



Russia's foreign policy does not help its economic modernization

Russia's over-ambitious foreign ventures have exacerbated the negative effects of the numerous economic headwinds it faces, Marek Dabrowski writes

Interrelation between economic and foreign policy

In the contemporary highly interdependent world, the foreign policy of a country has an important role to play. It is connected to a country's economy; a country's foreign-policy ambitions should correspond to its economic potential, or else it can be a costly and usually counterproductive overstretch for the country.

Russia's place in the world

Russia is a good example of an imbalance between economic potential and foreign-policy ambitions.

Russia has the largest territory in the world and is one of the two largest holders of nuclear weapons (the US is another one). It is also one of the five permanent members of the United Nations Security Council with veto power, a legacy of the Soviet Union's contribution to victory in the Second World War.

However, demographic and economic parameters put Russia in more distant positions. Its population accounts for only 2% of the world total population – and this share is systematically decreasing, due to negative population growth in Russia against the rising global population. With a population of 142 million, Russia occupied ninth position in the [world rankings](#) in 2017 – behind China, India, the US, Indonesia, Pakistan, Brazil, Nigeria and Bangladesh, but ahead of Mexico.

According to the International Monetary Fund's *World Economic Outlook* database of October 2018, in 2017 Russia's share in the world total GDP calculated in purchasing power parity (PPP) terms amounted to 3.2%, with declining tendency over time (in 2008, it amounted to 3.9%). Its share in global trade was even lower, at 1.8%.

In 2017, Russia was the sixth-largest national economy in PPP terms after China (18.2% of the world GDP), the US (15.3%), India (7.4%), Japan (4.3%) and Germany (3.3%). For comparison, the share of EU28 was 16.5%. However,

when GDP in current US dollars was taken into account, Russia occupied 11th position behind the US, China, Japan, Germany, the UK, India, France, Brazil, Italy and Canada, and only slightly ahead of South Korea.

In 2017, Russia's GDP per capita in PPP terms amounted to 46.6% of that of the US and 54.9% of Germany. When calculated at the current exchange rate the relative GDP per capita of Russia was only 18.3% of the US and 24.5% of Germany.

In the highly interdependent modern world, a country's economy and its foreign policy are strongly linked. A country's foreign-policy ambitions should correspond to its economic potential

Increasing ambitions of Russian foreign policy

Despite its limited economic potential, Russia wants to rebuild its Cold-War-era status of global superpower. Russia therefore engages in a number of costly foreign-affairs adventures: In August 2008 Russia intervened in Georgia and officially recognised two separatist Georgian regions – Abkhazia and Southern Ossetia – as independent states.

In March 2014, Russia annexed Crimea and then supported the separatist movement in Donbas. As a result, Ukrainian authorities lost control over approximately half of Donbas, where two unrecognised territorial entities – the Donetsk and Luhansk People’s Republics – were established.

Going beyond its direct neighbourhood, one should also mention Russia’s military engagement in Syria, Sudan and the Central African Republic (Ross, 2018), support for Venezuelan president Nicolas Maduro, increasing military confrontation with NATO, support lent to populist parties and movements in Europe, alleged interference in the US presidential election in 2016 – and so on. Russia has also tried to stop the accession of the western Balkan countries to NATO and EU, according to Stronski and Himes (2019).

These foreign-policy adventures not only have been costly in a financial sense (see Table 1 below) but also led to the substantial deterioration of Russia’s political and economic relations with the US and EU – two of the three largest economic superpowers, major financial and corporate governance centres, and sources of technology and knowledge-transfer so badly needed by Russia in order to continue its economic modernisation. It is worth remembering that the EU is the largest trade and investment partner of Russia.

Costs of assertive policies

In particular, the Ukrainian conflict has involved heavy direct and indirect costs for Russia, such as higher military spending, human losses, the social costs of refugee flows, aid of various kinds to rebel-controlled territories, and

so on. Aslund (2018) estimated the cost of administering Crimea and providing support to occupied Donbas at \$4 billion, or 0.3% of Russia's GDP. In addition, the cost of construction of the Crimea Bridge over the Strait of Kerch, which opened in May 2018, amounted to around \$4 billion.

Table 1 shows that Russia's military spending is higher than that of other European countries, oscillating between 3.3% and 4.1% of GDP in the 2000s and early 2010s. Military spending has increased since the beginning of the Ukrainian conflict, reaching a record-high level of 5.5% of GDP in 2016. High military spending crowds out expenditure on other public services, in particular education and health care, negatively contributing to potential economic growth. This is an argument frequently raised in the Russian economic debate (see Kudrin and Sokolov, 2017; Kudrin and Knobel, 2018).

Table 1. Russian government military, education and health expenditure, percent of GDP, 2000-17

Expenditure item	2000	2004	2008	2009	2012	2014	2015	2016	2017
Military expenditure	3.6	3.5	3.3	4.1	3.8	4.1	4.9	5.5	4.3
Government expenditure on education	2.9	3.5	4.1	...	3.8
GG health expenditure	3.2	3.0	3.2	3.7	3.4	3.5	3.4

Source: World Bank World Development Indicators

Sanctions and counter-sanctions

Annexation of Crimea and support of separatists in Donbas led to international sanctions against Russia, initiated by the US and the EU in 2014. Australia, Canada, Iceland, Japan, Norway, Switzerland, and most EU candidate countries followed suit, to various degrees. Sanctions¹ involve four groups of measures (Russell, 2016): political/diplomatic (Tier 1), against individuals and entities (Tier 2), economic sanctions (Tier 3) and those related to Crimea.

The Tier 1 sanctions excluded Russia from the G8, suspended negotiations on Russia's accession to the Organisation for Economic Cooperation and Development and the International Energy Agency, as well as the semi-annual EU-Russia summits, negotiations on a new EU-Russia treaty and EU-Russia visa liberalisation, the NATO-Russia cooperation, and the voting rights of the Russian delegation to the Parliamentary Assembly of the Council of Europe.

As a result, Russia became partly isolated on the international scene and its role in shaping global political and economic order diminished. Such an effect contradicts its declared ambitions.

The Tier 2 sanctions are targeted against named individuals and companies – for example, those engaged in business in Crimea. Measures include visa bans and asset freezes.

In the economic sphere (Tier 3), sanctions have concentrated on three areas:

- A ban on medium- and long-term financing of the largest state-owned banks and companies;
- A ban on trade in military and dual-use equipment, and in some oil exploration and production equipment and services;

- A ban on trade, including tourism, travel and communication services, with the annexed Crimea, prohibition on the use of Crimean ports and involvement in investment activity in this territory.

In April 2018, the US adopted the Countering America's Adversaries Through Sanctions Act, which partly codified the existing sanctions but also introduced new ones against selected Russian business-people and companies, in response to Russia's alleged interference in the US 2016 presidential election.

Another wave of US sanctions followed in August 2018, this time in response to the attempted assassination in the United Kingdom of a former Russian intelligence officer. In early 2019, the US Congress is discussing additional sanctions in response to the blockade of the Kerch Strait by Russia (Aslund, 2019).

In August 2014, Russia responded to the sanctions with a ban on imports of most food products from countries that adopted sanctions against Russia. Since 2014, Russia has also started to introduce a series of economic sanctions against Ukraine, the most significant being the revocation of the bilateral free trade agreement (FTA) on January 1st 2016 (in response to the entry into force of the EU-Ukraine FTA).

Between November 2015 and June 2016, Russia also adopted a ban on food imports from Turkey and several other economic sanctions against this country in response to the downing of a Russian fighter jet by the Turkish air force in the Syria-Turkey border area.

Assessing the impact on the Russian economy of these sanctions and counter-sanctions is not an easy task because of the difficulty of disentangling the effects of sanctions and counter-sanctions from other factors, such as the collapse of the oil price and other commodity prices in mid-2014 (see Korhonen *et al*, 2018), a poor business climate and declining working-age population.

Most available estimates found an annual negative impact ranging from 1-2% of GDP. Overall, sanctions and counter-sanctions aggravated the 2014-16 currency crisis and the 2015-16 recession (Dabrowski and Mathieu Collin, 2019) and since then they have slowed down the post-crisis recovery of the Russian economy.

Negative domestic consequences

Financial and sectoral sanctions limit Russia's growth potential by discouraging investment, both domestic and foreign. The negative effects apply not only to directly sanctioned sectors such as the defence and oil industries.

Indirectly, the sanctions, counter-sanctions and deteriorating economic and political relationships with the US and EU negatively affect the entire framework of economic and research cooperation with the West, increase the role of military and security agencies, and limit civil and economic liberties.

On the economic front, sanctions and counter-sanctions have strengthened protectionism and economic nationalism. For example, the ban on food imports from the EU, US and other countries introduced by Russia in August 2014 was, in fact, implementation of much earlier proposals of an agriculture lobby for stronger protection against imports, justified on the grounds of the country's food security (Korhonen *et al*, 2018).

The same can be said about numerous government import-substitution programmes launched since 2015 (Connolly and Hanson, 2016). They have led to additional fiscal and quasi-fiscal burdens, trade distortion, state capture by influential special interest groups and political corruption – and often they have contradicted Russia's commitments at the World Trade Organization.

Among various restrictive measures, Russia has extended limitations on non-resident ownership in some sectors – for example, the media and industries that may be important for national defence and security – and access of

foreign firms to public procurement – for example of medical equipment. At the beginning of 2019, the Duma (the lower house of the Russian Parliament) is working on a law that aims to create a separate 'Russian internet'. All these protectionist trends contribute to the deterioration of the already-poor business and investment climate in Russia.

How foreign policy can help Russian economy?

The Russian economy faces several headwinds, such as shrinking working-age population, difficulties in diversifying out of hydrocarbon dominance, poor business and investment climate, and declining or stagnating productivity (Dabrowski and Mathieu Collin, 2019). Overcoming those headwinds and returning to productivity growth and GDP-per-capita convergence with high-income countries will require, among other things, a reassessment of the goals and means of Russia's foreign and security policies.

First, foreign-policy ambitions should remain in line with Russia's modest economic potential. Second, foreign policy should rely on collaborative rather than confrontational measures. Third, the main foreign policy goal should be to support continuous modernisation and economic development of the country.

In turn, the latter depends to a large degree on global economic growth, stability of international commodity and financial markets, and smooth economic and technological cooperation with major partners – including the US and EU. Therefore, Russian foreign policy should be contributing to global stability and uninterrupted functioning of the liberal global economic order, rather than challenging them. ■

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Endnotes

1. See <https://www.state.gov/e/eb/tfs/spi/ukrainerrussia/> for the list and content of US sanctions and https://europa.eu/newsroom/highlights/special-coverage/eu-sanctions-against-russia-over-ukraine-crisis_en for the list and content of EU sanctions

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