

NEW CABINET, SAME POLICIES?

BENEATH THE SURFACE, CAUGHT IN AN OIL TRAP

→ **Felix Goryunov**
SPECIAL TO RBTH



Russia's recent government reshuffle can be seen as proof that President Vladimir Putin intends to fulfill his pre-election promises of radical improvements in economic performance, monitoring and governance. The firing of a few unpopular ministers was definitely meant to show that the Kremlin is bent on changing how the country's economy is run. However, the appointment of these former ministers to powerful positions in the presidential administration raises doubts as to whether the reshuffle will seriously affect government policies.

The penchant of the president and his cronies for micromanaging even microeconomic problems hasn't changed, and so the new cabinet is hardly likely to be any more influential than the old one — especially as many former ministers have retained their personal connections in the real economy. During the presidential election campaign, Putin voiced very grandiose but hardly realistic plans to make the economy more advanced and efficient. For example, he promised to increase the share of fixed investment in Russia's G.D.P. from 19.7 percent in 2011 to 27 percent in 2018; to raise labor productivity by 150 percent and to upgrade the country's position in the World Bank's Doing Business rankings from 120th place to 20th. The list of similarly unachievable goals is so long and ambitious that many reasonable Russian economists compare them with China's Great Leap Forward.

After three years of slow struggling out of recession, the Russian economy has basically repeated the 2008 indicators of performance, and with developed countries in or near a depression, Russia again looks like "an island of stability," as the Kremlin claimed four years ago. With 4.3 percent growth in 2011, Russia was the world's third-best performer, after China and India. The major driver of this growth, however, is the price of crude oil.

The Kremlin may rejoice that Russia has overcome the recession, but the economy can hardly benefit much from the recovery so far as the quality of its business activity is concerned. The Russian economy did not use the recession to undergo a much-needed process of creative destruction, in which the old ways of doing business are destroyed and replaced by new and more

productive ones. Not following this conventional mode of capitalist economic cycles indicates that deep down, there is something wrong with the Russian economic system.

Russia's stubborn dependence on the export of raw materials is not just a curse of natural wealth; this dependence has been Russia's systemic vulnerability. Since its birth in early 1990s, the development of Russian capitalism has been driven by external

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rather than domestic demand. The privatization of public assets in the mid-1990s was meant to make the economy more efficient, but the private businesses and banks that bought state-owned companies were interested only in commodities tradeable on the world market.

The strategy did not change in the new century since the economy continued to benefit from it. Exports of oil, gas, timber, steel

and other low value-added goods now account for 25 percent of G.D.P. and generate half of the federal budget revenues. As long as this remains the case, the promises of President Putin to renovate the economy can only be regarded as a political bluff.

The president has named the petrochemical, automobile, shipbuilding and aerospace industries as potential economic drivers eligible to receive financial support and trade protection. The improvement of agriculture and infrastructure are also priorities for the government. Can the economy sustain these plans? Russian economists have estimated that realizing all Putin's targets will require the country's growth rates in the coming years to be well over 5 percent. So the question is: How can this goal be reached when the forecasted 2012 G.D.P. growth rate will be 3.5 percent and the 2013 rate will depend solely on highly volatile world oil prices?

This systemic vulnerability of the Russian economy proceeds from the fact that no matter how vigorously Putin and his men proclaim their desire for change, they are personally committed to the existing order of things. And this order is often determined not inside the Kremlin walls, but in the boardrooms of Kremlin-friendly oligarch-owned companies.

/// *Felix Goryunov is a Moscow-based journalist who has been covering the global economy and international trade issues for more than 30 years.*

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TO ENCOURAGE BUSINESS, IT'S ONE STEP AT A TIME

→ **Alexei Kvasov**
VEDOMOSTI.RU

Vladimir Putin has declared the main economic goal for his latest presidential term: for Russia to rise 100 places in the World Bank's Ease of Doing Business rankings, from 120th to 20th.

Almost 10 years have passed since the International Finance Corporation launched the Doing Business report, and finally the Russian government has decided to take its assessments seriously. Both the creator of the report, current Bulgarian Minister of Finance Simeon Djankov, and the World Bank, which strongly supports it, believe the report has already largely achieved its goals of highlighting red tape and promoting reform. Russia has been very slow to address these issues, but now the country is preparing to head off in the right direction and, moreover, very quickly.

Is it realistic for the country to move up 100 places in the ranking in such a short time?

When speaking about Russia, it is important to keep in mind several facts. First, when the 2007 report (representing data from

2005–2006) was released containing the first consolidated rankings, Russia appeared in the 96th place, so it isn't unreasonable to think Russia could return to the top 100.

Additionally, in certain areas, Russia's position is already now significantly higher than its general 120th place ranking. In terms of the effectiveness of procedures related to financial insolvency, Russia holds the 60th place; in terms of property registration, it

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occupies 45th place; and in fulfillment of contracts, the plan has generally been overfulfilled, and Russia has risen to 13th in the world.

Then, there are large regional variations in the favorability of business conditions in Russia. In 2009, the World Bank tried to assess the regulation of entrepreneurship in 10 Russian cities across four indicators: company creation, receipt of construction

permits, property registration and foreign trade operations. In that year, Russia, which was represented by Moscow, came in the 120th out of 181 in the general rating, just like today. Moscow received the distinction of being the most difficult place in the world in which to obtain construction permits.

If Russia were not represented by Moscow, the picture would have looked better: In all nine other cities, approval procedures were better than in the capital. In Moscow, the collection of all documents for construction on average takes 704 days, but in Rostov-on-Don, it takes 194, which is closer to the average of 162 days for countries in the Organization for Economic Cooperation and Development (O.E.C.D.).

In Moscow, the number of necessary procedures and approvals for starting construction is the largest in the world at 54; Perm, Kazan, and Rostov require 24, 23 and 22, respectively. Among O.E.C.D. countries, the average is 15 such required procedures and approvals. It turns out that it is no more difficult for an entrepreneur to build in Rostov-on-Don than in Portugal.

Should Russia spend time and effort to increase its ranking? For all its shortcomings, the rating is a useful tool for improving the effectiveness of state regulation. The main thing the government needs to keep in mind is that this goal should be pursued systematically on all fronts rather than through half-measures in one area at a time. A rating can be greatly improved once, but it is only possible to stay on top through sequential, continuous efforts.

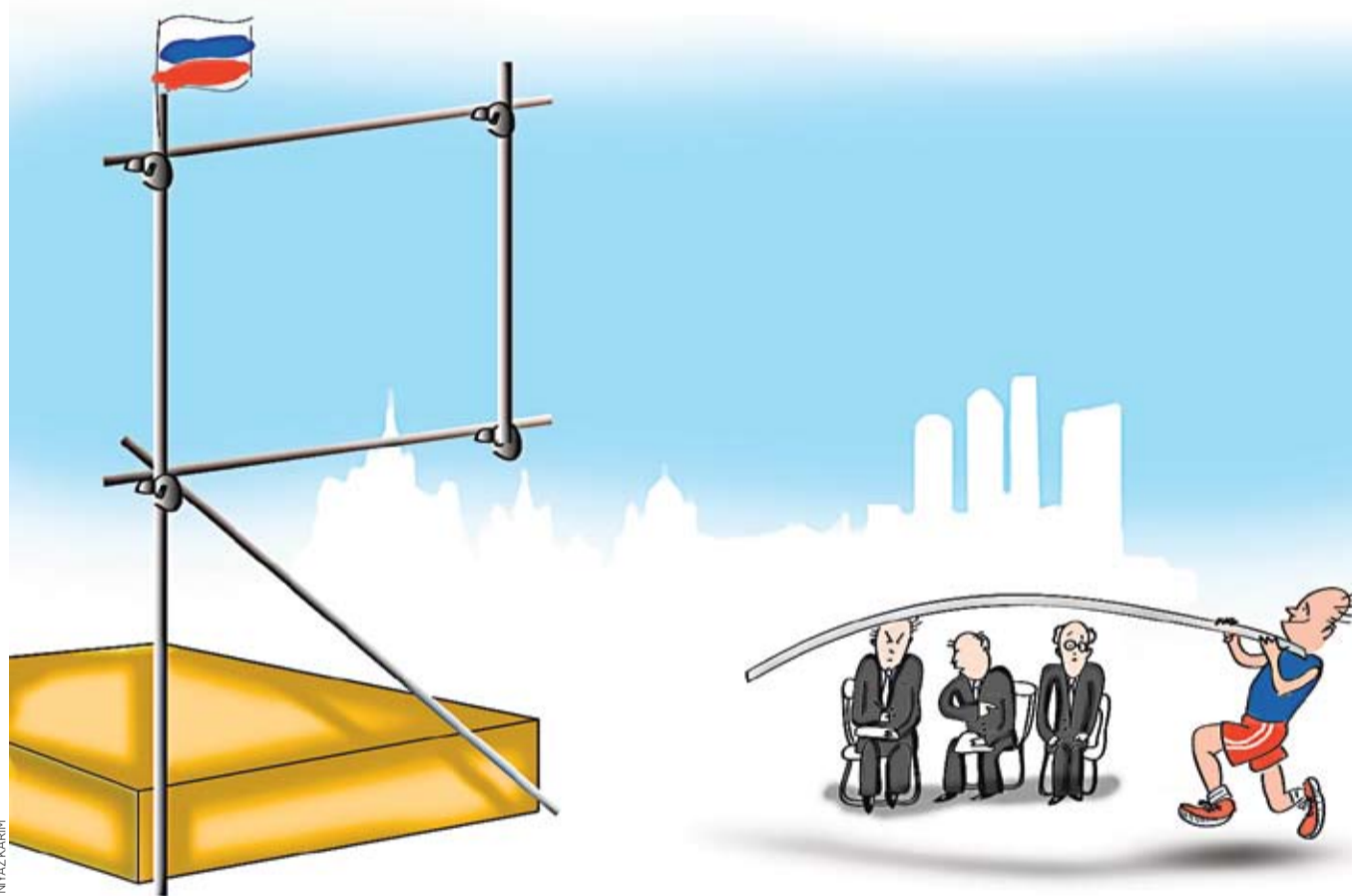
The latest scientific research also provides additional arguments in favor of the special emphasis given to the ranking. For example, if a country, in the process of competing for a higher evaluation, reduces the registration period for a new business by 10 days, on average it can count on an increase of 0.36 percentage points in G.D.P. growth.

Other experts see a strong correlation between a consistently high ranking on the one hand and the state of the business climate and the depth and quality of measures for regulating the business environment on the other. It turns out that in the final analysis, the Doing Business ranking is not at all a false target.

The economic history of Russia shows that the country has had success with symbolic national projects. Given Russia's traditionally small institutional infrastructure, associated external effects by themselves are so significant that they can exert substantial influence on the country's development.

/// *Alexei Kvasov is the World Bank's executive director for Russia and a former member of the board of directors of World Bank Group institutions.*

ВЕДОМОСТИ
RUSSIA'S LEADING NEWS



FOR TECH, SUCCESS ABROAD STARTS WITH CREATING DEMAND AT HOME

→ **Andrei Bunich**
SPECIAL TO RBTH



Russia's efforts to diversify its economy must focus on creating demand for modernization at home rather than just exporting products. Recently, Russia's efforts at developing high-tech production have focused on two different directions: cultivating scientists to develop innovative products, and convincing businesspeople to provide sources of credit. Unfortunately these efforts ignore the most critical elements to success: the end users who benefit from advanced technology.

Again and again at the recent Skolkovo Innovation Summit, I heard the questions: "What specific market are these products being developed for?" and "Is there already strong demand from Rus-

sian industry to use innovative products in modernizing production and improving efficiency?"

Of course success stories already exist in cases where there is a definitely both a demand and a robust market: Yandex, Russia's largest search engine, has done remarkably well honing its unique technology to the needs of the Cyrillic alphabet and Russia's exploding base of Internet users. The company has also successfully addressed problems of everyday Russian city dwellers via its Yandex.Maps and Yandex.Probki (traffic) services. These factors have helped Yandex maintain its leading position in Russia and launch a recording-breaking I.P.O. last year on the NASDAQ exchange in New York.

In order to create more of these success stories, the state needs to

send a strong signal that it is not just interested in, but will bravely implement, a long-term restructuring of the economy through issuing tax breaks, fighting inflation and other business-

/// **Russia's efforts to develop high-tech production have ignored the end users who benefit from technology.**

friendly policies in the short term. Additional funding for universities, business incubators and venture funds would then bolster those policies.

One of the greatest faults of Russia's existing state policies is that they are directed at creating products for Western markets.

While some successes have been achieved by Russian innovators — notably, Kaspersky Labs' anti-virus software, which exports around 80 percent of its production — I'm convinced that a long-term strategy for weaning Russia's economy off raw materials must also generate domestic demand for innovation.

The Skolkovo Innovation Center may be an efficient vehicle for generating some demand by providing both favorable business conditions for innovators and linking them with companies interested in modernizing production. I hope more nationally significant efforts at stimulating this demand will follow suit.

/// *Andrei Bunich is a prominent Russian economist and commentator for Kommersant FM and other Russian media outlets.*

LETTERS TO THE EDITOR

Joseph Brodsky and Spaceships

John Freedman's article about Ann Arbor, the Proffers and Joseph Brodsky caught our eye. Shortly after his arrival in the U.S. my husband and I had the pleasure of meeting him. When we entered his small dormitory room, he was reading a letter from the U.S.S.R. I asked to see the envelope, tore it open at the seam and showed him a tiny numerical imprint, the mark of the censor. He could not believe his eyes. The next day the room was filled with cigarette smoke and Brodsky was sitting on the bed surrounded by envelopes; he'd spent the night searching for those minute numbers.

There had been such vociferous worldwide protests after his arrest that the Soviets released him after 18 months and deported him to the West. Their loss was our gain, and surely the Soviets must have been gnashing their teeth, because if he had stayed, he could have been their hero, their great poet. Their cruel

punishment pursued him in exile as well because when Brodsky's parents were dying, permission to visit them was refused.

Our compliments to Mr. Freedman and RBTH.

Dr. Gene & Gloria D. Sosin

West Plains, NY

In looking up information about hydrogen fusion, I stumbled onto the fact that it was Russians who invented the plasma fusion idea and developed it, in 1956. It is still one of the best prospects for developing fusion for power. And of course it is Russian rockets that are now lifting crews to the space station. All this leads me to believe that the inventiveness of Russian scientists has been grossly underplayed in the press over the past half century. The Russian media should pull its reporters off the streets of Moscow and send them to places where science is going on.

Joe Dart
Fairbanks, AK

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