



## REP Roundtable Summary

# The Modernization of Russia: Possibilities and Limits

Alexander Voloshin

Chairman, Norilsk Nickel

Roger Munnings (discussant)

UK Special Trade Envoy to Russia

Philip Hanson (discussant)

Russia and Eurasia Programme, Chatham House

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## Alexander Voloshin

The discussion about modernisation which is taking place in the media and expert circles is very positive. However, there has so far been a gap between rhetoric and action. It is much easier to speak about these issues than act on them.

Russia needs to make up for a significant technological and innovation lag. It needs to develop a new knowledge-based economy. Such an economy is fluid and mobile; labour moves where it feels most comfortable, and where the opportunities for development and advancement are greatest. The traditional economy is tied to specific geographical areas. You can't extract oil where there is no oil, you can't mine coal where there is no coal. The investment climate in Russia is far from perfect. However the country is rich in resources, and so the traditional economy continues to exist where it must despite the unfavourable circumstances. The more advanced elements of the global economy stay away from Russia, concentrating on those areas of the globe where the investment climate is more favourable.

You won't change the investment climate in Russia overnight. The average policeman or judge will not change his behaviour because of a presidential decree. This is the dilemma facing those in power: they want rapid modernisation and economic transformation, but changing the economic climate takes a long time and a lot of heavy lifting. It can be achieved provided two conditions are fulfilled: there is serious political will to implement reform and incentives are provided to representatives of the 'new economy' to compensate for the negative investment climate. These incentives should include tax breaks and administrative support.

Looking in a comparative perspective at state-sponsored modernisation projects, it is evident that none of them have been totally successful. Nevertheless, the example of India and other states show that governments which manifest the necessary resolve and invest political capital can achieve significant success. Corruption and inefficiency are still found in India, but no one can deny that the country has made significant strides forward in modernising its economy. The lesson from these examples is that there has to be constant pressure placed on the bureaucracy to change their practices. The bureaucracy is the main obstacle because it has nothing to gain from a change in the status quo. Stagnation suits them. We must hope that the Russian leadership are able to show sufficient political will to overcome these obstacles and provide the necessary incentives to compensate for the poor investment climate.

## **Roger Munnings**

On a global scale, there are two sources of competitive advantage: a rich raw materials base and brain power. Russia should certainly not regret that it has the former, but it needs to work hard to develop the latter. It is important to stress the moral role of business. Those who do business in Russia have to understand the important part they play in society.

It is important to understand the nature of the challenge. It is not a developmental or training issue. Modernising Russia requires a change of mindset. It is clear that the younger generation are receptive to new ways of doing things, and are happy to adopt innovative approaches, but changing attitudes takes time. The challenge is to foster a generation which will take responsibility for the process so the government doesn't need to rule by decree.

## **Philip Hanson**

Social development is difficult anywhere. If one decided to set up a knowledge economy one wouldn't start in Russia. The reason, as Yulia Latynina has put it in a recent article, is that it is not possible to have nanotechnology in a Byzantine Empire.

There are several grounds for scepticism about the modernisation programme. First, there is the resource curse. This refers to the body of empirical evidence suggesting countries that rely on the export of natural resources for a large proportion of their budgetary receipts tend not to have highly developed economies. Ricardo Hausmann's theory of 'product space' suggests that economies progress because countries upgrade what they produce. The more closely related the product lines, the easier it is for countries to make progress. However, the cluster of products associated with a high-tech, innovation economy are a long way from those which develop around the hydrocarbon sector. It's a big leap to move from an oil and gas economy to one which can successfully compete in nanotechnologies.

A second issue to consider is the recent open letter from a group of expatriate Russian scientists describing the state of Russian science and academia as catastrophic. They pointed out that Russia has just four universities in the top 500 in the world, whereas China has ten and India eleven. The share of total patent applications made outside the first-named country from Russia is 0.14 per cent. For India it's 0.48 per cent, for China 0.90 per cent. Anatoly

Chubais, CEO of Rosnano, has pointed out that 70 per cent of the investment in research and development in Russia is provided by the state. Private sector interest in research and development is low. A top-down approach can be shown to have worked in some cases – in the USSR it worked in specific scientific niches such as the development of nuclear technology or ICBMs, and indeed the US adopted a similar state-led strategy in these areas. However, the third wave of military development, which incorporates IT and smart weapons technology was not the product of a top-down government-led approach, but a spin-off from civilian research. If the Russian government plans to rely on a top-down state-led approach to development it will have great difficulty modernizing because this is not the state one would choose to foster scientific innovation.

## Questions and Discussion

**The general perception is that Putin, though now Prime Minister rather than President, is still in charge. However, he is not associated with this new paradigm of an improved investment climate and a more open dynamic Russia. What does this say about the project's prospects for success?**

The view that there are major policy differences between Medvedev and Putin is mistaken. Clearly, these are two different people with different CVs and backgrounds. I know both men well – one was my boss, and I was effectively the manager of the other. There are no substantial differences between the two on a strategic level. Putin is not against the modernisation of Russia. In the early years of his presidency he streamlined the tax system, pushed through a package of land reform, made possible for the first time the private ownership of agricultural land. The later years of Putin's presidency may have been less dynamic, but he nevertheless pushed through a new labour code which had a significant impact. There was also major reform of housing law. Previously, it was virtually impossible to evict someone from their residence even if they refused to pay any bills. Under Putin, a mortgage system started to develop. This is still modest, but it is not trivial. Putin may be a little more conservative than Medvedev, but he is not the enemy of modernisation.

**Medvedev's rhetoric about the need for modernisation is similar to that made by Putin in 2000. So why should we expect the results now to be any different?**

The modernisation programme could have begun earlier, but when Putin came to power he faced other more pressing challenges. Above all, he had to restore the credibility and effectiveness of the federal government. Many subjects of the Federation were not paying any tax to the centre, federal laws were not being implemented. The situation is now much more favourable. There is a widespread agreement that the country cannot remain dependent on oil and gas. The political elite has seen what happens when prices go down. The nature of the world economy is changing very fast. Soon the most profitable business will be the import of brain power. Those countries which are able to attract the best minds will lead the world. The US remains the world leader in importing brain power. For us, the task is only just starting.

**Corruption is one of the biggest obstacles to economic development in Russia. How can this be overcome?**

There is a belief that freedom of speech and democracy are all that is required to reduce corruption. Look at the example of Ukraine. They have a free press and political competition but corruption is rife. The challenge is of a different order. You can't fight corruption when the bureaucracy has absolute power. The key is to reduce the influence of the bureaucracy and government in general in the economy. State property must be reduced, the state's regulatory functions should be reined in. The state's functions should become more transparent. Civil servants should be paid a decent salary so there is less incentive to supplement their incomes through corruption. And of course the punishments for corruption should be severe.

**How important is it to improve protection of intellectual copyright?**

Russia has difficulties in this area. Changes have been made to the civil code, but the problem is not bad legislation but a lack of tradition in this sphere. On the other hand, copyright is poorly protected in China, but this has not prevented the country achieving high growth and joining the WTO. The problem is that the legal position across the world lags behind technical realities. Advances in mass communications and IT mean traditional understandings of intellectual property are become outdated. We need to look for new solutions, because at the moment the law is not keeping pace with real life.

**Building an inviting investment climate is partly about perceptions.  
What can be done to improve Russia's image abroad?**

Don't blame the mirror if you don't like the image in it. We should not deny problems which really exist. At the same time, Russia has a PR problem because the problem of corruption is exaggerated. Having worked in the Kremlin, I can testify that there are many decent, dedicated people working in government who are not motivated by money. And they understand that reputation is important. We need to improve our PR in that area. We must be more open – there are not many people who can discuss politics in a normal way. But we need to solve our problems for our own sakes, not anyone else's. What is unacceptable is when outsiders use Russia's internal domestic politics as a means to construct unequal relations or lecture us on how we should behave.