

2012

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### Recommended Citation

Richard E. Ericson, *Development Progress in Russia*, 18 LAW & BUS. REV. AM. 471 (2012)  
<https://scholar.smu.edu/lbra/vol18/iss4/5>

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# DEVELOPMENT PROGRESS IN RUSSIA

*Richard E. Ericson\**

**R**USSIA has been a prime mover in the organization of the BRIC group of nations. The BRICs, originally a Goldman-Sachs conception, comprise the leading developing economies in their respective regions, with Russia central among the Eurasian emerging economies. In response to the question, “Can the BRICs be the drivers of world economic growth?,” we briefly explore Russian economic performance and structure, and the prospects for Russia to become a driver of the world economy in the coming decade.

## I. THE RESURRECTION OF RUSSIA

Russia emerged from the collapse of the Soviet Union a disorganized and greatly shrunken economy, struggling through a “transformational depression” from 1991 through 1998, when Russia defaulted and its emerging financial markets collapsed. To the surprise of many, the economy “bottomed out” in the 1998 financial crisis and a strong recovery began; a recovery that coincided with the first Putin presidency, beginning with appointment by the resigning Boris Yeltsin on December 31, 1999, and then his first round election victory on March 26, 2000. Driven by a four-fold devaluation of the ruble and subsequent import substitution opportunities, tight fiscal and monetary policies, and renewed structural reform, the macro economy grew rapidly during Putin’s first presidential term, overcoming the transitional depression by 2004 (Ericson, 2009).

Putin’s second term as president, 2005-2008, witnessed new economic growth and a significant and sustained, if unequally distributed, rise in the Russian standard of living. This growth of GDP, at a rate of over 7 percent per year in 2003-2008, made Russia the fastest growing as well as the largest economy in its region, and evidently a driver in regional, and indeed world, economic development. The performance indicators, presented in Table 1, gave credence to the Goldman-Sachs (2003) concep-

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tualization of the BRIC economies as presenting significant investment opportunities in emerging markets, with Russia as the Eurasian regional anchor.

Indicator	2000	2004	2005	2006	2007	2008
GDP2000 = 100	100.0	126.6	134.7	145.7	158.1	166.3
GDP % Ä	10.0	7.2	6.4	8.2	8.5	5.2
Industry % Ä	11.9	8.0	5.1	6.3	6.8	0.6
Investment % Ä	17.4	13.7	10.9	16.7	22.7	9.9
Unemployment %	10.2	8.3	7.6	6.9	6.1	7.8
Consumption % Ä	5.9	9.2	11.0	11.0	13.0	8.0
Current Account, \$billion	46.8	59.5	84.6	94.7	77.8	103.5
FDI, \$billion	4.43	9.4	9.0	29.9	47.1	76.0
Budget Balance % GDP	1.2	4.4	7.5	7.4	4.1	7.0
FOREX +Stab Funds, \$billion	32.1	143.4	211.4	392.1	633.2	652.2
Inflation %	20.2	11.7	10.9	9.0	13.3	14.7

Fig. 1: Russian Macroeconomic Performance pre-Crisis (Source: Compiled from BOFIT Russia Statistics Reports).

Putin and the Russian leadership seized on this concept as a way to return Russia to a significant position in world affairs. The humiliation of the 1990s—the loss of economic and military power, the loss of empire, and the encroachment of NATO in the post-Soviet spaces of Eurasia—had to be erased in the revival of Russia, and her renewed leading role in a new world order.<sup>1</sup> Russia looked to international organizations and alliances of convenience with other major and rising powers to restrain the United States and create a multi-polar world with Russia as a pole. Thus, Russia actively used the United Nations, OSCE, and other organizations in which it had a veto or decisive vote to block initiatives it opposed, and actively pursued the development of international organizations it could control such as the SCO, the Eurasian Economic Union, and a Gas OPEC.<sup>2</sup> And with its substantial rate of growth, Russia had the eighth

1. This can be seen in numerous speeches by Putin throughout his time in office, especially in the address to the Munich Conference on Security Policy, 10 February 2007, and in his recent election platform statements. See Vladimir Socor, *Putin's Eurasian Manifesto Charts Russia's Return to Great Power Status*, EURASIA DAILY MONITOR (Oct. 7, 2011, 5:49 PM), [http://www.jamestown.org/single/?no\\_cache=1&tx\\_ttnews%5Btt\\_news%5D=38501&tx\\_ttnews%5BbackPid%5D=512](http://www.jamestown.org/single/?no_cache=1&tx_ttnews%5Btt_news%5D=38501&tx_ttnews%5BbackPid%5D=512).
2. On the Eurasian Economic Community, see Eurasian Economic Community, *EurAsEC Today*, EURAsEC (2011), [http://www.evrases.com/i/other/EurAsEC-to-day\\_eng.pdf](http://www.evrases.com/i/other/EurAsEC-to-day_eng.pdf). On the SCO, see SHANGHAI COOPERATION ORG., <http://www.sect-sco.org/EN/> (last visited Sept. 15, 2012); Representatives from Russia, Qatar, and Iran, the top three holders of proven NG reserves with 60 percent of the total, met October 21, 2008, in Tehran to discuss forming a gas exporting cartel. Nothing, however, has come of this initiative. See Bruce Pannier, *Russia, Iran, and Qatar Consider Gas Troika – Or Gas Cartel*, RADIO FREE EUR. RADIO LIBERTY (Oct. 22, 2008), [http://www.rferl.org/content/Russia\\_Iran\\_and\\_Qatar\\_Consider\\_Gas\\_](http://www.rferl.org/content/Russia_Iran_and_Qatar_Consider_Gas_)

largest economy in the world in PPP terms by 2010, and has become the sixth largest in 2012 with expectation of moving into fifth place in the next three years.<sup>3</sup>

Thus, in 2008, Russia had great expectations for a new world order, one in which it would play a pivotal role. Russia had not only recovered economically, but had substantially internationalized her economy, with international trade being a major factor in both Russian economic growth and standards of living. The leading producing sectors of the economy were substantially integrated into and dependent on world markets, and consumption, particularly of electronics and automobiles, was heavily dependent on imports. Outside of dying rural regions, the economy was monetized and marketized, with financial and “real” markets substantially intertwined. And state finances were on a firm basis, with minimal state foreign debt and substantial state reserves and FOREX holdings.<sup>4</sup> While Russian entities owed international creditors some \$420 billion, over 93 percent of that was the private debt of large Russian companies; a reflection of the “globalization” taking place in the Russian economy. And both GDP and consumption, the standard of living of the Russian population, were apparently inexorably growing, and the poverty level inexorably shrinking, as Putin had promised in 2004 at the beginning of his second term (Ericson, 2009). This evident success was understood by the Russian leadership as the consequence of wise monetary and fiscal policy and the “firm hand of the state” directing economic development and reallocating its fruits. But as one commentator quipped, the Russian government confused high oil prices with the genius of their economic management.

Thus, high growth, high export prices, and substantial reserves spurred increasingly assertive state policy both domestically and abroad. In 2007-2008, among the policies pursued was growing state intervention in the domestic economy, including price controls and openly questioning the property rights of companies failing to hold down prices and maintain employment.<sup>5</sup> Major business leaders were required to regularly report to the government (i.e., Putin) on progress toward goals the government

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Troika\_Or\_Gas\_Cartel/1332004.html; Iran, Qatar, Russia Form Gas Alliance, WALL ST. J., Oct. 22, 2008, at A13.

3. For Medvedev's final State of the Nation address see Vladimir Rodionov, *Outgoing Medvedev Proposes Sweeping Political Reforms*, RIA NOVOSTI (Dec. 22, 2011, 3:37 PM), <http://en.rian.ru/russia/20111222/170427189.html>. For Putin's final Report to the Duma as a Prime Minister see Konstantin von Eggert, *Due West: A Few Surprises in Putin's Final Duma Report*, RIA NOVOSTI (Apr. 12, 2012, 2:15 PM), <http://en.rian.ru/columnists/20120412/172771791.html>.
4. Energy export revenues, largely from oil and natural gas, comprised some 25 percent of Russian GDP and over 40 percent of budget revenues in 2008. WORLD BANK IN RUSS., RUSSIAN ECONOMIC REPORT NO. 18 (2009); WORLD BANK IN RUSS., RUSSIAN ECONOMIC REPORT NO. 19 (2009).
5. Numerous food price controls were introduced beginning in 2007. In July 2008 a federal investigation of Evraz Holding and Raspadsty Ugol mining companies for price fixing was launched, and Mechel steel was publicly attacked by Putin for its price policies. See *Stock Markets React to Prime Minister's Statements*, BOFIT WEEKLY (Bank of Fin., Helsinki, Finland), Aug. 1, 2008, at 75.

had proclaimed, and Putin has reminded business leaders that they needed to pay back society for their wealth.<sup>6</sup> Major companies, including Gazprom, Lukoil, Rusal, etc., were encouraged to expand abroad as national champions, acquiring equity in companies in the same or related (upstream or downstream) industries. This was accompanied by an increasingly aggressive foreign policy, particularly in Russia's near abroad, actively intervening in the Ukrainian elections, dictating the terms of "peacekeeping" in Moldova and The Caucasus, blocking any independent OSCE initiatives, and rejecting the right of any outsiders to monitor Russian elections.<sup>7</sup> The assertion of Russian preeminence in the region included "cyber warfare" in Estonia and Georgia, winter energy cutoffs (both oil and natural gas to Belarus and natural gas to Ukraine), ostensibly over pricing, and culminated in the long prepared invasion and dismemberment of Georgia in August 2008.<sup>8</sup> Economic confidence was evident in increasingly frequent calls for a new world economic order and replacing the dollar as the international currency, medium of exchange, and unit of account. Indeed, both Putin and Medvedev, elected president in May 2008, asserted that the ruble should become an international currency, equal to the dollar, with Moscow as an international financial center, and that Russia was ready to become a leader in the new world order (Ericson, 2009, p. 221). And as a step in that direction, Russia took the initiative in organizing and convening a BRIC group, beginning with ministerial discussions after G20 meetings in 2006 and 2008 and culminating in a BRIC Foreign Ministers Meeting in Yekaterinburg in May 2008, to provide a common front and supporting actions in the development of the new world order.<sup>9</sup>

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6. Most recently, see Putin's speech to the Union of Industrialists and Entrepreneurs on 9 February 2012, as reported in Ira Ioeabashvili & Jacob Gronholt-Pedersen, *Putin Seeks Payments From Those Who Made Fortunes in '90s*, WALL ST. J., Feb. 10, 2012, at A11.
  7. One can see a complete record of this behavior in the Jamestown Foundation's Eurasia Daily Monitor from 2003 through 2012. *Archives*, JAMESTOWN FOUND., <http://www.jamestown.org/archives/monitor/m2002/> (last visited Jan. 6, 2013).
  8. Putin recently admitted that the invasion was preplanned and provoked by Russia. Pavel Felgenhauer, *Putin Confirms the Invasion of Georgia Was Preplanned*, EURASIA DAILY MONITOR (Aug. 9, 2012, 1:18 PM), [http://www.jamestown.org/programs/edm/single/?tx\\_ttnews%5Btt\\_news%5D=39746&cHash=177fd31d57370a96ac7da644dc280014/](http://www.jamestown.org/programs/edm/single/?tx_ttnews%5Btt_news%5D=39746&cHash=177fd31d57370a96ac7da644dc280014/). On Russian use of cyberwarfare, see Alexander Melikishvili, *The Cyber Dimension of Russia's Attack on Georgia*, EURASIA DAILY MONITOR (Sept. 12, 2008, 12:00 AM), [http://www.jamestown.org/single/?no\\_cache=1&tx\\_ttnews%5Btt\\_news%5D=33936](http://www.jamestown.org/single/?no_cache=1&tx_ttnews%5Btt_news%5D=33936).
  9. Russia has continued as a prime mover in organizing BRIC summits, first in Yekaterinburg in 2009, then in Brazil in 2010, China in 2011, and New Delhi in March 2012. South Africa joined at the 2011 Summit, making the BRIC organization 'BRICS.' The fifth summit will be hosted by South Africa. See *BRICS Official Documents: Summits*, BRICS INFO. CENTRE, <http://www.brics.utoronto.ca/docs/index.html> (last visited Jan. 6, 2013).

## II. GROWTH FOUNDATIONS

This growth, and the confidence it engendered, was however built on a rather unstable foundation. While Putin's first term had finished the transition process from Soviet-type to a market economy, completing many of the structural reforms started in the 1990s and reestablishing central authority and state functioning, much institutional and structural reform remained to be done (Ericson, 2006). Further, much, if not most, of the economic recovery and new growth was based on favorable world market conditions and on high and growing prices for that which nature and Soviet development had bequeathed Russia—energy carriers and raw materials. Thus, the foundation of this strong performance was resource extraction and the export of energy, metals, and grain, generating a huge financial surplus which the newly effective state was increasingly able to capture.<sup>10</sup> The export earnings of these leading, largely extractive industries multiplied through the economy as they purchased inputs from domestic manufacturing and service industries, generated new incomes, and stimulated a rapid rise in consumption and the standard of living. This demand fueled a rapid rise in imports, as well as domestic consumption. The subsequent expansion of domestic economic activity spurred borrowing on international markets, particularly as domestic financial markets remained seriously underdeveloped. While newly created wealth remained highly concentrated, the Russian state redistributed much of these rents, primarily to maintain political power and the support of the elite (Gaddy & Ickes, 2011). Hence, rents were used in support of existing industrial, and other economic structures, in order to maintain employment and their continuing operation: a primary component of social and political stability.

In this fortuitous international economic environment, in part as a reaction to the economic and political chaos of the prior decade, it was easy for the Russian state to reassume a leading role in the economy. Indeed, some 50 percent of Russian economic activity remained under state control at the federal, regional, or local level.<sup>11</sup> Putin's Russia opted for state-directed development in the pursuit of national power and the au-

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10. See the World Bank's Russian Economic Report, especially number 1 through number 6, 2001 through 2003, for the statistical record and budgetary impact. *E.g.*, WORLD BANK IN RUSS., RUSSIAN ECONOMIC REPORT No. 1 (2001). The origin and use of resource rents in the Russian economy are analyzed in Clifford G. Gaddy & Barry W. Ickes, *Resource Rents and the Russian Economy*, 46 EURASIAN GEOGRAPHY ECON. 559 (2005).

11. This was asserted by both Finance Minister Alexei Kudrin and Deputy Minister of Economic Development Andrei Klepach during interviews. Interview with Alexei Kudrin, Finance Minister, Russia (Oct. 5, 2009); Andrei Klepach, Deputy Minister of Economic Development, Russia (July 2, 2009). A detailed study by the Siberian Academy of Innovation concluded that "the share of the state sector in the economy (is) . . . no less than 50%." A. Neschadin et al., *The Public Sector of the Economy: the Current Russian Case*, SIBACADEM INNOVATION (Oct. 27, 2007), <http://old.sibai.ru/content/view/1185/1330/> (translated by author).

tonomy of action of a world power.<sup>12</sup> Thus, the extractive industries were natural leaders in the recovery and development processes, but they had to be kept under tight state supervision, if not direct control, for the state to properly benefit from their success. The oligarchs were reigned in, and they and their firms were subject to close political supervision, as were other major economic operations/firms. All major development projects/investments required prior (at least tacit) ‘authorization’ by the leader, and business leaders undertook regular accountability reporting to him.<sup>13</sup>

Major corporations with foreign operations became “National Champions,” and priority development areas were led by state directed Federal Corporations and National Projects. Among the National Champions at the time were Gazprom, Rosneft, Lukoil, Rusal, Polyus Gold, Alrosa, and Severstal. And the major Federal Corporations/National Projects (major funding channels) were Rosatom, VEB, Rostekhnologii, Rusnanotech, Olimpstroï, and the Housing and Municipal Infrastructure Development Fund. In addition, “leading sectors” and elites, however, directly and deeply integrated into the world economy, often served as (indirect) agents for the Russian state (*e.g.*, Alfa-group in Central Asian energy development, and in Turkish telecoms) (Ericson, 2009). This “development structure” was controlled by Putin, both directly and through his plenipotentiaries, and through state control and use of the financial commanding heights, and key state banks: VTB, VEB, Gazprombank, Sberbank, and Rossel khozbank.<sup>14</sup> It was a system of control, far looser than that of the Soviet command economy that appeared effective in an environment of effortlessly rising resource incomes and extremely easy international financial credit.

This system, however, allowed only limited room for institutional innovation. Maintaining control in such a system requires limiting experimentation with alternate structures or activities. This institutional conservatism was reinforced by the fear of political and social instability of the chaos associated with the democracy of the 1990s. Hence, there was no room for Schumpeterian creative destruction of firms and economic activity; only the politically inconvenient could be removed, and only the familiar and authorized could be initiated. Stability was maintained and cooperation was reinforced by the redistribution of resource rents; directing subsidies, benefits, and privileges toward social and politi-

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12. Putin was quite explicit about this strategy of using natural resources for state power in his doctoral dissertation at the St. Petersburg Mining Institute. See Harley Balzer, *The Putin Thesis and Russian Energy Policy*, 21 *POST-SOVIET AFF.* 210 (2005).

13. This can be seen in the regular meetings reported on the website of the President of the Russian Federation, particularly during Putin’s presidency. See *PRESIDENT OF RUSSIA*, <http://eng.kremlin.ru/> (last visited Jan. 6, 2013).

14. State officials were placed on Boards of Directors, usually as Chairman, or in executive positions, of major business operations. For example Medvedev at Gazprom prior to running for President, Igor Sechin in Rosneft, Vladislav Surkov in Transneftprodukt, Sergei Prikhodko in TVEL (nuclear fuel), and Viktor Ivanov in Aeroflot and Almaz-Antei (air defense).

cal groups, and traditional economic activities/industries, supporting the existing structures of economic growth and political power (Gaddy & Ickes, 2011). Finally, a substantial portion of those rents were sequestered in stabilization (Welfare and Development) Funds and State FOREX Reserves as a buffer against outside shocks, against market and price volatility.

### III. CRISIS AND RECOVERY

Vladimir V. Putin handed over the (formal) presidency to Dmitry A. Medvedev on May 7, 2008, as the Russian economy began showing signs of overheating. Inflation was accelerating (to 15 percent year on year in June), provoking the controls noted above, and both output (10.3 percent to 3.2 percent) and investment growth (25 percent to 9.9 percent) began slowing. Financial markets were sharply hit (stocks down over 50 percent; ruble down almost 18 percent) by September, from both war-induced (invasion of Georgia) capital flight and the severe contraction in world financial markets, both of which led investors to pull out of Russia. Major Russian firms, heavily indebted to foreign banks, faced loan recalls, just as commodity prices collapsed, destroying their ability to repay.<sup>15</sup> After initially denying that Russia could be seriously affected, the Russian government (Putin, as Prime Minister) reacted strongly and decisively, providing both direct and indirect funding to Russian banks and firms, using control of the financial “commanding heights,” to the tune of one-seventh of Russian (dollar) GDP—an intervention unmatched in size, relative to that of the economy in the world.<sup>16</sup> The primary focus of this support was on preventing equity transfer to foreigners, shutdown of manufacturing operations, and an increase in unemployment. Thus, subsidies and zero interest loans were provided to pay off foreign debts and to maintain manufacturing activity, compensating for the collapse in non-state demand and sales revenues.<sup>17</sup>

Despite this strong policy response, the world financial crisis of 2008/2009 hit Russia harder than the other BRIC countries, although it only reached Russia late in 2008.<sup>18</sup> Indeed, in the first half of 2008, GDP grew

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15. The inability to repay loans led creditors to demand the loan collateral, often equity in Russian firms, which the Russian state did not want transferred. Hence the state massively intervened, providing easy credits/grants to pay off loans, forcing sales of foreign subsidiaries, or blocking equity transfer through Russian court decisions. See Richard E. Ericson, *The Russian Economy in 2008: Testing the “Market Economy”*, 25 POST-SOVIET AFF. 223 (2009).

16. For comparison, the immediate U.S. response package of \$752 billion, was about 5 percent of U.S. GDP in 2008, and less than half of it was expended by the end of 2008. President Obama’s near \$800 billion stimulus package raised the total intended U.S. effort to about 10 percent of U.S. GDP.

17. Putin attacked a prominent oligarch, Oleg Deripaska, for failing to maintain operations in unneeded factories in Pikalevo, and subsidized the automobile maker, Avtovaz, to maintain employment despite a 90 percent drop in sales. See Ericson, *supra* note 16, at 224-25.

18. China, India, and South Africa continued to grow at robust, if slower, rates. Only Russian and Brazilian GDP fell in 2009, and Brazil’s drop was only 0.6 percent.

by almost 8 percent, investment and consumption by over 13 percent, and unemployment fell to a new post-Soviet low (5.3 percent). This maintained the appearance of continuing economic strength through 2008, with the full extent of the collapse in growth and economic activity only evident in the figures for 2009.

Indicator	2000	2008	2009	2010	2011
GDP2000 = 100	100.0	166.3	153.3	159.9	166.8
GDP % ©	10.0	5.2	-7.8	4.3	4.3
Industry % ©	11.9	0.6	-9.3	8.2	4.7
Investment % ©	17.4	9.9	-15.6	6.0	8.3
Unemployment %	10.2	7.8	8.2	7.2	6.1
Consumption % ©	5.9	8.0	-5.0	2.1	6.5
Current Account, \$billion	46.8	103.5	48.6	71.1	101.1
FDI, \$billion	4.43	76	27.7	13.8	18.4
Budget Balance %GDP	1.2	4.1	-5.9	-4.1	0.8
FOREX +Stab Funds, \$billion	32.1	652.2	591.1	593.3	610.6
Inflation %	20.2	13.3	8.8	8.8	6.1

Fig. 2: Russian Macroeconomic Performance post-Crisis (Source: Compiled from BOFIT Russia Statistics Reports).

Indeed, in the first half of 2009, Russia suffered a much deeper drop than the table reflects, as second half performance was supported by the massive subsidies of business that Putin implemented, including the use of over \$250 billion from the stabilization funds. Growth from 2009 was also supported by a rapid recovery in energy prices,<sup>19</sup> cushioning the drop in stabilization funds and renewing the substantial flow of funds into government coffers. Energy export revenues came to the rescue, supporting the subsidization policies of the government's crisis rescue operation. Massive state intervention had pulled the economy out of serious contraction by 2011, albeit at a lower growth rate, but with higher incomes and employment, and lower inflation. But the result remained unsatisfactory; Russia was no longer a world leader in economic growth.

Russian economic policy in the face of the crisis had been sufficient to block a depression, and restore some growth, but nowhere near the prior rates that had made Russia a regional development driver. The economic situation, post crisis, reflected the stability and resilience of the system, but also showed its apparent inability to generate qualitatively new

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Dominic Wilson et al., *The BRICs Remain in the Fast Lane*, GOLDMAN SACHS 3 (June 24, 2011), <http://www.goldmansachs.com/our-thinking/topics/brics/brics-reports-pdfs/brics-remain-in-the-fast-lane.pdf>.

19. From about \$40/bbl., Brent oil rose over \$80 within a year and was near \$120/bbl in less than two years. See *Crude Oil, Brent Price Chart*, MONGABAY, <http://www.mongabay.com/images/commodities/charts/chart-crudebrent.html> (last updated June 9, 2012).

growth. President Dmitry Medvedev, who assumed his position as the country was overwhelmed by the crisis, began calling for a new growth model, moving from a resource to technology driven basis, in order to restore the dynamism of the Russian economy and its position as a potential engine of world economic development.<sup>20</sup>

#### IV. SEEKING A NEW GROWTH MODEL

In 2009, as the recovery from the crisis was underway, President Medvedev declared it inadequate. In a series of speeches, he pointed to the stultifying impact of the current economic system on economic growth and dynamism. In a major White Paper, presented to the legislature, "Forward, Russia!," he called for a new innovative, liberal economic "model," one built around the initiative of the creative classes that would create qualitatively new growth driven by technological innovation.<sup>21</sup> His administration also commissioned, in 2008, the development of a new growth strategy, consistent with this vision, to be prepared by the National Research University—Higher School of Economics (NRU-HSE).<sup>22</sup> The Russian Presidency (Medvedev) also proposed to the Russian Government (Putin) and the legislature (Duma and Federation Council) a series of administrative reforms and anti-corruption measures, and pushed WTO negotiations to a successful conclusion in December 2011. A major government program to create a "Russian Silicon Valley" in Skolkovo, outside Moscow, was launched, and a new Direct Investment Fund with \$2 billion state seed money was created to attract \$100 billion in "venture funds" in support of Russian innovative development.<sup>23</sup>

The logic of the new growth model was laid out in a major set of analytic reports in late 2011 by scholars largely from NRU-HSE under the title: *Strategy 2020: New Model of Growth*.<sup>24</sup> This was to be a model of controlled innovation, innovation that avoided social disruption and upheaval, while pursuing the progressive objectives of the Russian State and

20. This was the focus of his second state of the nation address. See Dmitry Medvedev, Presidential Address to the Federal Assembly of the Russian Federation (Nov. 12, 2009), available at [http://archive.kremlin.ru/eng/speeches/2009/11/12/1321\\_type70029type82912\\_222702.shtml](http://archive.kremlin.ru/eng/speeches/2009/11/12/1321_type70029type82912_222702.shtml).

21. For the fullest statement of his approach, see Dmitry Medvedev, *Go Russia! PRESIDENT RUSSIA* (Sept. 10, 2009, 12:00 PM), <http://eng.kremlin.ru/news/298>.

22. *Strategy 2020*, INST. PUB. ADMIN. MUN. MGMT., <http://www.ipamm.hse.ru/eng/authorities/> (official web page for NRU-HSE program and discussion of its origins) (last visited Jan. 7, 2013). For the final summary report, see *STRATEGY 2020, STRATEGY 2020: THE NEW GROWTH MODEL - A NEW SOCIAL POLICY*, (2012), available at <http://2020strategy.ru/data/2012/03/14/1214585998/1itog.pdf>.

23. Skolkovo was announced on Nov. 12, 2009 by Dmitry Medvedev, to be headed by Russian oligarch Viktor Vekselberg and co-chaired by former Intel CEO, Craig Barrett. It is still developing with little payoff, despite international buy-in. See Irinia Mokrousova, *Who is earning off "Skolkovo"?*, *VEDOMOSTI* (on file with the author). On the new Direct Investment Fund, see *About RDIF, RUSSIAN DIRECT INVESTMENT FUND*, [http://rdif.ru/Eng\\_Index/](http://rdif.ru/Eng_Index/) (last visited Jan. 9, 2013); Gregory White, *Russian Fund Seeks Foreign Investment*, *WALL ST. J.*, Apr. 5, 2011, at C3.

24. For access to the documents, see *STRATEGY 2020*, <http://2020strategy.ru/> (last visited Jan. 9, 2013).

Society. Its key recommendations were: (i) emphasis/reliance on human capital and on innovation by the creative class; (ii) pursuit of institutional reform, removing barriers to economic growth, and improving the business and regulatory climate; and (iii) stimulation of economic competition through trade liberalization and integration in world manufacturing. Hence, a critical role is to be played by expanding trade relations, with particular focus on CIS and the EU.<sup>25</sup>

This pursuit of this new growth model, a more liberal economic system, appears now to be something of a mirage. Despite new anti-corruption laws, repeated anti-corruption campaigns, and the constant rhetorical push during the Medvedev Presidency, the patrimonial system, run by and for a politically connected elite revolving around Putin, remains fundamentally unchanged.<sup>26</sup> Reform measures and laws have been stalled in endless and repeated “consultations and negotiations” among state and government bodies—presidential, executive, and legislative—rarely emerging with any impact.<sup>27</sup> The sole exception appears to be WTO membership, for which Russia received sufficient concessions to allow buy-out of the political opposition.<sup>28</sup> For all but superficial changes, the need to maintain social and political stability and order, emphasized by both Putin and Medvedev, particularly in the wake of the economic crisis, has triumphed. The system and its leaders are united in blocking socially disruptive, unauthorized, economic change in pursuing the current leadership’s vision of managed “progress” to a technological frontier. Indeed, even the rhetoric of “Forward, Russia!” and a new growth model has vanished with the (evidently long planned) return of Putin to the Presidency, and the demotion of Medvedev to the role of an implementer of Putin’s initiatives.

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25. *Strategy 2020 Emphasises Economic Cooperation with CIS Countries and the EU*, BOFIT WEEKLY (Bank of Fin., Helsinki, Finland), Mar. 30, 2012, at 1.

26. For a recent analysis of the imperviousness of corruption to reforms and campaigns in the patrimonial system, see Alena Ledeneva & Stanislav Shekshnia, *Corporate Corruption in Russian Regions*, 92 RUSS. ANALYTICAL DIG. 2, 3-5 (Feb. 22, 2011); Svetlana Tulaeva, *How Anti-Corruption Laws Work in Russia*, 92 RUSS. ANALYTICAL DIG. 9, 9, 12 (Feb. 22, 2011).

27. This has been particularly true of Medvedev’s efforts toward legal reform “decriminalizing” private economic activity, where the Interior Ministry and Procuratura have worked to delay and nullify the proposed and decreed legal reforms. See William E. Pomeranz, *The Magnitsky Case and the Limits of Russian Legal Reform*, 92 RUSS. ANALYTICAL DIG. 12, 13 (Feb. 22, 2011); Lilia Biryukova, *President Popravili*, VEDOMOSTI (Feb. 17, 2011), [http://www.vedomosti.ru/newspaper/article/255220/prezidenta\\_popravili](http://www.vedomosti.ru/newspaper/article/255220/prezidenta_popravili) (describing how administrative departments corrected Medvedev’s legal reforms).

28. See William Mauldin, *Russia to Join WTO*, WALL ST. J., Nov. 10, 2011, at A12. Russian attitudes toward WTO membership have been ambivalent, with serious opposition from some affected businesses and in the Duma. WTO Ministerial Conference approved Russian accession in mid-December 2011, but only on August 22, 2010, did Russia fully agree to join. *Russia One Step Closer to WTO Membership*, BOFIT WEEKLY (Bank of Fin., Helsinki, Finland) Nov. 18, 2011, at 1; *Russia’s WTO Membership Brings Some Tariff Relief Important for Finland*, BOFIT WEEKLY (Bank of Fin., Helsinki, Finland) Aug. 24, 2012, at 1.

## V. THE FUTURE: PROBLEMS AND PROSPECTS

Russia remains the dominant economic power in its region, and a growing presence in the world economy. But can it be a driver of regional and world economic growth, and a significant part of an international investment portfolio, over the next two decades? The answer must depend not only on the ability of Russia to return to high rates of economic growth, but also on its ability to move to the world technological frontier. Medvedev and his advisors recognized this truth in the call for a qualitatively new economy, one based on innovation and human initiative and diversified across a broad range of new technologies and activities. But that is apt to require changes that the renewed administration of Vladimir Putin is unlikely to accept.

## VI. OBSTACLES TO QUALITATIVELY NEW GROWTH

The primary obstacle to qualitatively new economic growth in Russia is the nature of the economic system built by Putin since 2005. It is a highly dirigiste market economy, subject to a patrimonial system of governance. The patrimonial system, built around personalized authority and reward, remains strong and thriving. Its beneficiaries, both state and “private,” have no incentives to give it up, yet are the only ones with the power to carry out (non-revolutionary) change. They comprise the top political leadership, the burgeoning bureaucracy, and the owners and managers of the major firms, particularly in the leading sectors of the economy: natural resources and energy, banking and finance, transportation, and some critical manufacturing and strategic industries.<sup>29</sup> Liberalizing and decentralizing institutional reform directly challenges their power, perquisites, and wealth, and hence such reform flounders in endless bureaucratic discussion, consultations, and reviews, only making it into a law in a highly watered down, ineffectual form.

Such has been the fate of reform attacking that essential lubricant of most Russian economic interaction, corruption. Legal reforms liberalizing economic law and decriminalizing unauthorized private economic initiative have similarly died between the Procuracy and Duma, and even administrative reorganizations, threatening the livelihood of current office holders, have faded away before passage and implementation.<sup>30</sup> For example, state corporations are infamous for their wastefulness and non-

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29. A list of eleven Strategic Sectors was codified by law on May 5, 2008, restricting foreign investment in them. See Valery Fadeev, *State and Business: Infantilism Intellectuals*, VEDOMOSTI (June 7, 2008), available at <http://www.vedomosti.ru/news-paper/article/2008/06/07/150792>. The list remains, but amendments to the law implemented in December 2011 eased some restrictions on foreign investment. *Foreign Strategic Investment Law Continues to Evolve*, BOFIT WEEKLY (Bank of Fin., Helsinki, Finland), Jan. 13, 2012, at 1.

30. Pomeranz, *supra* note 27; Tulaeva, *supra* note 26; Medvedev *Reiterates Reform Goals at the St. Petersburg International Economic Forum*, BOFIT WEEKLY (Bank of Fin., Helsinki, Finland), June 23, 2011, at 1.

transparency in operation.<sup>31</sup> Medvedev announced an effort to eliminate the state unitary firm as a legal and administrative structure and to reform the “federal corporation” (e.g., Rostekhnologii, Rusnanotech) to introduce better control over, and greater efficiency in the use of, state property.<sup>32</sup> To date, these reforms appear to have vanished into bureaucratic discussions and interdepartmental consultations. Indeed, the patrimonial governance structure is essential to the “rent redistribution” system that maintains social stability and fuels economic activity. Hence, it is critical to the maintenance of political stability and control. So, as in Soviet days, we see a “treadmill” of administrative reforms and anti-corruption drives ultimately doing little to alter the existing system.

Another obstacle arises from the need to mobilize the creative class, those capable of truly innovating, of creating a new technological basis for economic expansion, development, and growth. Such creativity, such innovation, requires substantial individual freedom. In particular, it relies on the freedom to step outside of existing structures and constraints, to experiment with new, unauthorized, and even hereto unimagined, activities, and on the ability to choose one’s own leaders and dispose of one’s own resources and incomes without political direction from above. Such people are naturally politically restive, and their innovative activity presents an inherent threat to “controllability” of the development process, as well as to existing political structures. Further, they pose a “flight risk” as they are readily employable in the more liberal market economies of the West. Thus, stimulating qualitatively new economic growth poses a danger to the foundations of the current political system, the patrimonial structures insuring social stability and the well-being of the current elite. And perpetuation of that system blocks true innovation and qualitatively new growth.

Further, new growth is undercut by the structural legacies of the Soviet economy, including an aged and obsolete capital stock, a stagnant working age population lacking appropriate skills for new technologies, an inefficient organization of production and distribution, and inadequate

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31. See *Goskorporatsii poimali na narusheniakh* [State Corporations Caught in Violations], INTERFAX, (Nov. 11, 2009, 12:46 AM), <http://www.interfax.ru/business/txt.asp?id=109384>.

32. See *Changes Planned for State Companies*, BOFIT WEEKLY (Bank of Fin., Helsinki, Finland), Jan. 5, 2012, at 1 (describing criticisms regularly made of state corporations). Medvedev ordered a review of the criticisms in 2009 and raised the issue of abolishing State Unitary Enterprises. *Medvedev Orders Review of State Corporations*, BOFIT WEEKLY (Bank of Fin., Helsinki, Finland), Sept. 18, 2012, at 1. Nothing appears to have come of Medvedev’s initiative. The Prime Minister has ordered the government to prepare suggestions for doing so. See *Medvedev Wants Ideas to Make Cos Get Approval to Buy Assets*, PRIME BUS. NEWS AGENCY (Apr. 27, 2012), [http://www.1prime.biz/news/\\_Medvedev\\_wants\\_ideas\\_to\\_make\\_state\\_cos\\_get\\_approval\\_to\\_buy\\_assets/0/%7B19201595-CB1E-42EC-9593-0B33F4BDEC74%7D.uif](http://www.1prime.biz/news/_Medvedev_wants_ideas_to_make_state_cos_get_approval_to_buy_assets/0/%7B19201595-CB1E-42EC-9593-0B33F4BDEC74%7D.uif); see also Yana Vaziakova et al., *Russia: Progress in Structural Reform and Framework Conditions* 15 (OECD Econ. Dep’t, Working Paper No. 920, 2011), available at <http://www.oecd-ilibrary.org/docserver/download/fulltext/5kg0k6zsbjv.pdf?expires=1349882831&id=id&accname=guest&checksum=A98DA12501924E6BC318EF99F2FA802B>.

infrastructure.<sup>33</sup> These problems are aggravated by the inappropriate, and high-cost location of much production/manufacturing activity, a consequence of decades of economically irrational Soviet investment and the emigration of many of the highest educated skilled employees, a classic brain drain.

## VII. DRIVERS OF CONTINUING GROWTH

Despite the obstacles to implementing a new growth model, there are factors that will help sustain continuing economic growth and Russian economic predominance in the region. Resource prices, and in particular the price of oil, are apt to remain high and rising. Indeed, Russia's relatively rapid recovery from the financial crisis can be largely explained by the rapid recovery in the price of oil, generating sufficient state income to support recovery measures and replenish state financial reserves.<sup>34</sup> Unless there is a collapse of demand in Europe and/or China, energy and resource prices should continue rising, again generating an investable state surplus for development, infrastructure projects, and a substantial planned increase in military and social spending.<sup>35</sup> The Russian government has also made a priority of restoring Russia's prominence in science

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33. See RICHARD E. ERICSON, *LEGACIES OF COMMAND: THE RUSSIAN ECONOMIC TRANSITION EXPERIENCE* (forthcoming Summer 2013) (discussing Soviet legacies). The McKinsey Global Institute (1999 & 2009) studies the inefficiencies in ten critical economic sectors in Russia in 1997 and 2007, shows the impact of structural legacies in 1997, and both the improvements to 2009 and what needs to be done to reach western efficiency levels. MCKINSEY GLOBAL INST., *UNLOCKING ECONOMIC GROWTH IN RUSSIA*, (Oct. 1999); MCKINSEY GLOBAL INST., *LEAN RUSSIA: SUSTAINING ECONOMIC GROWTH THROUGH IMPROVED PRODUCTIVITY*, (Apr. 2009).
  34. Oil and natural gas export revenues provide over 40 percent to the state budget revenues. Russ. CEIC Database Team, *Russia's Oil and Gas Revenues: Federal Budget Dilemma*, ISI EMERGING MARKETS BLOG (May 16, 2011), <http://blog.securities.com/2011/05/russias-oil-and-gas-revenues-federal-budget-dilemma/>; *Russian Economic Report No. 14*, WORLD BANK RUSS. ECON. REV. (World Bank, Moscow, Russ.), June 2007, at 9; *Russian Economic Report No. 24*, WORLD BANK RUSS. ECON. REV. (World Bank, Moscow, Russ.), Mar. 2011, at 18; *Russian Economic Report No. 26*, WORLD BANK RUSS. ECON. REV. (World Bank, Moscow, Russ.), Sept. 2011, at 20-25; *Russian Economic Report No. 27*, WORLD BANK RUSS. ECON. REV. (World Bank, Moscow, Russ.), Apr. 2012, at 10-11, 26-28.
  35. Stephen Blank, *Lurching Toward Militarization: Russian Defense Spending in the Coming Decade*, EURASIA DAILY MONITOR (Jan. 5, 2011, 4:13 PM), [http://www.jamestown.org/programs/edm/single/?tx\\_ttnews%5Btt\\_news%5D=37318&tx\\_ttnews%5BbackPid%5D=27&cHash=5c3c1d0a84](http://www.jamestown.org/programs/edm/single/?tx_ttnews%5Btt_news%5D=37318&tx_ttnews%5BbackPid%5D=27&cHash=5c3c1d0a84); Pavel Felgenhauer, *Voters Will Pay for a Military Buildup After Electing Putin*, EURASIA DAILY MONITOR (Nov. 17, 2011, 4:08 PM), [http://www.jamestown.org/single/?no\\_cache=1&tx\\_ttnews%5Btt\\_news%5D=38683&tx\\_ttnews%5BbackPid%5D=7&cHash=f0ab715b475f27306279c57bec9c012e](http://www.jamestown.org/single/?no_cache=1&tx_ttnews%5Btt_news%5D=38683&tx_ttnews%5BbackPid%5D=7&cHash=f0ab715b475f27306279c57bec9c012e). The military build-up is a recently emphasized Putin-Medvedev priority. Spending on the power agencies is planned to rise from 24 percent to 30 percent, driven by defense spending rising from 15 percent to 20 percent. Social spending is to rise to 29 percent of the state budget. See *Current Budget Framework Calls for Sharp Hikes in Spending on Defence and National Security*, BOFIT WEEKLY (Bank of Fin., Helsinki, Finland) Oct. 14, 2011, at 1. The Finance Minister, Alexei Kudrin, lost his position in September 2011 after criticizing the planned 2.1 trillion ruble (\$66 billion) increase in defense spending. See Tai Adelaja, *A Laundry List for the Kremlin: Russia's Former Finance Minister Alexei Kudrin Has Come up With a Plan to Help the Kremlin Maintain Fiscal Dis-*

and technology, earmarking substantial budgetary resources to both fundamental and applied sciences and to R&D, reversing a two decade contraction, that will become available with continuing strength of resource and energy prices. Thus, rising energy prices should also help counter the brain drain of the past decades. Finally, increased business and state revenues from strong export prices will stimulate rising consumer demand and the development of both consumer and business services.

Another factor that should support continuing solid economic growth is Russia's recent accession to WTO, negotiated and signed in December 2011 and ratified by the Duma August 22, 2012. The agreement opens eleven service sectors to foreign participation, introduces international technical and phytosanitary standards, requires a 50 percent cut in agricultural subsidies, and general tariff reductions spread across eight years, one-third immediately, one-third in three years, and the rest in eight years.<sup>36</sup> This is apt to drive some further internal liberalizations and reforms and open more foreign markets to Russian goods, while increasing production efficiency by subjecting Russian manufacturers to (slowly, by design) increasing competition.<sup>37</sup> It will also help foster greater openness to foreign investment and technological sharing, enhancing modernization of industry. And this boost to growth is apt to be reinforced by the announced renewed privatization drive, aiming to reduce the state share in many industries without sacrificing state control.<sup>38</sup>

Growth in the near term will also be driven by the continuing restructuring of inherited industrial capacities, investment in modernization, and in new technologies and equipment. Transportation and energy infrastructures are also the subject of state development plans, where massive investments are required, and in social service infrastructure, including housing. This "development" investment can be expected to provide a stimulus for increased industrial production and investment. There are also a number of major state investment projects that will stimulate economic activity, including the 2014 Olympics and 2018 World Cup facili-

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cipline, RUSSIA PROFILE (Oct. 19, 2011), <http://russiaprofile.org/business/47417.html>.

36. *WTO Accession Means Many Changes*, MOSCOW TIMES (Nov. 10, 2011), available at <http://www.themoscowtimes.com/sitemap/paid/2001/11/10.html>.

37. For a summary of the World Bank's detailed analysis of the impact of WTO accession on Russia, indicating its strongly positive potential, see *Russian Economic Report No. 27*, *supra* note 34. As noted above, this is a major part of Strategy 2020.

38. Further privatization is emphasized in all government discussions of reform, although its contours and specific content continue shifting and remain unclear. See *Sale of State-Owned Enterprises Moving into New Phase*, BOFIT WEEKLY (Bank of Fin., Helsinki, Finland) July 1, 2011, at 1; *Cabinet Approves Latest Programme to Privatis State-Owned Enterprises; Exact Schedule and Scope Remain Unclear*, BOFIT WEEKLY (Bank of Fin., Helsinki, Finland) June 15, 2012, at 1; Maxim Tovkailo, *The Government is Preparing to Extend the Privatization Program*, VEDOMOSTI (Aug. 3, 2011), <http://www.vedomosti.ru/politics/news/2011/08/03/1332680>; Ira Iosebashvili, *Russian Privatization Plan Raises Questions*, WALL ST. J., June 21, 2012, <http://online.wsj.com/article/SB10001424052702303734204577468513760329818.html>.

ties, and off-shore Siberian and Arctic energy field development, with its supporting oil/gas export infrastructure.

### VIII. CAN RUSSIA HELP CARRY WORLD GROWTH TO A HIGHER LEVEL?

For the structural reasons discussed above, it is doubtful that Russia will have the impact on world economic development of the other BRIC, especially China. Russia, however, is and will remain the dominant economy in Central Eurasia and an engine of growth for the former FSU countries of that region. Its forecast growth to 2015, largely driven by oil prices, is unimpressive but stable; most analyses see growth in the 3.5-4.2 percent range per year.<sup>39</sup> But that is clearly inadequate for Russia's ambitions and will be only mediocre in international comparisons, particularly with the other BRIC.

The government sponsored Russia-2020 program demands at least 5 percent per year to meet social needs, and provides three potential scenarios for Russian economic development.<sup>40</sup> The first is what is called the Inertia scenario, without significant change in the structuring or functioning of the current system. It promises annual growth stagnation at 3-3.5 percent to 2020. The second is an Energy Resource Based scenario, where Russia focuses on fully exploiting its comparative advantage in energy resource development and export. In this scenario, annual growth steadies at 4-5 percent, but around 2020 begins tapering off. Finally, an Innovation Based scenario, built on economic liberalization and mobilization of the "creative class," is outlined. Here, annual growth rises to over 6 percent, 2015-2020, and the foundation is built for high growth beyond that. Unfortunately, none of these scenarios begins to grapple with the patrimonial system that is the true obstacle to rapid economic growth, despite much talk of reforms to improve the business climate.<sup>41</sup>

Again for the reasons adduced above, the innovation based, and even the resource based scenarios are much less likely than inertia, barring a major political change in Russia. Russia will provide a steady source of growing demand on the world market, but not enough to call forth new growth in the way Chinese demand has and will.

Russia's primary impact on world economic growth is far more likely to lie on the supply side. Russia will support world, especially Asian, eco-

39. At the end of 2011, all forecasts were lower: Russian domestic: 3.1-3.7 percent per year; BOFIT: 3.5 percent per year; WB-Russia: 3.3-4.0 percent per year. Following 4.3 percent GDP growth in 2011, WB-Russia increased its forecast growth rate to this range, with high oil prices driving growth at the upper end.

40. See the preliminary report from August 2011 and the final report of January 2012 on the website: <http://2020strategy.ru/>. For an early analysis of the state assignment see ANDREW C. KUCHINS, AMY BEAVIN & ANNA BRYNDZA, *RUSSIA'S 2020 STRATEGIC ECONOMIC GOALS AND THE ROLE OF INTERNATIONAL INTEGRATION* (2008).

41. The ambivalence about systemic reform was evident at the 2012 Davos Conference in St. Petersburg. See Schumpeter, *Davos on the River Neva*, *ECONOMIST*, June 30, 2012, at 70.

conomic growth by providing energy supplies and raw materials, while maintaining a steady demand for finished products from other countries. And its biggest impact will undoubtedly be regional. Russia is a primary purchaser of raw materials and semi-fabricates from the FSU states of Eastern Europe and Central Asia, and is a primary supplier of energy and finished products. And Russia is apt to maintain that position for the next decade, despite the efforts of some of these countries to diversify their international economic interactions. This role will be enhanced by closer integration of the Eurasian Common Market, and customs union, and the Shanghai Cooperation Organization (SCO) where Russia shares leadership with China, now her primary competitor in Central Asia.<sup>42</sup>

Finally, we might expect greater Russian integration into, and impact on, northeast Asian development through both energy supply (new oil and gas pipelines and LNG supply) and attracting development investment and skilled labor into its underdeveloped far eastern and east Siberian regions. While both political (Kuril/Northern Territory dispute) and psychological (Russian xenophobia) barriers remain, we might expect the natural economic benefits of such integration, the development of natural resources, and the opening of foreign markets, to overcome these barriers in the coming decade. But it is rather unlikely that Russia will become more than a regional economic engine in the coming decade, despite perhaps having the fifth largest (PPP) GDP in the world on the strength of its resource and energy export earnings.

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42. Some of the difficulties in pursuing the Eurasian Union Project are discussed in the April 20, 2012 edition of the Russian Analytical Digest. See Gennady Chufirin, *A Difficult Road to Eurasian Economic Integration*, 112 RUSS. ANALYTICAL DIGEST 1 (2012).