

State-Business Relations and Modernisation

Journal Issue

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Publication date:

2011-12-05

Permanent link:

<https://doi.org/10.3929/ethz-a-006844361>

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Originally published in:

Russian Analytical Digest (RAD) 105



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Modernization after Medvedev?

By Indra Overland, Oslo

Abstract

In March 2012 Dmitry Medvedev will step down as president of the Russian Federation. For five years he has been the main champion of modernization in Russia, and his change of status therefore raises a question: what will become of the modernization effort? Although the modernization project has encountered significant barriers and Medvedev himself is increasingly cast as ineffectual, the fact that some components of the modernization agenda are linked to strong interest groups ensures its continuation with or without Medvedev as Prime Minister. In particular, several of the country's main businesspeople may wish to promote modernization in the form of a new round of privatization.

Barriers to modernization

Despite the unbridled optimism that often accompanies modernization efforts, as highlighted in a seminal study by James Scott, historical modernization schemes around the world have been hindered by several factors, two of which are particularly relevant for Russia—economic complexity and institutional resistance. The first factor—the complexity of the private sector in an industrial economy—points to the impossibility of the state micromanaging the economy in its entirety. For more on this, see the article by Richard Connolly in this issue of RAD. The second barrier to modernization efforts is the existence of institutions that may resist a modernist drive. One of the most important premises of an institutionalist approach is that, due to path dependency, change is neither immediate nor costless and occurs slowly, if at all. In Russia a key path dependency is reliance upon informal practices and the use and abuse of administrative resources to achieve political ends at the expense of formal frameworks for governance. For more on this, see Richard Sakwa's article in this issue of RAD.

Modernization in Russia

The idea of modernization has deep historical roots in Russia—from Peter the Great's dream of a Europeanized Russia to the Soviet attempt to propel a peasant society into an urban industrial one. Although modernization was also one of the sub-themes of Putin's first presidency, over the past five years the notion of modernization has gained new currency in Russian politics, featuring regularly in Putin's and above all Medvedev's speeches.

In the autumn of 2009, Medvedev published a liberal manifesto, "*Go Russia!*", in which he argued that Russia is increasingly lagging behind developed countries in science, technology and economics due to corruption and dependency on natural resources. A typical example of the type of modernization targeted and emphasized by Medvedev is energy efficiency. According to World Bank estimates, Russia could reduce its primary energy consumption by 45% through increased efficiency. Energy

efficiency thus embodies the irresistible rationality of modernization: nobody disagrees that increased energy efficiency would be a good thing for Russia and for the world, as it would free up more petroleum for export, boost the profits of energy companies and the state, create jobs and address environmental problems all at once.

"Modernization" has supplanted and to some extent subsumed other buzzwords about Russia's development—transition, westernisation, privatisation, rule of law, democratisation and sovereign democracy. The emphasis on modernization amounts to an acknowledgement that the situation in the country is not ideal, and therefore needs to be changed, while avoiding taking a potentially divisive standpoint on exactly what needs to be changed. This vagueness—or openness, if one wants to see it in a more positive light—is a common strategy in political systems around the world. One of Barack Obama's main slogans in his 2008 presidential campaign was "Change we can believe in". Clearly, this phrase was designed to capture as broad a section of the American electorate as possible by sounding positive and dynamic without being concrete enough to alienate anyone.

The open-endedness of Medvedev's modernization agenda, however, has functions that are peculiar to the Russian context. Firstly, it makes it possible to talk about change and progress without having to say anything explicit about increased democratization. Secondly, it is useful because Russian society lacks a shared and clear understanding of its own communist past, and this in turn makes it difficult to talk coherently about the country's future direction. In post-communist countries like Estonia, the Czech Republic or Georgia, it is much easier for the political leaderships to articulate a generally accepted vision of what direction change should take, because the population is united around the idea that communism was an evil that was forced upon the country by an outside occupier. Once "liberated" these countries can unite around the task of returning to their historical destiny of democracy and capitalism. In contrast, the Bolsheviks used the Russian Empire as their vehi-

cle and Soviet communism thus became associated with Russia, Russian and Russians in ways that are difficult both for themselves and others to disambiguate. As a consequence, Russian society is neither united, nor clear on the status of its past, and this makes it difficult to unite around a path forward. In this situation, the concept of modernization is convenient as it makes it possible to talk about moving forward without going into too much detail about the future, or about the past upon which one's vision of the future depends.

Modernization and the Tandem

One of the advantages of the Putin-Medvedev tandem was that it made it possible to appeal simultaneously to two different parts of Russian society: Prime Minister Putin appealed more to conservatives, patriots and people in rural areas; President Medvedev tended to be more popular among liberals, city-dwellers and people with higher education—in other words the segment of the population that wanted change. This bore some similarity to multi-branding strategies for toothpaste, as in this hypothetical example: if some customers do not want to buy Colgate because they find the brand old-fashioned, it may make sense for Colgate to create another and seemingly competing brand with a more modern image. Thus, customers have freedom of choice between Colgate and its apparent competitor; in any case Colgate makes money.

Medvedev represented potential progress to reform-minded voters on two levels: firstly he promised to carry out a programme of “modernization”; secondly, the very fact that he could become president while Putin was demoted to Prime Minister showed that the constitution would be upheld, and in the process opened up the possibility that the country might drift towards some greater pluralism and incremental change. To many that seemed like a relatively positive prospect, especially in light of the dismal outcomes of the colour revolutions in other post-Soviet states: perennial political chaos and economic decline in Ukraine, semi-authoritarianism and war in Georgia and cyclical upheaval and ultimately ethnic cleansing and mass murder in Kyrgyzstan.

The problem with the tandem construct is that it probably cannot go backwards, and the attempt to do so by casting Medvedev to the prime ministerial post and Putin back to the presidency may fundamentally undermine their model of political legitimation. It renders Medvedev a spent political force, which makes it much more difficult to maintain expectations of gradual change and could encourage the liberal segment of society to reunite in opposition to the government. Although President Medvedev did not appeal to all liberals, he had sufficient appeal to split the potential liberal opposition into parts that were small enough to be

harmless. Even if Medvedev's detractors were right that he was no more than a decoy, he was still highly useful to Putin in that capacity, and his political decline is therefore a serious loss to Putin too.

In any case, one is left wondering what will happen with the modernization agenda after Medvedev steps down as President. Although it predates his presidency, he has clearly been its main flag carrier for several years. Some possible clues may be found in his relations with other actors. Although Medvedev is often presented as a Putin puppet without a powerbase of his own, there are some signs that Medvedev and his modernization discourse may have been linked to the group of businessmen behind the Alfa-Access-Renova (AAR) consortium.

The debacle of the BP-Rosneft partnership signed in 2011 was one of the most salient events in Russian business and politics during the Medvedev presidency and may offer glimpses of some of the inter-connections between AAR and Medvedev. This event involved the crashing of one of the biggest and most prestigious business ventures ever undertaken in Russia, including among other things a USD 7.8 billion share swap that would have put the Kremlin on the board of one of the oldest, biggest and most respected Western oil companies; the rights to three exploration blocks in the Kara Sea thought to hold as much oil and gas as the British part of the North Sea and the likelihood of several hundred billion USD in combined investment by the oil companies and the Russian state. The BP-Rosneft deal had been highly profiled at public events at Putin's residence at Novo-Ogaryovo, at BP's headquarters in London and at the World Economic Forum in Davos. At each of these events it was made clear that the deal was the brainchild of Deputy Prime Minister Igor Sechin and had the blessing of Putin. Nonetheless AAR challenged the deal, citing an exclusivity agreement with BP, ultimately succeeding in tearing the BP-Rosneft deal up.

How could this happen? Since 2003, Sechin had consistently been seen as one of the five most powerful people in the Russia and was perceived as the mastermind behind the dismantling of the business empire of Mikhail Khodorkovskiy, who was far wealthier and more politically powerful than AAR. The standing of the other parties involved in the deal was also substantial: Rosneft is the country's largest oil company, BP is one of the world's biggest oil companies and the power and influence of Putin needs no further comment. It is difficult to fully explain how the businesspeople behind AAR would dare to take on such actors, but it is clear whose side Medvedev was on. Shortly after AAR challenged the BP-Rosneft alliance, he publically said that “those who arranged BP-Rosneft deal should have practiced due diligence more carefully”, an obvious snipe at Sechin

and an expression of support for AAR. Medvedev also issued an order for all members of government to relinquish their positions on the boards of state-controlled companies, and Sechin was the first to be affected when he was forced to step down from the board of Rosneft.

There are also other connections between AAR and Medvedev. One of the businessmen behind AAR, Viktor Vekselberg, is President of the Skolkovo Innovation Centre, which is one of Medvedev's main modernization projects. Perhaps most importantly of all, Medvedev has been the main political actor in favour of a new large-scale wave of privatization, which fits neatly with

his modernization agenda, and might also be of great interest to the businessmen behind AAR. And to them it may be privatization that matters more than the declining political influence of Medvedev. One possibility is thus that Medvedev does not become Prime Minister, but is the fall guy for the failure of United Russia in the December 2011 parliamentary elections. Then somebody like former Finance Minister Kudrin could take over as prime minister once Putin becomes president in March. Who gets the job ultimately may be immaterial to AAR, as long as modernization continues, in the form of privatization.

About the Author

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Acknowledgement

The articles in this issue of RAD are products of a Norwegian Institute of International Affairs (NUPI) research project, "Modernizing the Russian North: Politics and Practice", which is funded by the Research Council of Norway.

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ANALYSIS

State-led Modernization in Russia: The Nanotechnology Industry

By Richard Connolly, Birmingham

Abstract

Since 2007, the development of a competitive nanotechnology industry has been identified as an issue of considerable importance by the Russian government. As part of wider efforts to promote economic modernization in Russia, the government has committed significant resources to support an active industrial policy to help achieve this goal, making Russia one of the world's largest state spenders on the nanotechnology industry. However, Russia's location, far behind the global technological frontier, has hampered state efforts to ignite a wave of activity in this industry, suggesting that state efforts to create high-technology, knowledge-based industries might be inappropriate for a country at Russia's stage of economic development.

Nanotechnology and Economic Modernization in Russia

Nanotechnology is, according to the International Organisation for Standardisation's definition, 'the understanding and control of matter and processes

at the nanoscale, typically, but not exclusively, below 100 nanometers¹ in one or more dimensions where the onset of size dependent phenomena usually enables novel

¹ A nanometer is one billionth of a meter.

applications'. Nanotechnology is, along with biotechnology and emerging web technologies, classed as an 'emerging technology', i.e., a technology which has 'the potential to create a new industry or transform an existing one, to provide investment opportunities, and to change the world in terms of offering new benefits, and transforming standards of living'.²

Nanotechnology is commonly considered to offer considerable promise extending across a wide range of applications, from business opportunities in a number of industries to broader socio-economic benefits globally. Nanotechnology has the potential to change almost every type of manufacturing process and product, across industries as diverse as electronics and engineering, chemicals, health care and pharmaceuticals, pulp and paper, textiles and construction to defence, energy and water. Nanotechnology is also seen as possessing the potential to help address some of the most pressing global challenges, such as those related to energy constraints, climate change, affordable health care and global access to clean water.

Because nanotechnology has such potential across a large number of areas, all significant economic powers—from the rich OECD economies, to large low- and middle-income economies, such as China and India—have expressed a desire to become world leaders in the industry. Russia, in this respect, is no different. Since 2007, considerable public resources have been allocated to help Russia become a prominent player in the global nanotechnology industry. In Russia, however, the development of a world-class nanotechnology industry has been assigned perhaps even greater importance relative to efforts in other countries. After the formulation of a comprehensive industrial policy in 2007 to create a competitive nanotechnology industry, Russia quickly became the world's second largest public spender on nanotechnology-related activities by 2009.

Prominent politicians, including Vladimir Putin and Dmitri Medvedev, have stressed the importance of achieving the goals formulated by the government in this area. That nanotechnology has been elevated to such a level is due to the desire among important Russian policy makers to effect a wider modernization of the Russian economy. The military application of nanotechnologies, with its potential to reinvigorate the ailing microelectronics industry, is also an important factor in explaining the priority assigned to this industry by the leadership. It is, however, the desire for economic

modernization which makes the success or otherwise of industrial policy in the nanotechnology industry of crucial importance to the Russian government: representative as it is of other government initiatives to promote economic modernization, the performance of industrial policy in this area can be considered as a useful indicator of whether the present state-led development agenda is likely to prove successful.

Industrial Policy in Russia's Nanotechnology Industry

The Russian government took its first significant steps in the sphere of nanotechnology in 2004, when nanotechnology was included as an item in the Federal Targeted Programme on Science and Technology and allocated some 4 billion rubles (approximately \$130 million) for the years 2005 and 2006. Federal Targeted Programmes (FTP) are among the main instruments for implementing government policy in the long-term development of Russia's economy and society. These early efforts were soon eclipsed by the formulation of the strategy for the development of nanoindustries in April 2007. The strategy was to be realised through a series of FTPs, among which was one specifically dedicated to the development of nanotechnology and the creation of new government bodies.

The most important aspects of this strategy were the creation of a governmental supervisory council, as well as of a state corporation for nanotechnology (at the time named *Rosnanotekh*). In late December 2007, the government also approved a Programme for the Development of the Russian Nanoindustry. Significant funds were assigned to this task: over 100 billion rubles (approximately \$3.3 billion) was envisaged to fund the various elements of the strategy up to 2015. The magnitude of resources allocated was a reflection both of the importance nanotechnology had acquired in policy-making circles, and also of the poor state of Russia's nanotechnology industry at this point. In particular, the earlier FTP had identified a large gap between the need for high quality research and development and the critically low level of infrastructure development in the nanotechnology industry. While such a gap existed, the prospects for the development of a vibrant nanotechnology industry in Russia appeared bleak.

The size of the resources allocated to the 2007 strategy led to the formulation of several ambitious objectives. First, it was hoped that annual sales of Russian nanoindustry products would more than double, with an increase from around \$0.7 bn in 2008 to \$1.5 bn in 2015. Second, the Russian share of the global nanoindustry market was targeted to grow from 0.07 per cent in 2008 to 3 per cent in 2015. Finally, annual nanoindustry exports were expected to reach a level of \$6.43

2 Narayanan, V.K., and O'Conner, G., (2010) 'What are Emerging Technologies?' in Narayanan, V.K., and O'Conner, G. (eds.) *Encyclopedia of Technology and Innovation Management*, John Wiley & Sons.

bn in 2015, from a meagre level of \$0.14 bn in 2008. Considering the relatively low level of Russia's nanoindustry in 2007, these were lofty ambitions. In order to achieve these ambitions, the overall strategy comprised three main policy instruments. First, a governmental supervisory board was created, tasked with coordinating the efforts of Federal organisations. Second, a much enhanced Development Programme for Nanoindustry was formulated. Third, and arguably most notably, the Russian Nanotechnologies Corporation—known more commonly at the time as Rusnanotekh, but now as Rosnano—was created in July 2007.

The Supervisory Council for Nanoindustry Development

Overall coordination of Federal bodies and other organisations involved in the nanoindustry was initially conducted by the Supervisory Council for Nanoindustry Development, consisting of a number of ministers, heads of government agencies and services, and deputies from the State Duma and Federation Council, as well as representatives from industry. The Supervisory Council was, however, later superseded by the Government Commission on High Technology and Innovations, to which many of the members of the Supervisory Council were appointed. The Commission has a broader remit than the Supervisory Council for Nanoindustry Development, and is charged with developing other high-technology industries and not just nanotechnology. The Commission is currently chaired by Vladimir Putin, and includes individuals associated most directly with nanotechnology, such as Andrei Fursenko, the Minister of Science of Education, Mikhail Kovalchuk, the director of the Kurchatov Institute, and Anatolii Chubais, Director General (functional equivalent of CEO) of Rosnano. The prominent role assigned to Chubais—the individual with a reputation as perhaps the most effective 'modernizer' within the elite—reflects the importance of nanotechnology to the leadership.

The Development Programme for Russian Nanoindustries

The Ministry for Science and Education formulated the Development Programme for the Russian Nanoindustry to 2015, which was approved by the government in December 2007. Under the supervision of Sergei Ivanov, the overall objective of the Development Programme was nothing less than the creation of internationally competitive research and development (R&D) capacities in the sphere of nanotechnology by 2011. Achieving this objective would, if successful, lay the foundations for the commercialisation of nanotechnology

products after 2011 in order to meet the ambitious targets outlined above.

The Development Programme identified four main tasks: to create a functioning and internationally competitive infrastructure for the nanoindustry; to develop efficient mechanisms for providing competent personnel; to create an infrastructure for harmonisation and standardisation; and, finally, to develop mechanisms for the commercialisation of the scientific results of domestic R&D. All are what economists would describe as 'supply-side' measures, i.e., efforts to improve Russia's capacity to supply nanotechnology. The Programme included a number of quantitative indicators against which progress in achieving these aims could be gauged. These included targets on the quality of equipment used in the industry, the age and qualifications of researchers, and the number of research articles published in international scientific journals.

The Development Programme was allocated a total budget of over 100 billion rubles (\$3.3 billion), of which more than two-thirds was assigned to R&D. Around 30 billion rubles (\$1 billion) was intended for building a nanoindustry infrastructure, and was almost entirely channelled through the FTP for the Development of a Nanoindustry Infrastructure in the years 2008–2010 mentioned above. The size of the Development Programme budget was, and remains by international standards, extremely impressive. However, Russia has failed to meet the objective of developing an internationally competitive R&D sector for nanotechnology by 2011. This is primarily due to the shortage of human capital and the failure to build significant nanoindustry research infrastructure capacity. Both issues are likely to act as significant obstacles to the planned development of a world-leading nanotechnology industry in Russia.

Rosnano

Created in July 2007, Rosnano (originally Rusnanotekh) was one of several state corporations which were intended to spearhead the economic modernization that was envisaged in the Concept for the Long-Term Socio-Economic Development of the Russian Federation (Strategiya 2020). Rosnano was intended to act as the primary organisation in the execution of state policy in the sphere of nanotechnology more generally, and also in developing the wider nanotechnology infrastructure in conjunction with the FTP described above. Primarily, it was tasked with implementing projects designed to establish a viable long-term nanotechnology industry. As a state corporation, Rosnano was exempted from the ordinary means of control of non-commercial state organisations and was also exempted from ordinary bankruptcy laws.

The main tasks defined in its strategy to 2020 were the commercialisation of nano-industry products and the coordination of innovation activity in the nanoindustry sphere. Because private sector activity in the nanoindustry was, and still is, so limited, Rosnano's remit effectively covered the creation of an entire industry from almost nothing. To do this, Rosnano is involved in a wide range of activities. These activities include: foresight and roadmapping exercises; co-financing of scientific and engineering infrastructure programmes, as well as industrial parks, technology transfer centres, special economic zones and business incubators; the financing of R&D projects based on projects' commercialisation prospects; the development of a substantial intellectual property (IP) portfolio; supporting educational projects dedicated to training specialists required for all stages of the innovation pipeline; efforts to improve the business environment for the nanoindustry; certification and standardisation activities; the promotion of nanoduct safety standards and cooperation with international bodies; raising public—domestic and foreign—awareness of the importance of nanotechnology; and the collation of nanotechnology-related information in Russia; and through international co-operation, based on agreements and cooperative efforts to facilitate the Russian nanoindustry's presence on the international scene.

In March 2011, President Medvedev signed a decree that reorganised Rosnano so that it became a Joint Stock Company. Although 100 per cent of shares in Rosnano are currently owned by the state, a gradual privatisation is envisaged. Ostensibly, this reorganisation was intended to increase transparency. In practical terms, it means that there are now two entities that are of importance to the nanotechnology industry in Russia: Rosnano, a commercial entity tasked with focusing on business projects; and the Fund for Infrastructure and Educational Programmes, a non-commercial entity charged with coordinating: infrastructure projects and programmes; foresight and road mapping activities; standardisation, certification, and metrology; education and popularisation; and organising the Nanotechnology International Forum.

The most important instrument for achieving the tasks envisaged in the long-term strategy is the considerable sum of money allocated to the co-financing of nanoindustry projects. In late 2007, RosNano reported that the company planned to make investments totalling 217.5 billion rubles (\$7.1 billion) over the period 2008–2015, although by 2011 this was revised up to around 300 billion rubles (\$10 billion). Of this, 34 billion rubles was to come from sales revenues and 53.5 billion rubles from investments from extra-budgetary sources. Of the 130 billion rubles government investment, some 70 per

cent was dedicated to developing nanoindustry production and creating a market for nanoproducts.

The number of nanotechnology projects initiated by the summer of 2011 was still rather small. Less than a hundred applications had been granted co-financing by the Supervisory Board. Of these, most were related to nanotechnology production and around a dozen were infrastructure projects. Even though infrastructure projects are small in number, they do in fact account for a disproportionate share of allocated funds (around a quarter). This is consistent with the priority assigned by policy makers to the creation of nanoindustry infrastructure. Optoelectronics and nanoelectronics account for the largest share of financing. This reflects the fact that this is the area in which Russian companies were strongest prior to the development of state industrial policy. The fact that the largest share of financing is going to the best established sub-field in Russia should be no surprise; investment funds are likely to flow to where existing capacity is found because this is where sufficient infrastructure and human capital are already present. It is clear that, until the wider efforts to improve the supply of infrastructure and human capital begin to register a significant effect, the growth of new sub-fields is likely to be slow.

Is the Promotion of Nanotechnology in Russia Likely to Succeed?

While state efforts to develop the nanoindustry in Russia have been, at least in material terms, impressive, there remains much work to be done. There are strengths on which to build. Russia appears relatively strong in theoretical research: it ranked eighth in nanotechnology publications between 1991–2007, behind China and Korea, but ahead of Italy and Switzerland. Public spending on nanotechnology research is currently among the highest in the world. A small but dynamic private sector exists: for example, NT-MDT, which specialises in scanning probe microscopes, is ranked second in terms of sales volumes on the world market. The firm reinvests c. 15–20 per cent of revenues in R&D and has forged a number of associations with foreign companies. In terms of regional distribution, some regions are especially active, with most nanotechnology activity concentrated in Central and North West okrugs (Moscow, St Petersburg, Tomsk, Kaluga, Perm).

However, the weaknesses remain severe. Russia performs badly in the commercialisation of research, ranking 16th in world in number of patents related to nanotechnology—behind Korea and China, a meagre 0.2 per cent of the global total. The industry is overwhelmingly state dominated, with over 80 per cent of all investment in nanotech-related activities in Russia subsidised to

some degree by the state. The acceleration of state investment since 2007 means that this tendency is unlikely to be reversed. Of particular importance is the fact that nanoscience infrastructure is—compared to the EU, USA and Japan, at least—extremely underdeveloped. While this remains the case, it is difficult to see Russia making any significant strides as a major nanotechnology actor. This manifests itself in the relatively small number of R&D personnel in fields of nanotechnology and nanoscience: c. 14,500 in 2009 (3.9 per cent of all researchers) compared to c. 150,000 in the USA in 2008.

There are also a number of weaknesses in the specific mix of policies designed to stimulate activity in the nanotechnology industry.

First, it is not clear that the efforts made so far will result in a significant expansion of private sector activity in the Russian nanotechnology industry. The co-financing element of Rosnano's activity—arguably the primary feature of Russia's industrial policy—means that any company will, to some degree, experience partial state ownership. While the state share does not, in most cases, exceed 49 per cent, it is certainly true that Rosnano—a state agency—makes the key decisions on lending. Moreover, it is not clear what role the state will play in those ventures that have been co-financed by Rosnano. The company claims that after 3–5 years, the state will relinquish its share in the co-financed projects. However, it is not clear that Rosnano will be able to relinquish its stake in unsuccessful ventures. If there are no buyers, will the state be prepared to make significant losses? In short, a clear mechanism for 'letting losers go' is required if the policy is not to turn into an open-ended rent-seeking arrangement.

Second, the wider, non-Rosnano related private sector will also need to grow if current policies are to be considered successful. However, while private sector investment in nanotechnology surpasses government financing in most other countries, the opposite is true in Russia. This resulted in a less privileged position for Russia when its total funding for nanotechnology development was compared with that of other countries. In 2010, there were few private investors in Russia, and foreign capital had shown little interest in high-tech industries such as nanotechnology, presumably due to the poor climate for long-term investment. Investors from developed countries are able to bring important capital to Russia, as well as ideas about corporate management, governance, and reporting and accounting standards—not to mention the fact that joint ventures are perhaps the most effective way of achieving technology transfer. While foreign activity remains subdued, the prospects for private sector development in nanotechnology appear especially bleak.

Third, there is only a muted demand for nanotechnology products in the Russian economy. This low demand is generally correlated with wider high-technology production levels. In Russia, high-tech products account for a small proportion of production and exports, so it should be no surprise that demand for nanotechnology products is correspondingly low. Without significant levels of sustained demand for these products, it is highly unlikely that supply—in the form of production facilities that allow high volume serial production of quality micro-components—will expand. If this continues to be the case the ambitious targets outlined in the 2007 strategy are unlikely to be achieved.

Implications for Economic Modernization

A wider issue—and perhaps the most important one—is whether the sort of industrial policy typified by efforts in the field of nanotechnology is really appropriate for a country like Russia. Russia's level of per capita income relative to the USA and the EU shows that Russia is located some way behind the global 'technological frontier'. Put simply, there are two routes to increasing productivity growth in an economy (economic modernization, in other words). The first is through innovation; the second is through imitation. The choice of which broad strategy is adopted should largely be a function of a country's position in relation to the technological frontier.

Broadly speaking, if a country is, like Russia, located some way behind the frontier, its mix of policies to promote economic modernization should include efforts to upgrade technologically through cooperation with foreign companies (through inward foreign direct investment [FDI], for example) and the import of embodied technology. The effective acquisition, absorption and diffusion of foreign technology require policies designed to enhance the absorptive capacity of an economy. Public policy should, for example, focus on attracting FDI and then embedding these actors within Russia's domestic economy by integrating FDI and stimulating multiple linkages between foreign and domestic firms. This type of process would be a slower and less grandiose path to modernization; it would also be much more likely to achieve significant results.

However, Russian state policies appear intent on building industries that, like nanotechnology, are by and large close to, or at, the technological frontier. Success in these industries requires the institutional conditions which will permit innovative development. Such conditions include: flexible labour markets, nimble financial systems, high levels of competition, and a high quality of tertiary education, and a well-functioning public administration. On all dimensions, Russia does not score highly in any of the seemingly ubiquitous inter-

national rankings compiled by the likes of the World Economic Forum and the World Bank. With this in mind, Russian efforts appear almost entirely inappropriate for the task in hand.

Ultimately, then, despite the promise of significant resources being allocated to the likes of energy efficient technology, nuclear technology, space technology and communication, pharmaceuticals, and strategic infor-

mation technology, the fact that Russian industrial policies are not appropriate for the domestic context means that modernization Putin-style is quite unlikely to result in anything other than, at best, the development of small 'enclaves' of innovation, weakly linked to the wider Russian economy, and too small to generate wide-scale economic modernization.

About the Author

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Acknowledgement

The articles in this issue of RAD are products of a Norwegian Institute of International Affairs (NUPI) research project "Modernizing the Russian North: Politics and Practice", which is funded by the Research Council of Norway.

ANALYSIS

Raiding in Russia

By Richard Sakwa, Kent

Abstract

Raiding has become one of the characteristic features of Russia in the twenty-first century. Raiders rely on their positions of authority and typically act with government approval, and often in concert with governmental authorities, to exert an improper influence on the prosecution process, in particular with the courts and the police. Applying the model of the dual state, this article notes the salience of instances of 'reiderstvo' from Yukos to Hermitage Capital. The political orders associated with the constitutional and prerogative states are locked in a stalemate. Meta-corruption operates in an economy of rents and political factionalism and is beginning to create a distinct order of its own. The entwining of political and criminal activities damages government, the courts and the investment climate and impedes modernisation.

Two political orders are locked in a stalemate in contemporary Russia: the constitutional state based on the rule of law and institutionalised processes, and the prerogative state operating outside of the constitutional constraints to which it is formally committed. This 'prerogative state', or as we call it, the administrative regime (*Verwaltungsstaat*), represents a distinctive case of 'domain democracy', where the rules applied to the rest of society do not apply to itself. The tension between these two principles of governance characterises Russian politics. Each of the two orders has its own logic and supporters, but the systemic paralysis provoked by the tension between these two pillars generates legal nihilism and opportunistic rent-seeking by officials, law-enforcement agents and economic actors and has allowed the consolidation of a third force.

Meta-corruption

Raiding (known as *reiderstvo* in Russian) has become not only an economic phenomenon, but also something permeating social life. The term is used to describe all sorts of attacks by one agency against another. For example, when in September 2011 Father Vsevolod Chaplin, the head of the public relations department of the Moscow patriarchate, called for women to observe a modest 'dress code', this provoked a furious reaction and a court case against a journalist who condemned the church's intervention in daily life. The journalist, Boris Obratsov, was accused of 'extremism', applying Article 282 of the Russian Criminal Code which provides a wide range of reasons to prosecute dissent, and the whole episode was called 'raiders in cassocks'.¹

1 Aleksandr Kukolevskii, "Reideram v ryasakh" naznachili tsenu', *Kommersant-Vlast*, No. 38, 26 September 2011.

Raiders and their activities are typically directed from the highest level of society and are endemic in the political fabric. The attack on the Yukos oil company from 2003 onwards can be interpreted as a spectacular case of *reiderstvo*. The defining feature was the instrumental use of the courts and the tax system to achieve political goals. The Yukos affair amply demonstrated the ability of the regime to apply 'telephone law'; that is, to influence judicial outcomes desired by the regime.² It was a classic case of a 'prosecution to order' (*zakazannoe delo*) accompanied by the malpractices that became known as 'Basmanny justice'.³

There are numerous other cases that can be considered examples of raiding, notably the attack on Togliattiazot (Toaz) and against Yevgenii Chichvarkin, the head of the mobile phone and electronics company, Evroset. The tensions between the two pillars of the dual state are also revealed in the Volgotanker, Russneft, TNK-BP, and Hermitage Capital (which will be discussed below) cases, to list just a few. This is far more than the venal corruption which is so much commented on as the defining feature of contemporary Russia, but what we can call meta-corruption: the systemic corruption of the constitutional order by the administrative regime and its agents. The entwining of political and criminal activities degrades government, in particular the law enforcement agencies, and undermines the autonomy of the courts and popular trust in them. Corporate raids of this sort, moreover, damage Russia's reputation and undermine its investment climate.

'Raiding' entails the hostile attack of one corporate entity against another, often accompanied by physical 'raids' by armed state organs. A report on the subject by the Centre for Political Technologies (CPT) defines raiding as:

'The illegal ... seizure of property ... The winning of control in the widest sense by one company over another by using both illegal and legal methods; the seizure of shares by provoking business conflicts; ... a way of redistributing property, which in essence is banditry, but which formally conforms to some sort of judicial procedure'.⁴

In contemporary Russia, raiding is categorised by various colours: 'black raiding' relies primarily on illegal methods; 'grey raiding' uses a combination of semi-legal

and illegal means; while 'white raiding' relies on semi-legal actions alone.⁵ In launching the CPT report, Alexei Makarkin, the vice president of CPT, categorised the raid on Toaz as 'one of the most glaring examples of a corporate raid in modern times, alongside Yukos, Arbat-Prestige, Eldorado and East Line'.⁶ In raids of whatever colour, criminal proceedings are used to force a business competitor to relinquish their stake to the raider, usually at a considerable discount or for no value at all. State agencies and officials are often complicit in such corporate raids.

The ability of corporate raiders to conduct hostile illegal takeovers, via the abuse of office by law-enforcement officials and the abuse of courts, is described in vivid language by another report on the phenomenon:

'A new danger is stalking Russian business, and spreading quickly to the regions. A new powerful force has arisen, for which the first priority is just to get rich, never mind how; the worst thing is the consequences which ensue after it is used in artificially provoked corporate conflicts. It is like a plague of locusts, leaving behind it nothing but naked fields and the remains of a harvest completely destroyed. The lack of preventive measures like laws or other barriers has created a very beneficial environment for this evil to flourish. Small and medium business might be completely destroyed, and taken under the control of raiders'.

In a climate in which the court system, the forces of law and order, and the supervisory authorities collude with the raiders, 'there is no possibility of combating illegal captures effectively'.⁷ The former mayor of Moscow, Yuri Luzhkov, called raiding a form of 'economic terrorism'. Raids in Russia are not comparable to mergers and acquisitions activity in the West, which can help economic efficiency and enhance market capitalisation, because in Russia raiders typically 'are normally not interested in the production process'.⁸

Hermitage Capital Case

The Hermitage Capital case has joined with the Yukos affair to become symbolic of the rise of what has become the third pillar of the Russian state, a criminal-administrative-business (CAB) network that has been forged in the crucible of *reiderstvo*. For a decade after having established its presence in Russia in 1996, Hermitage Capital Management, associated with HSBC, was the largest foreign investor in the Russian stock market. In

2 Alena Ledeneva, 'Telephone Justice in Russia', *Post-Soviet Affairs*, Vol. 24, No. 4, October–December 2008, pp. 324–50.

3 *Basmannoe pravosudie: Uroki samooborony: Posobie dlya advokatov* (Moscow, Publichnaya reputatsiya, 2003); www.ip-centre.ru/books/Basmannoe.pdf.

4 Centre of Political Technologies, *Reiderstvo kak sotsial'no-ekonomicheskii i politicheskii fenomenon sovremennoi Rossii: Otchet o kachestvennom sotsiologicheskom issledovanii* (Moscow, Tsentri politicheskikh tekhnologii, May 2008).

5 *Ibid.*, p. 13. The various colours are defined at pp. 13–14.

6 Mikhail Mkrtychyan, 'Ne na tekhn napali', *Samarskie izvestiye*, 21 May 2008.

7 A. V. Kitz and V. V. Zhagornikov, 'Administrative and Court Resources as a Weapon in the hands of the Raiders', *The Jurist*, No. 10, 24 October 2005, pp. 45–48, at p. 45.

8 Yuri Alexeyev, 'Raiders on the Attack', *Financial Control*, No. 11, 16 November 2005, pp. 64–71, at p. 64.

November 2005 it came under sustained attack, taking the classical form of a corporate raid, and in the end had to fight false bankruptcy proceedings. Its founder, Bill Browder, has further been classified a threat to national security and denied entry to Russia. The basic strategy of the hedge fund was clear—to improve corporate governance and thus to achieve added value for stockholders. Browder and Hermitage Capital publicly exposed the corruption in some of Russia's largest state-owned companies, and thus challenged the interests of highly-placed officials in government. The exposure of fraud and corruption clearly antagonised powerful sections of the Russian elite. The resources of the state, including the Ministry for Internal Affairs (MVD), the Federal Security Service (FSB), the General Prosecutor's Office (GPO) and the arbitration and civil courts have harassed and intimidated Browder and his associates. It is clear that the affair is an egregious case of the spillover of factional conflict into the business and legal arena.

Lawyers acting on Hermitage's behalf have been intimidated and targeted by police for searches and questioning as witnesses, in violation of lawyer-client privilege (a tactic also used in the Yukos affair). On 20 August 2008, the Moscow offices of all three law firms representing Hermitage (none of which were associated with each other) were raided by police, in particular those of the Moscow-based American legal services and auditing firm Firestone Duncan, in which the lawyer Sergei Magnitsky was a partner, and those of independent lawyers Eduard Khairtdinov, Vladimir Pastukhov and Vadim Gorfel. Documents granting the lawyers powers of attorney to represent Hermitage Capital in the courts were seized, thus impeding their ability to represent their clients, who were scheduled to appear in court that week. At the end of August, they were called to Kazan to act as witnesses in the case, against Article 8 of the Russian Law on Lawyers, which prohibits the questioning of lawyers concerning cases in which they are involved.

Khairtdinov, a former judge and lawyer in private practice in Moscow, filed more than thirty complaints on Hermitage's behalf questioning the actions of the government and law enforcement officials, and subsequently faced apparently retaliatory criminal proceedings. A criminal case was opened against Khairtdinov at the end of November 2008, for allegedly using an invalid power of attorney, and on 2 April 2009 a criminal case on the same grounds was opened against Pastukhov. The precarious balance in Russia's power order now looked lost. The system appeared to be out of control as both the constitutional state and the administrative regime were left helpless, and this particular CAB appeared to get away, literally, with murder. The Her-

mitage Capital affair demonstrated the ability of rogue elements to play the system with impunity.

The Hermitage case is an example of the fraudulent appropriation of private property. The case involved the fraudulent transfer of three Hermitage companies (Mahaon, Parfenion and Rilend) and a subsequent tax fraud using these companies. Browder and Hermitage Capital protested vociferously to the Russian authorities, and it appears that in response 'a number of spurious retaliatory criminal cases have been lodged against Browder, his colleagues, and four lawyers from four separate law firms'.⁹ It was precisely the discovery of the fraudulent transfer of ownership of these three companies and subsequent tax fraud that Magnitsky discovered and exposed. In 2008 he gave three witness statements to the Russian authorities in which he stated that the frauds could not have been committed without the use of documents confiscated by MVD officials from Hermitage's offices during the various raids. He highlighted the role of a certain MVD Lt-Col Artem Kuznetsov in their seizure. The last of these statements was delivered on 7 October 2008.

On 24 November 2008 Magnitsky, who had helped Hermitage Capital expose abuse of office and fraud, was arrested by three of Kuznetsov's subordinates and placed in pre-trial detention. Bail was refused by a criminal court. On the same day his law office at Firestone Duncan was searched by police, and in contravention of Russian procedural law, the firm's lawyers were not allowed to be present. His detention was extended on a number of occasions, even though in the first four months he was not questioned on a single occasion.

Magnitsky was kept in poor conditions in the Butyrka prison, where he compiled a 40-page dossier of abuses. On 11 September 2009 he sent a petition to Oleg Silchenko of the MVD's investigative committee, protesting about the lack of evidence in his case and the conditions of his detention:

'[T]he investigators arranged for physical and psychological pressure to be exerted upon me in order to suppress my will and to force me to make accusations against myself and other persons. In particular, the investigators repeatedly proposed that I testify against William Browder in exchange for a sentence to be suspended during the trial and freedom. Every time, when I repeatedly rejected these propositions by the investigators pushing me to be dishonest, the conditions of my detention became worse and worse'.¹⁰

9 American Helsinki Association, 30 December 2009.

10 'English Translation of Complaint by Sergey Magnitsky to General-Prosecutor Yury Chaika', available from <http://www.scribd.com/doc/22654312/Sergey-Magnitsky-Complaint-to-General-Prosecutor>.

On 16 November 2009, aged only 37, he died after having been transferred to the Matrosskaya Tishina jail hospital (the Butyrka does not have a hospital). He had been diagnosed as suffering from pancreatitis and gall-bladder inflammation, but had been deprived of adequate medical attention and died of pancreatic necrosis, caused by acute toxicological shock. Even here his suffering did not end, since the death certificate stated that he died from acute cardiovascular failure no autopsy was allowed.¹¹ It also subsequently came to light that he had probably been severely beaten in his final hours.

A report on Magnitsky's death published on 29 December by the Moscow Public Oversight Commission, an agency responsible for monitoring prison conditions, made a series of hard-hitting comments. It found that 'psychological and physical pressure was exerted upon [Magnitsky]'.¹² A report on the Hermitage Capital case noted the parallels with the Yukos affair: 'Lawyers acting for the oil giant frequently complained of intimidation, including searches of their offices and confiscation of sensitive documents. Since then, Russian prosecutors have attempted to disbar 14 lawyers who represented Yukos defendants'. The report quotes Jamison R. Firestone, the managing partner of Firestone Duncan: 'It is now impossible in Russia to defend a client who is in a politically motivated case or in a [commercial] case where the other side has a lot of money and is willing to play dirty. At worst, you will end up in prison, in exile, or dead'.¹³ Ella Pamfilova, a former deputy of the State Duma and chair between 2004 and 2010 of the Presidential Council on Civil Society Institutions and Human Rights, noted that dying in prison had become an occupational hazard of being a businessperson in Russia. This was confirmed by the death of Vera Trifonova, a Russian businesswoman in pre-trial detention facing charges of fraud, on 30 April 2010, just six months after the death of Magnitsky. She too was denied appropriate medical care at the Matrosskaya Tishina detention facility (SIZO).

Despite Medvedev's promise to launch an investigation into Magnitsky's death, most of those apparently responsible for his death remained at liberty. The list now extends to some 60 individuals. Rather than being prosecuted, many were instead given awards for exemplary work. In October 2010 Silchenko, for example, was promoted to lieutenant colonel. There was pres-

sure in the European Parliament and the US Congress for them to be banned from foreign travel.¹⁴ US Senator Cardin and a US Representative introduced Bills on 29 September 2010 designed to freeze the assets and block the visas of those responsible for Magnitsky's death. On 23 November 2010, the Foreign Affairs Committee of the European Parliament approved, by a vote of 50–0, a call for EU-wide visa sanctions and asset freezes for those responsible for his death. A resolution to that effect was passed by the European Parliament on 16 December 2010.

Does Duality Still Exist?

The Hermitage Capital case reveals both sides of the dual state. Civil society defenders of the constitutional state prepared reports and condemned the actions of the perpetrators. Even the Presidential Council, mentioned above, investigated Magnitsky's death and detailed the abuses to which he had been subjected and named those responsible. The abuses were indeed defined as malpractices by the Russian public sphere, and ultimately remained susceptible to remedy. However imperfect the 1993 constitution may be, it provides the framework for the development of a pluralistic political society and open public sphere, and as long as the system remains dual, there remains a dynamic of renewal. During the Putin presidency (2000–2008), especially in the early years, considerable effort was devoted to strengthening the judiciary as an institution and the legal system as a whole. Measures included the adoption of a new Criminal Procedural Code, shifting the power of detention from prosecutors to the courts, significant wage rises for judges to insulate them from the pressure of bribes, an increase in the number of judges by a quarter, and an extensive programme of court building and refurbishment.

The Russian government, and in particular the presidency under Dmitry Medvedev from 2008, recognised the harm that *reiderstvo* inflicts on the country and its international standing. Its ability to remedy the situation, however, was caught in the broader contradictions of the Russian polity. The dual state model helps provide a framework to analyse the struggle between Medvedev's reform initiatives, conducted under the banner of modernisation and the struggle against legal nihilism, and entrenched interests, whose most powerful manifestation is the phenomenon of raiding. The main legislative innovations of the Medvedev era include reform of the police (MVD), limitations on the use of incar-

11 Philip Aldrick, 'Russia Refuses an Autopsy', *Daily Telegraph*, 20 November 2009, p. B3.

12 Report of the Public Oversight Commission for Human Rights Observance in Moscow Detention Centers, *Review of the Conditions of the Detention of Sergei Magnitsky in the Pre-Trial Detention Centers of the City of Moscow*, Mimeo.

13 Jason Bush, 'Russia's Lawyers Under Attack', *Business Week*, 29 January 2009.

14 'Cardin Urges Visa Ban for Russian Officials Connected to Anti-Corruption Lawyer's Death', *Helsinki Commission News*, 26 April 2010; www.csce.gov, 26 April 2010. [Media, vol. 1, item 16; see also Media, vol. 2, item 73]

ceration for economic crimes, anti-corruption laws, and attempts to defend the independence of the judiciary.

Medvedev's programme of controlled reform and modernisation sought to bridge the two pillars of the dual state in an evolutionary manner. The achievements, however, were minor, while the failings became increasingly obvious. His reforms were undoubtedly ambivalent, but the results were not entirely nugatory. The tension between the two systems endures, but the phenomenon of raiding demonstrated that a third force has emerged.

Conclusion

Putin's years in power saw the consolidation of a type of selective corporate state, with a consistent policy of incorporation of active social actors and the creation of para-constitutional bodies that subverted the work of the formal constitutional organs designed to do the work of representation and interest articulation. The result was a drastic decline in political pluralism and general competitiveness in the political system. Medvedev did not

repudiate the entrenched elements of corporatism, but sought to relax its parameters and to extend its scope to encompass some of the excluded. In that sense, he was very much a moderniser rather than a liberal. He sought to improve the operation of public institutions, and thus to strengthen the constitutional state. Taken individually, his measures were unable to change the system; but their cumulative impact suggested a movement away from corporatist inclusion towards a more pluralist social order. We now know that Medvedev's gradual decompression was not enough to strengthen the constitutional state to the point that it could challenge the administrative regime to create a more balanced and inclusive social and political order. Worse than that, the continued phenomenon of raiding demonstrated the consolidation of a third pillar and yet another source of attack on the constitutional state—the various criminal-administrative-business groups. The system remains locked in a stalemate whose outcome is unclear.

About the Author

Richard Sakwa is Professor of Russian and European Politics at the University of Kent and an Associate Fellow of the Russia and Eurasia Programme at the Royal Institute of International Affairs, Chatham House.

Acknowledgement

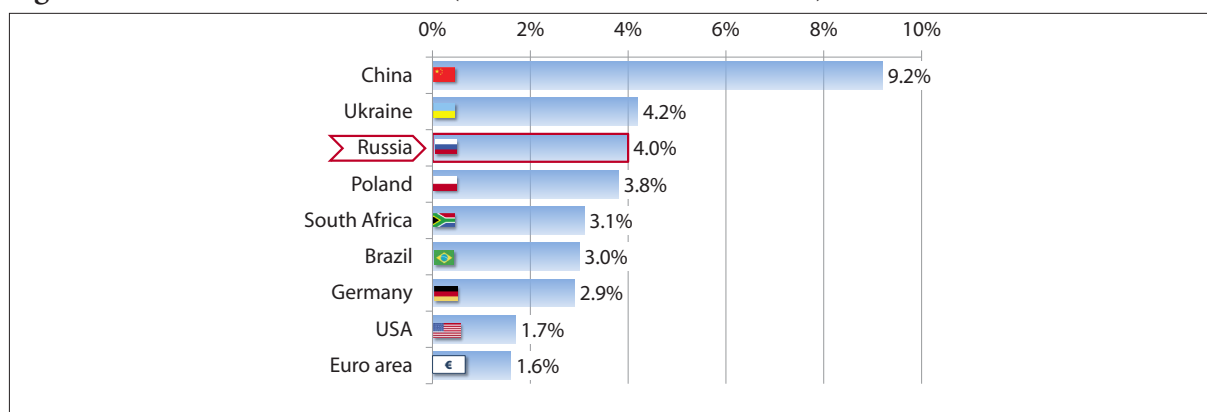
The author gratefully acknowledges the support of the Norwegian Institute of International Affairs (NUPI) project 'Modernizing the Russian North: Politics and Practice', 2011–2013, funded by the Norwegian Research Council (project number 209365/H30).

Further Reading

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- Frye, Timothy, *Building States and Markets after Communism: The Perils of Polarized Democracy* (Cambridge, Cambridge University Press, 2010).

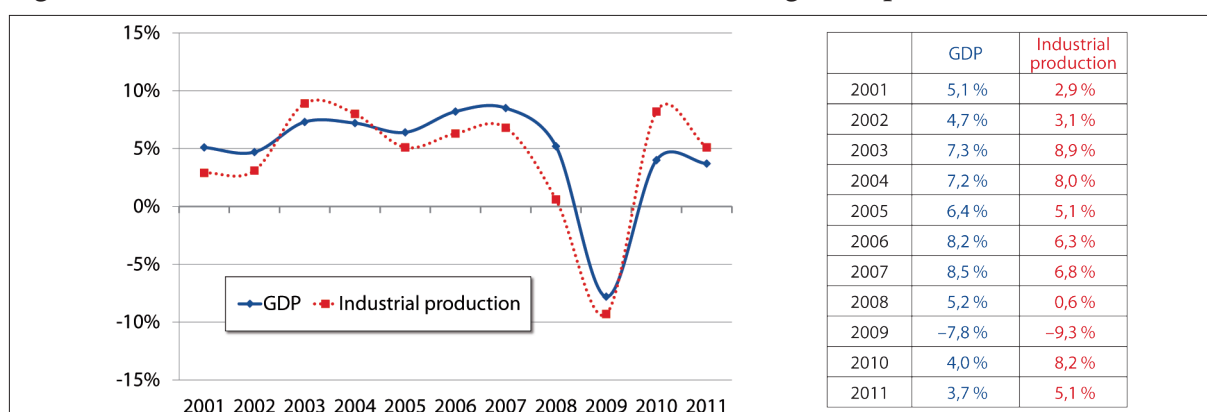
Current Economic and Financial Indicators

Figure 1: GDP Forecasts for 2011 (% Increase on Previous Year)



Source: *The Economist*, <http://www.economist.com/markets/indicators/>

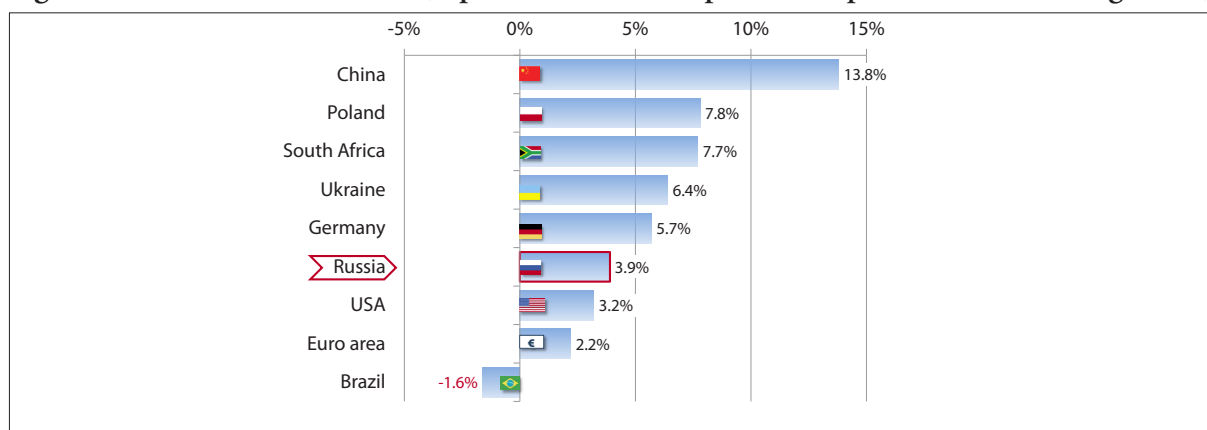
Figure 2: GDP And Industrial Production 2001–2010 (Change Compared to Previous Year, %)



NB.: The GDP figures for 2011 cover the period from January to June and the figures for industrial production the period from January to October.

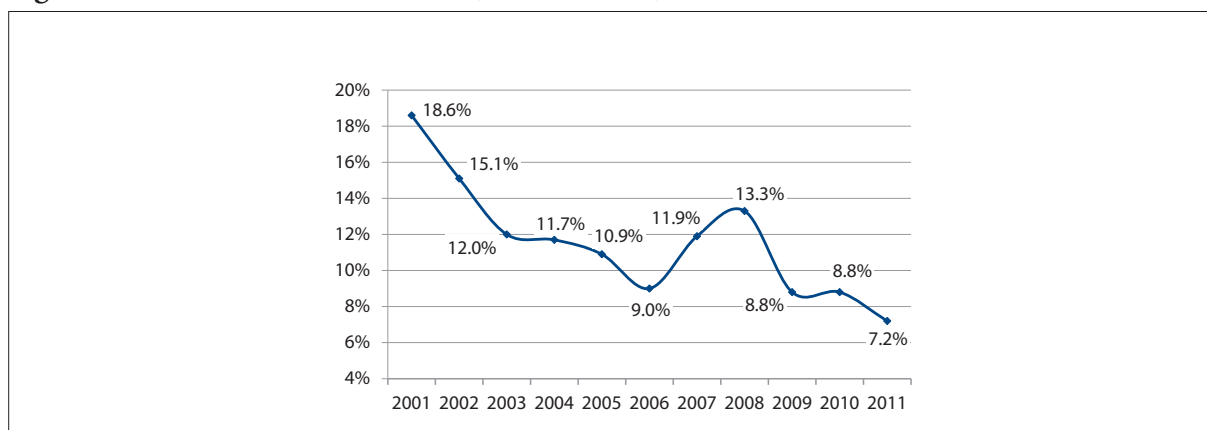
Source: Bank of Finland Institute for Economies in Transition, BOFIT Russia Statistics, http://www.boffi/bofit_en/seuranta/venajatilastot/

Figure 3: Industrial Production (September 2011 Compared to September 2010, Change in %)



Source: *The Economist*, <http://www.economist.com/markets/indicators/>

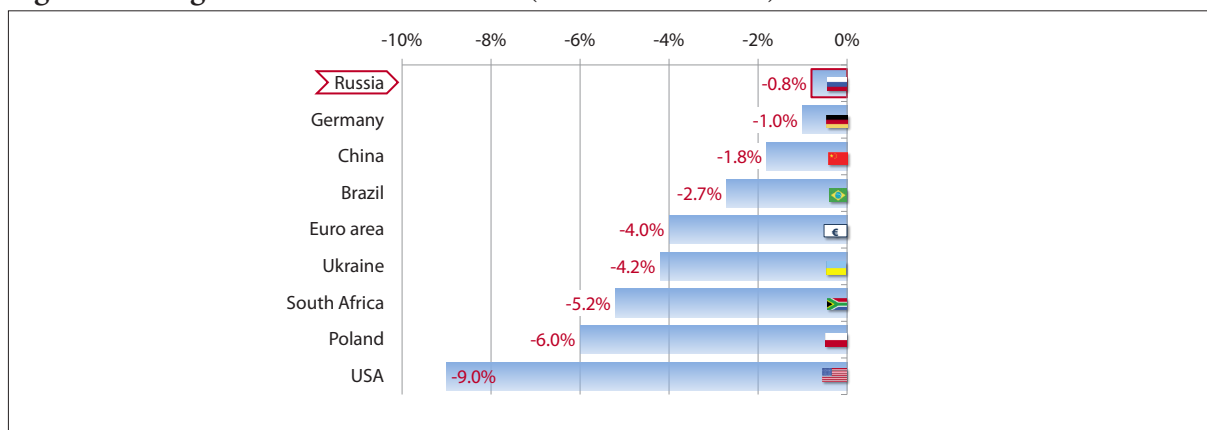
Figure 4: Inflation Rate 2001–2011 (End of Period)



NB: The figure for 2011 is as of October.

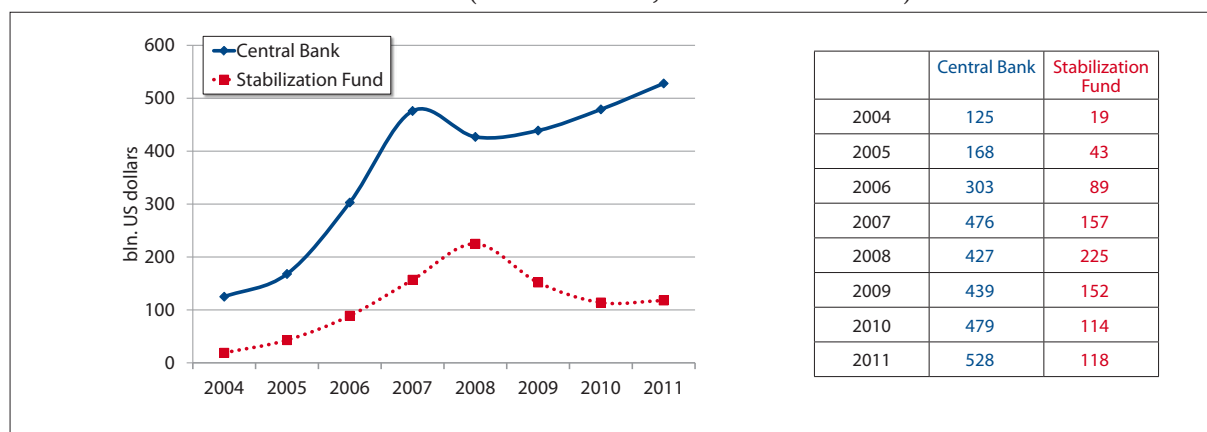
Source: Bank of Finland Institute for Economies in Transition, BOFIT Russia Statistics, http://www.bofi.fi/bofit_en/seuranta/venajatilastot/

Figure 5: Budget Balance As % of GDP (Estimate For 2011)



Source: *The Economist*, <http://www.economist.com/markets/indicators/>

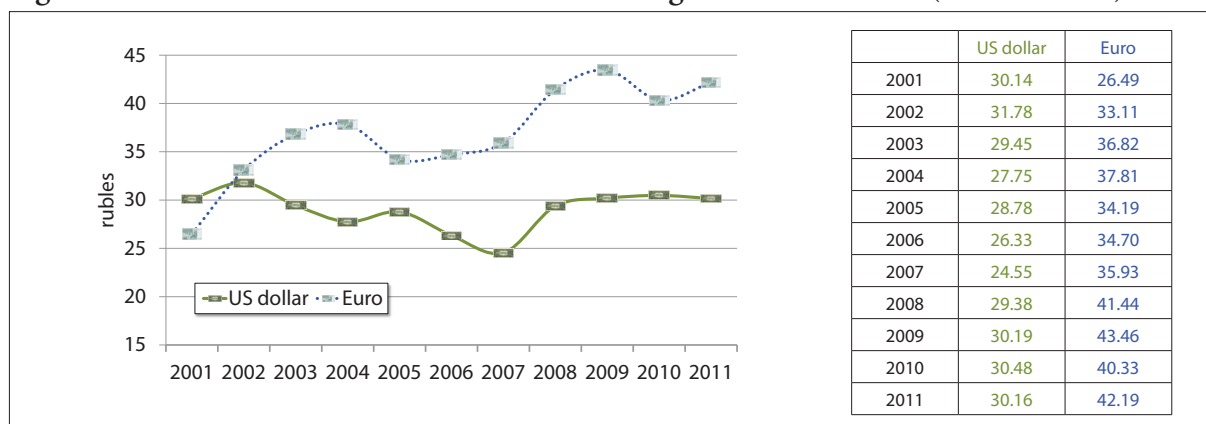
Figure 6: Foreign Currency Reserves of the Russian Central Bank and Assets of the State Stabilization Fund 2004–2011 (End of Period, in Bln. US Dollars)



NB: Figures for 2011 are as of October; the Stabilization Fund was split in 2008 into Reserve Fund and National Wealth Fund; the foreign currency reserves of the Central Bank include the gold reserves.

Source: Bank of Finland Institute for Economies in Transition, BOFIT Russia Statistics, http://www.bofi.fi/bofit_en/seuranta/venajatilastot/

Figure 7: Ruble/US Dollar and Ruble/Euro Exchange Rates 2001–2011 (End of Period)

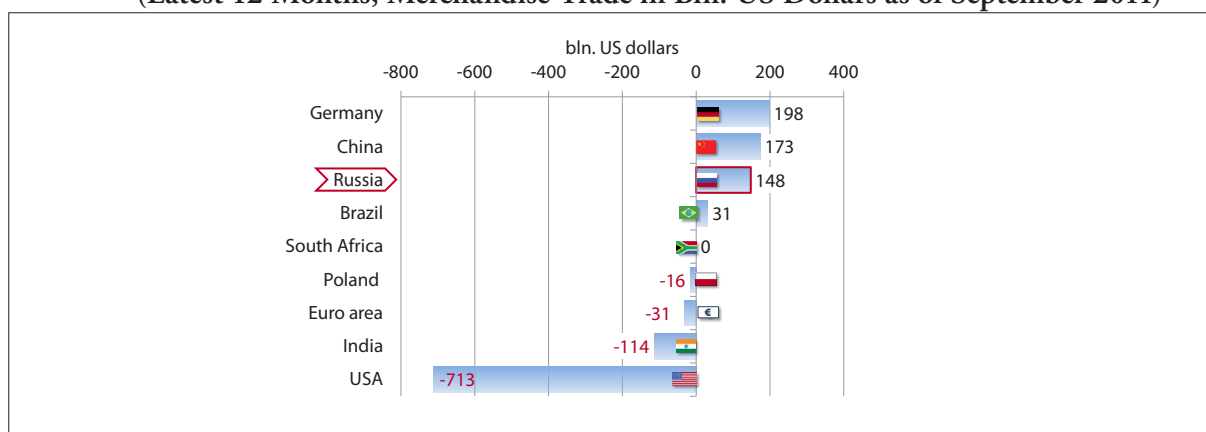


NB: Figures for 2011 are as of October

Source: Bank of Finland Institute for Economies in Transition, BOFIT Russia Statistics, http://www.boffi/bofit_en/seuranta/venajatilastot/

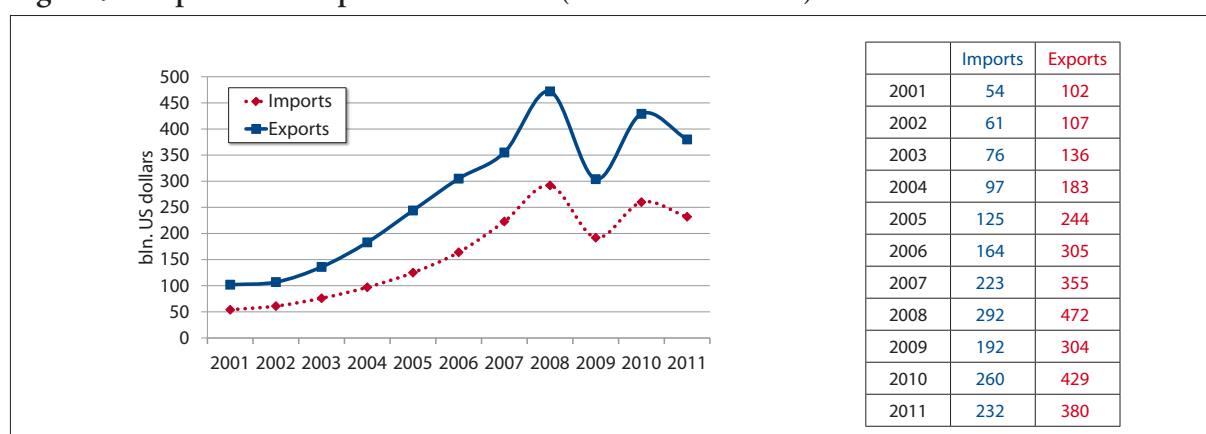
Figure 8: Trade Balance

(Latest 12 Months, Merchandise Trade in Bln. US Dollars as of September 2011)



Source: *The Economist*, <http://www.economist.com/markets/indicators/>

Figure 9: Imports and Exports 2001–2011 (in Bln. US Dollars)



NB: Value for 2011: estimate based on the figures for January to September.

Source: Bank of Finland Institute for Economies in Transition, BOFIT Russia Statistics, http://www.boffi/bofit_en/seuranta/venajatilastot/

ABOUT THE RUSSIAN ANALYTICAL DIGEST

Editors: Stephen Aris, Matthias Neumann, Robert Orttung, Jeronim Perović, Heiko Pleines, Hans-Henning Schröder, Aglaya Snetkov

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Editors: Stephen Aris, Matthias Neumann, Robert Orttung, Jeronim Perović, Heiko Pleines, Hans-Henning Schröder, Aglaya Snetkov

Layout: Cengiz Kibaroglu, Matthias Neumann, Michael Clemens

ISSN 1863-0421 © 2011 by Forschungsstelle Osteuropa, Bremen and Center for Security Studies, Zürich

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