

# The Missing Quadrant

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## Introduction

There is a lot of focus now on turning over a new leaf regarding relations with Russia. Vice President Biden has talked about pushing the reset button. That implies a rewind to the halcyon times of the Clinton-Yeltsin era. That era appears now to be a golden age of US-Russian relations. Russia was moving towards free market democracy and was acquiescent in US leadership around the world. In fact, however, we can no more go back to that era than we can to the US housing market of 2006. Both were based on a bubble. Reset to that point is an illusion.

In order to understand this we need to introduce the idea of the missing quadrant.

It is understandable why those of us in the west might long for a docile Russia. The assertive behavior of Russia in recent years has caused problems for western policymakers and caught many by surprise. Today's independent Russia seems something completely new. In the mindset of many people in Washington, the idea of a strong but not friendly, maybe even antagonistic, Russia would have been unimaginable. Observers had no difficulty imagining a weak but friendly Russia — a “good” Russia. And they did fear — and therefore could conceive of — a bad Russia.<sup>1</sup> But it would still be weak. In fact, that's why it would be dangerous. It would be dangerously weak, a “Weimar Russia” that would either become failed state or be taken over by extreme nationalists. But it would still be weak.

And there were some who even hoped for a strong Russia. But here's the key: their strong Russia would be good because — in their minds — the only way Russia could become strong would be because it continued to implement the reforms that we, the West, wanted, the pro-market, pro-democracy reforms.<sup>2</sup> The logic was straightforward, a simple syllogism: Russia could only become strong if it evolved as a market democracy. If it became a market democracy, it would be one of us — therefore, “good.” Hence, a strong Russia would be a good Russia.

	<b>WEAK</b>	<b>STRONG</b>
<b>GOOD</b>	Yeltsin	Market/ democracy
<b>BAD</b>	Failed state/ Weimar	

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<sup>1</sup> We use the terms “good” and “bad” to reflect the viewpoint of an idealized western policymaker. A good Russia is one that accepts the West's conception of international conduct and political-economic systems. A bad Russia is one that pursues its own strategic interests and its own development strategy.

<sup>2</sup> This is partly due to the Washington consensus about economic reforms, but more about the association of markets and democracy as the way to economic growth.

It is useful to think of this in terms of a simple matrix. We have the two options for Russia's strength in the columns, and the rows give *our* (i.e., the West's) characterization of Russia's behavior. Notice that one cell (quadrant) is empty: nobody imagined that Russia could be both *strong* and *bad*.<sup>3</sup>

In terms of the matrix, the priority of policy had to be to avoid the southwest quadrant, the cell (bad, weak). That could be best insured by continuing to push Russia towards a free market democracy. Even if the effort never actually led to a Russia in the cell (good, strong), it would help keep it out of the cell (bad, weak) and that could be taken as success.

Consequently, many observers saw a natural coincidence of interests between Russia and the west. If Russia would only follow our advice they could join the rich country club. If this path was rejected Russia would be consigned to weakness.<sup>4</sup> So, in the minds of many observers scenarios of a Russia that was "weak but good," "bad but weak," and "strong but good" were all possible. The one thing that was impossible to imagine was "strong but bad." That is the missing quadrant.

Meanwhile, the Eastern Europeans — former Soviet satellites and "captive nations" inside the USSR — did not trust this scheme. They wanted insurance against a bad Russia, the only kind of Russia there was in their view. NATO membership would be their insurance. The gain to western policymakers was obtaining new allies, at what seemed to be a very low cost.

NATO expansion looked like a winning proposition all the way around. The Eastern Europeans could be allowed to believe that NATO represented real protection against Russia. For the US this would be a costless promise since the potential futures for Russia did not include one where it was strong enough to cause problems and be willing to do so. The US and Western Europe could pretend that what they were actually creating was a new, "nice" NATO that was not only not a threat to Russia but even a friend.

When an outcome is unimaginable there is little cost to selling insurance against this possibility. It is like selling a put option that is far out of the money — you claim the premium income but nobody ever exercises the option.<sup>5</sup> NATO expansion was the put option. Russia's neighbors wanted to buy the put option and the US received the premium income (Rumsfeld's "New Europe"). But the US knew that Russia would either be weak or good so it made sense to sell this insurance. The US could promise NATO membership to the Ukraine and Georgia, put missiles in Poland, and radar in the Czech Republic. A weak Russia *could not* resist and a strong one would be good and hence *would not want to* resist.

Now suppose that you are Vladimir Putin and you see the US selling this insurance to all your neighbors. You do not have to be a genius to see the implications. One important consequence of insurance is moral hazard. The insured party takes greater risks because it has insurance to fall back on. Putin's fear is that these insurance policies would induce countries on Russia's periphery to greater risk taking. This creates a situation that is ripe for miscalculation. The insured parties —

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<sup>3</sup> Just as till very recently nobody imagined that average home prices in the US could decline.

<sup>4</sup> Of course in a long-run sustainable sense they may have been right. It may be that the current strength, due to oil, is not sustainable. But it does not mean that they are not strong now.

<sup>5</sup> This is exactly what AIG did in selling credit default swaps insuring collateralized debt obligations. They sold insurance because they believed that the risk of default was non-existent, and they did not hold reserves against those obligations because the CDS market was not regulated. As a result, when the mortgage market collapsed — the unimaginable event occurred — AIG was left having to pay out on those policies, and having insufficient reserves to cover the claims, has become a ward of the US government.

Ukraine and Georgia, for example – think that they have achieved independence of action, including with respect to Russia, because of the implied security guaranty of the NATO promise. Sovereignty and independence of action are worthy goals and objectives for any country. But they are not costless. They require a strong economy, a strong polity and a strong military. The NATO illusion made them believe that they could achieve sovereignty and independence of action on the cheap.

Putin needed to burst this bubble if for no other reason than to protect Russia against a disaster that resulted from miscalculation. The US had issued all of these contingent liabilities and Putin needed to indicate to the US the cost of this. But talk was not enough. Russia had been arguing for years that these acts had consequences but they had fallen on deaf ears. Hence, the Georgian conflict of August 2008. Regardless of who started it, the conflict demonstrated the cost of those insurance policies that the US has been selling. It seems that there is now a moratorium on NATO expansion. The apparent moratorium is indication that the cost has been recognized, at least to some degree.

The bursting of the insurance bubble also means that what looked like a nearly riskless strategy for re-ordering a post-Cold War world and for dealing with Russia turns out to have been a very risky one indeed. It was a gamble, and a gamble that failed. We built institutions on a fictitious foundation. For what happened between August 1998 and August 2008 is that the unimaginable occurred. Russia became strong, but “bad.” This is not a moral issue, but rather a characterization of how it is seen from the vantage point of the western policy makers who preferred the compliant Russia. What we call “bad” Russians would call independent. Russia became strong because oil prices rose to levels that were completely unimaginable in 2000-2002.

This perspective is important for it focuses our attention away from simplistic explanations of Russian behavior. Russia’s behavior did not change, nor did its evaluation of its own interests. What changed over time was Russia’s ability to conduct an independent foreign policy. But as long as the West was tied into strategies based on the “missing quadrant” fallacy, it was completely unprepared to anticipate them. And as long as the West continues to ignore Russia’s interests it will be unable to engage with them.