

Russia's Economic Travails in the Wake of Georgia

Anders Åslund argues that the Russian economy has been jolted by problems following its invasion of Georgia in August, 2008, and that the West can exploit these difficulties as it tries to modify Russian behavior.

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Steve Weisman: This is Steve Weisman, editorial director and public policy fellow at the Peterson Institute for International Economics. It's my pleasure to welcome Anders Aslund today for questions and answers about Russia. Mr. Aslund is a senior fellow at the Peterson Institute and author, most recently, of *Russia's Capitalist Revolution*. Welcome, Anders.

Anders Åslund: Thank you.

Steve Weisman: You've written that Russia's economy took a blow following its invasion of Georgia in August. Tell us about that.

Anders Åslund: Well, the Russian stock market is today down 47% from the 22nd of May, in two and a half months, and all prices of Russian debt have sharply increased. This was the time when Russia needed to undertake serious reforms. Now, this will not happen. Russia also needed more foreign economic cooperation at this time, and they have chosen themselves not to stop their accession to the WTO, and this happens at a time when the oil prices have already fallen by one-third from the top, and one of the greatest booms of all time is coming to the end. So Russia will be hit.

Steve Weisman: How much of this hit do you attribute to Russia's decision to go into Georgia?

Anders Åslund: I would say that the recent tough behavior has caused about 20% of the stock market value. That would be \$300 billion. Of course, this is a low assessment, but seeing how it has fallen and how investors' behavior has changed, that would be my assessment.

Steve Weisman: Which investors pulled out of the Russian stock market? Were they foreign investors or Russian investors?

Anders Åslund: The first wave early in the summer was big Russian investors who clearly saw that the Russian policy is getting worse. This is normally the case. It's the locals who are best informed, so they know when to run first. And now the

Russian stock market has fallen so much that all of these investors that have margin calls, they are being forced to sell.

Steve Weisman: Do we know the identity of any of these Russian investors?

Anders Åslund: Two of the big investors were identified in the Russian press. One was Suleyman Kerimov, one of the big billionaires in Moscow, owner of Moskva-Nafta, who's primarily simply a stock investor, and also Moscow mayor Yury Luzhkov's wife Yelena Baturina. These were the two big sellers of Gazprom stocks.

Steve Weisman: Do these investors...What is their political relationship to the Russian leadership, in particular Prime Minister Putin and President Medvedev?

Anders Åslund: Well, they're all close to the leadership. Otherwise, they wouldn't be allowed to be there after the arrest of Yukos owner Mikhail Khodorkovsky in 2003. But of course they can't be happier.

Steve Weisman: This may be a matter of speculation, but what do you suppose is the attitude of Mr. Putin to the fleeing of investors, even those with whom he has some ties, from the Russian stock market?

Anders Åslund: I think that they are feeling the pressure, but I think that the main pressure on the Russian government comes through the bond market rather than the stock market, because the big state corporations, they finance themselves through loans rather than through equity, and there's an immediate sense of credit squeeze in Russia; \$60 billion went out of Russia immediately during the first week of the war in Georgia, and you may say that doesn't much matter if you start with \$600 billion. But it causes a credit squeeze for concrete banks that lost that concrete money. So therefore the negative effects are much bigger, I would assume.

Steve Weisman: Might there be any failures of financial institutions or banks in Russia as a result of this crisis?

Anders Åslund: Probably, we'll see some medium-sized banks that will go under, and it's difficult to say since Russia has more than 1,000 banks, who is most vulnerable. But the housing market has probably reached a peak since less money is coming in, and you know when a housing market falls, it normally continues falling for awhile, and many banks hold mortgages so that they would suffer from credit losses.

Steve Weisman: The West, in particular the United States and Europe, have been discussing ways of sanctioning Russia or putting pressure on Russia as a result of the invasion of Georgia. What does this situation tell us about how the West should respond?

Anders Åslund: Well, the first impression is that the West can't do very much because Russia is only 4% of its trade with the United States. So you could say that Russia could stop trading with the U.S. and it wouldn't really matter. So it's important for the U.S. not to believe that it has a significant economic leverage on Russia on its own. But the other thing is that Russia is now integrated into the world economy. So we are in a situation where sin punishes itself, and what is important for the West in this regard is rather not to try to impose sanctions and think of trade sanctions because then the West would be blamed and the impact would be minimal. And of course Russians in such a case would support the government.

Steve Weisman: But is there anything that the West could do to heighten the economic pressure on Russia that would be wise to do?

Anders Åslund: Indeed, I think that we should impose those parts of our agenda on Russia that we want to pursue also in normal times but are then not politically possible, more controversial points. And I think essentially there are two things: transparency and deregulation. And deregulation concerns particular the energy trade with Russia where we know that big state-controlled energy companies in Russia are massively corrupt, and this poses a lot of dangers. We can see that former German Chancellor Gerhard Schroeder is openly bought by Gazprom, or former minister of Finland, Paavo Lipponen, and there are many other politicians in Europe who are rumored to be bought by Gazprom. So what could be done here, part of it is financial transparency on behalf of companies operating in this country, part of it is to introduce an American-style foreign lobbyist registry in various European countries.

Steve Weisman: Can the Europeans use their anti-monopoly laws to go up against Gazprom or other Russian state-owned or state-linked companies?

Anders Åslund: Absolutely. To begin with, the EU has long evolved an energy policy that has not been fully adopted, which says that the same company should not produce, sell, and transport energy, and that is exactly what Gazprom does. So the strange thing is that the European Commission goes after Microsoft for anti-trust, which is quite a difficult thing to define, while it's not going after Gazprom with anti-trust measures, although Gazprom is today pursuing actions which should be totally impermissible from an ordinary anti-trust EU position. And on top of that, you have an EU energy policy. This is something that the European Union should do in any case, and it would also be good for EU-Russian energy cooperation in the long-term. It's only certain officials right now who benefit from that non-transparency and crooked business, and this should not be accepted. And now the European Union is likely to come together with a much stricter attitude towards Russia, from Germany and France before. So the EU policy, which always evolves quite slowly, is

becoming much more united than it was, and my hope is that we'll see the EU energy policy really becoming a reality rather soon.

Steve Weisman: Despite these problems, the Russian economy has many strengths, doesn't it?

Anders Åslund: Oh, sure. What we are discussing essentially is in the medium-term, for the next five years, will the Russian economy grow by 7% a year, or will it grow by 3.5 to 4% a year? This is the range between the plausible assessments. But we could see a sharp decline all of a sudden because there are so many problems that the Russian government has not attended to, and all of a sudden, they are becoming acute.

Steve Weisman: Finally, let me ask you whether you think that the next few years are going to be very difficult for Western-Russian relations.

Anders Åslund: Yes. I think that whatever we say about Russia, it's clear that Western policy, both U.S. policy and EU policy towards Russia, have been a complete failure in both the goals and the means, and therefore everybody now needs to go back to the drawing board and see how shall we handle Russia, which are the important issues, and how shall we go about that.

Steve Weisman: Well, as we go back to the drawing board, thank you very much for helping us sketch out what that drawing board might look like. Thank you, Anders Aslund, for spending time with us today.

Anders Åslund: Thank you, Steve.