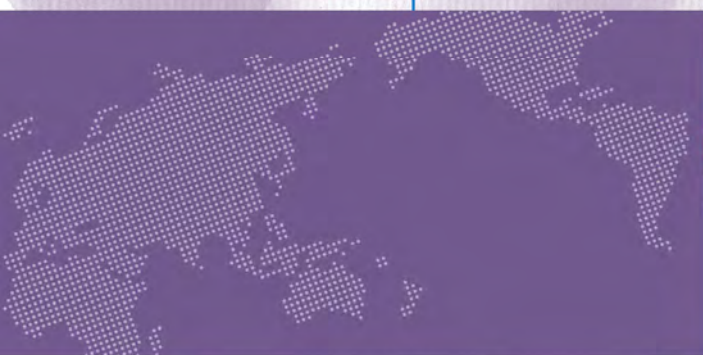


Regional Strategies International Edition

International Edition



Korea Institute for
International
Economic
Policy

Studies in Comprehensive Regional Strategies
(International Edition) 16-15

Studies in Comprehensive Regional
Strategies Collected Papers
(International Edition)

**Studies in Comprehensive Regional Strategies Collected Papers
(International Edition) 16-15**

**Studies in Comprehensive Regional Strategies
Collected Papers (International Edition)**

KOREA INSTITUTE FOR INTERNATIONAL
ECONOMIC POLICY (KIEP)
Building C, Sejong National Research Complex, 370,
Sicheong-daero, Sejong-si, Korea
Tel: 82-44-414-1251 Fax: 82-44-414-1144
URL: <http://www.kiep.go.kr>

HYUN Jung Taik, President

KIEP Studies in Comprehensive Regional Strategies 16-15
Published December 30, 2016 in Korea by KIEP

ISBN 978-89-322-2435-0 94320
978-89-322-2064-2 (set)

Price USD 20

© 2016 KIEP

CONTENTS

Acknowledgements	5
1. Defining Contours of the India–Korea Strategic Partnership: Political and Economic Parameters	9
• Pankaj Jha (Indian Council of World Affairs / Director)	
2. The Sweet Scent of Development: Korean Pop Culture in Latin America	89
• Ricardo Pagliuso Regatieri (Korea University / Research Professor)	
3. Productive Integration in Mercosur and Its Implications for Korea's Economic Cooperation with the Region	143
• Uallace Moreira Lima (Federal University of Bahia / Adjunct Professor)	
4. Russia's Changing Economic and Military Relations with Europe and Asia from Cold War to the Ukraine Conflict: The Impacts of Power Balances, Partnerships, and Economic Warfare	195
• Christopher Mark Davis (University of Oxford / Reader in Command and Transition Economies)	
5. Russia and ASEAN in Eurasia: Value–Added for Russia–ROK Cooperation	287
• Evgeny Kandeov (Primakov National Institute of World Economy and International Relations, Center for Asia–Pacific Studies / Leading Researcher)	
6. Social and Political Transformation of the Russian Society in New Geopolitical Conditions	333
• Sokolov Alexander Vladimirovich (Demidov Yaroslavl State University / Associate Professor)	

CONTENTS

7. Economic Cooperation between the Republic of Korea and Republic of Uzbekistan: Actual Problems and their Solution Course 397

- Nigora Talipova (Tashkent State University of Economics / Associate Professor)
- Ganieva Gulnora (History Institute of the Academy of Sciences of the Republic of Uzbekistan / Associate Professor)

8. Whither Turkey’s Integration to the European Union?
Economic and Political Challenges in Turkey–EU Relations 485

- Mahmut Tekçe (Marmara University / Professor)

9. Turkey’s Perspective on Enhancing Connectivity in Eurasia: Searching for Compatibility between Turkey’s Middle Corridor and Korea’s Eurasia Initiative 543

- Selcuk Colakoglu (Yildirim Beyazit University / Professor)

Russia's Changing Economic and Military Relations with Europe and Asia from Cold War to the Ukraine Conflict: The Impacts of Power Balances, Partnerships, and Economic Warfare*

Christopher Mark Davis**

* Acknowledgements:

I would like to express my gratitude to the Korea Institute for International Economic Policy (Seoul) for its support during my period as a Visiting Scholar in September 2014 and its award to me of a research grant in 2016 for work on this article. Oxford University has assisted generously my research on defense economic issues for 25 years through sabbatical leaves and grants from my two departments (Economics and Area Studies), Wolfson College, and the John Fell Fund. My research during 2013-2016 also has been funded by projects at the Russian Presidential Academy of the National Economy and Public Administration in Moscow and the Higher School of Economics-St. Petersburg. The author appreciates being given opportunities to present his ideas on economic-military power and economic sanctions at the following institutions: Hitotsubashi University, Institute of Economic Research, Tokyo (October 2014); NATO Parliamentary Assembly, Economics and Security Committee, The Hague (November 2014); Elcano Royal Institute for Strategic and International Studies, Madrid (February 2015); University of York, VOX Seminar on "Economic Sanctions," York (April 2015); Wolfson College, Seminar on "The Ukraine Conflict in 2014-15: Political, Economic, Military and International Dimensions" (September 2015); and School of Slavonic and East European Studies-UCL, Seminar on Economics and Business in East Europe (October 2016); and Institute of Europe of the Academy of Sciences RF, Moscow (March 2017). I appreciate the financing of my earlier research on defense economics by grants from the Ford Foundation, Pew Charitable Trusts, and Volkswagen Foundation. I also would like to give thanks to the journal *Post-Communist Economies* for allowing me to use in this article some published material from Davis (2016) *The Ukraine Conflict, Economic-Military Power Balances and Economic Sanctions*. This chapter is based on a draft completed in December 2016, but some minor updating was made during the correction of page proofs in early 2017.

**School of Interdisciplinary Area Studies, University of Oxford and Russian Presidential Academy of the National Economy and Public Administration, Moscow
Postal Address: Wolfson College, Oxford OX2 6UD, UK
Email: christopher.davis@wolfson.ox.ac.uk

Contents

1. Introduction
2. Conceptual and Historical Reviews Concerning Economic-Military Balances, Bilateral and Multilateral Relations in Regions of the World, and Economic Warfare Related to Russia
3. Russia's Economic-Military Power Balances, the Ukraine Conflict, Economic Sanctions, and Russia's Re-Orientation from Europe to Asia: 2000–2016
4. Changes in Russia's Long-Term Plans for Economic Relations with Asia: From *Strategy 2020* in 2012 to *Strategy of Russia in 2018–2024* in 2017
5. Conclusions

1. Introduction

The positions of countries in the global system are determined by their ideological-political characteristics, economic-military power balances, and bilateral relationships (as partner, neutral, or adversary) with major nations in relevant regions of the world. These inter-state relationships are influenced in turn by the extent of global economic integration, political changes, economic warfare, and armed conflicts (past, current, potential). All determinants can vary positively or negatively, as can the resultants of the various forces.¹⁾

1) For example, over the past thirty years there have been revolutionary changes in Europe and

This article is focussed on changes in Russia's economic-military balances and in the relationships between Russia and countries in Europe and Asia in the contemporary period, especially with respect to the Ukraine crisis.²⁾ The following questions are addressed: How did the dynamics of economic, technological and military balances influence general developments in security in Europe in the 2000s and the genesis of the Ukraine conflict?; What have been the unique defense economic institutions and policies that have enabled Russia to produce military capabilities that have appeared to be more substantial than warranted by its economic power?; How have Russia's economic and military relationships with countries in the regions of Europe and Asia changed during 2000-2016? Did Ukraine-related economic sanctions directed at Russia over the period 2014-2016 achieve established goals concerning the alteration of economic and military power balances?; and How has Russian strategic thinking concerning its future relationships with Europe and Asia evolved from its *Strategy 2020* document of 2012, which was intended to provide guidance for the policies of President Putin during his new term in office over 2012-18, to post-Ukraine conflict assessments in *Strategy of Russia in 2018-2024*?

Asia in: politics (the collapse of communism in the USSR), GDP growth (transformational recessions in former socialist countries, rapid development of the economy of China), economic integration (East Europe accession to the European Union), attitudes toward globalization and migration (Brexit, election of President Trump), Western anti-USSR/Russia economic warfare, military expenditure and deployment of armed forces (reductions by Russia and NATO, increases by China and India), peace (five 'frozen conflicts', Crimea, East Ukraine), and national borders (31 new states and disputed territories emerging in Europe during 1989-1999).

- 2) With respect to Asia, this article focusses on China, India, Japan, North Korea and South Korea, but also comments on developments related to Central Asia and Vietnam.

Section 2 reviews relevant concepts (production of economic and military power, economic-military balances and relationships between countries, economic warfare and sanctions) and defense-related economic history (1945-1991 and 1992-1999). Section 3 uses a diagram of international relationships (partnership, neutral, adversary) between countries in world regions as a framework for the analysis of a sequence of 21 steps in four categories that generated changes in Russia's relations with countries and organizations in Europe and Asia from 2000, before and after the start of the Ukraine conflict and the imposition of economic sanctions on Russia. Section 4 assesses likely developments in Russia's economic and military power and its position in the world out to 2020.

Concepts, historical coverage and empirical analyses of contemporary issues that are important for the line of argument of this article have been presented in two other works of the author and this material is cited when appropriate, rather than reproduced: Davis (2002) *The defence sector in the economy of a declining superpower: Soviet Union and Russia, 1965-2001* and Davis (2016) *The Ukraine conflict, economic-military power balances and economic sanctions*. An effort has been made to focus on new topics, such as the nature of relationships between countries and regions and Russia's evolving relationships with Asia.

2. Conceptual and Historical Reviews Concerning Economic-Military Balances, Bilateral and Multilateral Relations in Regions of the World, and Economic Warfare Related to Russia

A. Economic Systems, Defense Sectors, Economic and Military Power

The concept of economic power of relevance to national security concerns what Knorr (1957, 8) called 'economic defense potential,' which is determined by the volume and rate of growth of GDP, the structure and flexibility of output at the sector level (e.g. mobilization capacity), and capabilities in science and technology (Tables 2, 4, 6, 7, 14). Economic power is produced by an economic system (capitalist, transitional market, command) that is governed by its economic features and policies and functions in a multi-dimensional economic environment (Gregory and Stuart 1999) (Table 11).

The inter-relationships between economic power and military developments in Europe and Asia over the centuries have been studied thoroughly (Goodwin ed. 1991; Davis 1991a). Knorr (1957, 7; 1973) argued that 'defense potential' was dependent not only on economic power, but also on the efficiency of the utilization of resources devoted to defense and on the 'will to provide for military power' (e.g. share of GDP devoted to defense) (Tables 3, 8, 10).³⁾

3) The article argues that over the period of 1992-2013 NATO Europe countries did not demonstrate

Military capabilities and defense burdens are determined by the general conversion of economic power to defense potential, the priority status of the military sector, and the functioning of defense institutions (armed forces, defense industry, defense supply, military R&D, military foreign trade, central defense bureaucracy) (Davis 1990b, 2002).

A national security strategy takes into account external and domestic threats (military, economic, political) and includes programs to reduce threats (diplomatic, propaganda (including *dezinformatsiya*, or disinformation), arms control, espionage (now including computer hacking)) and develop appropriate military capabilities (Davis 1986, 1992). In the USSR, the strategy of the Brezhnev regime placed heavy emphasis on military power, whereas the Gorbachev government shifted it to threat reduction. In Russia, the government of President Yeltsin placed less emphasis on military power than has that of President Putin.

B. Political, Economic and Military Relationships of a Country, Economic–Military Balances, and Shifts in Strategies and Policies Concerning Regions of the World

A country's ideology and political system can affect its relationships with other states. For example, adherence to liberal democratic values helps to

this 'will' because of their sustained reductions in defense expenditures/burdens, whereas major countries of Asia did, as evidenced by their increases in defense shares of GDP.

solidify partnerships with the USA and EU. Economic systems and policies are of considerable importance. If a country has an open market economy, then it has good prospects for the establishment of beneficial global integration and trade. However, the relatively closed socialist countries with their shortage economies had more limited possibilities for foreign economic links. Military relationships can be bilateral in nature and involve arms trade, military training, cooperation in military R&D and defense industry production, and combat services of military personnel. Countries also can rely on various types of multilateral military alliances (e.g. NATO and the Warsaw Pact in the Cold War period).

This article makes use of the arguments of Kennedy (1988) that the rises and declines of major countries, empires and alliances in Europe and Asia in the 20th century were strongly influenced by the dynamics of economic, technological and military balances (Tables 2, 3, 4, 6, 8, 10, 14).⁴⁾ The adverse impacts on the USSR of distorted balances (relatively low economic power, heavy defense burden) are evaluated in Davis (1990a).

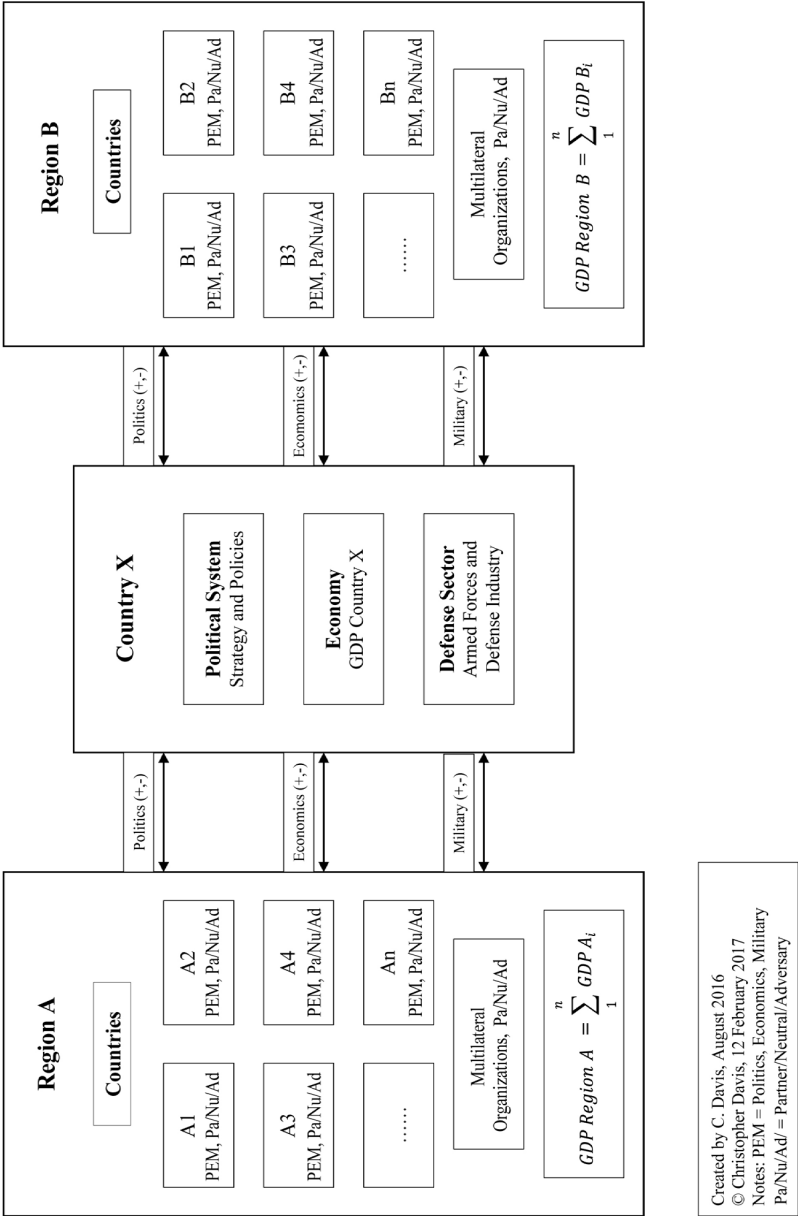
The multi-dimensional relationships between a country and regions of the world are illustrated in Diagram 1. Country X possesses Political (P), Economic (E) and Military (M) characteristics and has links with countries in Region A (A1...An) and Region B (B1...Bn) in the three dimensions (P, E, M). The

4) Kennedy (1988) evaluates the general dynamics of the Russian Empire and the USSR, as well as specific issues related to Ukraine, such as Russia's annexation of Crimea in 1783 and its relations with Ukraine and Poland (see map on page 109).

relationships between Country X and the others can be a Partnership (Pa), Neutral (Nu) or Adversarial (Ad).

Regions possess different multilateral organizations (e.g. EU, ASEAN) and have varying degrees of economic and military power (e.g. the magnitude and rate of growth of GDP). Decisions by a country about engagements in regions depend on characteristics of political relationships (adversary, neutral, partner) and economic-military balances. Country X (e.g. Russia) is likely to shift its involvement from Region A (e.g. Europe) to Region B (e.g. Asia) if the former becomes more adversarial or if the latter expands its economic power more rapidly and thereby provides better commercial opportunities.

Diagram 1. Interrelationships between Country X and Regions A and B of the World



The countries, territories and multilateral organizations of concern to Russia in 2017 in world regions are shown in Diagram 2.⁵⁾ In Europe the main countries are the UK, EU members, and Ukraine (the disputed territories are the Luhansk and Donetsk regions and Crimea). The key multilateral organizations are NATO and the EU. In the Middle East the most important states for Russia are Turkey, Iran, Iraq, Syria and Saudi Arabia. The significant countries in Asia are China, India, Japan, North Korea, South Korea, Vietnam and the five in Central Asia (Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan, and Uzbekistan).

C. Goals and Features of Economic Warfare and Sanctions

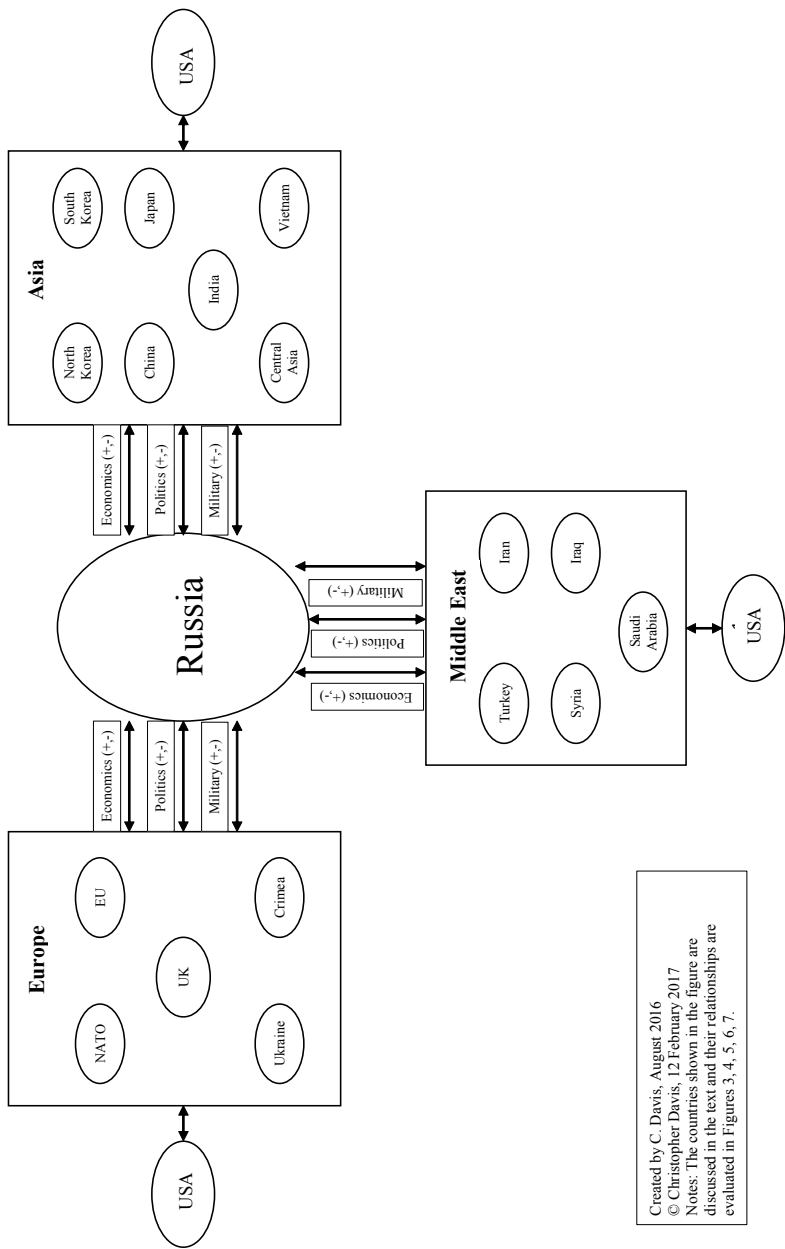
Economic warfare (including specific economic sanctions) has a dual relationship with economic and military power. First, it is intended primarily to influence economic, technological, and military balances to the advantage of the country/alliance conducting it. Second, the capability to conduct effective economic warfare is dependent on economic strength. Punitive measures can relate to trade in commodities (embargo, refusal of export licenses, preclusive buying) and finance (freezing of assets, restrictions on lending, expropriation of property) (Baldwin 1985, 41).

Economic warfare (including sanctions) is a politico-economic process with

5) The nature of the relationships between countries in the three regions are depicted for the USSR in 1985 in Diagram 3 and for Russia during 2000-2017 in Diagrams 4-7.

the following features: EWF (Economic Warfare Feature) 1 trigger (cause); EWF 2 establishment of objectives (economic, military, political); EWF 3 agreement on conditions for termination; EWF 4 decisions on specific measures (e.g. restrictions on trade and finance); EWF 5 comprehensiveness of participation; EWF 6 commitment to implementation (e.g. rigorous or symbolic); EWF 7 effectiveness of counter-measures; EWF 8 evaluation of impacts; and EWF 9 removal of restrictions/sanctions. Davis (2016) evaluates economic warfare directed against the USSR and Russia over the period 1917-2013 and presents summaries of results in Tables 6 (1917-1945), 7 (1945-1991) and 8 (1992-2013). An assessment of anti-Russia sanctions during 2014-2016 related to the Ukraine conflict is presented in Table 13ab of this new article.

Diagram 2. Organizations and Countries/Territories in Regions of the World of Importance to Russia in 2017



D. USSR Economic and Military Relationships with Europe and Asia: 1965–1991

1) Features and Performance of the Economy of the USSR

The USSR/CMEA (Council for Mutual Economic Assistance) countries had non-market economies characterized by centralization, state-ownership, compulsory plans, and autarky. The command economic system also had six important 'Hidden Processes' (HP) that influenced economic performance and have been carried over into the contemporary market economies of Russia and Ukraine: HP1 shortage economy features (quantity processes and signals, indirect bureaucratic control, soft budget constraints) (Kornai 1980; Davis and Charemza 1989; Kornai 1992); HP2 pervasive second economies with related corruption networks (Davis 1988); HP3 negative value added in industry (McKinnon 1991); HP4 a 'Rent Management System' (RMS) that involves the state re-distributing the value obtained from energy exports through formal and informal channels (Gaddy and Ickes 2005, 2010); HP5 'implicit' subsidisation of allied East European and Asian states (e.g. low oil prices in trade with CMEA countries) (Marrese and Vanous 1983); and HP6 illegal acquisition of restricted foreign technologies (CIA 1985).

The USSR emerged victorious from World War II and converted its highly centralized war economy back to a civilian one (Harrison 1985). From the mid-fifties the Soviet Union was able to achieve rapid extensive growth with rising living standards. The index of USSR industrial production (1970=100.0)

increased from 22.2 in 1950 to a peak of 189.1 in 1988 (Davis 1999). The Soviet planned economy was integrated across fifteen Republics, including the five in Central Asia. Several efforts to reform the command economic system failed, so it remained a shortage economy (Davis and Charemza 1989; Davis 1999, 2014).

Soviet centrally planned hard-currency trade expanded dramatically in the 1970s because of détente policies related to arms control, increases in world market prices for energy, and greater production of oil and gas: USSR energy earnings rose from \$388 million in 1970 to \$18,865 million in 1984. The government made use of its evolving RMS (HP 4) to redistribute the growing energy ‘rent’ to finance imports, support the defense effort, and subsidize inefficient enterprises (HP 3) and East European countries (HP 5) (Marrese and Vanous 1983; Gaddy and Ickes 2005; Davis 2014).

2) National Security Strategy and Defense Sector Performance in the USSR

From the mid-1960s the Soviet leadership pursued an ambitious strategy to enhance national security that placed emphasis on the generation of military power (Sapir 1991). The performance of the defense sector was greatly assisted by its high priority status, which meant that it benefited from the preferential allocation of scarce resources and protection by special organizations (e.g. the Military-Industrial Commission) (Davis 1990b, 1992, 2002). The allocation of

resources to the defense sector rose substantially and by the 1980s the defense burden was around 15% of GDP. A large share of the military equipment produced by the Soviet defense industry was exported to countries in the Warsaw Pact and Third World. The total value of Soviet arms exports rose from \$700 million in 1965 to \$17.3 billion in 1985 (34% of world arms exports) (Davis 2002). By the 1970s the USSR had become the second military superpower (DOD 1981...1990). The increases in the armed forces, deployed weapons and arms exports are shown in Table 1.

During the Gorbachev era (1985-1991) the Soviet leadership adopted a different strategy of ‘defense sufficiency’ and cut defense expenditures and deployed forces. However, these policies were not successful in significantly lowering the defense burden or in closing the economic power gap, so the USSR continued to decline in the international system (Davis 1990a, 1991b). The communist regimes in Eastern Europe collapsed in 1989 and in the USSR in 1991.

Table 1. Developments in the Soviet Defence Sector, 1965–91

Indicator	Units	1965	1985	1991
Armed Forces Manpower				
Total Armed Forces	Thousands	3885	3980	2910
Strategic Rocket Forces	Thousands	110	300	165
Ground Forces	Thousands	1460	1995	1400
Air Forces	Thousands	510	570	420
Air Defence Forces	Thousands	440	635	475
Navy	Thousands	390	480	450

Table 1. Continued

Indicator	Units	1965	1985	1991
Armed Forces Military Equipment				
Tanks	Number	28000	52600	54400
Total Artillery, Mortars, MLR	Number	19000	50200	64200
GF Helicopters	Number	300	4300	4500
AF Fighter/Attack Aircraft	Number	2300	5900	4905
Tactical Submarines (SS/SSN)	Number	190	203	221
Strategic Bombers	Number	118	160	100
ICBMs	Number	281	1371	1006
ICBM Warheads	Number	281	6813	6106
SSB/SSBN	Number	25	78	55
SLBMs	Number	75	980	832
SLBM Warheads	Number	72	2264	2792
Total Warheads	Number	882	9997	10164
Military Exports				
Total Arms Exports	\$ millions	700	17300	6600
Share of World Arms Exports	%	10	34	26
Non-Socialist Arms Exports	\$ millions	300	7500	4300

Sources: Davis (2002) provides information about references. The main source was IISS *Military Balance*.

3) NATO Economic Warfare and Soviet Countermeasures •

Throughout the postwar period NATO countries waged economic warfare against the USSR with the objectives of restraining the development of Soviet military and economic power (EWF 2). The *Coordinating Committee for*

Multilateral Export Control (CoCom) supervised the NATO containment policies (Adler-Karlsson 1968; Davis 2016). All important industrialized countries participated in these restrictions on trade and finance (EWF 5). Supplemental economic sanctions were introduced in response to unacceptable actions by the Soviet Union (e.g. 1956 suppression of the uprising in Hungary, 1968 Warsaw Pact invasion of Czechoslovakia).

The USSR developed economic warfare counter-measures (EWF 7) against the capitalist countries that involved hidden cooperation, trade diversion, and technological espionage (HP 6) (Andrew and Gordievsky 1990). By the 1960s the USSR had a well-organized counter-sanctions *Spetsinformatsiya* (special information) system that involved the intelligence services (*KGB (Komitet Gosudarstvennoi Bezopasnosti)*, *GRU (Glavnoe Razvedyvatel'noe Upravlenie)*) in covertly collecting restricted Western technologies on a large scale in accordance with detailed plans produced by the *Military-Industrial Commission* and *KGB Directorate T* (HP 6) (CIA 1985; Hanson 1987; Kostin and Raynaud 2011).

The efforts of NATO and OECD countries to use economic warfare to restrain the USSR were undermined by divisions between participants (e.g. West Europe cooperating with the USSR in the early 1980s in building a 4,000 kilometer gas pipeline from Siberia) and moderately effective counter-measures by the Soviet *Spetsinformatsiya* system (CIA 1981). Overall, Western economic warfare neither prevented the Soviet Union from becoming a superpower nor played a significant role in bringing about the collapse of the communist regimes in the late 1980s.

4) The USSR's Economic–Military Power Balances in Europe

OECD economies grew at healthy rates during 1950-73, experienced ‘stagflation’ in 1974-80 due to oil price shocks, and then entered a period of sustained growth. Table 3 shows that by 1980 the RSFSR (Russia) component of the USSR economy (55% of the total) was only 20% of the size of the USA economy. It was smaller than that of Germany, but larger than the economies of France, Italy, UK and Spain. From 1980 to 1990 the GDP of Russia remained around 25% of the combined GDP of the five European countries in Table 3. Furthermore, the shortage economy of the USSR was less efficient than the market economies and lagged behind in technological innovation (Ellman and Kontorovich 1992; Gregory and Stuart 2001).

During the late Cold War period NATO built up its conventional and strategic nuclear forces and achieved deterrence in Europe. This required substantial military expenditures and heavy defense burdens: USA 6% of GDP, UK 5%, France 4%, and Germany 3%. Although there were tensions in Europe during 1945-1989, there were no armed conflicts or changes in international borders.⁶⁾

6) The USA did not recognize the 1940 annexations of Estonia, Latvia and Lithuania by the USSR, but it treated this as a side-issue in order to manage its relations with the Soviet Union for the sake of global stability. This low-key but eventually successful USA policy contrasts with its more robust current policies toward Russia in connection with the annexation of Crimea.

Table 2. Comparison of GDP of Russia, USA and Countries of Europe and Asia, 1980 and 1990

Country	GDP Geary-Khamis \$ 1990				Ratio 1990 Country to Russia
	1980		1990		
	GK\$ Billions	% USA	GK\$ Billions	% USA	
USA	4,231	100.0	5,803	100.0	5.0
Russia	940	22.2	1,151	19.8	1.0
EU Top 5	3,734	88.3	4,634	79.9	4.0
Germany	1,105	26.1	1,264	21.8	1.1
France	814	19.2	1,026	17.7	0.9
Italy	742	17.5	925	15.9	0.8
UK	728	17.2	945	16.3	0.8
Spain	345	8.2	474	8.2	0.4
Asia Next 5	3,444	81.4	5,985	103.1	5.2
Japan	1,568	37.1	2,321	40.0	2.0
China	1,041	24.6	2,124	36.6	1.8
India	637	15.1	1,098	18.9	1.0
South Korea	157	3.7	373	6.4	0.3
Vietnam	41	1.0	69	1.2	0.1
Ratio Asia 5 to Europe 5	0.9		1.3		
North Korea	49	1.2	57	1.0	0.1

Notes: 1) According to Wikipedia (2016a): “The Geary-Khamis dollar, known as the international dollar, is a hypothetical unit of currency that has the same purchasing power parity that the U.S. dollar had in the United States at a given point in time. It is based on the twin concepts of purchasing power parities (PPP) of currencies and the international average prices of commodities. It shows how much a local currency unit is worth within the country’s borders. It is used to make comparisons both between countries and over time.”

2) Russia GDP for 1980 and 1990 was estimated to be 55% of the USSR GDP figures provided in Maddison (2016).

Sources: Prepared by C. Davis in 2016 from material in Maddison (2016), <http://www.worldeconomics.com/Data/MadisonHistoricalGDP/Madison%20Historical%20GDP%20Data.efp#>.

5) USSR Economic and Military Relationships and Power Balances in Asia

In the post-war period the USSR exerted significant influences on the economies of several major underdeveloped Asian countries. The Soviet economic model initially was adopted by North Korea in 1948, China in 1949, and Vietnam (in the North in the 1950s and in the whole country after 1975). This meant that the three countries had variants of the shortage economy and the hidden processes identified in Section 2.d (Ellman 1988, Kornai 1992). China had a turbulent politico-economic history with the *Great Leap Forward* in 1956 and the destructive *Cultural Revolution* during 1966-1976. This was followed by a restoration of political order by Deng Xiaoping and sustained economic reforms from 1979. North Korea began to deviate from Marxism-Leninism in the late 1950s in favor of the indigenous philosophy of *Juche*, which emphasized Korean self-reliance and patriotism. Vietnam retained an orthodox socialist economy until major reforms were introduced in 1986 to establish a 'socialist-oriented market economy.' Table 2 shows that in 1980 the GDP of China was smaller than that of the USSR, but marginally larger than that of the RSFSR. Over the next decade the ratio of China to Russia GDP rose from 1.1 to 1.8, although per capita GDP in Russia remained much higher.

India maintained a market economy after its independence in 1951, but it was influenced by the socialist model of the USSR to establish government ownership of strategic assets, to use central planning, and to place an emphasis

of the rapid growth of heavy industry (in accordance with the 1953 Mahalanobis model). By 1980 the GDP of India was 68% of that of Russia, but this increased to 95% by 1990. The per capita GDP of India also was much lower than that of Russia.

After World War II heavily industrialized Japan re-established a capitalist economy that had strong government institutions (e.g. MITI), partnerships of banks, corporations and trading companies (*Kieretsu*), and largely liberal economic policies. The economic output of Japan recovered rapidly and by 1980 it was the second largest economy in the world. The GDP of Russia compared to that of Japan fell from 60% in 1980 to 49% in 1990. South Korea had a low level of industrialization in the early post-war period and developed its capitalist economy slowly and unstably. It relied on government intervention and the *Chaebol* model of partnerships between banks, businesses and trading companies. However, in the 1980s the growth of the economy of South Korea accelerated and its GDP as a share of Russian output rose from 17% to 32%. Rapid technological development in South Korea was reflected in increasing success in the export of manufactures.

Russia's economic power balance with Asia in the late Cold War period shifted in favor of the latter. Table 2 shows that the Russia share of the GDP of the five identified Asian economies (excluding North Korea) dropped from 27% in 1980 to 19% in 1990. The USSR had substantial foreign trade links with India, Vietnam and North Korea throughout the Cold War period. Trade with China was severely disrupted by political turmoil in that country, but it

recovered in the 1980s. Soviet trade with Japan and South Korea was not significant due to adversarial political relationships. Financial markets in Asia in the 1980s were not important for the USSR.

The concept of ‘hysteresis’ is useful in evaluating Russia’s military inter-relationships in Asia, because shocks and events in the past (notably wars) have exerted strong influences on the present.⁷⁾ In the Soviet period Russians were encouraged to remember that Tsarist Russia suffered a humiliating defeat by Japan in the war of 1905 and that Japanese armed forces occupied territory of Soviet Russia during the Civil War of 1918-21. Tense relations existed between the USSR and Japan during 1939-45. The USSR declared war on Japan on 8 August 1945, rapidly defeated weakened Japanese armies in Manchuria and Korea, and occupied the Kurile Islands (Northern Territories). As a result of these experiences, the USSR had an adversarial relationship with Japan throughout the Cold War period. The bilateral military power balance was strongly in favor of the USSR given its military strength discussed above and Japan’s low defense burden (1% of GDP) linked to its peace constitution.

In the case of China, the USSR provided military and intelligence support to the communist forces in that country in their struggles against the Japanese

7) According to Wikipedia: “The term hysteresis is derived from ... an ancient Greek word meaning deficiency or lagging behind. It was coined around 1890 by Sir James Alfred Ewing to describe the behaviour of magnetic materials...for instance when magnetic induction lags behind the magnetizing force.” A formal mathematical theory of systems with hysteresis has been developed. In the social sciences, the concept of hysteresis has been influential in labor economics, with the insight that a negative shock leading to higher unemployment leads to a reaction that embeds a higher unemployment rate in an economic system in subsequent periods.

occupiers during World War II and the *Kuomintang* in the civil war. Following the establishment of a communist regime in 1949, the USSR supplied China with substantial quantities of weapons, military advisors, and assistance in developing its defense industry. However, USSR-China relations deteriorated in the post-Stalin period. In 1969 Soviet armed forces fought several battles against Chinese troops in disputed border territory near the Ussuri River. Relations between the two countries were adversarial for the next two decades. Although the USSR remained the dominant military power, the capabilities of the Chinese armed forces improved in the 1980s.

In August 1945 invading Soviet armies occupied the northern part of the Korean peninsula and gave the new communist state of North Korea large stocks of weapons and military training. The USSR strongly supported North Korea in its 1950-53 war with South Korea and UN (primarily American) armed forces and some of its military personnel (especially jet fighter pilots) engaged in combat operations. Due to the traumatic wartime experiences of the South Korean population and the strong anti-communism of successive governments, relations between the USSR and the Republic of Korea remained adversarial during the Cold War.

The USSR supported militarily the communist forces in Vietnam in their revolutionary struggles against French colonial forces and subsequently the government of South Vietnam and its foreign allies (USA, Australia, South Korea). During 1965-75 the USSR supplied North Vietnam with sophisticated weapons, large quantities of munitions and military technology, and numerous military

advisors. The USSR remained a loyal ally to communist Vietnam and signed a 25-year mutual defense treaty with it in 1978. When China launched a limited invasion of Vietnam in 1979 in response to the latter's military intervention in Cambodia, the Soviet Union provided Vietnam with intelligence, air transport services, weapons and military advisors.

Although India remained a democratic state with a market economy, the USSR developed a strong military relationship with that country and was its main supplier of weapons throughout the Cold War period. It gave India military support during its wars with Pakistan in 1965 and 1971 and China in 1962 and 1967.

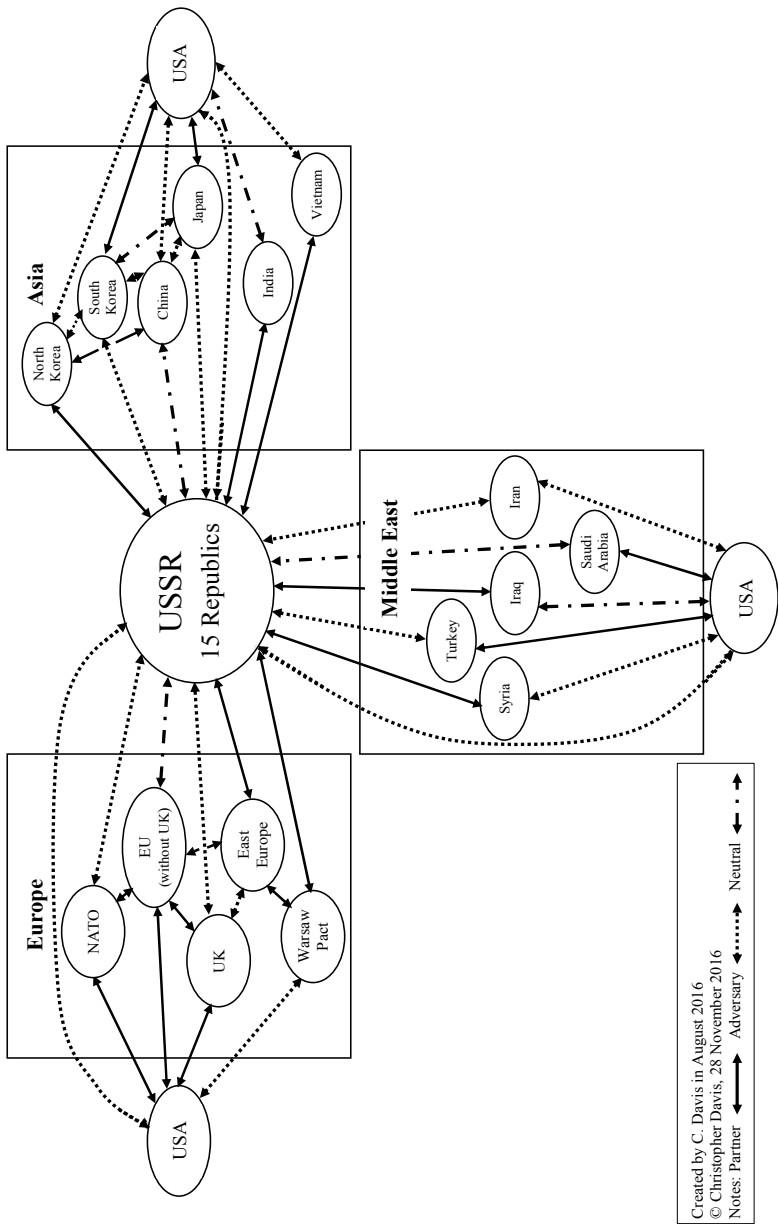
6) USSR Relationships with Countries and Regions of the World

The most important relationships of the USSR with countries and organizations in Europe, the Middle East, and Asia are shown in Diagram 3. The USA was the main adversary of the Soviet Union. Europe was the major economic region of the world and it became the leading capitalist trading partner of the USSR from the mid-1970s onwards. However, due to ideological and political differences the USSR had adversarial relations with NATO Europe countries. The diagram shows that the USSR had partnerships with the European socialist countries that were members of the CMEA and Warsaw Pact, but these were coercive in nature.

In Asia the Soviet Union had partnerships with India, Vietnam and North

Korea and, by 1985, a neutral relationship with China. Adversarial relations existed between the USSR and the USA (as a Pacific power), Japan, and South Korea. The balance of military power in Asia (excluding the USA) remained strongly in favor of the USSR. However, by 1990 the economic power balance in Asia had shifted away from the Soviet Union.

Diagram 3. USSR Relationships in 1985 with Countries in Regions of the World: Partners and Adversaries in Europe, Middle East



E. Russia's Economic and Military Relationships with Europe and Asia: 1992–1999

1) Collapse of the Soviet System, Russia's Transition Economy, and Economic Power Balances with the USA and Europe, 1992–1999

From 1989 anti-communist revolutions resulted in the collapse of regimes in socialist East Europe and the disintegration of the USSR. During the 1990s there were 31 alterations in the borders of Europe (after zero from 1945 to 1988). There were peaceful changes in 23 cases: reunification of Germany; fragmentation of the USSR into 15 successor states; division of Czechoslovakia; independence of Slovenia and FRY Macedonia; and Serbia and Montenegro splitting. Three states achieved independence following wars: Serbia-Montenegro, Bosnia-Herzegovina, and Croatia. In five other cases regions of a state with an aggrieved ethnic minority achieved autonomy through armed conflict with the support of a foreign power, and thereafter entered the category of 'frozen conflict': Transnistria (1992), South Ossetia (1992), Abkhazia (1993), Nagorno-Karabakh (1994), and Kosovo (1999).

All of the newly independent countries attempted to establish democratic political systems and market economies, but their early efforts at transition were characterized by economic disorganization, 'transformational recession' (output decline), corrupt and ineffective privatizations, and drops in living standards (Kornai 1994; Ellman 2000). However, the three former Soviet

Baltics states and countries of central East Europe were successful in carrying out market-oriented reforms and becoming members of the EU.

Russia inherited a weak state and a malfunctioning economy. Initial macroeconomic stabilization efforts failed, which resulted in a 40% decline in GDP and high inflation (EBRD 1994...1999). Microeconomic processes were dominated by barter between firms afflicted by negative value added (HP 3), build-ups of informal inter-enterprise debt, pervasive second economy activity and corruption (HP 2), ineffective privatization, and limited industrial restructuring. By the mid-1990s Russia had a 'virtual economy' in which the state pretended to promote market-oriented reform while using the RMS to distribute rent from the energy sector (less available due a low oil price of \$22 per barrel) to negative value-added industries (HP 1, 3) in order to avoid mass bankruptcies and political unrest (Gaddy and Ickes 1998, 2005). In 1998 Russia experienced a new financial crisis due to its large budget deficits and high debt (GKO) levels and the combination of a financial crisis in Asia with a 50% drop in the price of oil to \$11 per barrel.

2) Russia's Defense Sector, National Security Strategy and NATO's Military Power

In 1991 the military-industrial complex of the USSR fragmented into fifteen components, with the largest being inherited by Russia and Ukraine. Due to democratizing changes in the political system and tightening constraints in a collapsing economy the Russian government lowered the priority of the defense

sector and drastically reduced military expenditures (IISS 1992...2000; Davis 2002). Their armed forces and defense industries operated in difficult circumstances and their capabilities deteriorated (Allison 1996; Gaddy 1996; Odom 1998). Total arms exports to all regions of the world dropped from a peak of \$30.4 billion (constant 1996) for the USSR in 1987 to a low of \$1.5 billion for Russia in 1994 (WMEAT 1997, Table II). Negligible progress was achieved in defense-related reforms. Ukraine experienced similar defense-economic problems and in 1993 agreed to give up its nuclear weapons and to lease military bases in Crimea to Russia in return for energy subsidies and guarantees of its territorial integrity.

The effectiveness of NATO armies remained high in general and new military technologies were introduced (stealth design, smart bombs, drones). However, the NATO countries pursued an economic “peace dividend” by reducing defense expenditures, military personnel and weapon systems (see Table 3). The number of UK Main Battle (MB) tanks dropped from 1,330 in 1990 to 363 in 2000. In a somewhat contradictory move in economic terms, in 1999 the membership of NATO was expanded to include Czech Republic, Hungary and Poland. Due to this and cut-backs in defense budgets, per capita defense spending in NATO Europe dropped from \$715 (constant) in 1990 to \$515 in 2000.

3) Western Economic Sanctions, Russian Counter-measures, and Their Impacts in the Transition Period, 1992–1999

Economic warfare and sanctions directed at Russia diminished markedly

following the collapse of the USSR (Davis 2016). The rationale for maintaining *CoCom* was undermined and the organization was disestablished in 1994 (Joyner ed. 2006). However, the USA, UK and other technology leaders maintained national *Export Control Lists* concerning military and dual-use technologies, which limited some exports to Russia. That country attempted to circumvent foreign controls on technologies of relevance to its defense efforts by using a re-organized *Spetsinformatsiya* system (HP 6). The main agencies involved were the Ministry of Defense *GRU* and the successor to the foreign arm of the *KGB*, the *SVR* (*Sluzhba Vneshnei Razvedki*), notably its *Directorate X: Scientific and Technical Intelligence*.

4) Russia Economic and Military Power Balances and Relationships in Europe

Table 4 shows that the size of the economy of Russia relative to that of the USA fell from 19.8% in 1990 to 9.6% in 2000, and in the latter year it was smaller than the economies of Germany, France, Italy and the UK. In sum, gaps in economic power widened between Russia and important countries in Europe and the USA.

With respect to the military balance in Europe, both Russia and NATO countries reduced defense expenditures and force levels (Table 3). For example, the number of tanks fell from 61,500 in 1990 for the USSR (including all 15 Republics) to 21,820 for Russia in 2000, while the quantity of tanks deployed

in Europe by the USA, UK and Germany fell from 12,294 to 3,835. However, although the quantitative balance remained in favor of Russia, the quality-adjusted one shifted significantly to the advantage of NATO because of its superior technological capabilities.

Russia’s relationships with countries in Europe in the 1990s were transformed from adversarial to partnership or neutral. This reflected the pro-West foreign policies of Russia, as well as diminished NATO perceptions of political and military threats. Russia’s relationship with the USA became less adversarial and approached the status of neutrality, but wariness remained on both sides because of the continued existence of large stockpiles of strategic nuclear weapons.

Table 3. Armed Forces of USSR, Russia, Ukraine, UK, USA in Europe, Germany: 1990, 2000, 2013

Indicator	Years		
	1990	2000	2013
	USSR		
Military Personnel	3,988,000	NA	NA
Tanks	61,500		
Artillery	66,880		
Combat Aircraft	4,335		
Helicopters	4,500		
Defense % GDP	15.0		
		Russia	
Military Personnel	NA	1,004,100	845,000
Tanks		21,820	2,550
Artillery		20,746	5,436
Combat Aircraft		1,455	1,389
Helicopters		2,108	392
Defense % GDP		2.8	3.1

Table 3. Continued

Indicator	Years		
	1990	2000	2013
		Ukraine	
Military Personnel	NA	303,800	129,950
Tanks		3,937	1,110
Artillery		3,704	1,952
Combat Aircraft		543	139
Helicopters		247	221
Defense % GDP		3.4	1.3
		UK	
Military Personnel	306,000	210,940	169,150
Tanks	1,330	363	227
Artillery	705	418	610
Combat Aircraft	823	504	283
Helicopters	107	228	176
Defense % GDP	5.2	2.4	2.3
		USA in Europe	
Military Personnel	299,200	99,382	67,463
Tanks	5,917	657	53
Artillery	2,685	326	123
Combat Aircraft	660	237	179
Helicopters	210	134	48
Defense % GDP	6.5	3.4	3.7
		Germany	
Military Personnel	469,000	321,000	186,450
Tanks	5,045	2,815	322
Artillery	2,492	2,115	272
Combat Aircraft	697	457	205
Helicopters	210	102	22
Defense % GDP	3.2	1.6	1.2

Sources: Prepared by C. Davis in 2015 using material from IISS Military Balance (1991, 2001, 2014) and published in Davis (2016).

Table 4. Comparison of GDP of Russia, USA and Countries of Europe and Asia, 1990 and 2000

Country					Ratio 2000 Country to Russia
	1990		2000		
	GK\$ Billions	% USA	GK\$ Billions	% USA	
USA	5,803	100.0	8,032	100.0	10.4
Russia	1,151	19.8	774	9.6	1.0
EU Top 5	4,634	79.9	5,726	71.3	7.4
Germany	1,264	21.8	1,557	19.4	2.0
France	1,026	17.7	1,249	15.6	1.6
Italy	925	15.9	1,084	13.5	1.4
UK	945	16.3	1,211	15.1	1.6
Spain	474	8.2	625	7.8	0.8
Asia 5	5,985	103.1	9,663	120.3	12.5
Japan	2,321	40.0	2,628	32.7	3.4
China	2,124	36.6	4,319	53.8	5.6
India	1,098	18.9	1,900	23.7	2.5
South Korea	373	6.4	673	8.4	0.9
Vietnam	69	1.2	143	1.8	0.2
Ratio Asia 5 to Europe 5	1.3		1.7		
North Korea	57	1.0	25	0.3	0.0

Notes: 1) According to Wikipedia (2016a): “The Geary-Khamis dollar, known as the international dollar, is a hypothetical unit of currency that has the same purchasing power parity that the U.S. dollar had in the United States at a given point in time. It is based on the twin concepts of purchasing power parities (PPP) of currencies and the international average prices of commodities. It shows how much a local currency unit is worth within the country’s borders. It is used to make comparisons both between countries and over time.”

2) Russia GDP for 1990 was estimated to be 55% of the USSR GDP figure provided in Maddison (2016).

Sources: Prepared by C. Davis in 2016 from material in Maddison (2016), <http://www.worldeconomics.com/Data/MadisonHistoricalGDP/Madison%20Historical%20GDP%20Data.efp#>.

5) Russia's Economic and Military Power Balances and Relationships with Asia

The emergence of democracy in Russia contributed to improvements in its relations with countries in Asia, notably Japan and South Korea. Russia managed to improve its ties with China and to maintain positive relations with India, North Korea and Vietnam. Russia's economic power balances with Asian countries worsened considerably due to differentials in growth. Table 4 shows that the ratios of the economies of China and India rose from, respectively, 1.8 and 1.0 in 1990 to 5.6 and 2.5 in 2000. With respect to military power, Russia reduced its defense spending and conventional military capabilities, whereas China and India raised theirs.

Overall, economic and military power balances shifted in favor of Asia. However, due to the improvements in Russia's political relationships in Asia, these changes were not viewed by Russia as threatening to its national security in the short-term.

3. Russia's Economic–Military Power Balances, the Ukraine Conflict, Economic Sanctions, and Russia's Re–Orientation from Europe to Asia: 2000–2016

This section makes use of concepts concerning economic-military power

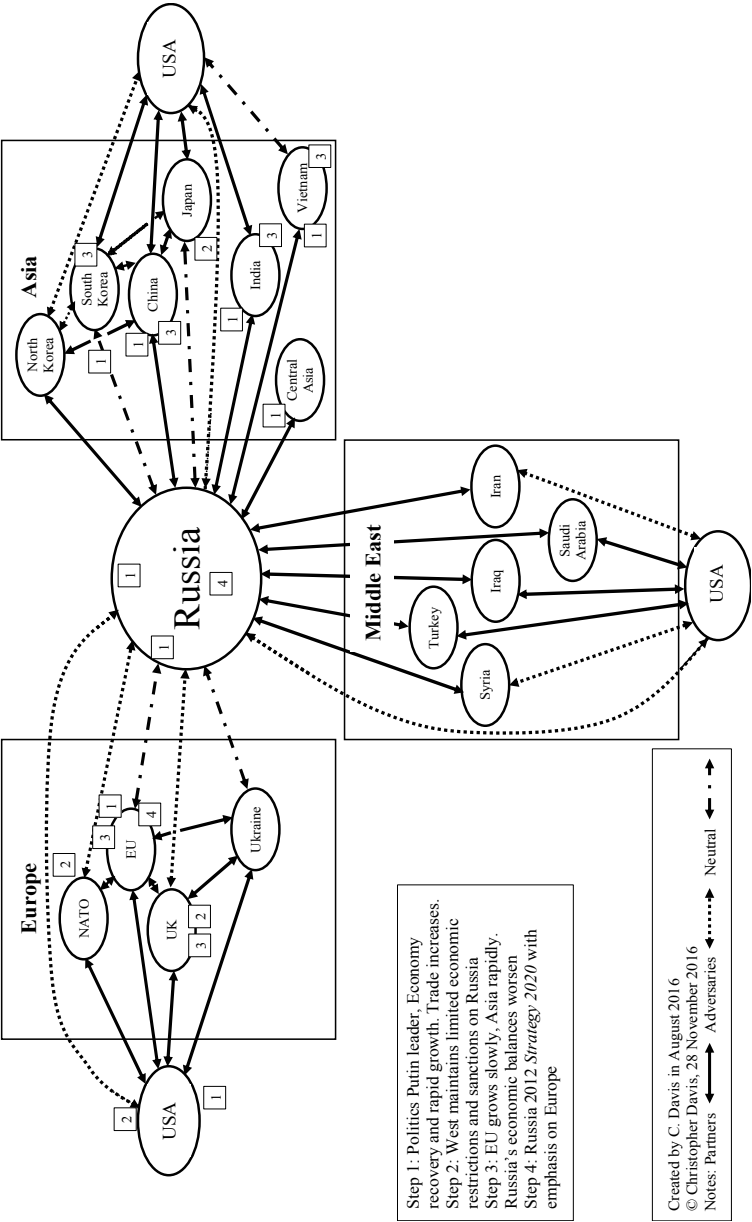
balances and relationships between Russia and countries in regions of the world, summarized in Diagrams 1 and 2, to evaluate the 21 Steps in the complex sequence (process) generating the Ukraine conflict, economic sanctions, and Russia's reorientation to Asia, which involved countries in Europe, the Middle East, and Asia. The 21 Steps are clustered into four sub-sections related to the years 2000-2016: a. economic power balances (Diagram 4 and Steps 1-4); b. military developments (Diagram 5 and Steps 5-10); c. conflict in Ukraine and economic sanctions (Diagram 6 and Steps 11-15); and d. the Russian economy, the effectiveness of sanctions, and shifts in regional relationships (Diagram 7 and Steps 16-21).

A. Russian Economic Performance and Economic Power Balances, 2000–2013 (Diagram 4)

1) Step 1: Russia Politics and Economy

Vladimir Putin was elected President in 2000 and has been a dominant and effective leader throughout the period to 2017. The recovery of the Russian economy began with a boost to domestic manufacturing as a result of forced import substitution and was maintained by the rise in the world market price of oil from \$11 per barrel in 1998 to a peak of \$145 in 2008. The stronger Russian government was able to impose high taxes on energy exporters and to divert a substantial share of the revenue into a Stabilization Fund.

Diagram 4. Russia Relationships During 2000–2013 with Countries in Regions of the World and the Ukraine Crisis (Steps 1, 2, 3, 4)



The Russian government used the RMS (HP 4) to distribute the greater resource rents to support welfare programs, subsidize negative-value added industries (HP 3), reduce domestic and international debt, and increase defense spending (Gaddy and Ickes 2010; Connolly 2015a). However, the RMS facilitated substantial informal siphoning of rents and the second economy (HP 2), with its related corruption networks, remained an important component of the Russian economy (Kim and Kang 2009). Despite slow progress with economic reforms (e.g. the Gref program), GDP grew by an average of 7% during 2000-08.

In foreign trade Russia's exports increased from \$99.9 billion in 2001 to a historic peak of \$527.3 billion in 2013 (Table 5). The EU was Russia's most important partner, accounting for 47% of trade turnover. The USA was a modest trade partner, receiving Russian exports worth \$11.2 billion in 2013. Exports to China grew from \$5.6 billion in 2001 to \$35.6 billion in 2013, and to India from \$1.1 billion to \$7.0 billion. China became a larger purchaser of Russian goods than Germany. Exports from Russia to the five Asian economies increased from \$10.4 billion to \$78.5 billion. The ratio of Russian exports to the five European countries in Table 5 to the five Asian countries reflected these developments and dropped from 2.7 to 1.8. Russia became involved in large scale infrastructure investment projects related to roads, railways, electrical power and fiber-optic cables that would cross CIS territories and link Asia and Europe markets.

The Global Financial Crisis (GFC) caused temporary negative growth in

Russia, but the population and economy were protected by the Stabilization Fund. During 2010-13 GDP growth was a healthy 3.4%, inflation remained low, and surpluses were achieved in the state budget and current account (Table 11 for 2009-2016).

Russia pursued integration both by deepening cooperation within the CIS and by joining the World Trade Organization (WTO) in 2012. It also developed plans for the establishment of a Eurasian Economic Union (EEU) with a target start date of 2015 that would involve as initial members Armenia, Belarus, Kazakhstan, Kyrgyzstan, Russia and Ukraine. But this proposed economic integration was not supported by many citizens in Ukraine.

2) Step 2: Western Economic Warfare and Russian Countermeasures

The USA intensified its controls on exports of military and dual-use technologies post-9/11 2001.⁸⁾ This increasingly inhibited high-technology trade with Russia, which countered by imposing restrictions on its own exports to and imports from the West (Davis 2016). Russian intelligence agencies (*GRU*, *SVR*) made efforts to obtain controlled military and dual-use technologies in the OECD countries and achieved some successes (HP 6).

8) By 2013 the following USA government organizations were involved in export control efforts: U.S. Department of State, Directorate of Defense Trade Controls and Bureau of International Security and Non-proliferation; U.S. Department of Commerce, Bureau of Industry and Security; U.S. Department of Homeland Security, Project Shield America and Export Enforcement Coordination Center; U.S. Department of Treasury, Office of Foreign Assets Controls; and U.S. Department of Defense, Defense Threat Reduction Agency (US SD 2015).

3) Step 3: Russia’s Economic Power Balances

Global processes of economic integration intensified in the 2000s. The Baltic and Central East European countries completed their accessions to the EU in 2004 and 2007 and benefited from substantial inflows of foreign direct investment that on a cumulative per capita basis over 1989-2008 were \$4,492 for Central Europe and the Baltic States (EBRD 2009, 27). The equivalent FDI figures for the partially reformed and poorly integrated countries of Ukraine and Russia were, respectively, \$899 and \$304.

The GFC caused recessions in most European countries, with average growth in the 2010-13 recovery period of only 0.9%. The poor economic performances increased pressures on European governments to reduce public expenditures, including on defense. Table 6 shows that the economy of Russia reduced its economic power gaps in Europe from 2000 to 2008.

Table 5. Russian Federation Exports of All Products to USA, Europe and Asia, 2001–2015

Destination	Exports in US Dollars millions								Ratio 2015 to 2013
	2001	2005	2008	2009	2010	2013	2014	2015	
World	99,868	241,452	467,994	301,796	397,068	527,266	497,834	343,908	0.65
USA	4,199	6,366	13,753	9,286	11,933	11,177	9,553	8,393	0.75
EU 5	27,824	77,814	159,280	97,885	112,497	139,670	132,967	79,899	0.57
Germany	9,194	19,736	33,187	18,708	15,862	22,962	24,950	15,906	0.69
Italy	7,402	19,056	41,962	25,063	24,376	29,165	28,991	16,204	0.56
Netherlands	4,695	24,614	56,944	36,290	53,241	69,260	66,683	40,198	0.58

Table 5. Continued

Destination	Exports in US Dollars millions								Ratio 2015 to 2013
	2001	2005	2008	2009	2010	2013	2014	2015	
UK	4,283	8,280	14,905	9,073	9,696	12,355	7,504	4,524	0.37
France	2,250	6,128	12,282	8,751	9,322	5,928	4,839	3,067	0.52
Ukraine	5,282	12,402	23,568	13,780	13,609	15,215	11,346	7,163	0.47
Asia 5	10,414	22,199	45,175	36,427	49,212	78,516	80,369	61,331	0.78
China	5,596	13,048	21,147	16,669	19,783	35,625	37,415	28,335	0.80
Japan	2,427	3,740	10,429	7,263	12,494	19,668	19,831	14,426	0.73
India	1,120	2,314	5,231	5,937	5,406	6,983	4,396	4,550	0.65
South Korea	1,108	2,359	7,787	5,689	10,408	14,867	18,082	13,196	0.89
Viet Nam	163	738	581	869	1,121	1,373	645	824	0.60
North Korea	62	226	97	42	45,797	103	82	78	0.70

Sources: Prepared by C. Davis in 2016 using material from UN COMTRADE Database 2016.

Table 6. Comparison of GDP of Russia, USA and Countries of Europe and Asia, 2000 and 2008

Country	GDP Geary-Khamis \$ 1990				Ratio 2008 Country to Russia
	2000		2008		
	GK\$ Billions	% USA	GK\$ Billions	% USA	
USA	8,032	100.0	9,485	100.0	7.4
Russia	774	9.6	1,282	13.5	1.0
EU Top 5	5,726	71.3	6,539	68.9	5.1
Germany	1,557	19.4	1,713	18.1	1.3
France	1,249	15.6	1,423	15.0	1.1
Italy	1,084	13.5	1,158	12.2	0.9
UK	1,211	15.1	1,447	15.3	1.1

Table 6. Continued

Country	GDP Geary-Khamis \$ 1990				Ratio 2008 Country to Russia
	2000		2008		
	GK\$ Billions	% USA	GK\$ Billions	% USA	
Spain	625	7.8	798	8.4	0.6
Asia 5	9,663	120.3	16,433	173.3	12.8
Japan	2,628	32.7	2,904	30.6	2.3
China	4,319	53.8	8,909	93.9	6.9
India	1,900	23.7	3,415	36.0	2.7
South Korea	673	8.4	949	10.0	0.7
Vietnam	143	1.8	256	2.7	0.2
Ratio Asia 5 to Europe 5	1.7		2.5		
North Korea	25	0.3	25	0.3	0.0

Notes: 1) According to Wikipedia (2016a): “The Geary-Khamis dollar, known as the international dollar, is a hypothetical unit of currency that has the same purchasing power parity that the U.S. dollar had in the United States at a given point in time. It is based on the twin concepts of purchasing power parities (PPP) of currencies and the international average prices of commodities. It shows how much a local currency unit is worth within the country’s borders. It is used to make comparisons both between countries and over time.”

Sources: Prepared by C. Davis in 2016 from material in Maddison (2016), <http://www.worldeconomics.com/Data/MadisonHistoricalGDP/Madison%20Historical%20GDP%20Data.efp#>.

Despite Russia’s robust economic growth over the years 2000-2008, the economies of Asia expanded more rapidly (Table 6). The ratios of the GDP of China, India and the Asia 5 to that of Russia increased respectively from 5.6, 2.5 and 12.5 in 2000 to 6.9, 2.7 and 12.8 in 2008. The GFC had a more disruptive influence on the Russian economy (negative growth in 2009) than on the Asian economies. From 2008 to 2012 the GDP of Russia increased by

13%, whereas the increments to the economies of China and India were, respectively, 41% and 34%.

4) Step 4: Russia Strategy 2020 and the Planned Relationships with Europe and Asia

The Global Economic Crisis of 2008–2009 demonstrated to the leadership of Russia that the country remained vulnerable to external shocks. During 2011–12 the government prepared a detailed *Strategy 2020* to provide guidance for President Putin during his new term in office (Strategiya 2020). The document recommended that Russia adopt a model of growth based on improvement of labour productivity, innovation, a re-oriented social policy, diversification, and international integration. It identified the fundamental international factors to be the continuation of globalization, acceleration of technological innovation, slow growth in the developed economies, and a shift of investment to the more rapidly growing developing markets (BRICs). The main risks for Russia would be the rise of China as an economic competitor, a radical shift in the global energy paradigm (e.g. the growing importance of shale oil production), and a deterioration of the competitiveness of industry in Russia.

Strategy 2020 argued that the EU would remain the largest market for Russia and the main goals should be to promote closer European integration and proceed with WTO accession and market-oriented economic reforms. The prospects of closer cooperation with the USA were poor and there was a risk

of a future G-2 made up of the USA and China. Asia would be key to future global economic development. The baseline macroeconomic projections of the Russian economy in *Strategy 2020* and actual developments are shown in Table 7. The world market price for oil (Urals) was projected to rise from \$97 per barrel in 2013 to \$122 in 2020. As a result, the annual GDP growth rate was expected to be around 4%.

Table 7. Strategy 2020 Forecasts of the Russian Economy to 2020

		2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
GDP Annual Growth (%)	Strategy 2020	4.1	3.7	4.0	4.6	4.9	4.4	3.3	3.5	3.5	5.2
	Actual	4.3	3.4	1.3	0.6	-3.8	-0.6				
	Forecast 2019						-0.2	0.8	1.8	2.2	
World Market Price of Urals Oil (\$/barrel)	Strategy 2020	109	100	97	101	105	107	111	115	118	122
	Actual	109	110	111	106	52	40				
	Forecast 2019						40	40	40	40	40
Inflation (%)	Strategy 2020	7.0	6.0	5.5	5.0	5.0	5.0	4.5	4.7	4.0	3.3
	Actual	6.1	5.1	6.8	7.8	15.5	7.5				
	Forecast 2019					12.9	6.5	4.9	4.5	4.0	

Sources: Prepared by C. Davis in 2016 using material from: Strategy 2020; EBRD 2015; RF MER 2016; and Neste website, <https://www.neste.com/en/corporate-info/investors/market-data/crude-oil-prices>.

In 2013 the *Ministry for Economic Development RF* produced an elaborate forecast of the Russian and global economies out to 2030 (RF MER 2013). As with *Strategy 2020*, the world oil price was expected to hover around \$100 per barrel. The baseline forecast projected the USA and EU shares of the world economy to decline from 19.3% and 15.3% in 2010 to 15.1% and 10.4% in 2030, whereas the China share would increase from 13.6% to 21.1%.

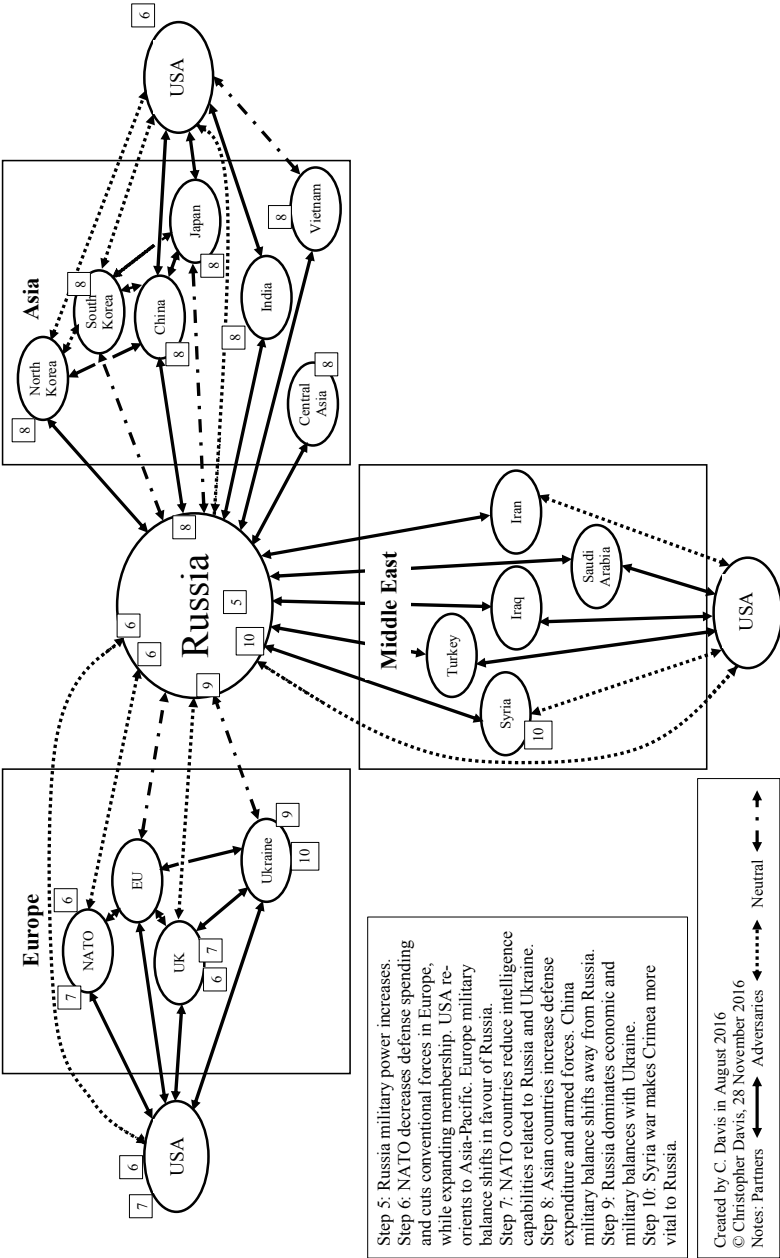
B. Russia, NATO and Asia Armed Forces and Defense Expenditures, Intelligence Capabilities, and Military Power Balances, 2000–2013 (Diagram 5)

1) Step 5: Russia's National Security Strategy, Defense Expenditure, Military Reform, and Capabilities of the Armed Forces

Russia changed its national security strategy in the 2000s to place more emphasis on military power. It raised the priority of the defense sector, increased defense spending and adopted ambitious plans for weapons procurement and reforms of the armed forces (IISS 2000...2014; SIPRI *SIPRI Yearbook* 2000...2015; FOI 2010; Davis 2002, 2011; Monaghan 2014). Real (\$2011) defense spending increased from \$31.1 billion in 2000 to \$84.8 billion in 2013 (SIPRI Milex Online Database 2015). The defense share of GDP rose from 3.6% of GDP to 4.2% (compared to 15% for the USSR in 1985). The size of the armed forces was reduced from 1,004,100 to 845,000, but defense expenditure per member of the military increased substantially. The number of MB tanks was

reduced from 21,820 to 2,550 as part of a planned modernization program (lower quantity, higher quality), which meant that the average capabilities of active tanks improved. Limited progress was made in military reforms in the 2000s. However, efforts were intensified after a short, victorious, but inefficient war against Georgia over South Ossetia in 2008. The Russian military engaged in counter-insurgency operations in the Caucasus (Chechnya, Dagestan) and Central Asia, especially Tajikistan.

Diagram 5. Russia Relationships During 2000–2013 with Countries in Regions of the World and the Ukraine Crisis
(Steps 5, 6, 7, 8, 9, 10)



2) Step 6: NATO Europe Reduces Its Armed Forces and Defense Expenditures, While Expanding Membership to the East

In the 2000s NATO continued to withdraw conventional forces from forward-operating bases in Europe. By 2013 the USA had only 53 MB tanks and 48 helicopters in the Conventional Forces in Europe (CFE) zone. Germany cut the size of its armed forces from 321,000 in 2000 to 186,450 in 2013 and the number of its MB tanks from 2,815 to 322 (Table 3). NATO defense spending rose after 9/11 2001, but most the increment was devoted to War on Terror operations in Iraq and Afghanistan. Defense expenditure was reduced significantly in most European countries after the GFC and by 2013 their average defense share of GDP was 1.6% (IISS 2014). In 2011-12 the USA announced that it would be making a major shift in its strategic focus away from the apparently peaceful Europe to the Asia-Pacific region to deal with new threats.

Despite the cutbacks in armed forces and defense expenditures, NATO expanded its membership by including the Baltic and East Europe countries in 2004 (Bulgaria, Estonia, Latvia, Lithuania, Romania, Slovakia, Slovenia) and 2009 (Croatia) and developed closer relations with some FSU states (Georgia, Ukraine, Moldova). NATO Europe per capita defense expenditure in real terms (\$2005) dropped from \$715 in 1990 to \$515 in 2000 to \$401 in 2013 (Table 8).

Table 8. NATO Europe Defense Expenditure: 1990, 2000, 2013

		1990	2000	2013
Total Defense Expenditures	\$ 2005 Million	274,923	247,363	225,767
Defense Expenditures as Share of GDP	%	2.7	2.0	1.6
Defense Expenditures per Capita	\$ 2005	715	515	401

Note: The defense expenditure share of GDP in the 1990 column is the average of 1990-1994.
Sources: Prepared by C. Davis in 2015 using material from NATO (2014) and published in Davis (2016), which provides information about sources.

These estimates should be reduced after 2001 to take into account the significant ‘out-of-area’ components, which were not relevant to the defense of Europe. NATO also proceeded with the development of a ballistic missile defense system in Europe, supposedly to counter-act rogue states in the Middle East. This was strongly opposed by Russia, which withdrew from the *Conventional Forces in Europe Treaty* in 2007 in retaliation.

With respect to the military balance in Europe in 2013, both NATO and Russia had reduced numbers of personnel and weapons compared to 2000. NATO military equipment remained superior technologically to that of Russia and potentially provided a deterrent to conflict involving members of the alliance. However, the numbers of operational NATO conventional weapons in Europe were at such low levels (Table 4) that Russia did not need to worry about account actual NATO capabilities when making national security decisions related to the Ukraine conflict.⁹⁾

9) Although in the period before the Ukraine crisis NATO would not accept the argument that the

3) Step 7: Reduction in NATO Intelligence Capabilities Concerning Russia

Over the period 2000-2013 NATO countries significantly scaled back intelligence efforts focussed on Russia (CIA/DIA in the USA and MI6/Ministry of Defence in the UK) because the conventional wisdom was that Russia no longer posed serious ideological, political or conventional force threats to security in Europe. After 9/11 the main focus of NATO intelligence efforts was on the threats posed by Islamic terrorists in the Taliban, al Qaida, and local groups (this was pre-ISIS). Intelligence agencies reduced the priority of Russia, cut resource allocations to this mission, did not develop a successor generation of intelligence officers with language capabilities, and redeployed experienced analysts with Russia/Ukraine area knowledge to the War on Terror. This downgrading was accompanied by the physical disposal of unique hard copies (prepared in the pre-electronic era) of intelligence reports and analyses of obscure places that appeared to the NATO elite to have no further significance, such as heavy and defense industry factories in East Ukraine. As a result of these policies, NATO countries were not in a strong position to analyse the likely evolution of the Ukraine conflict or the covert responses to it by Russia during 2013-14.¹⁰⁾

actions of its European member countries in reducing defense expenditures and military capabilities were undermining conventional deterrence, since 2014 NATO has justified its redeployments of troops and weapon systems to East Europe and Baltic states and calls for increased defense spending by claiming that these measures will deter future aggressive military moves by Russia.

4) Step 8: Russia's Military Power Balances and Relationships with Asia

Russia intensified its military links with Central Asia and Asia countries in the 2000s. In the case of the Central Asian states, this was carried out through the CIS and the Collective Security Treaty Organization. India and Vietnam remained historic military allies and cooperation in the military sphere with China improved. Russia remained supportive of North Korea, but was careful to develop a more positive relationship with South Korea. There was little military cooperation with Japan, which remained critical of Russia and aggrieved over its lost territories.

The dynamics of Russia's military links with Asia are reflected in arms exports to the region, which increased from \$3.1 billion (67.9% of total Russian arms exports) in 2000 to a peak of \$5.5 billion (65.3%) in 2012 (see Table 9). China was the major customer for Russian weapons in the early 2000s, but it was overtaken by India after 2006.

The conventional military balances between Russia and Asian countries shifted in favor of the latter in the 2000s (Table 10). By 2013 Russia had fewer military personnel (845,000) than China (2.2 million), India (1.3 million) or

10) The Directors of Central Intelligence/CIA who were responsible for the USA's intelligence capabilities related to Russia in this period were: 1997-2004 George Tenet; 2004-2006 Porter Gross; 2006-2009 Michael Hayden; 2009-2011 Leon Panetta; 2011 and 2012-2013 Michael Morell; 2011-2012 David Petraeus; 2013-2017 John Brennan. Due to space constraints it is not possible to call attention to the equivalent treatment of Russia by the USA Director of the DIA, UK Head of MI6, and Chief of Defence Intelligence, UK Ministry of Defence.

North Korea (1.2 million). Russian military expenditure increased 2.7 times in real terms from 2000 (\$28.8 billion 2014) to 2013 (\$79.0 billion), but defense expenditures of China remained substantially higher throughout this period (\$182.9 billion in 2013). In that year India spent \$48.4 billion on defense and Japan \$46.4 billion.

With respect to conventional weapons, in 2000 Russia had overwhelming superiority with, for example, 21,820 main battle tanks compared with 7,060 for China, 3,414 for India and 3,500 for North Korea. But by 2013 the Russian modernization program had reduced its active tank stock to 2,800 (about 18,000 older models had been moved to storage), whereas China, India and North Korea maintained previous levels of ready tanks. However, Russia was more advanced than Asian countries in military R&D and the defense industry, which enabled it to maintain a technological lead.

Table 9. Russia Arms Exports in Total and to Asia Countries, 2000–2015

Countries	Millions of US\$ at Constant (1990) Prices												2015 as % of 2013
	2000	2005	2008	2009	2010	2011	2012	2013	2014	2015	Average 2000–15	Total 2000–15	
China	2,231	3,107	1,529	1,102	744	811	741	870	714	824	1,652.7	26,443	94.7
India	655	653	1,555	1,464	2,391	2,593	3,953	3,782	1,871	1,964	1,873.8	29,981	51.9
North Korea	18	5	5	4	1						6.6	106	
South Korea	29	86									16.2	259	
Vietnam	2	233	153	55	151	987	713	313	983	812	304.4	4,870	259.4
Central Asia	121	41	8	87	64	180	131	67	45	412	92.8	1,485	614.9
Kazakhstan	121	38	8	19	50	45	75	54	28	412	70.8	1,133	763.0
Kyrgyzstan		3									0.8	12	
Tajikistan				32							3.3	52	
Turkmenistan				36	14	135	56	13	17		16.9	271	0.0
Uzbekistan											1.1	17	
Total to Asia	3,056	4,125	3,250	2,712	3,351	4,571	5,538	5,032	3,613	4,012	3,946.5	63,144	79.7
Total to World	4,503	5,210	6,265	5,070	6,172	8,695	8,480	8,107	5,468	5,483	6,047.7	96,763	67.6
Asia Share (%)	67.9	79.2	51.9	53.5	54.3	52.6	65.3	62.1	66.1	73.2	65.3		

Note: The export figures in the table are SIPRI Trend Indicator Values (TIVs).
 Source: Prepared by C. Davis in 2016 using material from SIPRI (2016) Arms Transfers Database <http://www.sipri.org/databases/armstransfers/background>.

Table 10. Military Power Balances of Russia and Countries of Asia, 2000–2015

Year	2000	2005	2008	2010	2012	2013	2014	2015	2015 as % of 2000	2015 Ratio Asia to Russia
Armed Forces Personnel (Thousands)										
Russia	1,004	1,037	1,027	1,027	956	845	845	798	79	1.00
China	2,470	2,255	2,105	2,285	2,285	2,285	2,333	2,333	94	2.92
India	1,303	1,325	1,288	1,325	1,325	1,325	1,325	1,346	103	1.69
Japan	237	240	240	230	248	247	247	247	104	0.31
North Korea	1,082	1,106	1,106	1,106	1,190	1,190	1,190	1,190	110	1.49
South Korea	683	688	687	687	655	655	655	628	92	0.79
Vietnam	484	484	455	455	482	482	482	482	100	0.60
Military Expenditure in Constant 2014 PPP Dollars, SIPRI (Millions)										
Russia	28,838	43,010	56,933	60,940	75,364	79,030	84,697	91,081	316	1.00
China	43,230	79,809	113,527	144,383	169,321	182,930	199,651	214,485	496	2.35
India	27,266	35,548	41,003	48,470	48,766	48,406	50,914	51,116	187	0.56
Japan	46,315	47,155	45,515	46,527	46,584	46,380	45,867	46,346	100	0.51
North Korea	8,181	8,135	7,959	7,092	7,006	7,235	7,457	7,728	94	0.08
South Korea	22,111	27,283	31,479	33,730	35,070	36,175	37,286	38,640	175	0.42
Vietnam	1,500	1,845	2,759	3,378	3,672	3,840	4,256	4,581	305	0.05
Main Battle Tanks (Number)										
Russia	21,820	22,800	23,000	23,000	2,800	2,800	2,550	2,700	12	1.00
China	7,060	7,580	7,660	6,550	7,400	7,430	6,840	6,540	93	2.42
India	3,414	3,978	4,059	4,047	3,233	3,274	2,874	2,974	87	1.10
Japan	1,050	980	900	880	806	777	777	688	66	0.25
North Korea	3,500	3,500	3,500	3,500	3,500	3,500	3,500	3,500	100	1.30
South Korea	2,330	2,330	2,330	2,750	2,414	2,414	2,414	2,418	104	0.90
Vietnam	1,315	1,315	1,315	1,315	1,315	1,315	1,270	1,270	97	0.47

Note: The large drop in the number of Russian tanks from 2010 to 2012 was due the processes of military reform and modernization of equipment, which resulted in around 18,000 older tanks being moved into storage.

Sources: Prepared by C. Davis in 2016 using material from SIPRI Military Expenditure Database Online version and IISS *Military Balance* 2000–2015.

The main relationships between Russia and Asian countries in 2013 are shown in Diagram 5. In contrast to Europe, all them (not counting the USA as a Pacific power) either were partnerships (Central Asia, China, India, North Korea, Vietnam) or neutral (Japan, South Korea). This meant that the shifting of economic and military balances to the advantage of Asian countries were not as threatening to Russia as they would have been in a more adversarial situation.

5) Step 9: Russia–Ukraine Military Balance

The economic and military balances in 2013 between Russia and Ukraine were strongly in favor of the former (see Table 5 in Davis 2016). Russia had three times the population and GDP Per Capita of Ukraine and nine times the GDP (PPP). In the military sphere Russia had substantially greater numbers of armed forces personnel and weapons, had raised the priority of its defense sector, and had been devoting more resources to defense both in absolute terms and as a share of GDP. Its armed forces had acquired combat experience in the Caucasus and operated at a higher state of readiness. In contrast, the Ukrainian government had maintained a low priority ranking for its armed forces throughout the 2000s, which resulted in low wages, technologically backward equipment, and poor operational capabilities.

6) Step 10: Syria Civil War, Russia's Support of the Syrian Government, and the Growing Importance of the Black Sea and Crimea to Russia

The USSR in the Cold War period and Russia over more recent decades viewed Syria as a close partner in the Middle East and was its main supplier of weapons and military equipment. The unrest in the Middle East associated with the 'Arab Spring' of 2010-2012 resulted in the overthrow of governments in Tunisia, Egypt (later reversed) and Libya (supported militarily by France, UK, and the USA). It also provoked street demonstration in many countries and civil wars in Iraq, Syria and Yemen.

From 2011 Russia provided weapons, munitions and military advice to Syria related to the intensification of the civil war as the result of the increasing involvement of foreign powers that supported either the government (Iran, Russia) or the opposition (France, Gulf States, Saudi Arabia, Turkey, UK, USA). Most deliveries of armaments and other supplies by Russia to Syria originated in Black Sea ports in the Russian Federation and Crimea. This made reliability of sea-based supply lines, including the ports of Crimea, an important national security issue for Russia.

C. Defense–Economic Power Balances and the Conflict in Ukraine 2013–2016 (Diagram 6)

1) Step 11: Malfunctioning of the Ukraine Economy, Failure of the Orange Revolution, Continuing Corruption, and the Election of President Yanukovich

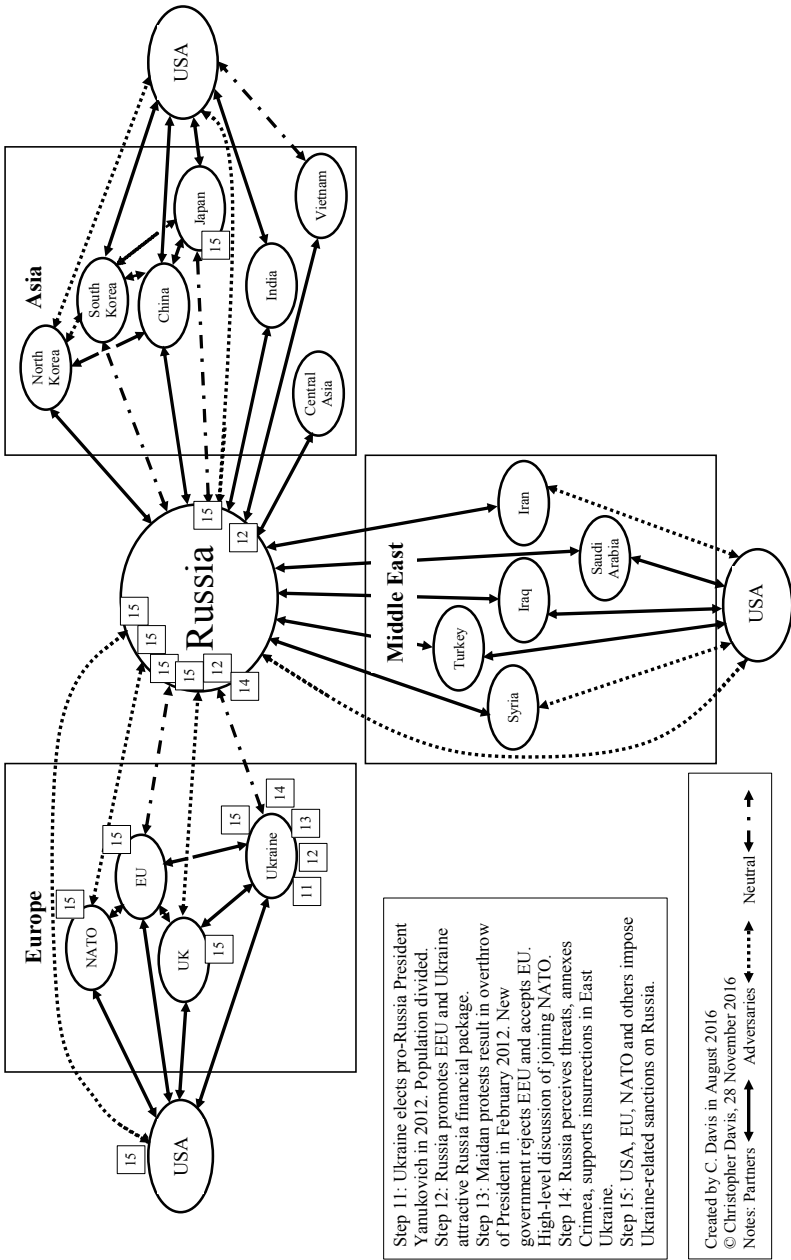
Ukraine has had a democratic political system, but one with instability due to the division of the population between pro-Europe segments in the West and pro-Russia ones in the East (Huntington 1996).¹¹⁾ During the 2000s most early-phase transition problems remained in the economy of Ukraine: weak institutions, indirect bureaucratic control (HP 1), corruption of the state (HP 2), negative value added in industry (HP 3), low productivity, and inadequate investment.

The peaceful ‘Orange Revolution’ in 2004-2005 brought to power a pro-West government that promised political and economic reforms. But it proved to be ineffectual in improving productivity and in eradicating hidden corrupt practices that severely distorted economic processes. Although growth of GDP in Ukraine averaged 7% over 2000-2008 (from a low base), it contracted by 15% in 2009. In 2010 the population elected the more pro-Russian President Yanukovich.

11) Huntington (1996, 165) claimed that Ukraine is a ‘cleft country’ that contains a ‘civilizational fault line’ between areas with backgrounds in Western empires and those rooted in Russian Orthodoxy and suggested that this could lead to the fragmentation of the country. See related maps on pages 159 and 166.

Russia's Changing Economic and Military Relations with Europe and Asia from Cold War to the Ukraine Conflict: The Impacts of Power Balances, Partnerships, and Economic Warfare

Diagram 6. Russia Relationships During 2012–2016 with Countries in Regions of the World and the Ukraine Crisis (Steps 11, 12, 13, 14, 15)



2) Step 12: Continuing Economic Problems in Ukraine, Russia's Plans for the EEU, and the Ukraine Government's Decision to Join the EEU Rather than Pursue Integration with the EU

Economic difficulties intensified in Ukraine in the aftermath of the GFC because it did not possess a natural resources-based Stabilization Fund like Russia and was unable to attract risk-averse foreign investors or to benefit from most EU assistance programs because it was not a member state. During 2010-13 Ukraine had a low average growth rate of 2.4% (zero in 2013), chronic budget and current account deficits, and high foreign debt to GDP burdens (79% in 2013). Ukraine remained dependent on Russia as an energy supplier and a market for exports of uncompetitive industrial commodities (HP 5) (Gaddy and Ickes 2014a).

By 2013 it was evident that Ukraine needed to obtain substantial external help for its faltering economy either from the EU/IMF or from Russia. To simplify, the EU offered Ukraine a modestly-scaled package with tough conditions (wide-ranging reforms and a Greece-style austerity program) and no guarantee of EU membership, whereas Russia offered generous subsidies and financial support for joining the new EEU. In autumn 2013 the government of President Yanukovich took the decision to pursue the latter course.

3) Step 13: Public Protest over the Decision to Join the EEU, Revolutionary Overthrow of President Yanukovich

The Maidan protest movement evolved into an increasingly violent civil

conflict that eventually resulted in the overthrow of the President in February 2014 (Gaddy and Ickes 2014a, UK House of Lords 2015). The successor interim government reversed foreign economic policies to favour the EU and important elements of it expressed an interest in joining NATO (Gaddy and Ickes 2014c). Since then the IMF, European Commission and USA have been providing Ukraine with financial assistance that is linked to economic reform and austerity.¹²⁾

4) Step 14: Russia's Threat Perceptions, Annexation of Crimea, and Support of Insurrections in East Ukraine

Russia was most displeased by the withdrawal of Ukraine from the EEU near to its launch date (January 2015), disapproved of the revolutionary change of government in Ukraine, and perceived a risk that it would lose its important military bases in Crimea (perhaps to NATO), which give it access through the Black Sea to the Mediterranean Sea (e.g. for naval transport of weapons systems and ammunition to Syria). Since the bilateral economic and military balances with Ukraine were in Russia's favor and conventional deterrence in Europe of NATO had degraded to a negligible level (Table 3), it implemented

12) IMF (2014) announced a \$17 billion support package in April 2014, and subsequently dispersed \$4.5 billion of it. In February 2015 a new \$17.5 billion conditional loan was approved to replace the initial one (IMF 2015). The EC provided Ukraine with Macro-Financial Assistance loans of (in millions) €100 (May 2014), €500 (June 2014), €260 (November 2014), €500 (December 2014) and €250 in (April 2015). It has approved an additional €1.5 billion in assistance for Ukraine (EC 2015).

a covert military operation to take control of Crimea and followed that by annexing the territory to the Russian Federation.

During Spring 2014 insurrections by pro-Russian forces developed in the East Ukraine regions of Luhansk and Donetsk that received hidden assistance from Russia (Allison 2014; IISS 2014, 2015). In June 2014 the Ukraine government attempted to re-establish control in the East by sending in its poorly prepared armed forces (supplemented by nationalist militias), which resulted in an intense armed conflict that ended in stalemate and the Minsk II peace agreement. During the active phase of the conflict a civilian airliner (Malaysia Airlines Flight 17) was shot down.¹³⁾

5) Step 15: Western Economic Sanctions Related to the Ukraine Conflict

In Summer 2014 economic sanctions were imposed on Russia by the EU, USA, Canada, Japan, and several other countries in response to the annexation of Crimea, the war in the eastern regions of Ukraine, and the shooting down of Malaysia Airlines Flight 17 (EWF 1). The official measures included: ① actions against individuals who played roles in the Crimea/Ukraine conflicts; ② trade embargoes; and ③ restrictions on finance. In addition, the Ukraine

13) On 28 September 2016 a Dutch-led Joint Investigation Team published a preliminary report on the incident that concluded that the airliner had been shot down by a Series 9M83 Buk missile in East Ukraine that had been transferred to the insurgents from the weapons inventory of the Russian Federation (BBC 2016). The Russian government has disputed these findings.

government subjected Russia to wide-ranging political and economic sanctions (e.g. banning Russian planes from flying through Ukrainian airspace) (EWF 4). NATO has supplemented these sanctions with military ones, notably by re-deploying troops, tanks and aircraft to 'front-line states' (notably the Baltic countries) for military exercises and border patrols and by providing the Ukrainian armed forces with military trainers and non-lethal military supplies.

D. The Deterioration of the Economy of Russia During 2014–2016, Impacts of Oil Prices and Sanctions, and Russia's Re-orientation to Asia (Diagram 7)

1) Step 16: Deterioration of the Economy of Russia

Developments in the economy of Russia in 2014-2016 were predominantly unfavorable, especially in 2015 (Table 11): negative GDP growth (-3.7%); acceleration of inflation to 15.5%; increase in the budget deficit to 3.5% of GDP and wide-ranging budget cuts of 10%; rises in interest rates to a peak of 17%; a 40% depreciation of the ruble-dollar exchange rate; large outflows of capital; higher risk premiums on bonds; and increases in unemployment and poverty (World Bank 2015abc; EBRD 2015, 2016; RF MER 2015). In the positive category in 2016 were the substantial surplus in the current account (5.2% of GDP), increases of import substitution production in Russian industry and agriculture, and reduction of external debt (to 27% of GDP).

Table 11. Performances of Economy of the Russian Federation, 2009–2016

	2009	2010	2011	2012	2013	2014	2015	2016	Average 2009–2016
GDP growth (%)	-7.8	4.3	4.3	3.5	1.3	0.7	-3.7	-0.6	0.3
Inflation (average annual %)	8.8	8.8	6.1	5.1	6.8	7.8	15.5	7.0	8.2
Government balance/ GDP (%)	-5.9	-4.0	0.8	0.4	-1.2	-1.1	-3.5	-4.0	-2.3
Current account balance/ GDP (%)	4.0	4.7	5.3	3.3	1.5	2.8	5.2	3.1	3.7
External debt/GDP (%)	38.2	32.9	27.6	29.3	32.7	29.5	39.1	27.0	32.0

Source: Prepared by C. Davis in 2016 using material from EBRD *Transition Report* 2013 ... 2016.

In order to assess the causes of the worsening economic situation in Russia it is necessary to evaluate not only the impacts of economic sanctions, but also the large drop in oil prices and strains on a weak economic system caused by new commitments of Russia in Ukraine. These explanatory factors are considered in the following sub-sections.

2) Step 17: The Impacts on Russia of the Fall in the World Market Price of Oil

A global development that adversely affected the economy of Russia from summer of 2014 was the drop in the world market price of oil (OPEC crude oil basket) from \$115 per barrel in June 2014 to \$50 in January 2015 and around \$31 in January 2016.¹⁴⁾ This external shock lowered Russia's dollar

14) A full explanation of the decline in the oil price is beyond the scope of this article. In brief,

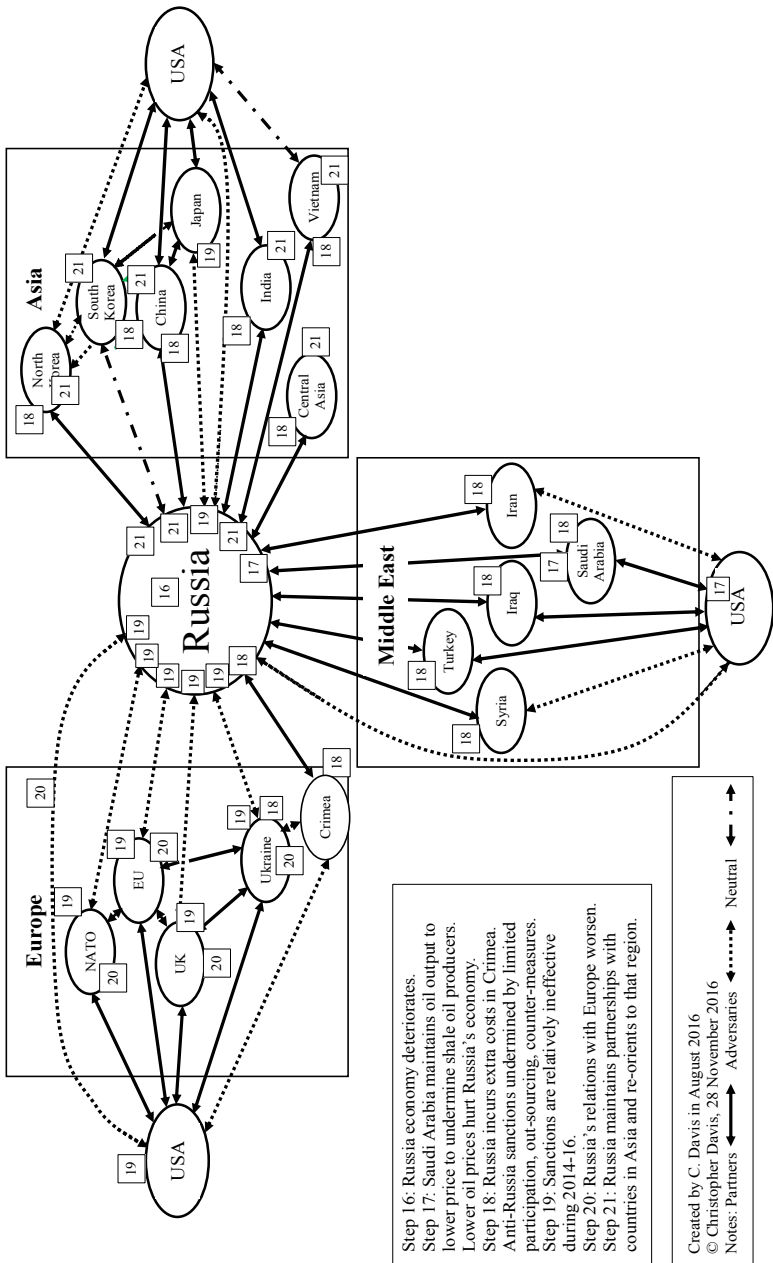
earnings from energy exports, which weakened the financial positions of its banks, businesses and government.

During 2014-16 Russia was able to use its RMS (HP 4) and its substantial Reserve Fund and Sovereign Wealth Fund to buffer partially the population, corporations and the financial sector from the adverse impacts of the sanctions. But the lower oil price reduced revenue flows through the RMS and prevented the replenishment of the stabilization funds, which are expected to be depleted in 2017.

At this stage it is appropriate to consider the counter-factual of the oil price not falling. If Russia had continued to receive payments of \$115 per barrel from June 2014 through 2016, it is likely that many of the negative phenomena in the Russian economy would not have developed. But since the oil price did drop, it is necessary to try to evaluate the impacts on the economy of non-energy factors, such as additional costs of the Ukraine intervention and economic sanctions.

by 2014 the oil market had entered a disequilibrium state of supply exceeding demand at the prevailing price due to sluggish growth of the global economy and rising production by traditional suppliers (e.g. Russia), countries whose output had been disrupted by wars and sanctions (Iraq, Iran), and the USA through the high-technology extraction of oil from shale deposits. In order to maintain its market share and undermine competitors Saudi Arabia decided to keep up its production of low cost oil, with the goals of driving down the world price and bankrupting high cost producers in North America and elsewhere.

Diagram 7. Russia Relationships During 2000–2016 with Countries in Regions of the World and the Ukraine Crisis (Steps 16, 17, 18, 19, 20, 21)



3) Step 18: Non-Energy Factors Affecting the Russian Economy Related to the Ukraine conflict and Sanctions

The annexation of Crimea and activities of Russia in East Ukraine have resulted in additional expenditures from the state budget: infrastructure and social investment (e.g. a new bridge to Crimea from Russia); wage and pension payments; military operations and maintenance costs; and subsidies of energy and raw materials for enterprises and cities. In March 2015 former Russia Finance Minister Kudrin estimated that the costs to Russia to that date of the support of Crimea to have been about \$7 billion and that the combination of direct and indirect costs (some generated by sanctions) over three years would amount to around \$150 billion (TASS 2015).

Two features of anti-Russia economic sanctions have undermined their effectiveness: participation and outsourcing. The sanctions have had the support of important countries with a collective GDP of US \$42.5 trillion. However, Table 12 shows that seven major industrial countries (Brazil, China, India, Indonesia, Iran, South Korea, Turkey) with collective GDP of US \$31.5 trillion have declined to participate (EWF 5 Comprehensiveness). Most goods and services restricted by USA/EU sanctions can be legally acquired in the well-developed and diverse non-participating countries.¹⁵⁾ This suggests that the

15) It appears that the USA believes in the extra-territorial applicability of its laws and administrative decrees (Ukraine sanctions are decrees of the President, not laws approved by Congress). It therefore applies direct and indirect pressure on foreign companies and banks to comply with US sanctions, even if their country is not participating. These secondary sanctions usually take the form of threatening difficulties in the US market for banks and companies that would like

current sanctions are much leakier than the marginally effective ones of the Cold War *CoCom* period.

Table 12. GDP of Participant and Non-Participant Countries in Anti-Russia Sanctions in 2013

Country	GDP PPP US \$ Billions, Current 2013
Participants in Sanctions	
EU Countries	17,578
USA	16,768
Japan	4,668
Canada	1,518
Australia	1,053
Switzerland	432
Norway	328
New Zealand	151
Total	42,496
Non-Participants in Sanctions	
China	16,149
India	6,776
Brazil	3,013
Indonesia	2,389
South Korea	1,697
Turkey	1,444
Iran	1,244
Total	31,467

Source: Prepared by C. Davis in 2016 using material from IMF (2015b) and published in Davis (2016).

to deal with Russia. These US actions can have short-term positive effects in enforcing economic sanctions, but usually have long-term negative effects because the foreigners resent US government interference in their business operations. This factor was evident in the decisions taken in the early 1980s by European banks and companies (with the support of their governments) to ignore tough sanctions imposed by the USA on the USSR and, instead, to help the Soviet Union build its 4,000 kilometer West Siberia to Europe gas pipelines (CIA 1981).

Another problem related to the enforceability of sanctions is that NATO countries have transferred much of their electronic and high-technology production to lower wage non-participating countries, unlike in the more restricted Cold War period.¹⁶⁾ As a result, significant production that is sensitive to national security is no longer controlled by national authorities in countries like the UK and USA.¹⁷⁾

Third, the Russian government has responded to foreign sanctions by adopting numerous counter-measures (EWF 7) (Davis 2016). With respect to Ukraine, it imposed restrictions on that country's exports of agricultural and industrial goods to Russia, cut energy subsidies, and demanded pre-payment of gas supplies.¹⁸⁾ It banned imports of food from the countries imposing sanctions (notably those in the EU) and imposed restrictions on Western firms operating

16) Vernon and Kapstein (1991) edited a special issue of *Daedalus* that examined the break-down of the Cold War practice of maintaining national capabilities in defense industries as a result of the seemingly inexorable trend toward globalization. Over the past 25 years no NATO defense sector has been able to sustain autonomous military R&D and production capabilities. Instead, many critical components of weapons/sensor production have been out-sourced to low-cost high-tech countries, such as the People's Republic of China. Russia and China have established close links in the technological espionage and weapons production spheres.

17) President-elect Trump has focussed on the problem of previously successful industrial regions in the USA losing out to low-cost foreign producers due to free trade agreement, without adequate compensation of the losers (the USA elite has done extremely well). He has not yet mentioned the detrimental impacts on US national security of globalization as practiced by US conglomerates.

18) Gaddy and Ickes (2014a) point out that Russia is the sole market for many Ukrainian industrial goods because of historically-determined technological compatibilities and their uncompetitive characteristics. So Ukraine's embargo on exports of industrial products to Russia is likely to mean that its firms will not find alternative customers. Some Russian industrial firms face similar difficulties due to Ukrainian restrictions on imports.

in Russia. The Russian government has supported numerous import-substitution programs (Hanson and Connolly 2016). In response to the embargo on exports of military equipment (e.g. helicopter carriers from France), Russia has been moving back toward self-sufficiency in defense and has revived aspects of the priority protection system in the economy. Russia also has intensified the activities of its large and capable *Spetsinformatsiya* system (EWF 7, HP 6). Russian intelligence missions of technological espionage and trade diversion have been facilitated by the decentralized business decisions in profit-oriented NATO countries to move sensitive defense production abroad (e.g. cutting jobs at home) to less controllable environments (e.g. the communist People's Republic of China).

4) Step 19: Effectiveness of Anti–Russia Sanctions

Davis (2016) presents assessments (not reproduced fully in this article) of four types of Ukraine-related economic sanctions: actions against individuals; restrictions on trade; restrictions on finance; and actions against Russia as a state. Table 13ab summarizes findings concerning goals of sanctions and their impacts (economic, military, political), which have been, in sum, modest.

Restrictions on exports to Russia of military and energy extraction technologies have had some detrimental effects, but the sanctions have been offset by moves to self-sufficiency and import-substitution, black market activities, technological espionage, and reduced demand for investment in energy projects (a global phenomenon). The financial sanctions have had negative impacts on the specified

banks and firms (difficulties in obtaining new loans and rolling over existing ones) and indirect adverse consequences for other Russian companies because of uncertainty in global markets about USA informal secondary sanctions. However, the Russian government has assisted targets of sanctions and, in any event, most Russian external debt obligations in 2014 were with Russian entities and have been re-scheduled (Connolly 2015b). Furthermore, informal channels (HP 2) have been used to obtain financing in the complicated and ineffectively regulated global financial system.¹⁹⁾ The most important effect of these Western financial sanctions probably has been to make the most market-oriented Russian businesses and banks become more dependent on the Russian state (Gaddy and Ickes 2014b).

19) The Global Financial Crisis provided ample evidence about the ineffectiveness of financial regulators in the UK and USA. The UK relied on the risk-averse Crown Prosecution Service to bring charges against violators of rules in the financial sector and, unsurprisingly, it found virtually no evidence of criminal activity in the UK. The USA engaged the FBI and the U.S. Attorney's Office for the Southern District of New York in the investigation into the inter-connections between the GFC and Wall Street and, unsurprisingly, they found significant evidence of criminal activity in the USA financial sector.

Table 13a. Impacts of Ukraine–Related Foreign Sanctions on Russia During 2014–16

Type of Sanction	Goals	Economic Impacts	Military Impacts	Political Impacts
Actions against Individuals				
Bans on travel (no visas)	Punish participants in Ukraine conflict and put pressure on Russian government to change policies.	Negligible from travel ban. But asset freezes and bans on business have micro impacts.	Negligible. Russia bans officials from foreign travel and accounts.	Negligible. Russians would boast not complain about sanctions.
Freezing of assets				
Bans on business dealings				
Restrictions on Trade				
Bans on exports to or imports from Crimea	Disrupt economy of Crimea and force Russia to increase subsidies to it.	Sanctions disruptive and Russia forced to increase support.	Negligible.	Popular support for annexation, but complaints about subsidies could grow.
Bans on transactions by foreign businesses in Crimea				
Embargoes on exports to Russia of weapons and military equipment	Constrain Russian military power, discomfort national security elite	Cuts in spending on foreign arms/equipment, funding of import substitution	Disruption of defense supply and industry	Pushes Russia back to self-sufficiency in defense
Embargoes on exports to Russia of dual-use technologies	Constrain Russian economic and military power	Limited due to trade diversion and espionage	Limited due to trade diversion and espionage	Russia tries for self-sufficiency and searches for new partners
Embargoes on exports to Russia of energy exploration technologies (deep-sea drilling, shale)	Constrain development of new oil fields to limit export earnings	Limited in medium-term due to stock-piling, trade diversion and espionage	Negligible.	Russia tries for self-sufficiency and searches for new partners

Table 13b. Impacts of Ukraine–Related Foreign Sanctions on Russia: 2014–2016

Type of Sanction	Goal	Economic Impacts	Military Impacts	Political Impacts
Restrictions on Finance				
Bans on loans to and transactions in Crimea	Disrupt economy of Crimea and force Russia to increase investment there.	Sanctions disruptive and Russia forced to increase financial support.	Negligible.	Leaders committed to covering costs of annexation, but public support could waver.
Restricted access by Russian state-owned/influenced banks and enterprises to West capital markets	Limit new credit and complicate re-financing to increase vulnerability and limit investment in Russia	Sanctions have adverse direct effects on targets and indirect impacts on other Russian companies	Some defense-related firms cannot pursue foreign projects	Sanctions make banks and firms more vulnerable and therefore dependent on state. Helps consolidate regime.
Reduction in the period of loans in capital markets to 30 days	Increase vulnerability of specified banks/companies		Foreign operations of some firms impeded	
Freezing of the assets of specified Russian firms of individuals	Complicate international transactions of target firms/banks (individuals)	Some impacts until counter-measures in place	Negligible	Firms use sanctions as a plus to obtain state support
Actions Against Russia as a Country				
Expulsion of Russia from G8	Undermine status of leaders, exclude for important discussions	Negligible	Negligible	Viewed as insulting by Russian elite, but minor impacts

Sources: Prepared by C. Davis in 2015 using the materials identified in Table 10 of Davis (2016), as well as new information obtained in 2016.

5) Step 20: Russia's Relationships and Economic Balances with USA and Europe

Russia's political, economic and military relationships with NATO/EU countries deteriorated significantly after the annexation of Crimea and the imposition of anti-Russia sanctions (see Diagrams 6 and 7). Few government leaders or organizations in the West have maintained more than basic, strained relations with their Russian counter-parts. The worsening of economic relations was reflected in large reductions in investment in Russia by entities in the sanction-imposing countries. The value of Russia's total exports dropped from \$527 billion in 2013 to \$344 billion in 2015, or by 35%. This was driven by a 43% drop in exports to EU countries and a 53% decline in sales to Ukraine, previously one of Russia's largest customers. Russia's economic power balances with the USA and leading countries in Europe became more unfavorable after 2014. This was due to the fact that Russia's energy-dependent economy experienced recession because of the drop in oil prices, whereas the economies of the USA and the main countries in the EU achieved positive growth and increased their competitiveness.

Russia's strategic nuclear balance with the USA/UK/France remained unchanged during 2014-2016, while the conventional force balance in Europe remained in favor of Russia. The Russian military received substantial quantities of new equipment, carried out large scale military exercises, deployed new weapons in Kaliningrad and border regions, and acquired additional combat experience in

counter-insurgency operations and in sophisticated all-arms warfare in Syria. NATO conventional forces in Europe remained insufficient to re-establish credible direct deterrence, even though some efforts were made to improve combat readiness and to deploy forces to the Baltic states and East Europe. However, it was understood on both sides that NATO possessed substantial reserves and had a higher technological standard than the Russian military, so there was credible indirect (e.g. mobilization-related) conventional deterrence.

The subject of Russia's military threat to European countries is related to issues discussed above, so it is addressed briefly below. By 2016 Russia was facing adverse shifts in economic and military balances in Asia, engaged in challenging counter-insurgency operations in Central Asia (e.g. Tajikistan) and the Caucasus, dealing with five 'frozen conflicts' (Transnistria, Abkhazia, South Ossetia, Nogorno-Karabakh, and East Ukraine), heavily involved in a military campaign in Syria against ISIS and other enemies of the Syria government and experiencing strains in maintaining ready reserves of high-quality troops. Given this situation, it is unlikely that Russia has had recently or will have intentions to become involved in armed conflicts with countries in the Baltic area, Scandinavia (Finland, Sweden, Norway), or East Central Europe (Poland), which probably would result in engagements with technologically-superior NATO forces. Although some national security officials in these countries have been warning of a Russian military threat, government fiscal policies (e.g. continued low defense expenditure) demonstrate lack of the 'will to provide for military power' (see the concept in Section 2). This may reflect the reluctance

of parliaments and voting citizens to cut social welfare, education and health spending to support a military build-up to counter a threat that they perceive to have a low probability.

6) Step 21: Russia's Re-orientation to the Middle East and Asia During 2014–2016

Although Russia's relationships with European countries became and remained adversarial during 2014–2016, it maintained or developed partnership relationships with all major countries in the Middle East (Iran, Iraq, Saudi Arabia, Syria, Turkey) and with most in Asia (Central Asian states, China, India, North Korea, Vietnam) (Diagrams 6 and 7). It had a neutral relationship with South Korea and an adversarial one with Japan.

In the economic sphere, Russia made energetic efforts to improve trade, finance and investment linkages with the economies of Asia, which continued to grow rapidly. However, Table 5 shows that exports to the five selected Asian countries (China, India, Japan, South Korea and Vietnam) fell by 22% from 2013 to 2015. Since this decline was significantly lower than the reduction in trade with Europe, the Asia share of Russia's world exports increased. Russia achieved limited success in obtaining loans through the growing Asian financial markets, but it reached agreements to start numerous large scale infrastructure (rail transport, roads, energy pipelines) projects in Asia. Another potentially positive development was that the EEU was established in January 2015 and by 2016

included Armenia, Belarus, Kazakhstan, Kyrgyzstan and Russia. Overall, there was a limited economic re-orientation of Russia to Asia during the period 2013-2016.

In response to the Ukraine-related deterioration of relationships with NATO, Russia has intensified its military cooperation (e.g. joint military exercises) with Central Asian countries, China, India and Vietnam. Due to economic and geo-political factors Russian arms exports to Asia decreased from an annual average of \$5.3 billion over 2012-13 to \$3.8 billion over 2014-15, or by 28% (Table 9). However, total arms exports dropped by 34%, so the Asia share of the total increased. China, India, Japan, North Korea and South Korea continued to spend heavily on defense and to enhance capabilities. Given these developments, it can be concluded that Russia's military balances with Asia worsened, despite the improving capabilities of the Russian armed forces.

4. Changes in Russia's Long-Term Plans for Economic Relations with Asia: From *Strategy 2020* in 2012 to *Strategy of Russia in 2018–2024* in 2017

A. Russian Post-Ukraine Conflict Scenarios of the Economic Future

Russia's baseline scenario of the future expressed in *Strategy 2020* (see

Table 7) was optimistic (oil prices over \$100 per barrel and GDP growth of 3-4% per annum) and anticipated further integration with the EU zone (Strategiya 2020). Russian thinking about the future has changed markedly over the past five years. This was reflected in the May 2016 medium-term projections out to 2019 of the *Ministry for Economic Development RF* and is being incorporated into the ongoing work on *Strategy of Russia in 2018-2024*, which will be unveiled in 2017 (RF MER 2016; Strategiya Rossii 2017).²⁰⁾ The revised baseline scenario anticipates continuation of low energy prices and economic sanctions and calls for closer economic integration within the EEU and with the economies of Asia.

B. Prospects for the Economy of Russia out to 2020

The baseline Russian government projection out to 2019 assumes an oil price of \$40 per barrel over the next three years, while a worst-case scenario has been included with an oil price of \$25. Russia GDP growth is forecast to be 0.8% in 2017, 1.8% in 2018, and 2.2% in 2019 (Table 7). Low positive growth is likely to continue to 2020. This modest upward trend appears to be plausible given other likely determining factors.²¹⁾

20) The forthcoming *Strategy of Russia in 2018-2024* document will outline a new economic strategy for Russia that will include more market-oriented reforms and will focus on four priority areas: investment, import substitution, state governance, and budgetary issues (such as pensions).

21) By February 2017 the OPEC Crude Oil Basket price had risen to \$54 because OPEC reached an agreement among its members (and with other countries) to constrain production in the

Table 14 shows that the Russian government anticipates that world GDP will grow by an average of 3.4% during 2016-19. There will be lower than average growth rates for the USA (2.5%), Russia (1.2%), the EU (1.5%), the UK (2.2%), and Japan (0.8%). In contrast, average growth will be 6.2% for China and 7.0% for India. Russia's share of global GDP will decrease from 3.3% in 2015 to 2.9% in 2019, which is a decline of 12%. There will be increases in the shares of China (16.6% to 18.6%) and India (6.8% to 7.9%). Given these global trends, Russia plans to increase its integration with Asia through trade, financial activities and large infrastructure projects.

C. Changes in Russia's National Security Strategy out to 2020

Since the start of the armed conflict in Ukraine in 2014 Russia has produced two important documents related to future military balances. A revised *Military Doctrine* was adopted in December 2014, which clearly identified NATO as the main military threat as a result of the expansion of its membership to include East European and Baltic states, deployment of more conventional forces with high-precision weapons in East Europe, military involvement in the former USSR countries of Georgia and Ukraine, construction of an advanced anti-missile system in East Europe, and encouragement of domestic dissent and unrest in Russia (Voennaya 2014). The second document is the new *National*

future. So the assumptions of the forecasts may be on the pessimistic side.

Security Strategy, which was approved in December 2015 (O Strategii 2015). Both of these documents make it clear that Russia intends to make strenuous efforts to develop the military capabilities necessary to cope with external and internal threats by continuing military reform, upgrading its defense industry and military R&D, and acquiring more advanced weapons and military equipment through the approved *State Armaments Program 2011-2020* (Gorenberg 2010, Nichol 2011).

Table 14. Russian Government Forecast in 2016 of World Economy Out to 2019

Country	2015		2016		2017		2018		2019		Average GDP Growth 2016–19(%)	Ratio 2019 GDP to 2015
	Growth of GDP (%)	Share Global GDP (%)	Growth of GDP (%)	Share Global GDP (%)	Growth of GDP (%)	Share Global GDP (%)	Growth of GDP (%)	Share Global GDP (%)	Growth of GDP (%)	Share Global GDP (%)		
World	3.1	100.0	3.2	100.0	3.4	100.0	3.4	100.0	3.4	100.0	3.4	1.00
USA	2.4	15.9	2.2	15.8	2.4	15.6	2.6	15.5	2.7	15.3	2.5	0.96
Russia	-3.7	3.3	-0.2	3.1	0.8	3.0	1.8	2.9	2.2	2.9	1.2	0.88
EU	1.5	12.0	1.5	11.8	1.4	11.6	1.6	11.4	1.6	11.2	1.5	0.93
UK	2.2	2.4	2.1	2.3	2.0	2.3	2.2	2.3	2.3	2.3	2.2	0.96
Japan	0.4	4.4	0.8	4.3	0.6	4.2	0.8	4.0	1.0	3.9	0.8	0.89
China	6.9	16.6	6.5	17.2	6.2	17.7	6.0	18.2	5.9	18.6	6.2	1.12
India	7.4	6.8	7.4	7.1	7.3	7.4	7.0	7.6	6.3	7.9	7.0	1.16

Source: Prepared by C. Davis in 2016 using material from RF MER 2016.

Although Russia has demonstrated that it has the ‘will to provide’ for military capabilities through higher defense spending, the problems in its domestic economy (flawed economic system) and difficulties in the foreign economic sphere (low oil prices, economic sanctions) have disrupted its ‘economic defense

potential' in general and the ambitious armaments program in particular. Over the next four years it can be anticipated that Russia will improve its military capabilities at a modest pace, but this will not be sufficient to prevent its military balances with both NATO Europe and Asia from deteriorating.

D. Prospects for Russia's Economic and Military Relationships with Asia out to 2020

It is likely that Russia will continue to reorient its economic strategy to Asia and will make efforts to improve political and military relationships in that region. This reorientation reflects both Russia's existing adversarial relationships with countries in Europe, and with the EU and NATO as organizations, and the positive partnerships that the country has developed in the relatively peaceful and rapidly growing Asia region.

It should be recognized, though, that there will be unanticipated developments in the years ahead. In summer 2016 the UK made the decision to leave the EU and the start of the multi-year Brexit process will be in 2017. This economic dis-integration by the UK will prove to be disruptive to both the withdrawing country and to those countries remaining in the unreformed EU zone. A second major recent event that will contribute to uncertainty was the election of Donald Trump as President in the USA, with the Republican Party keeping control of the Senate and House of Representatives. These two politico-economic developments in core OECD countries reflected the wide-spread

dissatisfaction of majorities of populations with stagnant standards of living, poor job prospects and insecurity of employment, concerns over immigration, and perceptions that their real-life concerns were being neglected by insulated and affluent elites.²²⁾ Since those in charge in Europe appear to be resistant to criticism from below and reluctant to change, dissent and electoral insurgencies are spreading throughout Europe. In late 2016 a large minority of the population of Austria voted for a Far Right candidate for President, while in Italy a populist dominated majority rejected the government reform package of Prime Minister Renzi, resulting in his resignation. During 2017 it is likely that these social forces will influence national elections for parliaments and leaders in France, Germany, Italy and The Netherlands. A third factor that will contribute to future instability is the continuing developments of nuclear weapons and ballistic missiles in North Korea, which will complicate the situations of China, Japan, Russia, South Korea, and the USA.

5. Conclusions

The findings of this paper support the general concept that the position of a country in the global system is strongly influenced by the dynamics of its

22) According to *The Guardian* (2016) the UK Prime Minister recently said in a speech that voters 'see the emergence of a new global elite who sometimes seem to play by a different set of rules and whose lives are far removed from their everyday existence.'

economic and military power. However, the conversion of economic capacity into military strength depends on both a government's commitment to national security goals and institutional arrangements to help ensure that they are achieved.

During 2000-13 Russia significantly augmented its economic power, with substantial assistance provided by rising world energy prices. In this period the Russian Federation also was successful at improving its military power despite its relative (to NATO countries) economic weakness due to the effective organization of the defense sector, a raised priority of the military, and increased defense spending (Davis 2002, 2011; IISS 2001...2015).

In Europe the conventional military balance shifted in favor of Russia because NATO Europe countries demonstrated a lack of 'will to provide for military power' (see Section 2.a) by continuing to cut back deployments of conventional forces, reduce defense expenditures, and degrade intelligence capabilities related to Russia well beyond the point when it was clear to anyone who could read IISS *Military Balance* that Russia was enhancing its capabilities. The rapid expansion Eastward of NATO in combination with cuts in NATO defense budgets generated more responsibilities in a period of reduced resource allocations to the military alliance.

Over the 2000s Russia's relationships with the USA and leading European countries became more adversarial for a variety of reasons. In contrast, Russia established partnerships with most of the leading Asian countries, which continued to achieve high economic growth and substantially improved their

military capabilities. Although the power balances in Asia shifted away from Russia, its positive relationships in that region meant that these developments were not perceived as threatening in the short to medium term.

The domestic conflict in Ukraine resulted from the sustained poor performance of the Ukrainian economy, pervasive corruption that resisted eradication, political divisions, and disputes over the future path toward economic integration (EU versus EEU) and the sources of external financial assistance. Russia considered the revolutionary overthrow of the elected pro-Russia government and the re-orientation of its replacement to the EU and NATO to be serious threats to its economic and national security interests and made an assessment that military power balances were in its favor with respect to both Ukraine and NATO Europe. It therefore intervened to annex Crimea and covertly supported the insurgencies in Eastern regions of Ukraine, which caused instability in that country.

Davis (2016) has evaluated the 100 years of economic warfare that the West has waged against Russia from 1917 in attempts to undermine its economic and military power or to influence its international policies and has concluded that these efforts have achieved little success. The recent political, economic and military sanctions imposed on Russia by NATO/EU have coincided with the dramatic fall in world market price of oil since summer 2014 and rising costs to Russia related to Crimea and East Ukraine. These external factors have combined with weaknesses in Russia's economic system to generate poor economic performance and weaken Russia's economic power. But it should be

recognized that sanctions have been undermined by the lack of comprehensiveness of the anti-Russia economic measures, the global diversification of industrial production and financial markets, and counter-vailing actions of the Russian government. As a result, the sanctions on their own have been of limited effectiveness in achieving objectives, especially with respect to alteration of Russian behavior in the national security domain.

The Ukraine conflict and the resulting economic sanctions have transformed Russia's relationships with North American and European countries into openly adversarial ones, whereas it has maintained partnerships with most leading Asian countries (Central Asian states in the EEU, China, India, South Korea, Vietnam). These political circumstances combined with the continued rapid economic growth in Asia have resulted in intensified efforts by Russia to shift its strategy from one of more integration in Europe (expressed in the 2012 Strategy 2020) to one of greater political, economic and military engagement in Asia. The changes in strategy and policies have not yet (as of December 2016) generated significant economic advantages for Russia, but they could prove to be beneficial to that country and its Asian partners in the longer term future.

From the perspective of Russia, the changes in the international environment out to 2020 could be positive if they result in the weakening and/or re-orientation of the EU and NATO bureaucracies, leading to negotiated reductions in economic sanctions and compromises concerning security in Europe. This in turn could result in an unexpected re-engagement of Russia with an EU no longer

containing the strongly adversarial UK. In a similar manner, a less hostile USA could involve Russia more in security arrangements in the Middle East and Asia, notably the management of the Syria crisis and the North Korea challenge. The USA under President Trump could insist that NATO Europe, South Korea and Japan make more substantial contributions to their defense, which could constrain their social welfare programs and economic growth. In sum, it is likely that Russia will continue its shift to Asia out to 2020, but this is not a certain outcome given impending, but rather opaque, developments in the world.

References

- Adler-Karlsson, G. 1968. *Western economic warfare 1947-1967. A case study in foreign economic policy*. Stockholm: Almquist & Wiksell.
- Allison, R. 1996. The Russian armed forces: structures, roles and policies. V. Baranovsky ed. *Russia and European security*. Oxford: Oxford University Press.
- _____. 2014. "Russian 'deniable' intervention in Ukraine: how and why Russia broke the rules." *International Affairs*, 90 (6), 1255-1297.
- Andrew, C. and O. Gordievsky. 1990. *KGB: The Inside Story*. London: Hodder & Stoughton.
- Baldwin, D.A. 1985. *Economic statecraft*. Princeton: Princeton University Press.
- BBC. 2016. "Dutch investigation of aircraft downing MH17 Ukraine plane crash: What we know." *BBC News Online*, 28 September 2016. <http://www.bbc.co.uk/news/world-europe-28357880> (accessed 28 September 2016).
- CIA = See U.S. Central Intelligence Agency.
- Connolly, R. 2015a. Troubled times: Stagnation, sanctions and the prospects for economic reform in Russia. London: Chatham House Russia and Eurasia Programme Research Paper. (February)
- _____. 2015b. "Western financial sanctions won't break Russia." *The Moscow Times*. (28 June). Online version (accessed 3 July 2015).
- Davis, C. 1986. "Economic and political aspects of the military-industrial complex in the USSR." H.-H. Höhmann, A. Nove, and H. Vogel eds. *Economics and politics in the USSR: Problems of interdependence*. London: Westview Press, 92-124.
- Davis, C. 1988. "The second economy in disequilibrium and shortage models of centrally planned economies." *Berkeley-Duke Occasional Papers on the Second Economy in the USSR*, No. 12.
- _____. 1990a. "Economic influences on the decline of the Soviet Union as a great power: Continuity despite change." *Diplomacy and Statecraft*, 1 (3), 81-109.
- _____. 1990b. "The high-priority military sector in a shortage economy." H.S. Rowen and C. Wolf Jr. eds. *The impoverished superpower: Perestroika and the Soviet military burden*. San Francisco: Institute for Contemporary Studies, 155-184.

- _____. 1991a. "Marxist and Soviet defense economics: 1848-1927." C.D. Goodwin ed. *Economics and National Security: A History of the Interaction*. Annual Supplement to Volume 23, *History of Political Economy*. London: Duke University Press, 191-225.
 - _____. 1991b. "The defense sector in the Soviet economy during Perestroika: From expansion to disarmament to disintegration." F.G. Adams ed. *The macroeconomic dimensions of arms reductions*. Oxford: Westview Press, 189-215.
 - _____. 1992. "The changing priority of the Soviet defense sector: 1985-1990." C. Wolf Jr. and S.W. Popper eds. *Defense Sector and the Soviet: Military Muscle and Economic Weakness*. Santa Monica: RAND Note 3474-USDP, 139-168.
 - _____. 1999. "Russia: A comparative economic systems interpretation." J. Foreman-Peck and G. Federico eds. *European industrial policy: The Twentieth-Century experience*. Oxford: Oxford University Press, 319-397.
 - _____. 2002. "The defense sector in the economy of a declining superpower: Soviet Union and Russia, 1965-2000." *Defense and Peace Economics*, 13 (3), 145-177.
 - _____. 2011. "Russia's military reforms and defense budgets 2011-2013: Goals, assumptions, prospects." *Proceedings of U.S. Department of State/Department of Defense Conference on Russian Decision Making and Implications for Defense Spending*. (2 March) Arlington: System Planning Corporation, 1-21.
 - _____. 2014. "Industrial performance in the USSR, 1945-1980: Influences of state priorities, economic system, industrial policies, and hidden processes." A. Nützenadel and C. Grabas eds. *Industrial policy in Europe after 1945. Wealth, power and economic development in the Cold War*. London: Palgrave, 337-371.
 - _____. 2016. "The Ukraine conflict, economic-military power balances, and economic sanctions." *Post-Communist Economies*, 28 (2), 167-198.
- Davis, C. and W. Charemza eds. 1989. *Models of disequilibrium and shortage in centrally planned economies*. London: Chapman and Hall.
- DOD = U.S. Department of Defense.
- EBRD = European Bank for Reconstruction and Development.
- EC = European Commission.
- Ekspertnaya Gruppya NIU VSHE i RANKhiGS. 2012. *Strategiya 2020: Novaya model' rosta - novaya sotsial'naya politika*. Moscow. Scientific Research University Higher

- School of Economics and Russian Presidential Academy of the National Economy and Public Administration. <http://2020strategy.ru/> (accessed 15 May 2015).
- Ellman, M. 1988. *Socialist Planning*, 2nd ed. Cambridge: Cambridge University Press.
- _____. 2000. "The social costs and consequences of the transformation process. In Economic Commission for Europe." *Economic Survey of Europe: 2000 No. 2/3*, Geneva, United Nations, pp. 125-145
- Ellman, M. and V. Kontorovich eds. 1992. *The disintegration of the Soviet economic system*. London: Routledge.
- European Bank for Reconstruction and Development. 1994...2016. *Transition Report: 1994...2016*. London: EBRD.
- European Commission. 2015. "EU support to Ukraine in the economic field." *European Commission website for the European Neighbourhood Policy*. Online version (accessed 4 May 2015).
- FOI = Swedish Defence Research Agency.
- Gaddy, C. 1996. *The price of the past: Russia's struggle with the legacy of a militarized economy*. Washington DC: Brookings Institution Press.
- Gaddy, C.G. and B.W. Ickes. 1998. "Russia's virtual economy." *Foreign Affairs*, 77(5), 53-67.
- _____. 2005. "Resource rents and the Russian economy." *Eurasian Geography and Economics*, 46 (8), 559-583.
- Gaddy, C.G. and B. Ickes. 2010. "Russia after the global financial crisis." *Eurasian Geography and Economics*, 51 (3), 281-311.
- _____. 2014a. "Ukraine: A prize neither Russia nor the West can afford to win." *Brookings Research Articles*. Online version (accessed 22 May 2015).
- _____. 2014b. "Can sanctions stop Putin?" *Brookings Research Articles*. Online version (accessed 3 June 2015).
- _____. 2014c. "Ukraine, NATO enlargement and the Geithner doctrine." *Brookings Research Articles*. Online version (accessed 10 June 2015).
- Goodwin, C.D. ed. 1991. *Economics and National Security: A History of the Interaction, Annual Supplement to Volume 23, History of Political Economy*. London: Duke University Press.

- Gorenburg, D. 2010. Russia's State Armaments Program 2020: Is the Third Time the Charm for Military Modernization, CNA Strategic Studies, PONARS Eurasia Policy Memo No. 125.
- Gregory, P.R. and R.C. Stuart. 1999. *Comparative economic systems*. 6th ed. New York: Houghton Mifflin.
- _____. 2001. *Soviet and post-Soviet economic structure and performance*. 7th ed. London: HarperCollins.
- Hanson, P. 1987. "Soviet industrial espionage. Some new information. London: Royal Institute for International Affairs." *RIIA Discussion Paper*, No. 1.
- Hanson, P. and R. Connolly. 2016. *Import substitution and Economic Sovereignty in Russia*. Chatham House Research Paper. (June)
- Harrison, M. 1985. *Soviet planning in peace and war 1938/1945*. Cambridge: Cambridge University Press.
- Huntington, S. 1996. *The clash of civilizations and the remaking of world order*. New York: Simon & Schuster.
- IISS = International Institute for Strategic Studies.
- IMF = International Monetary Fund.
- International Institute for Strategic Studies. 1990...2015. *The Military Balance in 1990...2015*. London: IISS.
- International Monetary Fund. 2014. "Ukraine unveils reform program with IMF support." *IMF Survey Magazine*. (30 April) Online version (accessed 20 March 2015).
- _____. 2015a. "IMF announces staff level agreement with Ukraine on a new US\$ 17.5 billion Extended Fund Facility Arrangement." *IMF Website-Country Info-Ukraine*. Press Release No. 15/51. Online version (accessed 12 February 2015).
- _____. 2015b. [show as -----]. 2015b.] *World Economic Outlook Database April 2015*. Online version. <https://www.imf.org/external/pubs/ft/weo/2015/1/weodata/index.aspx> (accessed 15 May 2015).
- Joyner, D. ed. 2006. *Non-proliferation export controls: Origins, challenges and proposals for strengthening*. Farnham: Ashgate Publishing.
- Kennedy, P. 1988. *The rise and fall of the great powers: Economic change and military conflict from 1500 to 2000*. London: Unwin Hyman.

- Kim, B.-Y. and Y. Kang. 2009. "Informal economy and the growth of small enterprises: Evidence from Russian regions." *Economics of Transition*, 17 (2): 351-376.
- Knorr, K. 1957. "The concept of economic potential for war." Washington DC: Industrial College of the Armed Forces, Publication No. L57-133, 1-20.
- _____. 1973. *Power and Wealth: The Political Economy of International Power*. New York: Basic Books.
- Kornai, J. 1980. *Economics of shortage*. Amsterdam: North-Holland.
- _____. 1992. *The socialist system: The political economy of communism*. Oxford: Clarendon Press.
- _____. 1994. "Transformational recession: The main causes." *Journal of Comparative Economics*, 19(1), 39-63.
- Kostin, S. and E. Raynaud. 2011. *Farewell: The greatest spy story of the Twentieth Century*. Las Vegas: AmazonCrossing.
- McKinnon, R. 1991. "Foreign trade, protection, and negative value added in a liberalizing socialist economy." R. McKinnon. *The Order of Economic Liberalization*. Baltimore: Johns Hopkins Press, 162-186.
- Maddison, A. 2016. <http://www.worlddeconomics.com/Data/MadisonHistoricalGDP/Madison%20Historical%20GDP%20Data.efp#> (accessed 20 August 2016).
- Marrese, M. and J. Vanous. 1983. *Soviet Subsidization of Trade with Eastern Europe: A Soviet Perspective*. Berkeley: Institute of International Studies.
- Monaghan, A. 2014. *Defibrillating the Vertikal? Putin and the Russian Grand Strategy*. London: Chatham House Research Paper. (October)
- NATO. 2014. Defence expenditures data for 2014 and estimates for 2015. NATO Online database. http://www.nato.int/cps/en/natohq/news_120866.htm (accessed 16 April 2015).
- Nichol, J. 2011. *Russian Military Reform and Defense Policy*. Washington DC, Congressional Research Service. (24 August)
- O Strategii = President of Russia 2015.
- Odom, W.E. 1998. *The collapse of the Soviet military*. London: Yale University Press.
- President of Russia. 2014. *Voennaya Doktrina Rossiiskoi Federatsii*, 26 November 2016 <http://kremlin.ru/events/president/news/47334> (accessed 20 November 2016).

_____. 2015. *Ukaz Presidenta Rossiiskoi Federatsii from 31.12.2015 r. № 683: O Strategii Nacionalnoi Bezopastnosti Rossii*. (31 December) <http://kremlin.ru/acts/bank/40391> (accessed 20 November 2016).

RF MER = Russian Federation, Ministerstvo Ekonomicheskogo Razvitiya

Russian Federation, Ministerstvo Ekonomicheskogo Razvitiya. 2013. *Prognoz dolgosrochnogo sotsial'no-ekonomicheskogo razvitiya Rossiiskoi Federatsii na period do 2030 goda*. Moscow: Konsul'tantPlyus.

_____. 2015. *Plan pervoocherednykh meropriyatii po obespecheniyu ustoichivogo razvitiya ekonomiki i sotsial'noi stabil'nosti 2015 godu*. MER website, 28 January 2015. Online version (accessed 15 April 2015).

_____. 2016. *Tsenarye uslovia, osnovnye parametry, prognoza sotsial'no-ekonomicheskogo razvitiya Rossiiskoi Federatsii... na 2017 god i na planovyy period 2018 i 2019 godov*. MER website. (16 May) Online version (accessed 18 August 2016).

Sapir, J. 1991. *The Soviet Military System*. Oxford. Basil Blackwell Ltd.

SIPRI = Stockholm International Peace Research Institute.

Stockholm International Peace Research Institute. 2000...2015. *SIPRI yearbook: Armaments, disarmament and international security*. Oxford: Oxford University Press.

_____. *SIPRI military expenditure (MilEx) database*. Online version (accessed 3 April 2015).

_____. 2016. *SIPRI Arms Transfers Database*. Online version (accessed 4 November 2016).

Strategiya 2020 = Ekspertnaya Gruppa.

Strategiya Rossii na 2018-2024 gg. 2017. Moscow. Centre for Strategic Research (Tsentr Strategicheskikh Razrabotok). <http://csr.ru/> (accessed 27 December 2016).

Swedish Defence Research Agency. 2010. Economic and military expenditures trends since 1990 for the Russian Federation and for EU and NATO. Stockholm: FOI Memo 3203. (May), 1-81.

TASS. 2015. Russia's losses from Crimea integration estimated at \$150-200 bln – ex-finance minister. *TASS Russian News Agency*. (31 March) Online version (accessed 26 June 2015).

The Guardian. 2016. "The fat cats keep dogging British business. Put them on a diet."

Russia's Changing Economic and Military Relations with Europe and Asia from Cold War to the Ukraine Conflict: The Impacts of Power Balances, Partnerships, and Economic Warfare

The Guardian, Op-Ed article. (30 November)

U.K. House of Lords. 2015. *The EU and Russia: before and beyond the crisis in Ukraine*. London: The Stationery Office.

UN COMTRADE Database. 2016. <https://comtrade.un.org/> (accessed 23 October 2016).

U.S. Central Intelligence Agency. 1981. *USSR-Western Europe: Implications of the Siberia-to-Europe gas pipeline*. Washington DC: CIA (Declassified 'Secret' document). Online CIA historical archive (accessed 20 August 2014).

_____. 1985. *Soviet acquisition of militarily significant Western technology: An update*. Washington DC: CIA, ER-81-10085.

U.S. Department of Defense. 1981...1990. *Soviet Military Power 1981...1990*. Washington DC: U.S. Department of Defense.

US SD = U.S. State Department.

U.S. Arms Control and Disarmament Agency. 1997. *World Military Expenditure and Arms Trade (WMEAT) 1997*. Online version (accessed 14 June 2015).

U.S. State Department. 2015. U.S. export controls. *Strategic Trade Management and Export Controls*. Online version (accessed 15 April 2015).

Vernon, R. and Kapstein, E. eds. 1991. *Searching for Security in a Global Economy*, *Daedalus*, 120: 4, 1-228.

Voennaya 2014 = President of Russia 2014.

Wikipedia. 2016a. *Geary-Khamis Dollar*. Online version (accessed 13 July 2016).

_____. 2016b. *Hysteresis*. Online version (accessed 8 October 2016).

WMEAT = US Arms Control and Disarmament Agency.

World Bank. 2015a. *Russia Economic Report 33: The dawn of a new economic era?* (April) Online version (accessed 2 May 2015).

_____. 2015b. *Russia Economic Report 34: Balancing economic adjustment and transformation*. (September) Online version. (accessed 26 November 2015).

_____. 2015c. World Bank keeps 2015 growth projections for Russia, and slightly revises 2016-2017 outlook. *World Bank Press Release 2016/ECA/073*. Online version (accessed 15 January 2016).