



INTERACTION COUNCIL

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Chairman's Report on the High-level Expert Group

**Future of Russia and Her Relations with European and
Asian Neighbors and the United States**

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The New Russia : a Test for the World

1. The end of the Cold War and the demise of Soviet Russia as a Super Power was a shock, not least to Russia itself. But the brave new world of a diminished Russia is not necessarily a safer place.
2. Just to take the new geo-political world map as a starting point, Russia occupies not only a central place, but is the largest territory on the Eurasian continent, a vast sprawling landmass extending from the densely populated and developed cities of St Petersburg and Moscow to the sparsely populated areas of Siberia, which are home to rich resources.
3. This Russia is a neighbour to more numerous and varied countries than any other state in the world so that Russia will have to expend great efforts to keep harmonious relations with them all.
4. To the east are China, ruled by a Communist Party and with a different culture and world view; and Japan that industrially is modern and developed but has a territorial dispute with Russia. The immediate neighbours on Russia's southern borders are what might be called the soft underbelly of Central Asia and Caucasus, an area with so many flashpoints and the potential to be the new hotspot of the world. Given too that Russia is no longer a SuperPower but still possesses nuclear capacity and holds 10,000 nuclear weapons, it behooves the rest of the world, and particularly the sole remaining SuperPower and its allies, to treat Russia with respect, prudence and understanding of Russia's difficult journey to find its place in the modern world.

Putin's Election as President Takes Russia to a New Crossroads

5. In this context, the election of Vladimir Putin to succeed Boris Yeltsin as President of Russia marks an important milestone in Russia's journey. Putin is something of an unknown quantity but he won a clear mandate and represents the yearning of the Russian people for a strong leader with a sense of mission.

6. Putin himself has to make the journey from being a bureaucrat with the reputation of being a good listener and operator to the decision taker. He is the person who has to accept the ultimate responsibility and take the hardest decisions.
7. Putin has quickly shown awareness of the problems in front of him by describing Russia as a rich country of poor people, by appointing some good advisers, welcoming investment from the West and persuading the Duma to pass the nuclear test ban treaty. On the other hand, there are questions whether he understands the building blocks of democracy.
8. Until the 19th Century the autocracy of the Czars, followed by the Communists, created a state with a strong centre but which not only lacked concepts, such as democracy and the rule of law, but also discouraged free enterprise and the development of markets. The economy depended directly on the political leadership, and this mutual entanglement has not been fully cleared.
9. What Putin has to do is very much the basic task of laying the foundations of modern nation-building: to define the various powers of the presidency, the government, parliament and courts and to decide which powers and functions should be decentralised to the provinces and to make sure that they can all go about their work effectively and efficiently.
10. The task is made the harder by two factors. Russia is very short of qualified senior civil servants who will implement the policies. At lower levels, for example, the procurators (prosecutors), who were part of the long arm of the Communist Party, still entrenched in the provinces, prevent implementation of laws.
11. On the other hand, any clear lines of efficient policy are distorted by the power and influence of the so-called oligarchs and organized crime.
12. Putin has to find a way to reconcile the deep yearning for stability and order with the need for freedom and reform.

Quest for a Modern Economy

13. Nowhere can this be seen more clearly than in the economy. Superficially, Russia has recently done well. The economy has been growing by 7 to 8 percent and will show 5 percent growth this year, but it is not clear whether investment is rising. Production and exports are also growing rapidly, thanks to the undervalued rouble and rising oil prices.
14. The modern economy is still only a thin veneer on top of many problems. The improved performance offers a breathing space, a short time for Putin to tackle the deep underlying problems. In Putin's own words, "It would take us approximately 15 years and the 8 percent annual growth of our GDP to reach the per capita GDP level of the present day of Portugal or Spain, which are not among the world's industrialised leaders.
15. One aspect of these is to look at the levels of poverty in Russia. Putin said "The overall working incomes of the population add up to less than 10 percent of the U.S. figure." According to the World Bank household survey data for 1998, about half of the Russian population lives below the poverty line, and 20 percent falls into the category of "very poor". Although higher economic growth is necessary, it is not sufficient to rid Russia of poverty, and specific steps will be needed to address poverty and attendant social problems.
16. It is instructive to compare recent Russian economic history with that of China. China has shown rapid growth rates in the region of 10 percent a year for 20 years and has become the supplier to the world of many popular consumer goods, today including computers. But China had important advantages that Russia lacks, including a developed and historic entrepreneurial tradition, especially in Shanghai and the coastal areas, that dated back to before the Communist era; well functioning governmental authority, an economic transition that was cautious and gradual; and 50 million overseas Chinese prepared to invest their private fortunes in helping to develop the motherland.

17. When Mikhail Gorbachev began his reform programme, Russia did have first-class scientists and engineers able to turn out quality productse but no entrepreneurs, no competition and no legal framework..
18. The role of the army and the power of the military-industrial complex still has to be sorted out, which will be particularly tricky since it accounts for a large portion of GDP. Western experts estimated that it was worth 15-17 percent, but Gorbachev put the figure at 20 percent of GDP, and in some local areas it may account for as much as 70 percent of the economy.
19. Economic restructuring particularly needs to go wide and deep, which may challenge the yearning for stability. Another problem may be that the feelgood factor is too strong and the price of oil too high. Reforms have previously been enacted when the oil price was low and the sense of crisis imminent.
20. Economic reforms will mean tackling and cutting through the historic identity and fusion between capital and power. It will also mean surgery to cut out the cancer in which criminal elements have laid claim to large chunks of resources. Estimates vary between 40 – 60 percent for their control of the economy.
21. Essential economic reforms should embrace industrial restructuring and labor mobility; the banking and financial system; public finances, and particularly the power to collect taxes, including from national monopolies; establishment of a modern legal system which will incorporate bankruptcy laws and enforcement of private contract. An effective, efficient and predictable legal framework is important along with a strong professional administration in helping to stem the flight of capital, estimated at between \$1 and 2 billion a month.

Russia In Her International Setting

22. For almost all the rest of the erstwhile Soviet empire, the fall of the Berlin Wall, the end of the Soviet Union and the collapse of Communism was a time of liberation. For Russia on the other hand, it was a time of humiliation, which had started already by the defeat in Afghanistan. It was followed by further humiliations in the Kosovo war, where Russia's wish was ignored, and in the defeat of the first

Chechnya war.

23. Russia's struggle to transform itself to cope with the modern world is further complicated by the way it has seen its identity historically. Until the time of Peter the Great, Russian identity was seen through the Orthodox church. After him the identity was with Russia as a power in world politics. During the 1990s the enemy has been perceived as the financial and industrial centres of the West, NATO, the US, Muslims and Zionists. Before Chechnya, the US probably climbed to the second position.
24. Given this history, it would be tempting, especially for a strong nationalist government to divert attention from domestic economic problems by embarking on foreign military adventures. But the grim truth is that with a budget of \$20–25 billion modern Russia does not have the economic wherewithal to sustain foreign military action.
25. Dealing with Russia that is still struggling with the core issues of how to modernise raises more questions than easy answers for the neighbours. The issue is the more difficult because if countries, especially the West, take a soft line, Moscow is all too likely to take all the advantage, but neglect reform; and if they press too hard, Russia will stubbornly recoil.
26. For the US, now the sole SuperPower, the issue is how to persuade Russia to accept the obligations of a modern state, particularly in relation to questions of democracy and human rights. Surveys of the Russian people have shown that they don't much care for or see the advantages of multi-party democracy, even though they effectively have the beginnings of one.
27. Europe has to work out how to respond to Russia's desire to try to become formally a part of the European Community. It is unlikely that the European Union could integrate Russia with its 146 million people as a full member and withstand immense problems. The answer probably lies in closer economic and trade links.
28. For the West as a whole, including Japan, the question is how to wire Russia up to the information age. Greater trade, cultural and student exchanges may be the way to help Russia feel that it is not excluded.

29. For the Central Asian neighbours, the challenges are the greatest, particularly because of their own economic and political turmoil and Russia's fears of attacks from fundamentalists. Leaders of the world outside would do well to think of how they could help smooth out relations and get the fire brigade ready to put out sparks before they can develop into dangerous flashpoints and conflagrations.

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