

# Russia's Economic Modernization: The Causes of a Failure



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# ***Russie.Nei.Visions***

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- “Russia’s non-Soviet Path”, *Aspen Review Central Europe*, 2015, No.1, p. 82–86;
- “Yes, Sanctions Work”, *The American Interest*, March-April 2015, Vol 10, No.4, p. 33-38;
- “Russia of 2010s: How to Live with It and how to Outlive It”, *DGAP Kompakt* No.7, Berlin, DGAP, June 2015, p. 1-9;
- “Russia's Putin and Putin's Russia: How They Work and What We Should Expect” in Hamilton, Daniel & Meister, Stefan (eds.) *The Eastern Question: Russia, the West, and Europe’s Grey Zone*, Washington (DC), Johns Hopkins Univ. Press, 2016, p. 93-108

# Summary

In this short study of attempts that have been made in recent years to modernize the Russian economy, the author explains why they have all ended in failure. Unlike most experts, he focuses on politics and ideology. He stresses that the idea of modernization runs counter to the historical vision that is now propagated by the Russian leadership, to the system of governance that it has chosen and to Russia's current path of isolation from the West. In his view, such political choices have rendered modernization of the Russian economy unfeasible. The author also points to other problems: the effects of privatisation, which have made investment in new industrial facilities unprofitable, the declining quality of business leaders who are chosen for their political loyalty and the lack of independent big businesses that could insist on reforms being carried out.

# Table of contents

|                                    |           |
|------------------------------------|-----------|
| <b>INTRODUCTION .....</b>          | <b>5</b>  |
| <b>HISTORICAL FACTORS.....</b>     | <b>7</b>  |
| <b>ECONOMIC FACTORS .....</b>      | <b>9</b>  |
| <b>FOREIGN POLICY FACTORS.....</b> | <b>12</b> |
| <b>THE RUSSIAN ELITE .....</b>     | <b>14</b> |
| <b>PUBLIC OPINION .....</b>        | <b>18</b> |
| <b>THE GLOBAL SITUATION .....</b>  | <b>20</b> |
| <b>CONCLUSION .....</b>            | <b>22</b> |

# Introduction

Assessments of modern Russian politics differ widely: some reject Vladimir Putin's regime out of hand while others support it almost unconditionally. This observation holds true not only in Russia but in most European countries. However, when discussion turns to economics, the disagreement disappears. The vast majority of specialists consider Russia as a relatively backward country regarding the structure of its economy, which survives mainly by exporting its natural resources and which is therefore critically dependent on the state of world commodity markets.

Meanwhile, not only historians, but also politicians, entrepreneurs and ordinary citizens, both in both Europe and in Russia, remember that the Soviet Union was an economically self-sufficient country for a long time. In Russia, the authorities have tried to remind people of late that they ought to take pride in the industrial and technological pre-eminence that their country once enjoyed. At the same time, however, it is becoming ever clearer that Russia is in no fit state to make a new industrial breakthrough. Despite all the talk about "overcoming the raw material curse", the share of oil and gas in Soviet/Russian exports has increased from 37% in 1989 to 43% in 1998, 58% in 2004 and 66% in 2013.<sup>1</sup> Over the same period, Russia has become increasingly dependent on imports, not only of high-tech goods but also of everyday consumer goods, while its own industrial production has declined.

Leaving aside most modern production and examining only crude statistics for heavy industry, it turns out that 89 million tons of steel were smelted in 1985 on the territory of the RSFSR, along with 79 m. t. of cement, 18m T of fertiliser and 5m T of paper, while by 2015, these figures had fallen by 20, 19, 11 and 10% respectively.<sup>2</sup> The statistics for investment-intensive production and relatively high-tech items for general consumption are even more woeful. Between 1985 and 2009, the number of lorries, combine harvesters and tractors manufactured in Russia

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Translated from Russian by Cameron Johnston.

1. V. Inozemtsev: "10 tsifr, kotorye ob'iasniaiut Rossiuu" [10 Figures which explain Russia], Slon, 17 September 2015, [www.slون.ru](http://www.slون.ru).

2. Calculated using: *Narodnoye khozyaystvo RSFSR v 1985 g.*, [Economy of the RSFSR in 1985], Moscow, Ed. Finansy i statistika, 1986 and Rosstat data: [www.gks.ru](http://www.gks.ru), website visited on 17 May 2016 (since 2010, data on the production of watches and cameras has not been published).

decreased 6, 14 and 34 times, while production of watches and cameras fell by a factor of 91 and 600 respectively.<sup>3</sup> According to official data from the Ministry of Industry and Trade, 45 classes of items were entirely sourced abroad in 2014, while imports accounted for more than 90% of a further 200 types of goods.<sup>4</sup> To conclude, it is worth noting that Russia is even losing ground in the field of energy: by the end of 2014, its share of world oil and gas extraction had fallen to 12.6% and 16.7% respectively, compared to 17.8% and 29% in 1989.<sup>5</sup>

The Russian leadership is constantly referring to the need to “overcome technological gap”, “reindustrialise” and “get off the oil needle” but in fact, no serious attempts have been made to stop the rot. In 2008, then-President Dmitry Medvedev insisted that modernization was his top priority: but the reform programme and the various milestones were set up in such a way that it was clear from the beginning that nothing would come of all the hype.<sup>6</sup> In countries which have succeeded in modernizing, the process has moved “from simple to complex”, with entrepreneurs, workers and engineers gradually acquiring new skills and inserting themselves into new markets. In Russia, by contrast, they decided that the “breakthrough” would mainly be made in complex fields, and in the ones that are largely insulated from the free market, such as nuclear energy, space technology and pharmaceuticals. Even in the unlikely event that they blossomed, these fields could not kick start large-scale economic growth across the country. It was no accident that modernization under Medvedev failed or that it disappeared almost completely from the agenda after Putin’s return to the Kremlin. Rather, this was caused by at least six sets of factors related to history, economics, foreign policy, the global situation, society and the elites.

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3. V. Inozemtsev, “Nineteen Eighty-Five”, *Russia in Global Affairs*, 8(4), October-December 2010, p. 9.

4. See: Rosbalt, 16 April 2016, [www.rosbalt.ru](http://www.rosbalt.ru).

5. Calculated using *BP Statistical Review of World Energy 2015*, British Petroleum, June 2015, [www.bp.com](http://www.bp.com).

6. For more details, see: V. Inozemtsev and E. Kuznetsova, “Modernizatsiia po ostatochnomu printsipu” [Modernising with what is left over], *The New Times*, 18 January 2010, <http://newtimes.ru>.

# Historical factors

The fundamental difference between Russia and most successfully industrialised countries is that Russia had already been a great industrial power. Almost everywhere in the world (in Japan, Korea, China, Malaysia and so on), modern industrialisation was a way of overcoming the economic processes of an agrarian society and it happened once, never to be repeated. Even in China, which experienced several waves of industrialisation, the industrial revolution of 1980 to the 2000s began in a predominantly agrarian country, although it contained pockets of heavy industry. Russia confronted an unusually difficult task at the dawn of the 21<sup>st</sup> century: how to industrialise anew when the 1920s and 1930s had destroyed traditional society under the slogan of industrialisation, and after Russia had become the world leader in certain sectors and products in the 1960s and 1970s. In these circumstances, the challenge of industrialising runs up against three main obstacles.

First, it runs against the grain of public discourse and undermines people's sense of themselves as citizens of a great country and a mighty industrial power. It is notable just how much attention the government pays, for instance, to supporting the defence sector or big national industries. This approach suggests that everything is going fine with industrial development and that state policy in recent years has helped it take a turn for the better. Any attempt to dispel this myth is anathema to the elites who are invested in Russia's so-called "stability" and who talk up the superiority of Russian and Soviet societies. The task of industrialising of a industrialized economy is transformed into an oxymoron. This problem is not unique to Russia: the 20<sup>th</sup> century abounded in unfinished modernizing projects that "backfired", making societies unreceptive to new modernizing initiatives (Latin America was particularly prone to this throughout the 20<sup>th</sup> century) and leaving them in a state of either permanent stagnation, as in Argentina, or prolonged depression, as in Venezuela.

Second, in the mind of Russians, industrialisation is strongly associated to the worsening conditions for the population. Whenever rapid industrial development has occurred in Russian history, the powers that be have destroyed the existing patterns and rhythms of everyday life. From Peter the Great to the communist leaders, industrialisation has involved deprivation and harnessing all the power that society can muster. This is



only natural: successful attempts at modernization have nearly always implied restrictions on current consumption and tight regulation by the state. Simply by examining those Asian countries where, in the first decade of their modern industrial revolution, real incomes barely rose, it is clear that this policy would not be supported by the current Russian government, whose popularity is based on lavish hand-outs, not on the ability to mobilise the masses for economic transformations that inevitably entail deprivations. As a great social project, industrialisation is incompatible with political “stability”: remember that all attempts at authoritarian modernization have ended, sooner or later, in radical political change.

Third, a certain type of “historical memory” plays an important part in setting the parameters for a potential industrialisation drive, rendering it pointless from the very beginning. In the Soviet Union, industrial development occurred within a planned economy that always paid little attention to efficiency as traditionally understood. The country reached a dead end at the time largely because it tried to “tame” nature and territorial distances, to pull back manufacturing into the most inaccessible locations where it would never have developed had there been a market economy.<sup>7</sup> And if we look today at what “industrialisation” and “modernization” really entail, we see almost exactly the same unrealistic projects: from the bridge to Sakhalin and the tunnel under the Bering Strait to the modernization of the Baikal-Amur Mainline (BAM) and the construction of the Power of Siberia pipeline. If you have already experienced one unsuccessful industrialisation, it is also too easy to repeat the same mistakes a second time round. The more authoritarian the government, the more likely this is to happen.

Russia therefore presents a very unfavourable environment for industrialisation; the doubtful experience of its earlier industrial revolutions (none of which was natural) exists alongside a certain nihilism, which springs from the illusion that Russia is well versed in these matters, and is reinforced by the authorities’ unwillingness to destabilise society. All this demonstrates that in terms of history, ideology and worldview, Russia currently possesses none of the prerequisites for a new round of industrialisation.

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7. C. Gaddy and B. Ickes, *Bear Traps on Russia’s Road to Modernization*, London/New York, Routledge, 2013, diagram No.3.1, p. 38.

## Economic factors

The second set of obstacles, quite diverse, is due to economic factors, although all these are of course connected to political factors and “the specificities of the national elite”.

First, the most important barrier on the road to successful industrialisation in Russia is the privatisation that took place in the 1990s. Privatisation allowed the new owners to gain control of large assets at very low prices (51% of “Norilsk Nickel” was bought for \$170m, 51% of “Sidanko” [later—TNK] for \$130m, 51% of “Sibneft” for \$100m, 40% of “Surgutneftegaz” for \$89m, while many large industrial enterprises were acquired for a few million dollars). The problem here is not that the state was short-changed during privatisation but that the foundation of the economy in the 2000s was made up of assets that were virtually given away, with their cost being recouped in just a few years. This acted as a powerful brake on investment: every potential investor realised that he would have to spend billions of dollars to compete with those who had acquired their assets on the cheap. Surviving in this environment demanded the most up-to-date management techniques and by no means all managers possessed them. Privatisation, in other words, having been carried out in the interests of the oligarchs, continues to influence economic strategy two decades down the line, discouraging new players from investing in industry (it is not surprising that only one new oil processing plant has been built in the “energy superpower” since the collapse of the Soviet Union). China, whose industrial revolution has been overall successful, took a different path by keeping the industrial giants under state control but sponsoring the creation of new companies that play by market rules.<sup>8</sup> This helped to unleash entrepreneurship in industry, as opposed to killing it in embryo.

Second, from the beginning, no strategy was devised for rapid industrial growth and no one therefore posed the question of what might underpin such a strategy. Across various historical epochs, stimulating economic growth in developing countries has generally come in two forms: heavily redistributing resources from one sector to others (like Stalin’s industrialisation, which ruined the countryside), or artificially depressing

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8. For more details, see: H. Sheng and Z. Nong, *China’s State-Owned Enterprises: Nature, Performance, and Reform*, Singapore, World Scientific Publishing Co., 2012.

the price of certain resources (labour in China or other South-East Asian countries, for instance). Russia possessed two relatively cheap resources after the collapse of communism, namely qualified workers and natural resources. This meant that it was quite possible to carry out a “new industrialisation” but the government did not even consider using either of these resources on the cheap. Supplying the economy with cheap raw materials might have attracted foreign investment and allowed industry to thrive but the government was hand-in-glove with the oligarchs who controlled the raw materials and derived most of its income from redistributing natural-resource rents. It also needed the support of the masses and therefore bought their loyalty by increasing people’s incomes. The ability to improve the well-being of unproductive groups by simply redistributing income from the extraction and export of raw materials became the foundation of the Russian economy, but this did nothing to develop manufacturing or shift the main burden of tax onto industry. To put it more simply, instead of forcing the people to work, using cheap Russian raw materials and accessible foreign technology, the Russian government preferred instead to redistribute the proceeds from raw materials directly. As one might expect, this enriched state employees and raw material barons, but removed the incentive for investors to develop production in Russia. Time and again, the authorities gave their seal of approval to monopolies that, at times, sold Russian raw materials at higher prices at home than abroad (when the Federal Anti-Monopoly Service sanctioned the creation of United Company RUSAL in 2007, one condition was that the price for aluminium on the Russian market should not exceed that on the London Metal Exchange by more than 5%).<sup>9</sup> Needless to say, the Chinese economic miracle was not repeated in Russia. Indeed, it has no chance of being repeated because, at a time of instability on world markets, owners of raw materials will try to increase the valuations of their companies within the country, driving down competitiveness even further. Meanwhile, the environment for doing business in other countries will only improve.

Third, the Russian economy has developed and is still developing along relatively autarchic lines. It exports unprocessed raw materials and imports ready-made, high-tech goods. As such, industrialisation is seen almost exclusively as a way of reducing Russia’s dependence on foreign goods—that is, the “import substitution” that is now so popular—but no more than that. In recent years, Russia has the distinction of being the only country where “free economic zones” were set up to increase the supply of

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9. K. Rybak, “FAS dast dobro ‘Rusalu’” [FAS will give green light to Rusal], *Vedomosti*, 18 January 2007, [www.vedomosti.ru](http://www.vedomosti.ru).

goods on the internal market (like, for example, the free economic zone in Kaliningrad oblast) and not for export, as is the custom practically the world over.<sup>10</sup> This gives rise to a problem that was identified long ago by the American economist Jagdish Baghwati: modernization cannot succeed in closed economies because autarchy restricts competition, while any “new industrialisation” requires greater competitiveness: the statistics bear out his conclusion that the key to industrialisation is integrating a national economy into the world economy.<sup>11</sup> In Russia today, there are no markets big enough to absorb enough industrial output to guarantee economies of scale and such markets will not appear in the near future (for this reason, projects like “Yo-Mobile”<sup>12</sup> have not and will not see the light of day). The only way to reindustrialise the country, therefore, is to attract foreign manufacturers that own wide sales networks and to increase exports of ready-made items bearing well-known global brands. However, as we already know, the Russian government believes that the country is surrounded by enemies and is shaping its policies around the idea of yet more autarchy. With Russia’s rapidly shrinking internal market and with hopes of a change in political course proving illusory, we can be almost certain that attempts at industrialisation will fail. In addition to economical factors, foreign policy factors are no less important.

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10. V. Inozemtsev, “Khimery razvitiya. Pochemu provalilsia eksperiment osobykh ekonomicheskikh zon” [Chimeras of development. Why the experiment with special economic zones failed], *Slon*, 27 June 2016, <https://slon.ru>.

11. J. Bhagwati, *In Defense of Globalization: How the New World Economy Is Helping Rich and Poor Alike*, Oxford/New York, Oxford University Press, 2004, p. 180.

12. A Russian project for a hybrid vehicle with an electrical transmission.

# Foreign policy factors

Foreign policy accounts for a third set of obstacles, the most important of which is the character of Russia's relations with its closest ally.

Contemporary Russian foreign policy will not be analysed here, though it is highly detrimental to the country's economy and runs against the grain of modernization. One factor, however, should be highlighted.

Every successful attempt at modernization in the modern world has required partnership with a country that is not only politically well disposed but also acts as the biggest market for its partner's industrial production and as the prime source of the investment and technology needed for rapid development. If, in the USA and EU countries, the share of exported industrial production accounts for no more than 8-9% of GNP, in China in the mid-1990s this figure reached 21%, in Indonesia 22%, in the Phillipines 24%, in South Korea 27%, in Thailand 30%, in Taiwan 43% and in Malaysia 78%.<sup>13</sup> In the 1980s, 42% and 74% of the economic growth experienced by South Korea and Taiwan respectively was sustained by exports to the United States.<sup>14</sup> At the same time, American imports accounted for nearly 85% of the positive side of Mexico's balance of trade.<sup>15</sup> Having a partner like this is a determining precondition for successful modernization.

Russia, however, does not have such a partner. Having turned away from Europe—whose market is now the reference point for the successfully industrialising countries of the former Warsaw Pact—for purely political reasons, Russia turned towards the largest industrial economy in the world, China, which has no interest at all in Russia becoming a competitor. A whole raft of evidence backs up this view: since the first half of the 1990s, China has progressively reduced the proportion of industrial goods in its imports from Russia, while increasing the proportion of unprocessed raw materials (the former has now fallen below 3% while the latter has reached 75%, exceeding the corresponding figure for trade between Russia and the EU). China is the main potential consumer for Russian oil and gas

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13. M. Goldstein, *The Asian Financial Crisis: Causes, Cures, and Systemic Implications*, Washington D.C., Institute for International Economics, 1998, p. 27.

14. L. Thurow, *Head to Head. The Coming Economic Battle Among Japan, Europe and America*, New York, Warner Books, 1993, p. 62.

15. R. Reich, *Tales of a New America*, New York, Vintage Books, 1988, p. 56.

extracted in Eastern Siberia and the Far East but, despite the Russo-Chinese “programme of cooperation” adopted in 2009, Russia has failed to convince its partner to build even one enterprise on Russian territory that can process raw materials from start to finish. In the same way, we are not seeing a boom in Chinese investment in industrial facilities in other parts of Russia. The lesson is clear: successful industrialisation requires close trading and investment links between the industrialising country and a state or several states at a much higher level of development, which regard it not as a competitor but either as an addition to its own economic systems or as an opening for significant investment and technology transfer.

The alliance between Russia and China, or, to put it more accurately, Russia’s following of China’s trajectory, is not based on such cooperation. This is almost the only case in the world when a leading (or, at least, larger) economy is not interested in developing its satellite and cannot offer anything to help that satellite move forward quickly. The most that China is capable of is to promote quantitative growth in the Russian economy without structural change. This begs the question of whether economic issues are at all important to the Russian elite when charting a course in foreign policy and choosing allies on the world stage. Positioning in foreign policy and the choice of allies is clearly another obstacle on the road to a “new industrialisation” of Russia.

# The Russian elite

The fourth set of problems is directly bound up with the defining features of the Russian political elite and with Russian bureaucrats as a class.

First, this elite is a “raw materials elite”, focused on maintaining control of its own sector of the economy, extracting as much revenue as possible for the budget and redistributing budget flows. It should be noted that this is not a “timeless characteristic” but a new phenomenon that can be traced back to the start of Putin’s presidency. A catastrophic mistake was made in 2002 which set this process in train, namely the introduction of the Minerals Extraction Tax and a new system of export duties: from that time onwards, the state bureaucracy and the oligarchs who controlled the raw materials began to merge, while the idea of a “rent economy” appeared for domestic consumption and the “energy superpower” for the wider world. It was the Putin period of Russian history that witnessed the most dramatic rise in the share of Russian exports made up of “mineral products”, from 54% in 2000 to 72% in 2013.<sup>16</sup> When oligarchs and state officials are one and the same, of course, it is difficult to promote the idea of industrialisation which, one way or another requires that the oligarchs’ appetites be curbed. In essence, the very idea of an “energy superpower” implies that, under the current leadership, industrialisation and modernization cannot be regarded as anything other than fiction or cheap propaganda, if only because it is impossible to industrialise the country without stepping on the toes of representatives of the raw materials companies.

Second, this elite is “attached” to the Soviet Union, not in terms of ideology or intellectual calibre but with respect to the material assets that underlie its wealth. Seventy four of the largest 100 Russian firms by market capitalisation work almost exclusively with fixed assets dating from the Soviet era (for comparison, 14 of the 30 companies that now make up the Dow Jones Industrial Average were not part of it the last time it was revised in Soviet times, on 6 May 1991), while only 4 of China’s 100 largest companies by capitalisation are critically reliant on productive capacity

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16. Rosstat data issued from [www.gks.ru](http://www.gks.ru).

brought on line 25 years ago or more.<sup>17</sup> The elite's unwillingness to countenance change is therefore understandable, for the greater the changes, the higher the risks for old companies that are sure to lose out in a competitive contest. Industrialisation does not figure in the Russian elite's plans, not only because it calls into question the role of the raw materials sector, but also because it entails greater competition in industry as a whole. This explains the generally negative attitude towards foreign investment in industry: since the 2000s, when it guaranteed basic standards of production in a range of sectors focused on the consumer market, the flow of inward investment has almost dried up.

Third, the Russian bureaucratic machine is constructed in such a way that corruption is not a by-product, but its main motive force. The effectiveness of the "vertical of power" in modern Russia relies on the "vertical of corruption".<sup>18</sup> Corruption on such a huge scale, however, is incompatible with industrial development, for two reasons. On the one hand, the cut that state employees are prepared to take increases as the state grows stronger, but if these bribes come not from redistributing rent but by extorting money from industry, the latter quickly becomes uncompetitive (for instance, corruption has made building roads and infrastructure so expensive that it has all but stopped). In today's Russia, the official tax burden on business is similar to that in developed countries but considering that corruption increases that burden by at least a third, it is clear that only the most monopolistic of firms can survive in such an environment, which is toxic to rapid industrial development (the mass creation of state corporations supports this view). On the other hand, the bureaucracy must have a pretext to engage in corruption and in Russia, it finds these grounds in regulation: the more rules and norms that businesses must follow, the easier it is to keep them "under the thumb". This is why 1970s-era technical regulations and standards are still in force in Russia. There is no willingness to adopt regulations that would accord with those used in Europe or OECD countries while over the past five years, taxes have been supplemented or changed once every two weeks, on average. The problem here is that the competitive industry should update its product lines fast enough that is impossible with the shifting regulations. By building its "vertical of power", therefore, the political elite has knowingly condemned Russia to being a mere supplier of raw materials.

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17. For more details, see: V. Inozemtsev, "Chto tyagnet nas obratno v SSSR? Ne FSB i ne 'Edinaya Rossiya'" [What is pulling us back into the USSR? Not the FSB and not 'United Russia'], Slon, 20 May 2015, <https://slon.ru>.

18. For more details, see: I. Krastev and V. Inozemtsev, "Putin's Self-destruction", Foreign Affairs, 9 June 2013, [www.foreignaffairs.com](http://www.foreignaffairs.com).



Fourth, developed industrial enterprises have always been, and still remain, places where relatively well organised workers gather together: the modern workers' and trade unions' movement was born with the rise of industry for the simple reason that industrial production was a collective enterprise. The political elite in Russia is able to manipulate society because it is divided, while its strategy generally rests on suppressing collective action as much as possible.<sup>19</sup> There is abundant evidence that the Russian authorities are wary of any sign that an independent trade union movement might be in the offing and they are hostile to any form of professional solidarity. This, then, is yet another reason (not the main one but important nonetheless) why the idea of rapid industrialisation is discounted. History—in the case of, say, South Korea or Taiwan—clearly shows what fate lies in store for members of the ruling elite when industrialisation leads to the creation of a strong and independent middle class (in Russia, the middle class currently consists largely of state employees), the development of democracy and the advent not only of economic, but also of political, competition. This helps to explain why modernization is not on the agenda in Russia today.

Fifth and finally, another obvious factor should be noted. Over the last decade, Russia's elite has evolved by "negative selection", with competence sacrificed in the name of loyalty.<sup>20</sup> Although this allows the elite to feel that it is insured against change, it sharply undercuts efficiency, which is crucial for industrial development. It would be no exaggeration to say that modern Russian politics neglects efficiency in favour of stability. This approach is at odds with modernization (and industrialisation as its most important component), which promotes efficiency as the ultimate objective and attach less importance to other considerations. In modern Russia, shifting the emphasis onto efficiency is taboo for politicians and state servants who are unused (and most of whom are unable) to working in an environment where efficiency is the main yardstick by which their actions are judged. Therefore, the system will almost certainly sacrifice industrialisation and efficiency, preferring to keep the old hierarchical structure of governance intact.

We could also discuss at length such weighty problems as official accountability, the transparency of contracts and the absence of a truly

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19. V. Inozemtsev, "Russie, une société libre sous contrôle autoritaire" [Russia, a free society under authoritarian rule], *Le Monde diplomatique*, October 2010, No.10, p. 4-5, [www.monde-diplomatique.fr](http://www.monde-diplomatique.fr).

20. V. Inozemtsev, "Neo-Feudalism Explained", *The American Interest*, March-April 2011, Vol. 6, No.4, p. 73-80, [www.the-american-interest.com](http://www.the-american-interest.com).

independent legal system. All these factors are crucial, but they have been amply explored before.

# Public Opinion

The fifth set of problems which reduces the likelihood of modernization in Russia to near zero is the unprecedented state of public opinion in Russia (diligently cultivated by the authorities), which prevents reforms from being launched.

History shows that for modernization to be successful, both the elites and the people must recognise that the current state of affairs is unbearable and that it must change. Change involves analysing earlier mistakes and understanding that modernization is about catching up with countries that have been more successful and have pulled ahead. The very notion of “modernization” can be understood as “bringing up to date”, and it therefore partly implies that the country is currently on the decline. Without this awareness, modernization cannot succeed, since it can only yield temporary achievements that are easily dismantled as soon as the course of politics changes. Russia is an anti-model in this respect: each century, it tries to modernize at least once, only to start discussing a new round of modernization. The explanation for this recurring pattern lies in the fact that the elites do not understand why modernization is needed and the people feel that they have no stake in it. Successful modernization occurs where the authorities decide that they must break with the past and face the future, while also knowing how to excite the people’s interest in the changes ahead. Lee Kuan Yew in the 1960s, Den Xiaoping in the 1980s and Fernando Cardoso in the 1990s embodied precisely this strategy.

Moscow has taken the polar opposite approach on both counts. The authorities, having bowed to populism, are unable to admit that the situation in Russia is bordering on catastrophic (on the contrary, they say that the country has “risen from its knees” and will be outstripping its chief opponents in no time). This alone is enough to discredit modernization. On the ideological level, moreover, the elites are busy searching for a line of historical succession that would connect them to the Soviet Union, whose positive image is becoming the main tool of official propaganda. Of course, if you convince the people that they will soon reach an ideal state, what sense does it make to talk about modernization? Why strike out into an unknown future when it is much simpler and more comprehensible to recreate the past? Populism, moreover, involves focusing on the distribution of goods and the paternalistic role of the state, whereas modernization always entails huge investment and certain restrictions on

the growth of consumption. Therefore, the government's unwillingness to demystify the past and the people's unwillingness to restrict current consumption for future benefit constitute the last, but most important, reason why modernization will not receive wide support in Russia, either now or in the near future.

# The global situation

Finally, the sixth set of reasons, which stood out in sharp relief after the latest attempt at modernization had failed, is connected to changing economic outlook in Russia and the world. Oil prices fell sharply in 2014, leading to a decline in export revenues and a dramatic weakening—nearly twofold—of the rouble. As the experience of various different modernization drives shows, success depends on either large-scale imports of technology and equipment, if the goal is to increase exports, or active capital investment on the part of foreign companies if they are intent on capturing the country's market. In today's Russia, neither condition applies.

First, the government must ensure that it can cover its budget expenditure, even though expenditure this year is 10-15% lower than planned, and pensions, which accordingly the law should be indexed at the rate of inflation, have risen by only 4%, while inflation runs at 13%. A weak rouble is therefore in the state's interest because export duties on oil and gas, which make up close to a third of budget income, are denominated in dollars. The weaker the currency, the more roubles flow into the budget. From the point of view of modernization, though, this trend is ruinous because over the last two decades, most of the equipment needed to improve production was bought abroad, so when the rouble falls, it becomes unfeasible for companies to make such investments. All the attempts at "import substitution" are unrealistic: Russia is decades behind in producing modern industrial equipment and what it does produce is often even more expensive than the imported versions. Theoretically, therefore, Russia could only have modernized when the price of oil was high. However, when the going was good, no one even considered it.

Second, in the past, an alternative driver of modernization might have been investment by Western companies in production for the domestic Russian market. This occurred on a limited scale in the 2000s when new car factories were built by western corporations. They were interested in Russia because of the size of its internal market (it was said that Russia would be the largest market for cars in Europe by 2016)<sup>21</sup> and its isolation

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21. Based on projections made by Boston Consulting Group in 2013, see: D. Nizhegorodtsev, "V 2016 godu Rossiia stanet krupnejshim avtomobil'nym rynkom Evropy" [In 2016 Russia will become Europe's largest market for cars], *Vzgliad*, 19 July 2013, [www.vz.ru](http://www.vz.ru).

from the WTO, which promised significant cost reductions when localising production. Since the start of the economic crisis, however, the Russian car market has contracted by more than 45% and costs are not nearly as attractive as they were before: the same goes for an array of other products which Western investors sought to make in Russia (white goods, TVs and radios, construction materials).<sup>22</sup> It is not profitable to invest hard currency in Russia only to sell products on the internal market in devalued roubles. This just goes to reconfirm a surprising paradox: in a country that is dependent on exporting raw materials, modernization is only possible when the price of these exports is at its height. Besides, it is only achieved in places where the authorities are competent enough to grasp this fact. To date, only the leaders of the United Arab Emirates have done so.

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22. See: D. Lomakin, “Padal, padaet i budet padat” [“It fell, is falling and is going to fall”], *Gazeta.ru*, 14 January 2016, [www.gazeta.ru](http://www.gazeta.ru).

# Conclusion

To sum up, modernization is not on the cards at present, with Russia increasingly alienated from the wider world, oil and gas prices low, the increasingly ineffective ruling class, and ideology clashing with economics. Indeed, in the eyes of most Russians, modernization is not even desirable. The Putin regime's greatest political "achievement" has been to convince most Russians that following the course of global progress is not only pointless but also dangerous for the country. The atmosphere in Russia is now such that regression and backwardness are interpreted as evidence that the country is succeeding on its special path. In such circumstances, discussing modernization is purely theoretical.

Does this mean that modernization will never happen in Russia or, in a phrase widely repeated during the presidency of Dmitry Medvedev, that "there is no alternative to modernization"? Both these inferences are mistaken.

Modernization will certainly become a priority in Russia, but only after the country has passed through a deep crisis, when the population experiences something similar to what happened at the beginning of the 1990s, when they fell into poverty; when the political class is finally convinced that its foreign policy has completely failed; when the country is on the verge of collapse and the people lose all faith in the "law enforcement oligarchy." Modernization will begin when Russians look ahead and reject the former regime. Since the Kremlin's current policies are leading to this sorry end, there is no doubt that modernization of the economy and of society will occur in Russia, though not any time soon.

On the other hand, in the meantime there undoubtedly is an alternative to modernization, which consists of preserving the country intact, a gradual decline in living standards, paralysis of the political system, an increase in emigration and a stronger role for the state in the economy. Venezuela shows where such policies will lead. However, if problems build up relatively slowly, the Russian population is prepared to put up with them for a long time. Although modernization is bound to happen in Russia eventually, therefore, one cannot expect it to take place in the next 10-15 years as a factor in economic and foreign policy.

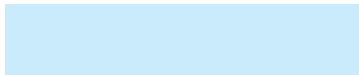
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