

## Why Russians fear August

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As we all know only too well, winters are long and cold in Russia while summers are relatively short but quite pleasant. Once Easter has passed, people start marking the calendar until they can throw off their winter armour and re-open their dachas. August is the main vacation month and should, therefore, be the most eagerly anticipated month of the year.

But, as with many issues in Russia, all is not what it seems even when it comes to what should be the most carefree of the 12 months. In fact people approach August with almost a sense of dread. It is a case of "if something bad is going to happen it is more likely to happen in August". History certainly confirms that to be less of a paranoia and more a precedent-based reality.

In recent memory there have been a number of accidents and disasters which are firmly rooted in people's memory and which add to the August phobia. These are some of those episodes:

In August 1998 Russia defaulted on its domestic debt. That led to a complete collapse in the capital markets and the RTS equity index reaching an all-time low of 38.5 on October 5th. Foreign investors exited Russia in 1998 and, apart from trading funds, did not return until 2004. It piled misery onto an already depressed economy and left a legacy of fear about ruble volatility and suspicion about banks for many years.

August can also be an accident-filled month, such as in August 2000 when there were a number of serious accidents including the sinking of the Kursk submarine and a fatal fire in Moscow's landmark Ostankino TV tower. In August 2006, 170 people died in an airplane crash on a flight from the Black Sea resort of Anapa to St. Petersburg. In August 2005 the first case of bird (avian) flu was reported and while thankfully that did not develop as had been feared, it did lead to a sense of heightened concern for the month. In August 2009 one of the country's largest hydro-power stations suffered a catastrophic explosion in which 75 people died.

August is also associated with various acts of terrorism. In August 2004 the country was rocked with a series of terrorist actions including a car bombing in Moscow and the destruction of two passenger aircraft. A thoroughly miserable and fear-filled month was rounded off with one of the biggest tragedies to hit post-war Russia when terrorists took over the school in Beslan in southern Russia with such tragic consequences.

Even when such serious tragedies are avoided the weather can often be less of a positive contributor to the vacation season and pile on its share of misery. In August 2002 widespread fires raged in the peatlands around Moscow and blanketed the city in a nasty and health-damaging haze. August 2013 brought very destructive flooding to much of Russia's Far East, which led to both expensive economic disruption and loss of life. The worst weather-related disruption, however, came in August 2010 when large swathes of the country were hit with high temperatures and forest fires. That combination contributed to drought conditions across much of the farming belt and led to a big drop in the year's harvest.

August surprises are not only confined to domestic events as events in 2008 and again last year proved. The Russia-Georgian war took place in August 2008 and, along with the rapidly declining oil price, led to an acceleration in capital flight and a loss of investment. The oil price decline was the more important of these events but the war headlines certainly added to the negative pressure.

August 2014 saw the step-up in western sanctions against Russia and, in particular, the damaging block on access to western debt and credits. Later that month Moscow retaliated with a ban on some food items from the EU and other western countries and that directly contributed to the high level of inflation, especially food price inflation, through the winter months. Here again the ratcheting up of sanctions took place just as the oil price started to roll over very sharply, in late August, so it is impossible to allocate the damage between sanctions and oil price weakness. Both have certainly hurt.

Apart from accidents and terrorism August is also a month when events with a significant and lasting legacy can take place. Most notable was the first appearance of Vladimir Putin in a high-profile political role when he was appointed prime minister in August 1999. That was the month when we saw the precursor of the second Chechnya War. On August 2nd the Islamic International Brigade (IIB) invaded the neighboring Russian republic of Dagestan, in support of the Shura of Dagestan separatist rebels. The war ended with a Russian victory and the retreat of the IIB. The following month the apartment block bombings in Moscow were blamed on the IIB and the war formally started.

Even in relatively quiet Augusts, of which there have been very few over the past fifteen years, there is always something noteworthy or just odd. In August 2001 the North Korean leader, Kim Jong IL, visited Moscow. But because of his fear of flying he rode his private train across Russia and caused havoc to passenger services. Such was the frustration of the inconvenienced people that when the train arrived at a Moscow station there were multiple bullet holes clearly visible on the side of the train. In August 2007 a group of nationalist politicians paid for a mini-sub to take them to the floor of the Arctic where they planted a Russian flag in support of the country's claim to sovereignty over the Lomonosov Ridge.

Rounding off the sequence of memorable events which have had a lasting impact on the country and the economy, in August 2012 Russia was finally admitted into the World Trade Organisation (WTO) after almost 19 years of negotiations. In August 2003 BP-TNK was created and apart from being the biggest foreign investment in Russia at that point it also created a great deal of continuing controversy until it was finally acquired by Rosneft in 2013. In August 2011 the so-called Golden Welds were made to the Nordstream gas pipeline and that marked the completion of the first major new gas pipe into Europe which by-passed Ukraine and Belarus.

Not wishing to leave you with the impression that the August syndrome only started in 1998, Russia's history is filled with events which had a significant legacy impact on the country. The effect dates back to, e.g. August 1530 when Tsar Ivan the Terrible was born in August that year. In the last century Russia entered World War I in August 1914 and declared war on Japan in August 1905 which, technically, still continues. The Molotov-Ribbentrop Pact was signed in August 1939 and the start of the construction of the Berlin Wall was in August 1961. Soviet troops entered Prague in August 1968 and, in August 1991, there was an attempted coup against Gorbachev by those looking to prevent the ending of the Soviet Union.

It is tempting to blame the relaxed mood and high temperatures for the spate of accidents and, possibly, the distraction of holidays as to why political and terrorist actions take place so often in August. But that is probably not valid given the sheer diversity of notable events which have occurred in this particular month. And it is also wrong to point at these events as all negative. The various accidents led to long overdue changes and safety improvements and, after the 2009 dam explosion, a national debate over the poor state of the country's infrastructure. The drought of August 2010 led to the awareness of Russia's vulnerability in such basic areas as food production and is the origin of the import substitution debate which received such a major boost after last year's sanctions.

Finally, to reinforce the message that sometimes August events can have a positive legacy and can create an opportunity; consider this: if you had invested \$10,000 in Sberbank shares during the default of 1998 and sold them 10 years later you would have pocketed a profit well in excess of \$1mn. Be lucky.

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After several failed efforts by the US and Europe in the nineties and early noughties, a new Great Game has finally started in Central Asia. This time the principal protagonist is China with Russia again in the supporting role. It appears that Beijing is prepared to spend up to half a trillion dollars to win this game because the prize it is competing for is a big boost for its ambition to become a global super-power.

Moscow cannot compete with that financial firepower, but is very adept at the sort of political subplots that can keep it very relevant, and very integral, to the game. The countries in Central Asia, which provide the physical surface for the game, will gain financially, some very handsomely, from their respective roles. In this particular game, there is almost zero incentive or pressure for any countries to make political or investment climate changes. These are not required to play in this particular game – and nor were they in the original game. Hence it is a very attractive win-win for the host country elites.

The first Great Game in Central Asia started to wind down sometime during World War I and formally ended as the countries in the region fell to the Bolshevik invaders. One hundred years later a new Great Game has started, although some of the players are late onto the field and appear to be still reading the playbook. The first Great Game, a description properly credited to one of the more important individual participants, Arthur Conolly, and later made famous by Rudyard Kipling in his novel “Kim”, involved a great deal of adventurism and espionage (Conolly, a British spy, was beheaded in Bukhara in 1842) and this latter day variant promises to be just as intriguing and durable.

In the 19th century, the principal players were Great Britain, the superpower of the age, Russia and, to a lesser extent, Persia. Today the world’s superpower, the US, is not involved and neither is Europe, despite the occasional flag waving tour. Instead, the principal protagonists are China, Russia and, in a lesser role for now, Iran. The Central Asian states, no more than pawns in the original contest, have a greater role to play this time. Pawns with self-awareness and at least an ambition for self-determination will always complicate any game of chess. They add another layer of unpredictability to this game version. Finally, Turkey, the great power in Central Asia hundreds of years before the British and Russians arrived, is showing signs that it too wants to play in the game, albeit mostly nearer to its border.

## **Status anxiety**

What do we mean by the Great Game? In simple terms it is the contest between great nations to establish political influence, if not actual power, in the countries stretching from the Black Sea to the border of China’s Xinjiang province. The reason to get this political influence is so that trade and supply routes can be set up securely to allow the external nations to become more economically powerful and self-contained and to enhance their status as a global power.

At stake for China is nothing short of its ability to push beyond being the dominant regional power in Asia, which it undoubtedly is, to become a global superpower. For Russia the goal is to stay relevant in its traditional backyard and to break up the geopolitical dominance of the US and Europe. Iran is starting to emerge from 35 years of isolation and is keen not only to have a political role in the countries atop its northern border, but also to attract investment to help it rebuild its battered economy. For the incumbent leaders in the Central Asian states it is all about maximizing income and being left alone to run their respective countries without external criticism.

China is undoubtedly the dominant player in Great Game II. It wants to at least equal the global power of the US. To achieve that, apart from military muscle it must become a more important economic power. It is starting to address one part of this equation with the new Asia Investment Bank, which it will dominate. But another of its big problems is that it does not have a dominant presence on the world’s oceans. It is building

that far too slowly. Ruling the waves was a large factor supporting Great Britain's global dominance in the 19th century and it is a big factor supporting the US' dominance today. It means that, without this, Beijing is very vulnerable to any disruption to both the export of its goods and imports of raw materials. A block on either would neuter China's global ambitions quite quickly.

The alternative, at least until a grander navy can be built, is to replicate the sea routes across land and, especially across friendly lands. This is the basis of Beijing's 21st Century "Maritime Silk Road" program. Basically it means building multiple rail and road links across Central Asia to link into transport networks that China is starting to fund in Turkey, Eastern Europe and in East Africa. But instead of building only one import/export route China is engaged in several proposed projects, which include:

- During his recent visit to Pakistan, China's president promised \$45bn of investment into infrastructure projects principally aimed at creating a rail link from the common border to a planned \$10bn rebuild of Gwadar port on the Arabian Sea. That would allow for the faster export of goods to markets in Africa, India, Europe, and the east coast of North and South America.
- China is the main source of finance for the proposed rail link between Urumqai, the capital of Xinjiang province, to an Iranian port on the Gulf of Oman, which will transit Kyrgyzstan, Kazakhstan and Turkmenistan.
- Beijing is paying several hundred million dollars for a new rail line linking Armenia with Iran. This will eventually be a spur from the main China-Gulf line to a port on Georgia's Black sea coast.
- Beijing is also discussing a new rail line that will run through Tajikistan and Afghanistan to link up with the rail lines running to either the Black Sea, the Gulf of Oman or to Istanbul.
- China has said it plans to directly invest \$1bn and make another \$5bn by way of loans and guarantees, in the \$21.2bn Moscow to Kazan highspeed rail link, which it sees as part of a larger project to build a high-speed passenger and freight line from China's pacific coast via Kazakhstan to St Petersburg, and then onwards into Europe. The estimated cost of that total project is put at almost \$250bn.
- During the Eastern Europe-China summit held last December, Beijing promised \$1.5bn to build a highspeed rail link between Belgrade and Budapest, and indicated it is interested in funding a larger expansion of rail links from Istanbul into Central and Western Europe. It is also providing most of the funding for the upgraded rail link between Nairobi and Mombasa in east Africa.

China is not just funding rail and road lines to expand and secure its global trade routes. Under a separate program called the Silk Road Economic Belt, Beijing is moving fast to establish more secure and direct supply lines bringing materials and energy into its growing economy. It has already made a great deal of progress:

- Approximately \$20bn has been spent building three gas lines from Turkmenistan, via Uzbekistan and Kazakhstan. Since the first lines opened in 2009 a total of 93bn cubic metres (cm) has been exported and Turkmen gas supplied 52% of China's gas needs last year. A fourth line is currently under construction that will take gas via Uzbekistan and Tajikistan.
- Kazakhstan already exports 200,000 barrels of oil per day (b/d) to China via direct pipeline. But the big prize for Beijing is the estimated 1.5mn b/d that Kazakhstan's offshore Kashagan field is expected to eventually produce when technical problems are sorted out. No final route has yet been determined for that oil, ie. the US and EU are lobbying for the oil to flow west to a terminal on Turkey's

Mediterranean coast, but China has the resources and determination to make sure either most, if not all, comes its way.

- Those projects are in addition to the oil that China now imports directly from Russia via the East-Siberia Pacific Ocean (ESPO) pipeline and the recently agreed major gas pipeline to be built to carry 40bn cm a year of Russian gas direct to China's industrial heartland.

For China, therefore, the objective of participating in the Central Asia Great Game is clear enough; if it wants to have a secure global trade footprint and safe supply lines for the energy and materials it requires, it needs multiple road and rail links and pipelines across the region. The fact this vast transport infrastructure will also create lots of jobs at each stop on the line and offer improved trade links for countries also able to access the road and rail links certainly helps ensure that the political ties are also strengthened. Not to mention the billions of dollars each pipeline and rail transit country will earn from annual fees. Tajikistan, for example, is expected to earn \$3.7bn from gas transit fees from the new gas pipeline over the next thirty years. A huge sum for a country whose total GDP is only \$8.5bn.

### China's Maritime Silk Road plan



Source: Reuters

## **Polar opposite**

As mentioned, Moscow cannot compete with the huge sums being spent by Beijing and nor does it even have the opportunity. It has no need for trans-regional rail links and it will, in any event, be the biggest beneficiary of Chinese infrastructure spending if the proposed China-Kazakhstan-Russia-EU rail line is built. For the Kremlin the issue is different; it is partly about helping China's political emergence as a means of breaking what it sees as the dominance of the US (aligned with the EU) in global power.

But simply helping China become the next global super-power is dangerous for Russia, as it could end being marginalized again. Hence the focus on such other groups as the BRICS and the Shanghai Cooperation Organization (SCO), in which most of the Central Asian states are members. Pakistan and India are expected to join the SCO this summer in an expansion that is important for Moscow. While Pakistan's cooperation is being bought off with Chinese investment, India creates a better balance in the organization and can help prevent total Chinese dominance.

Russia's persistence in pushing the Eurasian Economic Union (EEU) is also part of a Moscow gambit in the Great Game. The Kremlin has made many unexpected concessions to ensure the EEU came into being, eg. substantial energy subsidies to Belarus and Armenia, loans and investment to Kyrgyzstan, and agreeing that the office of the financial regulator, which will eventually oversee all financial institutions and activities within the EEU, will be based in Almaty. The reason for that is because, without having a strong position within the EEU, Moscow risked being marginalized in its own backyard by China's economic encroachment.

The leadership in Tehran has also been very busy in recent months with bilateral minister meetings covering trade, investment and political cooperation. Like Russia, Iran is also currently benefitting from Chinese investment and is set to gain further as transport links are extended to the Arabian Sea. China has already invested over \$25bn into Iran's energy sector and is openly eager to play a major role in opening up the country's vast oil and gas resources.

Central Asia is a key part of China's ambition to become a truly global superpower. What it can't do, or do far too slowly, with aircraft carriers and naval battle fleets, it can do much more quickly with railroads and asphalt stretching across Kazakhstan's Steppe, the Ferghana Valley and Turkmenistan's deserts. Along with expensive investments in Pakistan, Russia, east Africa, Turkey and the Balkans, this can eventually help China compete globally with the US. Of course, for the government in Beijing this process can hardly be described as merely part of a game; for them it is a deadly serious great (global) game.