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The review provides a detailed analysis of main trends in Russia's economy in 2014. 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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## **6.6. North Caucasus: The New Management Model and Old Problems**

In the North Caucasus, one of the most ‘problematic’ parts of the Russian Federation, the year 2014 was very eventful both in political and socio-economic terms, such events playing a significant part in the life of the region. The management structures of the North Caucasian Federal District (NCFD) were transformed and its priorities clarified. The beginning of the economic crisis has determined new challenges for the regional authorities and once again raised the question: will the worsening economic situation result in degradation or be a factor motivating a search for new opportunities? The Olympic Games had offered hopes (which were subsequently quenched by the terrorist act in Grozny) that the power model would ultimately be able to resolve the terrorism problem in the North Caucasus. Consideration of all these factors is essential to an understanding, not only of the current situation, but also of the prospects for its development in the region.

Let us consider some aspects of how the situation in the North Caucasus developed in 2014, which, in our opinion, are the most important in relation to forming the federal policy for this region. These are the changes in the system of federal management structures responsible for NCFD, the dynamics of the terrorist threats, the situation with financing the resettlement of people from the conflict zones and the payment of compensation for appropriated lands in the North Caucasian regions.

### **6.6.1. Changes in the management structures and priorities**

Discussions over the future of the North Caucasian Federal District intensified at the very beginning of 2014. Will it be liquidated after the Sochi Olympics? Will it be amalgamated with the Southern Federal District? The answer to these questions was given in mid-May. Contrary to widespread predictions, no aggregation of the management structures occurred. By contrast, in accordance with the model already tried in the Far East and in Crimea, in addition to the Office of the President’s Special Envoy, there emerged the Ministry for Development of the North Caucasus Regions. Moreover, Alexander Khloponin, who resigned from the office of President’s Envoy in the NCFD but remained the Deputy Prime Minister of the Russian Government, also retained certain control functions in respect of the North Caucasus. Management transformations also affected some North Caucasian development institutions: the North Caucasus Development Corporation (NCDC) and the North Caucasus Resorts (NCR) saw such management changes.

In parallel with these changes there appeared the first signs evidencing that the priorities of the economic policy for the North Caucasus would be adjusted. A shift away from reliance on mega-projects as the strategic basis of positive changes in the region was outlined. Instead of the continuous expansion of tourist clusters, there was an emphasis on the clear determination of their priorities. At the moment there are three clusters: Arkhyz, in the Karachay-Cherkess Republic (KCR), where the first stage has already been commissioned; Elbrus-Bazangi, representing expansion of the existing resort centre of Prielbrusie in Kabardino-Balkaria; and the obviously highly ‘political’ resort of Veduchi in Chechnya. It is also planned to introduce significant changes to the activities of the NCDC, which has been much-criticised lately – its emphases will be shifted from global tasks to projects relating to small and medium-sized business.<sup>1</sup> The Minister for Development of the North Caucasus Regions clearly defined his ideology on this matter – there will be no phantom projects in the Caucasus.<sup>2</sup>

So, what are these changes in the federal policy of the region associated with? Several factors can be highlighted here.

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<sup>1</sup> [http://kavpolit.com/articles/kto\\_spaset\\_kavkazskih\\_biznesmenov-10640/](http://kavpolit.com/articles/kto_spaset_kavkazskih_biznesmenov-10640/)

<sup>2</sup> [http://kavpolit.com/articles/kuznetsov\\_proektov\\_fantomov\\_na\\_kavkaze\\_ne\\_budet-11902/](http://kavpolit.com/articles/kuznetsov_proektov_fantomov_na_kavkaze_ne_budet-11902/)

*Firstly*, the initial five years of existence of the NCFD showed that the expected investment breakthrough had not occurred. The large-scale state support allowed the implementation of a few major projects but failed to change the situation cardinally or to benefit the lives of ordinary people. The improvements seen in a range of economic indicators in the region were, in fact, driven by factors independent of the NCFD's development strategy, for example, the growth of the defence orders.

*Secondly*, it has become obvious that implementation of the strategy not only failed to mitigate the overall conflict background in the North Caucasus, but is even contributing to the appearance of new centres of tension, as resource-related conflicts arise between those carrying out traditional economic activities and the external investors. Even the projects remaining in the list of priorities are not completely free of these problems – there are also conflicts between the use of land for cattle farming and for the construction of tourist facilities.

*Thirdly*, new 'external' restrictions have appeared—the crisis situation has limited financial appetites and the accession of Crimea moved the goalposts in the field of tourism development.

The first two of these risks, at least, had been obvious and voiced by experts as early as when the Strategy for Socio-Economic Development of the NCFD was being developed.<sup>3</sup> However, it was only after several years that their proposed adjustments to the Strategy started, at least, to be declared, even if not implemented in practice, by the decision makers.

Does this mean that a new (even if not written) and more balanced strategy of regional development relating to the change in priorities has more chance of successful implementation? It should be noted that while the risk of 'gigantomania' has apparently been overcome to some degree, it is clear that other problems still remain. It appears necessary to highlight the following two aspects here:

1. Any structure has its own inertia, so, declaring a change in the priorities of its activities does not really mean that these priorities will be changed in practice, even more so where the investment support mechanisms initially provided by the strategy have not been reviewed. At the same time, these very mechanisms carry significant internal risks when they take place, not only in the quite chaotic institutional environment of the North Caucasus, but also involve European countries that follow clearer and more transparent principles of attracting investment. The risks particularly involve the fact that a high level of support stimulates investors to invest even in objects with a negative market value.<sup>4</sup> That is why the projects, which remain top priorities for the NCFD, are in need of additional analysis in terms of their economic feasibility.

2. The transformation of the management structures in the NCFD organisationally formalised the gap between economic policy in the North Caucasus and the strategy of the activities of the power block. *De-facto*, this gap had existed previously. The NCFD's strategy for socio-economic development did not include any approaches to the provision of security in the region, and this, obviously, had a significant negative impact on its implementation. However, these matters are closely interrelated in practice. Both, the administrative barriers to business and the need for ensuring tourist safety are problems that are more than purely economic, but ones which majorly affect the prospects for the economic development of the region. It is not an accident, according to the RA Expert rating of investment attractiveness of the Russian regions, that the only republic, in which, the investment climate has significantly improved is Karachay-Cherkess<sup>5</sup>, where the government consistently implements peaceful dialogue-based procedures for conflict resolution within society and does not allow the degree of opposition between the various national and

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<sup>3</sup> See, for example: North Caucasus: Modernisation Challenge/I.V. Starodubskaya, N.V. Zubarevich, D.V. Sokolov, T.P. Intigrinova, N.I. Mironova, Kh..G. Magomedov.–Moscow: Publishing House 'Delo', Russian Presidential Academy of National Economy and Public Administration, 2012.

<sup>4</sup> For instance, the expert analysis of the first 10 years of support of eastern German lands identified that its investment support tools were not without flaws either, so it was proposed to give them up (See: Starodubrovskaya I., Zubarevich N., Markvart E. Federalism and Local Self-Governance –Taking into Account Territorial Variety (International Experience and Lessons for Russia). Expert Report–Moscow, 2015).

<sup>5</sup> См.: [http://kavpolit.com/articles/skfo\\_ekonomika\\_nesbyvshegosja\\_optimizma-13189/](http://kavpolit.com/articles/skfo_ekonomika_nesbyvshegosja_optimizma-13189/)

religious groups to increase to dangerous levels. The administrative transformations in the NCFD do not create favourable preconditions for ensuring unity of policies in these two interrelated areas – economics and power – across the entire territory of the region, and thus preserves the related future risks.

#### 6.6.2. Budgetary funding of resettlement programmes and payment of compensation

Among the acute questions, which the federal government faced in the North Caucasus in 2014, were those of the further implementation of a range of measures connected with the organised resettlement of citizens to new territories, and of compensation payments for appropriated land. The problems associated with the implementation of such measures can be divided into two categories. On the one hand, changes in the general economic situation in the country have forced a stricter assessment of the efficiency of budgetary expenditure on resettlement and the payment of compensation. On the other hand, some of the specific circumstances associated with the practical implementation of these state measures evidenced the necessity for their critical conceptualisation and for possible adjustments.

The resettlement of the Lak from the Novolaksky District in Dagestan remained the largest-scale of all the ‘resettlement’ measures in 2014, while the most notable ‘compensation’ event was the payment of compensation for agricultural lands in the area of flooding the Gotsatl Hydroelectric Plant (HEP) in Dagestan. The federal budgetary funding of these measures is being executed within the framework of the ‘South of Russia’ Federal Target Programme, whose Dagestan sub-programme for 2015-2025 is now under discussion by the federal government authorities.<sup>6</sup> In 2014 the Russian government demonstrated that it sees the resettlement from the Novolaksky District and the payment of compensation for land plots in the area of the Gotsatl HEP as two of its top-priorities. This was reflected in Resolution of the Government of the Russian Federation of 23 December 2014 No.1444 ‘On the Top-Priority Measures for Ensuring Rapid Development of the Republic of Dagestan’, envisaging that the set of measures for resettlement of people from the Novolaksky District to a new settlement area would be completed by 2018, and ensuring that the payment of compensation for appropriated land plots in the area of flooding the Gotsatl Hydroelectric Plant would be completed by 2016.

**The settlement of the conflict in the Novolaksky District of Dagestan**, including the completion of measures for the resettlement, elsewhere, of the Lak residing in this region is one of the necessary conditions for supporting inter-ethnic peace in Dagestan. In accordance with the Resolution of the Third Congress of the People’s Deputies of Dagestan (June 1991) the Novolaksky District of Dagestan, located next to the border between the Republic of Dagestan and the Chechen Republic, was to be ‘re-created’ in another territory immediately to the North of the Dagestan capital, Makhachkala. This decision was made in order to remove a serious problem threatening the inter-ethnic relations at the Dagestan-Chechnya border. The problem was that the Lak population had found itself in the Novolaksky District as a result of a forced resettlement previously conducted by the Soviet government. In February 1944, at the time when the Chechen were deported to Central Asia and Kazakhstan, the territory of the current Novolaksky District was included in the Aukhovsky District, populated mainly by the Chechen. Following the deportation of the Chechen about 7 thousand Laks were forcefully resettled from the mountains, after which the Novolaksky District was formed. When, in 1957 the Chechens were allowed to return to their native lands, the Soviet government was opposed to their settlement in the Novolaksky District. However, in the perestroika years the Chechen deported from the Aukhovsky District and their descendants bluntly re-stated the questions of their right to return to their native land and of the restoration of the Aukhovsky District. After the Resolution of the Third Congress

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<sup>6</sup> RIA Dagestan, 9 December 2014 ([http://www.riadagestan.ru/news/tourism\\_events/rayudin\\_yusufov\\_i\\_shakhabas\\_shakhov\\_prinyali\\_uchastie\\_v\\_soveshchani\\_u\\_zamministra\\_rossiyskoy\\_federatsii\\_po\\_delam\\_severnogo\\_kavkaza/](http://www.riadagestan.ru/news/tourism_events/rayudin_yusufov_i_shakhabas_shakhov_prinyali_uchastie_v_soveshchani_u_zamministra_rossiyskoy_federatsii_po_delam_severnogo_kavkaza/))

of the People's Deputies of Dagestan the construction began of houses for the Lak resettling in the future territory of the Novolaksky District, financed from the federal and regional budgets. The houses being left behind by the Lak were then occupied by descendants of the deported Chechens.

The fact that, even under the changing economic conditions, the federal government continued to conduct its programme for the resettlement of the Lak seems reasonable because any suspension of the programme may cause the resumption of ethnic tensions in the area and in the region as a whole. However, the preservation of the existing system for financing the resettlement and the general scheme of conflict settlement may result in poor value for money and become a new cause of destabilisation.

According to the Ministry of Economic and Territorial Development of Dagestan, by mid-2014 a total of 3,052 private houses, as well as many social and infrastructure facilities, had been built for the Novolaksky Lak in their new region of residence (the Makhachkala suburbs). The overall allocated expenditure for implementing the resettlement of the Lak population of the Novolaksky District for the period 1992-2013 was Rb 7,512,100,100, including, from the federal budget – Rb 6,058,500,000, and from the republican budget – Rb 1,453,600,000. According to estimates by the Government of Dagestan, the construction of a further 1,500 private houses for the migrants will be required, i.e. almost half as many, again, as the total number that have been constructed since 1992. Taking into account the considerable budgetary funds already spent on resettlement and the actual resettlement of the Lak to their new place of residence, the process of 'moving' the Novolaksky District to a new territory can be considered irreversible.

However, the currently effective procedure for the resettlement of the Lak does not, in reality, allow any determination of the 'horizon' of the funds required for this purpose. Pursuant to the republican legal acts, all Lak families whose head resided in the Novolaksky District in 1991 are eligible to receive a free private house in the resettlement area.<sup>7</sup> If any of the children of such a resident has started his or her own family, this family is also eligible to receive a separate house. Two separate houses are also to be provided to now-divorced spouses who had lived together in the area in 1991. As a result of such rules, the lists of those eligible to receive a house in the resettlement area are constantly being updated. Hence, the number of required houses and the required funding continue to grow. This 'self-perpetuating' process is leading to increased expenditure from the federal budget.

Another problem is that the completion of the resettlement of the Lak will, in turn, raise other very acute questions, mostly of a political nature. The restoration of the Aukhovsky District poses a threat of serious conflicts due to the lack of consensus on its borders. The Novolaksky District includes only a part of the territory of the former Aukhovsky District. There are currently about 14,000 people residing in villages previously included in the Aukhovsky District but not included in the Novolaksky District (Leninaul and Kalinaul). The residents of these villages represent multiple nationalities, so the intent of the Chechens residing there to have these villages included in the Aukhovsky District has provoked a negative response from a proportion of the residents of these villages who are of different nationality (the Avar). Our research shows that, in 2014, the situation around these 'disputed' villages had continued to worsen and posed a threat of serious destabilisation, not only in the villages themselves, but in the North-Western part of Dagestan in general. This is not about a deterioration of inter-ethnic relations *per se* but about the deepening of the disparities of the views of the two ethnic communities on the future of the 'disputed' villages and in the context of a radicalisation of the demands of both parties. It is significant that in their fight for determining the future of these villages the different resident groups are obtaining external support. In particular, on 23 December 2014, the Tenth Congress of the Chechen of Dagestan was

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<sup>7</sup> See the Regulation on the Procedure for Resettlement of the Lak Population from the Novolaksky District to a New Place of Residence (approved by the Resolution of the Council of Ministers of the Republic of Dagestan of 17 February 1993); Resolution of the Government of the Republic of Dagestan of 16 July 2004 'On Making Amendments to the Regulation on the Procedure for Resettlement of the Lak Population from the Novolaksky District to a New Place of Residence.'

held in the Dagestani town of Khasavyurt, and at which there were representatives from all the settlements of the Republic where Chechens reside. The demand to include the villages of Leninaul and Kalinaul as part of the Aukhovsky District was central in the declaration adopted by the Congress.

Without the achievement of an inter-ethnic consensus in respect of the future of the 'disputed' villages the launch of any process of restoration of the Aukhovsky District seems quite risky. However, after the completion of the Lak resettlement process it will be extremely difficult to 'defer' the beginning of such a restoration of the District, that today is already acute and leading to a deteriorating situation around the 'conflict' villages.

In light of the above one can conclude that, in 2014, the process of implementation of measures for the resettlement of the Lak from the Novolaksky District of Dagestan implied the following organisational *problems*:

1. No date has been set, after which the list for receiving houses will no longer be expanded. The approval of such a date by the Government of Dagestan would allow a determination of the final number of houses which must be constructed beyond those which already exist, the ability to plan for the definitive completion of resettlement and for the volume of funding required.

2. Political questions relating to the restoration of the Aukhovsky District have not been resolved. First of all, there is the question of the inclusion in the District of the disputed villages. According to our estimates, the process of reaching agreement on this question between the affected population groups could take 3-4 years. It would be expedient to organise the programme for the construction of houses to cover approximately the same period and to distribute the yearly budgetary funding accordingly. It is necessary to monitor the situation, with agreement procedures being applied to ensure compliance with the borders of the future District, so that the resettlement of the Lak is not completed before there is clear evidence that the procedures are successful.

As for the **payment of compensation for land plots appropriated due to the construction of the Gotsatl HEP**, in 2014, this complex of measures that are also financed from the federal budget, was plagued by the same unresolved problems as in previous years. In the area of HEP flooding in the Khunzakhsky District of Dagestan there are land plots used either by Gotsatl village residents or those of a number of near-by settlements for agricultural purposes. Locals have expressed their dissatisfaction that no compensation is envisaged for users of many of the land plots, access to which will be almost impossible after the reservoir has been created.<sup>8</sup> Furthermore, the protests of the local population are resulting in violations of the compensation payment schedule. As a result, this caused multiple mass-protests of the residents of the Khunzakhsky District of Dagestan between 2010 and 2014. The budgetary 'price tag' is relatively small: according to the estimates of local residents, they are being 'underpaid' compensation to the tune of Rb 400m.<sup>9</sup>

The situation in other Districts of Dagestan shows that the conflicts relating to the flooding caused by the HEP construction could have quite a serious negative impact. For example, the actual destruction of agriculture in a number of villages in the Untsukul District, which found themselves in the middle of the flooding area of the Irganai HEP has become one of the main reasons for the radicalisation of a part of the population in this area, and this is now one of the most unfavourable regions in terms of extremism.

In light of the above, the obvious insufficiency of the 2014 measures for informing residents in the area of construction of the Gotsal HEP of the real situation regarding the payment of compensation, and the procedure for such payments, may become a serious destabilizing factor.

To sum up, it can be stated that the events of 2014 have confirmed the necessity to continue the budgetary funding of the programmes of resettlement and the payment of compensation for

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<sup>8</sup> Money in the morning, chairs in the evening// 'Present Time' (Makhachkala), 23 April 2010 (<http://gazeta-nv.info/content/view/3998/216/>).

<sup>9</sup> Residents of the Dagestan village of Gotsal Will Not Receive Full Compensation in 2015 for Land Forfeited for Construction of the HEP// IA REGNUM, 26 December 2014 (<http://www.regnum.ru/news/economy/1881107.html>).

appropriated land plots in Dagestan, which is justified and necessary to maintain stability in this region. However, without significant clarification of the plans for these measures, and for addressing the associated risks, they may become inefficient and even have a destabilising effect.

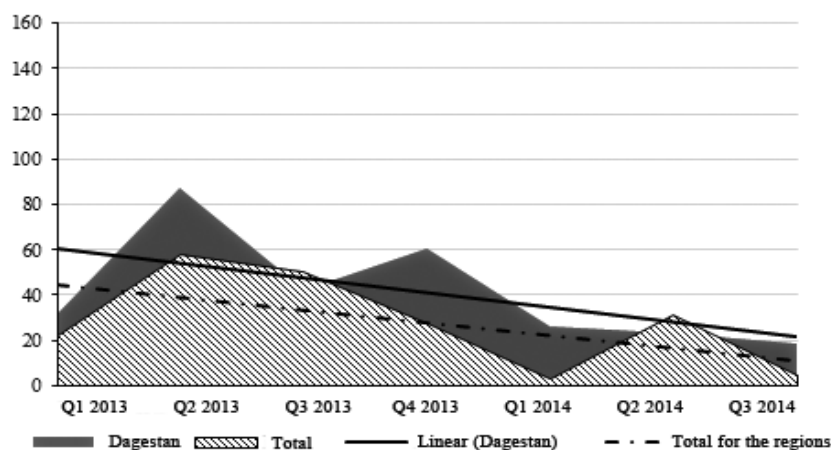
### 6.6.3. The dynamics of terrorist threats

The 2013 Annual Review provides a detailed analysis of the alternatives within the counter-terrorism policy and their potential consequences. Two anti-terror models were outlined: a hardline ‘power model’ and a ‘soft power’ policy. The period of implementation of the counter-terrorism policy in the North Caucasus can be divided into three sub-periods during which different combinations of the above ideologies were typical. Until autumn 2010 the ‘power model’ had been almost entirely dominant. The period from autumn 2010 to late 2012 can be interpreted as a combination of approaches characteristic of both models: along with the continuation of power pressure in a number of North Caucasian regions (Dagestan, Ingushetia) commissions for the adaptation of militants were created and inter-confessional dialogue between the conflicting Islamic movements began. This change in policy clearly gave a positive result – a tendency towards a reduction in the number of victims of armed conflicts began to manifest itself.

However, since early 2013 the domination of the ‘power model’ has returned as a result of a number of factors – a general tightening of ideological control in the country, the necessity to ensure the safety of the Olympic Games in Sochi and changes in the government of some of the North Caucasian republics. Based on an analysis of the trends of previous periods one might have expected that terrorist activities would intensify in response. However, as can be seen from the data on terrorist activities presented in *Fig.15* and *16* (noting the linear trend for the NCFD – solid line, and for Dagestan – dashed), no such effect could be observed for quite a long time, and this has supported the arguments of the advocates of the hardline scenario.

However, it should be noted that the situation has been influenced by many *external factors*, modifying the previously identified tendencies.

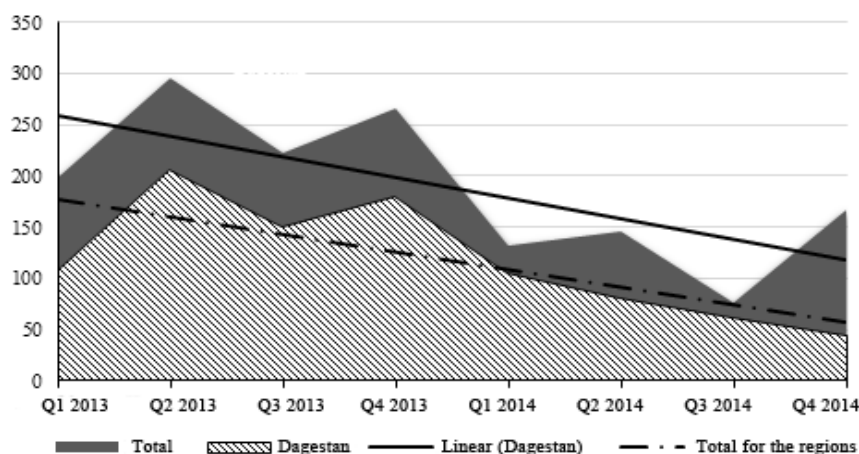
Firstly, there was a change in power within the ranks of the North Caucasian underground. The new leaders of the ‘Caucasus Imarat’ took a more moderate position: they argued against terrorist acts with civilian victims, against female suicide bombers, against resistance until the last bullet. No alternative strategy was actually proposed. Such changes could not but affect the activity of the illegal armed groups.



Source: Memorial’s data.

*Fig. 15.* Law enforcement officer casualties (killed and wounded) for the NCFD in general, and for the Republic of Dagestan, by quarters of 2013-2014





Source: data of the Caucasian Knot.

Fig. 16. Total victims (killed and wounded) for the NCFD in general, and for the Republic of Dagestan, by quarters of 2013-2014

Secondly, the North Caucasian situation is increasingly affected by the aggravation of the opposition in Syria and Iraq due to the appearance in their territories of the so called Islamic Caliphate (ISIS, ISIL or IS). Initially, this factor resulted in the outflow of young radicals from territories of the Russian Federation, and until recently, by using tough measures, the law-enforcement bodies had managed to prevent them from coming back. The effect had been to reduce the terrorist threats within the country. However, at the end of the year the situation began to change. One by one, the North Caucasian combat leaders started to fall away from the moderate Imarat Caucasus and to swear allegiance to the much more radical ISIS.

How might this process affect the level of terrorist threats? One might expect that it will further weaken the underground forces and facilitate counter-terrorism policy. However, there could be other, much more negative effects. For there is just one key theme in the competition between the different terrorist cells – successful terrorist acts. This is how certain experts explain the December terrorist act in Grozny—as the Imarat’s response to ISIS activity.<sup>10</sup> Information on the total number of militants who entered the city has varied greatly but combat operations continued in the city for almost 24 hours. In the course of the special operation 15 militants were eliminated, 14 police officers were killed, and a few dozens of people were wounded.<sup>11</sup>

At the same time, the response of the leaders of the Chechen Republic, calling people to destroy the houses belonging to the relatives of the militants and to expel the families from the republic, cause a sharp negative reaction on the part of the human rights community in Russia. The Chairman of the Committee against Torture, I. Kalyapin, urged that some of the calls by Ramzan Kadyrov be checked for compliance with the Russian Constitution. In response to this, an office of the mobile human rights group in Grozny was burnt down and the human rights activists were accused of protecting terrorists. The opposition between the Chechen leaders and the human rights activists has spilled over into the all-Russian information field, and related questions were asked of the President of Russia at his press conference. However, no clear legal assessment of the calls was given and the President’s answer was interpreted by each party in the conflict in its own favour.<sup>12</sup>

The lack of an unambiguous position of the government authorities on the matter of the admissibility of collective liability for terrorist actions has not only had a negative effect on the situation in Chechnya. The practice of the destruction of the houses of the relatives of real or

<sup>10</sup> [http://kavpolit.com/articles/dialog\\_vnutri\\_podpolja-11930/](http://kavpolit.com/articles/dialog_vnutri_podpolja-11930/)

<sup>11</sup> [http://kavpolit.com/articles/ot\\_snosa\\_domov\\_do\\_zabrasyvanija\\_jajtsami-12060/](http://kavpolit.com/articles/ot_snosa_domov_do_zabrasyvanija_jajtsami-12060/)

<sup>12</sup> Large press conference of Vladimir Putin of 18 December 2014 <http://www.kremlin.ru/news/47250>

suspected militants has spread quite widely in other republics of the North Caucasus – Dagestan, Ingushetia. At the same time, such actions are inadmissible, not only on the basis of human rights, the freedoms provided by the Russian Constitution and the provisions of Russian legislation but also in terms of the counter-terrorism policy itself.

Firstly, the hope that young people will stop performing acts of violence for fear of reprisals against their relatives is in vain. In the North Caucasus, inter-generational conflict is vividly manifested, with radical Islam being a stumbling block in this conflict. This is why older people are unable to influence the younger generation so the activities of latter will not be prevented because of threats to the older generation.

Secondly, the pressure on relatives may even worsen the situation. Today the key mechanism causing young people to become involved in armed resistance is the ‘pressure spiral’ when young men (and women as well) avenge loved ones and associates whom they think of as being innocent victims. Therefore, each turn of the spiral increases the number of those taking revenge, and the less selective and greater the violence becomes.

Thirdly, the destruction of houses is a serious factor in conflict conditioning of the younger generation. Children who have suffered such a trauma or who have witnessed it with their neighbours, become inclined towards resistance to a Russian government, which is directly associated with the tragedy they saw occurring, and this lays the foundations for a sustained terrorism problem in the future.