

# **Russian Diplomacy between Asia and the Euro**

by Jacques Sapir

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The discussions which took place in Moscow on October 24 and 25 in the frame of the “Valdai Club” and which the author attended allowed to clarify a certain number of issues concerning Russian diplomacy. Not the least of these, stated by M. Andrei Pushkov (President of the Foreign Affairs Commission at the Duma) as well as by M. Serguei Ivanov (former Minister of Defense and presently head of the Presidential Administration) was that Russia would from now on be stressing what we call “soft power.” Indeed, both of them declared that the elements of military power, if they remained important in localized crises, had lost some of their significance to the benefit of elements of economic power, but also of political and cultural influence. This confirms an important evolution in Russian diplomacy. It implies the development of an “economic diplomacy,” the goal of which is not merely to reinforce the positions of Russia, but which will also allow it to establish important relationships in the economic as well as in the political domain. This goes way beyond what has been called in recent years “the diplomacy of oil and gas”.

As matters stand, this economic diplomacy of Russia is presently undergoing important changes. It is not wrong to consider that it is oscillating between attraction towards Asia, and more specifically towards the Asia-Pacific zone, and disappointment in regard to Europe, as concretized in President Putin’s severe assessment of the Euro crisis. It is important, from the standpoint of European countries such as France, to be aware of these, if they don’t want to find themselves relegated within a few years into a position of little importance.

## ***(i) A relative priority in favor of Asia***

During the four days duration of the forum, we were reminded several times that the XXI. Century would be the Century of Asia. Surely this much overused formula will hardly appear original. Moreover it is, nowadays, inexact. In fact, the European Union remains, together with the United States, the most importance world market. But it is also true that when one looks at the evolutionary dynamics over a generation, the increase in power of the emerging countries, and of those of Asia in particular, remains impressive. There can be little doubt therefore that the Asia-Pacific zone will be called to take up a considerable importance in the decade ahead. Already, the

currencies of some countries of this zone, such as Australia and Singapore, are beginning to be used as reserve currencies at the regional level. Therefore Russia, without denying its belonging culturally to Europe, must take this development into account. Already today, the volume of its trade with China has overtaken, thanks to a turnover of over 70 billion dollars, the volume of its trade with Germany, which remains around 60 billions. The emergence of a tropism towards Asia among Russian elites is under these conditions becoming more and more apparent. Besides, it comes with a renewal of interest in Asian development models (China, Korea, Japan, Taiwan), in which the role of the state has been, and often remains, important. <sup>1</sup> This is particularly the case in the development of high-technology industrial branches.<sup>2</sup>

Such an Eastward leaning, wished for and even sought for, can nevertheless not be immediately effected. Russia will remain dependent on its relations with the countries of the European Union. But the message came through: the influence of the European Union can only go diminishing. If, in 2010, the European Union was by far the biggest commercial partner of Russia with exchanges amounting to 48% of the total, the weight of Southeast Asia was undergoing a strong and steady growth to a total of 19%, overtaking the CIS countries, counting for only 14,9%, and the USA, with 3.8%. The importance for Russia of its presidency of the countries of APEC, which it wielded in 2011-2012, becomes apparent. Russia expects to find in Asia a good amount of needed techniques which it hitherto acquired foremost in the European countries and, secondarily, in the United States. The appearance, in Russian enterprises, of machine-tools produced in Japan, South Korea or Taiwan testifies to this. Beginning in 2013, in the case of China, this developing trade is set to occur in local currencies (Ruble and Yuan). Russia also hopes to develop monetary accords of this type with Japan and Korea. Russian authorities sent a clear signal that they intended to forego, as much as possible, the Dollar and the Euro in their economic relations with Asian countries.

The development of these relations includes, of course, the question of direct investments. The Chinese have obtained advantageous conditions to invest in Russia and they expect to do so in the area of infrastructures as well as in a certain number of branches qualified as “strategic” by Vladimir Putin, such as nuclear energy, and the space and aeronautics industry. Some accords, admittedly of a limited nature, have been passed in the domain of oil exploitation. Moreover, a similar accord should be made with India, which Sergei Ivanov qualifies as a “strategic partner.” <sup>3</sup>

### ***(ii) What role for the Shanghai Cooperation Organization?***

Such a priority given to relations with Asian countries implies a relatively active role of traditional Russian diplomacy in the region. Russia conceives its role as a facilitator of relations between China and Japan, between China and India and - indirectly - between India and Pakistan. It does not conceive of this role as being necessarily antagonistic to the United States, but takes note of the fact that the USA is no longer

able to play the role of “facilitator” of diplomatic relations as it did before. The problems encountered by NATO and the United States in Afghanistan show the relative “wearing-down” of western countries in these regions. In such a context, Russia expects the Shanghai Cooperation Organisation to play a greater role, as the latter has evolved in recent years from a military into an economic one. The SCO was initially created to fight against “separatism” and “terrorism.” Such is quite clearly the tenor of the Shanghai Convention signed in 2001. Since 2002, there exists an integrated structure of anti-terrorist combat which conducts yearly maneuvers including forces of the member states (China, Kazakhstan, Kirghizstan, Russia, Tadjikistan and Uzbekistan).<sup>4</sup>

Since 2006, an economic secretariate has been implemented, which now works together with a bank-consortium uniting the largest banks of the member states. It is quite clear, for the founders of SCO, that only economic development of this region can guarantee it political stability. Moreover, the development of the countries of Central Asia might contribute to slow down the flux of immigration towards Russia which risks to destabilize the country. Russian leaders are well aware that their country will need an immigrant workforce in the next twenty years, but they also know that too rapid an influx could stir up hostile reactions in the Russian population, as is already happening in Moscow and Saint-Petersburg. It is therefore logical for them to give priority to the development of the Central Asian countries, particularly Uzbekistan and Tadjikistan. It is against this background that the Customs Union between Belarus, Kazakhstan and Russia must be apprehended. This Customs Union, destined to extend itself to Uzbekistan and - why not - to Ukraine, would reinforce the cohesion of the SCO.

### ***(iii) Russia, Europe and the Euro***

The rise of Asia in Russian diplomacy must also be apprehended in the context of the crisis now hitting the European Union and the Euro-zone. On this matter, Russian authorities have these days been holding two discourses. The one, by MM Pushkov and Ivanov, consisted in extolling the support given by Russia to the efforts of European construction. The European Union indeed represents nearly 50% of the external trade of Russia, and close to 40% of its currency reserves are constituted by securities made out in Euros. M. Pushkov actually declared that Russia was ready, if need be, to extend a particular help to Greece.

The second discourse, held by Vladimir Putin, consisted in a qualified criticism of the Euro and of the policies conducted within the Euro-zone during these past two years. While he was preserving diplomatic formality, and insisting on the fact that he is putting his entire trust in the governments of the Euro-zone, one could not help being struck by his extremely pessimistic tone in considering the future of the zone.

## **What Putin said on October 25 at his encounter with the members of the Valdai Club**

Given the importance of the subject, we report here as faithfully as possible what was said on October 25 (this translation is made from the French, not the original Russian - *note of the translator*).

**The crisis is in reality much deeper than a debt crisis. We know, from experience, that the accumulation of debt is but a symptom. The governments and institutions of the Euro-zone have committed a grave error in taking on the Euro crisis by way of the debt question. The crisis of the Euro is much graver and deeper than the debt crisis.**

**When one wants to create a single currency (in Russian: a common currency) one must take into account four factors: the technological level of the countries of this monetary zone, the problems of relative competitiveness and of the harmonisation of the labor markets, the problems of political integration and the problems of a community of language . This was not the case in Europe. The Euro was created foremost for political reasons, and without taking these factors into account. The present crisis was therefore inevitable. One wanted to take a big step forward and it was done without preparations. This is another error. A much more pragmatic and much less dogmatic approach would have been necessary.**

**When the crisis broke out, the responses were inadequate. Only the symptoms of the crisis were treated, country after country, and without an organized plan. This can only lead to failure. The system of political power is the worst that can be. One has the costs of federalism but not its advantages, nor its coordination. I can see no real coordination in the past nor in the future when reading attentively the various accords which have been signed. Either the countries of the Euro-zone adopt a true (*tchistny*) federalism - but do they only know what this will imply in the way of transfer flows - or they will have to find another solution. If complete federalism is not possible, then one will have to give oneself important margins of flexibility.**

**We are disposed to aid European governments if they decide on reasonable policies.**

It appears from this that Russia is preparing itself for a breaking-up or a dissolution of the Euro-zone. In fact, it is apparent that in the absence of a federal solution, the cost of which would be prohibitive for Germany, there are no other alternatives than a continuous impoverishment of the countries of Southern Europe or a dissolution of the Euro.<sup>5</sup> In fact, the latter solution might end up imposing itself when the cost of maintaining the Euro-zone will be considered too high by a certain number of countries.<sup>6</sup> Russia is therefore seeking the least traumatizing solution for itself. It is probable therefore that the Euros presently held by the Central Bank of Russia as reserve currency are constituted in majority by German securities. If one listens closely to the President, and taking into account the compulsory figures of diplomatic formulas, it becomes evident that a profound pessimism has taken hold among the Russian authorities.

In the same time, Vladimir Putin insisted on common projects which might be set up between Russia and the EU and signalled his disponibility to do anything possible to avoid the EU and the Euro-zone entering a period of prolonged recession and economic effacement. He repeatedly insisted on projects in the domain of infrastructures, and on the development of advanced technologies which could be furthered in common. He insisted in particular on Russian projects in the domain of research and education, which could be extended to European researchers and which could later be developed by means of co-financing.

#### ***(iv) The constitution of a “new” Eurasian “center of power”***

Confronted with a rapidly developing Asia and a Europe stuck in crisis and risking to stay that way for many years, Russia is intent in developing the institutions of the Eurasian Customs Union (Russia, Belarus, Kazakhstan) and to erect the latter into an “alternative center of economic power.” The discourse of the Russian authorities was nevertheless little specific in this regard. They clearly also see the customs union as a possibility to constitute a market of a greater size than today’s Russia, in order for it to absorb part of the production of a reconstructed Russian industry. This would certainly become more credible if other countries were to join this customs union in the years to come, such as Uzbekistan, Kirghizia and Ukraine.

Financial and monetary integration seem nevertheless fated to slow down, most probably because of the Euro-crisis. Russian authorities have taken the measure of the difficulties of a monetary union and of the costs which must be assumed by the richest country. The subject is therefore no longer in the limelight. To the contrary, the development of Moscow as a local financial place, turned towards the countries of the Eurasian Customs Union, is a topic which is being raised again. The number of transactions effected in rubles is increasing steadily. But this increase is paradoxically being put a brake on by the very low amount of public debt (11% of GDP in 2011, going on 9% for 2013).

Indeed, for the ruble to become a reserve currency, Central Banks of other countries of the Customs Union would have to be able to hold State securities in rubles. Russian authorities make, on this subject, contradictory declarations. Russia has indeed the project of turning the ruble into a reserve currency, but it *also* hopes to bring down the level of the public debt. Let's not forget the crisis of 1998 and the ensuing default. The reticence of authorities to increase the debt is easily explainable. It remains nevertheless that the level of the Russian public debt would have to at least double, that is, to hover around 22%-25%, for the ruble to have a chance of being used as a reserve currency by a number of countries. And we are far from that. A palliative might be found if the State were to guarantee some of the debt of companies which it owns (GAZPROM, ROSNEFT). As matters stand, the idea to turn the ruble into a regional reserve currency will remain a project or, at best, will move ahead only very slowly.

The Eurasian Customs Union constitutes an important project, which will for the time being remain limited in scope, except if Russia were to succeed in opening it up rapidly onto countries such as Ukraine and Uzbekistan. Still, the necessity of such a project will not go away with time, for the problems of Europe and of the Euro-zone can only go on worsening. Russia has indeed the need for an international economic institution which can serve as a safety-lock against the economic power of China and of the Asia-Pacific zone, which keeps increasing in regard to that of Europe. But the development of such an institution in the times at hand will require all the ingenuity which Russian authorities can muster.

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*translated by Anne-Marie de Grazia, (October 29, 2012)*

1.F.C.Deyo, (éd.), *The Political Economy of the New Asian Industrialism*, Cornell University Press, Ithaca, (NY.),1987; R.Wade, *Governing the Market – Economic Theory and the Role of Government in East Asian Industrialization*, Princeton University Press, Princeton, (NJ.), 1990.

2.D.C. Mowery, “Economic theory and government technology policy”, in *Policy Sciences*, n°1/1983, pp.27-43.

3.Gen. V. Trubnikov, « I believe that Russia's Only real Strategic Partner is India », *Moscow Defense Brief*, n°4, 2012, pp. 6-10.

4.To these 6 countries must be added the “observer” countries: India, Iran, Mongolia, Pakistan and Afghanistan, and two countries with a “partner” status: Sri-Lanka and Belarus).

5.Artus P., « Trois possibilités seulement pour la zone euro », NATIXIS, *Flash-Économie*, n° 729, 25 octobre 2012.

6. Artus P., « Honnêtement, ne serait-il pas plus raisonnable de casser l'euro ? », NATIXIS, *Flash-Économie*, n° 723, 24 octobre 2012.