
Help Build Markets in Russia and the Region

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| EU | PUTIN | SANCTIONS | U.S. FOREIGN POLICY |

The dominant narratives about Russia and Putin are neither accurate, sufficient, nor useful. These narratives tend to view Russia in monolithic terms; President Putin, the Russian state, and Russia's state capitalist system often appear nearly synonymous. In reality, the Russia of 2014 is a complex, multifaceted emerging market powerhouse, weakened by recent events and its own economic shortcomings, but still the world's sixth largest economy.

Reflecting two decades of dramatic market development spurred by Russian-led efforts as well as international technical assistance, Russia today is well on the way toward achieving the status of a modern market economy supported by a healthy banking and financial sector. The country's economic interests link it irreversibly with the global economy and the international financial system.

Globalization has permanently changed Russia, creating an overlapping set of interests with numerous other countries that far exceed the linkages that existed even a decade ago. These overlapping interests make it harder to isolate Russia in order to employ sanctions to punish it for bad behavior. In a

context where Russian trade with the EU totaled \$370 billion in 2012, and where 30 percent of Europe's gas supplies originate in Russia, it is doubtful that European countries would support more severe sanctions for an extended period. In fact, long-term isolation of Russia is not realistic.

Market forces will be more effective than sanctions in influencing Putin's behavior, and there is already ample evidence that markets are extracting their price in terms of a weakened ruble, falling foreign exchange reserves, capital flight, and reduced growth.

Globalization and the growth of the modern Russian economy have also created a powerful and diverse set of interests within Russia that seek engagement with the rest of the world. Narratives about Russia need to take account of this internal diversity. Market forces will be more effective than sanctions in influencing Putin's behavior, and there is already ample evidence that markets are extracting their price in terms of a weakened ruble, falling foreign exchange reserves, capital flight, and reduced growth. While Putin is domestically both popular and powerful, Russian business and economic interests are likely to begin to limit his range of maneuver on foreign policy matters, even on matters as compelling to the Russian soul and spirit as Ukraine.

Engaging with Russia, and with Putin, is a more promising policy approach than seeking their isolation. Putin and his closest advisers, some of whom are well-versed in market-based thinking, are surely aware of the potentially grave economic risks of a continued nationalistic strategy toward Ukraine. A few prominent Russians even believe he will be looking for opportunities to "smooth the waters" with the West in the coming months. U.S. officials could miss those overtures if lines of communication are weak and U.S. policies are focused primarily on ratcheting up sanctions.

A more productive approach would be to take advantage of the myriad channels of interaction between Russians and Americans. Even when official lines of communication have barely functioned, commercial, professional and civil-society linkages have helped maintain a rich and fruitful exchange between the two countries. The U.S.-Russia relationship is currently heading in a direction, however, that threatens to unwind many years of extraordinary engagement.

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The linkages that helped to entangle Russia in a globalized world are unraveling. This is a disturbing development for Russia, but just as alarming for the West. Keeping the dialogue going through informal channels would be better than closing it down altogether. Constructive engagement, rather than shunning, is what is needed. A more accurate narrative for the overall relationship, taking account of business, civil society, and other forms of non-official engagement, would support that approach.

A philosophy of engagement, recognizing the increasingly globalized order in which we live, should guide U.S. policies toward Russia as well as its neighbors. For any of these countries to achieve lasting stability and prosperity, they will need to establish vibrant market economies combined with the rule of law, and they will need to overcome the endemic corruption that is common in so many emerging market countries. U.S. efforts in Ukraine should be focused on helping to strengthen governance and to build the underpinnings of a viable market economy; U.S. and Western efforts to help Ukraine achieve that result over the last two decades have fundamentally failed.

Similarly, once the current crisis has passed, U.S. and Western efforts should continue to support the development of a broad-based market economy in

Russia. Such a market-based system, supported by a modern financial sector, will help keep Russia inextricably linked to the global economy. A market-based economic structure can also play a critical role in helping to create a middle class, which in turn can provide incomparable support for democratic institutions. This backdoor approach, through the market mechanism, would provide the most effective constraint in the long run over authoritarian and corrupt regimes, as well as highly nationalistic foreign policies. Engaging with Russia, rather than trying to ring-fence it, will produce the most beneficial results.

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What a refreshing proposal! It is both common-sense and very wise. So wise and realistic that one is moved to nominate J Andrew Spindler to head US Department of State. Bravo Andrew!

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