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The review provides a detailed analysis of main trends in Russia's economy in 2013. The paper contains 6 big sections that highlight single aspects of Russia's economic development: the socio-political context; the monetary and credit spheres; financial sphere; the real sector; social sphere; institutional challenges. The paper employs a huge mass of statistical data that forms the basis of original computation and numerous charts.

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The North Caucasus in 2013: the conflicts are escalating

The most obvious feature of the situation in the North Caucasus during last year was the disturbance of the fragile balance which had apparently begun to form in the preceding period, the escalation of existing conflicts and the emergence of new ones, including those related to resources. What was the cause of this escalation? What are its possible consequences? How does all this affect the economic situation in the region? These are the key questions which the authors aim to answer in this review.

Return to a power model: possible consequences

The post-Soviet history of the republics of the North Caucasus has been characterised by two approaches towards the resolution of the conflicts in these regions. Usually, these are presented as two variants of the counter-terrorism policy, but in fact, the choice of one model over the other, can fundamentally affect many other aspects North Caucasian society.

The first model can be described as the “tough course” model. It has the following main features:

- the broadest possible interpretation of the concept of “terrorists and their accomplices”, which in fact includes all representatives of those Islamic movements in the region which are not considered by the government to represent traditional Islam and are therefore considered to be a source of radical views;
- uncompromising priority given to tough methods of counter-terrorism;
- the goal is to fight to the bitter end, to achieve a full overthrow of the enemy.

In relation to the second model experts use the term the “policy of soft power”. It takes a less linear view of the problem of terrorism:

- the followers of non-traditional Islam are allowed to practise their particular religions within the freedoms guaranteed by the Constitution of the Russian Federation and are considered as being separate from the terrorists and their accomplices, i.e. separate from those people violating the law and guilty of particular crimes;
- terrorists themselves are divided into the arrant, uncompromising ones, and those who would be prepared to end their unlawful activities; the latter include some who “have blood on their hands” and some who “have no blood on their hands”;
- a different policy should be applied to each of the above groups:
 - subscribing to non-traditional Islam, in the absence of any violation of Russian laws is generally taken to be that individual’s private business;
 - young people who “got into the forest” by accident or through folly, and who do not have blood on their hands should be helped to withdraw from “the forest” as soon as possible and enabled to live a peaceful existence;
 - militants who are ready to cease terrorist activities should be enabled to adapt to peaceful life, although views on the form of this kind of ‘adaptation’ vary: from full amnesty to the commutation of sentences in return for voluntary surrender;
 - tough forceful methods should unequivocally be applied to uncompromising militants;

- enforcement action and counter-terrorist operations should be carried out in strict compliance with the law, and should observe the rights of civilians;
- the purpose of the policy is civil pacification, reduction of conflicts, and a termination of splits within society.

The period of conduct of counter-terrorism policy in the North Caucasus can be divided into three sections, each of which is characterised by a different combination of these two ideologies. Until autumn 2010 the power model almost fully dominated. The period from autumn 2010 to late 2012 can be interpreted as a combination of approaches typical of both models: along with the continuing military pressure in a number of North Caucasus regions (Dagestan, Ingushetia) with commissions for the ‘adaptation’ of militants being created and the start of an inter-confessional dialogue between conflicting Islamic movements. It can be stated that in early 2013 a return to dominance of the “tough course” model began. This change has been particularly pronounced in the Republic of Dagestan, although it also affects other territories of the North Caucasus Federal District (NCFD). It was manifested in the following ways:

1. All forms of inter-confessional dialogue and coercion of militants that had been tried and tested in the preceding year almost completely ceased. As early as 2012, the activities of the Commission for Adaptation in Dagestan were being increasingly blocked by the representatives of the national security forces included in its composition and, finally, when the government of the Republic changed in early 2013, it was liquidated with the following assessment by the leader: “it played its part but this was insignificant”. In Ingushetia, with the assassination of the Secretary of the Security Council, Ahmed Kotiev, who had been responsible for the Commission’s activities, this work, apparently, also trailed away. After the terrorist attack on Shafii Shaykh Said Afandi al-Chirkawi, one of the the most influential people in Dagestan, the dialogue also proved to be in a deep crisis.

2. Using large special operations, increasingly tough methods have begun to be applied, targeting not only the militants themselves but also their families and the communities from which they come. For example, in April 2013, during a large-scale special operation in the village of Gimry in the Untsukul'sky District of Dagestan, all the inhabitants of the village were temporarily evicted, and when they returned, they found that much of their property (both personal and public) had been stolen. Ten houses in the village had been blown up, which the local residents believe was because they belonged to the relatives of militants (even though such information was not always accurate)¹.

3. Detachments, formed of local residents, were involved in military actions, and although their activities went far beyond legality, they were supported by the security agencies. There are two well-known examples of this are. In Khadzhal'makhi village in the Levashinsky District of Dagestan the activities of armed members of a vigilante group resulted in the followers of non-traditional Islam being forced to flee their village, leaving their property behind, and some of them were killed². In Leninkent village (a part of Makhachkala) there were several forcible attempts to prevent the activities of a Salafi mosque and dozens of people were injured as a

¹ See, for example: R. Kadiev, M. Shevchenko. Gimry is Common Heritage of Dagestan. Kavpolit.com, 20 September 2013 (<http://kavpolit.com/ramazan-abdulatipov-gimry-eto-obshhedagestanskoe-dostoyanie/>).

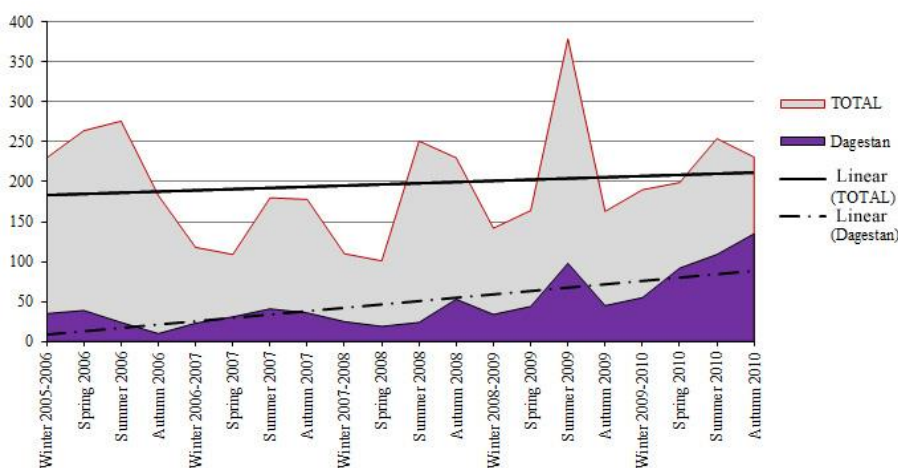
² General characteristic of the situation in the village based on the media materials and the author’s own impressions obtained during her visit to Khadzhal'makhi is laid out in: I. Starodubskaya, K. Kazenin. Expert report: “North Caucasus: Quo Vadis?” (<http://polit.ru/article/2014/01/14/caucasus/>).

result of the clashes¹. In both of the above cases, not only did the law enforcement agencies not intervene to prevent such violent actions, but on some occasions they even supported them.

4. Pressure, clearly including significant force, was applied on representatives of non-traditional Islam who were not using any violent practices to achieve their goals but were focused on promoting Islam through preaching and personal example, and who were ready to associate and cooperate with the State in areas where this did not conflict with their ideology.

5. Many of the above practices have even been recognised in legislation. For example, the basis for the approach of adaptation has been almost completely removed with the sharp curtailing of opportunities for the mitigation of punishment of militants in the case of voluntary surrender. There has been legal recognition of some forms of liability of the families and close friends of militants for their activities. The evolution of legislation in similar directions is still continuing.

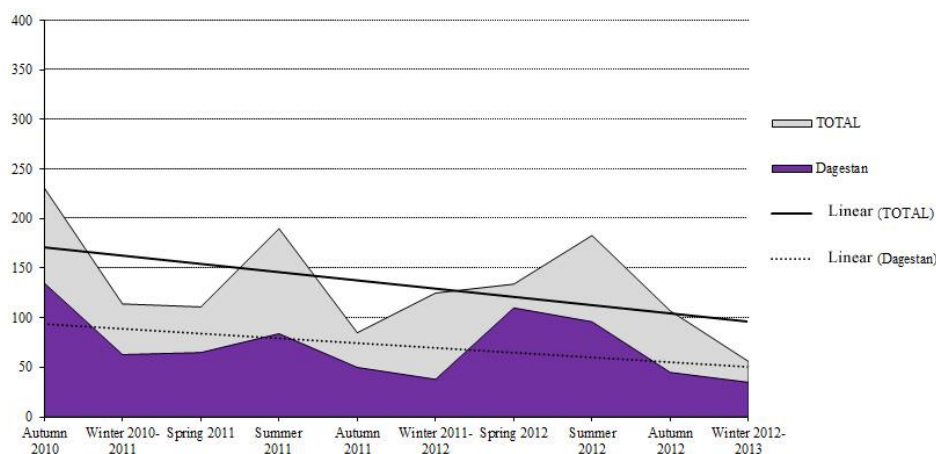
Can we conclude that this change in policy, implying a return to the force scenario, is the result of the failure of attempts at non-forceful settlement? An analysis of the situation in the period from autumn 2010 to late 2012 does not provide any grounds for such a conclusion. Let us consider just one confirmation of this thesis. *Figures 22 and 23* shows the changes in the numbers of victims of terrorist activities amongst members of the national security services (total numbers of killed and wounded), according to the “Memorial” Society, for the entire North Caucasus and for the Republic of Dagestan from 2005 (the authors do not have any earlier data) to the autumn of 2010, and from autumn 2010 to early 2013. Whilst the first period is characterised by an insignificant upward trend in casualty numbers, despite considerable fluctuations in the specific indicators, in the second period an obvious downward trend can be observed. These trends can be observed in the number of victims both in the NCFD and in Dagestan where casualties have recently been the most significant. It should also be noted that the trend reversal is even more obvious for Dagestan. The data available for 2013 are insufficient to draw definitive conclusions about the influence of the return to the force scenario on the dynamics of casualty numbers but there are some grounds to assume a return to the trends of the period up to the autumn of 2010. However, it is obvious that additional circumstantial factors also have some effect here, for example, the Olympic Games in Sochi.



¹ See, for example, <http://ndelo.ru/novosti-7/2340-ozhidaemoe-krovoprolitie>; <http://regnum.ru/news/1734663.html>

*total number of killed and wounded (The “Memorial” Centre for the Protection of Human Rights maintains statistics based on data from open sources: official websites of the national security agencies and the media)
 Source: “Memorial” data, authors’ calculations.

Fig. 22. Casualties amongst members of the national security services in the NCFD and Republic of Dagestan in 2005 – autumn 2010



* total number of killed and wounded (The “Memorial” Centre for the Protection of Human Rights maintains statistics based on data from open sources: official websites of the national security agencies and the media)
 Source: “Memorial” data, authors’ calculations.

Fig. 23. Casualties amongst members of the national security services in the NCFD and Republic of Dagestan in autumn 2010-2013

However, the consequences of the return to a force scenario go beyond the area of counter-terrorism. In fact, such a change has considerably affected various areas of public life, including the interaction between government and business. It is especially obvious from the example of Makhachkala where the force scenario manifested itself mainly through two processes: firstly, an increase in direct pressure on the so-called Salafi businesses and, secondly, in a toughening of policy in respect of the shadow economy (in particular, in the field of payments).

First, we should explain the term “Salafi businesses”. In Makhachkala a considerable proportion of small and medium-sized businesses in various industries are run by followers of non-traditional Islam. This type of business has developed both in spheres which have particular religious connections – for example, halal cafés and restaurants (where the food and atmosphere reflect Islamic canons) and in many other areas. The origin of the term “Salafi business” is associated with the fact that all the followers of non-traditional Islam are usually equated with Salafists (one of the Islamic movements), although in fact this is not completely accurate.

Reputedly, the most well-known action against “Salafi businesses” was carried out in October 2013, when, over a period of three days, halal café employees and visitors were being detained en masse, without any explanation. They were subjected to mandatory fingerprinting and had their photographs taken, and some of the detainees were subjected to violence. As a result, one of the most famous halal restaurants in the city was closed and some others were forced to change ownership¹. The reason behind such action is still not entirely clear – maybe

¹ See, for example: <http://ndelo.ru/novosti-7/2110-mentovskoj-bespredel>; <http://wordyou.ru/v-rossii/religioznye-pretenzii-na-ekonomicheskoy-osnove.html>; <http://chernovik.net/content/lenta-novostey/siloviki-v-mahachkale-proveli-reydy-po-kafe-zaderzhivali-predstaviteley>.



it was an attempt at business redistribution or a peculiar demonstration of potential preventive measures ahead of the Olympic Games in Sochi. But, according to available data, such actions were taken not only with respect to halal business: “this wave ... affected private kindergartens, cafés, restaurants and the manufactures of windows and furniture, and shops selling cell-phones and clothes”¹. In all cases serious damage was caused to the businesses (for example, on the pretext of the use of unlicensed software, computers were confiscated which resulted in paralysis of company activities).

While the above measures in respect of Salafi businesses have an obviously forceful nature, the effects of toughening the policy towards the shadow economy requires separate comment. At first sight, the shadow economy which operates outside the control of Russian legislation constitutes a violation of the law and the fight against it should be as uncompromising as that against any other offence. However, the situation is not so simple.

One must take into account that the reason for the shadow nature of the Dagestan economy is not solely due to an unwillingness to pay taxes. It is primarily an attempt not to demonstrate publicly the real potential of one’s business, in a situation where people possessing administrative resources could destroy or take away almost any successfully developing business. Moreover, in many cases the government agencies themselves are not interested in the legalisation of such businesses, preferring bribes and extortion over taxes being paid to the budget. For example, a few years ago a fishery in one of the coastal villages close to Makhachkala made an attempt to legalise its business. Once the fishery started demonstrating really good results, it was subjected to a huge fine forcing it to retreat to ‘the shadows’. At the same time the shadow sector provides employment and a means of livelihood to a considerable part of the city population. There are no alternative sources of employment in the city.

Even now the first results of the toughening of State policy in respect of business can be seen.

Firstly, according to the available evidence, medium-sized business (Salafi businesses, initially) are making efforts to leave the Republic by moving funds to other regions of Russia or abroad.

Secondly, the possibilities for illegal employment are being reduced even though there are no legal substitutes.

Thirdly, public protest is increasing against clearly discriminatory measures towards a group of businessmen on religious grounds (the headlines of articles reporting on the raids on halal cafés speak for themselves: “Abuse of power by cops”, “Your halal threatens our freeloading”, “Shurik, these are not our methods...”).

All this is happening in a situation where small and medium-sized businesses in Makhachkala, and in the whole Republic, are already in quite a difficult position. The economy has been depleted in many respects by the large-scale financial fraud (pyramids) in which huge amounts of money were invested². Competition in the market is increasing due to an inevitable process of penetration by national Russian companies which reduce the demand from traditional manufacturers and suppliers. Under such conditions any additional complications have particularly severe consequences.

So, paradoxically, it can be stated that the attempts to suppress negative social phenomena, in particular, terrorism-related ones, using force may have the opposite effect. People who have

¹ O. Ostrovsky. Shurik, those are not our methods ...// Chernovik, No.46, 29 November 2013.

² See, for example, <http://dargo.ru/news/2013-12-03-1417>.

lost their businesses or jobs, and are outraged at clearly illegal sanctions, create an enabling environment for the propagation of radical views, including religious ones. The economy is just one of the examples of increased tension and widespread discontent in the society here, but there are many, many others. This complicates the process of combatting extremism and terrorism, so the tendency towards increasing casualties amongst members of the security services under these conditions is hardly surprising.

At this point we should like to remind you of the example of alternative policy in respect of the shadow economy that is described in the book “The Other Path” by Hernando De Soto, which has often been discussed before¹. It is based on working with the communities of shadow businessmen themselves and identifying the conditions under which they would agree to legalisation. This can be facilitated by the simplification of administrative procedures and a reduction of administrative barriers, the enforcement of property rights guarantees and the creation of trust-based relations between business and government. According to De Soto, such approaches played a crucial role in the suppression of terrorism in Peru.

¹ De Soto, Hernando. The Other Path: The Economic Answer to Terrorism. Chelyabinsk, Socium, 2008.