

РОССИЯ ►►
ВПЕРЕД!



New Decade, New World, New Policy – Russia in 2011

2011

the 1990s, the number of people in the UK who are employed in the public sector has increased by 1.5 million, from 2.5 million in 1980 to 4 million in 1998. The public sector has become a major employer in the UK, and its growth has been a key factor in the overall growth of the economy.

The public sector has also become a major employer in the UK, and its growth has been a key factor in the overall growth of the economy. The public sector has become a major employer in the UK, and its growth has been a key factor in the overall growth of the economy.

The public sector has become a major employer in the UK, and its growth has been a key factor in the overall growth of the economy. The public sector has become a major employer in the UK, and its growth has been a key factor in the overall growth of the economy.

The public sector has become a major employer in the UK, and its growth has been a key factor in the overall growth of the economy. The public sector has become a major employer in the UK, and its growth has been a key factor in the overall growth of the economy.

The public sector has become a major employer in the UK, and its growth has been a key factor in the overall growth of the economy. The public sector has become a major employer in the UK, and its growth has been a key factor in the overall growth of the economy.

The public sector has become a major employer in the UK, and its growth has been a key factor in the overall growth of the economy. The public sector has become a major employer in the UK, and its growth has been a key factor in the overall growth of the economy.

The public sector has become a major employer in the UK, and its growth has been a key factor in the overall growth of the economy. The public sector has become a major employer in the UK, and its growth has been a key factor in the overall growth of the economy.

The public sector has become a major employer in the UK, and its growth has been a key factor in the overall growth of the economy. The public sector has become a major employer in the UK, and its growth has been a key factor in the overall growth of the economy.

The public sector has become a major employer in the UK, and its growth has been a key factor in the overall growth of the economy. The public sector has become a major employer in the UK, and its growth has been a key factor in the overall growth of the economy.

Content

- 3 Preface
- 4 Recovery from Recession
- 7 Innovation and Modernisation
- 10 Privatisation
- 11 M&A Activity and Foreign Investment
- 12 International Relations
- 13 Drought and Destruction
- 14 The Sacking of the Mayor –
How Top Officials Come and Go
- 18 Political Change
- 20 Protest Movements
- 23 Metro Bombings – the War in the Caucasus
- 24 Khodokovsky Trial and Yukos
- 25 Conclusion – Russia in 2011



Preface

Last year we called our review *"Russia in 2009: after a year of crisis"*. This left our options open to describe another year of crisis in 2010 but fortunately Russia, as we expected, has fallen back into step with other economies and 2010 saw the country making, at least, a fitful recovery. A lot of this was domestically driven, not least through the sheer spending power of the state as a result of the very significant amount of money accumulated in the Stabilisation and other similar funds during the pre-crisis period of incredibly high oil prices, and the strengthening of the current account as a result of a better than expected oil price during the year.

Foreign appetite for investment, however, remained subdued throughout 2010 and foreign "risk aversion" has seemed to be particularly directed at Russia over other emerging and transitional economies. As much as Russia has tried to be attractive to foreign investment in the post-crisis period, it has constantly seemed to send out negative signals: continuing to score badly on corruption scales (and even admitting that little progress has been made), meting out high-handed treatment toward public figures and allowing, or failing to prevent the never-ending saga of Yukos and the destruction of Khodokovsky to continue to play itself out in prime media channels across a sceptical world.

We are not investigative journalists and we do not try to dig too deeply behind these stories or the operations of the state machine. Our essay is no more than a general commentary on the predominant economic, political and social events and trends in Russia from the start to the end of 2010, based purely on secondary sources – newspaper and internet reports on news events – and personal experience. We hope that a broadly ranging survey of this kind from the perspective of a group of professional people living and working in Moscow is of interest to our international clients and this was indeed the feedback we had from last year. Of course this is not an advice and the usual disclaimers apply.

From this perspective, if the central theme of 2009 was the crisis, that of 2010 was the new economic policy of modernisation and investment in new technology. We saw a lot of President Medvedev championing the modernisation agenda, the liberalisation of the economy and the attraction of foreign capital. We also heard him speak of political reform, transparency and democracy and there seemed to be some popular stirrings of revolt. However, the pace of political change remained indiscernible and a number of news stories during this period cast a very negative light on the power of the executive. We have therefore made the interaction of economic and political reform the theme of this essay. It appears that economic and political reform are both on the agenda but it is, and will be, a carefully, and centrally, managed process.

The views expressed here are inevitably the views of the authors. Obviously our colleagues at CMS hold a range of personal views on the various political and economic issues affecting Russia but we have at least a consensus, among a peer group of Russians and expats, that the opinions set out here are informed and reasonably objective.

Recovery from Recession

In 2010 the economy grew by about 4,5% but the recovery remains fragile. In contrast, in 2009 the economy contracted by 7,9% with domestic demand falling sharply following plunging oil prices and an abrupt reversal of capital flows. While all components of demand appear to be expanding at the end of 2010, growth is becoming increasingly driven by consumer spending, partly fuelled by the 45% cumulative increase in pensions and other social payments. This, however, may be symptomatic of other problems – low wages that discourage saving, lack of financial sophistication and an undeveloped market for pensions and other financial planning products. In any case, consumer spending is closely linked to job confidence and this may be fragile.

The unemployment rate climbed steeply in the second half of 2009 as the crisis dug in, reaching a peak of 9%. In 2010 unemployment fell back steadily, coming down to about 7,5% in the middle of the year. At the same time, wages and real disposable income strengthened, further fuelling some recovery in “high street” consumer spending.

In the first half of 2010 inflation began to fall sharply from 14% year on year in early 2009 to 6% by mid 2010. In the second half of 2010 inflation started to grow again partially due to an abnormally hot summer, widespread forest fires, a poor internal harvest and a rise in the price of imported food. According to the Prime Minister's address to the state Duma, agricultural production dropped by 9,9% in 2010.

The overall balance of payments remained in surplus in 2010 and the rouble appreciated by about 20% in real effective terms since its low in February 2009, bringing it broadly back to its pre-crisis level. During the period of mid 2009 to mid 2010 currency reserves increased by some US \$60 billion. It was indicated that the Central Bank policy will now be toward minimal intervention in the currency markets.

As global conditions recovered over the course of 2009, financial market indicators in Russia improved markedly. Russia's stock market index more than doubled and a somewhat short and volatile mini rally took place in the last weeks of 2009. The Russian stock market became and remained one of the best performers among emerging markets in 2010.

The banking system is liquid, in no small part due to large cash injections by the Government, primarily through the four state owned banks. However, banks have been strained by bad loans and credit has remained stagnant. Banks have preferred to speculate in the foreign exchange markets instead of accepting lending risks. Together with weak demand for credit and the continuing efforts by banks to restructure their balance sheets, these factors caused credit to the economy to remain largely unchanged in nominal terms since January 2009. During 2010, however, it seemed that the accumulation of overdue loans was decelerating and that banks were scaling back efforts to boost provisions and capital. Indeed some of the larger banks, citing an improvement in asset quality, signaled that they may release provisions to fund new loans in the last part of 2010. A good example is the revival of mortgage lending which had practically ceased



Widespread destruction of agricultural land in the summer of 2010 impacted inflation in H2

in 2009. Although banks' pre-provision income was relatively healthy in 2009, falling interest rates have squeezed interest margins and increased pressure on banks to begin lending. In this context, credit growth picked up in the spring of 2010, reflecting an improvement in credit demand and moderating credit supply constraints.

In place of the previous surplus, a budget deficit appeared in 2009 almost entirely due to higher spending. The Government undertook one of the largest packets of fiscal stimulation measures amongst the G-20 countries. Much of this expansion went into defense and security, i.e. zero or very low multiplier areas. The prudent past management of Russia's oil wealth by the late Yegor Gaidar, left the country with large international reserves and low public debt. This allowed Russia to finance the deficit – which swung from a surplus of 4¼% of GDP in 2008 to a deficit of 6¼% of GDP in 2009 – by drawing down the reserve funds and without significantly impacting the stability of the country's financial system.

The Stabilisation Fund, created by taxing and accumulating excess oil revenues, has served the Government well, providing room for manoeuvre in response to the crisis. Some of the spending decisions were questionable but nevertheless even after spending much of it and allowing a sizeable package of fiscal stimulation, Russia faces no present solvency or financing problems.

Russia's economy remains heavily dependent on primary commodities. Structural reforms have stalled in recent years, although there are increasing calls by the President in the

first place, to modernise the economy and reduce its dependence on oil and natural gas exports. The crisis has further increased the dominance of the state in Russia's economy, and the task of reducing inefficient and weak enterprises' dependence on state support, along with significant restructuring, will be a central, yet difficult, challenge in the years ahead.

A new package of structural reforms remains a top priority. With a shrinking labour force, adverse demographic trends, an unfavorable investment climate, and inevitably declining scope for further catch-up gains in productivity, post-crisis potential output growth is likely to be lower than pre-crisis levels. This shows the need for rapid and decisive action to advance structural reforms, with a focus on improving the investment climate and boosting the potential for productivity gains.

Workforce productivity in Russia is historically much lower than in more advanced economies. In their April 2010 study "Efficient Russia: productivity as the foundation for growth" McKinsey & Company and McKinsey Global Institute (MGI) analysed labour productivity, determined the reasons for the lag of the Russian economy behind developed nations and outlined potential ways for productivity growth in a number of key sectors of the Russian economy. Their findings showed that in the last ten years productivity in Russia grew by 6% per annum on average. This proved to be the dominating factor of the economic renaissance, providing 2/3 of GDP growth per capita, mostly by increasing the utilisation of existing industrial capacities. During this period the average labour productivity in ten key industrial sectors grew from 18% of the productivity in the USA in 1999 to 26% in 2007. For example, compared to the USA, Russian productivity in steel production is 33%, in retail 31%, in retail banking 23% and 15% in the power sector. Evidently, a lot remains to be done.

A primary challenge facing Russia is to ensure that consumption of its large but diminishing oil wealth does not get ahead of the expansion of its still-limited productive capacity outside the primary commodities production. A main problem is the exhaustion of the "petro state" development potential. It is very doubtful that the sustained oil price bonanza of the last ten years will return. Indeed, the country continues to extract and sell oil and gas but neither a noticeable growth in production volumes, nor the incredible profits from oil and gas exports that in recent years allowed Russia to accumulate financial reserves, increase state expenditure and maintain a budget surplus, can be foreseen. If in 2002 the federal budget had a 1,4% of GDP surplus at prices for the Urals oil of US \$24 per barrel, the 2011 budget is planned with a 3,6% of GDP budget deficit at a forecasted oil price of US \$75 per barrel. In recent months the Reserve Fund stabilised at US \$40 billion which is only 70% of the planned budget deficit. Unavoidably, the fund will have to be spent on financing the budget deficit despite the oil price being in the order of US \$90 per barrel.

Russia's record in the area of expansion of its industrial capacity outside the primary commodities production, prior to the recent crisis, was somewhat disappointing as the steady increase in the non-oil deficit in the face of buoyant private demand, combined

with stalled structural reforms, caused signs of the “Dutch Disease.” Encouragingly, the sharp contraction in output as a result of the crisis, and the appreciation of the fact that another prolonged period of rapidly growing oil prices is doubtful, are fuelling calls for change. Preventing an overvalued exchange rate by taxing and saving oil revenues, while moving decisively to strengthen the investment climate, remain the key to modernisation and diversification of the Russian economy. At the end of 2010 the investment climate remains damp however, with Russia maintaining a poor image abroad for corruption, bureaucracy and an over-powerful state and the investment decision makers much more wary of “country risk” than in the years before the crisis.

As far as the outlook for the immediate future is concerned, the World Bank improved the growth forecast for the Russian economy in 2010 to 5.5%, and Merrill Lynch predicted the “biggest bounce” in the world with 7% growth and full recovery in the first quarter of 2011. Most Russian economists remained far more conservative, pointing to the low demand for credit and close to non-existent investment activity and current assumptions show that they were right with growth expected to be 4.5% at year end.

The Russian stock exchange attracted more than US \$1 billion since early March, but that does not register in the total outflow of capital in 2010 that reached US \$38,3 – although this was some improvement on the negative balance of US \$56,9 billion in 2009¹.

The main parameter in the optimistic forecasts is the price of oil, which has gradually climbed to the level last seen in the fall of 2007, when the future of the Russian economy appeared cloudless and its hard currency reserves exceeded half a trillion dollars and were seen as a guarantee against any turbulence. However, as indicated above, on the same level of oil prices Russia’s economy is doing far worse, and a return of petroprosperity cannot be orchestrated or realistically expected.

One reason for this disconnect between growing oil and gas revenues and stagnating investment is the emphasis of the government’s anti-crisis policy on mitigating the impact of the decline by rescuing inefficient enterprises and expanding social payments. In tandem with this, various administrative costs, including corruption, have risen.

A very simple conclusion follows. The continuation of the old model of the country’s development in the “hydrocarbon civilisation” paradigm is not possible for much longer. There is only one scenario in which this way of doing things is tenable, that of oil prices all of a sudden going sky high again and remaining there. It is, however unlikely that this scenario will happen.

Innovation and Modernisation

In the course of 2010, therefore, it seemed that Russia was actively repositioning itself away from the western stereotype of a “raw materials supplier with an authoritarian

¹ Figures from Global Financial Integrity

government”² toward a Russia of the future as a “democratic and meritocratic centre of innovation”. In the political sphere, as we discuss below, there were some nice words but no visible sign of life. In terms of the economy however, the “modernisation agenda” at the start of 2011, is quite discernable but the limits are becoming apparent too.

The creation of a science and technology park in a suburb of Moscow and named after the existing Moscow School of Management “Skolkovo”, is one of the landmark projects for the strategy of innovation and modernisation of the economy and the one that has received the most international coverage. President Medvedev has been involved with the Skolkovo project since 2006 as Chairman of the Skolkovo International Advisory Board but less was heard about it until the global financial crisis highlighted Russia’s vulnerability to instabilities caused by the economy being locked into natural resource pricing on the global markets. The project is set to focus on renewable energy, information technology, telecommunications, biomedical research and nuclear technologies and therefore quickly found its place as a sign post for the Russian economy moving away from its dependence on primary commodities production. The President – an enthusiastic “tecky” and regular blogger – has personally identified himself with the project, attempting to create a conceptual association with California’s Silicon Valley which he visited in 2010 with a reciprocal visit to Russia by the Californian governor and a delegation of American high-tech companies taking place within weeks. From a political point of view, this is variously seen as Medvedev’s search for a legacy to outlast his presidency (expecting no second term) or evidence of his longer term political ambitions and a bid for electoral credibility in 2012. However, leaving cynical politics aside, the project is a clear and very positive policy statement of the current administration, show-casing the “modernisation agenda”.

Skolkovo is a “green field” project supported by legislative provisions that will give the techno-park a special status³ and allow it its own police department, tax and customs services and patent authority. Those with the special status of “project participants” will enjoy a VAT tax break for ten years if they meet the legal criteria and carry out research and development, with commercialisation of results obtained. At this time the only visible sign of the new future is the Moscow School of Management “Skolkovo” – a privately owned and financed project set up on the initiative of Ruben Vardanian, head of Troika Dialog. Work on the tech park and infrastructure should start in 2011 and is expected to need between \$4 and \$6 billion of state and private sector funding. Describing the tech park at Skolkovo, the president’s advisor Arkadi Dvorkovich, announced that those that want to come to Skolkovo from abroad will have “*all the accommodations for them and their families they have in their own countries*”.

Skolokovo should not be seen in isolation. Head of the project, Russian tycoon Viktor Vekselberg, has hinted that this could be only the tip of the iceberg and that what is being created is a prototype, with multiple technology parks based on Skolkovo to follow. In

² <http://www.bloomberg.com/news/2010-12-28/hedge-funds-crash-apple-turns-uncool-in-2011-commentary-by-matthew-lynn.html>

³ Federal Law dated 28 September 2010 N 244-FZ “Regarding innovation centre “Skolkovo”



The President unveils Moscow School of Management “Skolkovo”

addition, Rusnanotech, a state controlled corporation aimed at achieving Russian leadership in nanotechnology – the exact goal of the US National Nanotechnology Initiative – received state funding to the tune of one billion Roubles in 2010 for investments in a range of technology projects ranging from nanotechnology for global LED industry and markets to explosives and drugs detectors.

Neither is the interest in new technology purely a Federal enthusiasm. The concept of specialist industrial “clusters” has been taken up by a number of regional administrations in Russia including Kaluga, St Petersburg, Novosibirsk, Nizhny Novgorod and Tyumen whereby investors in specific sectors are provided with tax breaks in return for establishing operations locally with the added attraction of sector-specific infrastructure and a particularly qualified local workforce. Kaluga is an example of one of the most successful industrial clusters. A city some 200 kilometers away from Moscow and capital of the Kaluzhsky Region, one of the constituent regions of the Russian Federation. The regional government has placed an emphasis on attracting direct foreign investment by creating industrial clusters with the result that there are three clusters – the automotive cluster that hosts such giants as VW, Volvo, Mitsubishi and Peugeot-Citroen, the pharmaceutical cluster accommodating the manufacturing facilities of NovoNordisk, Berlin-Chemie, Hemofarm and Sanofi Aventis, and the logistics cluster (DB Schenker, GEFCO). There are also manufacturing sites of L’Oreal and Lafarge, research facilities of GE and subsidiaries of many other mid-size and major foreign companies.

These projects point to a clear intention on the part of the federal and local governments across Russia to re-base the economy and take a leading part in the global hi tech economy, but how innovative Russia really is, and whether it can develop the best new products domestically, remains the Big Question. The relaxation of the visa regime introduced in July 2010, applying to highly qualified individuals, seems to be part of the process of building up the intellectual infrastructure of the country by attracting foreign specialists, but the real risk for Russia is the movement the other way with a massive exodus of its own, homegrown talent. Furthermore this is just a political concession making it easier to *employ* specialists. It does not make Russia any more attractive to the blue-sky thinkers – Russian or foreign – as a place to settle with their families for the long term and develop new ideas and products and it is partly on this that the success of a modern Russian diversified economy probably depends. Leaving aside its generally poor image in the western press, in terms of the physical environment, lack of services, lack of confidence in public officials and the high cost of living, Moscow scores badly against other capital cities which are similarly trying to attract global talent – and Russian regional centres will have a tougher time still.

Neither is it very clear the extent to which the administration means, by these modernising processes, to open up the Russian economy and roll back the heavy preponderance of the state. In this regard, observers have eagerly awaited further information concerning the government's privatisation program.

Privatisation

Throughout 2010 there was much interest both in Russia and internationally in the upcoming privatisations of Russian state-owned assets expected to take place in the course of 2011 to 2013, with an estimated market value of \$33 billion. The program was finally approved by a government resolution on 27 November 2010 (and amended on 29 December 2010) revealing the keenly awaited information about what stakes will be offered to investors. It identifies ten leading companies in various sectors of the economy where only minority participations will be offered – for example, 25%-1 in Rosneft; 7.97%-1 in RusHydro; 7.58%-1 in Sberbank; 35.5%-1 in VTB, 25%-1 in RZD, etc (the only exception is United Grain Company where 100% is offered). Each of these privatisations will require special government resolutions and their timing, price and method are still unknown and will depend on many factors (market conditions, etc). The program also includes a list of smaller assets (state-owned enterprises and open joint stock companies) that will likewise be subject to privatisation. In these cases the stakes offered will vary from 13% (Uljanovsk Car Factory – producer of UAZ) to 100% (Air Company Siber; Murmansk Port).

For some the sell-off harks back to the 1990's privatisations which led to the scandalous seizure of former State owned assets by the new oligarchs. However, the legislative pro-

visions implemented specifically for this round of privatisations indicates a much more carefully managed process. In particular, the amendments to the law on privatisation of state assets⁴ as adopted in May 2010⁵ define the ground rules for the latest round and the focus appears to be the increase in efficiency and transparency of the privatisation process and a reduction in the level of bureaucracy involved.

The Russian privatisation program could be a big driver of M&A activity and foreign investment if it would provide foreign investors with genuine opportunities and signify a real liberalisation of the economy and reigning back of state control. However, given the generally small stakes offered in the most attractive assets, the program seems driven more by the need to plug budget deficits than anything more radical. At the same time, although no special limitations for foreign investors have been announced, what is not known is whether majority stakes, where these are to be privatised, will be accessible to foreign control or whether, say, a broad range of sectors perceived as vital for the economic recovery of the country (food production, telecoms, health etc), or on some other bases, will be treated by the state as vital for its security so that opportunities for foreign investors to acquire control of some of these assets will be subject to the carefully managed process established under the 2008 Law on Strategic Industries. We have no clarity on this at this time but what happens in this respect will be revealing as to where the real limits are to the liberalisation of the Russian economy.

M&A Activity and Foreign Investment

The exact state of the M&A market is difficult for international law firms to assess since it is clear that there is much unseen activity in the domestic arena – distressed and other deals done as only the locals know how – while the volume of mainstream inward investment remains subdued. International private equity and portfolio interest fell away dramatically with the onset of the worldwide recession and the crisis in Russia but strategic investors have been more active and at CMS we have seen a marked upturn in our own transactional business as compared to 2009. At the end of 2010, CMS commissioned research into current attitudes of foreign players in the Russian corporate market, from the M&A intelligence service Mergermarket and the initial findings are very positive toward Russia, confirming that it was generally not so difficult to invest in Russian enterprises and few had any regrets⁶.

This does not surprise us greatly. With a sharper focus on “country risk”, it is the portfolio investors that have been most put off by an ill-defined “political risk” and the threat, as they see it, that their assets will be plundered – by the managers, by the state or otherwise one way or another. Indeed, they are right to observe that the State remains very big in Russia and it still has a worrying-for-investors tendency toward an unpredict-

⁴ Federal Law No. 178-FZ dated 21 December 2001 “On the Privatisation of State and Municipal Property”

⁵ Federal Law No. 106-FZ dated 31 May 2010 “On Introducing Amendments to the Federal Law “On Privatisation of State and Municipal Property””

⁶ “Deal Drivers” Report 2011 published in conjunction with Mergermarket – please request a copy

able and disproportionate exercise of its power. And there is no judicial review. Dawn raids by armed and masked militia continued in 2010 – such as the 2 November 2010 raid at the HQ of Russia's National Reserve Bank. The Yukos affair, the Khodorkovsky indictment, the Magnitsky investigation (and his allegations against state officials which have still not been properly aired) keep Russia's reputation for arbitrary exercise of state power in front of the world's investment decision makers. Old cases perhaps, but they need to be resolved and closed.

Aside from the macro policy issues, some foreign funds with an appetite for Russian risk/reward, perceive a lack of suitable assets with good management teams and opportunities for steep turnaround growth and valuations of Russian assets still appear high to them. The domestic funds seem to disagree and they have been much more active – we guess you have to be here.

The strategic investors, used to operating in emerging markets, take a generally more robust view of these matters and tell us quite simply they cannot afford *not* to be here; the size of the market, the demand for products, technology and skills. A strategic investment affords much greater practical protection against the country risk as a result of their management on the ground and the mutuality of commercial benefit (including where the other partner is the State). The financial investor for the most part must put his faith in documents alone – which work up to a point in Russia but it involves a leap of faith nonetheless.

International Relations

Continuing the process started at the G20 summit in 2009, the openly hostile stance that the former Bush administration in the US took towards Russia has been replaced by the symbolic pressing of the “reset” button by the Russian Minister of Foreign Affairs, Sergey Lavrov and U.S. Secretary of State, Hilary Clinton who visited in 2010. However, the main Russian-US foreign policy initiative in the year was the new START treaty aimed at reducing stockpiles of nuclear warheads and re-establishing the system of monitoring that operated under the expired Strategic Arms Reduction Treaty of 1991. This initiative struck some here as being an oddly old-fashioned way to mark the new relationship. Notwithstanding attempts to re-brand it “New-START”, the treaty negotiations showed, as much as anything could, how much and how little has changed: it was relatively easy to get the parties to agree to a new treaty and its signing and ratification seems not to be in any doubt, but the US Senate approval of the treaty was qualified at the last minute by a resolution providing that the treaty should not restrict US plans for development of its missile defense system – a move that irritated the Russians and called to mind the late President Reagan's Strategic Defense Initiative (“Star Wars”) and the pernickety arguments of the last years of the Cold War.

The Chinese premier visited, as did the German and Irish presidents. France and Russia cooperated in a year of culture and Great Britain worked hard to give a very low profile



August 2010: not a great time to see Moscow

to the diplomatic rows which have dogged its relations with Russia in recent years and there was a visit from the British foreign secretary and rumours of the prime minister visiting in 2011. Travelling the other way, the Russian president took in visits to Denmark, Finland, California, the Ukraine, France, Argentina, Poland Norway, China and others.

It was Russian-US diplomacy that provided the spy story in 2010 with the discovery and expulsion from the US of 11 Russian individuals who had apparently been working as “sleepers” in so-called deep cover for years. Whereas it was the charm and beauty of Anna Chapman that achieved the most profile, chief among the members of the ring by all accounts, was the so-called Christopher Metsos (apparently an alias) who handled the cash transactions. He fled to Cyprus, was apprehended there and immediately released on a mere 27,000 Euro bail. Accordingly, it was not perhaps surprising that he jumped bail and disappeared, with the American FBI apparently unable to track him down. It seemed to us that no one involved was much interested in spoiling the Russo-US entente cordiale with another British-type extradition row.

Drought and Destruction

Moscow is noted as the capital city with the greatest seasonal temperature variation in the world. We are prone to some exaggeration – the very low temperatures of -32°C in January 2006, for example, were unusual and lasted inside a week – but the normal swing is

truly from around +28°C to -28°C. This year was something different, with daytime temperatures in Moscow remaining above 30 degrees throughout most of July and well into August when the temperature hit 40 degrees in central Moscow. We thought it could not go on but in fact the heat and unbroken sunshine did not break until 18 August.

The hot weather was not, at first, unwelcome. Moscow is blessed with delightful woodland parks and – because this area once lay under the sea – sandy beaches (real ones) on the shores of the Moskva River. The local newspapers were full of amusing pictures of Moscovites misbehaving in the city fountains (until they were switched off). The cause, we were told, was the same as caused the flooding in Pakistan and as we watched their suffering it was clear we were having much the better of these complex weather patterns. While all this was going on, however, a real problem was developing outside the city as the peat bogs surrounding Moscow dried out and started to burn, along with large areas of forest, spreading a pall of thick suffocating smog over western Russia. By August the problem had become extreme and for several weeks Moscow and the whole area was fried by day- and night-time temperatures close to and above 40 degrees and saturated with acrid, choking smoke. Standing in Red Square, St Basil's was invisible.

Villages were burned down, crops were destroyed and people lost their lives. The State was not ungenerous and extraordinary compensation was offered to those who had lost their homes in the maximum amount of RUB 4,200,000 (around EUR 104,000) each. The Russian Ministry of Agriculture estimated that the drought and forest fires had destroyed 13.3 million hectares of the country's grain crop with the immediate result that on 4 August all grain exports were temporarily stopped causing a 19% surge in grain prices on the international markets as Russia is one of the top 5 wheat exporters. This ban was later extended in October on the basis of assurances in Russia that the country had sufficient stocks for its own consumption but not enough for export. The ban is to continue until 1 July 2011. Some of the traditional staples like potatoes, in which Russia was self-sufficient, will have to be imported from Belarus and Eastern Europe.

The Sacking of the Mayor – How Top Officials Come and Go

During September, rumours began to fly around that the mayor of Moscow, Yuri Luzhkov, would be sacked and these seemed to be confirmed as we watched a series of unscheduled documentaries on the state controlled television channels about corruption in City Hall and the destruction of historic buildings in Moscow – all this implicating the mayor and his high profile wife, Elena Baturina. It later emerged that Luzhkov had been given a week to think over his position, but he had refused to go. The end to the mayor's 17 year term of office came on 28 September when he was dismissed with immediate effect, by presidential decree.

Speculation about the timing and real reasons for the dismissal lasted a short while, but no clear conclusions were drawn. Whatever, it was not difficult for his enemies to put him under pressure. Moscow's road system is utterly choked, notwithstanding the ratio of only



Yury Luzhkov lost the confidence of the President and was gone

0.17 cars per person⁷, and it was not difficult to lay blame for this on uncontrolled building – retail developments mainly – at major intersections with the inference that permits had been issued without proper process. The fact that the mayor's wife is well known as the head of the ubiquitous construction company, Inteco, by which she is one of the world's richest women, made the pair of them an easy target for a media-led slur campaign. Since the mayor's sacking, commentators, including high level officials, have declared it "open season" on Inteco and Baturina. Luzhkov, himself, denies any wrongdoing.

That said, Luzhkov was not unpopular and over an eighteen year tenure of office, he was extremely public facing and energetic and is widely (and probably rightly) credited with the transformation of the city from the grim soviet capital into the modern, cosmopolitan capital of today. Despite some of his serious lapses of taste – such as the huge and many think, completely hideous monument to Peter the Great (rated as one of the ten ugliest statues in the world) – many Russians consider he made the city prosperous and even beautiful.

But the mayor of Moscow shares the distinction with the mayor of Minsk as one of the only two unelected city mayors in Europe. He is proposed by the president and appointed by the Moscow Duma and, like all regional governors, requires no popular mandate and so the views of the citizenry, whether for him or against him, are irrelevant. This is why Luzhkov's low public profile and absence from Russia at key moments in the drama is not so strange.

⁷ ...but a 50% year on year increase.

What really matters to a high public official in Russia is his standing with the men who personally run Russia's internal affairs. In this regard it seemed Luzhkov was a "Putin man" rather than a "Medvedev man" and some of the independent media excitement over the affair stemmed from the possibility that these events would cast some light on the relative ascendancy of the president and the prime minister of Russia. Putin said in an interview for Channel One television during a trip to Syktyvkar: *"Yury Mikhailovich [Luzhkov] has done a lot for the development of Moscow and is, to some extent, a landmark figure for modern Russia but it's absolutely clear that the Moscow mayor didn't get along with the president, and the mayor is subordinate to the president, not the other way around."* In other words, he seemed to say, this was the President's hobby horse not his, he did not really understand and it must be some sort of personal thing, but neither was he much bothered. And the truth is, he probably wasn't.

What the prime minister did not do was align himself with the speculation over Luzhkov's personal integrity, his family's business dealings or with allegations of corruption in City Hall. One line of comment in Russia at the time was to see these events, and Medvedev's personal association with them, as evidence that the president's popular campaign against official corruption – part of his "modernisation program" and a subject on which he has been consistently outspoken – might be setting the agenda; a sign that Medvedev was taking a hard line by clearing out the old guard and bringing in transparency and change. Medvedev's own comment seemed to emphasise his personal authority and responsibility and left plenty of room for people to suspect that the mayor had been sacked on suspicion of corruption: *"As the president of Russia, I have lost my trust in Yury Mikhailovich Luzhkov as the mayor of Moscow"*.

The mayor's very public rough handling of certain local issues might have led to this conclusion. On the freezing night of January 21 the residents of the riverside village of Rechnik, who had long been in dispute with the city authorities over their rights to build on land originally allocated for orchards, awoke to find the mayor had sent in the bulldozers to demolish their homes and scenes of elderly people standing in the deep snow as their houses were pulled down made news around the world. This was Luzhkov's very personal style of law enforcement but it did not seem to meet with the president's approval as it was not long before the president stepped in and demanded that the issues be heard by the courts. In the summer the president intervened again over the protests in the Khimki region over the routing of the proposed Moscow–St Petersburg highway, ordering a new environmental impact survey. It would seem impossible for a new road in Russia not to destroy tracts of original forest and the new survey supported the original route, but it may have been that the president believed the process needed to be more visible and the incident revealed a degree of presidential frustration or even hostility towards the mayor who had been facing down the acrimonious protests.

After some weeks of speculation over a line up of more or less pro-Kremlin candidates, the City Duma appointed Sergey Sobyenin. This rather put an end to the idea that the removal of Luzhkov was a sign of any Putin/Medvedev split as the new mayor is close to



Rechnik: Residents had described their riverside homes as “like living on the edge of a volcano” – on the night of 21 January 2010; it erupted

both the president and the prime minister and so it was an entirely neutral choice. He was head of the presidential administration under Putin and then under Medvedev from 2005-2008 and he also ran Medvedev’s presidential election campaign in 2008.

The new mayor, nevertheless, has a reputation as a fair and efficient administrator and his appointment might indeed be part of the president’s campaign for transparency and greater public confidence in public officials. The new city administration got off to a good start with undertakings to solve the city’s traffic and construction problems as well as addressing housing, education and health care. A large number of building projects were immediately put on hold pending further review. In June 2010 City Hall published its General Plan of Moscow introducing greater and more transparent regulation of building in the city. The plan puts a halt to any new construction works unless the developers are able to demonstrate the necessary infrastructure within the development, allowing for parking and addressing any potential traffic issues. Real estate investors, too, believe the field has been leveled with Inteco losing what was seen as a “special position” in City Hall. So far, however, he has not backed the plans of his immediate predecessor, Vladimir Resin who held the mayorship in the brief interregnum, to pull down or relocate Peter the Great.

As an aside, it is well known to Muscovites that the Peter the Great monument is actually a portrait of Christopher Columbus that its creator, Zurab Tserateli tried to sell to the US, Spain and to some Latin American countries but all of them refused the colossal artwork on the grounds that it is so ugly.

Political Change

Political change in Russia continues to be a geophysical process and apart from Russia's occasional revolutions, it is normally difficult to report dynamic year on year developments in an annual publication such as this. So in terms of politics, 2010 was unsurprisingly much like 2009 and there is little psephological data around on which we can report to you any major swings in the public mood. In a predominantly one party state where the prime minister has made no secret of the fact that he decides the election and the population is pretty sanguine about that, there is really only one political story – the Putin/Medvedev tandem, how we all think they might be getting on and what might be their plans for Russia's future leadership.

As political drama goes, this is not the liveliest. Indeed, in 2010 politics as a spectator sport was elsewhere in the world, with so many political leaders humiliated in national polls after mishandling the economies and coalition government emerging as the norm in the new, post-crisis world order where no one seemed to have a clue. In Russia, by contrast, the huge reserves that had been put aside as a stabilisation fund had prepared the country well for the crisis and the low level of national and personal debt meant the Putin/Medvedev administration avoided criticism and came through well where others did not. In any event they were not unlucky enough to have to face an electorate in 2010.

In the lead up to the last presidential elections it was the prospect of Russia without Putin that was the overriding anxiety of international observers. This time, for some the worry is that Putin might come back. International opinion – business and political – wants Russia to be open and democratic because of the nasty things you find in dark and airless places. Against this yardstick, it is Dmitri Medvedev who is widely perceived as standing for a brisk march toward modernisation and democracy, whereas the prime minister gives out a more mixed message and remains associated outside Russia with the Chechen war, Yukos, Khodokovsky's arrest, and subsequent trials, and the doubtful activities of the United Russia Party's youth organisation, "Nashi". Aside from such controversies, Putin's legacy as the one who restored order by imposing the state over all aspects of political life, the media and the economy, itself means he has more to do to look like a moderniser in the western sense of transparency and submission of the executive to democratic processes. So far, as western opinion is concerned, Medvedev, not Putin, is the Gorbachev of our time: "a man you can do business with"⁸. In constant to the President's constant mantra of technology, anti-corruption and criticism of the judiciary, the prime minister has a more conservative image both politically and personally with frequent appearances exploring the Russian outback in camouflage fatigues, shooting Siberian tigers (with tranquiliser darts) and riding with bikers in the Crimea.

As these two, and not the country, will choose the next president, this polarised characterisation of the candidates creates uncertainty about the future direction of Russia after the presidential elections in 2012. The worry for some is that a third Putin presidency will

⁸ Words of Margaret Thatcher after first meeting the newly appointed Mikhail Gorbachev as Soviet premier.

undo and reverse the modernisation process which appears to have the president's name all over it. On this analysis, a second Medvedev term would see a more confident Medvedev returned, more inclined to force the pace of change and usher in a leap forward in economic modernisation and the development of democratic institutions while in contrast, Putin would clip his younger protégé's wings and return the country to hard line statism.

It sometimes looks as if there might be something in this. It was difficult not to be surprised by the president's ten-minute video-blog at the end of November for example. In it, the President declared that Russian politics was "dull", exhibited symptoms of "going stale" and there was a risk that stability would turn into "stagnation", a term associated in Russia with the un-lamented Brezhnev era. He told us that where the ruling party has no "worthy opposition" i.e. the opposition does not have any chances of winning, and such a ruling party can never lose, the ruling party will "turn into bronze" and "degrade". He concluded that it is time to create a more competitive political climate where opposition can compete with the ruling party. In his words, *"we just want to make our political system fairer... It must be trusted by the electorate more than it is now"*. It sounds an extraordinarily discordant note in the mainstream of Russian politics. The importance of the statement for international observers was the seeming link in Medvedev's political thinking between democracy and economic competitiveness – part of holy writ in the west but not by any means a given in Russia and not so obviously part of Putin's personal mindset.

But this may be more beguiling than real. Taken as a whole, the piece seems more aspirational than a call to arms. For one thing, the President noted that taking this process too fast would be "very unfortunate" for Russia; *"Russian democracy is young, immature and inexperienced, therefore political changes need to occur carefully and step by step"*. It can all sound like St Augustine's "grant me chastity and continence, but not yet". Certainly none of the initial steps in this process – such as attempts to increase professionalism in the management of the election process, or the proposal that the party with a majority in a local parliament should propose a candidate to the President for appointment as local governor – has been very profound and none is likely to be a threat to the current ruling elite or otherwise affect the status quo as long as there is no real prospect of broad based political parties emerging.

And yet these and other statements of the President are difficult to write off. Whether or not this administration intends to deal with the possibility of the current ruling party "turning into bronze" (for example by the active encouragement of opposition parties – free media, freedom of public assembly and access to public elections⁹) may be a question but there is no doubt his liberal statements are an unnecessary hostage to fortune unless there is some genuine belief behind them and some long term agenda in which they have a place.

⁹ The electoral law passed in 2003 increased the minimum number of votes needed to win seats from 5% to 7% and excluded many independents from running. This spelled the end for example of the Union of Right Forces which failed to reach the 7% at the last election.

For all Medvedev's apparent democratic enthusiasm and Putin's darker counterpoint, the differences between the two may be more apparent than real. Putin even softened his macho image by spending his 2010 summer holiday driving across Eastern Russia in a bright yellow Lada Kalina Sport. We think Putin might be less statist and autocratic and Medvedev less impatient for change than the images they respectively portray and that what they say about themselves – that there is no difference between them – might actually turn out to be the truth. One could, for example, speculate with an unfashionable lack of cynicism, that the long term agenda they both have is to use the executive mandate to create the conditions necessary for there to emerge a democratically elected successor for them both – not soon, maybe, but sometime.

Russian domestic opinion is less exercised by the slow pace of political change than the international media but nevertheless, in conversation, Russians are perfectly aware of this missing element in their political life and many regard it as a final frontier to aim for. In the meantime there seems to be general resignation to the fact that public officials are answerable to the executive rather than to the electorate and their occasional public dressings down by the president or the prime minister when things go wrong is a regular part of our news programs. However, during 2010, it sometimes seemed that others were becoming less patient and starting to find a voice.

Protest Movements

In our survey of 2009, we noted that the crisis risked triggering social unrest in Russia and that maintaining public order despite the effects of the crisis would remain a key government priority. This is because of the vulnerability of countries with, as Medvedev puts it, "dull" politics, to popular revolt and indeed 2010 presented reminders of this in Bishkek and Minsk. Indeed, over 2010 the 45% cumulative increase in pensions and other social payments as well as generous handouts to those affected by natural disasters, may have been aimed at counterbalancing any such tendency. Protest movements in Russia did, however, gain a somewhat greater profile during the year and we wondered at times if there might be an increase in the willingness of the ordinary citizen to openly challenge the state as this would be a significant social development.

Strategy 31 is a protest group led by the Union of Right Forces and more latterly "Solidarity" co-founder, Boris Nemtsov. Drawing attention to the fact that the right of assembly is expressly provided for under article 31 of the Russian constitution but in practice public gatherings have been frequently refused by the authorities on various, not very plausible, technical and health and safety grounds, Strategy 31 has been attempting to stage democracy demonstrations at the Triumfalnaya Square in central Moscow each 31st day of the month during 2010. They made their point well enough with their meetings attracting a substantial presence of OMON riot police in full rig and there was ugly police treatment of protesters at demonstrations held on 31 May and 31 July, including the elderly human rights campaigner, Ludmilla Alexeyeva. In August, the

area became unexpectedly ear-marked as the site of a proposed underground car park and was cordoned off for that purpose. With the change of mayor there seemed to come a thaw, when the city authorities allowed the demonstration for the first time on 31 October which briefly seemed to hint at a more liberal regime under the new mayor. However, this was not the case and at the same rallies on 31 December 2010, Nemtsov and other opposition leaders were arrested and sentenced to 15 days gaol to the condemnation of certain US senators. Amnesty International named Nemtsov a prisoner of conscience. Ludmilla Alexeyeva was also among those detained by OMON riot police creating images of some resonance. "Day of wrath" rallies in 2010, attempted by the Left Front, were similarly treated.

Popular public protest also showed itself in a different way with the widespread taunting of "chinovniki" (people of rank) who, to everyone's considerable annoyance, enjoy special dispensations from traffic laws for which purpose their official cars are marked with a "migalka" – a flashing blue light warning ordinary motorists to get out of the way fast. During the summer, many took up the cause by strapping blue plastic buckets to the top of their cars revealing, to the delight of western European residents, the Russian capacity for satire which is not so much seen here as in the west. The protests had a serious edge, however. Driving is notoriously hairy in Moscow with very heavy traffic, huge urban highways and a significant number of drivers holding licenses of doubtful validity so that the large number of VIP's, licensed to break the rules under the badge of a flashing blue light, is a real danger to the public. On the morning of 26 February, a Lukoil vice president's Mercedes S500 Sedan collided with a Citroen C3 hatchback on Gagarin Square, killing both occupants of the Citroen, a prominent gynaecologist and her daughter. The slow response of the investigating authorities, the unexplained absence of video footage and the statements of people claiming to be eye witnesses, gave rise to a huge amount of speculation about a police cover-up. Many supposed that it had in fact been the Mercedes that had crossed the central line under cover of its blue light in order to beat the heavy traffic going into Moscow. Although the official investigation closed in September, concluding that the Citroen had caused the collision, Muscovites were not persuaded and the special privileges assumed to go with a blue light remain a source of real irritation.

The end of 2010 saw three significant riots on the streets of Moscow which at first looked like further popular demonstrations against state authorities, albeit of a far more angry nature, but later emerged as something darker and, at the same time, less politically significant. The first of these genuinely violent demonstrations took place on 7 December on the Leningradskiy Prospekt, closing for a while on Saturday afternoon the main thoroughfare in and out of the city toward the north, and the second on 11 December on Moscow's central square – Manezh – right under the walls of the Kremlin. A third occurred a few days later at Kievskaya but under a heavy police presence. The trigger for each of these was, as it was reported, the killing of a Russian supporter of the Spartak football team by, allegedly, a group of non-Russian men, apparently from the Caucasus. But what seems to have ignited the protests was the later release without

charge, of the alleged perpetrators – circumstances which to some Muscovites either showed a failure of the law enforcement agencies to take the issue of “immigrant crime” seriously or, more sinister, the infiltration of the Moscow police by non-Russian criminal gangs. Characteristically responding to direct action by direct intervention himself, the prime minister met with the leaders of the relevant fan clubs which denied organising the demonstrations so that it was clear that these were flash mobs organising themselves through the internet and capitalising on the mistrust of Caucasian immigrants that is prevalent in Moscow. The extreme nature of the violence provides evidence of the existence of a significant hard line fascist movement here, fuelling and exploiting low-level Russian racism. The Kremlin has attempted to diffuse a serious situation by responding to the original concerns that provided the oxygen for the violent elements – although no prosecution has occurred. Putin attended the grave of the murdered supporter and the head of the Moscow police made public statements which seemed to give official endorsement to the issue of immigrant crime by claiming that a high level (2/3rds) of crime in Moscow may be committed by immigrants to the city from non-Russian CIS states.

The progress or otherwise of opposition groups and whether they can unite to any extent to create the “worthy opposition” Medvedev says he wants, will be a topic to watch during the current year and lead in to the 2012 election season. One new political hopeful is the ex-mayor, Yuri Luzhkov, who made unflattering remarks about the present state of Russian politics to various papers following his sacking and promised to stick around in order to start a reform movement. It will be interesting (and surprising) if there is anything in this. There is a feeling that Russia is an uncomfortable place for those that have fallen out of political favour and that Luzhkov, for all his fighting talk, may be disinclined to start engaging in opposition politics and wait for the Kremlin’s reaction. Moreover, as the man who consistently banned the Strategy 31 and other demonstrations throughout his term of office, and served a total of 17 years as mayor without a single election, Russians might think he lacks the credentials, despite his “man of the people” image. However, the serious point is that there are actually very few individuals in Russia who have both the necessary profile and the public’s trust to provide leadership and a voice to any movement for political change or to bring together the various disjointed opposition groups as a serious counterbalance to the present administration, and it is still a brave man who raises his voice in protest. One person who has been attempting this for many years and remains both visible and plausible, is Boris Nemtsov and the fortunes of his Solidarity movement is something to watch in 2011.

2011 will provoke a lot of comment and analysis on the progress of democracy as the country marks its 20th anniversary of transition from the Soviet Union to the Russian Federation and the transition from a centrally planned “command” economy to a market or “transition” economy. The focus clearly remains on economic growth through a managed liberalisation of the economy and general support for foreign investment rather than the opening up of political institutions as a parallel process. But this administration seems not to be unconscious of, nor much concerned by, the probable long term

implications of the transition to an innovation and technology-based economy in terms of reducing the political elite's access to economic power. This is a markedly different economy than that of the first 20 years of the transition, which enriched and empowered the owners of natural resource assets, and one which could promote a real and vocal domestic middle class as a vital stimulant for political change.

Metro Bombings – the War in the Caucasus

During the morning rush hour of 29 March 2010, 40 people died and over 100 were injured in two suicide bombings at Park Kultury and Lubyanka metro stations. The city authorities dealt with the practicalities with disconcerting efficiency so that by mid-morning both platforms were repainted and back in action. In the metro stations themselves, hundreds laid single red Carnations (no cellophane packaging) around icons flanked by lighted candles and stood in silent contemplation. It was very beautiful, very discreet and very moving.

Investigations confirmed that the bombings were carried out by Islamic Chechen separatists and that the bombers were a Dagestani girl aged 17 and the Chechen woman aged 28. A Chechen rebel leader, Doku Umarov, later confirmed that he was responsible for the attacks and stated that such attacks would continue if Russia did not grant independence to the Muslim states in the north Caucasus region. However, confusion remains as to who was behind these bombings. A spokesman for Umarov's Caucasus Emirate organisation had earlier stated that it was not responsible for the Moscow bombings and no very clear conclusion as to the perpetrators has emerged.

It is difficult to make sense of all of this. Russia is involved in a relentless war in the Caucasus region, an area of strategic importance for its oil pipe lines and as a buffer region over which Russia believes it must keep hegemony particularly while the region has enjoyed the attentions of NATO. It is well-known that the United States has in the past, actively courted Georgia as an ally although, as Georgia discovered to its cost in 2008, the US would fail to come to Tbilisi's aid following its "irresponsible" (according to the EU report on the conflict) invasion of South Ossetia and Russia's "irresponsible" (same report), response.

Russia's counter terrorism activity in the North Caucasus is uncompromising and probably fuels the violence of the insurgents in the region who have become increasingly radicalised. Bomb explosions and other terrorist incidents are part of daily life in the region and, as we were reminded in March, this occasionally reaches out to the Russian capital and no doubt will continue to do so from time to time. It is a case of probably unrealistic aspirations of nationhood and self determination among disparate ethnic and religious groups that seem to have an appetite for war as well as more general effects on the population of a low level of prosperity and opportunity, and a superpower that cannot realistically let the region fall into internecine chaos.



Russians display sympathy with quiet dignity but do not see the “annihilation” of the perpetrators as the whole solution

Whatever the responsible parties intended to achieve by the atrocity on 29 March – retaliation, retribution or recognition, the president’s reaction picked up the anger of Muscovites with his somewhat extra-judicial declaration that the people behind the attacks would be “*annihilated*”. Shortly afterwards, Magomedali Vagabov, husband of one of the bombers and four others were killed in a security operation in Dagestan with FSB chief Alexander Plotnikov commenting with mock sentimentality that “*to our great regret, we were unable to detain them alive because they put up fierce armed resistance and were killed*”.

Khodokovsky Trial and Yukos

In a long awaited judgement, Mikhial Khodokovsky was found guilty of stealing oil from Yukos subsidiaries and laundering the proceeds. The conviction earned him a further 7 years of imprisonment and once again captured headlines and the attention of leader writers around the world. The view expressed by many foreign political leaders and much of the international press was that the decision was politically motivated and further evidence that Russia does not respect the rule of law. Some analysts saw this as another set back for the country’s investment prospects even though it was just a criminal case, while others said the outcome was already priced into the market, the outcome having been predicted by all in Russia. Within Russia where few spare any tears for an oligarch down on his luck, the case is seen as one on its own facts and if

not entirely a one off, the Khodokovsky case is not going to be taken in Russia as a basis to draw any wider conclusions about the justice system still less about the reliability of the *civil* courts here.

Still awaited, however, is a judgement from the European Court of Human Rights in the case of Yukos v. Russia where, in a David and Goliath showdown, Piers Gardiner QC faced a legal team of 20 lawyers representing the Russian government in the oral hearing. A judgement is expected any time and if the decision goes against the Russian government, which we see as more likely than not, there will be another round of high profile critical comments in the international political and media arenas. The difference this time though will be that the decision itself may be a direct confirmation from some of Europe's leading jurists that the civil proceedings against Yukos were unfair and not in accordance with the standards expected of a member of the Human Rights Convention. Add to this the potential award of significant financial compensation to the Yukos shareholders (including the prisoner in Siberia) and you have a cocktail for a political storm of some magnitude.

In any event this judgement will not mark the end of the Yukos dispute. An appeal in the European Court of Human Rights case is possible and a further claim before the Permanent Court of Arbitration in the Hague is stayed pending the decision from Strasbourg. In the Netherlands litigation continues around control of the Yukos finance companies there with the Amsterdam court refusing to recognise the appointment of the Yukos liquidator by the Russian court. In the Stockholm arbitration court an ex-Yukos investor recently won compensation under the UK Russia investment protection treaty and many more cases are now likely to proceed. So wherever you stand on the is he a thief is he a martyr for civil rights debate, there will be plenty of opportunities to continue the discussion in the months and years to come.

Conclusion – Russia in 2011

While the economic indicators were overall positive in the period, throughout 2010 the global investment community generally expressed a much reduced appetite for investment in Russia than pre-crisis and the Russian leadership had a rough time of it at the hands of the international press which continued, throughout the year, to portray the country as disfunctional in one way or another. However, those closer to Russia and companies that are already here, tend to see it differently and much more positively.

There is good reason to be confident about the Putin/Medvedev long term strategy which is unlikely to be affected, we think, whichever one of them takes the top slot in 2012. Economically the leaders seem to have got the longer term strategy right and to have a real appetite for rebasing the economy although the considerable amount of state spending that was directed toward propping up the "old economy" during the crisis and after, suggests the process of change and transformation will be cautious.

The modernisation of the economy should not be confused with liberalisation and rolling back of the state. The much anticipated privatisation program at this stage seems to be more of a cash raising exercise and the administration stands at no risk of being accused, as Margaret Thatcher was, of selling off the family silver. The Strategic Industries Law is a powerful weapon against foreign control of Russian assets and remains a snake in the grass.

Politically, we think the greater risk for Russia comes not from a return to so-called “Putinism” but from the lack of any sort of credible alternative administration. 2010 witnessed a certain amount of popular rebellion on the streets and some healthy political satire, but no consistent opposition agenda, and no credible anti-government personalities, still less political parties, emerged. Russia at the start of 2011 remains a country without any mainstream opposition and without any executive accountability. We see no change to this any time soon. However, if the exercise of executive power in Russia sometimes seems to be disproportionate and lacking due process, it is not necessary to conclude, as many in the west do, that Russia is generally dismissive of the rule of law. The heavy-handed persecution of certain non-establishment individuals may be intended to undermine the political power base of the old insiders, good and bad, with their historical baggage of various alliances and business interests and therefore, whatever the rights and wrongs of that from the point of view of a liberal democracy, it might be wrong to draw too broad conclusions from these high profile cases.

Although no agenda for the development of democratic institutions or executive accountability has yet emerged, the President has, on a number of occasions, stated this explicitly to be his/their aim and unless one takes a deeply cynical view of the present administration, it is possible to see a quite a degree of consistency between what the ruling tandem says and what they do. The evidence is that they do intend to modernise and rebase the economy and will continue to develop the conditions that encourage foreign investment in this process, and that they do accept the probable long term effect of this on the political landscape. But they will continue to set their own agenda for change as well as its parameters. At this time it looks as if they do not intend to roll back the state and the economy will remain heavily nationalised for some time still, with privatisation and foreign control occurring only within set limits. Accepting these coordinates however, there is every reason to consider Russia in 2011 open for business.

This publication has been prepared for the purpose of comment only, and does not constitute legal or professional advice. The information is based on secondary sources, has not been separately verified by CMS and relates to circumstances prevailing at the date of its original publication and may not reflect subsequent developments. For specific advice please contact us:

CMS, Russia

119019 Moscow, Russia
11, Gogolevsky boulevard
Tel. +7 495 786 4000
Fax +7 495 786 4001

Contact us:

CMS

11, Gogolevsky blvd.

119019, Moscow, Russia

Tel.: +7 495 786 4000

Fax: +7 495 786 4001

CMS in Russia is a representative office of CMS International B.V., a limited liability company registered in the Netherlands. For more information, please visit www.cmslegal.ru.

CMS aims to be recognised as the best European provider of legal and tax services.

CMS operates in 28 jurisdictions, with 53 offices in Western and Central Europe and beyond.

CMS was established in 1999 and today comprises nine CMS firms, employing over 2,400 lawyers.

CMS is headquartered in Frankfurt, Germany.

CMS member firms are:

CMS Adonnino Ascoli & Cavasola Scamoni (Italy); CMS Albiñana & Suárez de Lezo, S.L.P. (Spain);

CMS Bureau Francis Lefebvre (France); CMS Cameron McKenna LLP (UK); CMS DeBacker (Belgium);

CMS Derks Star Busmann (Netherlands); CMS von Erlach Henrici Ltd. (Switzerland);

CMS Hasche Sigle (Germany) and CMS Reich-Rohrwig Hainz Rechtsanwälte GmbH (Austria).

CMS offices and associated offices: Amsterdam, Berlin, Brussels, London, Madrid, Paris,

Rome, Vienna, Zurich, Aberdeen, Algiers, Antwerp, Arnhem, Beijing, Belgrade, Bratislava, Bristol, Bucharest, Budapest, Buenos Aires, Casablanca, Cologne, Dresden, Duesseldorf, Edinburgh, Frankfurt / Main, Hamburg, Kyiv, Leipzig, Ljubljana, Luxembourg, Lyon, Marbella, Milan, Montevideo, Moscow, Munich, Prague, São Paulo, Sarajevo, Seville, Shanghai, Sofia, Strasbourg, Stuttgart, Utrecht, Warsaw and Zagreb.

www.cmslegal.ru

www.cmslegal.com