

Special
Supplement

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The real Russia





EXPERT GROUP

Specialising in the analysis of contemporary Russian business and economics, politics and society, **Expert Group** comprises a think-tank, a rating agency and a publishing house.

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About this supplement

Old attitudes to Russia die hard. The west has always been suspicious, and often rather frightened, of that vast, alien and unpredictable country. Before the fall of the Berlin Wall, westerners mentally dismissed anything to the east rather as the medieval map-makers did when they reached the limits of the known world: “there be dragons”. Today, though some eastern European cities have become familiar to weekend trippers, others, particularly Moscow, are regarded as wild and lawless. The image of a country under lock and key has been succeeded by one of a country terrorised by guns and gangsters.

This supplement does not attempt to deny that Russia has problems. It does try to present a more rounded, less apocalyptic picture. In many respects, the popular western view is outdated. The past few years have been times of significant economic growth and greater stability in Russia – but this news is less dramatic than what went before, and therefore, as is always the case, it is under-reported.



The supplement is produced jointly by the *New Statesman* and the Moscow-based weekly *Expert*. The latter, founded in 1995, has a circulation of 75,000 – some of it in the newly independent states that were formerly part of the Soviet Union, some in Germany and Austria, as well as in Russia itself – and a staff of 200, including six foreign correspondents.

Though primarily a business weekly, *Expert* also covers politics, arts, science and books and carries out long-term research projects, notably one (involving more than 3,000 interviews) on the nascent Russian middle class.

This is an unusual publishing project, not least because *Expert* describes itself as “right-central”, in contrast to the *NS*'s own political position. Most articles (there are two exceptions) were commissioned by *Expert*; but the contents of all were jointly agreed and edited. As in the rest of the *NS* issues, the viewpoints vary widely; but they all try to show that Russia is not quite as most westerners think. I hope you find it both enlightening and enjoyable.

Peter Wilby, editor, *New Statesman*

Contents: The Real Russia



iii Leader 1 by Peter Wilby

iv Leader 2 by Valeri Fadeyev

v Tatyana Gurova looks at how to sustain economic growth

viii Aleksandr Privalov on who runs the country

x Natalya Arkhangelskaya on a new type of politician

xi Nick Paton Walsh gives a western correspondent's view

xiii John Lloyd examines a not-yet-modern, post-empire Russia

xv Teodor Shanin looks at the education system

xvi Anna Starobinets finds modern Russian literature dirty

xviii Vera Krasnova talks to jeans tycoon Vladimir Melnikov

xx Iskander Khisamov on foreign alliances

xxii Aleksandr Ivanter profiles the man behind economic reform

xxiii Alex Kokcharov enjoys Moscow's hectic nightlife

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Russia and Europe: equal partners

In past years, the west has acquired a fairly set notion of modern Russia. This image includes many stereotypes but few subtle insights into the dramatic processes that Russia has experienced in the course of its transformation.

It would be naive to expect western observers to have a deep understanding of the situation in Russia. For the past ten to 15 years, since the fall of the Berlin Wall and the collapse of the Soviet Union, Russia has been far from the world spotlight. However, it would be wrong to write off Russia, a huge country with a population of 145 million and the largest territory in the world. A huge range of factors makes Russia, though weakened by internal crisis, an influential world power.

Russia has the most natural resources in the world and is a leader in energy and fuel exports. Europe depends to a large extent on Russian natural gas for its energy – half of the EU's energy is imported, of which Russia provides more than 30 per cent. Though fortunately no one expects another energy crisis like the ones that shook the 1970s, those providing fuel to the world market do have an important influence on the global economy.

Russia shares a border with 11 countries, from North Korea in the Far East to Finland in Europe. Another dozen countries are in Russia's area of immediate interest. This geographic factor forces Russia to take on an active geopolitical role, objectively drawn into most international discussions. Problems such as North Korea, the war in Afghanistan, Iraq and Nato expansion are important for Russia, and it has to engage with them, like it or not. Russia maintains the second-strongest military after the US, despite huge losses after the collapse of the Soviet Union. Though Russia's traditional forces are not in the best of shape and are modernising extremely slowly, its nuclear capabilities are as powerful as ever.

Russia's weakest point is its economy. During the crisis of the 1990s, the country lost nearly half of its

GDP (from US\$1.1trn to \$492bn) and more than half its manufacturing. This loss is greater than that of any western country during the Great Depression of the 1930s. However, for the fourth year in a row, the Russian economy has been growing at an annual rate of 4-6 per cent. The Russian consumer market is now the fastest-growing in Europe. According to researchers from the Expert Analysis Centre, roughly ten million Russians are already enjoying standards of living comparable to those of central Europeans. Another 20 million belong to the Russian middle class, with incomes that allow them to buy not only modest food and clothing, but also cars, cell phones and holidays.

Most Russian companies are still inefficient. In part, this is why the country's stock market is still very limited. Today, however, it is possible to point to dozens of companies, such as Yukos and Gazprom, whose market capitalisation will double, triple, or even expand tenfold or twentyfold. But this will happen only if Russia continues on the path to modernisation. The Russian economy is a large potential area for western capital investment.

Russia is not Europe, or at least not completely Europe. We can have long philosophical debates on the subject, but anyone who has ever flown over Siberia and looked out of the airplane windows to see endless stretches of taiga or steppe without a sign of human life below can draw his own conclusions. However, Russia without a doubt can and should become an equal partner with the west. It is in Europe, not the east, some argue, that Russia's strategic interests lie. This is why we need to make as many connections as possible, not only at the state level, but also in the public sector. This is the reason, as we see it, for publishing a special supplement on Russia in Great Britain. We hope some will find our offerings interesting and helpful.

Valeri Fadeyev, *editor-in-chief*, Expert magazine



A Russian economic miracle?

Thanks to oil prices and domestic demand, Russia has achieved higher growth. But the government needs to change if it is to keep it up. By **TATYANA GUROVA**

I've told my colleagues more than once that Russia will establish capitalism before China," declared George Russell, the well-known American financier and president of the Russell 2020 Fund, in an interview with *Expert* magazine. He is not alone in his assessment. A large number of western analysts and entrepreneurs have started to make similar observations, arguing that Russia is now emerged from the economic collapse of the 1990s.

In September 2002, the Russian Marketing Association surveyed representatives of 340 foreign companies working in Russia, including such global brands as Coca-Cola, Canon, Xerox and Unilever: 75 per cent saw Russia today as attractive to investors.

Is such optimism justified? The Russian economy has grown for the fourth year in a row, and the pace of this growth averages between 4 and 6 per cent a year. The standard of living for Russians has improved by one and a half times in the past three years. Capital flight has slowed from \$24bn in 2000 to \$10bn in 2002. But you can find just as much support for pessimism. Russia is a country very much dependent on exports. The proportion of exports to GDP – 25:30 per cent – is not in itself unusual by international standards. The trouble is, first, that the economy's high dependence on exports reflects a weak domestic market and, second, that the exports are mostly of raw materials, whose prices are determined on a world market that Russia cannot control. Sceptics point out that nearly all periods of economic growth in Russia coincide with higher prices for raw materials, particularly oil.

So, depending on which side you listen to, Russia is on the brink of an economic miracle or, given the continuing instability of world markets, it is on the verge of economic catastrophe. Nobody can say unequivocally which side is right.

In the post-Soviet reform era, Russia lost roughly half of its GDP – about as much as the US during the Great Depression of the 1930s. The price liberalisation of 1992 caused roaring inflation. The state fought it by limiting the amount of currency in circulation, leaving companies short of cash, and thus leading to the so-called non-payment crisis. And the abrupt end of state orders for many goods and services left many companies without outlets for sales.

However, the most important reason for economic collapse in the early 1990s was that nobody in Russia then understood how to conduct business in a free market. Forcing the people to learn was a cruel process. Russian incomes fell drastically,

and in 1992/3 the average was only \$20-25 a month.

By 1996, some companies had emerged that knew what, how and for whom they were manufacturing: oil companies such as Lukoil and Yukos, and producers such as Siberian Aluminium and the Bratsk Aluminium Factory. Consumer firms improved, too; examples include the food manufacturers Vimm-Bill-Dann, the cellular company Vypelkom, and chain stores such as Sedmoi Kontinent and Partia.

The problem was that the government could not pay its workers properly or fund schools, hospitals and the military while still paying its external debt. The government therefore wanted people to subscribe to state bonds. To make this an attractive proposition, it had to stabilise the rouble by introducing an exchange rate strictly defined in relation to the dollar. But a highly valued currency (as the British have often discovered) makes your manufactured goods uncompetitive, both at home and abroad. Though the rise in world prices for raw materials permitted Russian producers of oil, aluminium

Russia had no alternative but to default on its debt. But then crisis laid the foundations for growth

and some other primary products to do well – allowing the economy to continue growing, albeit by a mere 1 per cent per year – other industries barely grew at all. They could not sell overseas, and Russians' own increasing incomes immediately went to imported products that easily beat home goods in quality and price.

In early 1998, when world prices fell and the price of oil was only \$10-12 a barrel, the Russian economy stopped growing. The country's balance of payments went into deficit, and government debt reached catastrophic levels. Russia had only one choice in the summer of 1998: to default on its debts.

But as so often (think of Britain after it fell out of Europe's exchange rate mechanism in 1992), economic crisis laid the foundations for growth. When the Russian government refused to pay its debts in August 1998, this hit both foreign and Russian creditors hard. "The government ruined us. You can't do business in this country. I'm thinking about moving to the west." This statement was typical for many entrepreneurs

immediately after the default. But with no need to service debt, the government could allow the rouble to fall (just as the British could allow the pound to fall after dropping out of the ERM). Within three months, in autumn 1998, the exchange rate fell from 24 to six roubles to the dollar. The effect of this devaluation on the economy was entirely positive.

“Finally, we can make some money in this country,” many businessmen said, just two months later. “Our well-off customers who used to prefer western products are now coming to us.” From telecommunications to clothing, Russian goods began to replace imports. “In autumn 1998, our customer base changed suddenly,” recalled Arkady Pekarevsky, vice-president of the Sela Clothing and Trade Company. “Before then, we made things for poorer people who simply did not have the money to buy western brands. In the autumn of 1998, better-off people started coming to us who could no longer spend money on goods from the Italians, Germans and so on, though they had enough income to dress decently. Despite our expectations, our market share and profit margin were not reduced; on the contrary, both expanded.”

The results were dramatic. In the first six months after the default, industry grew at an annualised rate of 20-30 per cent – an achievement worthy of Asian economic miracles.

But a single devaluation for a country as poor as Russia would not have been enough. Its effects would have faded in a year and the economy would have returned to stagnation. Something else was needed, and Russia was lucky enough to get it.

The world economy, which had cooled off after the Asian crises of 1997-98, heated up again in the second half of 1999, thanks to a powerful upswing in the US. Prices for oil and other raw materials skyrocketed, and Russia played its cards effectively.

Russian exports grew from \$65bn to almost \$100bn in 1999. This was the major, but not the only, contributor to growth. Producers of Russian raw materials first got the money, then they got development strategies. They

began to invest. In 2000, the rate of investment growth reached almost 20 per cent. This was a new game altogether. In response to oil-company investment, the very troubled machine-building industry, as well as the ferrous metal and coal industries, got a jump start. Once economic growth got rolling, it spread to the entire Russian economy.

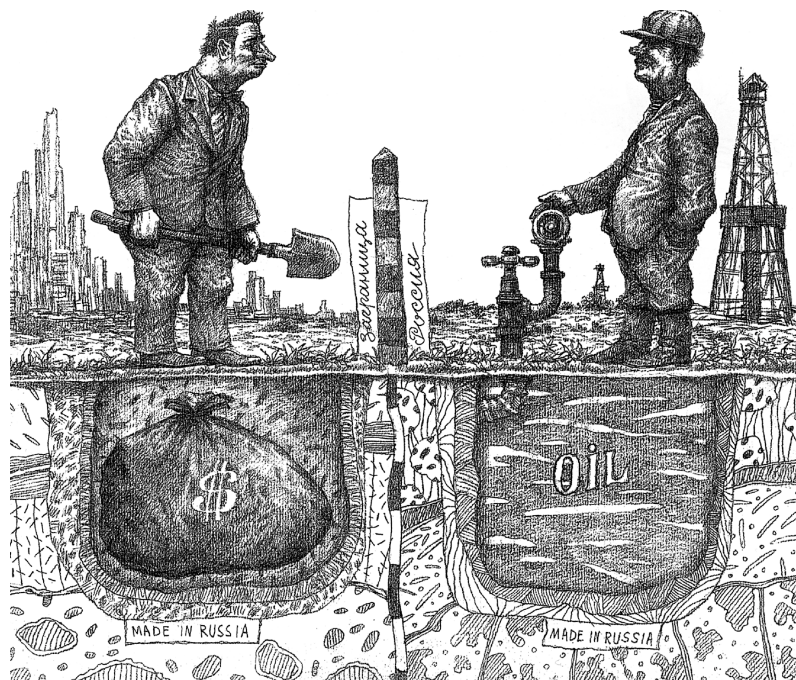
Despondency is never far away in Russia and there was plenty of it at the beginning of 2001. Exports had no more room to grow; the US was moving into recession; oil prices were poised to fall – and analysts began to forecast a serious slowdown, if not stagnation. But Russia got lucky again. The economic machine, which had been running energetically for the previous two and a half years, created a sudden increase in Russian incomes.

With its 145 million citizens, Russia has always been potentially a huge consumer market. And in 2001, when those citizens had money, that potential became reality. Indeed, representatives of western consumer companies now tell *Expert* that they regret not getting into the Russian market sooner, thus missing an opportunity to make good money.

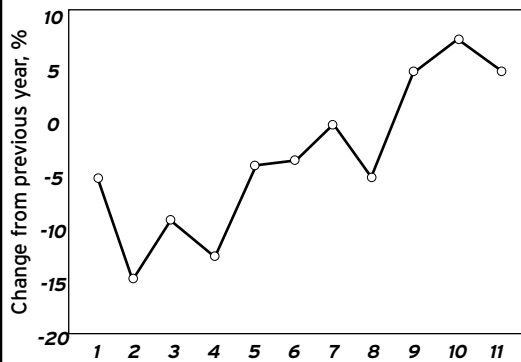
The Russian middle class bought and bought and bought. The country’s strongest markets – restaurants, real estate, furniture, household electronics and cars – grew at an annual rate of 20-30 per cent. The profitability of almost all consumer markets exceeded that of analogous markets in the west. For example, the profit margin for construction of real estate – where builders in Europe had long forgotten making even 10 per cent – reached 30-35 per cent in Moscow. Thus domestic

demand at last became a factor in Russian economic growth.

Today, the growth continues. In 2002, despite a brief winter slowdown, the GDP grew at about 4 per cent, supported, in roughly equal proportions, by oil prices (which have continued to rise because of tensions over Iraq) and by the expansion of domestic demand. But as the English economist and Nobel laureate John Hicks observed in *Value and Capital* (1939), sustained economic upturns occur when business people come



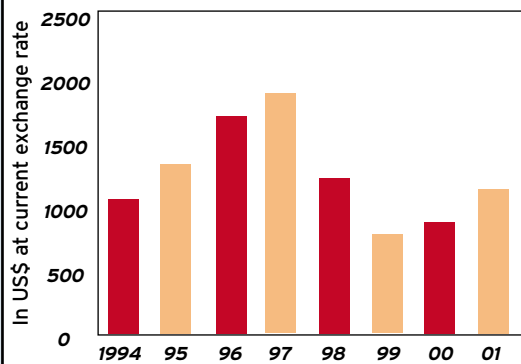
Changes in GDP



Source: State Statistics Committee

1991	-5	1997	0.9
1992	-14.5	1998	-4.9
1993	-8.7	1999	5.4
1994	-12.7	2000	8.3
1995	-4.1	2001	5
1996	-3.4	2002	4

Average monetary income per capita



Source: calculations based on State Statistics Committee and Central Bank data

up with economic plans and decide to implement them. This is the situation in Russia today. Russian business people are confident; they know where they are headed.

So we could well say that Russia is indeed on the threshold of an economic boom. But there are reservations.

The first is the unstable world oil market. Oil price forecasts for 2003 range from \$16 to \$24 a barrel. A fall to \$16 would lead to a reduction in Russian export revenues. The most reliable forecasts suggest that, unlike 1997, when a drop in oil

prices led to a recession, a fall now would merely reduce growth, probably from 4 to 2 per cent. That would still be bad because the country would not be able to continue renewing its manufacturing capital by replacing outdated equipment, especially in infrastructure-related sectors such as energy. Sooner or later, the country's economy could fall apart – not figuratively, but quite literally.

Can more vigorous developments in the domestic market come to the rescue? Only if another obstacle is cleared away. At present, Russian entrepreneurs are doing their best to refute the axiom that there is no capitalism without credit. There is simply nowhere to borrow money in Russia. The major banks are tied to major manufacturing holding companies. The pension system is weak and managed by the government. Insurance and mortgage industries are in an embryonic state. Banks cannot offer loans for long periods at viable rates. The rate of capital accumulation (the relation of investment to GNP) in Russia is now 17 per cent, which would be a respectable figure for a developed country, but is low for a country that needs to rebuild most of its economy – by comparison, Germany and Japan in the 1950s and 1960s, while rebuilding their economies after defeat in the Second World War, had capital accumulation rates above 40 per cent.

How can Russia get out of this bind? There are two ways. The first is to look west. Russian business plans to modernise its capacity in the next two to three years, and then enter western stock markets and borrow serious amounts for the long term. Whether it finds willing lenders remains to be seen. The second way is to turn Russia's wealth – real estate, land, natural resources – into working capital. This presents a major challenge to the Russian government. If it is to meet it, it has to stop being afraid of managing the economy.

The government can take no credit for the economic successes of the past few years. Business evolved on its own. The government simply sat back and watched, afraid to support the upswing. For example, in 2000, the government promised to reduce taxes in order to stimulate economic growth, but proved too timid to do so. To be sure, it lowered some taxes – for instance, on profits – but it raised others by eliminating tax breaks for capital investments. The overall tax burden was not reduced; it actually increased.

The Russian government is still ruled by fear: fear that inflation will heat up again; that the credit system will collapse under the weight of bad loans; that oil prices will fall; that there will be nothing left to pay foreign debt if taxes are cut; that the budget will collapse; and so on. Yet Russian business does not want endless caution and “what ifs”. It wants a new policy for economic growth.

Tatyana Gurova, an editor for Expert, has recently completed a three-year study of Russia's middle class

Who runs Russia today?

The once all-powerful oligarchs represented the entanglement of business and politics. Now, though, it is bureaucracy that rules. By **ALEXSANDR PRIVALOV**

Who runs Russia? It's a short question with a long answer. The conventional, cynical answer would be "the oligarchs" – the post-communist tycoons who have made fortunes from natural resources and finance in the past decade. It's a neat answer, but the wrong one.

To understand why, remember the following: Russia's business elite has three roots. One is the "red directors", an inaccurate shorthand term for the bosses of communist-era enterprises (whose beliefs, in fact, were anything but communist). These people were the winners in the first "wild" privatisation that took place amid the collapse of the planned economy, when they simply took over the enterprises that they had already been running.

The second capitalist breeding ground was the middle and lower ranks of the Communist Party and its youth wing, Komsomol. These people (notable for their aggressive careerism and lack of scruples) built huge fortunes by working in the cracks that opened between the old and new economies. Raw materials that cost pennies in the planned system could be sold for world prices abroad. The banks and exchanges that they set up sounded reassuringly normal, but in reality were nothing of the kind.

The third group was organised crime, with start-up capital accumulated during the Soviet Union's experiment with prohibition: Mikhail Gorbachev's "anti-alcohol" directive of 1985. The effect was the same as in America 60 years earlier.

In this prehistory of Russian business, there was very little politics. Even after the democrats took power, the economic liberals, who have maintained a strong influence over policy whether directly in government or on its margins, hoped – seemingly in vain – that business people would eventually form a solid lobby for liberal capitalist democracy. When business did wake up to politics, it was for a different reason. The government, strapped for cash in the mid-1990s as the economy disintegrated, decided to borrow from businesses, using shares of the most attractive state enterprises as collateral. To nobody's surprise, the state did not pay back its loans, and businessmen such as Vladimir Potanin walked away with the country's industrial crown jewels – in his case, the vast and lucrative Norilsk nickel mine.

The victors formed the famous "gang of seven" bankers, soon to be known as the oligarchs, and for the next two to three years, while the enfeebled Yeltsin administration tottered in the Kremlin, the idea that they owned half and ruled

all of Russia gained ground.

The first part of this was basically true. The second half was horribly exaggerated. Even though the oligarchs' cash helped re-elect Boris Yeltsin in 1996, they themselves always understood that what the state had given, it could also take away. The only question was when someone strong would arrive in the seat of power and start exercising it.

It might have been different if the oligarchs had stuck together. But they did not. The first and last thing that they were able to do in a friendly fashion was the initial division of the spoils. After that, they squabbled among themselves and fought the government over privatisation issues. Two oligarch-controlled television channels, ORT (owned by Boris Berezovsky) and NTV (owned by Vladimir Gusinsky), were particularly vitriolic in their attacks on the feeble organs of state power. A quietly spoken young Kremlin bureaucrat called Vladimir Putin watched in horror as the country's disabling political weaknesses

If the oligarchs had stuck together after the initial division of the spoils, it might have been different

finally led to the financial crisis of August 1998, when the country defaulted on its foreign debt, and was forced into a humiliating devaluation.

A year later, Putin was prime minister; he immediately started to tame the oligarchs' power. One crucial change was that he would not sack ministers because of outside commercial pressure. Suddenly, the government could talk tough to the tycoons, without the fear of a behind-the-scenes phone call, blackmail or any of the other dark arts of Russian politics.

So the oligarchs finally got down to business. They began rationalising their baroque, randomly constructed empires. They brought in professional managers. They started worrying about their battered reputations abroad. Their political efforts were focused on pushing for new laws that would help their businesses. Not all of these were admirable. The new bankruptcy law, for example, which allows organisations with strong ties to the government bureaucracy (ie, former

oligarchs) to get their hands on almost any manufacturing assets that catch their eye.

But they have completely ignored the mainstream of political reform, such as a new law on political parties, which makes it much harder for them to run electoral organisations to represent their interests. And they have also been remarkably inactive when it comes to a matter that should interest them a lot: the direction of Russia's economic policies.

Where big business does have an opinion on broader policy issues, such as Russia's membership of the World Trade Organisation, it expresses it in a civilised and conventional way, chiefly through the Russian Union of Manufacturers and Entrepreneurs. President Putin and his prime minister, Mikhail Kasyanov, regularly meet with the union's leaders and hear their opinions on such key problems as tax reform and currency regulation. But it often goes no further than listening. Recent tax reforms, for example, went against all of the union's recommendations.

Another volte-face is on investment. The ex-oligarchs, who under Yeltsin sucked tens of billions of roubles from Russia, are actively expanding their domestic investment. They know better than anyone the opportunities that the country now offers for the big, tough, well-connected investor.

Away from the murky peaks of business life, even more significant changes have occurred in the manufacturing industry. A whole new class of people not seen for a century in Russia has reappeared: energetic and knowledgeable professional managers. The crisis of 1998 gave them a big leg-up. Russian-made products suddenly became hugely more competitive against foreign imports. Many companies used the opportunity to modernise and increase quality. They have every intention of defending the



ground they have won and of exporting Russian products to third countries, especially in the former Soviet Union.

That reflects another important shift: the centre of gravity of the Russian economy is shifting away from raw materials to manufacturing.

As business becomes more normal and more broadly based, the oligarchs' collective weight is inevitably shrinking. This hiatus in influence – when there are no more oligarchs, but no one else has yet

taken their place – coincides with, and to a significant extent is explained by, an obvious and unwelcome strengthening of the corrupt, unaccountable and incompetent state bureaucracy. A failure to deal with this has been the greatest weakness of the Putin years to date.

However, there is some hope that this hiatus is drawing to a close. In some areas, business has already started to push the bureaucrats aside. This is exactly how many observers saw the election of Aleksandr Khloponin: it was a classic example of the new kind of Russian businessman in a governor's race in the mineral-rich Krasnoyarsk region. His defeated rival, Aleksandr Uss, was an old-style local power broker.

Yet at the federal level, nothing of the sort is happening, and the state bureaucracy remains the most influential corporation in Russia. So who runs Russia? The short and simplistic answer is that, for most things, it is neither business nor politicians, but the bureaucracy. That is certainly not the best situation, but it is not quite the worst either.

Aleksandr Privalov is one of the founding members of Expert. He has worked for the Department of Economic Modelling and helped develop methodology for privatisation. He has created strategy and tactical policy for several political parties and civil movements

The next president of Russia?

Beyond the Urals, deep in Siberia, a new sort of politician has emerged: a young man with a record of management success. By **NATALYA ARKHANGELSKAYA**

In the formal sense, Russia is completely democratic. It has all the necessary elements: free and just elections, separation of powers, political parties. Moreover, Russians value being able to choose their leaders. Asked recently if provincial governors should be appointed instead of elected, more than 70 per cent said no.

Yet democracy functions with great difficulty at all levels below the presidential elections. The main problem is the lack of new blood in politics. The nation's energies, its brightest and best people, have gone into business. There are no new names in politics. The Communist Party is still Russia's largest, and it is dominated by a Soviet-style bureaucracy. The second significant party, United Russia (Edinaya Rossiya), was founded by a collection of regional bureaucrats on the eve of the 2000 elections. Bureaucracy, at least in Russia, is devoid of ideas. Bureaucrats do not know and do not care to know about the real problems affecting Russians, be they top industrialists or rank-and-file workers.

But, from the Krasnoyarsk region, it is possible to detect a new beginning. Krasnoyarsk is the second-largest territory in Russia, easily four times the size of France. It lies beyond the Ural range in Asia and its northern edge crosses into the permafrost zone. By a cruel twist of fate, in this particularly inhospitable northern climate—where interruptions to the electricity supply are commonplace—lie all the country's natural resources, including 75 per cent of Russia's cobalt, 80 per cent of its nickel and 70 per cent of its copper. Krasnoyarsk has the lowest population density in Russia, but also the highest per capita concentration of natural resources.

Far from the European centre, this region has long been noted for its independence of mind. The serf system never existed here and, for centuries, it was a refuge for rebels against the tsar or the church. Stalin sent legions of political undesirables to the region, including entire minority nations forced into resettlement, and it was home to numerous prisons and internment camps.

In the post-Soviet era, Krasnoyarsk has acquired a reputation rather like New Hampshire's in the US: political developments there can be extrapolated to the nation as a whole. In 1993, a reforming economics professor from the local university became Krasnoyarsk's first democratically elected leader. The election of reforming democrats became a trend across Russia. Five years later—with the people exhausted by the shock therapy of the reforms—the professor lost to a former

general. Again, the nation followed suit, favouring professional bureaucrats or strong military hands. Krasnoyarsk's choice was Aleksandr Lebed, a former candidate for the Russian presidency.

Lebed governed for four years before he died last spring. His successor, elected in September, was 37-year-old Aleksandr Khloponin. Note this name for the future.

Born in Ceylon, the son of a translator, Khloponin is a self-made banker and executive, who has spent nearly all his life in Moscow, graduating from the financial institute there. In 1994, as president of a Moscow bank, he convinced Vladimir Potanin (one of Russia's best-known entrepreneurs) to buy out the failing nickel producer, Norilsk Nickel. Potanin agreed, but suggested Khloponin himself head the company.

In just four years, it was transformed. Its employees not only received very good salaries by Russian standards, but also an

In four years, Khloponin turned around the failing nickel producer. It bought him political success

array of company benefits, such as free kindergartens and medical care. Retired employees were given funds to leave frigid Norilsk for more hospitable parts of Russia. From this success, Khloponin was propelled in 2000 into the governorship of the Taimyr peninsula.

During his campaign, Khloponin spoke of the need to help vulnerable groups, particularly pensioners, and to support young families in order to make the region more attractive to the young. He had already done these things in Taimyr. His opponent, Aleksandr Uss, on the other hand, after ten years as vice-governor and then as chair of the regional parliament, had to answer for months of unpaid salaries, for the pitiful condition of housing and for public utilities, unprepared as always for the Siberian winter. Since both candidates had direct connections to large Russian corporations (Uss was supported by Russian Aluminium, which owns the Krasnoyarsk aluminium factory and produces a third of Russia's aluminium), the voters were none too enthusiastic about either, regarding both as oligarch stooges. Many boycotted the second round.

But where else can a new generation of politicians come



In the business of making things work: Aleksandr Khloponin

from, if not from those who have successfully founded or managed a business? Such people not only have the necessary management experience, they also have reputations to protect, so that they are not easily bought off by others.

Currently, Krasnoyarsk resembles a colony. Its companies make millions on the region's natural resources but pay ridiculously low taxes. For example, the Krasnoyarsk aluminium factory contributes only 4 per cent of the regional budget, is allowed to transfer profits outside the region very easily, and gets electricity at subsidised rates. "Business conditions should be the same for all companies," Khloponin says. Apparently, voters agree with this idea, which is quite new for Russia. If the ambitious young governor can deliver on his promises, and if he can be as successful in his new job as he has been in his previous ones, Russia may not have to look far in 2008 for a successor to Vladimir Putin.

Natalya Arkhangelskaya is a political columnist for Expert

Wealth that moves sideways

NICK PATON WALSH fears that the Russian middle class is too small and too fragile to sustain the country's economic prosperity

The central streets of Moscow clatter and sing with new money. Rich Muscovites make their gaudy tastes known all year round. In midwinter, blacked-out BMWs with diplomatic licence plates whisk their elite passengers between glowing ivory towers. In midsummer, the fierce heat makes the city, with all its exorbitance and heady neon lights, resemble a heavily polluted Las Vegas – albeit one that has been dumped unceremoniously in the middle of a conventional, drab region in the former Soviet Union. It is easy to get taken in by Russia's new-found sense of wealth and recovery. It is nearly five years since the 1998 crash, when the savings of ordinary Russians became worthless overnight, and confidence is back in fashion. But step outside central Moscow and the real Russia reveals itself.

Few can deny that there is an emerging middle class in Russia, but life for most remains a grim, poorly paid existence, eked out amid huge Soviet-era tower blocks crammed with thousands of flats. The average income in Moscow is about \$350 a month – considerably higher than in the rest of Russia. And it is part of the problem that salaries are still reckoned in dollars, not roubles. In a telling comment, the US ambassador to Moscow, Alexander Vershbow, took the trouble over the recent holiday season to reassure Russians that the issue of new dollar banknotes, to be tinged pink in some parts, would not affect their savings.

Despite the return of confidence, Russia still relies on the dollar. Banks are still not trusted, and savings are still stuffed, in dollars, in a plastic bag under the mattress. When the dollar recently dropped in value, Russia panicked and began to look to the euro as a more stable alternative.

This daily reality of Russian life overshadows all the rhetoric from the Kremlin. When President Putin held his annual question-and-answer session with the public, he launched into a ten-minute, unsolicited defence of the economy. Inflation is a little too high, he said, but things are on the mend. ►

► His audience seems a little less positive. An end-of-year poll released by the news agency Interfax showed that, in 2002, life in general was, for one in three Russians, harder than in the year before. For another 46 per cent, life was no better. Seventeen per cent said their income had fallen during the past year. Women, the over-forties, the least-educated, the worst-paid and those living in the vast tracts of the country east of Moscow were most likely to think that life was bad. Young men living in and around Moscow expressed more positive views.

This last category – the roots of the growing middle class – are riding the crest of a wave that will eventually hit the shore. But there is still little infrastructure in place to permit irreversible growth. There are no real law courts or objective authorities to protect lawful investment.

If you are, for example, a business, you need your own roof or “*krisha*” – someone with a strong arm and the right connections to keep the wolves from the door. These wolves could be your competitors, who might pay a hitman to remove you. They could be aggressive local authorities. Or they could be the police themselves, looking for a cut. The grim reality is that the law is a flexible friend.

With all this happening, it is hard to be genuinely optimistic. And few are. At the end of last year, the ministry of finance predicted significantly slower economic growth in 2003. The benefits of the crisis – such as cheap labour – have now subsided, the rouble is stronger, and production costs are up. Small business, the hub of the middle classes, needs more opportunities. It expects 2003 to be a hard year.

The Putin administration is caught in a Catch-22. Without proper tax revenues, there can be no state infrastructure to protect and foster investment and growth. But without growth, tax revenues will not improve. So Russia’s energy giants, which bought their formerly state-owned wares for pennies in exchange for supporting Boris Yeltsin’s ailing 1996 electoral campaign, get free rein to sell the nation’s oil reserves as quickly as possible. The Kremlin takes its cut, calculating the annual budget around the market price. The hope is that life will have stabilised before the oil wells dry up or the power axis in the Middle East changes.

“A war in Iraq would initially be good news for Russia,” says Evsey Gurvich, from the Economic Experts Group, with close links to the government. What he means is that oil prices would rise, creating opportunities for cheap Russian exports to the US and booming state revenues. “But in the long term,” he adds, “it will have adverse consequences, as it will make people feel that all is well with the economy and that no additional reforms are required.”

Vladislav Inozemtsev, founder of the Centre for Post-Industrial Studies, goes further. “High prices of oil,” he says, “have a narcotic effect on the keepers of the economy, making them feel that there are limitless possibilities.” Lower prices,



Behind the bright lights lurks a grim reality for many Russians

he thinks, would secure the Kremlin’s grip on reality and concentrate its mind on economic development.

Yet few deny that there has been an improvement since Putin became president in 2000. “Standards of living have improved in the past three years,” said Gurvich. “Real incomes are 10 per cent higher than last year. We have a consumer boom. These are not feelings, they are figures. The economy is now stable enough. There is a Russian middle class in terms of standards of living and lifestyle. But they are less the middle, and closer to the top. One to 2 per cent of the population is very, very rich. Twenty per cent have a lifestyle that can be considered middle class by Russian standards.”

Gurvich points out that the middle class is not yet politicised, merely a powerful consumer force. However, Inozemtsev will not agree even with that. He puts a lower figure on those who can be defined as middle class and considers them too small a group to change life significantly for the average Russian. “In Russia,” he said, “the middle class does not exceed 8 per cent of the population, whose broad demand for consumer goods does not affect the lives of those below them.” The masses, he reminds us, struggle with poor living conditions, and “healthcare that is simply inaccessible – by western standards – to most of the population”.

He says: “The ‘overflow of wealth’ from the upper classes



to the middle and lower, as happens in the west, does not occur here, as the wealth tends to go sideways because of the specific nature of property structures.” Inozemtsev is alluding politely to the intricate system of bureaucrats – of the pen-pushers who need to be paid off in Russia if things are to happen. Instead of the money “trickling down” to the country’s have-nots, it lines the pockets of officials.

It is a habit, formed amid the opportunism and chaos of the Yeltsin years, that has proved infectious. Putin owes part of his surprisingly high popularity to the economic and political stability he has brought to Russia, as well as to his image as a “man of the people” who tried to become a taxi driver when he came out of the KGB.

For his birthday, he was given a replica of a tsarist crown, the cap of Monomakh, insured for \$10m. Named after the revered Prince of Kiev, Vladimir Monomakh, whose son founded Moscow, it became a symbol of the autocracy meted out by the tsarist families. Putin would do well to remember that, hundreds of years later, the same families were bloodily deposed – partly because their programmes for economic reform and transfer of wealth, intended to lift the serfs out their lumpen misery, failed to move quickly enough.

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After the end of empire

If Russia is to become a truly European country, it needs a self-confident elite willing to bear the odium of imposing modernisation. By **JOHN LLOYD**

Britain coped with the loss of power and empire through a dense network of political agitation and reform, assisted by a moral sense that empire was wrong, an economic recognition that it was unprofitable, a military calculation that it was untenable. Finally, it underwent a war which cut the imperial party’s legs off. Even on the right – perhaps most of all on the right – imperial characters became figures of fun: Apthorpe in Waugh’s *Men at Arms* is a tragicomic fantasist, marooned with his thunder box (chemical toilet) and mosquito nets in a dank Britain fighting for its life against a more powerful nation. Churchill, who said he did not become the king’s first minister to lose the king’s imperial possessions, could do nothing about their loss.

Britons still debate the pluses and minuses of it, as Niall Ferguson’s TV series and book, *Empire*, shows. But that is done from the comfortable position of an intellectual and political class that no longer has or wishes to bear the burdens, and which baulks at the neo-imperialism implied in the strong version of the war against terrorism.

Russia, too, has comic figures in its post-imperial fiction, as found in the novels of Viktor Pelevin. But these are very bitter comedies indeed, and the politics of coping with the empire’s loss – as well as with the pitiless struggle to keep Chechnya – are unrelieved by any reflections of Russia’s continued importance in the world, or by any ability to build a new Jerusalem in Russia to answer the needs of the workers, as Labour did in postwar Britain. Russia is poor, even as its economy grows and the rise in the oil price assists the exports on which that growth largely relies: and as for new Jerusalems, Russians have been led there and found a place to avoid.

Britain’s post-imperial choices have been delayed: pro-Europeans took Dean Acheson’s comment – that it had not found a role after empire – to mean that the role must be a place within the EU. Illusions and grandiosity played a large role: but the advantages of transatlantic ambiguity were and are consid- ►

► erable, and the recoil from the federalist version of Europe's future inevitable – there was no political or psychological imperative to subsume nationhood into a European statehood.

Russia, again, does not have that luxury; and delay will be terribly costly. Its obvious course is westward, to a closer relationship with Europe. But that is humiliating for much of its ruling class, and for many of its citizens. It has no ambiguous double relationship to sustain it: an alliance with China would be culturally fraught and give few benefits except a temporary market for defence technology. Russians see modernity as European, as they have since before Peter the Great. Vladimir Putin, a Petersburger and a German speaker, would be inclined to agree, and at times says so – last year, for instance, when he addressed the German Bundestag. But few of the elite would agree with him: the citizenry would like a European standard of life, but have not been prepared to do the work to get it.

Russia's pro-Europeans are stirring themselves. Last December in Moscow, I met some members of the Club of 2015 – mainly young, mainly business people, who came together after the financial crash of 1998. One, a young manager named Vladimir Preobrazhensky, has written an essay on the likely scenarios for Russia over the next ten to 15 years.

He argues that the “new Russians” are already old. They are typified by the businessmen who appeared at the end of the

Senior bureaucrats can't be paid high salaries; that would create public discontent. So they steal

Gorbachev period and flourished briefly and luridly under Yeltsin. He has a new coinage: the “other Russians”. By this, he means not only rising people like himself who have established themselves in business, but also that section of the Russian population that no longer wishes the return of the Soviet Union, or of any kind of ordered, hierarchical state.

But don't the majority want that kind of state? It's a myth, Preobrazhensky says, albeit one believed by many foreigners and promoted by many Russians in the elite. Russians are not vegetables, dependent on a benign but determined autocratic governing class to tell them where to go and what to do.

Preobrazhensky, quoting research commissioned by the club from the main Russian polling centre, VTsIOM, says that only roughly 30 per cent of the Russian population actually wants what he calls “the Russian system” – that is, “the dominance of the state over the individual, paternalism and a closed society”. The rest, to differing degrees, want individual choice, an open and democratic system of power at every level, and a country more open to the world. Even among those who say they want the “Russian system”, many mean

by that a more ordered existence – not an authoritarian state.

But the grip of illusion, or of multiple illusions, is strong. These include the illusion of the state chosen by God or ideology to lead the world; or, on the other hand, the illusion that Russia's plight has been all the fault of others, whether enemies within or powers without. Self-pity can be a national trait: for Russians, it is one of the many traps to be avoided.

The vision of Preobrazhensky and his colleagues is of “real-time Russia” – a country whose dependence on energy exports has been reduced; where the educated intelligentsia, in which the country is rich, has produced a slew of new industries and services; where the state works in partnership with private business and not-for-profit organisations to raise the (shockingly low) level of its population's health and its (even lower) level of social provision; where global competition is seen as a stimulus rather than an attack; where schools and universities are linked by a network of constant learning. It's not a new vision: any western technocrat will come up with something similar. But in Russia, it's a revelation.

Russian reform discussions tend to run in closed loops. As Viktor Chernomyrdin, the former prime minister, said of his own government: “We tried to do better, but in the end it turned out like it always does.” The civil service cannot be reformed to make it less corrupt unless the senior bureaucrats are paid high salaries. But they can't be paid high salaries because that would create widespread discontent. So they continue to steal in order to augment their low salaries. No number of grand plans, visions or scenarios can break out of such loops. Only an elite can do so – conscious of itself as an elite, with the will, the numbers and the influence to take on the task of modernisation – and bear the odium modernisation will bring with it.

The advantage of Vladimir Putin, that hooded and guarded man, is that he shows, when he cares to, that he understands what Russia must do and what kind of figure she can cut in the world. If it is not clear how much he is driven by resentment against the west and a desire for an eventual return to a zero-sum game of power, he has as few illusions as he has scruples.

Russia remains poised between painful modernisation and a continuing decline into third-world status – a position some of its regions already have. The collapse of empire left it exhausted: its men die at an average age of less than 60, its population is shrinking, tuberculosis is a major killer and Aids is spreading very fast. It is not yet politically stable; it is not yet an ally of the western states; it is not yet modern. Yet if – as the members of the Club of 2015 believe – modern democracy is what the people want, they, or a group speaking and acting in their name, have to go for it now.

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In education, the state rules

Russian schools are still modelled on the German gymnasium of the late 19th century, with little scope for individuality or creativity. By **TEODOR SHANIN**

The Russian education system is immense, diverse and yet, to many eyes, overly homogeneous. It is a substantial and lasting achievement of the Soviet regime, but it is also a major expression of its limitations. Russia has 70,000 schools with more than 20 million pupils, plus approximately 1,000 post-school institutions with five million students. These are spread across a country with 11 time zones and 72 provinces, where more than 100 recognised languages are spoken. Yet there remains a powerful centralising element, combined with deeply rooted Russian nationalistic tendencies. The very language of policy in Russia reflects this statist aspect: the agrarian reform (for a country of numerous climatic zones), the tax reform (for a country of great market diversity) and the educational reform.

Russia may be, in the eyes of some foreign media, “Burkina Faso with nuclear weapons” but in many respects its educational system bears comparison with far more developed countries. This has long been true of mathematics, natural sciences and some arts subjects but heavy ideological censorship made the teaching of social sciences remarkably inept.

After the Soviet collapse, reformers believed that a different society should mean a different education. They “loosened up” the educational structure by permitting variety: state and private, local and national, general and specific. New disciplines were introduced, and the teaching of established disciplines and textbooks diversified. But alongside some new and high-quality education came numerous unregulated and money-grabbing institutions under fanciful names. During the economic crises of the Yeltsin era, many of the better-qualified lecturers and most promising students left education to go into business or “informal economies”, in Russia or abroad.

Then there was a dramatic turnaround. Student demand rose steeply and desertions from the teaching profession slowed, especially at university level. This was not just the result of a more stable economy, it also reflected the growing

determination of Russia’s parents to do all they could to advance their children’s education. Most westerners are struck by the extraordinary levels of sacrifice that Russian parents will make. Members of the new business elite often send their progeny to schools and colleges abroad. Others will pay heavily for tutors, and sometimes resort to bribes to get the best for their children from schools and colleges.

So we have seen a rush for the “best education” – increasingly expensive and therefore less accessible to the majority. At the other extreme are underfunded state schools in

poverty-stricken areas, where there are high proportions of disintegrated families and where absenteeism increases daily. There is also polarisation, if less dramatic, in post-school education, between Moscow and the “provinces”, large cities and smaller ones, elite establishments where fees run to tens of thousands of dollars and colleges for the commoners.

Under Vladimir Putin, the state has reasserted its educational power, introducing, for example, unified, nationwide university entrance exams. The pedagogic content, too, is driven by state officials rather than by educators’ visions or parents’ choices. As in Soviet times, the model is one of big, standard schools for the majority with a few “quality institutions” for the elite. The pedagogical model remains the German gymnasium of

the late 19th century. Ideas of individualised learning, and the encouragement of creativity and flexibility for a rapidly changing world, are mostly passing Russian education by. The ablest must find these things outside educational establishments.

State officials are now in charge, teachers are disunited and partly demoralised, parents have no say. The long-term development of Russia’s education – and of her civic society – will depend on how this balance of power changes.

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Learning Russian near the village of Sleptsovskaya

Shocking words

In the course of a post-Soviet revolution, Russian literature has finally found its voice. It's just a pity that it is such a dirty one. By ANNA STAROBINETS

The modern Russian book business and easy availability of popular Russian literature have been around for less than 15 years. In the Soviet era, strict political and aesthetic censorship seriously distorted the literary process. The beginning of the new, post-censor epoch is usually perceived as 1987, the year Anatoly Rybakov's novel *Children of the Arbat* was published, in which Stalin's dictatorship was described warts and all. One year later, the first private publishing house, Tekst, appeared in Russia.

The real boom began in the early 1990s. Publishers were filling the holes in Russian culture with western bestsellers and Russian dissident literature. "When we put out a thin little booklet with Brodsky's poems in 1990, the queue for it was longer than the queue for cigarettes, which were in very short supply back then," recalls the publisher Vadim Nazaro. The company's second book was Tolkien's *Lord of the Rings*. The combination of the two helped to satisfy Russia's hunger for the wisdom of dissident intellectuals and for fantasy literature.

Soon, however, mayhem ensued. Over the previous 70 years Soviet literature had become a stable system with clearly established values. There were the classic Soviet novels, such as those of Mikhail Bulgakov, on the one hand; and there were *samizdat* offerings, the underground alternative, on the other. In the 1990s, readers were suddenly confronted by a huge diversity, a mix of classics and western popular literature, without any real guides in presentation or branding to distinguish between them. Even when a sort of system appeared, something was clearly missing. Russian readers wanted their own native authors. It was not until the mid-1990s that western paperback novels began to be replaced by a wave of Russian popular literature – for the most part, mystery novels.

The undisputed leader of the mystery novel boom was Aleksandra Marinina. Written in highly accessible language, her works broke every record for popularity. Marinina became such a cultural phenomenon that she was even discussed by serious literary scholars at academic conferences. The secret of her success was simple. She used the style of western pulp crime fiction, unknown in the Soviet Union, and set it in Russia. Russian readers had never been so excited.

Action thrillers followed. Instead of American heroes, we had Russian special agents fighting the world's evils and Russian investigators – intellectuals, naturally – cleaning up the dirty politicians.

By the end of the 1990s, Russian readers were hungry for more. According to Andrei Ilnitsky, a leading publisher: "The middle class wanted high-quality, new literature." In 1997, Vagrius Publishing finally decided to experiment with "grade-A" Russian authors. Enter Viktor Pelevin.

Pelevin's first fantasy fiction had appeared in the late 1980s and quickly gained popularity. His novels did not make futuristic predictions; they involved sermons with a Zen Buddhist subtext, and satirical dystopias with esoteric elements. His first novel *Chapaev and Emptiness* became a bestseller. Set after the Russian revolution, during the civil war, the plot centred around the Red commander Chapaev who, along with his adjutant Petka, had long ago become a stock character in Russian folklore – Chapaev and Petka were the stars of many a Russian joke. Pelevin turned these characters into true Buddhists. In the process, he also proved that a Russian publishing project did not always lead to financial ruin.

Publishers began to go in two directions. They put out calm, quality prose for the middle-class over-forties and radical self-expression for a younger audience.

The former was epitomised by the intellectual historical mystery genre, in which Boris Akunin, the Russian Umberto Eco, was the main author. Akunin is a pseudonym for the philosopher and translator of Japanese Grigory Chkhar-

Scandalous texts have gone from being simple gestures of freedom to civil disobedience

tishvili, well known among the intellectual elite. His first novel, *Azazel*, about the adventures of Erast Fandorin, was published in 1999 and was followed by a series of books about the same character. Fandorin, the Russian version of Sherlock Holmes, untangles mysterious murders and decides the fate of the Russian empire from behind the scenes. As well as his ingenious plots, Akunin is notable for the way he imitates the style of 19th-century Russian literature, weaving together quotes and references to literary classics. A reader unfamiliar with the works of Dostoevsky and Tolstoy will be lost in Akunin's novels.

The figurehead of the "radical postmodernist" direction is

Russians are hungry for their own literature and there is now a huge choice available on the market



Vladimir Sorokin. Many see him as a continuation of Pelevin, but he started writing much earlier, at the end of the 1980s, and it was he who informed Pelevin's work, rather than the other way round. He can be considered a "continuation" only in the sense that, after Pelevin's success, publishers decided to print the more aggressive and radical prose of Sorokin, who had previously been published only in *samizdat* form.

Sorokin's popularity exceeded that of Pelevin's. Recent scandals over the pornographic nature of his work have made him into a kind of hero and poster boy for Russian literature, though this hardly fits him. In his novels, characters barbecue human flesh for breakfast, eat excrement for lunch, and emptiness for supper. In the novel *Norma*, the Russian expression "to eat one's fill of shit", in its literal meaning, becomes a ritual that supports society. Whoever refuses, for whatever reason, is a dissident.

Sorokin is not alone. The number of writers trying to shock the public is growing. Scandalous and challenging texts have been transformed into something close to civil disobedience. Publishers, too, are cultivating shock value.

After the recent release of a multi-volume dictionary of swear words, Viktor Toporov, senior editor at Limbus Press, a highly respected publisher, said: "We don't need the censorship of good taste and decency. It ensures that, despite a huge number of talented people, only mediocre, dull prose gets published. If there is talent, it doesn't matter if there are dirty words and perversion."

"Our strange and brutal history has also influenced literature," says Vitaly Babenko, former editor at Tekst. "When the

taboos disappeared, authors were no longer concerned with what readers thought. They were only interested in their own, not always skillful, self-expression."

To a large extent, the situation remains the same today. New, high-quality prose is practically non-existent in Russia but there are radicals aplenty. Bayan Shiryanov fills pages with swear words about his drug trips. Eduard Limonov, in prison for organising an anti-government group, describes in fictionalised form the establishment of the National Bolshevik Party he heads.

The most surprising figure in Russian contemporary literary, however, is Aleksandr Prokhanov. A confirmed communist and editor of the communist-cum-fascist newspaper *Zavtra*, his popular novel, *Mister Hexagen*, is an astonishing combination of Soviet aesthetics and trendy postmodernist tendencies. Noble, elderly KGB agents collect butterflies, communist clairvoyants predict new miseries for Russia, and a mysterious union implements a secret plan for the sake of the motherland.

Prokhanov's unexpected popularity is proof of how unstable the current Russian literary scene is. In search of a way to orient themselves, Russian readers are ready for everything, from nostalgic remembrances of the Soviet good old days to the most extreme novelties. A telling lesson comes from the famous Russian playwright Edvard Radzinsky who organised the "Debut" competition for young writers. He created a new award for authors who do not use a single swear word. Not one entry qualified.

Anna Starobinets is editor of the cultural division at Expert magazine

The rebel who became a tycoon

In the Soviet era, Vladimir Melnikov was a black market trader. Now he makes jeans so popular that they sell even in Europe and the US. By **VERA KRASNOVA**



The man with the greatest jeans

Vladimir Melnikov, director of the Russian children's clothing company Gloria Jeans, is screaming at his designers. "In Italy, one person finishes a pattern in two days. You have 50 people working under you and you have nothing to show me after one week!" Two young translators try to repeat Melnikov's passionate and frustrated words into Italian and

English, as the managers accused of inordinate slowness are not Russians. Melnikov is definitely the boss, the kind typical in today's Russia. He may be stern, but his business, based close to his home town of Rostov-on-Don in southern Russia, is growing very fast.

The pressures of making his business succeed in post-communist Russia have taken their toll and Melnikov appears older than his 54 years. But dressed in a conservative, hand-tailored suit, he has an air of elegance that sets him apart from the world of entrepreneurship. Not that he has ever blended easily into his surroundings. At school, he was rejected from the Pioneers, the Soviet Scout organisation, because he spoke out against communism. He bought the daily catch from the men who fished the Don river and sold it at several times the price at the local market. When the Komsomol (Communist Youth Organisation) offered membership, he refused.

As a university student, Melnikov became involved with a group of so-called *fartsovschiki*, people regarded as highly undesirable and even criminal in the Soviet system. *Fartsovschiki* purchased foreign goods unavailable in the USSR, as well as hard currency, and resold them. Jeans were some of their most popular wares. As a result, Melnikov was sentenced to prison for illegal trade and speculation in 1969 and then again in the late 1970s. Undeterred, he went straight back to black market business each time he was released. In the Gorbachev era, private enterprise was legalised, and Melnikov, now involved in clothing manufacture, took the opportunity to come out from the shadows. But currency operations were still illegal, and when in 1988 he was found guilty of converting his roubles to dollars, in an attempt to buy

more up-to-date equipment overseas, he was sentenced to a third prison term.

In all, Melnikov spent nine years in prison. Many are surprised he stayed in Russia. But he had always longed for freedom and wealth in his own country and was prepared to stay and fight for it. A deeply religious man, he also believed that God had given him a personal calling. "God didn't give me wealth," Melnikov explains, "but gave me the talent to create wealth and the right to use it to help others, which makes me different from most people." When he last came out of prison, the Yeltsin-era free economy reigned. The clothing factory – managed by Melnikov's wife in his absence – had shrunk noticeably, but was still making good money.

It was a period when there was ample scope for Melnikov's talents. The economy, despite liberal reforms, was in crisis, and millions of professionals had slipped from their former comfortable standard of living ever closer to poverty. They found it hard to believe in anything, let alone the enterprises of Vladimir Melnikov. When he bought the controlling shares in a nearly bankrupt clothing factory in Novoshakhtinsk,

Making clothes affordable is the aim. "Every Cinderella should have the chance to feel like a princess"

rumours spread through the small mining town that a capitalist was coming to take away the garden plots which provided the locals with their only steady source of income. But confidence grew as Melnikov acquired more failing factories and put them back into production. Today, Gloria Jeans owns four factories employing 7,000 people. It turns over \$100m annually.

Melnikov's idols are Henry Ford and Bill Gates, who both allowed the average consumer to own what had previously been the property of the elite: cars and personal computers. Melnikov aimed to do the same with children's jeans.

He resolved to make a quality product available throughout Russia. After the collapse in the mid-1990s of the state factories that had been the sole producers of children's clothing, Russian consumers had been forced to make do with cheap, low-quality goods from south-east Asia. The turning

point for Gloria Jeans came in 1998, when the company's prices were lowered by 25 per cent and the jeans became affordable to lower-income consumers. Sales rocketed. Even the economic crisis in August 1998 did not affect the company's growth of more than 70 per cent a year.

Low prices are Melnikov's priority. A piece of clothing from Gloria costs a mere \$7 at a retail outlet. At that price, according to market analysts, 80 per cent of Russian families can afford to buy it. More important, quality is not sacrificed in the process, so that poor children do not feel embarrassed about the way they look. "Every Cinderella should have a chance to feel like a princess," says Melnikov. It's not surprising that his

jeans have become more popular in Russia than the world leaders Levi, Lee and Wrangler, and that last year 200,000 pairs were sold in Europe and the United States. The Swedish clothing company H&M and America's KS Trading say that Gloria jeans are selling well.

Melnikov is involved in every stage of the business. He spends days in the design workshop, where his Italian design-

ers and their Russian trainees wrangle over patterns, decorations and thread colour. But cost is always at the forefront. "You must love to waste money," he spits at the head designer, pointing to a wide strip of cloth decorating the hem of a sample sun dress. Then, at another more classically designed sample, he exclaims in English: "It's fantastic!" – and looks gratefully at the designer, who in turn seems relieved.

The balance between low prices and high quality is sustained by updating, at great expense, the factory equipment at least every three years. As a result, productivity at the company is more than double that of similar firms in China. Machines that burn designs into denim, embroider, add sequins and, due to the achievements of Melnikov's engineers, now use non-toxic insulating materials "make us millions in profits," he proudly claims.

Melnikov's main problem is that nobody, including the Italian and British specialists employed at twice what they received in Europe, can keep up with him. Hence his constant dissatisfaction. Today, for example, Gloria Jeans is launching a plan to bring out six collections a year instead of two. While the company's managers see this as an idea for the future, Melnikov is already insisting that two months old is out of date.

Non-Russians manage the finances, marketing, production, design and the retail chain. Many fight bitterly with their boss. Often they quit. Often they come back again. But it is impossible to imagine how Melnikov could succeed without them. It was the marketing and sales department director, recruited from

Nestlé, who recommended the pricing changes in 1998 that caused sales to escalate. "In order to reach their level of expertise, you have to study for six or seven years, and study in Europe. We just don't have time for that," Melnikov says. But he is committed to the career progression of his Russian employees. Every foreigner is surrounded by five Russians learning the ropes, a policy that dates from the company's early days. It now has



Nothing's past its sell-by date at Gloria Jeans

several high-level Russian managers who have worked their way up from the bottom.

Melnikov is fair: he treats his Russian employees with the same toughness as he treats the foreign ones. He admits that his management style is far from ideal; but, he says, it works, because everybody has a common goal. "If you are ready to come along, then forward march! But be ready to suffer," he says. Yet he, too, suffers from his inability to convince his employees that they can have complete faith in Gloria. Hundreds of them still take weeks off in spring and autumn to plant and harvest their gardens to secure their food supplies.

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In search of a place in the world

Vladimir Putin's foreign policy must deal with new foes and support new friends. But where do his priorities lie – in Europe or America? By **ISKANDER KHISAMOV**

At the end of 2001, the Russian president, Vladimir Putin, made a flying foreign policy tour that included visits with leaders of the EU countries in Brussels, negotiations with George Bush near St Petersburg, and trips to Beijing and Delhi. The trip ended in Bishkek, capital of Kyrgyzstan, a former Soviet republic in central Asia.

These meetings represent Russia's current foreign policy priorities: Europe, the US, China, India and the CIS (Commonwealth of Independent States), an alliance, including Russia, of 12 out of the 15 countries in the former USSR. The question on everyone's lips in Russia is: which priority will dominate. Many think the new Russia has yet to find its place in the world and thus which international partnerships to emphasise.

In the late 1980s and early 1990s, everyone thought the question of Russia's position was decided. In the Gorbachev era, Russia was already looking to get closer to the west and establish western-style democratic and market institutions. Russians were convinced that they would be "rewarded" for their victory over communism, for their voluntary withdrawal from Germany, and for letting go of the eastern bloc.

These expectations were not met – and by the time Putin came to power in 2000, Russian disappointment with the west had reached its highest point. The country's new leadership understands that they have no friends to rely on and can talk only about tactical alliances. This new policy answers a question often posed in the west: who would Russia prefer as its main strategic partner, the US or Europe?

"Today, there are no symmetrical solutions," Gleb Pavlovsky, director of the Fund for Effective Policies and a political analyst with close ties to the Kremlin, says. "The old world order, along with the old system of international rights and institutions, has been shaken and is no longer functioning. In today's world, no one can give Russia any guarantees of security or territorial integrity, any guarantees that its interests will be respected."

Russia has chosen the tactic of "multilateral gratitude", concluding a range of bilateral settlements with the US, the EU, the Shanghai group and the NIS (newly independent states). This series of agreements is, for the time being, the only dependable means of guaranteeing the country's security and interests.

"Europe is of huge significance to Russia," argues Mikhail Margelov, who chairs the foreign affairs committee of the

Council of the Federation, Russia's upper house. "Due to the geographic proximity and complementary nature of our economies, the EU remains our main trade partner, and the US could never take its place. However, a dialogue with the US remains a priority . . . to guarantee our mutual security. This is connected to our numerous shared threats and our responses to them. Russia remains sceptical about Europe's ability to mobilise in the face of danger."

However, there is no consensus on this issue among Russian society at large. Surveys show a consistently high level of anti-American sentiment. In 1995 only 9 per cent of Russians felt negatively about the US, compared to 2002 when the Russian Academy of Sciences found this had grown to 45 per cent. Russians prefer a strategic partnership and accord with Europe, not America.

The events of 11 September forced Washington's Republican administration to revise its list of friends. It became clear that only two countries were realistically capable of standing up to the global terrorist network: the second was Russia. As a member of the anti-terrorist coalition, Russia has several advantages. It has a powerful military, a well-developed intel-

9/11 made the US see that only two countries could stand up to terrorism: the second was Russia

ligence network and geographical proximity to terrorist breeding grounds. Most important, Russia has the will to fight extremists and terrorists that both Europe and Asia seem to lack. The operation to free the hostages taken by an Islamic suicide squad in one of Moscow's theatres last October proved that Russia's military organisations are capable of successfully solving difficult problems in today's war against terrorism.

"From the American perspective," says Andrew Kuchins, director of the Russian and Eurasian programme at the Carnegie Endowment for International Peace, "a new Russian-American partnership is based on reformulated US foreign relations and security objectives which include 1) successfully combating international terrorism; 2) actively strengthening measures to prevent access to and the proliferation of weapons of mass destruction; 3) peacefully elevating China to

Let's shake on it: George W. Bush and Vladimir Putin after their talks at Brdo Castle, Slovenia



the status of world power; and 4) stabilising the world's energy supply . . . These aims can be met effectively only in collaboration with Russia."

As the new number one oil producer in natural gas, Russia is capable of providing for the west in case of an energy embargo from the Persian Gulf nations. The participants at this year's meeting of G8 energy ministers in Detroit and of the Russian-American energy summit in Houston realised as much. With as many atomic weapons, technologies and control systems as the US, Russia remains a key player in non-proliferation. Finally, whether or not China will have the most cutting-edge military technology and weapons depends on Russia.

But Russia has its own set of foreign policy and defence priorities: neutralising the terrorist threat from domestic and international extremists; establishing a political climate that will encourage investment and economic growth; maintaining strategic security; maintaining territorial and administrative integrity in distant and troubled regions such as Kaliningrad, the Caucasus and the Far East.

After 11 September, Putin announced a policy of détente with the west and an active participation in the worldwide struggle against terrorism. Moscow softened its stance on the American missile defence system and Nato expansion. The creation of a new Russia-Nato Council this May, the American and European recognition of Russia as a "country with a market economy", and negotiations with the World Trade Organisation all signal the dawn of a new era of partnership.

Meanwhile, Moscow is also eager to forge stronger bonds with the newly independent states. In a world of increasing

threats from radical Islam and international terrorism, the central Asian and to some extent Caucasian states vitally need to strengthen their military ties to Russia. Indeed, Nursultan Nazarbayev, president of Kazakhstan has said that his country is willing to give up a significant part of its sovereignty in order to establish effective organisations, like Nato and the EU, for the NIS. In his opinion, these organisations could expand from the Eurasian Economic Union established a few years ago and from the Collective Security Agreement organisation.

Local elites, however, remain suspicious: they cannot completely escape the idea that Russia has been "programmed" by history for imperial expansionism. Yet, at present, everyone recognises that the instability and weakness of its economy prevent Russia from pursuing the issue of a more complete economic and military integration with its neighbours.

Last September, the US published its new national security strategy. This document stated that if the US government establishes that a particular state could pose a future threat to America or that it is harbouring potentially threatening terrorist groups, the US will pursue a change of regime if absolutely necessary. This statement undermined the principle of national sovereignty established in 1648 with the Treaty of Westphalia, which proclaimed the absolute sovereignty and equality between states.

The American "strategy" caused consternation among European politicians and legal specialists, but in Russia it barely caused a stir. This is not only because Russia in the Soviet era rejected Westphalian principles, by insisting that the proletariat had the right to change the "unjust" world order. The 1944 Yalta conference agreement and the major revision of borders that followed was celebrated by Europe, but seen in post-Soviet Russia as the end of Westphalia. America's recent step in this direction was completely predictable and perhaps, considering the new threats facing humanity, even necessary. However, "Russia does not want to see the breakdown of the world order, which is happening and deepening right before our very eyes, to lead to a war of all against all," Pavlovsky stated. "We must try to correct the US when the Americans are acting too haphazardly."

Yet when centuries-old rules are changing, everyone involved acts more or less haphazardly. New rules and a new order are necessary and Russia should contribute to this new system of agreements and understandings.

Iskander Khisamov is political editor at Expert magazine

Mr Order takes charge

He has been burnt in effigy on the streets of Moscow, but the head of economic development is determined that Russia must change. By **ALEXSANDR IVANTER**

Things have stepped up apace in the ministry of economic development and trade since May 2000. That is when German Gref or “Mr Order” took control and created the department from two former Soviet ministries. It now has responsibility for an even greater range of economic tasks than these ministries did during the Soviet era. According to experienced officials, nobody in the cabinet equals Gref for efficiency.

After Yegor Gaidar’s chaotic administration, Gref has kickstarted the economic section of the cabinet, armed with a development strategy for the next ten years. He has promoted, as his main priorities, tax reduction, using pension funds as savings mechanisms, reforming the banking industry and entering the World Trade Organisation as quickly as possible.

“The potential for economic growth is 6-10 per cent per year, and we are in no position at the moment to increase it significantly,” Gref explains. Russia’s high number of monopolies, the pressure of high taxes and bureaucracy on business, and the weakness of government institutions are putting brakes on growth. As a result, Gref has named reform of the natural resource monopolies, reduction of economic bureaucracy and administrative reform as policy priorities.

“The most difficult thing to reform is ourselves, in terms of technology and psychology,” Gref admits. “We still have a sluggish Soviet-style government, a vertically organised state that is absent from traditionally regulated sectors of the economy. Hence the additional tax on the economy in the form of ineffective administration and a lack of quality institutions supporting the normal functioning of the market.”

But the 38-year-old reformer is no dreamer. He admits that no significant change has occurred in the nature of economic growth in Russia. “Growth is still based on an advantageous world economic situation that stimulates domestic investment. It is impossible to change the structure of growth in one, two, or even five years. It requires much more time.”

When President Putin demanded that growth rates be raised



Gref: the path to economic growth is long and weary

during the slowdown that followed the boom years of 1999-2001, Gref stood his ground and firmly opposed him. Russia’s negotiations regarding entry into the WTO demanded fortitude no less, with strong pressure for reform coming from member countries as well as criticism from anti-globalist protesters in Russia. Gref did not even lose his cool when his effigy was burnt on the streets of Moscow. He remains optimistic. “It is still impossible to give dates for our entry into the WTO, but many of the most contentious issues have been resolved, such as levelling energy prices and the amount of farming subsidies. A worrying problem is the Ukraine, which seems likely to enter the WTO in the near future under

disadvantageous conditions. Entry is seen there as a step toward EU membership and, as a result, the country will dramatically reduce the prices and duties on all goods, including those exported to Russia. When this happens, we will have to protect our market from Ukrainian products.”

Two months ago, Alexey Kudrin, the minister of finance, and Putin himself suggested that there would be no further reduction in taxes in the near future. But for many companies, especially those actively investing, taxes have in fact increased. Understandably, Gref has come under fire.

“My position is that without lowering taxes, which are estimated at 40 per cent of GDP, we will not have high rates of economic growth. I do not agree that the president is in favour of slowing tax cuts,” the minister insists. “On the contrary, both the president and the prime minister are holding true to the course of tax reduction. The question is only how, and how quickly, to implement reforms.”

Gref is not willing to carry out reforms at any cost and is certainly willing to admit to and learn from his own mistakes. Bringing order to a Russia catapulting into a freedom bordering on chaos is difficult. If Gref manages, it will be one of few examples of constructive reform that Russia has seen.

Alexsandr Ivanter is Expert’s economic editor

Into the night

Young Muscovites revel in living in a real metropolis at last. Today, you can drink until dawn – and even the bookshops are swinging until midnight. By **ALEX KOKCHAROV**



Sing out loud. Muscovites praise the day that nightlife found them

Moscow has now become a 24-hour city. Living by night there is as easy as living by day and it's a lifestyle that's all too easy to get used to. What a thump back to reality, then, to arrive in London after a summer in Russia – and find it impossible to get a decent meal or see a movie after 10pm. Past the witching hour, Muscovian night-time habits need to be well and truly forgotten here.

In Moscow, going to the cinema at any time is no problem at all. To see a movie at 4am is perfectly normal. Although darkness falls early in the winter, heading into the city before 10pm is, for Muscovites, strictly a teenager thing. This late-night culture is simply part of the yuppie lifestyle of the growing middle class, desperate to have it all, all of the time.

"We have done so much to get where we are now, and we need some compensation for our years of hard study and work," says 24-year-old Ilya, a lawyer who arrived in Moscow from Siberia several years ago. Having climbed the career ladder to a top position at an independent law firm, he is now one of the self-made professionals who "work hard and play hard". Polls say that the average middle-class Russian works nine to ten hours a day, or longer for those under 30 who feel less secure about their jobs and financial stability.

After long hours at the office, young professionals stream into Moscow's downtown, now packed with cafés, sushi bars, restaurants, multiplex cinemas, bowling alleys and night-clubs. These popular haunts are packed every evening, and even at 11pm on a Monday night, you'll be hard pushed to get a table for dinner at the exquisite Café Pushkin. Such a wide variety of late-night venues is a recent phenomenon in Moscow. Just ten years ago, entertainment in the Russian capital was limited to very expensive restaurants and clubs for the nouveaux riches. But, gradually, things started to change. In

1996, Moscow experienced a real nightclub boom, followed by a wave of sushi bars and high-quality coffee shops. In 2000, at least one café opened in the city every week.

Restaurants now offer different cuisines in price ranges from Russkie Bliny's caviar pancakes at £1.20 to Russo-Italian fusion at Moskva-Rim starting at £15 a head. Dinner is followed by a cappuccino at one of the numerous coffee house chains (such as Shokoladnitsa, Café-In and Café-Tun) or by a cocktail at a trendy bar.

After that come going to the movies, bowling, gambling in casinos or clubbing. Moscow's dance clubs pump out music of the same high calibre as you will hear in London. Often, clubs such as Propaganda (a favourite among foreigners), Ministerstvo, Shangri-La or 13 fly in DJs from London to spin the tunes the music capital of the world has to offer. The hour-long queues, even on a wintry night, are proof that it pays off.

But there is more to Moscow by night than eating, drinking and being merry. If you can do it by day, you can usually do it by night. The trendiest shops on Tverskaya Street, as well as the GUM, the Manege and the Atrium centres, are all open until 10pm. Some boutiques keep their doors open until midnight.

Bookstores, too, have reacted to the changing lifestyle of Muscovites. Literature and high-quality fiction are back in style. Moskva Bookstore on Tverskaya Square is now open until 1am and the nearby OGI bookstore, part of the Pirogi eatery, is open round the clock. Amazingly, these places are packed with book enthusiasts, even at midnight.

Add supermarkets and food stores to the list, most of which are open and sell alcohol all night, and you can see that Moscow never sleeps. Nor, it seems, do the young Muscovites who manage to fit it all in.

"It's true, we do sleep less these days," says Max, a 27-year-old banker. "After decades of no nightlife during the Soviet era, we are finally a real metropolis, a real big smoke. Our generation is lucky – we have it all and we don't want to miss out."

Moscow certainly has it all – and it's definitely worth a try.

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