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# The Post-Soviet Space: An Obituary

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Russia's relations with its post-Soviet neighbors reached an all-time low with the Russian-Georgian war in August 2008. How did Russia end up in this undesirable situation and what should it do to foster more constructive relations with its neighbors? In fact, the neighbors with which Russia has the best relations never belonged to the Soviet Union: China, Finland, and Norway.

Each former Soviet country has its own complaints, but the four dominant issues are Russia's lacking respect for territorial integrity, gas policy, trade policy, and finance. The Kremlin needs to fix each of these four policies to restore its reputation in the region. At the same time, foreign direct investment of private Russian corporations is proceeding with success and little concern. The big as yet untold story is the rapid advance of China into Central Asia, and in the west the European Union is showing new interest.

The best illustration of the current state of relations was the October 9, 2009 annual summit of the Commonwealth of Independent States (CIS) in Kishinev. The headline in *Nezavisimaya gazeta* said it all: "Summit in 30 Minutes. The CIS leaders...had nothing to tell one another."<sup>1</sup> The CIS had 12 members until Georgia left on August 18. From the remaining 11 members

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1. "Sammit na 30 minut. Liderami SNG, sobiravshimsya v Kishineve, nechego bylo skazat' drug drugu ["Summit in 30 Minutes. The CIS Leaders, Who Had Gathered in Kishinev, Had Nothing to Tell One Another"], *Nezavisimaya gazeta*, October 12, 2009.

only six presidents arrived—of Russia, Belarus, Ukraine, Armenia, Azerbaijan, and Kyrgyzstan—while the host Moldova temporarily had no president. Only one of five Central Asian presidents bothered to come. Needless to say, nothing was accomplished. To aggravate things further, President Dmitri Medvedev refused to meet Ukrainian President Viktor Yushchenko or Belarusian President Aleksandr Lukashenko. Everybody left quickly after their half-hour meeting. The CIS is Russia's baby and failure.

Arguably, Russia's relations with CIS countries are not better than they were in 1992. If the CIS does not have any positive contribution to make, why maintain it? All actual problem solving is done bilaterally in any case. The CIS stands out as a potential threat of Russian neoimperialism. Since Russia has neither apparent neoimperialist intentions nor the necessary resources to carry them out successfully, it should be in Russia's interest to close down the CIS and the suborganizations and establish normal bilateral relations with all the former Soviet republics. After all, the CIS was conceived as a vehicle for civilized divorce. As Yegor Gaidar, the author of the Belovezhskaya Pushcha agreements, wrote in his memoirs, this agreement was "the dissolution of the USSR by the three governments that had in 1922 been its founders."<sup>2</sup> By dissolving it, the CIS countries would recognize that they have achieved their aim.

## Dissolution of the Soviet Union

The collapse of the Soviet Union in 1991 was as sudden as it was dramatic. The implosion was multiple and overdetermined. It was fiscal, monetary, national, systemic, and political but not military or religious. Its grace was that no great empire disappeared as swiftly or peacefully: "By the standards of other collapsing empires the bloodshed has been remarkably small.... In the post-Soviet case almost no Russian civilians were killed or ethnically cleansed from any of the fourteen republics of the former USSR."<sup>3</sup>

Its very peacefulness and speed left many with the impression that the dissolution was not necessary. Today it is difficult to imagine how close Moscow was to war with some republics in 1990 and 1991. Not without reason, Boris Yeltsin accused Soviet President Mikhail Gorbachev of "a deceptive compromise that had the country a hair's breadth away from an inevitable bloodbath and war between the center in Moscow and the republics."<sup>4</sup>

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2. Yegor T. Gaidar, *Days of Defeat and Victory* (Seattle, WA: University of Washington Press, 1999), 124.

3. Dominic Lieven, *Empire: The Russian Empire and Its Rivals* (New Haven: Yale University Press, 2000), 379–80.

4. Boris Yeltsin, *The Struggle for Russia* (New York: Crown, 1994), 115.

After the August 1991 coup, the USSR ceased to function as a political entity in most regards. The three Baltic republics, Estonia, Latvia, and Lithuania, claimed their independence, and Yeltsin recognized them on August 24. Georgia, Armenia, Moldova, and Azerbaijan were well on their way toward national independence. The other republics were more hesitant, leaving Ukraine pivotal as the eighth of 15 union republics.

President Yeltsin thought strategically and moved radically on three issues. First, he secured power. Second, he dissolved the Soviet Union, thus easing the national tensions. Third, he focused on the rampant economic crisis, which demanded instant deregulation and financial stabilization.<sup>5</sup>

He understood that the Soviet Union could no longer survive and it had to be dissolved before he could proceed with other policies. Yeltsin presented union dissolution as a positive choice: "I was convinced that Russia needed to rid itself of its imperial mission."<sup>6</sup> On December 1, 1991, Ukraine voted with 90 percent majority for independence. Yeltsin acted instantly. In complete secrecy, he organized a meeting one week later in Belarus with the heads of state of Ukraine and Belarus. Together these three men dissolved the Soviet Union. As Yeltsin saw it: "In signing this agreement, Russia was choosing a different path, a path of internal development rather than an imperial one." He insisted that this was "a lawful alteration of the existing order," because it "was a revision of the Union Treaty among [the] three major republics of that Union."<sup>7</sup>

As a replacement for the USSR, they set up the loose Commonwealth of Independent States, which appeared most inspired by the British Commonwealth. Yeltsin wanted a minimal organization without supernational power: "There will be no coordinating organs.... If there is coordination, it will be between the heads of state of commonwealth members. They will have some kind of a working group to resolve certain questions, and that's it."<sup>8</sup>

Most of the other Soviet republics wanted to join the CIS. Yeltsin accommodated them. On December 21 in Kazakhstan's capital Almaty, the CIS was expanded to include 11 republics, while Georgia and the already-independent Baltic states stayed outside. The treaty of 1922 on the formation of the Soviet Union was formally abrogated. In 1993, Georgia also joined the CIS, increasing the membership to 12, though not all of them ratified the CIS charter, leaving the organization legally indeterminate.

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5. I discuss this in detail in my book *Russia's Capitalist Revolution: Why Market Reform Succeeded and Democracy Failed* (Washington: Peterson Institute for International Economics, 2007).

6. Yeltsin, *The Struggle for Russia*, 115.

7. *Ibid.*, 113. That some people still embrace the idea that the Soviet Union could have remained viable just shows the success of Yeltsin's sudden dissolution of it.

8. "'We Are Taking Over,'" interview with Yeltsin, *Newsweek*, January 6, 1992, 13.

Yeltsin refrained from making any claims on behalf of Russia on territories of other former Soviet republics. By respecting existing borders, Yeltsin left a valuable, peaceful legacy. The integrity of the existing borders between the union republics was enshrined in the CIS treaty and bilateral friendship treaties between Russia and most CIS members.

On December 25, 1991, the Soviet Union was formally dissolved. Surprisingly few problems remained unresolved. One was the four so-called frozen conflicts—unregulated, separatist territories outside the control of the national government, the Moldovan province of Transnistria, the Georgian territories of Abkhazia and South Ossetia, and the Azerbaijani autonomous territory of Nagorny Karabakh, which was controlled by ethnic Armenians. The leaders of the first three territories were pro-Russian, and the Kremlin supported them with troops.<sup>9</sup>

Military issues were resolved with impressive ease, as military assets were divided as other property. The biggest issue was the ample nuclear arms. In 1992 Ukraine was actually the third largest nuclear power in the world. By June 1996, even Ukraine had transferred all its nuclear arms to Russia, as had the others. This was an amazing achievement in containing the proliferation of nuclear arms. In these multiple multilateral and bilateral agreements, Russia made strong commitments to the national sovereignty and territorial integrity of the other former Soviet republics.<sup>10</sup>

One of the worst remaining problems was the common currency zone. A competitive issue of ruble credits had erupted between 15 newly formed republic central banks. The more ruble credits one republic issued, the larger share of the common GDP it extracted, but the higher overall inflation became. Everybody had a strong incentive to pursue a more expansionary monetary policy than others, but as a consequence all were worse off. In 1993 the Central Bank of Russia finally terminated the ruble zone by declaring old Soviet banknotes null and void. This action caused panic and compelled all remaining members of the ruble zone to establish their national currencies within the next few months.<sup>11</sup> As the dysfunctional ruble zone lingered for so long, 10 of the CIS countries experienced hyperinflation. The end of the ruble zone made monetary stabilization possible and completed the separation of the CIS countries. Contrary to popular views, there was no other solution. No preconditions for an orderly currency union were present. Any comparison with the European monetary union, which was then being formed, is misplaced.<sup>12</sup>

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9. Nagorny Karabakh did not involve ethnic Russians or Russian forces.

10. James M. Goldgeier and Michael McFaul, *Power and Purpose: U.S. Policy Toward Russia after the Cold War* (Washington: Brookings Institution, 2003).

11. Brigitte Granville, *The Success of Russian Economic Reforms* (London: Royal Institute for International Affairs, 1995).

12. Anders Åslund, *How Russia Became a Market Economy* (Washington: Brookings Institution, 1995).

## CIS: A Patchwork of Trial and Error

After the Soviet Union had been dissolved, the newly independent states had to establish new relations.<sup>13</sup> The CIS evolved in fits and starts. Almost every year, an attempt was made to set up a new organization with some CIS countries, but none of these organizations has proven successful. They have fallen by the wayside and been neglected. Instead of resolving the problems with the failed organization, Russia has instigated setting up a new suborganization to the CIS.

In Russia, two approaches have existed. Yeltsin wanted the CIS to be like the British Commonwealth, but his view was shared by only a small liberal minority. The dominant Russian view was that the Soviet demise was a tragedy and that as much as possible of this great power should be maintained and restored. These two lines of thought found an uncomfortable compromise in the idea that the CIS should become like the European Union. But Russia contained half of the former Soviet population, and most of its economy, so Russia would naturally constitute a majority, which was unacceptable to the other CIS countries.

The attitude of the other CIS states varied with their view of Russia. Essentially, they were divided into a group of five close friends to Russia and six that preferred to keep Russia at arm's length.

Among Russia's five friends, Belarus wanted the tightest links to Russia. For geographical and ethnic reasons, Kazakhstan was compelled to be close to Russia. The three small and poor nations of Kyrgyzstan, Tajikistan, and Armenia, none of which borders on Russia, desired Russian protection and economic support. With its allies, Russia has formed a customs union, the Eurasian Economic Community (EurAsEc), and a military pact, the Collective Security Treaty Organization (CSTO). Another group of six CIS countries kept greater distance from Russia. Ukraine, Moldova, Georgia, and Azerbaijan desired to be quite independent from Russia but favored trade cooperation with Russia. Together, they set up the alternative organization GUAM (stands for Georgia, Ukraine, Azerbaijan, and Moldova) in 1997. Georgia waited to join the CIS for more than a year and formally departed from the CIS on August 18, 2009. Uzbekistan tended to keep a distance from Russia but joined both the EurAsEc and CSTO briefly from 2006 and 2008, when their bilateral relationship temporarily improved. Turkmenistan has been outright isolationist. Ukraine and Turkmenistan never ratified the CIS statutes and do not consider themselves members, only participants.

As a consequence, the CIS became paradoxical in many ways. It was important in protocol terms, holding annual summits with heads of state

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13. Martha Brill Olcott, Anders Åslund, and Sherman Garnett have elaborated on the evolution of the CIS in *Getting It Wrong* (Washington: Carnegie Endowment for International Peace, 1999).

and annual prime ministerial meetings. But little of significance was accomplished multilaterally, while bilateral meetings were vital. When a multilateral agreement was concluded, about half the CIS countries closest to Russia usually signed on, but hardly any ratified an agreement, so few came into force. Even ratified agreements were not necessarily complied with because there were no mechanisms for surveillance, arbitration, or penalty. Only 4 percent of CIS decisions actually resulted in national legislation.<sup>14</sup>

By and large, multilateral attempts at cooperation failed, because Russia aspired to closer cooperation than any other state. In reality, relations between Russia and the former Soviet republics have been predominantly bilateral.

## Territorial Integrity or the “Biggest Geopolitical Disaster of the Century”

For the newly born CIS states, the most fundamental issue was security: Russia’s respect for their national sovereignty and territorial integrity was sine qua non for their cooperation with Russia. They knew only too well that Yeltsin’s view of the demise of the Soviet Union was a minority Russian view.

Unlike Yeltsin, President Vladimir Putin had all along expressed nostalgia about the Soviet Union. In his interview book *First Person* Putin stated: “We would have avoided a lot of problems if the Soviets had not made such a hasty exit from Eastern Europe.” He expressed sympathy with the putschists in August 1991: “In principle, their goal—preserving the Soviet Union from collapse—was noble....”<sup>15</sup>

As president, Putin took some time to develop his policy on the former Soviet republics, and in his first term it was passive. In his second term, Russia’s policy toward the CIS was dominated by the so-called colored revolutions in Georgia, Ukraine, and Kyrgyzstan, and gas trade. In his annual address in April 2005, Putin went all out: “the collapse of the Soviet Union was the biggest geopolitical disaster of the century.... Tens of millions of our co-citizens and compatriots found themselves outside Russian territory...old ideals [were] destroyed.”<sup>16</sup> He presented himself as a neoimperialist.

The Moldovan government has persistently wanted to restore its national integrity over Transnistria, and so has the Georgian government

14. “Yushchenko ne ponravilsya sammit SNG” [“Yushchenko Did Not Like the CIS Summit”], [www.rosbalt.ru](http://www.rosbalt.ru), October 9, 2009.

15. Vladimir V. Putin, *First Person* (New York: Public Affairs, 2000), 81, 93.

16. Vladimir V. Putin, Annual Address to the Federal Assembly of the Russian Federation, April 25, 2005, [www.kremlin.ru](http://www.kremlin.ru).

over Abkhazia and South Ossetia, whereas Moscow seems to have appreciated the complication. In 2006 these conflicts escalated, and Russia suddenly embargoed Georgia's and Moldova's large exports of wine and fruits to Russia. It also blocked most transportation to and from Georgia and even bank transactions. Georgia played hardball, revoking its bilateral protocol on Russia's accession to the World Trade Organization (WTO), thus blocking Russia's entry into that organization, of which Georgia was already a member.

In January 2008 the United States started campaigning for a Membership Action Plan to the North Atlantic Treaty Organization (NATO) for Ukraine and Georgia, but most of the European NATO members were surprised and some opposed. The issue came to a crunch at the NATO summit in Bucharest in April 2008. The summit did not offer a Membership Action Plan to Ukraine, but its communiqué stated boldly: "NATO welcomes Ukraine's and Georgia's Euro-Atlantic aspirations for membership in NATO. We agreed today that these countries will become members of NATO."<sup>17</sup>

President Putin also attended that NATO summit. In a closed meeting on April 4, 2008, he intimidated Ukraine. He disqualified Ukraine's claim to sovereign statehood and territorial integrity, reversing Yeltsin's policy and contradicting the 1997 Russian-Ukrainian Treaty on Friendship, Cooperation, and Partnership. He suggested that Ukraine's composition was artificial, its borders arbitrary, and the transfer of Crimea to Ukraine illegal.<sup>18</sup> More nationalist Russian politicians, notably Moscow Mayor Yuri Luzhkov, went much further, claiming that Sevastopol and Crimea belonged to Russia. In June 2008 Luzhkov stated: "Sevastopol was never given to Ukraine. I have studied all basic documents carefully, and I can make such a declaration."<sup>19</sup>

As president, Putin routinely confirmed Russia's commitment to Georgia's territorial integrity, but from 2006 Georgia became the focal point of Russia's CIS policy. From April 2008, Russia stepped up its engagement in Abkhazia and South Ossetia contrary to various international agreements.<sup>20</sup> In early August 2008 military action escalated in the secessionist Georgian territory of South Ossetia. On August 7, Georgian troops entered South Ossetia but were immediately rebuffed by well-prepared

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17. Bucharest Summit Declaration, issued by the Heads of State and Government participating in the meeting of the North Atlantic Council, Bucharest, April 3, 2008, [www.nato.int](http://www.nato.int).

18. "What Precisely Vladimir Putin Said at Bucharest," *Zerkalo nedeli*, April 19, 2008.

19. "Luzhkov izuchil vopros Sevastpoloya i reshil, chto ego ne peredali" ["Luzhkov Studied the Sevastopol Question and Decided that They Had not Transferred It"], *Ukrainskaya pravda*, June 24, 2008.

20. Andrei Illarionov, "The Russian Leadership's Preparation for War, 1999-2008," in *The Guns of August 2008: Russia's War in Georgia*, ed. Svante E. Cornell and S. Frederick Starr (Armonk, NY: M. E. Sharpe), 68-72.

and overwhelming Russian troops, which secured South Ossetia and Abkhazia and occupied some other parts of Georgia. The Russia-Georgian war lasted only five days, August 8 to 12.

On August 26, 2008, the Kremlin dealt the most devastating blow to its own standing in the post-Soviet space by recognizing the sovereignty of Abkhazia and South Ossetia. Russia broke with its long-standing principles of respect for national sovereignty and territorial integrity inscribed in the Organization for Security and Cooperation in Europe (Helsinki) convention (OSCE), the CIS convention, and multiple bilateral friendship treaties with CIS countries. Its excuse was that Kosovo had declared independence from Russia's friend Serbia, but in the process Russia abandoned its broadly shared principle not to recognize secession. Many countries had considered Kosovo an extreme case, but few reckoned that South Ossetia or Abkhazia belonged to this category. South Ossetia was just too small with only a few tens of thousands of people, and in Abkhazia the Abkhaz had not been more than the third largest ethnic group for decades. In spite of considerable Russian pressure, no CIS state recognized them because ultimately it concerned their own sovereignty. Russia scared even its closest allies, Belarus and Kazakhstan, which harbor large Russian ethnic populations. After the war in Georgia, President Medvedev stated that Russia had "regions with privileged interests," referring to "close neighbors."<sup>21</sup>

Russia's actions confirmed that it had become a revisionist power in the region, preoccupying all the other CIS countries with their national integrity vis-à-vis Russia. Needless to say, they all rushed to the exits as fast as they could. If Russia is their main national threat, they have no need for the CSTO, which presupposes that these countries face common external threats. The Kremlin needs to restore its respect for its neighbors' territorial integrity to be able to improve its relations with them.

## Gas Policy: More Aggressive than Successful

In its gas policy Russia has shown little respect for its neighbors.<sup>22</sup> As the former Soviet Ministry of Gas Industry, Gazprom lives in symbiosis with the Russian government and plays a unique political role outside Russia's borders. Its actions comprise an uneasy mixture of commerce, politics, and apparent conflicts of interest.

Since 2005, Gazprom has hiked prices, which had remained artificially low since the Soviet era. It has claimed to depoliticize prices but has boosted them in big steps, which have varied greatly between countries. Prices were raised faster for weak and not very friendly countries, such as

21. "Dmitri Medvedev's Interview with the television channels 'Rossiya', the First Channel, and NTV," [www.kremlin.ru](http://www.kremlin.ru), August 31, 2008.

22. Russia's gas policy in general is discussed in chapter 7.

Georgia and Moldova, than for Russia's close ally Belarus. Neither the old nor new prices have been set by any objective standard. No world market prices exist for piped natural gas, as all prices depend on local demand and supply through one or few pipes, but Gazprom has long solved that problem in Europe through an agreed pricing formula.

In recent years, Gazprom has repeatedly cut gas supplies to many countries. Georgia, Azerbaijan, Moldova, Ukraine, and Belarus have experienced several such cuts. In January 2006 Gazprom turned off gas to and through Ukraine, which transits 80 percent of Gazprom's exports to the European Union. In January 2007 it meted out the same treatment to Belarus, the Kremlin's closest ally, through which the remaining 20 percent of Russia's gas deliveries go to the European Union. The worst disruption occurred in January 2009, when Gazprom cut off all gas deliveries through Ukraine. Few disagree with the principle of gradual transition to market prices, but the transition needs to be transparent and founded on agreed principles; frequent supply disruptions are unacceptable.

For years, Gazprom has tried to exchange gas arrears for gas pipelines in debt-equity swaps in customer countries. It has succeeded in doing so in several countries, notably Belarus and Moldova, but these countries have not found it any easier to reach agreements with Gazprom. Instead, Russia is attempting to resolve its persistent problems with gas transit through Ukraine and Belarus by building alternative gas pipelines that bypass these two countries, Nord Stream through the Baltic Sea and South Stream through the Black Sea and the Balkans.

Another Gazprom strategy is to extend monopolistic control over transportation, production, sales, and purchases in all directions through long-term contracts, trying to monopolize gas supplies from Central Asia. But when European gas demand and prices dropped, Turkmenistan's gas pipeline to Russia blew up as did two gas pipelines to Georgia in January 2005.<sup>23</sup> After the pipeline was repaired, Gazprom refused to accept the contracted volumes or pay the agreed price. Not surprisingly, the Turkmens instead turned to the Chinese, who have just built a large gas pipeline to Turkmenistan and are now preparing to buy most of Turkmenistan's gas exports, as is already the case with Kazakhstan. Turkmenistan has also shown interest in a Transcaspien gas pipeline to Europe.

## Well-Intentioned but Unsuccessful Trade Policy

In trade, Russia has proven good intentions but has not been very successful. The CIS has long tried but persistently failed to establish a well-functioning free trade area.<sup>24</sup> The fundamental problem is that Russia has been

23. "Russia Blamed for 'Gas Sabotage,'" BBC News, January 22, 2006, news.bbc.co.uk.

24. An excellent overview of CIS trade policy is Sherzod Shadikhodjaev, "Trade Integration

trying to reinvent the wheel with its own free trade agreements (FTAs) in an area where Russia has neither knowledge nor body of conventions. When it should have leaned on the established trade framework of the WTO. Having tried all the alternatives, it is now time for Russia to turn to the WTO (see chapter 10).

In the aftermath of the Soviet collapse, trade between the former Soviet republics dwindled from 1991 to 1994. One of the chief goals of the CIS was to facilitate mutual trade. In September 1993 CIS countries signed a treaty on an economic union. It was highly ambitious, supposed to lead to a free trade area, a customs union, a common market, and a currency union, but it was concluded just as the ruble zone was falling apart. It was declarative rather than operative and was never taken seriously.<sup>25</sup>

In April 1994, all the CIS countries, except Turkmenistan, signed a multilateral FTA. However, some countries, including Russia, never ratified it, so it has never come into force. An attempt was made to revive it in April 1999 through an additional protocol, but Russia never ratified that either. Still, the CIS FTA functions as a model agreement.

Instead, most CIS countries have concluded bilateral FTAs, which have been ratified but lack legal teeth. Whenever one country wants to undertake protectionist measures against another, it does so with impunity because detailed rules, arbitration, and penalty mechanisms are missing. For example, in 2006 Ukrainian vodka producers seized one-quarter of the Russian vodka market, which led to prohibition of their imports. Two years later, a Kyrgyz cement factory made headway into the Kazakh market but suddenly faced a prohibitive 100 percent import tariff and was forced to stop production until it was sold to a Kazakh businessman. Examples of prohibitions, quotas, and high tariffs abound. As a consequence, trade within the CIS is often disrupted, as successful exporters are blocked through quotas, tariffs, or outright prohibitions.

Because FTAs malfunctioned, Russia and its closest allies aimed at a customs union. In January 1995, Russia and Belarus signed an agreement on a customs union, which Kazakhstan joined. Kyrgyzstan and Turkmenistan signed on in 1996 and 1999, respectively. But the parties neither knew how to form a customs union nor could agree on it. Instead of giving up, they decided to form EurAsEc in 2000. It was designed to be a customs union and a common economic space, inspired by the European Union, but in reality little happened. Uzbekistan joined in 2006 for foreign policy reasons but suspended its membership in 2008. EurAsEc persists as a bureaucratic structure of little significance.

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in the CIS Region: A Thorny Path towards a Customs Union," *Journal of International Economic Law* 12, no. 3 (2009), 555–78.

25. Constantine Michalopoulos and David G. Tarr, "The Economics of Customs Union in the Commonwealth of Independent States," *Post-Soviet Geography and Economics* 38, no. 3 (1997): 125–43.

True to its habit, Russia initiated a new, even more ambitious, pact rather than mending the old, failed one. In March 2003 it launched the Common Economic Space (CES) for Russia, Ukraine, Kazakhstan, and Belarus. The CES was supposed to start as a free trade area, become a customs union, and eventually a currency union, again modeled on the European Union. But it was an evident ploy to tie Ukraine closer to Russia before the presidential elections in late 2004. When Moscow's candidate lost, the CES lost meaning, but its structures linger.

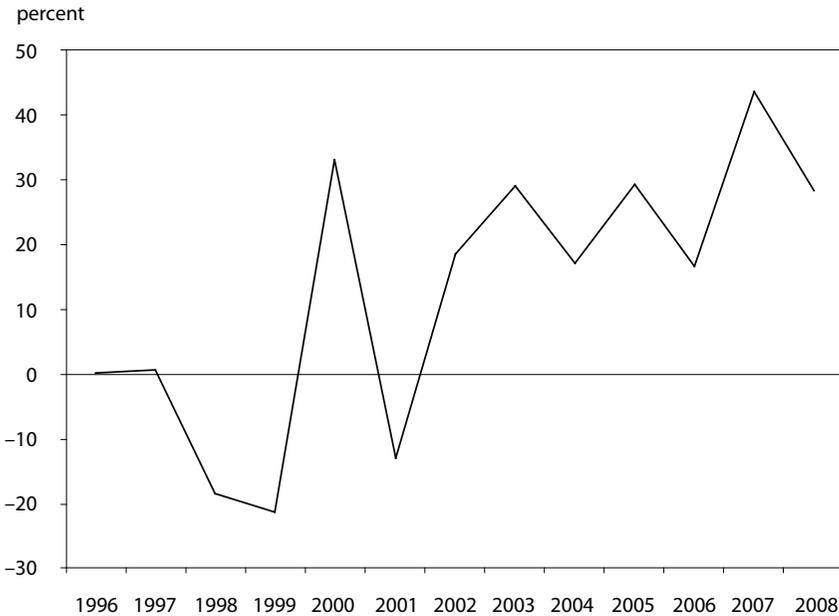
In all these endeavors, no attempt was made to find a mechanism to reinforce the desired free trade. The resolution is evident: WTO accession for all. The WTO has the requisite rule book, arbitration, and penalties. Many WTO members use these WTO instruments to give teeth to their FTAs. Five CIS countries—Kyrgyzstan, Georgia, Moldova, Armenia, and Ukraine—have become members of the WTO, but Russia has failed to do so. It should be in Russia's interest to join the WTO as soon as possible and bring in the other CIS countries as well.

In June 2009, when Russia was close to WTO accession, Prime Minister Putin surprised everybody, including his own cabinet, by stating that Russia, Belarus, and Kazakhstan would enter the WTO as a customs union. WTO Secretary General Pascal Lamy declared that this was impossible. Putin also declared that the customs union was as important as the WTO to Russia, which is rather surprising as Russia's attempts to form a customs union with these two countries have yielded no success since 1995.

Russia, Kazakhstan, and Belarus are no natural partners for a customs union because their economic interests and structures vary greatly. Kazakhstan is largely a raw material exporter, and Belarus an exporter of the best Soviet-manufactured goods. Russia, with its large but substandard manufacturing, is inclined to impose high import tariffs, but Kazakhstan and Belarus want none of it. In early 2010, Kazakhstan insisted that 409 items be excluded from Russia's higher import tariffs; the list includes major import items such as cars, which Kazakhstan barely produces. Another conflict concerns Russia's low energy prices because of price regulation and export tariffs. Belarus has persistently demanded that Russia's low domestic energy prices also apply to it and has refused to accept export tariffs because of the purported customs union, which has led to severe supply disruptions. The benefits of this customs union remain doubtful.

In spite of persistent trade disputes, trade of and between the CIS countries has skyrocketed. From 2002 until 2008, total CIS trade rose by an average of 26 percent a year (figure 11.1), and the unweighted average of their mutual trade is about 40 percent of their total trade (table 11.1). The country that trades the least with the CIS is actually Russia, which has only about 15 percent of its trade with the region, so the weighted average is only about 20 percent. Yet this is natural for a big country and does not say anything about Russia's policy intention, rather a lot about how captive the others are because of geography and infrastructure.

**Figure 11.1** Average annual increase in intra-CIS trade, 1996–2008  
(percent)



CIS = Commonwealth of Independent States

Note: Figure includes trade with Mongolia, but this amount is insignificant. The average annual increase is an unweighted average of the sum of exports and imports.

Sources: IMF, *Direction of Trade Statistics*, October 2009; author's calculations.

At first sight, the persistence of CIS trade might appear surprising, but a cursory look at the map explains it. Many CIS countries are land-locked, and distances over land are enormous. Poor transportation and barriers to trade limit their choices of trade partners. Often, disruption of trade does not mean diversion of trade but no trade or production at all.

Russia's persistent failures to build a customs union and a currency union are not haphazard but based on fundamental theoretical flaws, so there is no reason to believe in success in the foreseeable future (see chapter 10).<sup>26</sup> Even so, Russian leaders persistently advocate a customs union and a currency union, which only hurts Russia's national interests. In the early 1990s, Russia lacked trade expertise, but a decade later such expertise had evolved and a rational trade policy should have been possible. Even so, the Russian government has insisted on reinventing the wheel again rather than opting for free trade before a customs union and adopting the nearly universally accepted WTO rules.

26. Anders Åslund, "The Ruble as a Global Reserve Currency? No!", *Moscow Times*, September 23, 2009.

**Table 11.1 Intra-CIS trade, 2000-08** (percent of total trade, unweighted average)

Country	2000	2001	2002	2003	2004	2005	2006	2007	2008
Armenia	21	25	27	25	25	26	29	32	30
Azerbaijan	21	18	23	23	25	28	26	26	7
Belarus	66	65	62	63	63	56	55	57	56
Georgia	35	37	40	37	40	42	39	36	32
Kazakhstan	34	38	32	32	31	29	30	31	31
Kyrgyzstan	48	45	46	47	52	56	55	59	52
Moldova	43	47	45	46	46	44	45	35	37
Russia	19	13	17	18	13	15	12	15	14
Tajikistan	65	56	50	44	44	47	41	46	44
Turkmenistan	46	48	44	45	50	54	55	55	48
Ukraine	44	42	38	36	39	40	39	40	38
Uzbekistan	45	44	41	40	43	45	43	45	50
Total Intra-CIS trade	41	40	39	38	39	40	39	40	37

Sources: IMF, *Direction of Trade Statistics*, October 2009; author's calculations.

## Foreign Direct Investment: Quite Fortuitous

Russian foreign direct investment has skyrocketed since 2000 and has not been too controversial. In September 2003 Anatoly Chubais, then CEO of Russia's Unified Energy Systems, aroused an outcry when he pronounced the concept of "liberal imperialism," effectively saying that Russia would regain its influence in the former Soviet Union through corporate investment.<sup>27</sup>

Yet, Russia's private corporations have mainly been driven by commercial interests. They have invested grandly in other post-Soviet states, most of all in Ukraine. Their rights as investors have become a major issue of Russian policy. These investments have rarely been political but comply with the textbook of foreign direct investment. They have been initiated by Russian corporations, private or state-owned, and the Russian state has supported its companies abroad as any other state would. First, Russian oil companies undertook downstream investment in oil refineries and chains of gas stations, pursuing vertical integration. Second, Russia's metallurgical companies and retail chains went ahead with horizontal integration, that is, doing on a larger scale what they already did so well at home. Third, Russian consumer and mobile phone companies extended their successful business model abroad.

Russian foreign direct investment in the post-Soviet region has been huge.<sup>28</sup> Political reaction to it has been very limited because it has been so obviously commercial. Another reason is that Russian companies have competed with local companies on a fairly level playing field. The most controversial Russian investments in the CIS have been the biggest ones relative to the national economy (Rusal wanting to purchase the dominant Tajik aluminum company) and all state corporation purchases of infrastructure, notably Gazprom's debt-equity swaps to acquire pipelines.

## Russian Financial Assistance to Counter the Global Financial Crisis

The global financial crisis offered Russia new possibilities of playing a major, helpful role in the CIS. The Russian government assumed this challenge. It provided mainly cofinancing to International Monetary Fund (IMF) agreements to Armenia (\$500 million), Belarus (\$2 billion), Kyrgyzstan (more than \$2 billion), and Moldova (\$500 million). It also initiated

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27. Igor Torbakov, "Russian Policymakers Air Notion of 'Liberal Empire' in Caucasus, Central Asia," *EurasiaNet.org*, October 27, 2003.

28. Keith Crane, D. J. Peterson, and Olga Oliker, "Russian Investment in the Commonwealth of Independent States," *Eurasian Geography and Economics* 46, no. 6 (September 2005): 405–44.

a EurAsEc financial assistance fund of \$10 billion, of which Russia would contribute \$7.5 billion and Kazakhstan \$1 billion.<sup>29</sup> With its \$598 billion of international currency reserves in early August 2008, Russia seemed eminently equipped to relieve its poorer neighbors.

Yet the financial assistance has caused considerable chagrin. Not very surprisingly, Russia and Ukraine never succeeded in agreeing on tentative stabilization credit of \$5 billion. Belarus, Kyrgyzstan, and Moldova all complained about not getting all the money promised. Belarusian President Aleksandr Lukashenko stated publicly about the Russian leaders: "It came to the point that they came and said: You recognize Ossetia and Abkhazia and you receive \$500 million."<sup>30</sup>

EurAsEc's financial assistance fund seems to have stayed on paper. The reasons for Russia's partial fulfillment were real disagreements, which differed in each case. Its neighbors were not very appreciative of Russia's assistance, because only about half of the promised assistance was actually disbursed.

As Vladimir Ryzhkov concluded:

The Kremlin was not able to exploit its huge reserves that it accumulated after eight years of an oil boom by turning its economic power into political clout in the global arena. On the contrary, Russia's global standing has worsened across the board. Russia's leaders have managed to alienate even its strongest allies.<sup>31</sup>

## China's New Expansive Role

Nature abhors vacuum, but Russia has taken this vacuum as a given. That is no longer true. The big new factor in the region is China. For a long time, China seemed exceedingly cautious and constrained. Credibly, Chinese officials claimed that their interests in the former Soviet Union were limited to political stability in Central Asia.

As the Chinese economy has surged and trade liberalization proceeded, trade has exploded between China and most of the region. Relations between China and the post-Soviet region reached new heights with the formation of the Shanghai Cooperation Organization (SCO) in 2001. It has six members: China, Russia, and four Central Asian countries, Kazakhstan, Uzbekistan, Kyrgyzstan, and Tajikistan. The SCO maintains both security and economic aspirations and has brought Central Asia much closer to China.

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29. "Central Asia: Eurasian Economic Community to Set up Financial Crisis Fund," EurasiaNet.org, February 4, 2009.

30. "Belarus-Russia—Mutual Accusations, Trade War Cause New Crisis," Open Source Center, June 25, 2009.

31. Vladimir Ryzhkov, "Kremlin Burning Bridges with Every Neighbor," *Moscow Times*, August 4, 2009.

The significance of the SCO became evident at its summit immediately after the Russian-Georgian war of August 2008. Russia appealed for support, but nobody complied, as China offered the Central Asian states the opportunity to hide behind its back. For the first time since the war over the Ussuri River in 1969, China openly challenged Russia in its own backyard and won.

China has already built pipelines to Kazakhstan and Turkmenistan, and it is likely to seize market control in the region from Gazprom. The global financial crisis offered China—with the world's largest international currency reserves—new opportunities in the region. It has bailed out not only Central Asia but also Belarus and Moldova with larger amounts than Russia, admittedly in bilateral loans in yuan.

Thus, while the Kremlin is spoiling its relations with its neighbors in a seemingly mindless fashion contradicting Russia's national interests, China is swiftly establishing itself as the major customer for Central Asia's gas exports and other products, while it provides tens of billions of dollars of finance.<sup>32</sup>

## The European Union's Eastern Partnership

The European Union started taking a greater interest in the former Soviet Union when its big eastern enlargement was concluded in 2004. In 2003 it launched its European Neighborhood Policy, and in 2008 it presented its Eastern Partnership, which included six CIS countries—Ukraine, Belarus, Moldova, Georgia, Azerbaijan, and Armenia.

For the time being, the European Union has accomplished little in the region, but with Ukraine it is negotiating a European Association Agreement on deep and comprehensive free trade, which will also be offered to other members of the Eastern Partnership. These agreements will offer much more than greater market access. They will also involve harmonization of rules and institutions, bringing about a potentially far-reaching integration of these six countries with the European Union. So far, Russia has chosen to stay aloof from this cooperation.

As a consequence, at least Ukraine, Georgia, Belarus, and Moldova are now increasingly being attracted to the European Union for the sake of trade and institutional convergence, though unlike Russia and China the European Union has not offered any bilateral financial support.

Russia has chosen to stand outside all this multilateral cooperation with the European Union. In 2003, when the European Union proposed its European Neighborhood Policy for both North Africa and western CIS,

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32. Bobo Lo, *Axis of Convenience: Moscow, Beijing, and the New Geopolitics* (Washington: Brookings Institution, 2008); Louis O'Neill, "China Is Gaining a Foothold in Russia's Backyard," *Financial Times*, July 29, 2009.

Russia turned down the offer. Instead it wanted to negotiate a new version of the rather empty ten-year Partnership and Cooperation Agreement concluded in 1994, while the three Caucasian states insisted on becoming part of the European Neighborhood Policy. In May 2009, when the European Union adopted its Eastern Partnership Policy, Russia was never part of it, having excluded itself in advance.

## **Conclusion: Dissolve the CIS as a Goodwill Gesture!**

In sum, Russia's policy in the former Soviet space is strikingly ineffective. The only Russian activity that has really worked has been foreign direct investment of private corporations, which has not been part of government policy. The country has failed to develop good relations with its neighbors, but the Kremlin does not seem to care. Its policy in the former Soviet space cannot be characterized as neoimperialism but as disinterest and disrespect. Russia is increasingly behaving as if it can force the CIS countries to obey, without considering their national interests, but it does not have the strength nor is it prepared to devote the resources to do so. Deterred, its neighbors turn their backs on Russia.

Russia's recognition of Abkhazia and South Ossetia left the whole region worrying about territorial integrity. Although mutual trade remains plentiful, no Russian free trade initiative can work without a mechanism for conflict resolution; only the WTO can offer the necessary institutional framework. Russia has cut lingering gas subsidies to its poorer neighbors, who are trying to reduce their dependence on Russia because it no longer offers any benefits and has proven highly unreliable through many sudden disruptions of Russian gas deliveries and embargoes on successful exports.

In the last few years, Russia has solidified its reputation as an unreliable and unpredictable partner among its neighbors, who run for the exits, leaving Russia increasingly lonely. For the time being, Russia seems to have decent relations with only Armenia and Azerbaijan, which represents an all-time low. Russia has an obvious interest in improving its tarnished international reputation. For many years, many of its neighbors have been its captive customers and suppliers because of the existing infrastructure, but that situation can change with new pipelines and roads, especially given the new interests of China and the European Union. Russia's monopoly position in the region can suddenly be lost in the same way as Britain and France lost out in their former colonies.

Therefore, Russia urgently needs a new, constructive policy toward its post-Soviet neighbors so that it does not lose out altogether. As Dmitri Trenin writes: "Russia's foreign policy needs more than a reset: it requires a new strategy and new policy instruments and mechanisms to imple-

ment it."<sup>33</sup> This concerns most of all Russia's policy toward its neighbors. "Russia needs to focus on overcoming its economic, social, and political backwardness—and use foreign policy as a resource to meet this supreme national interest."<sup>34</sup> Russia can no longer afford to pursue policies that only aggravate its relations with the whole post-Soviet space. It needs to think anew.

In fact, the many failures of Russia's policies show that the opposite needs to be done. The CIS summit in Kishinev in October 2009 should be the last summit. As a goodwill gesture to its neighbors, Russia should take the initiative to dissolve the CIS, clarifying that it does not pursue any neoimperialist designs. While dissolving the CIS, Russia should also dissolve its suborganizations, EurAsEc, the CSTO, and the CES, none of which adds value but only costs to all parties concerned.

Russia does not benefit from alienating all its post-Soviet neighbors. Its interest should be to develop as good relations, including trade, finance, and investment, as have proven possible with other neighbors. Therefore, it must convince all countries in the region that it has no territorial claims. In one way or the other, the Kremlin should play down its recognition of Abkhazia and South Ossetia in its own interest.

With regard to trade policy, the obvious solution is the WTO, which Russia should join as soon as possible. It should encourage its neighbors to do so as well to facilitate trade with them. If Russia is to stay a major gas trader in the region, it will need to undertake market-oriented gas reforms at home and reach an agreement with the broader region on a framework of gas trade, be it the Energy Charter or some new agreement. Russia needs to restore its credibility as a reliable gas supplier.

The Ukrainian presidential elections in January and February 2010 did represent a substantial improvement in Russian-Ukrainian relations. In the last presidential elections in 2004, President Putin campaigned actively in Ukraine for then presidential candidate Viktor Yanukovich, who eventually lost. This time, the Kremlin revealed its preference for Yanukovich through the official television channel but not more, and Yanukovich actually won. Former president Viktor Yushchenko's contentious bid for a NATO Membership Action Plan for Ukraine has been set aside. Prime Minister Yulia Tymoshenko's gas agreement with Prime Minister Putin in January 2009 disarmed the gas conflict. Ukraine is still pursuing a European Association Agreement and is unwilling to join the Russia-sponsored customs union, but Russian-Ukrainian relations have been dedramatized. This improvement has entirely been based on bilateral actions, without any CIS institution playing any role.

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33. Dmitri Trenin, "Reimagining Moscow's Foreign Policy," *Foreign Affairs* 88, no. 6 (November/December 2009), 65.

34. *Ibid.*, 74.