The expansionary fiscal policy planned for next year means decreasing the size of the federal surplus. Several years ago, it seemed inevitable that Russia would have to return to the arms of the IMF when \$17 billion of official debt came due in 2003 but this year, Finance Minister Kudrin was able to tell the annual meeting of the World Bank and IMF confidently, "We do not anticipate any major difficulties in servicing this debt." Consequently, the IMF does not currently represent a constraint on Russia's policies, or a potential source of leverage over Russia.

## The World Trade Organization

Russia has been negotiating since 1993 to join the World Trade Organization (WTO), which with 144 members is one of the world's largest and fastest-growing clubs. With the successful conclusion of the Uruguay Round of trade negotiations, the cost of being excluded from the international trade regime rose, but so did the bar for countries seeking to join. The WTO now includes extensive rules on agriculture, public procurement, intellectual property rights (TRIPS), trade-related investment restrictions (TRIMS), and the service sector (GATS), which were areas traditionally ceded to domestic control.

Russia has labored over the last decade to build a market economy while subject to substantial trade discrimination from advanced industrial countries. Some of this discrimination is a legacy of the Cold War and has gradually been dismantled; some of it applies generally to non-members of the WTO; and some of it was adopted in response to pressure from domestic interest groups, such as steel producers in Europe who were threatened by Russian competition. Although Western countries have been fairly liberal with foreign aid—particularly when it helped them to promote their own exports—they

have been less willing to afford Russia equal trading privileges. This has complicated an already painful transition. With a small market, Russia does not have the leverage to negotiate deep cuts in foreign protection on a bilateral basis comparable to those provided automatically to all WTO members. Furthermore, Russia has an interest in participating in negotiations over the future rules of the international trade system, rather than being a passive bystander. This is particularly urgent after the successful launching of a new round of trade talks by the WTO Ministerial Conference at Doha last year. The current trade round covers controversial issues of great interest to Russia, such as rules about foreign direct investment and agricultural subsidies, and should be completed by 2005. If Russia failed to become a member in time, it could find the bar for joining the WTO raised again, perhaps to a level that Russia would be unwilling to meet.

In return for President Putin's strong support for U.S.-led intervention in Afghanistan, and as part of an informal package of emerging policy compromises ranging from National Missile Defense and strategic arms reduction to Russia's relationship with NATO, the Bush administration signaled a commitment to try to accelerate Russia's entry into the WTO. The G-8 members affirmed this objective at their meeting at Genoa, and the talks have moved forward significantly. The former director-general of the WTO, Mike Moore, has described Russia's accession talks as "entering a decisive and final phase," adding that "it would be a great failure of leadership if this accession was not completed in time for the Mexico Ministerial" in 2003.

It now appears likely that Russia's entry into the WTO will proceed on its new, accelerated timetable, and that Russia will succeed in implementing the still substantial array of domestic legislation necessary to bring it into formal compliance with the WTO regime. If WTO accession became too closely associated with U.S. foreign policy demands, however, this process could be derailed. The danger is that this would undermine the incentives for Russia to take the politically difficult steps necessary to reform its corrupt civil service and its energy monopolies. If it fails to make these key institutional reforms during the WTO-accession process, it will miss a historic opportunity to break the political stalemate, and Russia's long-term economic performance will be compromised. Furthermore, the political role of corruption has a corrosive effect on Russia's democratic institutions. The prospects of democratic development and economic development are intimately linked.

## Lessons for the Current Crisis

Russia's key interests in Iraq are oil, export markets, and debt collection. There are also secondary interests in reaffirming the importance of the Security Council, where Russia holds a veto, and in gaining legitimacy for Russia's own quixotic struggle against stubborn Islamic separatists. The United States could strike a variety of deals with Russia to secure its cooperation with, or at least tacit acceptance of, U.S. policy. In no case should it be necessary to bring the multilateral economic institutions into the bargain. Russia will be satisfied with an outcome in which its oil companies regain their concessions, its heavy and military industries regain their export market, and Iraq repays its Soviet-era debts. These are the dimensions on which the United States should reassure Russia if it seeks Russian support. These are the essential areas of Russian interest, and

concessions on these dimensions will do nothing to jeopardize Russia's integration into the global economy. To the contrary, this would settle an outstanding conflict of interest between the United States and Russia, smoothing the path toward cooperation once Russia's global power revives. On the other hand, efforts to link Russia's policy toward Iraq to its participation in multilateral institutions will further degrade the ability of these institutions to create incentives for Russia to reform itself and deepen the Russian public's mistrust of their purpose. In the not too distant future, the consequences of those choices could turn out to be much more significant to U.S. security than anything that takes place in Iraq.

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