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## What is Russia trying to defend?



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Andrei Yakovlev

## What is Russia trying to defend?

### Abstract

Contrary to the focus on the events of the last two years (2014–2015) associated with Crimea and military conflict in Eastern Ukraine, I stress here that serious changes in Russian internal politics (with strong pressure on political opposition, state propaganda and sharp anti-Western rhetoric, and the fight against ‘foreign agents’) became visible already in 2012. Geopolitical ambitions to revise the ‘global order’ (introduced by USA after USSR collapse) and the increased role of Russia in ‘global governance’ were declared by leaders of the country much earlier – with the famous Munich speech of Vladimir Putin in 2007. These ambitions were based on the robust economic growth of the mid-2000s, which encouraged the Russian ruling elite to adopt the view that Russia (with its huge energy resources) is a new economic super-power. In this paper I will show that the concept of ‘militant Russia’ in a proper sense can be attributed rather to the period of the mid-2000s. After 2008–2009, the global financial crisis and especially the ‘Arab spring’ and mass political protests against electoral fraud in Moscow in December 2011, one can speak mostly of ‘militant’ attempts of the Russian ruling elite to defend its power and assets.

**Keywords:** Russian elite, Putin, Medvedev, model of economic developments, political protests, budget constraints, lost vision of future

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The term ‘militant Russia’ recently offered by Silvana Malle (2015) as a characteristic of contemporary Russian policy has Latin roots and means activeness in maintaining certain ideas and principles (following the logic of the expressions ‘militant materialism’ or ‘militant church’). Silvana Malle used this concept to explain the phenomena often described in the Russian media and social networks using the image of ‘Russia rising up from its knees.’ However, the big question is: what exactly is Russia trying to defend with its policy, which is presently regarded by many people in the world as aggression?

In this article, I present my personal opinion about the causes of Russia’s ‘militant turnaround’ in its relationships with the West and the factors underlying it at different stages – before the 2008–2009 global economic crisis, after the Arab Spring of 2011, and after the events in Crimea and the Ukraine in 2014. I will also analyse shifts in the social structure of Russian society that occurred during the 2000s, and the changes in the patriotic sentiments of the general public which transpired after the Crimea accession to Russia. This is the basis for considering the factors and resources Russia could employ for development in conditions of economic sanctions and international isolation. In the final section I will also highlight the key challenges and risks encountered by the Russian authorities and Russian society after the affiliation of Crimea and the start of the military conflict in Ukraine.

## 1 Prehistory of the ‘turnaround’ in Russia’s relations with the West

It may seem at first glance (especially from the perspectives of external observers) that the dramatic change in Russia’s domestic and foreign policy is connected first and foremost with the events in Crimea and the East of Ukraine in 2014. However, in my opinion, the fundamental domestic and foreign policy shifts began much earlier – as early as mid-2000s. Moreover, the basic concepts underlying this ‘new political course’ were changing over time and have undergone at least four different stages. My vision of the general characteristics of these stages is presented in Table 1.

Table 1 Main stages in the evolution of Russia’s domestic and foreign policy since early 2000s in the logic of the concept of ‘militant Russia’

Stage	Years	Main characteristics of the period
Non-militant Russia	2000–2003	Ensuring Russia’s economic independence – after payment of the debts that caused the 1998 default. Focus on internal policy issues. Foreign policy is orientated predominantly on partnership relations with the West.
Militant Russia – 1	2004–2008	Russia’s positioning as an ‘energy superpower’ in conditions of skyrocketing oil prices on the world market, high pace of economic growth and inflow of investment. Tense relations with the West in connection with the ‘colour revolutions’ on the former post-Soviet space. Promotion of ideas of a ‘new global order’ taking into account the interests of Russia and other major developing nations. War with Georgia as a demonstration of Russia’s military power.
Russia at the crossroads	2009–2011	Deep economic recession against the backdrop of the global crisis in 2008–2009. Quest for new economic development models. Attempt to ‘reset’ the relations with the US. Growing internal dissatisfaction with the inefficiency of state. Mass-scale political protests against electoral fraud in December 2011.
Militant Russia – 2	2012–2013	Slowing of growth after economic recovery in 2010–2011. Suppression of the opposition and tightening of internal policy – in response to the events of the Arab Spring and political protests in Moscow in late 2011 – early 2012. Scaling up anti-Western and anti-American rhetoric.
Isolated Russia	2014–...	Crimean accession to Russia in response to the revolution in Kiev and forcible ouster of Viktor Yanukovich from the post of President of Ukraine. Support of separatists in Eastern Ukraine. International sanctions against Russia and beginning of a new economic recession.

Although the first stage in Table 1 is characterized predominantly by partnership relations with the West, it is crucial for understanding the further development pattern. One of the key events of this stage was **ensuring Russia's economic independence**. For nearly fifteen years prior to that, neither the Soviet Union nor, later, Russia could collect a sufficient amount of state budget revenue to finance its own expenditure commitments. This led to the need to attract Western loans which, given the related conditions and terms, were perceived as an instrument of pressure on the Soviet and later Russian government.<sup>1</sup>

The rouble devaluation in August 1998 created incentives for investment and production growth. Rapid economic growth later became sustainable owing to the strengthening of the state's capacity and formation of 'common rules of the game' within the context of the liberal economic policy (including radical tax reform, lowering of administrative barriers for business, etc.; see Luong & Weinthal (2004)). All this enabled a significant increase in tax collection rates and repayment of debts that had caused the 1998 default. Thus, for the first time in a long period Russia's leaders started to feel and present themselves as capable of conducting an independent economic policy.

However, the attention of the Russian authorities during that period was focused mainly on addressing internal policy issues – such as ensuring control over regional governors, the fight against terrorism, and resisting political pressure from oligarchs. At the same time, despite the restoration of government control over central television channels, there was still room for active political competition (including a genuine multi-party pattern of the State Duma).

The foreign policy of that period, notwithstanding the tension in connection with the conflict in Yugoslavia, was characterized by predominantly cordial relations with the West. The emotional reaction to 9/11 in 2001 and sympathy with the Americans deserves special mention. On the whole, the fight against terrorism could be regarded as an important factor uniting Russia with the West. Nevertheless, Russia's openness to equitable cooperation during that period did not find an adequate response from the West. In this context, the accession to NATO by a new large group of Eastern European countries in 2004<sup>2</sup> was considered by Russian leaders as important negative signal.

The transfer to a 'new course' starting 2004 was connected with several events. Firstly, it was the 'YUKOS affair' that objectively reflected the acute conflict between key groups within the elite over control of natural rent (Yakovlev, 2006). The defeat of big business in this conflict accompanied by massive support gained by the ruling political elite in the parliamentary and presidential elections in 2003-2004, against the background of Mikhail Khodorkovsky's arrest, led to a shift in the relative balance of forces within the ruling coalition, which became overtly dominated by the federal bureaucracy and representatives of the law enforcement agencies, the so-called *siloviki*, which was dissatisfied with the geopolitical outcomes of the 1990s. Big business (always more pragmatically minded toward the West) then found itself in an apparently subordinate position.

Secondly, a significant role in the change of the Russian political course was played by the 'colour revolutions' in Georgia, Ukraine and Kyrgyzstan in 2004–2005, encouraged by the United States and leading European countries. The conservative part of the Russian elite regarded support of these new regimes by the West and especially by the US as an encroachment on Russia's interests in the post-Soviet space (Karaganov, 2007).

The stormy economic growth of the mid-2000s and dramatic hike in world oil prices accompanied by an inflow of direct investment and termination of capital flight also contributed to the shift towards the 'new course.' Combined with the European countries' dependence on Russian energy supplies, all this generated among the top political elite a feeling of Russia's new status as an 'energy superpower' and an aspiration for restoring Russia's role in world politics. I am convinced

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<sup>1</sup> At the same time Russia as a country was running a current account surplus with the exception of two or three quarters before 1998. Thus it was not a question of the country's external position as such, but rather government's inability to collect taxes.

<sup>2</sup> Hungary, Poland and Czech Republic joined NATO in 1999. Accession of Bulgaria, Latvia, Lithuania, Romania, Slovakia and Estonia to NATO was approved in March 2004.

that Vladimir Putin's well-known speech at the conference on security in Munich in 2007 can be described as a concentrated public manifestation of this new course. One of its key elements was the promotion of the idea of a 'new global order' taking into account the interests of major developing countries, in contrast to the full dominance of developed countries (represented by the G7) in the 1990s. This approach of the Russian leadership created preconditions for a possible geopolitical alliance with China, India and Brazil. At the same time, the war with Georgia in August 2008 can be regarded, within this context, as an indirect display of military power confirming Russia's claims on a new role in geopolitics.

However, the crisis of 2008–2009 (with an exceptionally deep recession of Russian GDP) vividly demonstrated that the model of economic development applied in Russia in the 2000s was not suitable for the new realities. The claims of a different role in global politics were not backed by sufficient economic capacity. The realisation of this fact brought about a demand for modernisation (voiced by the new president Dmitry Medvedev) and attempted dialogue with the business and expert communities in 2009–2011 (Malle 2012, 2013). The outcomes of this dialogue included measures for improving the business climate (including amendments to the Criminal Code restricting possible pressure on business, introduction of regulatory impact assessment procedures, and the establishment of the Agency for Strategic Initiatives) as well as the elaboration of Strategy 2020 with broad expert participation in 2011. The attempt to 'reset' US–Russian relations occurred at the same period. However, all these steps were accompanied by a programme of modernisation of the army and an increase in military spending (in spite of a large budget deficit).<sup>3</sup>

## 2 Main features of the 'new course'

A fresh twist toward a more 'militant policy' (including attempts to suppress political opposition, increased pressure on nonprofit organizations by the adoption of the law on 'foreign agents,' and reinforcement of anti-American rhetoric) became obvious as from mid-2012. From a formalistic perspective, this twist can be regarded as a 'conservative' reaction to mass-scale political protests in Moscow against falsifications of parliamentary elections at the turn of 2011–2012. However, I see more fundamental reasons behind this turnaround in the events of the Arab Spring. The series of revolutions in Arab countries in the spring of 2011 comprised a strong 'external shock' to the Russian political elite, comparable with events in Prague in 1968 in their impact on the senior Soviet elite. A fear of possible developments in Russia following the Egyptian or Libyan scenario within the context of mass political protests in Moscow and other large cities against parliamentary elections falsifications in December 2011 triggered a 'defence reaction.' This reaction took various forms.

First and foremost, mention should be made of a package of measures for improving the business climate. Specifically, in February 2012 Vladimir Putin declared the National Entrepreneurial Initiative (NEI), whose task was to bring about a radical improvement of Russia's place in the Doing Business ranking.<sup>4</sup> During the same period there were declarations concerning the upcoming spread of the regulatory impact assessment (RIA) procedures on tax and customs legislation as well as regional regulations, the establishment of the post of Business Ombudsman within the Presidential

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<sup>3</sup> According to Cooper (2015) until the Georgia war Russia's in 2008 spending on 'national defence' was relatively stable at 2.5–2.6% GDP. In 2014 it was about 3.4% GDP, but the law on the 2015 federal budget provided for the increase of military expenses to 4.3% in 2015.

<sup>4</sup> NEI envisaged Russia's rise from the 120<sup>th</sup> place in 2012 to 20<sup>th</sup> place in this rating by 2018. To attain this goal the Agency for Strategic Initiatives (ASI) developed detailed roadmaps simplifying the procedures for getting access to electricity, obtaining construction permits, stimulating exports, etc. As a result, the Doing Business 2016 report published by the World Bank at the end of 2015 rated Russia 51<sup>st</sup>, which was a significant leap forward ahead of China, India and Brazil (<http://www.doingbusiness.org/data/exploreeconomies/russia>).

Administration<sup>5</sup>, and amnesty plans for businessmen convicted for economic crimes. Because the most radical measures from this package were effected in early 2012, during the presidential election campaign, it is fair to assume that the authorities were trying to deter business (above all, medium-size and small enterprises) from supporting the political opposition.

An increase in the income level of public sector employees (a major support group for the current political regime) can be considered an important element of the authorities' reaction to the 2011–2012 political protests. A series of presidential decrees signed in May 2012, envisaging a rise in the salaries of doctors, teachers and other workers in the public sector, was part of the effort to accomplish the increase. As a result, according to the Minister of education and science Dmitry Livanov, the average monthly salaries of secondary school teachers increased from 16 thousand roubles in 2011 to 28 thousands rubles in 2013 (see <http://www.rg.ru/2014/01/23/livanov-anons.html>). However, the major responsibility for implementing this task was given to the regional authorities, which afterwards brought about a dramatic deterioration of regional finance: the average deficit of regional budgets (as a percentage of regional government's own income) increased from 4% in 2012 to 8% in 2013 (Zubarevich, 2014).

It is also important to mention the increased emphasis on fighting corruption, including hasty adoption of a law on the declaration of officials' expenses in the beginning of 2012 and imposition of liability for imbalance between income and expenditure. These actions on the whole ran counter to the public statements made by senior Russian officials as recently as the fall of 2011, which alleged that the measures prescribed by Art. 20 of the UN Convention against Corruption violated the 'presumption of innocence.'<sup>6</sup> Anticorruption activities were thereafter included among priority lines of activity of the Federal Security Service.<sup>7</sup> This resulted in a considerable increase in the number of criminal cases and arrests of high-ranking officials, including some regional governors and deputy federal ministers. To all appearances, the authorities were resorting to such actions to improve the performance of the government mechanism and reduce the dissatisfaction with the quality of public goods and services underlying the protests of 2011.

Another aspect of the reaction to political protests at the turn 2011–2012 was the pressure on political opposition (starting with a disruption of the meeting at Bolotnaya Square on 6 May 2012 and subsequent trials against the participants) and tightening of control over the operations of nonprofit organizations through the law on 'foreign agents' (Gel'man, 2014).<sup>8</sup> The anti-Western and anti-American rhetoric also intensified in the State Duma and pro-government media after Putin's victory in the presidential election.<sup>9</sup> Another component of increasingly anti-Western trends in Russian policy involved measures for 'nationalization of the elite' such as prohibiting deputies and officials from having accounts at foreign banks and restrictions on travel abroad.

Finally, it is necessary to mention further growth in military and law-enforcement spending. Julian Cooper (2015) stressed that military modernization, with increased spending, was long overdue and would have been undertaken by any government of Russia at this time. However I suppose that

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<sup>5</sup> Boris Titov, one of the founders of the Delovaya Rossia association, was appointed to that post in June 2012. Another functionary of that association, Alexander Galushka, in 2012 became co-chair of the All-Russian National Front (ONF) and in 2013 was appointed Minister for Development of the Far East.

<sup>6</sup> Meeting of RF President Dmitry Medvedev with media representatives of the Volga Federal District on 19 November 2011 <http://www.pfo.ru/?id=49949>.

<sup>7</sup> See the speech of Vladimir Putin at the annual meeting of top officials of Federal Security Service in April 2014 where he named the fight against corruption among three major priorities of this agency – along with the fight against terrorism and subversive activities: <http://kremlin.ru/news/20724>.

<sup>8</sup> Taking into account the geography of the protests, the Kremlin started to apply a new 'smart' policy, using (as before) administrative pressure to achieve necessary electoral results in the regions and allowing honest elections in big cities. Mayoral elections in 2013 in Moscow (with 27 per cent of votes going to Alexei Navalny) and Ekaterinburg (where Yevgeny Roizman won) exemplify the second tactic.

<sup>9</sup> One of the most striking examples is the notorious Dima Yakovlev Law imposing a ban on adoption of Russian children by American families.

the ruling elite was aiming not only at actual enhancement of military power, but also (to a no lesser degree) at sustaining the loyalty of law enforcement agencies perceived as the main stronghold of the regime after the events of 2011–2012. This policy also enhanced the support for the regime among employees of defense industries, including residents of many one-factory towns.

This political turnaround was accompanied by attempts to develop an ‘alternative ideology.’ For example, the ultra-conservative Izborskii Club was created in the fall of 2012 with informal support from the Kremlin administration and almost immediately became active in the media. The key figures of the Izborskii Club included economists Mikhail Delyagin and Sergei Glaziev and publicists Alexander Prokhanov, Alexander Dugin and Maksim Kalashnikov.<sup>10</sup> In their first report, published in January 2013, the Izborskii Club experts proceeded on the inevitability of a ‘third world war’ within the stipulated period of some 5–7 years, which would be unleashed by the ‘global financial oligarchy’ and would be targeted primarily against Russia. Hence the arguments for Russia’s being a ‘besieged fortress’ and the need for mobilization, in the spirit of Peter the Great and Stalin.

Therefore, it may seem at first glance that after the ‘period of uncertainty’ of 2009–2011 the top national political elite made its choice and began to return to the ‘militant Russia’ policy beginning in 2012. However, the difference from the period of the mid-2000s lies in the harsher forms of implementing such a policy. But in my opinion, despite the similarity in rhetoric, the basic factors underlying the political course in these two periods differ substantially.

In the mid-2000s this policy was mainly orientated to foreign political targets. Offering an alternative to the ‘unipolar world’ that took shape after the collapse of the Soviet Union and striving for a ‘new global order,’ the Russian elite wanted to gain recognition and respect from global elites, in both developed and developing countries. This policy was based on internal consensus on the following key issues. Firstly, full control by the ruling elite over political processes underway in the country substantiated by the outcomes of the 2003–2004 and 2007–2008 elections. Secondly, the conviction that Russia with its supplies of energy resources possessed sufficient economic power to pursue an independent policy corresponding to its status as a nuclear power. This conviction was reinforced by the dynamics of world oil prices, the inflow of investment and robust economic growth.

However, the 2008–2009 crisis vividly demonstrated the vulnerability of the economic development model applied in Russia in the 2000s. The protests in 2011, not expected by either the Kremlin or the opposition, in their turn, raised doubts about how fully the ruling elite controlled the political processes. Combined with events of the Arab Spring, this led to a situation wherein the internal political dimension became much more important for the new policy that had been pursued since 2012, and the ‘protective function’ became the top priority. In the mid-2000s the Russian ruling elite resorted to ‘militant’ rhetoric in an attempt to win itself a decent place among the global elite, whereas presently the point at issue was sustaining the right to power in its own country. However, the leadership failed to present a convincing ‘vision of the future’ to other elite groups and society at large.<sup>11</sup> The predominant role of appeals to Russia’s ‘great past’ in official propaganda is very typical of such campaigns.

### 3 Impact of ‘new course’ on behavior of economic actors

The aforementioned measures aimed at regaining control over political processes and ensuring support of the regime by the main social groups had an ambiguous impact on the behavior of economic entities and officials in the government itself. In particular, it was clear already in 2012 that

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<sup>10</sup> For more details on Izborskii Club, see the paper by Marlene Laruelle (2015)

<sup>11</sup> The policy proposals of the Izborskii Club have failed to reach this objective, as representatives of the Russian administrative and political elite, who have enjoyed the “blessings of civilization” in full measure in the 1990s-2000s, would hardly be willing to voluntarily return to a society living behind the “iron curtain.”

the government did not have the resources to enable an increase in public sector financing while simultaneously pursuing an accelerated build-up of military expenditure. Persistent declaration of these goals raised doubts as to the overall adequacy of economic policy and the maintenance of macroeconomic sustainability. This contributed to increased capital flight from the country. Increased pressure on the bureaucratic machine for anticorruption purposes also had contradictory implications. In conditions of excessive and inconsistent regulation as from the 2000s, such tightening of administrative pressure increased the risks for officials in displaying any sort of initiative and in fact weakened the motivation for creating a good environment for economic development (Yakovlev, 2015).

As a result, a significant slowdown in economic growth (down to 1.3% compared to the consensus forecasts of 3–3.5% at the beginning of the year based on fairly stable oil prices), a drop in investment, and an increased outflow of capital were registered already in 2013.<sup>12</sup> The decrease in political support (and lowering of Putin's personal ratings from the summer of 2013) that began against this background was of no less significance. In my opinion, these processes set the stage for the following phase of evolution of Russian domestic and foreign policy, which we have been witnessing since 2014 and which is connected with the events in Ukraine.

The developments in Ukraine at the turn of 2013–2014 (resulting in the forced ouster of President Viktor Yanukovich) were a consequence of deeply inadequate policies with respect to Ukraine carried out by important stakeholders, including Russia, the European Union and the United States. A no less lamentable role was played by the utterly self-concerned behavior of the Ukrainian elite. For twenty-odd years its members had been feuding for control over rent flows and gambling on conflicts between Russia and Europe instead of building a set of normal institutions at home.

Nevertheless, in the context of current developments in Russia, the crisis in Ukraine should probably be perceived as a mobiliser of social support for the existing political regime. The Kremlin's political technologists have in fact succeeded in capturing the patriotic sentiments built up in the Russia in the 2000s. It must be emphasised that patriotism is in itself a healthy phenomenon. The desire to be proud of one's country is natural for its citizens. It was hardly relevant to talk about such things in the severe 1990s, but economic revival and positive social shifts in the 2000s provided grounds for realising such aspirations. Moreover, historical experience shows that patriotic sentiment can be an important factor in economic development by consolidating different social groups, as happened in South Korea and Taiwan in the 1960s-1970s or as is presently happening in China.

However, in 2014 the Russian ruling elite started using this resource for strictly utilitarian ends. Against the background of the unfolding negative internal political tendencies the crisis in Ukraine became a pretext for a fresh (compared with the presidential campaign of early 2012) mobilisation of mass-scale political support inside the country. Further developments showed that this solution produced the tangible internal political effect of 'patriotic consolidation' and a jump in support for the authorities and in Vladimir Putin's personal popularity ratings, which rose to 85–90 per cent.

But at the same time practical actions to affiliate Crimea had a radical effect on the foreign political situation and on Russia's relations with Europe and the US.<sup>13</sup> Prior to that, the Russian leaders actually managed to manoeuvre – intensifying or reducing the 'anti-Western' rhetoric. The events in Crimea and the outset of military conflict in Ukraine have finally destroyed the remnants of the former trust between the parties and may have become a point of no as regards the restoration of

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12 Of course, the deterioration of economic conditions in the EU zone may also contribute to these results because the Russian economy is quite dependent on the European market.

13 Apparently, the Kremlin strategists who were staking on Europe's energy dependence on Russia did not expect such an acute reaction from the West. Undoubtedly, the Malaysian Boeing brought down on 17 July 2014 over the territory occupied by rebels has played a significant role in this respect. The death of a large number of people from the Netherlands, Australia and other countries provided a strong argument for the forces demanding a heavy-handed policy vis-a-vis Russia. Nevertheless, we are convinced that Russia's international isolation was inevitable even without this tragic event.

normal interactions between Russia, the EU, and the United States, which had lasted over the past 25 years. In the economic sphere this turnaround was manifested in international sanctions from the West and Russia's embargo on food imports.

Although different experts have provided different quantitative evaluations of the losses inflicted by international sanctions, it is obvious that the sanctions (above all, financial ones) had a serious negative impact on the Russian economy. It has spotlighted the weakness of the Russian financial system and its dependence on global markets. Moreover, restriction of access to financing has affected not only the companies on sanction lists but virtually all enterprises attempting to obtain foreign loans. According to a top manager of a large Russian state-owned bank, to discuss any issue, even a minor technical one, regarding a possible project with European partner banks the Russian bank must now provide a full package of documents, whereas previously one telephone conversation would suffice. This resulted in significant increases in administrative costs of attracting financing and a radical extension of timeframes for considering projects.

It should also be mentioned that despite all the remaining capabilities of the Russian market the Ukrainian crisis has clearly shown Russia's marginal role in the world economy. Of course it is clear that the 'freezing' of relations with Russia has inflicted damage on European businesses and that the EU depends on supplies of Russian energy sources. But it is also apparent that the European countries can switch over to other markets and have in fact started doing so. As for Russia, access to global financial markets and Western technologies seems to be a critical condition for economic modernisation.

Having encountered tangible negative effects of the sanctions, the Russian leaders tried to compensate for the losses connected with European trade and economic relations by turning sharply toward the East, above all toward China. But soon it became clear that, notwithstanding the existence of some common geopolitical interests, China had no intention of rendering serious support to Russia and would continue acting in its own pragmatic interests.

Within this context Russia's activity in Syria can be regarded as an 'asymmetrical response' to the deadlock situation created by the Ukrainian crisis. The deadlock consists in the fact that all actual participants in this crisis, including the EU, Russia and Ukraine's current ruling elite, are sustaining significant losses and bearing risks, but at the same time cannot venture a compromise without considerable 'loss of face.' On the contrary, for the United States (which objectively influences the situation through direct contacts with the Ukrainian authorities and its EU allies in Eastern Europe), virtually nothing that happens in the East of Ukraine requires substantial outlays of any kind.

To overcome this deadlock, Russian leaders need to make clear exactly which global problems can only be resolved via cooperation between the West and Russia. The fight against terrorism is clearly one of such problem, as terrorist attacks in Egypt and Paris in October–November 2015 tragically give witness. The initial reaction of the EU showed that cooperation between Russia and the West can probably be resumed in the format of 'security services in exchange for access to financing and technologies.' However, the incident of the Russian jet at the Turkish border and new acute tensions with Turkey negate such a hope. One has to acknowledge that Turkey, during the last 15 years, has probably been the closest partner for Russia among NATO members. From this viewpoint, the recent conflict with Turkey again highlighted the issue of mutual trust, which undoubtedly has been deeply undermined in relations between Russia and Western countries. After the Ukrainian crisis, both parties will continue treating each other with suspicion for many years (if not decades) to come. Therefore, even in the event of 'warming' of relations with the West within the context of the common struggle against terrorism, Russia should not count on a return to the previous format of economic relations. In addition, geopolitical confrontation will continue (albeit in less acute forms) due to the objective divergence of interests between the parties involved in the process.

Therefore, the prospects for economic and social development in Russia in the coming years should be viewed in the context of 'relying on one's own forces.' Perhaps, Russia will evade a situation like that of Iran in recent years, but the country is already close to a situation similar to that

experienced by Iran over a period of 25 years (from 1979 to the mid-2000s). What resources could be put to use under such circumstances?

## 4 Resources, opportunities and restrictions to development

The Higher School of Economics (HSE) policy paper of 2013 on a new economic development model highlighted two sufficiently large social groups formed under conditions of economic growth and socio-political stability in the 2000s. These groups could become the drivers of growth under new conditions (Yasin et al, 2014).

One of these is ‘new business’, i.e. successful medium-size companies that managed to take advantage of the opportunities provided by the robust growth in domestic demand. Some five thousand medium-size firms with average annual turnover per company exceeding \$10 million were operating in the Russian economy before the crisis of 2008, steadily maintaining average annual rates of sales growth of 20 percent or more (Vin’kov et al., 2008). These companies were particularly active in construction and trade, but were in fact represented in all economic sectors. Moreover, the share of rapidly growing companies (‘gazelles’) was much larger in Russia than in developed countries both before and just after the crisis (Yudanov, 2010).

The economic growth of the 2000s was supported to a significant extent precisely by those successful companies using the favorable situation for development of their business (including investment, technological re-equipment, expansion to new markets, and attraction of foreign partners). At the same time, their owners acknowledged the fact that they could attain a high social status only in Russia. This is exactly why such companies became involved in collective action to change the investment climate, first of all through the Delovaya Rossia association after the 2008–2009 crisis. Such companies, familiar with the Russian market, disposing of financial resources and management teams, could become the basis for the new model of economic growth. However, in order to succeed they should be sufficiently motivated to invest.

The second potential driver group, the ‘new bureaucracy’ – represented both by officials at various levels and by managers of public sector entities – played a significant role in the structure of society in the 2000s. Unlike in the 1990s, representatives of this group have restored their social status and started earning considerably higher incomes. In addition (inter alia, owing to noticeable renovation of the personnel in this group), their skills improved and they developed the necessary professional competencies. These people know how to manage regions, municipalities, universities, schools and hospitals by following unified ‘rules of the game’ which the federal centre tried to establish in the 2000s. As a matter of fact, despite the traditional accusations of corruption, the majority of representatives of this group prefer bona fide behavior strategies because, unlike in the 1990s, they have much to lose. Their expertise and skills would be an asset for development, including the creation of a favorable business environment. But to achieve this, the ‘new bureaucracy’ should also be sufficiently motivated to take initiative.<sup>14</sup>

Following the change in geopolitical environment in 2014–2015 related to the events in Crimea and Eastern Ukraine, the situation for these two groups has considerably deteriorated. Nevertheless, in my opinion, only they can become the driving forces of the new economic growth model.<sup>15</sup> The

<sup>14</sup> The presently existing system of management does more to discourage than promote such motivation – because of detailed regulation of their current activity instead of control and responsibility for performance outcomes (Yakovlev, 2015).

<sup>15</sup> The inclusion of these groups in the ‘ruling coalition’ could result in ‘broader access’ in the terms of the concept of ‘limited access orders’ developed by North et al (2009) and can help to increase the sustainability of the existing social order. However, this would require readiness on the part of elite groups forming the present ‘ruling coalition’ for self-restriction. Historical experience shows that this is hardly feasible without strong external or internal pressure on these groups.

barriers to employing the modernisation potential of these two social groups are erected by the existing super-centralised system of governance, figuratively described by the term ‘vertical of power.’ This system of administration was formed in the early 2000s as opposed to the near-chaotic decentralisation of the 1990s. The main tasks of the vertical of power included restoration of order and ensuring the territorial integrity of Russia. These tasks were fulfilled, but at the same time the pendulum seems to have swung to the opposite extreme, as the vertical of power generated distorted incentives for the bureaucratic machine,<sup>16</sup> as did the decentralized system of the 1990s, and it turns out to be unsuitable for performing the tasks of social and economic development.

Therefore, the inadequacy of the current system of governance is one of the key problems in Russia. However, the interests of three main elite groups forming the present ruling coalition’s basis of power – the senior federal bureaucracy, law enforcement agencies and large oligarchic businesses – prevent a change in the existing model. Each of these groups extracts economic rents within the framework of the super-centralized administrative system. At the same time, their rent-seeking behavior, tolerable in conditions of high profits from exports of hydrocarbons, presently, with falling profits, has begun to create a divide between the political leadership and the elites.

This conflict was manifested in Vladimir Putin’s actions to ‘nationalize the elite’, aimed above all at fighting opportunism on the part of representatives of the elite social groups and ‘tying’ them to the present political regime.<sup>17</sup> However, these measures have infringed on their economic interests.

It needs to be mentioned that such things had happened before in Russian history – suffice it to recall Ivan the Terrible, Peter the Great or Stalin, each of whom entered into acute conflicts with the existing elites in the process of creating a new system of public administration. In so doing, in opposition to the old elites, each of these leaders relied on their own newly created elite groups (Ivan the Terrible’s Oprichniks, Peter the Great’s Poteshny Regiments, Stalin’s NKVD apparatus), and the outcome of conflict was always an actual change of elites.<sup>18</sup>

The tightening of the budget constraints that began as early as during the 2008–2009 crisis could be expected to change requirements for senior officials and heads of state companies – they would need to display not only loyalty (as was the case in the 2000s) but also competence. Such changes in personnel policies with respect to regions have resulted in the appearance of new ‘heavy-weight’ governors with experience in top positions in the federal centre,<sup>19</sup> and active use of governors’ performance ratings by the Kremlin. The replacement of Rashid Nurgaliev by Vladimir Kolokoltsev in the post of Interior Minister in 2012 can be regarded as a manifestation of this approach in the federal government.<sup>20</sup> The resignation of Vladimir Yakunin from the post of head of the Russian

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<sup>16</sup> This distortion of motivations is very expertly described in the article (Paneyakh, 2014) using the case study of interactions between the courts and law enforcement agencies.

<sup>17</sup> Following the logic “We are all in the same boat, and if the boat goes down, there will be no escape – you will drown along with me.”

<sup>18</sup> Nevertheless, there has been another precedent in Russian history – Emperor Pavel I also launched reforms infringing on the interests of the elites, but he did not attempt to create a new elite and was ultimately killed in a palace coup d’etat.

<sup>19</sup> Aleksey Gordeev (Minister of Agriculture since 1999 and Vice-Premier in 2000-2004) was appointed governor of the Voronezh Region in 2009. Vladimir Gruzdev (deputy of the State Duma since 2003 and one of the functionaries of Unified Russia) was appointed governor of the Tula Region in 2011. Andrei Vorobiev (deputy of the State Duma since 2003 and head of the Executive Committee of Unified Russia party since 2005) became governor of the Moscow Region in 2012. Svetlana Orlova (Deputy Chair of the Federation Council since 2004) was appointed governor of the Vladimir Region in 2013.

<sup>20</sup> It should be mentioned that Rashid Nurgaliev (Interior Minister in 2004-2012) originally hailed from KGB. His function (as well as that of his predecessor Boris Gryzlov) consisted primarily in ensuring control over this law enforcement agency numbering approximately one million staff members. Unlike Gryzlov and Nurgaliev, Vladimir Kolokoltsev is a professional policeman who pursued his entire career in the system of the Interior Ministry. It would be appropriate to note the invitation by Kolokoltsev of Vladimir Ovchinsky who headed the Russian Interpol Office in the 1990s and publicly criticized the management of the Interior Ministry in the 2000s, to the post of adviser to minister. Kolokoltsev’s interaction with former Finance Minister Alexei Kudrin and experts from his Committee of Civil Initiatives during the discussion of new proposals on the law enforcement system reform is also noteworthy.

Railways (RZhD) in August 2015 and his replacement by Oleg Belozеров – a technocrat not belonging to the narrow circle of Putin’s protégés – can be considered within the same logic. RZhD is a major state company comparable with the Interior Ministry in terms of the number of staff and professional competence needed to render effective management under hard budget constraints.

However, in addition to the clash between the leader and the elites, conflicting interests within the ruling elite are a no less serious problem. After the YUKOS affair in 2003–2004 the top federal bureaucracy together with *siloviki* started playing the leading role within the ‘ruling coalition’ while major oligarchical businesses moved to positions of ‘junior partners’. In 2009–2011 a certain weakening of *siloviki* was observed in connection with the outrageous incidents of violence and inefficiency of the Interior Ministry in the fight against crime,<sup>21</sup> as well as business protests against corporate raiding with the participation of law enforcement agents (Firestone, 2010; Gans-Morse, 2012; Rochlitz, 2014). However, starting 2012, the influence of power structures has grown substantially against a backdrop of suppression of political opposition and a search for ‘foreign agents.’ According to high-ranking government officials (from personal conversations in the spring of 2014), whereas the actual centre of decision-making in 2008–2012 was the government and in 2012–2013 the presidential administration, with the onset of conflict in Ukraine the role of the decision-making center passed to the Security Council. Under these circumstances the government has been increasingly performing merely technical functions.<sup>22</sup>

This change in the balance of forces was reflected, on the one hand, in the accelerating growth of defense and law enforcement spending in the process of budget distribution. On the other hand, capital flight, to the extent of \$154 billion in 2014 and over \$52 billion in January–August 2015,<sup>23</sup> along with high volatility in the currency exchange market, constitute evidence of falling confidence of the business elite as regards the leadership’s policy approach. But this means that the current balance based on dominance of power structures is fragile and temporary and that the gap between the military-political ambitions proclaimed by the national leadership and the economic and technological basis will only be growing wider.

Another line of internal tension is connected with the divide between the masses and elites. This conflict is engendered by strong social inequality. Conspicuous consumption and overall cynicism of the elites in the 1990s predetermined society’s deep mistrust toward business and the state and triggered strong redistributive sentiments. Aware of these sentiments, in the 2000s the ruling elite consciously channeled a considerable portion of natural rent to increase people’s incomes, striving to preserve social and political stability. This policy was continued in the period of the global financial crisis, with incomes increasing by 2 per cent on average (mostly due to increase of pensions and salaries in the public sector) despite an almost 8 per cent drop in the GDP.

However, the present financial situation leaves no room for further implementation of this strategy. Therefore, starting in 2013, the Kremlin political technologists started using the resource of ‘patriotic mobilisation’ for maintaining sociopolitical stability. In the short term such a policy yielded its fruit. The accession of Crimea to Russia stirred an emotional reaction among the broad public, including the readiness of ordinary people to make sacrifices for the sake of national interests. However in conditions where it is unclear for citizens what sacrifices are being made by the elites this emotional force may change its vector quite quickly and become a destabilizing factor, with support from radical groups on the left and right wings of the political spectrum.

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<sup>21</sup> The shooting of visitors in a Moscow supermarket by district police chief Major Yevsyukov in 2009, bloody massacre in Kuschevskaya village in Krasnodar Territory in 2010, tortures in “Dalny” police office in Kazan, etc.

<sup>22</sup> Very demonstrative is the interview of deputy Minister of Finance Tatiana Nesterenko saying that her ministry was not asked about the economic consequences of the decision on Crimea – see <http://www.forbes.ru/forbes-woman/karera/281919-minfin-ne-sprashivali-vo-skolko-oboidetsya-reshenie-po-krymu?page=0,1>

<sup>23</sup> For 2014 see <http://www.themoscowtimes.com/business/article/russia-massive-capital-flight-continues/520112.html>, for 2015 - [http://www.gazeta.ru/business/news/2015/09/11/n\\_7581881.shtml](http://www.gazeta.ru/business/news/2015/09/11/n_7581881.shtml)

## 5 Concluding remarks

Finishing this paper, I would like to refer to the preliminary conclusions of a recent research project of HSE Institute for Industrial and Market Studies analyzing the strategies of foreign companies operating in the Russian market. The project involved a series of interviews held in the spring and summer of 2015 with representatives of business associations uniting foreign companies such as the American Chamber of Commerce, the Association of European Business, the Russian-British Chamber of Commerce and others. Notwithstanding international sanctions, the respondents voiced their companies' willingness to continue working in Russia and mentioned long-term competitive advantages of the Russian market. Among such advantages they named the following:

- Availability of various natural resources (including, in addition to oil, also metals, timber, agricultural lands, etc.). In contrast to sceptic's reflections of a 'resource curse' typical of the Russian liberal experts, business representatives unambiguously regard rich supplies of natural resources as a substantial potential advantage for Russia.
- Significant structural distortions in the economy (inherited from the Soviet plan system and not overcome during last 25 years). For many companies these distortions mean the existence of market niches with opportunities for sales growth for many years to come.
- High qualification of labour force. Despite the criticisms expressed by many Russian experts about deterioration of the quality of education, the qualification of workers in Russia, in the estimates of foreign companies, is still higher on average than in other developing countries, which provides an opportunity for locating high-tech production facilities in Russia.
- High urbanization level. A considerable part of the urban population, combined with a high level of education and increased level of incomes, creates mass-scale demand for consumer goods of high and medium quality.<sup>24</sup>

In respondents' opinion, the combination of all these factors before 2014 provided opportunities for sustainable long-term growth of the Russian economy at a pace of 5–6% a year. According to respondents this potential has not been realised due to inadequacy of economic policy and mistrust of business toward the state. However, even now, regardless of the inevitable tension in relations with developed countries in the coming years, Russian companies' restricted access to capital and technologies, and the probability of long-lasting low levels of oil prices, the effect of the aforementioned factors has not disappeared. Russia still has potential for development.

However, its practical implementation requires the settlement of the systemic conflicts described above and development of new agreements between key groups within the elite, as well as the formation of a new 'social contract' between the elite and society. These processes require the formulation of a new national development strategy, and a new vision of the future providing answers to the questions: What exactly is Russia defending by its 'militant policy'? For the sake of which ideas and values does the state call upon society and elites to undertake self-restraint and self-sacrifice? Russia will be ruled by those who can provide convincing answers to these questions.

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<sup>24</sup> In 2013 about 74 percent of the total population in Russia lived in cities vs. 54 percent in China and 32 percent in India.

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