Russia 2020

Scenario One:
Working Authoritarianism

After a prolonged period of economic stagnation, Russia is forced to dramatically shift gears. Moscow rejects liberal-oriented economic solutions, steps that could lead to calls for more political openness. It ultimately manages to energize and diversify its economy without extensive liberalization by restructuring its energy sector and forging strategic commercial and financial alliances with China, Germany, and South Korea.

Scenario Two:
Bottom-Up Liberalization & Modernization

A struggle for dominance between reformist and conservative elements results in a stalemate, reducing the government’s ability to address economic challenges. Fueled by the dynamism of a new generation of entrepreneurs and capital from Moscow, new enterprises emerge in a number of Russia’s regions, symbolizing Russia’s economic rebirth and the beginning of political pluralism.

Scenario Three:
Degeneration

The Russian government remains unable to solve the country’s deep economic and social problems and deflects alternative solutions that might weaken its grip on political power. The country continues to stagnate, forcing the regions to “fend for themselves.” Gradually, state capacity erodes, social fabric breaks down, and the country begins to fragment politically and geographically.
PROJECT OVERVIEW

This CGA Russia Scenarios workshop, conducted on February 26, 2010, was the fourth of several events at CGA designed to reduce surprise and expand U.S. foreign policy options. Previous events focused on Iraq, Iran, and China. We have scheduled further workshops on Turkey and Ukraine. The workshops in China, Russia, Turkey, and Ukraine are funded by the Carnegie Corporation of New York.

In both official and academic policy debates, the future is often expected to parallel the recent past. Potential discontinuities are dismissed as implausible, information that conflicts with prevailing mindsets or policy preferences is unseen or viewed as anomalous, pressure for consensus drives out distinctive insights, and a fear of being “wrong” discourages risk-taking and innovative analysis. This conservatism can reduce foreign policy choice. Our experience, through several workshops, is that experts tend to underestimate the degree of future variability in the domestic politics of seemingly stable states. This is the case with Iran and with the Soviet Union. Globalization, financial volatility, physical insecurity, economic stresses, and ethnic and religious conflicts challenge governments as never before and require that we think seriously about American policies in such uncertain circumstances.

The CGA Scenarios project aims to apply imagination to debates about pivotal countries that affect U.S. interests. The project assembles the combination of knowledge, detachment, and future perspective essential to informing decisions taken in the presence of uncertainty. The project comprises long-term research on forces for change in the international system and workshops attended by experts and policymakers from diverse fields and viewpoints. The workshops examine the results of current research, create alternative scenarios, identify potential surprises, and test current and alternative policies against these futures.

Michael Oppenheimer, the founder of the project, has organized over thirty such projects for the State and Defense Departments, the National Intelligence Council, the Central Intelligence Agency, the U.S. Institute of Peace, the Brookings Institution, the Council on Foreign Relations, and the President’s Science Advisor. He is a professor at the Center for Global Affairs at New York University.
FOREWORD

A famous Soviet anecdote says: “The future is certain, it is the past that keeps on changing.” Since the collapse of the Soviet Union, Russia’s future has been far from certain. Many changes—political, economic, geo-political—have left deep scars not only on the memory of the Russian people but also on the reputation of Russia-watchers who often got the future wrong. Gorbachev’s reforms prompted Russia’s liberation from the Soviet ideology, only to be followed by Yeltsin’s years in which political freedoms coexisted with corruption, economic degeneration, and bloody war in Chechnya. Just when Russia was firmly on the path towards irrelevance, Putin has managed to consolidate Russia’s authoritarian model by reviving its commodity export based economic growth, asserting a new international role, but undermining hope for Russia’s democratic development.

Today, Russia once again finds itself at a historic crossroads. On one hand, it can either continue on the current path, which has survived the impact of the global financial crisis, but which is increasingly associated by Russians with a Brezhnev-era-like period of stagnation. On the other hand, Russia can attempt to modernise itself—both economically and politically—in order to prepare itself for the challenges of the 21st century while overcoming the difficult legacies—such as demography—it has inherited from the last century. The stakes are high, but the outcomes remain uncertain despite President Medvedev’s enthusiastic rhetorical embrace of a “modernization” vision for Russia.

In this context, the current publication with three distinct scenarios for Russia’s development over the next decade represents a very useful framework to conceptualize Russia’s future choices. Clearly these scenarios are written to provoke a reader to debate these outcomes. They guide well beyond the usual assumptions and as such are likely to cause as much disagreement as agreement. Their value is not to predict the future. They help to explore drivers, trade-offs, and wild cards, which can influence the pathways to Russia in 2020.

The NYU team led by Professor Michael Oppenheimer has done a terrific job weaving together different strands of thinking from among a truly diverse multi-disciplinary group of scholars who were assembled to provide the initial input into the process. My recollection of the meeting,
which in good Russian tradition was almost interrupted by a massive snowstorm that hit New York City on the day when the meeting was due to take place, was that we had a fantastic debate that fell short of actually drawing the scenarios. Yet the NYU team used their experience and methodology to bring together a very diverse set of ideas, often contradictory to the point of being mutually exclusive, to prepare the final product.

The three scenarios are clearly larger than the sum of their parts, as no one expert in the group could have drawn them as they are on his own. Yet participants could find a trace of their thinking reflected throughout the complex intellectual mosaic incorporated into the final product. What I particularly like about the scenarios is that they challenge the conventional thinking on Russia by suggesting that an authoritarian rule can produce a successful economic revival, that a grassroots movement can break the power of the current political elite, that Russia’s stagnation could lead to a catastrophic degeneration, that regional developments can force political changes in Moscow and many others. Even if these assumptions are unlikely to be accepted, they help a reader to think outside the box. The scenarios also offer valuable recommendations on the implications which each outcome could have for U.S. policy.

I guarantee that any reader will find in these scenarios many things they disagree with, but they also find a new lens through which to view Russia’s uncertain future.

*Oksana Antonenko*

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INTRODUCTORY NOTES

The scenario process employed during the Russia workshop in February adhered to the format of previous Iraq, Iran, and China sessions. The session was designed to facilitate open dialogue among leading Russia experts. There were no assigned roles. No papers were presented. Participants were encouraged to consider a wide range of plausible futures and challenge conventional wisdom. The objective of the session was not to predict the nature of a 2020 Russia, but rather to identify three materially different but plausible scenarios to increase our understanding of factors that could impact Russia’s future path. These scenarios were chosen to encompass a wide range of conditions, including some that are of low probability but which would be highly impactful if realized, and to challenge conventional assumptions and preferences.

The fifteen participants represented varied expertise across economics, domestic politics, global energy markets, ethnic and cultural studies, and foreign and security policy. The Center for Global Affairs project team opened the session by briefly introducing a set of “starter” scenarios as a means to provoke the discussion. Session participants had previously been provided with a background “drivers” paper, which identified factors likely to have the greatest impact on Russian behavior and the greatest influence on Russian policy decision-making over the course of the next decade. Participants were encouraged to challenge the starter scenarios, which they most certainly did, and to propose alternatives.

We encouraged participants to adopt an “inside-out” approach, in recognition of the criticality of Russia’s internal environment. In the West, Russia is often characterized by the nature and direction of its foreign policy. While it is essential to appreciate the central role foreign policy plays in Russian political thought, fixing the emphasis on international relations often serves to obscure the highly dynamic nature of Russia’s internal circumstances. As is illustrated clearly in the scenarios included in this report, Russia’s future will be shaped primarily by internal forces. In fact, Russia’s behavior on the global stage is a reflection of its complex internal environment—its intricate domestic politics, the demographic risks it faces, the myriad of regional and ethnic conflicts and contradictions it faces, and the geographic breadth and scope of the Russian Federation, spanning eleven times zones, and dozens of cultures, religions and...
individual dialects. While Russia is a major player in the global economy and is highly exposed to changes in the global energy markets, twenty-first century Russia is a reflection of its domestic struggle to escape from its Soviet legacies. Given this inside-out approach, participants were able to avoid deterministic conclusions about which of Russia’s futures are beneficial or detrimental to U.S. policy.

A wide range of topics and issues was discussed during the process of selecting and framing out the final list of scenarios. Initially, the focus was on the long-term impact of the global recession. Participants debated whether the global downturn would serve as a catalyst for change, propelling efforts to diversify and modernize the Russian economy, or whether the eventual economic recovery would only reinforce the current oligopolistic nature of Russia’s domestic commercial environment. A number of experts questioned whether economic liberalization is possible without deep changes to Russia’s authoritarian political structure. Many were skeptical that a vibrant economy and competitive marketplace are possible under authoritarian rule. Several participants cautioned that it would be very difficult for Russia to follow China’s current “economic pluralism-political monopoly” model, contrasting Russian and Chinese economic circumstances and endowments. Others thought that it is possible for Russia to expand its economy without modifying the current governance model, given its vast energy resources. This was one of many instances where the experts’ views and opinions diverged.

There was support for the argument that Russia’s economy would continue to be highly centralized and tightly controlled from the top as long as Russia remained principally a hydrocarbon export nation. Proponents of this view pointed to the Russian government’s continuing support of large state-owned enterprises, which would continue to constrain innovation and free-market competition. They questioned whether Russia would be able to gain access to the investment capital and technological know-how necessary to expand and modernize the economy without first committing to wholesale reform and implementing policies that encourage innovation and risk taking.

Participants emphasized the corrosive effects of corruption, especially in Russia’s outlying regions. Political authority was shifted from the regions to the central government in the mid-2000s in an effort to staunch the spread of official corruption. Experts debated whether political
liberalization and the decentralization of political authority would ultimately lead to a loss of control and unleash new ethnic tensions in these regions, possibly leading to economic or political fragmentation.

The focus then shifted to the likelihood of dramatic change in Russia over the next decade. There are few examples of bottom-up or organic change in Russian history. Several participants noted that most instances of structural change resulted from unilateral decisions made by Russian rulers or as a result of elite power struggles. There was a lengthy discussion about how changes could occur in the context of Russia’s current political structure. Most were not persuaded that organic or bottom-up change would be possible. Participants debated the importance of popular support and questioned whether the Russian public would continue to support the current political structure without substantial improvement in Russia’s economic circumstances. Conversely, many of the participants challenged the notion that a major economic or political shock (e.g., external conflict, wave of terrorism, economic calamity) would lead to a rejection of the current system. They argued that Russian citizens historically rally to the government in times of crisis.

After this lively two-hour discussion, participants were able to identify three alternative scenarios that reflect the highly variable nature of Russia’s political and economic environment. As has been the case in all the previous scenario sessions, participants were asked to suspend disbelief, set aside probabilities and build the most persuasive case for each scenario. All three narratives begin in the present, with the same economic and political circumstances, but they begin to diverge significantly as a result of how policy makers in Moscow react to the unfolding events and circumstances.

- **Working Authoritarianism:** After a prolonged period of economic stagnation, Russia is forced to dramatically shift its policies to jump-start growth. It enacts a draconian austerity program that includes wage ceilings and the elimination of the household electricity subsidies. It also establishes strategic partnerships with China, Germany, and South Korea, which enable Russia to gain access to much-needed capital, technology and know-how without being subject to “conditionality.” Thus, Russia is able to energize and diversify its economy without political liberalization or reform.
Bottom-Up Liberalization: The struggle for dominance between reformist and conservative elements in the Moscow power structure results in a stalemate, reducing the government’s ability to act decisively to address economic drift. Fueled by the dynamism of a new generation of entrepreneurs and seed money from Moscow, new industries and commercial enterprises emerge in a number of Russia’s regions. This symbolizes a Russian economic rebirth and paves the way for new political forces to gain traction.

Degeneration: Deep into the new decade, the Russian government remains unable to solve the country’s deep economic problems. But Moscow is unwilling (or unable) to tolerate alternative solutions that might weaken the regime’s grip on political power. The country continues to stagnate, forcing the regions to “fend for themselves.” This further reduces the Russian state’s capacity to govern and leads to political and geographic fragmentation.

The final part of the session was devoted to a discussion of what we learned, or had confirmed, about possible change in Russia and in U.S.-Russian relations. We then opened the discussion to other faculty, students and observers for questions and comments.

The scenarios delineated in this publication are the product of a rich discussion encompassing a full range of topics and perspectives. They are not intended to be mutually exclusive. Each scenario, however, represents a dominant tendency with distinctive implications for Russia, its neighbors, partners, and rivals. They are not predictive in nature. Rather, each is a plausible picture intended to demonstrate the non-linear nature of change in Russia. The hope is that by employing this alternative scenario format and processes, we have been able to reveal challenges and opportunities for U.S. policy that might not become apparent in more traditional policy-driven debates.

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The scenarios presented in this document were prepared by faculty and students at CGA, based on discussions at a full-day scenario workshop and additional research.

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Scenario One:

WORKING

AUTHORITARIANISM

INTRODUCTION

Coming out of the economic downturn, Putin is under public pressure to improve economic conditions and the quality of life in Russia. It becomes clear that Russia’s current economic model will not provide the basis for future growth or the ability to meet the public’s expectations. Efforts to modernize Russia’s industrial base face overwhelming odds of failure. Even Russia’s energy sector, the traditional engine of growth, is mired in inefficiency and corruption. Russia’s subordinate role in the global economy has led to feelings of anger and resentment.

Conflict within the upper echelons of the Moscow elite becomes the political catalyst behind Putin’s decision to recalibrate domestic and foreign policies. He launches a radical program for achieving global competitiveness. The combination of restrictive trade barriers, deepening economic engagement with Germany, China, and South Korea, large-scale foreign investment, and the restructuring of key industries collectively result in the resurgence of Russia’s economy. Russia “opens” its energy sector and other key markets to foreign participation, but on a highly selective basis. China, Germany, and South Korea become strategic stakeholders in Russia’s economic rebound. All three possess capital and technology, and do not require political reform as a condition for their participation in these ventures.

The key to Putin’s success is his ability to leverage strategic relationships and to modernize Russia’s industrial base without relinquishing his grip on political power inside Russia.
drivers of this scenario

The working authoritarianism scenario emerges due to the cumulative effect of the following drivers:

- **Domestic Politics.** No serious opposition party emerged to contest United Russia’s control of electoral politics in Russia. Instead, competition emerged from within the ruling elite and forced Putin to embark upon a radical economic recovery plan. Putin’s popularity within Russia declined after the 2012 election, but public dissent is repressed. Putin and United Russia’s political fortunes rebounded with the improving economy towards the end of the decade.

- **Global Economic Trends.** The global economy succumbed to a double-dip recession early in the decade. Lingering solvency issues in the European Union reduced Russia’s ability to tap global capital markets and further weakened the ruble. After a partial economic rebound in 2010, Russian annual GDP growth flattened to 0 percent by 2012. Highly restrictive trade policies were implemented to shield Russia from foreign competition. Income from new import taxes enabled the government to fund a portion of its domestic programs and balance its budget.

- **Diversification and Economic Reform.** Weakening global demand for oil and gas masked the deep structural problems in Russia’s energy sector. However, addressing these structural problems and increasing competitiveness would require substantial capital investment. Rather than reform the domestic economy on the “Western model,” the Russian government elected to take a more mercantilistic approach, erecting non-tariff trade barriers and negotiating special commercial alliances with foreign governments. Consequently, Russia gained access to capital and technology without liberalizing, suggesting that it could decouple its economic growth and political reform, at least temporarily.

- **Energy Markets and Resource Management.** Russia’s unproductive and inefficient energy sector faced serious structural problems that had consistently been masked by high global demand. The introduction of competitive technologies and new energy extraction processes threatened the oligopolistic positions of energy exporting countries and their profitability. By the end of the decade, Russia
streamlined its energy sector and gained access to the investment capital necessary to improve its competitive position globally.

- **Foreign Policy.** With its economy in crisis, Russia faced the difficult choice of either becoming a junior partner to China or accepting second-class status as part of an enlarged Europe. By reaching out to both, Russia was able to avoid dependence on either, while continuing to reject Western liberal institutions. As its strategic partnerships began to generate investment and growth, Russia began to dominate the CIS commercial and economic sphere.

**THE PATH TO 2020**

**2010–2011: Continuing Economic Stagnation**

Just as Russia was beginning to rebound from the global economic crisis, it found itself confronting a series of new economic challenges. Oil prices reached US$90 per barrel in the spring of 2010, but by early 2011, they dropped back to the US$60–70 range. By the middle of the year, the Greek sovereign debt crisis had turned into a full-blown eurozone crisis, which, coupled with China’s policy of economic “cooling off,” triggered a second global market collapse and a predictable reduction in the demand for energy resources. Russian exports declined precipitously, affecting the entire Russian economy. GDP growth projections for 2011 were cut back from 4.5 percent to under 1 percent, well below previous forecasts. While official unemployment numbers dipped below 10 percent, the actual jobless rate was estimated to exceed 16 percent. Russia’s balance of payments surplus was halved, driving down the ruble and putting upward pressure on inflation. Lower-than-forecast government revenues forced Moscow to reduce vital social programs and delay highly visible regional infrastructure projects.

Concerns regarding European bank solvency persisted well into 2011, just as Russia was reentering the global capital market. The widening yield curve drove up public- and private-sector borrowing costs, which only compounded Russia’s problems. Contrary to President Medvedev’s soothing pronouncements that Russia had weathered the worst of the recession, all was not well on the economic front.

The crisis in Russia’s energy and extraction sector was particularly troubling. Forecasters attributed the sharp reduction in domestic energy
production to multiple factors: lower yields from maturing oil fields, poor pipeline maintenance, project delays, and lack of refinement capacity. No new fields had been put into production for several decades. The combination of production inefficiencies, choking bureaucracy, endemic corruption, and a history of indirect appropriation of foreign assets (such as in the TNK-BP dispute) constrained Russia’s ability to attract the new capital necessary to address problems in its energy sector. In addition, Russia, as with all energy-exporting countries, faced a downward market trajectory due to the introduction of LNG and shale gas and the long-awaited flow of Iraqi oil onto global markets.²

Russian policymakers had no immediate cure for the chronic inefficiency and lack of managerial competence found in the majority of Russia’s state-controlled enterprises. Gazprom was emblematic of the overall problem. The majority of Gazprom’s capital expansion budget was tied up in new pipeline distribution projects in Europe, rather than in securing long-term gas supplies.³ These projects were driven by political objectives, and many were not financially viable. One prime example was the South Stream pipeline, launched primarily to deter European countries from pursuing alternative sources of natural gas (especially Nabucco), to which Gazprom committed in excess of US$20 billion, weakening its balance sheet and raising concerns about its liquidity.

With its domestic sources of oil and natural gas beginning to dwindle, Russia was forced to rely increasingly on Kazakhstan and other Central Asian countries to meet Europe’s demand for oil and natural gas. The need to back-fill supply from foreign sources reduced the profitability of Gazprom and of Rosneft, Russia’s state-controlled petroleum enterprises. It was becoming clear to Russian leaders that it would take more than a rise in global energy demand to address the problems facing Russia’s carbon-based economy.

The Medvedev-Putin administration faced a number of other domestic problems. Corruption was spreading. New accounts of graft and extortion in high places were being reported on a weekly basis. The public expressed outrage over the high cost of imported food, household electronics, and automobiles. The “second dip” in the economy had triggered a new wave of capital flight, such that the financial system was once again on the brink of failure and required a massive infusion of public funding. Higher prices, bank failures, and official corruption bred deep resentment and
spurred larger and more frequent public demonstrations, even in Moscow and St. Petersburg.

Nearly all non-energy sectors of the economy were suffering setbacks. General Motors’ decision to retain its controlling stake in the Opel automotive operations in Germany, rather than selling to a Canadian-Russian investment consortium, was a major setback in Putin’s efforts to resuscitate Russia’s automotive industry.\(^4\) Chinese munitions manufacturers had made headway into Russia’s lucrative arms export market. Turkish, German, and Chinese engineering firms had been the main beneficiaries of the decade-long construction boom in Russia, bypassing domestic suppliers.\(^5\) Well-reported plans to establish a domestic pharmaceutical industry remained on hold due to the lack of capital, and foreign pharmaceutical companies remained skittish about doing business in Russia in the absence of adequate patent and copyright protection. Even the much-touted nanotechnology initiative was at best a long-term strategy.\(^6\)

The Putin-Medvedev “tandemocracy” deflected blame for the stream of bad news and public disenchantment because, quite simply, there were no political alternatives on the horizon. The Kremlin continued to undermine opposition parties, and, with the help of an army of marketing and public relations specialists, distracted a weary public by flooding the Russian media with items about the upcoming Olympics, improving relations with Ukraine, and the soon-to-be-realized oil riches from the Arctic. Even skeptical members of the press found themselves spending more time focusing on the possible political showdown between Medvedev and Putin in the upcoming elections than on the financial plight of Russian households.

**2011–2012: A New Paradigm**

Medvedev, Putin, and their advisors recognized that there were no easy solutions to Russia’s economic malaise. Although the Kremlin understood the criticality of addressing structural problems in the economy, its primary objective was to retain its political authority. Putin and his siloviki supporters summarily rejected the liberal-oriented economic solutions proposed by Igor Yurgents and his reform-minded advisors in late 2009, which stressed the importance of an independent judiciary and enhanced property and contract guarantees, steps that could lead to calls for more political openness.\(^7\)
Putin knew that Russia was facing a long-term downward economic trend and that it would likely need financial assistance from the West, but he was also aware that global investors and multilateral institutions would insist on painful and politically destabilizing reforms as prerequisites to the provision of capital. Russian leaders continued to object to efforts by the EU and the U.S. (via the IMF) to make future economic dealings with Russia contingent on its willingness to commit to political liberalization. They also feared becoming economically dependent on China. Putin recognized the importance of balancing China’s growing economic dominance in Northeast Asia.

While Medvedev and Putin publicly advertised Russia’s economic potential, a debate surrounding the future direction of the country raged in the Kremlin. Younger members of the Russian elite, who had missed the chance to participate in the privatization schemes of the 1990s, demanded the Kremlin shift direction, but were unable to propose a workable alternative. Older statesmen, many of whom have been the major beneficiaries of the graft-ridden system, insisted that state control of the economy was critical to Russia’s long-term global competitiveness. Putin found himself caught in the middle of an internecine struggle between the oligarchic crony capitalists and a coalition comprised of key members of the siloviki, Western-trained technocrats, entrepreneurs, and nationalist elements within United Russia, all of whom felt humiliated by Russia’s economic circumstances and resentful of Russian billionaires, who lived and played abroad while Russia faced such problems.

Gazprom and its leaders became the major target of criticism. To its detractors, Gazprom represented everything wrong with Russian industry: it was bloated, inefficient, and poorly managed. Dmitri Medvedev, a former darling in reform-minded circles, became the scapegoat responsible for decimating Gazprom’s balance sheet and whitewashing its dismal project track record during his tenure as Gazprom’s chairman. Although Putin could just as easily have been blamed, to no one’s surprise, Medvedev wound up taking the bulk of the criticism. As his political stock fell in the run-up to the 2012 presidential election, Medvedev quickly became a lame duck president. As a result, United Russia leadership, thinking only in terms of survival, looked to Putin to rally the country and secure the

Scenario One: Working Authoritarianism

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Kremlin for the next six years. They beseeched Putin to run in 2012, and he relented. Medvedev offered his full support. Although United Russia had encountered problems in the most recent regional elections, Russia’s opposition parties remained fractured and politically inept. Thus, Putin was able to glide through the 2012 election campaign without serious opposition, and he was, once again, elected president.

It became clear from Putin’s cryptic campaign speeches that there would be a massive upheaval in the near future. Within days of the election, Putin requested and received legislative approval to return executive authority to the president, thus reducing the role of the prime minister. Putin then announced the formation of his new government. He nominated Sergei Lavrov, the current Russian foreign minister, as prime minister, emphasizing the importance of foreign affairs in Russia’s economic recovery program. Vladislav Surkov, Putin’s long-time advisor and proponent of the centralization of government authority (i.e., the “power vertical”) was responsible for designing Russia’s new economic and industrial strategy. Aleksei Kudrin retained his Central Bank portfolio. Igor Sechin was given responsibility for trade relations, and Dmitry Rogozin was named ambassador to Germany.

Building strategic alliances with China and Germany was the centerpiece of the new economic plan. Putin’s new program included five main components and would prove a radical departure from the previous decade. First, it called for a massive restructuring of Russia’s energy sector in an effort to spur innovation and professional management practices and instill a sense of urgency among Russia’s energy titans. Second, broad trade restrictions were to be erected, encompassing all essential industrial sectors, such as construction materials, automotive parts, industrial chemicals, cement and asphalt, and memory chips, with the objective of reducing dependency on foreign products and improving the competitiveness of Russian firms in these sectors. Import duties and “domestic content” requirements were established, despite their prohibition under WTO guidelines. Putin, thus, categorically rejected the advice of Moscow’s liberal, reform minded think tanks. Third, the plan called for targeted de-monopolization in peripheral industrial sectors to encourage both innovation and direct competition. Putin needed Russia’s entrepreneurs to play a role in a technological reawakening across Russia’s domestic economy and created an Industrial Investment Fund (IIF) to...
capitalize new business ventures. Fourth, the Kremlin placed restrictions on wages across all state-controlled enterprises and all domestic companies that did business with the Russian government or received government funding. This included practically every domestic firm with more than fifty employees. The Kremlin also accelerated the phasing out of the electricity and petrol subsidies in an effort to increase the working capital of utility companies. Lastly and most dramatically, Putin’s plan called for the creation of deep commercial alliances with a number of strategically important countries, most notably China, Germany, and South Korea. These partnerships were designed principally to provide Russia with access to capital, technology, and managerial expertise. In return, China, Germany, and South Korea would receive preferential treatment from the government and would have a distinct competitive advantage in tapping into Russia’s consumer markets and vast energy and mineral resources.

The Kremlin needed to prepare the country for this major policy shift. Russians had always looked to their government to manage the economy, while providing little input. Public opinion, however, had become quite important to the Kremlin. Moscow launched a number of new Internet sites extolling the virtues of the new economic strategy and promising that wage ceilings were temporary. The message to the public was that Russia had entered a new phase in its quest to become a global power. Its partnerships with key industrial nations signaled Russia’s global importance and status as a key emerging market.

Building strategic alliances with China and Germany was the centerpiece of the new economic plan and was conceived as a way to reinforce Russia’s status as a key emerging market. Moscow first looked to China. Russia’s commercial relationship with China had deepened considerably since the Russia-China summit in 2009, during which Putin and Chinese premier Wen Jiabao reached agreement on a number of key projects, including the development of high-speed rail service between the two countries to facilitate commodity transport and the creation of a new pipeline to transport Siberian natural gas to China.¹²

Putin’s one-on-one session with Chinese president Xi Jinping at the Shanghai Cooperation Organization meeting in 2012 focused on how to further expand the partnership. For example, recognizing China’s need for timber due to rapid deforestation of its northern regions and Russia’s need to revitalize its inefficient forestry industry,¹³ Xi and Putin concluded a
ten-year timber agreement, under which Russia would commit 75 percent of its timber exports to China and China would finance the modernization of dozens of mills across Siberia and the Russian Far East. Putin also agreed to provide China with up to 75,000 non-resident work permits to accommodate the need for Chinese workers to handle the large number of projects. In addition, during the meetings Xi voiced China’s concerns about growing Russian protectionism, and the two countries agreed to continue to lower barriers to cross-border trade.\textsuperscript{14}

Later that year it was announced that Russia and China had formed a new Far East Commodities Development venture partnership. This new venture, based in Vladivostok, was granted a fifty-year exclusive exploration charter to establish iron ore mining and energy distribution facilities across the Russian Far East. Russia retained a 51 percent interest, and, in return, it was guaranteed US$3 billion in annual income from the venture, plus 25 percent of all revenues derived from international sales.

The relationship between Russia and Germany was also about to expand significantly. The two countries had successfully collaborated on the development of the Nordstream gas consortium, which was expected to become the primary source of natural gas delivery to Northern Europe. German investors and manufacturing firms coveted Russia’s untapped mineral and energy endowments. In addition, Germany’s electronics and automotive sectors sought to penetrate Russia’s expanding consumer markets. Thus, Germany pursued deeper commercial links with Russia, despite criticism from fellow EU member-states.\textsuperscript{15}

Under the terms of the new alliance, Ruhrgas, the German energy conglomerate, became a crucial stakeholder in the newly formed transnational natural gas consortium to be built upon the foundation of the proposed merger of Gazprom and its Ukrainian counterpart, Naftogaz.\textsuperscript{16} This German-Russian-Ukrainian consortium would own 80 percent of the natural gas pipelines across the Eurasian landmass. Berlin, Moscow, and Kyiv approved the venture in late 2012, and installed former Russian president Dmitri Medvedev as CEO. The venture became the largest natural gas company in Europe and, under its new management and streamlined operational structure, immediately dominated gas distribution in Europe and the CIS. Over objections from Poland and the UK, the venture was approved by the EU’s Competition Commission, despite its obvious anti-competitive aspects.
Russia’s partnership with South Korea began with a series of strategic mining and semiconductor alliances. South Korea’s Samsung and its Russian counterpart, Elbrus International, jointly established large-scale chip design and manufacturing facilities in Russia, which were exempt from Russian import and domestic content restrictions. The Russian–South Korean venture agreed to grant to Russian firms long-term licenses to advanced technology for use in the Russian military technology sector. In return, Samsung gained a major foothold in the Russian computer and mobile phone markets. In early 2013, Russia and South Korea created a global nuclear energy venture. Korean Power Engineering Company (a subsidiary of Korea Electrical Power Corp or KEPCO) joined with Russia’s Atomenergoprom, the leading Russian supplier of nuclear power facilities, combining technologies and market presence to become one of the leading suppliers and operators of nuclear power facilities in the world. Independently, the two companies had been awarded contracts in the UAE, Turkey, and Saudi Arabia. Collectively, the new venture was expected to win 40 percent of the international projects up for competitive bid over the next decade.

Prime Minister Lavrov’s primary role in the new administration was to ensure Duma approval of new legislation that elevated these new venture agreements to the status of treaties under Russian law, thus providing German and Korean companies with enhanced contractual protection and property rights. These agreements also provided these companies with competitive advantages over other foreign investors. Unlike the U.S. and the EU, the German and South Korean governments decided to decouple commercial relations with Russia from their human rights and democratization preferences. All references to EU normative standards were excluded from the language of the venture agreements and subsequent domestic legislation enacted in Germany.

These alliances provided the Russian government with US$20 billion in new capital over a ten-year period. A significant portion of these funds was earmarked for oil and gas exploration, refining, and distribution. The remaining capital was allocated to a new industrial investment fund to provide capital to new businesses, primarily east of the Urals and in the Russian Far East.

Once these alliances were in place, Putin moved aggressively against the Russian oligarchy. The oligarchs had much to lose and violently opposed
Putin’s strategy. They accused Putin of placing his trust in foreigners rather than his own countrymen, which was not far from the truth. To promote professionalism and displace entrenched oligarchs, Reutersberg and other newly appointed members of the leadership team were recruiting professional managers from leading German, Korean, and American companies. To reinforce this new commitment, the Kremlin promulgated a set of corporate governance guidelines, including draconian penalties for mismanagement, stiff anti-corruption provisions, and performance incentive bonuses.

2013–2014: Foreign Diversions to Deflect Domestic Woes

The dramatic shift in Russia’s economic strategy stunned its population and enraged Putin’s political rivals. The Brown-Red parties accused Putin of selling out Russia’s national interests to foreign banks and corporations. Foreign ownership stakes in Gazprom and Russia’s other energy giants led to sharp criticism of Surkov and Putin. Mid-level workers bemoaned caps on wage increases; absenteeism increased at large SOEs. Rising electricity costs hit households hard and stoked demonstrations across the country. Opposition parties complained that none of these issues had been raised during the presidential election campaign.

The government harshly repressed street demonstrations, breaking up public meetings with a brutality rarely seen in Russia since Soviet times. It closed down a number of independent newspapers and blocked access to popular web sites that had allegedly published “inflammatory and libelous” accounts of the government’s response to the civil disobedience. Rosneft continually laid off masses of workers for participating in “sick-outs” and distributing anti-Putin literature.

The level of repression was widely reported in Europe and the U.S. Members of the European parliament criticized Russia for its new mercantilist policies and for intolerance of public dissent and “Stalinist tactics” for managing it. The WTO formally rejected Russia’s pending request for membership, citing Russia’s imposition of new trade barriers.

Tension also increased along Russia’s borders. Russian intelligence had advised Putin that Georgia was harboring terrorists who were planning attacks during the Sochi Olympics in the following year. In response, Russian security forces conducted raids inside Georgian territory, and
Putin made dark threats of coming to Tbilisi to “clean house once and for all,” which was widely interpreted as a threat to overthrow the Saakashvili government. These actions triggered emergency NATO meetings. Russian security forces were also active in Central Asia. Soon after the death of long time Uzbek dictator Islam Karimov in November 2013, Russian forces (reportedly at the “request” of the new government in Tashkent) swept into the Fergana Valley, ostensibly to root out a group of Islamic fighters with ties to Dagestani Jihadists. A battalion of Russian peacekeepers remained in Uzbekistan to deal with the “ongoing threat” to the stability of Uzbekistan and the region. Russia’s efforts to consolidate its positions in the Caucasus and Central Asia alarmed the U.S. and the UK and drew a strong rebuke from Beijing, which feared for its own commercial interests in Central Asia. Many Western analysts believed that the Kremlin had created these provocations in an effort to divert attention away from its failing economy and the harshness of its new economic plan.

Putin’s most provocative foreign initiative involved political re-unification with Ukraine. Ever since the 2010 Ukrainian presidential elections, relations between the two countries had improved. Russia and Ukraine continued to seek new forms of economic and political collaboration. The Ukrainian Regions Party launched a campaign in support of a formal union with Russia, and eventually legislation was introduced in the Ukrainian Lada to call for negotiations to establish a federation with Russia. Opposition parties in Ukraine, such as the All-Ukrainian Union “Fatherland,” attacked these efforts as unconstitutional and warned that Russia was seeking a stranglehold over the country.

Poland and Lithuania, fearing the loss of Ukrainian sovereignty, threatened to seek economic sanctions against Russia at the EU, but these calls were deflected by Russia’s major energy partner, Germany. The EU found it increasingly difficult to build consensus around a response to the possible Russia-Ukraine reunification, given the still-frayed relations that resulted from the bailouts of Greece in 2010 and Ireland in 2012 and Germany’s tilt toward Russia. Many EU members criticized Germany’s relationship with Russia. German leaders maintained that their approach was consistent with the EU’s policy of gradually integrating Russia into the European community. In Russia, these international debates boosted support for the Russian government and distracted the public from the more adverse effects of the economic plan.
By mid-2014, after nearly three years of stagnation, the economic plan began to show results. New oil drilling projects had finally begun. Plans to modernize the Ukrainian gas pipeline network were underway. Hundreds of new commercial ventures had received funding from the Industrial Investment Fund (IIF). Thus, while the situation was fragile, Putin and his team were still in charge. United Russia retained its commanding majority in the Duma after regional elections in 2014 and held on to key posts in Russia’s regions.

2015–2016: Signs of Emerging Economic Growth

The economy finally stabilized in mid-2015, aided by an improving global economy, higher industrial productivity, and the increasing competitiveness of Russia’s non-energy-related exports. GDP growth increased to 4.5 percent in 2016. Energy economists forecast the first net increase in Russian oil and natural gas exports since 2006. Gazprom announced the cessation of the South Stream project, and redirected its focus to modernizing Ukraine’s gas pipeline facilities. A spike in employment boosted the Putin administration’s standing with the public, and demonstrations became smaller and less frequent. Three years of wage controls and the elimination of electricity and petrol subsidies had taken their toll on workers and households, but social programs were fully funded in the 2016 budget.

In the context of improving domestic affairs, the Kremlin began to repair relations with its neighbors. Increasing demand for Russian oil and gas in 2015 enabled Russia to leverage its energy dominance in Europe once again, and it offered price concessions to a number of influential European countries. The government’s announcement that it would phase out import restrictions improved relations with China. Russia’s external relations appeared to be returning to normal. Moreover, foreign investment flows were increasing as European and Chinese companies entered the seemingly untapped Russian market.

For the first time in nearly a decade, there was a sense of optimism and political stability in Russia.
2017–2018: Momentum Leading Up to the Presidential Election

The general opinion in Russia was that Surkov’s version of “shock therapy” had put Russia on the right track. Both public and private debt had been reduced. Productivity had increased due to new management and corporate governance guidelines. The most impressive sign of economic progress was the improved performance of Russia’s restructured energy sector: new projects were being completed on time, incidence of industrial accidents had declined, and the new Gazprom was finally being run like a for-profit enterprise rather than a political arm of the Kremlin.

Putin’s import-substitution strategy had allowed Russian companies to dominate domestic auto parts, light machinery, steel, and lumber markets. In addition, improved technological and management practices had enabled Russian companies to expand across the CIS and into select European markets. In an attempt to replicate China’s successful currency management practices, the Russian Central Bank pegged the ruble to the euro, thereby enhancing Russia’s regional price competitiveness. By January 2018, Russia reported the highest increase in non-energy-related exports in two decades. Hundreds of new firms that had received IIF funding were thriving and distributing their products in foreign markets. Lower cost Russian steel and light machinery were selling well in Europe. The merger of Russian and Ukrainian steel in 2017 had created a dominant global competitor, taking market share away from China and Japan.  

The economic expansion had its unintended consequences. Russian subsidiaries of German and Korean enterprises, which were exempt from import tariffs and domestic content restrictions, began to dominate the domestic automotive and computer markets, thwarting Putin’s objective of creating Russian champions in each of these important sectors. In addition, corruption in both government and industry was once again on the rise, threatening to undermine productivity gains. Moscow countered by requiring the frequent rotation of SOE managers and by loosening restrictions on non-resident work permits that would enable the hiring of managers from Europe and the U.S.

For the first time in nearly a decade, there was a sense of optimism and political stability in Russia.
Attention turned to the upcoming 2018 presidential election. Putin announced his intention to retire from public office after completion of the current term, but United Russia officials launched a nationwide “Stay Vladimir” campaign and he agreed to run for reelection in 2018. He based his campaign on a commitment to withdraw wage caps and to offer electricity rebates to households on a lottery basis. To no one’s surprise, Putin received 78 percent of the votes cast.

2019–2020: Tension Among Partners

The election results and an improving economy emboldened the Putin administration, which began to seek new ways to leverage Russia’s newfound economic and political strength. Moscow initiated negotiations with Japan over Arctic transport links, including expanding the existing Sakhalin Project to increase natural gas pipeline capacity. Russia and Japan entered into an agreement to build a cross-border high-speed rail. Although China had expressed its displeasure with the prospects of Japan gaining a foothold in Russian Siberia, Russia moved forward and concluded additional agreements with Japan.

The Russia-China relationship ran into further turbulence several months later. Russian Interior Ministry officials based in Khabarovsk reported that there were in excess of 250,000 Chinese laborers working and living in Russian territory across the Amur River, far exceeding limits imposed in 2012. The Russian government demanded an explanation from Beijing. Rather than responding to this accusation, Chinese officials renewed criticism of Russian restrictions on Chinese imports, arguing that Russian trade barriers were specifically targeting Chinese products. China accused Russia of deliberately delaying its entry into the World Trade Organization in order to perpetuate its protectionist policies. This dispute developed into a full-blown diplomatic crisis.

Putin and Xi resolved the stand-off. Russia agreed to expand the number of Chinese guest workers allowed in the Russian Northeast to 150,000, and China committed to implementing stricter border controls. Russia also lifted import duties on several dozen Chinese products. Parenthetically, Russia’s WTO membership application—strongly supported in Europe and the U.S.—was approved in early 2020 on the basis of Russia’s commitment to phase out all import restrictions and export subsidies by 2024.
Russia’s relationship with Germany was also in flux. In 2017, the Social Democrats and their Green Party partners had gained control of the upper house in the German parliament and were able to select the next German chancellor. Formerly, while in the minority, the Social Democrats had been highly critical of German policy towards Russia, citing the apparent willingness to overlook Russian human rights violations and lack of progress on electoral reform. Consequently, the change in leadership in Berlin led to a chill in relations with the Kremlin and strained the German-Russian commercial alliance.

Although by 2020 the global economy had regained momentum, global energy prices had leveled off. Iran had reentered the global oil and natural gas markets after becoming a signatory of the Global Non-Proliferation Treaty and pledging to destroy its modest nuclear arsenal. This led to a significant increase in the supply of oil on the world’s markets. As a result of flagging energy prices, Russia, once again, faced an economic downturn. However, because it had become far more diversified, Russia found itself less susceptible to fluctuations in the global energy markets than earlier in the decade.

**IMPLICATIONS FOR U.S. POLICY**

This scenario presents a Russia that succeeds in upgrading its economy without instituting the liberal reforms Americans associate with modernization and growth. As such, it presents an inherent challenge to our mindsets and expectations; a statist approach which diversifies and expands the Russian economy, enhances Russian power and influence, and fuels a more assertive foreign policy, without succumbing to political reform or sacrificing its autonomy to a web of trade and financial interdependencies and liberal global institutions.

This direction in Russian policy is in keeping with recent trends in the way emerging countries engage the global system. Liberal global institutions have atrophied as regional and bilateral arrangements have proliferated. States have sought strategic alliances with like-minded partners having compatible economic interests. National political economies have taken on a homegrown quality, as the returns to neo-liberal formulas have diminished. The continued imperative of engaging the global economy now generates a multitude of national approaches. State direction of investment and outright ownership of strategic industries, selective trade
and financial liberalization, local content requirements, weak intellectual property protection, mercantilist pricing of currencies, are all in the policy mix. A highly volatile global economy further reinforces the movement away from liberalism.

Russia, in this scenario, is both a reflection of these trends and a contributor to their acceleration. It finds significant trade, investment, and technology opportunities with select partners who are prepared for their own reasons to operate outside the multilateral system, and to provide capital, markets, and technologies essential to modernizing and diversifying the Russian economy. These relationships—principally with China, Germany, and South Korea—are essential to Russia’s success in this scenario, and allow us to think systematically about what this future might mean for U.S. interests.

The gains from these relationships will grow Russian power and enable a more robust foreign policy, improve ties with American allies (Germany, South Korea) and potential adversaries (China), and further contribute to a diffusion of global power and a weakening of American-brokered global institutions. As such, the scenario would be viewed with some alarm in Washington. A Russia that has never abandoned its strategic preoccupation with America-as-principal-adversary, now operating with enhanced capacity in a multipolar system with powerful partners, would indeed present a formidable challenge. The prospect of a Russia-China collaboration on a range of issues would be troubling (though Russia’s threat perception could shift as Chinese power continued to grow); Germany’s commitment to Europe, and possibly to NATO, would be questioned (reinforced by a visibly growing skepticism within Germany about the gains from its EU leadership); Russian assertiveness in its near-abroad would present challenges to both American and European economic and geopolitical interests, and precipitate conflicting responses from within Europe, and across the Atlantic; Russia would be better positioned to complicate the American policy agenda of global governance and economic liberalization, democratization, nuclear non-proliferation, stabilization of failing states, counter-terrorism, and Middle East peace (and also to win benefits in exchange for its collaboration).

Yet the fact remains that U.S.-Russian interests are coincident in many respects, and that the challenges presented in this scenario are balanced by the potential benefits of a “successful” Russia: one that is relatively
secure within its own territory, has leverage over other states and the capacity to act effectively—both as adversary but also as partner—and the self confidence to finally move beyond its sense of grievance at the collapse of the Soviet Union. The interests we share are compelling: slowing the spread of WMD and nuclear materials; addressing the threat of terrorism; reducing/containing the chaos of failing states; managing the rise of China; enhancing and stabilizing global growth; the (hopefully) shorter term challenges of containing/deterring Iran, and stabilizing Iraq and Afghanistan. All these issues could easily become the substance of future U.S.-Russian conflict, and in even the best case our natural rivalry will prevent close, permanent collaboration. But joint management of some of them, and genuine collaboration on a few (as is the case with arms reductions and control of nuclear materials) should not be beyond our capacity.

In this scenario, a U.S.-Russian “limited partnership” would openly acknowledge differences, accept sovereignty and non-interference as the basis of the relationship, operate largely through regular bilateral channels, and embrace a specific, limited agenda for cooperation: non-proliferation of WMD weapons and materials; counter-terrorism; arms reductions (to enhance mutual security and lend credibility to the non-proliferation regime); bilateral trade and investment promotion (the U.S. can play this game as well as Germany and China); and managing China’s rise. Off the table are human rights, WTO accession, and NATO membership (probably no harm in offering closer association, but less reason here for Russian interest). Stabilizing and growing the global economy might be included, centering on institutionalizing the G-20 and reforming the IMF to enlarge emerging country representation. Middle East peace is worth trying, given the benefits for containing terrorism and the spread of nuclear weapons, but here the temptations for each country to seek special advantages require limited expectations.

Realizing the upside of this scenario requires that both sides see and act on these possibilities. For a successful Russia, the natural tendency will be to abandon restraint, expand its definition of vital interests and inflate its assessment of its capabilities. The U.S. could react in such a way as to reinforce Russian views of the U.S. as its main adversary. A U.S. policy agenda devoid of human rights and economic liberalization would

This direction in Russian policy is in keeping with recent trends in the way emerging countries engage the global system.
also experience tough going domestically. It would be all too easy to find ourselves again in a highly conflictual, zero-sum relationship.

Thus far we have addressed U.S. policy *within* the scenario, imagining how we might make the best of a more powerful, assertive Russia. The hope, however, is that these scenarios can also be used as planning tools over the shorter term, to think systematically about U.S. policy should the future begin to track this scenario. This does not imply that the U.S. has decisive leverage over Russia's future, and indeed in this scenario our leverage is modest. But we may be able to tilt the direction of change in more favorable directions, if we can accept the plausibility and significance of “working authoritarianism.”

Broadly, two policy responses are possible should the scenario begin to unfold. One would be to resist the emergence of a successful Russia, using whatever leverage we had over its strategic partners, and accepting whatever conflicts resulted as less costly than the reemergence of an aggrieved, powerful peer competitor. However, Russia's success in this scenario depends primarily on its own internal actions, and on strategic relationships with countries that are acting with increasing independence in, for them, a less threatening environment. Preventing such an outcome would absorb enormous diplomatic capital, have minimal effect on Russia’s new partners, and guarantee Russian hostility.

The preferable approach, and the one in keeping with the current administration, is closer to “limited partnership”—a pragmatic, issue-specific, weakly institutionalized set of discussions/negotiations, the net effect of which could be a more cooperative relationship. The benefits of this relationship to both parties would hopefully be sufficient to help contain the damage from the inevitable conflicts—in resources, trade, the Middle East, etc.—between the U.S. and a successful Russia.
Scenario Two:

BOTTOM-UP LIBERALIZATION & MODERNIZATION

INTRODUCTION

By the end of the 2010–2020 decade, Russia’s economy has fully recovered from the great global recession of 2008. Surprisingly, the rebound is triggered by regional economic diversification and development and not by recovery programs originating in Moscow. While Russia’s energy-derived revenues continue to be essential to its economy, it is the successful industrial diversification into non-commodity sectors that has shielded the Russian economy from the effects of chronic price volatility in the global markets.

The dynamics of Russia’s political environment changes during the decade with the emergence of a unified opposition movement (Our 21st Century) based on strong nationalist themes, calls for industrial renewal, and the increasing public pressure for managerial competence in high public office. After years of corruption scandals, failed policies, and social unrest, United Russia has become damaged political property. A new generation of industrial leaders comprises the core of the opposition movement, all of whom are former members of United Russia. This group rallies behind Alexander Khloponin, a former governor and mining executive, who becomes the movement’s mouthpiece and most visible advocate for modernization and the rebuilding of Russia’s global competitiveness.

This new political movement wins the support of regional leaders, which facilitates the enactment of a wide range of pro-growth, anti-corruption measures and the funding of new businesses. Evidence of regional successes, especially east of the Urals, prods many political elites to abandon United Russia and to support broader modernization and reform efforts. The opposition party (National Vanguard) sweeps into power in 2018 and begins the difficult process of taking on institutional corruption in Moscow and implementing comprehensive national modernization and recovery programs.
DRIVERS OF THIS SCENARIO

The bottom-up liberalization and modernization scenario emerged due to the cumulative effect of the following drivers:

- **Global Economic Trends.** The global economy returned to moderate GDP growth of 2–4 percent during the 2010–2012 timeframe. Oil prices remained far below their 2007 peak. After reaching US$90 per barrel in 2010, prices fell back to the US$60–75 range—barely meeting Russia’s reduced budgetary targets. After recovering from negative growth in 2009, Russia’s GDP growth remained around 4 percent. Consequently, government revenues were well below what was required to fund previously committed social and investment programs.

- **Corruption.** Without the necessary support from the Kremlin, the anti-corruption program initiated in 2007 was more about words than meaningful action. If anything, the program ended up being misused by regional incumbents as a tool with which to harangue their political opponents. Kremlin officials largely ignored evidence of widespread organized crime within the police and security forces. Given the reduction in federal subsidies to regions, corruption and extortion became the major source of income for regional officials. Small- and medium-sized businesses suffered as a result, and support for the regime further soured. This discontent became the impetus behind political opposition.

- **Economic Development.** At local and regional levels, small- and medium-sized enterprises continued to thrive despite endemic corruption and the lack of national economic reform. Modernization of factories, funded by private investors, led to new vitality in a number of regions. Left wanting due to the curtailment of government subsidies from Moscow, a number of cities east of the Urals enacted legislation in an effort to become “investment-hospitable” and attract private investment. A series of ad hoc business-government partnerships was established with the objective of creating much needed social safety net programs. These partnerships reduced chronic interference from Moscow in the region’s local affairs. Thus, economic growth was bottom-up, driven by demand for lower cost alternatives to imported industrial products, the ingenuity of local business people, and the involvement of technical universities, which
Scenario Two: Bottom-Up Liberalization & Modernization

provided access to technological know-how. Small investments went a long way, and innovation drove growth. The enterprises behind this change were shielded from the volatility of global energy and credit markets, since they borrowed primarily in rubles.

- **Reform.** The Medvedev reform initiative was stymied by the siloviki. Although the government’s actions were nothing more than window dressing, some ideas were adapted and implemented in a piecemeal fashion in the regions at the insistence of the business community. New bankruptcy and contract dispute magistrate courts were established. Improved commercial licensing guidelines were enacted to rein in petty corruption. Reform became a theme across the political landscape, and regional politicians endorsed it as the only way to spur economic growth. Thus, conservative politicians identified with what once were considered liberal programs.

- **Domestic Politics.** United Russia’s monopoly on political control disintegrated due to the effects of a chronically ailing economy, its inability to rein in corruption, and the emergence of a credible oppositional movement (Our 21st Century). Putin was reelected in 2012 but faced attacks from the center-right for failed economic policies and for lacking managerial professionalism. Failing social safety net and infrastructure rebuilding programs deepened inequality, especially outside major cities. As a result, support for Putin plummeted, and United Russia faced a profound loss of political legitimacy. While the liberal-reformists were unable to contest Putin, a number of regional business leaders began to build a true oppositional political movement, fueled by defections from United Russia. It took a number of years for a movement to gain traction, but the formation of a regional association of governors created the necessary momentum and critical mass. Without sufficient tax revenues to mollify local politicians, Moscow’s control withered, and central rule became deeply contested.
THE PATH TO 2020


Three years after the collapse of the global economy and slow growth in the Russian economy, the Russian population continued to search for solutions, answers, and leadership. United Russia, the ruling party, had largely been discredited outside of Moscow and St. Petersburg. Growth in Russia showed no signs of recovering to pre-crisis levels of around 7 percent, hovering instead around 3–4 percent a year, derived from low energy prices and consumption levels. Russia’s economy remained heavily dependent on oil and natural gas, which comprised up to 60 percent of exports and roughly 25 percent of GDP. Increases in taxes and utility costs were severe, greatly affecting ordinary citizens. The long-awaited crackdown on organized crime and corruption had predictably focused on low-level offenders, while corrupt officials and oligarchs remained untouched. The number of public demonstrations increased in response to falling living standards, which resulted in repressive government police action. Large demonstrations were reported in Kaliningrad in the West and in Irkutsk in Siberia, as well as a variety of other cities.

Favoring a conservative course, Prime Minister Putin continued to support the central roles of oil and gas in the Russian economy, which he was able to do, given that oil prices remained between US$60–80 per barrel. Capital inflows into the energy sector showed signs of recovery after 2011, and the government was able to increase its foreign reserves and reduce the federal budget deficit to 3 percent of GDP by 2012. However, it elected not to implement structural reforms. Thus, while the government strove to increase FDI to pre-crisis levels, it fell short of this objective due to intense global competition and the failure of reform measures, such as amendments to the Strategic Sectors Law of 2008, to meet investors’ expectations.

Gas production grew only minimally (1–2 percent) since the energy sector continued to suffer from aging fields, excessive state intervention, and insufficient export pipelines. Moreover, the U.S. was becoming more “gas independent” thanks to shale extraction, while energy demand from EU countries remained below pre-crisis levels due to a shift to imports from the Middle East and North Africa.
Scenario Two: Bottom-Up Liberalization & Modernization

Gazprom failed to control operating costs and consequently lost both production and distribution capacity due to a series of refinery and pipeline failures. In each subsequent year, Gazprom lost share in the international market due to ill-conceived pricing policies, its inability to meet project deadlines, and chronic facility failure. To make up some of the shortfall in tax revenues caused by Gazprom’s declining income, the government allowed domestic energy prices to rise 27 percent, precipitating a wave of popular discontent. Household utility costs rose dramatically.

Moscow struggled to fund critical infrastructure projects as tax revenues waned. There were small improvements in manufacturing and retail output, but these followed significant declines during the crisis. The Putin government possessed fewer funds available to channel to the regions—and was consequently unable to buy political and economic influence. Local officials were now on their own, financially speaking, and predictably ramped up their efforts to extract revenues through higher taxes and license fees, as well as blatant extortion. Moscow continued to bail out regime-friendly oligarchs who mismanaged their empires, which reinforced the impression of a two-track Russia—one in which the population (with unemployment at almost 10 percent) was suffering at the hands of the elite.

Public protests erupted in Kaliningrad in early 2010, triggered by the city’s requirement of expensive (US$2,000), bi-monthly license renewals for businesses, which were viewed as an attempt to gouge small businesses. When the Kaliningrad oblast governor sought to ease the tax burden by modifying the program, local bureaucrats lobbied the Kremlin to have him removed, echoing a pattern that had become common in Russia since 2010.

Despite uncertainty on the national level, some signs of economic vitality began to emerge in a number of regional centers, such as Yekaterinburg, Samara, and Krasnoyarsk. Slowly, new industrial and service-based enterprises started taking off, and a new generation of business leaders emerged. These new commercial leaders were typically relatively low-ranking within the official United Russia power structure, but began to convince local politicians that economic revitalization was the only way out of the deepening economic malaise.
Economic development had remained sluggish until a number of cities ("magnet cities") enacted investor-friendly legislation, which included the provision of long-term land grants, ceilings on taxable corporate income, legislative recognition of previously negotiated contractual terms and conditions, the creation of bankruptcy and contract dispute magistrate courts, and improved commercial licensing guidelines. In return, local entrepreneurs agreed to support underfunded social programs and make hefty political contributions. These partnerships reduced the negative effects of bureaucratic abuse and "unofficial" corruption, enabling these new enterprises to flourish. While material economic growth would not appear until 2015–16, the foundation for recovery was being established.

These measures attracted new sources of investment, initially from émigré Russians. The first wave of investment capital went to “import-substitution” enterprises that were taking advantage of the weak ruble and meeting the domestic demand for light machinery, construction materials, and replacement auto parts. A second wave of investment targeted software development for industries, which began to fuel broader industrial modernization. This opened additional markets to Russian products and services.

The Krasnoyarsk Krai administrative district in central Siberia emerged as one center of economic activity. Alexander Khloponin, the former regional governor, had proved an exception among the many ineffective governors appointed by Putin. Prior to his election as regional governor, Khloponin had been the managing director at Norilsk Nickel and in 2002 was named “person of the year” by the influential business weekly, Expert Magazine, which recognized his transition from business to government as an example for the new Russian elite. After his first term, he had been reelected in 2006 and then re-appointed by Putin in 2007.

A key factor in Khloponin’s previous successes was his habit of surrounding himself with effective managers. He partnered with pro-reform oligarchs, such as Mikhail Prokhorov. He had a strong track record for efficiency and effective crisis management. In early 2010, Khloponin’s ability to execute under difficult circumstances led to his elevation to the role of deputy prime minister and presidential envoy to the newly created...

Upon assuming his new responsibilities, Khloponin designed an economic renewal program for Chechnya and the adjacent republics in the North Caucasus. Khloponin was intent on encouraging the creation of micro-businesses to jump-start the local economy and provide employment opportunities for young men who might otherwise be tempted to become insurgents. He quickly identified 139 investment projects requiring immediate federal funding, including a new gas refinery in the Stavropol territory, a hydropower plant in North Ossetia, and the development of rock deposits in Kabardino-Balkaria. However, even with strong support from his sponsor Dmitri Medvedev, Khloponin failed to gain the necessary budgetary approval for these projects. Khloponin’s efforts to rein in Chechen strongman Ramzan Kadyrov, with whom he clashed openly and often, were halted by the Moscow metro bombings in March 2010 and the subsequent wave of violence in the North Caucasus. Khloponin was not given the authority he needed to curb the endemic corruption and abuse of government power plaguing the region. Retribution for the metro attacks took precedence, and after 14 months on the job, Khloponin was transferred back to Siberia to oversee a series of underfunded state infrastructural projects.


Yet, Khloponin maintained his reputation as a solid businessman and competent reformer. In 2013, he was approached by a number of leading regional businessmen from Moscow, St. Petersburg, Yekaterinburg, Samara, Chelyabinsk, and Krasnodar—many of whom were well-known Putin supporters—and asked to become the champion of a nationwide economic revitalization campaign. Khloponin agreed on the condition that the program would include a major anti-corruption push. The campaign, named “Our 21st Century,” focused on re-creating Russia’s global competitiveness through the creation of high-growth employment zones, reducing barriers to new investment, protecting property rights, and holding government officials and business owners responsible for economic damages and bodily harm caused by industrial accidents, power outages, and defective products. This movement drew various disparate organizations, including
political movements, environmentalists, consumer protection groups, and drivers’ rights activists, into a coherent coalition and powerful grassroots political force.

Leaders of the Our 21st Century campaign collected and disseminated evidence of corruption and mismanagement. Local newspapers and Internet sites reported these findings, which included evidence of shoddy hospital and bridge construction, failures to perform critical product safety testing, and fraud in the awarding of government contracts. In one case, it was reported that local officials had siphoned off funds slated for infrastructure improvements, which could have prevented the collapsing of the metro bridge in Nizhny Novgorod—responsible for the death of 47 people and the injury of 130 others. All of the regional officials single out for their misdeeds openly opposed the economic modernization initiatives proposed by Our 21st Century.

Initially, Our 21st Century leaders had wanted to avoid the issue of government corruption, fearing backlash from Moscow. However, like most grassroots political movements, the campaign took on its own life, and corruption surfaced as a major concern. In a series of exposés, popular Internet bloggers revealed that misuse of public authority in the regions was even more widespread than commonly thought, citing the fact that less than 20 percent of all administrative orders from the Kremlin were actually carried out. Reports of cases in which public funding found its way into the pockets of local authorities were widely circulated and brought about a number of leadership changes. For example, Sergei Mironov, former speaker of the Federation Council and one of Putin’s closest allies, was implicated in one of the stories and, although the evidence was never fully validated, was eventually forced to resign. Similarly, the anti-corruption campaign led to a number of high-profile prosecutions in Nizhny Novgorod and Samara. Corruption remained the rule, but public outrage was now at a fever pitch.

Thanks to Internet forums and a growing number of independent bloggers, local issues gained greater prominence, helping to bring national recognition to the Our 21st Century campaign. Khloponin and the rest of the campaign leadership decided to seize upon communications technology to communicate people’s grievances. They established a website and telephone network where people could report incidents of corruption and expose the government’s policy failures. Through these
networks, Our 21st Century gained momentum and energized public support. The public felt that their grievances were being considered, at last. By emphasizing the public’s role in the campaign, Khloponin was able to energize the populace to move towards civil and political action in order to challenge the Putin government.

On the economic front, technological and commercial innovation continued to gain momentum. Russian economists reported significant gains in productivity and economic growth in the 2015 official statistics. Vanguard regions appeared to be stabilizing, so much so that waves of new capital (much of it from émigré Russians) began to flood magnet cities in the Urals and Volga regions. A number of regional banks successfully attracted capital and became centers of commercial lending. Consequently, a wave of new projects emerged in light industry, industrial software, consumer goods, and, most significantly, military technology.

Putin took note of this progress in his prime minister’s report to the Duma in early 2013, but he clearly underestimated its impact on regional politics. He appeared to be completely absorbed in his re-election campaign, the chronic bureaucratic infighting in Moscow, preparations for the 2014 Olympics in Sochi, and the outbreaks of violence in the North Caucasus. By the time the political significance of the Our 21st Century initiative became apparent to the Kremlin, Khloponin had solidified his reputation as a competent reformer and gained a national following. Many local communities competing for new sources of employment and tax revenue threw their support behind this modernization push. Khloponin’s program gained the endorsement of the Communist Party (CPRF) and a number of the other opposition parties, all of which had been marginalized by Putin and United Russia. In many regions, almost any candidate that opposed a United Russia party official had a decent chance of electoral victory.


A number of sitting governors, all members of Russia’s State Council, decided to establish a governors’ association in an effort to cooperate and solve mutual problems. Khloponin, himself a former governor, was invited to speak to the new Governors’ Council and to serve as a senior advisor to the group. He became the face of the economic boom east of
the Urals, attending opening ceremonies for new or revamped factories and personally appealing for the return of capital that left the country. When he announced his intention to seek the Russian presidency in 2018, he was joined by many hundreds of business people, university professors, and scientists from all over the country. He formed a new political party, National Vanguard, around a pro-growth, anti-corruption platform. Its program of national recovery borrowed heavily from the 2010 Institute for Contemporary Development Reform Plan (Yurgens Plan), which had been rejected by Medvedev and Putin.34

National Vanguard developed a substantial following in St. Petersburg and Moscow. Khloponin’s speeches began to deride Putin for his paternalism and overemphasis on state-owned monopolies:

“Nothing less than global competitiveness will satisfy Russia. Modernization and innovation are essential if Russia is to regain its status as a global power.

“Mr. Putin’s verticalization of government power is not the answer. Russia has been victimized by high-level corruption, managerial ineptitude, heavy reliance on foreign ideas and capital, and the lack of a strong legal and judicial foundation.

“Corrupt officials are bleeding Russia dry. They, including many regional officials, must be identified and stripped of their political and economic authority. When elected, I intend to appoint a special prosecutor to oversee the effective elimination of these corrosive factions.

“Our colossus Gazprom is undermining the Russian state. It is not in Russia’s national interest to permit Gazprom and the others (SOEs) to give out huge salaries while failing to complete key projects. Why should they be allowed to invest outside Russia when so much needs to be done here inside Russia to revitalize the economy? I say that the current managers must be held accountable for incompetence.

“Russians do not need a father. Our government should not be based on a single leader, especially one who lacks the imagination to bring our Russia squarely into the 21st Century. The people need to reclaim their government from foreign interests, corrupt politicians, and oligarchs. The government belongs to Russia. It is OURS.”
Scenario Two: Bottom-Up Liberalization & Modernization

The government’s failure to properly regulate the flow of illegal immigrants into Russia continued to be a source of opposition to the government in Moscow. This problem was compounded by the government’s failure to bring down unemployment rates as it had from 1999 to 2008, when unemployment fell from 12.6 percent to 6.3 percent. With unemployment rates still hovering around 10 percent, ethnic Russians began demonstrating against what they perceived as the government’s failure to protect jobs for Russians. Seizing upon the opportunity, Khloponin and the National Vanguard highlighted the government’s failures and pledged to control illegal immigration and reduce unemployment through economic reform.

In addition, Khloponin committed to preventing a demographic crisis through policies to encourage Russians to have children and to attract expatriates back to Russia. While the Putin government had already enacted similar policies, Khloponin argued that they were inadequate given the lack of economic reform, which had made returning to Russia unattractive to expatriates. Kholopin’s position on population growth solidified him as a champion for the Russian people. Additionally, it further improved his standing among the governors of border regions, areas which suffered most from these demographic concerns.

Khloponin’s candidacy thus took on a decidedly nationalist flavor. He opposed foreign control of Russian companies and cast a wary eye toward China and the U.S., accusing both of exploiting the Russian government’s incompetence.

Authorities’ efforts to suppress National Vanguard rallies were strongly resisted by the party’s growing number of supporters and further inflamed public opinion against the government. Putin’s opinion poll numbers collapsed, and he decided not to run for reelection in 2018. Khloponin’s National Vanguard party was swept into power.

2019–2020: Liberalization with a Russian Accent

Once in the Kremlin, Khloponin and a parliament dominated by National Vanguard undertook a series of measures that signaled their intention to follow through on campaign promises:

- An East of Urals Initiative was created, which directed US$5 billion to the region for new and revitalized commercial activities. Eventually,
this initiative led to the first voluntary migration to eastern Russia in modern times.

- The Duma voted to replace the practice of presidential appointment of regional governors with direct elections.

- Khloponin negotiated Ukraine’s entry into the CIS’ Common Economic Space (CES) cooperation treaty (which included Kazakhstan, Belarus, and Azerbaijan). The CES began to coordinate monetary and economic policy, and CES members were all individually admitted into the World Trade Organization. Several joint energy projects emerged from this measure, including the reorganization of Gazprom.

- Russia reached an energy agreement with China, according to which China agreed (reluctantly) to pay for energy at prices comparable to those paid by Europe.

- Firms that had been privatized between 1998 and 2008 (under questionable circumstances) were required to pay the government a special tax assessment. These funds were expected to go to the formation of new regional economic development zones.

- To encourage commercial investment and reduce the fear of property loss, arbitration courts were given greater authority and funding.

- The government tripled the funds available for improving roads and expanding drivers’ education programs in order to reduce the increasing number of highway fatalities across the country.

- Despite Khloponin’s nationalistic rhetoric, his administration encouraged foreign investment in Russian industry and reduced the number of “strategic sectors” off-limits to the international investment community.

By 2020, the results of these initiatives bore fruit. Russia’s annual GDP growth was now above 6 percent. Demographic trends were positive for the first time since 1998. Male life expectancy rose above 60 years due to a reduction in suicides, murders, and traffic fatalities. Productivity growth increased from under 2 percent to over 3 percent per year. Despite restrictions on foreign ownership, overall private investment increased by 65 percent per year over comparable 2010 numbers. For the first time
Scenario Two: Bottom-Up Liberalization & Modernization

since 1994, Russia’s GINI coefficient had improved, indicating a modest, but important, decrease in wealth disparity.

There was still much work to be done. Per capita income still lagged behind a number of Russia’s former Warsaw Pact satellites. Corruption still placed a serious drag on economic growth. It would take several more elections to rebuild a true multi-party electoral system. The Russian government, however, had succeeded in establishing a powerful governance model and had begun to reintegrate the center and the Russian periphery.

**IMPLICATIONS FOR U.S. POLICY**

In this other “successful” scenario, Russia adopts an approach to economic growth that incorporates elements of liberal reform, but is far from the market model promoted by the U.S. It does this not as a matter of strong preference, but as a result of the accumulating crises of demographic decline, low output and productivity growth, crumbling infrastructure, over-dependence on resources, inefficient state enterprises, and an eclipse of its global influence. Unable to ignore these realities, but immobilized by political conflict among deeply imbedded interests and unwilling to take the risks of full-blown reform, the leadership devolves greater economic latitude to local entrepreneurs and regional officials. This releases long suppressed impulses for investment, innovation, business formation, and the acquisition of new markets internally and abroad. The newly empowered business class becomes a growing political force for additional economic reforms, reduced corruption and cronyism, political openness and improved state-to-state relations essential for further trade and investment growth.

The success of this bottom-up strategy is demonstrated by accelerated growth and diversification beyond extractive industries.

The success of this bottom-up strategy is demonstrated by accelerated growth and diversification beyond extractive industries.
reform. Confronted by these challenges, politics at the center remains highly contested among siloviki and reformist elements. As a consequence, the Kremlin is unable to effectively respond to the forces set in motion by its own policies of devolution, and is thus incapable of either fully realizing their benefits, or of suppressing them.

This is clearly the most favorable scenario for the U.S., and potentially for Russia itself, though not an unmitigated blessing for either. The challenges for Russia are discussed above. From an American perspective, evidence of increased economic independence, decentralization, and market driven trade/investment opportunities will be greeted with great enthusiasm, and will build expectations for further reform and collaboration that could be easily frustrated. Russia is still, in this scenario, a rising power with a strong residue of grievance towards the U.S., though with a government less able (than in the first scenario) to capture growth dividends for its own purposes. It will define its own interests, often in a way that conflicts with our own. It will seek to complicate or thwart our policy agenda when it sees advantage or threat. Its government is also less coherent, more internally divided, less able to control its near abroad or deliver on any commitments that reflect U.S.-Russian commonality of interests. More pliable, but less effective, this scenario may not net out as a plus for either party.

That being said, the potential for a sustained improvement in relations, and for joint action on common threats and opportunities is greatest in this scenario. So is the opportunity to influence Russian behavior. The coincidence of interests described in the first scenario remains: global prosperity, arms reductions, counter-terrorism, non-proliferation of WMD, management of China’s rise, and stability in failing states and contested regions. Added to this formidable list is some—though not complete—consensus on market driven growth and strengthening of global institutions, including reform of those institutions to enhance their legitimacy among rising powers. Bottom up pressures within each country for improved relations should reinforce these common interests, as private linkages in trade and finance proliferate. Russian fear of China, and its deepening influence in Siberia (a risk inherent in devolution), will solidify a U.S.-Russian common interest in managing Chinese power (without provoking it into greater hostility), and provide additional leverage to the U.S. in generating support for its policy agenda.
Scenario Three:
DEGENERATION

INTRODUCTION

In 2020, Russia is in secular decline. After years of mismanagement, underinvestment, and stalled reforms, the economy is languishing. The energy sector, once the guarantor of soaring profits and rising incomes, has lost its commanding share of global markets. No alternative engine of growth has emerged because rampant corruption has rendered virtually every enterprise unviable. Structural unemployment has markedly increased since 2010, while real incomes have stagnated. The country’s social fabric has broken down and crime rates have surged. Violence has leaked out of the North Caucasus, and terrorist attacks plague Russia’s cities.

While the demands of Russian society have broadened, the government’s ability to meet them has diminished. United Russia is divided and opposition parties are fighting among themselves. Central government institutions are near paralysis. Moscow seems more distant from the remote regions of the Far East than ever. Regional leaders have begun to fill the governance void, distancing themselves from central government and rallying their constituents around their own ideas for the future.

Russia’s delegitimized leaders have difficulty commanding respect from neighbors who are faring noticeably better economically and politically, particularly China. Unable to solidify its national identity and place in the world, relations within both the Euro-Atlantic region and East Asia are in decline. By 2020, marginalized in Western institutions and ignored by Eastern neighbors, Russia is slipping into what it fears most: irrelevance.
Drivers of This Scenario

The degeneration scenario emerged due to the cumulative effect of the following drivers:

- **Global Economic Trends.** The effects of the global downturn and subsequent eurozone crisis on the Russian economy were profound. They also had a lasting impact: incomes and employment did not fully rebound with accelerating growth because investors’ former optimism about the potential of the Russian market had waned. Moreover, because of failures to resolve management and production problems, the energy sector gradually lost market share. In the absence of viable alternative industries, Russia was unable to capture gains from improving global economic conditions for the remainder of the decade, much less distribute these to the population at large.

- **Diversification and Economic Reform.** Economic policies were reactionary and, by any measure, ill-conceived throughout the decade. Initially, discussions of “modernization” were common, but these disappeared as Medvedev’s high-tech initiatives faded into oblivion and Putin’s pet infrastructure projects fell into disrepair. For the rest of the decade, the country’s overall development strategy centered on subsidizing “national champions,” especially the energy sector. Few measures were undertaken to improve Russia’s business climate. The increasing unpredictability of policy and the lack of transparency drove investors from Russia and stymied employment opportunities for the population.

- **Corruption.** Corruption became still more pervasive—and less controllable—throughout the decade, but drifted ever further from the political agenda. As it spread, it drove foreign investors out of the market, crippled local businesses, enabled organized crime, and eroded the quality of public services. Most seriously, because policy outcomes were distorted by the diversion of funds from projects to officials’ pockets, it undermined the government’s legitimacy.

- **Domestic Politics.** The recession at the beginning of the decade stoked a flurry of criticism of Moscow, and opposition parties appeared to be broadening their support bases. However, voters’ concerns centered on the corruption and unresponsiveness of local officials, much more than on national issues. Opposition parties, catering to
Scenario Three: Degeneration

these region-specific issues, could not unify nationwide opposition to United Russia, especially in the face of electoral fraud, press censorship, and repression of civil society. United Russia thus remained the dominant political force, even as its inability to provide prosperity, social protection, and security to its citizens undermined its legitimacy. However, the party itself began to fragment and showed increasingly overt signs of internal conflict. By the end of the decade, political divisions are so deep and the competition over scarce government resources so intense that the political system is paralyzed.

- **Ethnic Conflict.** Throughout the decade, conditions in the North Caucasus deteriorated. Living standards worsened considerably as a result of the recession, failed development policies, and escalating violence. Attempts to improve security failed, and because they relied on draconian tactics, further alienated the population. To avoid further government intervention, elites in the North Caucasus worked to establish greater autonomy. Violence and extremism continued to intensify, however, spreading to other regions of the country and heightening Russians’ sense of insecurity and perceptions of government failure.

**THE PATH TO 2020**

**2010–2012: The Lingering Crisis**

2010 was an uncertain year for Russia. The country was still struggling through the aftereffects of the global financial crisis while it prepared for potential further shocks from the Eurozone crisis. A tentative recovery in 2010 was touted by politicians, but fell far below the expectations of the public, particularly because few forecasters predicted a return to pre-recession growth rates any time in the near future. Households across the country struggled to make ends meet. A terrorist attack on Moscow’s metro in March 2010 further unsettled the country, raising fears of future attacks—and the government’s ability to deter them.

Frustration with Moscow grew, and—surprisingly, for a country accustomed to keeping dissent quiet—was increasingly expressed publicly. Opposition groups tapped into this discontent and organized mass demonstrations. Despite predictions that they would lose momentum in the face of ever-harder restrictions on public gatherings, enforced by arrests and violent crackdowns, demonstrations continued.
Opposition leaders were disappointed to find, however, that while protestors decried Putin and Medvedev’s failure to guarantee economic growth and security, they were much more frustrated with their local governments. In light of frequent proclamations that Russia was rebounding from the recession, the struggles of the average household seemed an anomaly, which could only be attributed to the inefficacy of local leaders. Thus, while Russians hoped the Kremlin would improve its management of the economy and find a solution to violence in the Caucasus, it was the corruption of traffic police, unresponsiveness of bureaucrats, increases in fees for public services, and scaling back of welfare transfers (due to the recession being “over”) that invoked their ire and mobilized them politically. Since voters perceived these issues as particular to their region, opposition parties struggled to generate a nationwide challenge to United Russia. Instead, individual politicians sensed an opportunity to improve their own standing by galvanizing support based on local politics.

Meanwhile, conditions were deteriorating in the North Caucasus. The recession had seriously affected the region—where unemployment was estimated at 50 percent—and reinforced residents’ feeling that they were second-class citizens. Moscow’s—expensive—attempts at addressing the socio-economic causes of violence were proving glaringly ineffective, focusing on “development” projects with marginal impact and lining the pockets of regional strongmen. In addition, after the March attacks on Moscow, this “softer” approach lost its political appeal and was rapidly replaced by rhetoric promising harsh retribution for future attacks and greater involvement of the security apparatus in taming the region (a strategy formerly discredited as further alienating potential insurgents, but still appealing to Russians—and Putin).

2010–2012: “Modernization” Without Reform

While observers, including investors anxious to tap into Russia’s large market, watched for signs that the crisis was pressuring the government to undertake democratic and market reforms, no substantial changes emerged. Measures to “improve Russia’s business climate” raised expectations, but turned out to be little more than manifestations of political squabbles. Meanwhile, slow growth squeezed “national champions,” and the government, having stepped in as a guarantor of their unmanageable debt loads, became even more committed to protecting their market share.
Scenario Three: Degeneration

Most of Moscow’s efforts at ‘reform’ revolved around high-profile “modernization” projects, which it used as evidence of progress and a rallying point for national pride. Medvedev, for example, led efforts to build a “Silicon Valley” in Skolkovo and develop a nanotechnology industry, in which he hoped Russia could emerge as a global leader. Billions of rubles were dispersed in support of these projects, though foreign partnerships—critical to acquiring access to high technology—and qualified researchers were in short supply.58

Upgrades to the eastern port city of Vladivostok in advance of the Asia-Pacific Economic Cooperation (APEC) summit meeting in 2012, initially a source of excitement about Russia’s potential role in Asia, turned into a striking example of skewed priorities.59 Residents were pleased with the attention from the central government. However, by 2011, as citizens faced still-frozen wages, the unabated threat of unemployment, and rising fees for municipal services, the half-constructed conference center, theater for opera and ballet, and “bridge to nowhere”40 began to symbolize the insensitivity of government to the needs of the average person.

The project that gained the most attention—for all the wrong reasons—was Putin’s pet project, the upgrading of the resort town, Sochi, into a world-class venue for the 2014 Winter Olympics. From the outset, the Kremlin’s enthusiasm was overshadowed by frequent reports of poor planning and corruption, which eventually pushed construction costs from US$12 billion to above US$20 billion. International criticism of the Olympic Committee’s choice of venue on the grounds of environmental damage and potential security threats (due to Sochi’s proximity to the North Caucasus) further undermined the project’s reputation.41 Russians remained proud, but also began to worry that investments in Sochi were extending well beyond the country’s means and causing the government to neglect other pressing needs.

Thus, by 2012, Russia remained as fixed as ever on its trajectory of energy-dependent growth, supported by aging infrastructure. However, unlike in 2000–2007, this model was not producing results for most Russians. GDP growth appeared to have rebounded, but employment, wages, and optimism had not. Small businesses that had closed during the recession had not reopened, littering towns with empty storefronts. Larger enterprises were slow to rehire workers, since global demand still did not appear to have fully recovered, and life in mono-industry regions grew desperate.
2012: Putin Reelected

Putin’s decision to run for the presidency in 2012 came as no surprise. Neither did his victory, given the lack of viable alternatives. When he won, he claimed a broad mandate to take whatever measures necessary to reestablish Russia’s prosperity, security, and unity. But it was obvious that his support base was much less broad than supposed. Not only were allegations of unfair campaign tactics, media suppression, and election irregularities widespread—and widely reported in Western media—voter turnout had been much lower than in previous elections, only 51 percent of the electorate. Putin’s approval rating had dropped well below 50 percent, and Russians were cynical about his ability to deliver on his promises.

The 2012 legislative elections more accurately reflected the state of Russian politics: increasingly fragmented. United Russia had fared rather poorly, losing seats in the Duma despite Putin’s win, and showed signs of deep internal divisions. Opposition parties were even more divided. In many regions, campaigns had been bitter, driven by voters who were intensely dissatisfied with their local governments. Opposition parties, attempting to cater to a vast array of demands, often region-specific, could not agree—among themselves or with their potential allies—on a national platform.

2012–2013: Putin’s Firm Hand

Upon assuming the presidency, Putin immediately attempted to reclaim his former public appeal and command of Russia’s state apparatus, but encountered much more resistance than he expected. The consensus among economists was that Putin’s stated economic policies would be insufficient to guarantee sustainable growth, and that Russia urgently needed to reduce its energy dependence, address corruption, and improve its relations with foreign investors. Opposition parties rallied anti-Putin sentiment around election irregularities. A number of political elites, anticipating failure, began to distance themselves from him to increase their own maneuvering room.

In response, Putin stepped up measures to suppress criticism and undercut potential rivals. In regions where opposition parties had made a strong showing, he closed down independent media outlets and pressured local governments to enforce stricter anti-demonstration laws. Those non-
governmental organizations that still remained reported that government officials were harassing them and trying to force them to shut down. He also began to suspect the intentions of powerful members of United Russia and systematically undermined their influence by withholding appointments and leveraging his influence over the media and the judicial system to tarnish their reputations.

2013–2017: Putin’s Faltering Hand

Even though he repressed overt criticism of his policies, the public could not help but notice the growing gap between Putin’s promises and his real accomplishments. On the economic front, not only had economic growth still not improved living conditions as expected, Russia was lagging well behind other emerging markets, including many that it used to outperform, such as Ukraine. Inflows of foreign investment remained extremely low and concentrated in extractive industries where they contributed little to innovation and capital accumulation because investors feared the government was not committed to protecting their investments.

Putin’s “national champions” were struggling. These companies, having been kept afloat with government funds during the recession, were expected to have improved profitability as global demand recovered. However, this had not occurred. The most high profile case was that of Gazprom, Russia’s gas giant that received more than 10 percent of the government’s crisis bailout package in 2009. The government and company executives blamed poor performance on a temporary surge of influx of liquid natural gas in the European market. However, most analysts pointed to two more serious problems. First, the company’s budgetary practices, never the model of transparency, were characterized by severe, chronic waste: revenues were channeled to excessive compensation, frivolous investments, and an unmanageable array of subsidiaries, instead of to the maintenance and replacement of aging capital equipment. Second, despite awareness that the future of Russia’s gas exports depended on developing new fields, Gazprom’s development projects in the Arctic—where three basins containing 46 percent of Russia’s proven gas reserves lay—had all but stalled due to technical difficulties and capital
In 2013, the company’s attempts to make up technological and capital shortfalls by soliciting Western investors—who it had previously shunned—further delayed development because negotiations were drawn out and contentious, as investors were unwilling to accept Gazprom’s poor terms. Questions about Russia’s reliability created strong incentives for European countries to find alternative suppliers, which they did gradually.47

Corruption—which had long been a staple of Russian life—spun truly out of control, in part because Putin resisted calls for reform, and in part because Moscow underestimated both the extent and potential ramifications of local-level corruption. The long-lasting recession early in the decade had increased incentives for public officials, low-level bureaucrats, and police to engage in corrupt activities. However, these activities had not subsided with the resumption of growth; instead, corruption had become more pervasive than ever before. Small businesses complained that the high costs of licenses, tax filing, and other administrative procedures were driving them out of business. Multinational retailers closed stores, reporting that, despite the potential for growth in Russian demand, stores were simply not financially viable when the costs of corruption and complying with Russia’s inchoate corporate governance laws were taken into account. Most worryingly, citizens virtually stopped reporting crimes to local police because it seemed officers’ interest in public safety had all but disappeared.

The combination of flagging economic conditions, spreading corruption, and Moscow’s failure to ameliorate either, crippled Russian society. Crime rates surged, and the harsh, arbitrary responses of security officials only contributed to citizens’ sense of insecurity. Russians worried about their physical and financial survival. Spreading pessimism was evident in surging rates of alcohol, drug abuse, suicide, and domestic violence, which not only increased mortality rates, but also strained the country’s inefficient, underfunded health sector. Birth rates also fell precipitously because people feared they could not provide for additional children.

Compounding Russians’ feelings of insecurity, in 2016, the situation in the Caucasus reached a breaking point. Terrorist crime rates reached an all-time high of more than 1,000 in Chechnya, Ingushetia, and Dagestan as militants attacked police forces and assassinated low-level government officials on the grounds of brutality and corruption. Ruthless counterterror
campaigns, in turn, drove more people “into the woods” to join the militants. Spreading discontent about unemployment—which had reached more than 60 percent in the region as a whole—corruption, and insecurity accelerated the Islamization and de-Russification of the population. In November 2016, after five innocent young men were killed in a particularly brutal security raid in Makhachkala, Dagestan, Chechen separatists and members of Shariat Jamaat, a militant Islamic group, crossed the border into Dagestan and killed 12 police officers in retaliation. When a flurry of violence followed, Chechnya’s president, Ramzan Kadyrov, sent security forces into Dagestan, allegedly to bring order and prevent violence from spilling over into Chechnya. Putin reacted hostilely to Kadyrov’s show of force, abandoning pretenses of a development-oriented strategy in the Caucasus, and launched a full-scale military intervention in Dagestan with the dual goals of stabilizing the region and checking Chechen influence. Critics warned that this move would exacerbate social tensions and drain state resources, but Putin insisted that Moscow should demonstrate its commitment to maintaining control of the region and protecting Russians from terrorist threats.

2017–2018: A Stronger Hand?

By 2017, Russians were desperate for the country to get back on track. Not only did they feel extremely vulnerable, they were also painfully aware of Russia’s deteriorating position vis-à-vis its neighbors. While Russia’s economic prospects waned, Ukraine’s seemed to be blossoming under the influence of an attentive Europe, eager to invest in its growing export industries. In Central Asia, China had replaced Russia as the primary source of development aid. As it worked with governments of Kazakhstan, Tajikistan, and Kyrgyzstan to build railroads, pipelines, and power stations, it appeared to be chipping away at Russia’s influence over these countries.

Russians’ desperation for strong leaders able to restore economic vibrancy, social protections, security, and Russia’s influential place in the world was felt by all parties. Observers speculated that, if voters blamed United Russia for deteriorating conditions, the 2018 elections could bring about profound changes. Yet, this change did not come in the presidential elections for two reasons. First, while voters were, indeed, extremely dissatisfied with Putin, no alternative candidate was able to unify this discontent into a viable opposition. Second, in reality, most voters had
no real desire for United Russia to lose: the violence in the Caucasus had jarred them, and they hoped for an even stronger hand than Putin’s, which undoubtedly would have to come from within United Russia.

And, indeed, it did. Putin, aware of his declining popularity, decided to salvage his legacy by appointing a loyal, capable successor. He selected Aleksey Kuzmitsky, former governor of the Kamchatka oblast, who had served as deputy plenipotentiary of the president in the Far Eastern Federal District for the previous six years. The full weight of state-controlled media was thrown behind Kuzmitsky, and he sold himself as a visionary leader, deeply committed to restoring Russia’s “natural” state as a secure, prosperous, powerful country. Voters largely bought into this persona, though a small group of urban, educated elites fought ardently for a more genuinely reform-oriented president. Kuzmitsky’s election, like his predecessor’s, came as no surprise, especially since electoral fraud was again widespread, if underreported.

Profound change did occur at the local level: nearly all incumbents were voted out of office and replaced with candidates who pandered to voters’ desires for less corruption, more services, and job opportunities. These candidates relied heavily on sub-national ideologies in a marked shift from the staunch nationalism that had characterized previous elections. They articulated visions for how their regions could rebuild themselves, in spite of a declining Russia.

2018–2019: Political Fragmentation

The illusion of a stronger, more effective president faded immediately. Putin’s endorsement turned out to be insufficient for ensuring backing for Kuzmitsky within United Russia, which had fragmented during Putin’s presidency into a myriad of individuals, groups, and factions competing for preeminence within the party. The Duma was virtually paralyzed, as much from disagreements within United Russia as from competition among parties. The most obvious sign of Kuzmitsky’s weak influence was his inability to gain any leverage over the country’s economic elites. Energy company executives were able to deflect Kuzmitsky’s attempts to interfere in their internal affairs. He was isolated, without the support of the siloviki or the reformists.

Coupled with the sweeping leadership changes at the local level, the divisions emerging in Moscow increased incentives for party functionaries
Scenario Three: Degeneration

in the regions to distance themselves from Kuzmitsky, who by late 2018 suffered an approval rating below 30 percent. Parliamentarians lost interest in proving their loyalty to party heads and focused instead on building their own power bases, both by attempting to secure benefits for their constituents and by deepening patronage networks. Many officials believed that if they could solve their region’s problems, they would gain political ground.

Vladivostok’s mayor became exemplary in this regard. He had taken restoring the city’s economy into his own hands, attempting to solicit foreign companies and negotiating directly with the Chinese government—at a time when the president himself was scarcely welcome in Beijing—to draw investment and interest in the city’s potential. Chinese representatives elected not to respond to his overtures. When a federal investigation was launched into the financial affairs of the mayor—in a poorly concealed effort to oust him—citizens ardently protested. The arrival of federal troops in Vladivostok to quell demonstrations proved a serious miscalculation on Moscow’s part, since it further alienated the city’s residents and galvanized support for pursuing greater regional independence. In a belated attempt to buy loyalty, Kuzmitsky withdrew troops and promised to commit federal funds to the development of the Far Eastern regions. However, these promises soon proved false since rampant tax evasion, a declining energy sector, and burgeoning patronage networks had drained the government’s reservoir of resources.

To complicate matters, Moscow’s efforts in the North Caucasus were consuming ever more resources—and failing abysmally. The security situation deteriorated, such that contagion to other regions was no longer simply pessimistic speculation, and Moscow’s influence in the region had disappeared. The offensive in Dagestan had jarred regional elites, since security forces had resorted to draconian measures for maintaining control, including the unapologetic elimination of uncooperative elites, to compensate for the manpower shortages that resulted from high desertion rates and recruitment difficulties. With Russian troops now bogged down in Dagestan, the escalating Ingush-Ossetian conflict spun out of control. The new Ossetian separatist movement declared the unification of South and North Ossetia and the creation of an independent republic. Moscow rejected any form of autonomy and threatened intervention. However, marshalling sufficient military resources proved to be very challenging.
2019–2020: International Marginalization, Degeneration

By 2020, Moscow was nearly entirely consumed with domestic affairs. Paralyzed by internal divisions and corruption and delegitimized in the eyes of its own citizens for failing to address the country’s most pressing problems, the Kremlin found itself weakened internationally, no longer able to ride on its status of former superpower or as burgeoning “energy superpower.”

European consumers continued to diversify away from Russian gas, reducing Russia’s ability to use its supplies as a geopolitical tool. The loss of market share in Europe also decreased Russia’s leverage over Asian consumers, and it was forced to build new partnerships on much less attractive terms.

Foreign investors no longer speculated about the potential of the Russian market, and referred to the “BICs,” cutting Russia out of the club of leading emerging markets. Despite two decades of trying to build its Asian credentials, Russia remained marginal in Asian multilateral organizations. Relations with China had shifted dramatically, visibly giving China the upper hand over Russia. In Central Asia, Russia made the rhetorical claims of partnership it always had, but it was China’s partnership that governments and businesses wanted.

Russia’s diminishing position was not lost on the country’s citizens, who painfully felt their country’s loss of influence in the world. However, political, economic, and security conditions had grown so dire that most Russians believed they could no longer afford to worry about global affairs. Nationalism held little appeal, since it appeared that the only thing holding the country together was its decline.

Most people believed the best means of survival was to fend for themselves. Surging crime rates, unprecedented levels of corruption, and burgeoning organized crime networks reflected this tendency: the country’s social fabric was breaking down. Extremism—provoked in large part by clumsy, inappropriate government policies—was leaking out of the North Caucasus, and attacks in urban centers around the country became common. Insecurity became the defining feature of Russian life.

Moscow was not a passive bystander in Russia’s decline, but it was a powerless one. By 2020, it functioned primarily as the venue for intense power struggles between the country’s elites. Divided and ineffective, Moscow was thoroughly delegitimized. Every region sought a way to...
secure autonomy, rendering the central government's perennial fear of losing its grip on Russia's vast territory more likely than ever. Nowhere, however, did increased autonomy radically improve governance, economic prospects, or security. As of 2020, none of Russia's regions had been able to rescue itself from the sinking Russian ship.

**IMPLICATIONS FOR U.S. POLICY**

This is the dead-end scenario for Russia. It is overwhelmed by low growth and falling productivity; excessive dependence on extractive industries that are suffering from lack of investment and overexpose Russia to global volatility; crime and corruption; and political immobility. No set of external conditions is conducive to reform: rising demand and resource prices reduce the urgency for modernization; weak demand and falling prices increase the sense of urgency, but polarize the political debate and excite nationalist and populist impulses. The bottom-up growth strategy chosen in the second scenario, of devolving reform to regional governments and enterprises, is viewed here as risking too much political pluralism and interdependencies with other potentially rival-states. The regime lurches from crisis to crisis, muddling not through but down, resorting increasingly to repression as it fails to address the challenges of demographic decline and economic stagnation. Towards the end of the decade, signs of territorial fragmentation appear.

This is obviously the worst scenario for Russia (and by no means the least likely), and almost entirely negative for the U.S. Some Americans might celebrate the imminent demise of a still hostile and militarily powerful competitor, and the opportunities offered to extend our influence into Ukraine, Belarus, Central Asia, and the Caucasus. Others might see opportunities to leverage a weakened Russia to support U.S. global policy objectives, or to embrace a second run at extensive structural political and economic reform.

A besieged Russia is not likely to view such efforts as either benign or useful. It retains the capacity to do harm in reaction to efforts to exploit its weaknesses, but not the political capacity to respond affirmatively to outside offers of advice and assistance. Russia is weak and politically immobilized, thus at best irrelevant for satisfaction of U.S. policy goals. It is insecure and aggrieved, thus given to impulsive, unpredictable and xenophobic behavior. It has only tenuous control over unstable regions
within its territory, and is thus a source of spreading violence and crime, yet unlikely to collaborate with others in containing the chaos. Its shaky command over its own territory offers opportunities and temptations to other states that are actual or potential rivals of the U.S. It is still powerful, with an abundance of weapons and materials that can be used deliberately against its enemies, or transferred (inadvertently or not) to terrorists and dangerous states. It contributes little to global growth, is an unreliable supplier of oil and gas, and is an illiberal—and sometimes volatile—influence on the trade and financial order.

Thus, a degenerating Russia is a weaker partner in managing high priority problems, and a growing source of new instabilities and threats to U.S. security. As such, U.S. policy within this scenario would be aimed primarily at limiting the damage. This would be organized around maintaining Russian commitments to previously negotiated agreements on arms limitations, counter-terrorism, intelligence collaboration, non-proliferation (including Iran sanctions), open supply routes to Afghanistan, and Russian participation in NATO. Even such limited success would require much exertion, and would be very difficult to sustain as the returns to collaboration diminish. Limited agreements might be sought on reducing Chinese opportunities to exploit instability in Asia, and managing terrorist threats in the Caucasus. The withdrawal of Russia as a viable partner in managing complex global security problems will enlarge the importance of partnerships with other powerful actors, including the EU, emerging countries (especially India, Turkey, and Brazil) and most importantly, China, whose cooperation is essential (on any of the issues discussed earlier), but whose power and ambition will be enlarged by Russia’s decline.

The real value in presenting such a downside scenario is not in containing the damage, but in avoiding it entirely. Unfortunately, this is an internally (within Russia) generated scenario, reflecting the Russian leadership’s inability to think and act its way toward reform. Our ability to save Russia from itself is very limited, and as this scenario unfolds would be misinterpreted in any case. Perhaps the best we could do would be to persuade Russian leadership that the degeneration scenario is an entirely, even likely, outcome of political stasis, that Russia and the U.S. have a common interest in avoiding it, and that we’re prepared to do what we can, within the context of our multiple interests, to tilt Russia’s future in a better direction.
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