



Russia and Ukraine – update June 2014

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- Russia has contained the unrest seen in 2011 by limited reforms and by an appeal to conservative Russian nationalism in both domestic and international policy
- Corruption remains a severe problem and the Russian economy is relatively weak
- There have been moves to forge closer relationships with China as ties with the West are strained and further sanctions over Ukraine are threatened
- Analysts are wary of new conflict as Ukraine, Moldova and Georgia prepare to sign their Association Agreements with the EU

See also [Ukraine, Crimea and Russia](#) - Commons Library Research Paper 14/16, 17 March 2014



Source: EU External Action Service. Dark green countries are members of the European Neighbourhood Policy

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1 Domestic politics

The eruption of anti-government demonstrations in 2011, particularly by young urbanites not dependent on the state, in Moscow and St Petersburg but also in other towns and cities, shook the Russian government. It was the most important political mobilisation since the arrival of Vladimir Putin as Russian president in 2000 and was sparked by the dubious 2011 parliamentary election.

Hardliners in the Russian elite are extremely wary of any sort of popular mobilisation. Popular feelings of alienation caused by monopolisation of power by small elites, corruption, and a lack of genuine democracy, despite the adoption of democratic forms and language, brought about the fall of Viktor Yanukovich (now twice) in Ukraine and other 'colour revolutions' in former Soviet states. The Kremlin partly blames Western backing for NGOs working on promoting democracy and human rights for these movements. While Westerners tend to see these as universal values, worthy of support in any country, the Kremlin detects deliberate attempts to weaken the Russian state and to bring about regime change, and to drive a wedge between Russia and its natural allies, bringing Western power closer to its borders and reducing Russia's sphere of influence.

The opposition movement in Russia was never united and did not have a clear objective. While it was mainly perceived to be pursuing liberal aims, particularly in the West, there was also an element of Russian nationalism involved in the demonstrations. This strand was pushing for greater protection for ethnic Russians within Russia (where economic growth has attracted large numbers of people from former Soviet states, particularly from Central Asia and the Caucasus and particularly to Moscow). The opposition demonstrations had little to do with the official opposition parties represented in the State Duma, or parliament.

While it managed to bring tens of thousands of people onto the streets, it never reached the critical mass that might have brought about radical change in Russia's politics. However, it did alert the government to the possibility of popular protest and brought about some important changes.

The response of the government was varied. It increased the opportunities for political participation and party formation, particularly at the lowest levels of government. Many opposition parties have indicated their willingness to participate in the forthcoming local elections, set for September 2014.

But it also increased a clampdown on foreign funding for NGOs, obliging those that accept foreign funds to declare themselves to be 'foreign agents'. Alexei Navalny, one of the highest profile campaigners, was subjected to house arrest. When he supplied information on individuals involved in the annexation of Crimea that was used to create the US sanctions list, he was banned from using the internet.¹

Aside from such measures, Putin's government seems to have taken a decision, partly as a result of the rise of dissent, to increase the nationalist flavour of the government's discourse. The Russian government largely controls Russian television and there are reports that the Kremlin and its allies have moved to exert more control over television and social media and

¹ Richard Sakwa, *Whatever Happened to the Russian Opposition?*, Chatham House, May 2014

news networks.² However, Russian nationalism is a dangerous card to play for any Russian government. Tensions between ethnic Russians and minority and migrant workers are already high and manifest themselves from time to time in violence. With the economy predicted to grow very slowly over the next few years, these tensions are likely to get worse.

Russia has also taken a more socially conservative position, outlawing the 'promotion' of homosexuality to minors and criticising Europe's liberal attitude towards sexual minorities. Putin has also increasingly cultivated the support of the Russian Orthodox Church. The Church has supported the Russian government in its foreign policy as well as on domestic matters.³

The next presidential election is not due until 2018, at which point Vladimir Putin will be eligible to run for another six-year term.

1.1 Corruption

Corruption in Russia is endemic. In the most recent high-profile example of it, it has been estimated that somewhere between a third and a half of the \$50 billion cost of the Sochi Winter Olympics went on kickbacks,⁴ although the Russian government denies the figures. The chief military prosecutor has said that some 20% of the arms procurement budget is misappropriated.⁵ Russia remained at position number 127 out of 175 countries in Transparency International's Corruption Perception Index 2013, no change on its position in 2012, although that was an improvement on its score in the 2011 table.⁶

The government has admitted that it has a problem with corruption, particularly in view of the backlog of infrastructure that Russia needs to build in order to modernise its economy. A generalised culture of corruption is very difficult to tackle, however. In spite of some high-profile arrests, such as that of the Prime Minister of the Perm region in Russia's far east, and policies such as raising the salaries of officials at the same time as requiring them to declare income and assets, the dedication of the elite to the clean-up is sometimes questioned. There is also a risk that industry depends on corruption to oil its wheels and if it is clamped down on too quickly, the economy can suffer in the short term.

2 Russian foreign policy

Particularly since the return of Vladimir Putin to the presidency, Russia's foreign policy has become more assertive. This may be in part an attempt to boost the government's legitimacy, in view of the 2011 demonstrations.

The annexation of Crimea by Russia violated a norm of international relations and marked the end of the period of relative harmony in Europe after the Cold War, raising the possibility of a new one. It was justified by a doctrine of protecting ethnic Russians who found themselves outside Russia after the fall of the Soviet Union. This has caused consternation in other countries that have Russian minorities, especially in the Baltic States, and in other countries with a fear Russian domination, such as Poland.

² ['Kremlin ally cements control over top social media site'](#), *Reuters*, 18 March 2014; ['Kremlin Tightens Censorship as Tensions over Ukraine Increase'](#), Freedom House, 14 March 2014

³ ['Russian Orthodox Church sings from Putin hymn sheet on Ukraine'](#), *Reuters*, 7 March 2014

⁴ ['Sochi 2014 Winter Games: Corruption May Have Cost As Much As \\$30 Billion'](#), *Associated Press*, 30 May 2014

⁵ ['Can Russia Ever Extract Itself From Corruption?'](#), Chatham House, 11 February 2014

⁶ [Corruption Perceptions Index 2013](#), Transparency International

NATO has responded to the perceived Russian threat by bolstering its air surveillance mission based in Lithuania. The US has also moved a number of fighter aircraft to Poland.

2.1 Relations with China

At the same time as the increased hostility between Russia and the West, there appears to be a Russian policy of moving closer towards China – in May 2014, Russia and China signed a long-term deal to supply Russian gas. Reports suggested that the Chinese had driven a hard bargain on the price.⁷ The deal would help Russia compensate for any possible future reduction of gas purchases by Western and Central Europe (the EU is working on long-term policies to reduce dependence on Russian energy supplies, and sanctions could reduce sales in the shorter term). Putin said at the signing that the relationship between the two countries was at: ‘the highest level in all its centuries-long history’.⁸

Russia has also been preparing policies to respond to perhaps the gravest sanctions threat – exclusion from the Western financial system. In June, there were reports that Russian companies were starting to look at trading using the renminbi, the Hong Kong dollar and the Singapore dollar instead of the US dollar for international trade.⁹

The relationship with China may not run smoothly, however. The strength of the Chinese economy means that China is by far the more powerful partner and is increasing its influence in the very countries that Russia has declared are its area of ‘privileged interest’.

2.2 Syria

Russia has been significant, along with Iran and Hizballah, in helping the Syrian government to turn the tide against the rebellion that started in 2011. The principal source of support has been diplomatic, with Russia refusing to support Western and Arab moves to secure a negotiated settlement involving the removal of President Assad, vetoing UN Security Council resolutions. It is more difficult to be sure what practical assistance has been flowing to Damascus.

Russia’s intransigence over Syria probably has more to do with the fear of the destabilising effect of either a popular Islamic uprising or Western military intervention, rather than protecting any great Russian interests in Syria – arms sales or the use of the naval base at Tartus on the Mediterranean. Russian diplomats felt betrayed by what they perceived as the extremely liberal interpretation of the Security Council resolution on Syria to bring down the Qaddafi regime. They also warned that the West could be sowing the seeds of chaos in Libya and elsewhere by supporting uprisings – warnings that have proved prescient. Russia is also worried that it too might one day be the target of external intervention to bring about regime change.¹⁰

3 Ukraine

Russia/Ukraine timeline

17 March 2014 EU and US impose first round of Russia blacklists

20 March EU adds further names to the sanctions list

⁷ [‘Russia signs 30-year gas deal with China’](#), *BBC News Online*, 21 May 2014

⁸ [‘Putin pivots to the east; Relations with Russia’](#), *Economist*, 24 May 2014

⁹ [‘Russian companies prepare to pay for trade in renminbi’](#), *Financial Times*, 8 June 2014

¹⁰ For more on this theme, see Samuel Charap, [‘Russia, Syria and the Doctrine of Intervention’](#), *Survival*, International Institute for Strategic Studies, February-March 2014

- 23 March Ukraine and EU sign 2% of the Association Agreement
- 23 March The OSCE announces that it will send a team of 100 observers to Ukraine
- 28 March ‘Chocolate oligarch’ Petro Poroshenko and ‘gas princess’ Yulia Tymoshenko to run for president, among others
- 6 April Pro-Russian separatists storm local government buildings in Donetsk, Kharkiv and Luhansk, amid a Russian military build-up along its border with Ukraine
- 7 April US and Russia agree to hold talks over Ukraine
- 10 April Russia threatens to cut off Ukraine’s gas supply over unpaid bills. Demands meeting with European leaders to discuss Ukraine’s future
- 14 April EU adds individuals to Russian sanctions list
- 17 April US, Russian, EU and Ukrainian representatives meet in Geneva and agree a plan for de-escalation that includes the disarming of all illegal groups, the vacating of occupied public buildings and streets, an amnesty for all but capital crimes and moves towards a package of devolution
- 18 April Leader of the self-proclaimed Donetsk People’s Republic, says his forces will not surrender arms, vacate government buildings, or put off a referendum on independence
- 28 April EU adds 15 more names to the sanctions list. The US Treasury also adds individuals and entities to its list
- 2 May Angela Merkel calls on Vladimir Putin to secure the release of 11 OSCE monitors kidnapped in eastern Ukraine
- 7 May EU and US threaten more sanctions against Russia if it disrupts the Ukrainian presidential election scheduled for 25 May
- 7 May Vladimir Putin announces the withdrawal of Russian troops from the Ukrainian border
- 22 May Separatists kill 16 Ukrainian soldiers in eastern Ukraine
- 25 May Ukrainians go to the polls, although the OSCE observer mission says that armed separatists tried to stop those in the east of the country from voting. Petro Poroshenko wins by a landslide on a turnout of about 60% in areas under government control
- 26 May OSCE monitoring mission releases generally favourable preliminary statement, despite decrying the intimidation to prevent voting in rebel-controlled areas
- 6 June New Ukrainian President Poroshenko meets President Putin of Russia, in what Western officials welcome as a *de facto* recognition of the new Ukrainian leader by Russia
- 10 June Russian Foreign Minister Sergei Lavrov says that Russia sees no problem with Ukraine signing the remaining parts of the Association Agreement with the EU

- 13 June Reports of unmarked Russian tanks in Eastern Ukraine
- 14 June EU announces that the Association Agreement will be signed on 27 June and that it will mediate talks between the Ukrainian and Russian governments on the implementation of the agreement after signature

Rebels bring down a Ukrainian military plane, killing 49, in the largest single loss of life in the conflict so far
- 16 June State-controlled Gazprom cuts off Ukraine's gas supply in a row over bills
- 18 June Ukrainian President Poroshenko offers a unilateral ceasefire to allow Russian mercenaries to leave Ukraine
- 27 June Ukraine is due to sign the rest of the Association Agreement, along with Moldova and Georgia

The peace plan offered by the new Ukrainian president involves a ceasefire, where the Ukrainian forces would only fight back if attacked and an amnesty for those 'without blood on their hands', early elections for the eastern regional governments and increased decentralisation.

Russia has supported parts of the peace plan but criticised the lack of a provision for direct talks between the rebels and the government.¹¹ New Ukrainian president Petro Poroshenko has countered that the rebels have little support and that they were not legitimate representatives of the Ukrainian people.¹²

Despite the apparent relative success of the presidential election and some conciliatory noises from Russia, violence in eastern Ukraine does not appear to be reducing. Russian weaponry is thought to be flowing into the eastern provinces, including rocket launchers and artillery as well as tanks, according to the US State Department.¹³ Russia has countered that it is the EU and the West that is stoking tension in Ukraine rather than Russia.

Despite the ceasefire, there were reports of continued fighting in Eastern Ukraine. Meanwhile, NATO reported on 19 June that 'a few thousand' Russian troops were returning to near the Ukrainian border.¹⁴ Russia has also been accused of allowing fighters and weapons to cross into eastern Ukraine from Russia.

Russia's policy remained difficult to predict, however. On Monday the leader of the eastern Ukraine rebels said that they would abide by the ceasefire and on 24 June, President Putin asked the Federation Council, the parliament's upper house, to rescind the authorisation for military intervention in Ukraine, granted in March. The move was welcomed by Petro Poroshenko as the 'first tangible step' towards reconciliation and markets reacted with an increase in the value of the rouble.¹⁵

¹¹ ['Russian President Putin supports ceasefire call, but says peace plan is unviable'](#), *Deutsche Welle*, 20 June 2014

¹² ['EU prepares more sanctions against Russia'](#), *Euractiv*, 8 May 2014

¹³ ['US accuses Russia of sending rocket launchers to Ukraine rebels'](#), *Daily Telegraph*, 14 June 2014

¹⁴ ['NATO Secretary General Anders Fogh Rasmussen meets British Prime Minister David Cameron to prepare Wales Summit'](#), NATO press release, 19 June 2014

¹⁵ ['No more little green men? Putin takes military option in Ukraine off table'](#) *Christian Science Monitor*, 24 June 2014

3.1 EU restrictive measures against Russians and Ukrainians

Council Decision 2014/145/CFSP and Council Regulation (EU) 269/2014, of 17 March 2014, impose visa bans and asset freezes on certain individuals associated with 'actions undermining or threatening the territorial integrity, sovereignty and independence of Ukraine'.

There are two separate instruments because the action affects matters covered by both the Common Foreign and Security Policy and the Treaty on the Functioning of the EU (TFEU).

The European Scrutiny Committee considered the implementing decisions for the sanctions on 30 April.¹⁶ The Committee cleared the documents, decided that they were politically important and requested further information from the UK government.¹⁷ Further information about the measures is available in the Committee's report.

More names were added on 29 April and the list has been amended since then.

The sanctions were broadly in line with the US restrictions, and other countries such as Japan and Australia have adopted similar measures.¹⁸ Russia retaliated by implementing some similar sanctions. On 7 May, the EU Council expanded the criteria to make it easier to add Russian companies to the list, thereby bringing the EU sanctions list more in line with that of the US government.

On Monday 23 June, British Foreign Secretary William Hague warned that the EU was prepared to impose more sanctions on Russia if necessary.¹⁹ The EU has made refraining from imposing new sanctions conditional on the Russian reaction to the new Ukrainian government's peace plan.

A package of economic measures, which could damage both the Russian and the EU economies, has reportedly been drawn up by the EU. It is not clear how far they would go although it has been reported that they are divided into different stages of severity. EU governments are divided on the question. Carl Bildt, Swedish foreign minister said:

The important thing is we demonstrate that if they go on with destabilizing measures, we will go on with (sanctions) measures. I think there is agreement on that. Where we are on Friday, where the heads of state and government will end up, I don't know.²⁰

Some Ukrainians have expressed frustration that economic measures have not already been implemented. A Ukrainian NGO said on 14 June:

It is very difficult to understand why we are still hearing threats that 'a failure by Russia to de-escalate this situation will lead to additional costs.' Russia has not just failed to de-escalate the situation. It is actively escalating it.²¹

However, the different EU member states have diverging economic interests in Ukraine. German companies are reported to be reluctant to hamper trade, the UK financial sector

¹⁶ European Scrutiny Committee, [Documents considered by the Committee 20 April 2014, Ukraine and Russia: EU restrictive measures](#)

¹⁷ European Scrutiny Committee, [Documents considered by the Committee 20 April 2014, Ukraine and Russia: EU restrictive measures](#)

¹⁸ [Russia Sanctions developments](#), provided by the law firm Baker and McKenzie, provides some useful information

¹⁹ 'Hague says EU ready for more Russia sanctions if necessary', *Reuters*, 23 June 2014

²⁰ 'EU Ready to Increase Sanctions on Russia, Foreign Ministers Say', *Wall Street Journal*, 23 June 2014

²¹ 'Barroso agrees new Russia talks, as warfare escalates', *EUObserver*, 14 June 2014

benefits from Russian money, and many Central and Eastern European countries are highly dependent on Russian gas.

3.2 Impending signature of the Association Agreement?

Mr Hague said on 23 June that the decision about more sanctions would be taken on Friday 27, when Ukraine, along with Moldova and Georgia, is scheduled to sign the remaining elements of the Association Agreement with the EU. The agreement will be implemented provisionally, before ratification by the European Parliament and member states, in order to get results as soon as possible. Ratification can take some time.

The EU predicts that Ukraine's economy will benefit from tariff reduction and especially from regulatory approximation, to the extent that exports from Ukraine to the EU are predicted to increase by €1 billion per year.²²

EU leaders have also announced a formal EU operation to help train Ukraine's police and judiciary.

4 Moldova and Georgia

Moldova and Georgia initialled Association Agreements at Vilnius in November 2013. They are due to sign the agreements on 27 June.

Energy and trade are important interests for Moldova, which is heavily dependent on Russian hydrocarbons, although a gas pipeline connecting Moldova westwards to the EU gas network was opened in August 2013.²³

During a visit to Moldova in 2013, Dmitri Rogozin, Russia's deputy prime minister, said: "Energy is important. The cold season is near. Winter is on its way. We hope that you will not freeze this winter."²⁴ Moldovan officials complained of intense Russian pressure over the proposal to initial the Association Agreement with the EU at the Vilnius summit in November 2013.

However, as in Georgia, there is a 'frozen conflict' which sharply reduces Moldova's room for manoeuvre. Transnistria (also sometimes called Transdniestria or Trans-Dniestr) is an enclave with a substantial Russian-speaking population to the east of the River Dniester, bordering on western Ukraine.

On the collapse of the Soviet Union, a short war broke out between the Transnistrians, who did not want to leave the Russian fold, and the Moldovans, Romanian speakers who wanted their independence. The Moldovans lost that battle. The breakaway region, while it is not officially recognised by Russia (South Ossetia and Abkhazia, carved out of Georgia, are the only entities to recognise Transnistrian sovereignty) counts on many Russian troops, 440 as peacekeepers and several hundred more guarding Soviet era arms stocks.²⁵ Russia also supports the Transnistrians financially and by issuing Russian passports.²⁶

Mr Rogozin referred to the Transnistria problem on his 2013 visit, likening Moldova to a train on a difficult journey towards the EU. He said that Moldova was likely to lose some of its

²² 'The EU's Association Agreements with Georgia, the Republic of Moldova and Ukraine', EU press notice, 23 June 2014

²³ 'EU helps Moldova reduce dependence on Russian gas', *Deutsche Welle*, 27 August 2014

²⁴ Judy Dempsey, *How Russia Bullies the EU's Eastern Neighbors*, Carnegie Europe, 9 September 2013

²⁵ 'NATO commander warns of Russian threat to separatist Moldova region', *Reuters*, 24 March 2014

²⁶ 'Transnistria: Russia's beachhead in Europe', *Global Post*, 14 September 2013

carriages, implying that Moldova would lose Transnistria permanently if it continued on its present course towards the EU.

Georgia, which is also due to sign the Association Agreement on 27 June, has gone further along the process of detaching itself from Russia and aligning itself with the West. It hosts the Baku-Tbilisi-Ceyhan oil pipeline and the South Caucasus gas pipeline, both of which bypass Russia to carry hydrocarbons from Azerbaijan westwards and have BP as a significant investor. Russia therefore has less leverage over Georgia. The US military has helped to train and support Georgian forces.

5 Russian military

Russia has spent considerable sums on modernising its armed forces in recent years. The conflict with Georgia in 2008 was something of a revelation for the Russian government since the forces of tiny Georgia put up significant resistance which Russian forces did not easily overcome. Russian forces had been in decline since the end of the Soviet Union, with outdated equipment and command structures.

Since 2012, Russian military expenditure has accelerated, with a 12% real terms increase over the previous year. A further increase of 17% in real terms is planned for the period 2013-2017, with defence expenditure rising to 4.8% of GDP,²⁷ which puts NATO's 2% target (largely un-met) into perspective.²⁸

The army still relies on conscription, but the pay and conditions of conscripts have been improved, the number of professional soldiers increased and the number of officers been reduced while the contingent of non-commissioned officers has been strengthened.

The objective has been to create armed forces capable of projecting strength flexibly, particularly in Russia's neighbourhood. One analysis suggests that the government is dedicating most investment to forces on Russia's southern flank.²⁹ Here not only is there the problem of insurgency in some of Russia's own regions plus proximity to instability in Iraq and Syria, there are also the 'frozen conflicts' of South Ossetia, Abkhazia and Nagorno-Karabakh, the disputed Azerbaijani territory held by Armenia.

The Russian modernisation programme is not without its problems, however. The arms industry is not very advanced, after years of under-investment, and has had difficulty in producing the high-technology weaponry that the government wants. The government is investing \$78 billion to try to bring the industry up to date.³⁰ Corruption, too, is a massive problem as it is for other aspects of Russia's modernisation. A substantial proportion of increased investment disappears in kickbacks. Economic stagnation means that the proposed expenditure increases might amount to an even higher proportion of GDP than it did in plans made on the assumption of reasonable economic growth, or that they will have to be cut back. Russia's population is also ageing and there are problems of poor education and health, making recruitment difficult.

Nevertheless, the Russian military is becoming more effective. But a serious military engagement in Ukraine would reduce Russia's ability to respond to crises in its volatile

²⁷ SIPRI Yearbook 2013, p142

²⁸ NATO, Financial and Economic Data Relating to NATO Defence, [Defence expenditures as a percentage of gross domestic product](#) (p6), February 2014

²⁹ 'Putin's new model army; Russia's military modernisation', *Economist*, 24 May 2014

³⁰ SIPRI Yearbook 2013, p144

southern neighbourhood. Even without intervention by Western nations and without a substantial conventional confrontation with the Ukrainian armed forces, a significant resistance would be expected by pro-independence Ukrainians.

A more likely strategy for Russia as it tries to maintain influence over Ukraine is to continue to use covert methods to support pro-Russian militias in the south and east. One possible target might be the city of Odessa which, although it has not so far been the focus of conflict so far, lies between the Crimea and Transnistria, the eastern region of Moldova, which is under a pro-Russian breakaway government and has been the target of threats by Russian officials.³¹

6 Relations with the UK

Russia's relations with the UK have been strained. The Russian government was not pleased by the UK's granting of political asylum to Boris Berezovsky in 2003, when he had been accused of various crimes. He subsequently said that he was planning the overthrow of the Russian government. The UK granted asylum to other opponents of the Putin elite.

6.1 Magnitsky and Litvinenko

The death of Sergei Magnitsky continues to damage relations between Russia and the West. Sergei Magnitsky was a Russian lawyer who was representing the interests of Hermitage Capital Management, a UK-based company accused in Russia of tax evasion and fraud. Magnitsky had made revelations about an alleged multi-million pound fraud on the part of Russian officials and died in 2009 after spending almost a year in prison without trial, during which time he was allegedly mistreated and denied essential medical treatment. The case has caused deterioration in relations between the UK and Russia, and has been highly controversial in other countries.

On 7 March 2012, a resolution was moved by Dominic Raab MP calling on the government to pass legislation imposing sanctions on those who were involved in the death of Magnitsky.³² The motion was passed on a question.

The government's position is that there are already powers to impose visa bans on individuals involved in severe human rights abuses, so much of the content of the proposed legislation was unnecessary. However the government has not forgotten about the case, as set out in a debate in April 2014:

The circumstances surrounding his death—a human rights case—are of utmost concern. It is the most high-profile example of the failings of Russia's judicial and prison systems. The Government recognise that four years after Mr Magnitsky's death, there has been a lack of meaningful progress towards securing justice.³³

Alexandr Litvinenko was granted political asylum by the United Kingdom in 2000. While living in London, he had made some grave accusations about the Russian secret services, including that they had organised the notorious bombing of four apartment blocks in 1999. He was killed in London in 2006 by what proved to be radioactive polonium-210. The UK requested the extradition of alleged former intelligence officer Andrei Lugovoi, who was

³¹ Johan Norberg & Fredrik Westerlund, [Russia and Ukraine: military-strategic options, and possible risks, for Moscow](#), International Institute for Strategic Studies, April 2014

³² HC Deb [7 March 2012, c951](#)

³³ HC Deb [2 April 2014, c299WH](#)

suspected of assassinating him. Russia refused the request, saying that the Russian constitution forbids the extradition of Russian citizens.

6.2 UK ‘reset’?

In September 2012, David Cameron visited Moscow for a one-day visit during which he was scheduled to meet the President, Vladimir Putin, and Russian Prime Minister Dmitry Medvedev. Mr Cameron said in a speech at Moscow State University that the Litvinenko case was one of the “difficult issues that hamper mutual trust and co-operations.”¹ However, Mr Cameron said that while the UK was not trying to drop the Litvinenko case, Russia and the UK should go beyond that problem:

At the same time, we have a responsibility to recognise the many ways in which we do need each other... and find ways for us to work together to advance our mutual interests. The countries that will be successful in the 21st century will not be those that hunker down, pull up the drawbridge and fail to overcome their differences with others.³⁴

Mr Medvedev said that Mr Lugovoi would never be extradited:

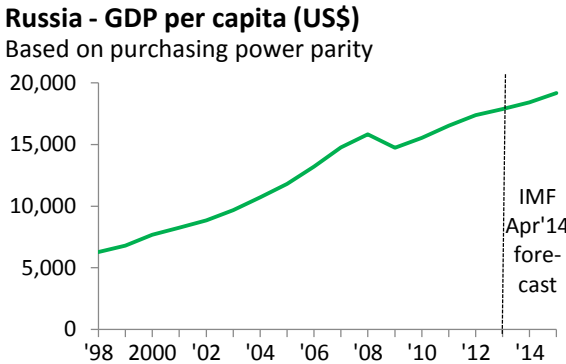
We all have to learn to respect our legal frameworks. That will never happen no matter what will be the circumstances.³⁵

Since the onset of the crisis in Ukraine, relations have become strained once again.

7 Economy

7.1 Background

Following the 1998 crisis, which saw Russia devalue the rouble and default on its debt, the economy rebounded strongly. GDP averaged annual growth of nearly 7% in the decade from 1999-2008, lifting living standards (see charts).³⁶ Economic expansion was underpinned by the rising oil price, as well as other commodities which Russia is a large exporter of, and the use of spare capacity following the 1998 crisis as well as the legacy of the post-communism transition to a market-based economy.³⁷

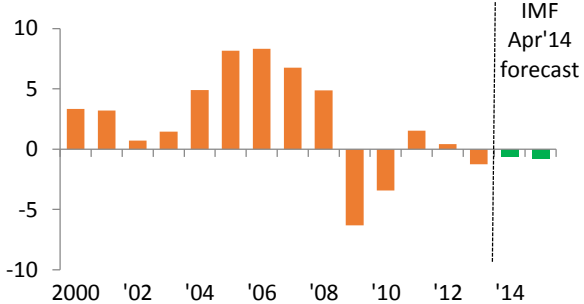


The global financial crisis, and concurrent (temporary) sharp decline in oil prices, caused the economy to contract by 7.8% in 2009. Growth during the recovery was not as fast as it was prior to the recession with annual growth rates of just over 4% between 2010 and 2012.

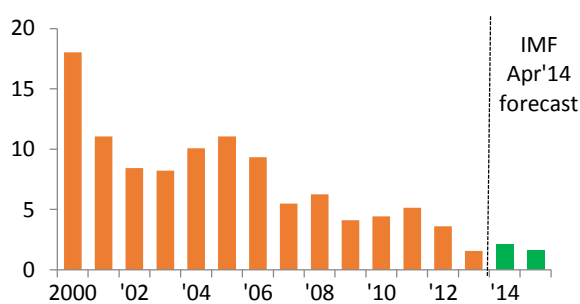
³⁴ “Cameron tells Russia: we must work together”, Channel 4 News Online, 12 September 2012
³⁵ *Ibid.*
³⁶ Most data in this section come from IMF, World Economic Outlook database April 2014
³⁷ IMF, “Russian Federation - Concluding Statement for the 2014 Article IV Consultation Mission”, 30 Apr 2014

The energy sector is vitally important to the economy. For example, oil and gas revenues account for around half of government budget revenues³⁸ and Russia is the world's third largest producer of oil (behind the US and Saudi Arabia).³⁹ Oil and gas revenues helped generate a large budget surplus in the 2000s; led to a large trade and current account surplus; and allowed Russia to build up a reserve fund; and accumulate foreign-exchange reserves of around \$500 billion.

Russia - General govt budget balance
% of GDP



Russia - Current account balance
% of GDP



It is worth noting, however, that the economy is not entirely dependent on the energy sector. Domestic demand has been growing strongly over the past decade, with consumer spending rising. Indeed, credit-fuelled consumption has underpinned recent growth. The mining and quarrying and utility sectors (which includes oil and gas production) accounted for only 14.4% of GDP in 2012.⁴⁰

7.2 Recent developments

GDP growth in 2013 slowed to 1.3%, as structural limitations inhibited economic activity. The IMF, in its October 2013 review of the world economy, summarised the view of many economists on the structural weaknesses of the economy:

The story in Russia is similar. For some time, the country has been held back by inadequate infrastructure, including the transportation and electricity networks; overreliance on commodities; and a weak business climate. The economy nonetheless managed to grow, on the back of rising oil prices and by using up spare capacity. But this model now seems exhausted, and growth will be further constrained by negative demographics.⁴¹

Tensions with Ukraine in early 2014 have further dented the economy, with GDP declining by 0.5% during Q1 2014. The uncertainty generated by the crisis, and the sanctions imposed on Russia in response, has caused the business climate to deteriorate. The lack of confidence – more so than the direct effect of sanctions – has hit investment and caused a number of negative effects. These include a depreciation of the rouble at the beginning of the year, in turn causing the annual inflation rate to rise to 7.6% in May 2014.⁴² Russia companies have found it harder to secure finance from abroad, and capital outflows increased sharply in the first quarter of 2014 to over \$50 billion; it is thought that this could reach \$100 billion by the end of 2014.⁴³

³⁸ Russia Today, “Russia prepares budget for oil drop”, 30 Aug 2013
³⁹ US Energy Information Agency, Oil production [accessed 17 Jun 2014]
⁴⁰ Russian state statistics office, Production of GDP [accessed 17 Jun 2014]
⁴¹ IMF, *World Economic Outlook*, October 2013, page 44
⁴² Bloomberg Businessweek, “Russia Holds Rates as Inflation Near Peak, Ruble Recovers”, 16 Jun 2014”
⁴³ FT *beyondbricks* blog, “Guest post: high interest rates will hurt Russia more than any sanctions”, 20 May 2014

In response, the Central Bank raised interest rates by 2 percentage points to 7.5% in two steps in March and April 2014.⁴⁴ This, combined with intervention in the foreign exchange market, has seen the rouble recover some of its lost ground since March.⁴⁵

The IMF downgraded its 2014 GDP growth forecast to 0.2% in April 2014 and the Russian central bank expects growth of 0.5%. The IMF noted that there are “considerable downside risks” to this forecast, citing concerns over potential further weakening of confidence related to geopolitical developments.⁴⁶

7.3 Long-term growth prospects

In November 2013, the Russian Economics Ministry lowered its forecasts for average annual GDP growth to 2.5% for the period up to 2030. The previous long-term forecast made in April 2013 had been 4.3%.⁴⁷

An October 2013 IMF report on the Russian economy called for a new growth model in order to achieve higher sustainable growth:

Russia needs to embrace a new growth model, complemented by more diversification, higher investment, and a more efficient use of resources, to raise its growth potential.⁴⁸

Many have been calling for structural reforms that would improve the business environment. On the first day of his current presidency, 7 May 2012, Mr Putin issued a decree on long-term economic policy which included measures to try and improve the investment climate. One goal was to move Russia up the rankings of the World Bank’s Doing Business index from 120th place to 20th place by 2018.⁴⁹ In the 2014 rankings Russia was ranked 92nd.⁵⁰

8 Trade

8.1 Russia’s trade with the rest of the world

Exports

Russia’s exports are dominated by fuel which accounted for around 70% of its exports of goods in 2012. Petroleum and related products, and gas, account for the vast majority of this. Manufactures made up 15% of Russia’s goods exports in 2012.

Russia’s top 10 export markets are shown in the table below. The data are for 2012 and are for goods only.

⁴⁴ Bloomberg, “[Russian economy to grow by 0.5 percent in 2014: central bank’s Nabiullina](#)”, 26 May 2014”

⁴⁵ Russian central bank, “[The Situation in Financial Markets](#)”, 3 Jun 2013

⁴⁶ IMF, “[Russian Federation - Concluding Statement for the 2014 Article IV Consultation Mission](#)”, 30 Apr 2014

⁴⁷ Reuters, “[In blow to Putin, Russia slashes long-term growth forecast](#)”, 7 Nov 2013

⁴⁸ IMF Survey magazine, “[New Growth Model Can Unlock Russia’s Growth Potential](#)”, 22 Oct 2013

⁴⁹ IMF, “[Russian Federation: Staff Report for the 2012 Article IV Consultation](#)”, Aug 2012, page 26, box 6

⁵⁰ World Bank, [Doing Business 2014 – Russian Federation](#)

Russia's top 10 export markets, 2012

	Country	Exports from Russia, \$bn
1	Netherlands	75.8
2	China	33.6
3	Italy	27.9
4	Germany	23.4
5	Belarus	20.8
6	Poland	19.6
7	Turkey	16.0
8	Japan	15.1
9	Ukraine	13.9
10	Republic of Korea	13.8
14	UK	9.1

Source: UNCTAD trade statistics

Imports

Manufactures account for four fifths of Russia's imports of goods. Machinery and transport equipment alone account for 44%. Food accounts for 13%.

The top 10 countries from which Russia imports goods are shown in the table below. By far the largest source of Russia's imports are China and Germany. The Ukraine is third and the UK 14th.

Russia imports of goods: top 10 sources

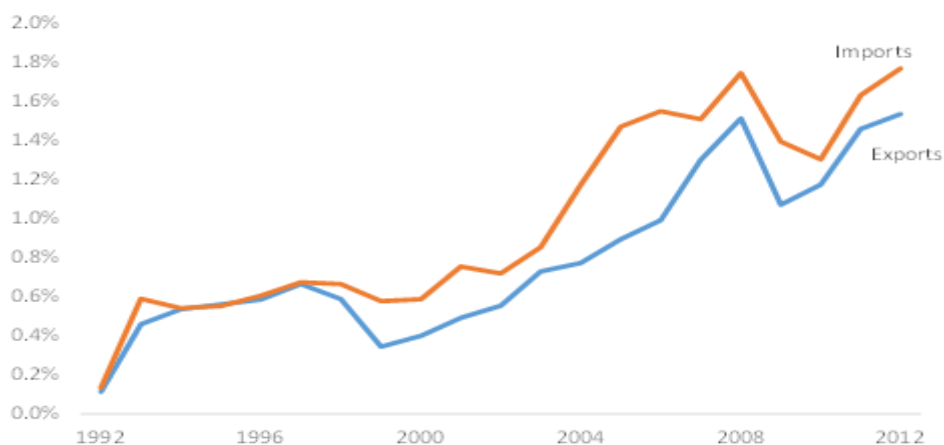
	Country	Imports, \$ bn
1	China	49.7
2	Germany	43.8
3	Ukraine	19.0
4	Belarus	15.3
5	Italy	13.6
6	US	12.2
7	France	11.5
8	Japan	11.2
9	Republic of Korea	10.3
10	Poland	9.2
14	UK	6.9

8.2 UK-Russia trade

In 2012, UK exports of goods and services to Russia amounted to £7.6 billion (1.5% of total UK exports). Imports from Russia were £9.3 billion (1.8% of total UK imports of goods and services in 2012).

While Russia accounts for a relatively small proportion of UK imports and exports, its importance as trading partner has increased significantly over the last 20 years, as the chart below shows.

Russia's share of UK exports and imports (Goods and services)



Source: UK Pink Book 2013, Table 9.3

Russia was the UK's 15th largest export market in 2012 (see table below).

UK Top 30 export markets - goods and services, 2012

	Exports £ million	Share of total exports
US	84,083	17.1%
Germany	43,191	8.8%
Netherlands	34,557	7.0%
France	30,155	6.1%
Ireland	26,971	5.5%
Belgium	17,360	3.5%
Switzerland	15,786	3.2%
Spain	14,174	2.9%
China	13,670	2.8%
Italy	13,616	2.8%
Australia	10,874	2.2%
Japan	9,429	1.9%
Sweden	8,959	1.8%
Canada	8,087	1.6%
Russia	7,576	1.5%
Saudi Arabia	7,495	1.5%
Hong Kong	7,473	1.5%
Singapore	7,160	1.5%
India	6,891	1.4%
Norway	6,618	1.3%
South Korea	6,367	1.3%
Denmark	5,452	1.1%
South Africa	4,956	1.0%
Poland	4,796	1.0%
Turkey	4,789	1.0%
Brazil	4,170	0.8%
Finland	2,791	0.6%
Luxembourg	2,638	0.5%
Thailand	2,600	0.5%
Malaysia	2,411	0.5%

Source: ONS Pink Book, 2013, Table 9.3

In 2012, the UK had a deficit of £2.9 billion with Russia in trade in goods, a surplus of £1.1 billion in services and a surplus of £4.7 billion on income giving an overall current account surplus of £2.9 billion.

9 Commentary

Notions that were widespread after the end of the Cold War that Russia would be easily integrated into the existing world order now look overly optimistic. The moves to bring Russia closer to China economically and politically raise the prospect of a world once more divided into hostile blocs, and the Russian government has shown increasingly authoritarian tendencies in recent years.

However, the West generally and Europe in particular have many strengths in comparison to Russia. Political uncertainty, the weak rule of law and corruption are holding back the Russian economy, which is not performing at all well considering Russia's riches in natural resources. These worries also encourage the Russian elite to safeguard their assets by transferring them into Western assets such as London housing and financial assets. This gives the West leverage over important decision makers in Russia. Many also think that Russia needs to attract international investment and expertise to modernise its economy. Corruption and problems with the rule of law reduce international investors' confidence.

In the longer term, many have pointed to the fundamental contradictions the political setup in Russia:⁵¹ while Russia claims to have its own form of 'managed' democracy (and President Putin is undoubtedly popular with large sections of society), can it survive forever when so much corruption and individual interference with the state's institutions takes place?

Russia's economy is a significant weakness for the future, particularly in comparison to China's. Whether Russia pursues an increasingly isolationist path or reconciles with the West is crucial.

In contrast, the 'soft power' of the West will probably continue to be a strong force of attraction, at least to those who are aware of the realities of life outside Russia.

However, there are very divergent opinions as to how Europe and the West should respond to Russia's more assertive foreign policy. Richard Sakwa for Chatham House argues that hard-line opposition to Russia will encourage the hard-liners within the Russian government and may encourage intransigent Russian nationalism, making it more difficult for the reformists within Russia to bring about gradual change.

Others have argued that, for example, the EU needs to take a stronger and more united line against Russia's foreign policy:

If Russia is determined to behave as a geopolitical and civilisational rival, the EU needs to find a way to defend its own interests and values. It neither can nor should use the same armoury of force, blackmail and bribery that Russia employs in the pursuit of influence. But it is not powerless, particularly if it can stay united.⁵²

In a recent article for the Brookings Institution, however, Clifford G. Gaddy and Barry W. Ickes argue that the West has consistently underestimated Russian determination to resist what it sees as Western threats to its interests and security:

⁵¹ See for example Richard Sakwa, *Whatever Happened to the Russian Opposition?*, Chatham House, May 2014

⁵² Ian Bond, *The EU and Russia: Uncommon spaces*, Centre for European Reform, April 2014

We have imposed a set of modest economic sanctions against Russia. They are not so strong as to cause real pain in the West, but we pretend they are enough to stop Putin and let us return to business as usual. In fact, [...] the sanctions will not deter Putin from his strategic goal of eliminating what he perceives to be direct security threats to Russia. Indeed, the various “purely-for-show” military measures being discussed by the West — increasing American troop presence and weapons deployment in Eastern Europe and sending NATO trainers to Ukraine, Georgia, and Moldova, for instance — will likely reaffirm for Putin that his message has gone unheard once again and thus guarantee that he sooner or later makes another, even more shocking, move.⁵³

Ickes and Gaddy compare the post-cold war period to an economic bubble which has now burst. They argue that the West is now faced with the question of how to clean up the mess — should the West fully honour its defence and economic commitments to countries formerly in the communist bloc, possibly at enormous cost? They say that the West will need to secure Russian cooperation to stabilise Ukraine, even if that involves making concessions that look unprincipled, just as a bail-out of financial institutions after a crash looks unfair but is necessary.

Steven Pifer, also of the Brookings Institution, argued for stronger sanctions against Russia in testimony to the Senate Foreign Relations Committee in June. He suggested the following possibilities:

- Expanding the list of individual Russians—inside and outside of government—targeted for visa and financial sanctions. Sanctions should apply to family members as well.
- Applying targeted sanctions on the Russian financial sector, beginning with the sanctioning of at least one major Russian financial institution (as opposed to smaller pocket banks).
- Blocking Western energy companies from new investments to develop oil and gas fields in Russia, just as the United States and European Union have moved to block their companies from investing in the development of oil and gas resources on the Black Sea shelf around Crimea.⁵⁴

Pifer, who is a former US ambassador to Ukraine, argues that the Ukrainian government and NATO should make clear that NATO membership is not on the cards in the near- or medium-term. NATO membership has not in any case been supported by a majority of Ukrainians in recent years, although the numbers in favour, particularly in the western regions, may be increasing.⁵⁵

⁵³ Clifford G. Gaddy and Barry W. Ickes, [Ukraine, NATO Enlargement, and the Geithner Doctrine](#), 10 June 2014

⁵⁴ US Senate Foreign Relations Committee, [‘Ukraine, Russia and the U.S. Policy Response’](#) Steven Pifer, The Brookings Institution, 5 June 2014

⁵⁵ [‘Before Crisis, Ukrainians More Likely to See NATO as a Threat; West and Central Ukraine warmer toward NATO than East’](#), Gallup, 14 March 2014