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Sanctions against Russia: No Blitzkrieg, but a Devastating Effect Nonetheless

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Abstract
In response to the Russian invasion of Ukraine, over 40 countries have introduced sanctions against Russia. The new restrictions concern finance, trade, logistics, and personal sanctions against businessmen and officials. In addition, more than 1,000 companies have ceased or limited their activities in Russia. In this article, I argue that the sanctions, despite their unprecedented scale, have not led to the collapse of the Russian economy, yet their effect is dramatic, multi-faceted, and will increase over time.

Introduction
Much has already been said about the unprecedented nature of the current economic sanctions against Russia. Never before has an economy of this size been subjected to such a sweeping blockade. The frozen Russian Central Bank reserves alone (according to various estimates, $300–400 billion) are comparable to all the reserves of Brazil ($350 billion) and three times the reserves of the United Arab Emirates ($120 billion).

With the start of the Russian invasion of Ukraine, Western countries switched from a policy of “smart” sanctions (which are selective and aimed at minimizing harm to ordinary citizens) to a policy of total embargo, limited only by the capacity of their own economies to cut off ties with Russia, primarily in terms of energy imports. Both the countries imposing the sanctions and their target, Russia, see the sanctions as “economic warfare”—war by other means. In this article, I argue that the West has not achieved a blitzkrieg-style victory in this war. Nevertheless, the effect of sanctions on the Russian economy is devastating. Under the present sanctions regime, the goal of national development is simply unrealizable.

Russia’s Vulnerability to De-Globalization
Russia is an extremely globalized economy. Its share of imports as a percentage of GDP (20.6%) exceeds that of the other BRIC countries (19.2% in India, 16% in China, and 15.5% in Brazil) (World Bank 2022a). At the same time, as is well known, Russia exports mainly raw materials and imports mainly high-tech goods (OEC 2022). The EU accounted for 36.5% of Russia’s imports in 2020, with another 2.6% coming from the US. However, the list of countries that have introduced sanctions against Russia goes beyond the EU and the US to include Japan, South Korea, and Taiwan, among others. In March 2022, the Russian government composed a list of 48 “unfriendly countries,” together, these account for more than half of Russia’s imports.

Russia is also dependent on foreign investment. On average, the ratio of foreign direct investment to GDP between 2000 and 2020 was 2.1%, lower than in Brazil (3.2%) and China (3%), but higher than in India (1.7%) (World Bank 2022b). As of 2020, 2.8 million workers in Russia were employed by foreign-owned or mixed-ownership enterprises. If we take into account Russian suppliers connected to these companies, the number of workers dependent on foreign capital could be as high as 5 million—about 12% of all those employed in the formal sector.

Beyond the sheer numbers, Russia’s integration into the global economy is complex and multi-faceted. Like any other modern economy, Russia is dependent on geographically distributed supply chains and “just-in-time” delivery systems. The full effect of a logistical blockade on this scale is thus impossible to predict.

Directions of Attack
Economic sanctions against Russia, both public and private, can be divided into five categories: finance, logistics, export and import restrictions, foreign businesses pulling out of the country, and, finally, personal sanctions against businessmen and officials.

The hardest blow was dealt by the freezing of Russia’s reserves. Sanctions against the Central Bank and a number of commercial banks—including the cutting-off of some banks from SWIFT, as well as a ban on the import of hard currency (dollars and euros)—also belong to this category. Some countries have banned all investment in Russia. Visa, Mastercard, PayPal, and other financial companies have blocked transactions with Russian clients.

As regards logistics, European countries have closed the skies to Russian aviation, while foreign leasing companies have withdrawn their aircraft from Russia. European ports are shut to Russian-flagged ships. Most major container lines, such as Maersk, have suspended operations in Russia. Delivery by road and rail is made as difficult as possible.
Sanctions have also hit hard trade between the EU and Russia. EU countries have banned imports of Russian steel, significantly reduced oil imports, and will gradually give up imports of coal. In the private sector, a huge number of Western companies have stopped exporting goods and services to Russia. Moreover, to date, more than 1,000 companies have stopped or limited their activities in Russia (Yale School of Management 2022). Finally, unprecedented personal sanctions (asset freezes, entry bans, etc.) have affected more than 1,000 Russian businessmen and officials.

**The Impact of Sanctions So Far**

Western hopes of a blitzkrieg-style victory in the economic war against Russia hinged on the shock of the unprecedented financial sanctions introduced early in Russia’s invasion of Ukraine. However, the Russian financial system weathered the storm.

Western countries froze Russian dollar and euro assets in order to take away the Central Bank’s ability to maintain the ruble exchange rate through currency interventions, i.e., the sale of foreign currency on the domestic market. However, capital controls, the forced sale of Russian exporters’ foreign-exchange earnings, and the sale of gas exports for rubles saturated the Russian market with foreign currencies and helped keep the ruble from plunging in the short term. After the initial shock in March, the ruble quickly recovered its value.

Nevertheless, just like on the battlefields of Ukraine, the blitzkrieg phase of the economic war has given way to a long war of attrition. In this war, the reduction of exports to Russia plays a central role. Rosstat, Russia’s statistical agency, no longer publishes trade statistics (which in itself says a lot), but various indirect assessments indicate that Russian imports from “unfriendly countries” have fallen by at least 60–70%.

Elvira Nabiullina, the head of the Central Bank, noted in her report to the State Duma in April: “The main problems will be associated not so much with the sanctions against financial institutions, but with the restrictions on imports and logistics in foreign trade and, down the road, with potential restrictions on Russian exports. Manufacturing in the modern world is organized so that almost any product has a portion of imported components. Even if this portion is small compared to the total output, an enterprise may be critically dependent on a certain part or component. Currently, this problem might be less acute because the economy still has inventory, but we can see that the sanctions are being tightened almost every day, including restrictions on Russian goods transportation and the operation of Russian carriers. The economy will be able to make do with existing inventory only temporarily (Nabiullina 2022).

Indeed, a huge number of factories—including, for example, almost all car plants—have already stopped operating. Nabiullina’s speech is illustrated well by the situation at the Tikhvin Freight Car Building Plant, the largest of its kind in Russia and the post-Soviet region as a whole. Even though the plant itself is owned by a Russian company, it is critically dependent on foreign-made components for bearing units. These components are no longer supplied and production at the factory has stopped, with no clear date for its resumption. Tikhvin is a small city in the St. Petersburg area. Out of its population of 50,000, 7,000 people are employed by the freight car plant and several thousand more work at an IKEA factory, which is also currently closed due to IKEA’s exit from Russia. If both factories are unable to reopen, Tikhvin will become a ghost town.

Apart from factory closures and cascading unemployment, the dramatic fall in imports has produced macroeconomic distortions. Since its initial collapse in March, the ruble has been steadily recovering its value, eventually surpassing its pre-war exchange rate to become “the best-performing currency in the world” (Ivanova 2022). This simply reflects the balance of supply and demand: while soaring energy prices ensure the supply of foreign currency to Russia, falling imports result in a lack of demand for dollars and euros. However, the overvalued ruble puts pressure on the Russian budget (which is dependent on the ruble value of energy exports) and reduces the profitability of non-energy exports (most notably, metals such as steel). As German Gref, the head of Sberbank, noted during the St. Petersburg Economic Forum, “Export is now becoming poison for the economy. Import… becomes the main medicine” (RT International 2022).

While macroeconomic imbalances and most supply chain bottlenecks can eventually be overcome, the biggest problem created by sanctions is long-term. In the context of the economic blockade, the technological
gap between Russia and the advanced economies will widen over time. In the absence of global cooperation and with hundreds of thousands of skilled professionals having left the country, innovative and technological advancement in Russia is simply impossible. The sanctions regime (or, rather, the war that has triggered it) robs the country of its future. Even if most sanctions are lifted, the damage already done will set Russia back by years, if not decades.

And yet, even though the long-term impact of sanctions will be devastating, they are not critically reducing Russia’s ability to wage war in Ukraine. High energy prices ensure that the Kremlin can still finance this war. While the economic blockade most likely had a negative impact on the military-industrial complex, which is still dependent on foreign-made components, Russia will probably be able to smuggle many of them into the country, including by contraband. Nor, as I argue below, have sanctions created significant problems for the regime.

The Politics of Sanctions
Sanctions have failed to achieve a significant impact on Russian politics. Among the elite groups, the oligarchs are the most hurt by Russia’s economic isolation. However, there is not much they can do to express their frustration within the system established by Putin many years ago. Furthermore, for the business leaders, there is a silver lining: Western companies are leaving behind assets that can be acquired at discounted rates or even for free. With the elimination of foreign competition, oligarchs automatically increase their share of the domestic market. As in any monopolistic environment, this gives them the ability to sell lower-quality goods at inflated prices. Consequently, the economic impact of sanctions is shifted from the business elites to the population at large. And in terms of their luxury lifestyle, the oligarchs still have safe havens such as Dubai, where they are reportedly acquiring new properties at a rapid pace (Fernández 2022).

For the ordinary people, sanctions are a heavy burden. There are indirect signs that the economic situation impacts the perception of the war: for example, people with lower incomes tend to be less supportive of the “special military operation” than the middle class. At the same time, surveys that measure attitudes toward sanctions directly do not show any significant changes since the start of the war. The share of those who were “concerned” or “very concerned” about the sanctions did increase from 32% in December 2021 to 46% in March 2022, yet it declined to 38% in May 2022. Furthermore, 75% of respondents believe that Russia should “continue its policy regardless of the sanctions,” while only 19% claim that Russia should “seek compromise, make concessions in order to withdraw from sanctions” (Levada 2022). It should be noted that any survey results coming from Russia since the start of the war are highly problematic due to the issue of preference falsification, which is amplified by the new repressive laws. However, even bearing this in mind, it is clear that sanctions have not created widespread dissatisfaction with the regime. Rather, they continue to act as a “rally around the flag” mechanism, especially in the context of the regime’s near-total control of the media space. Mass layoffs in the coming months may create pockets of protest activity, but such protests are likely to face the full power of the repressive state.

Conclusion
Sanctions against Russia represent an unprecedented weaponization of economic ties. In their scale and significance, they are comparable to the Russo–Ukrainian war itself, which is the biggest military conflict in Europe since the Second World War. The long-term impact of sanctions on the Russian economy will be devastating, even though they have not—and probably cannot—end the war or trigger regime change in Russia. While the imposition of sanctions on this scale was perhaps inevitable, as they correspond to the threat that the Kremlin’s aggression poses to the international order, the ultimate consequences of sanctions for global economic and political relations are yet to be seen.

About the Author
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Bibliography


ANALYSIS

Fighting the Pandemic and Fighting Sanctions: Can the Russian Economy Now Benefit from Its Experience with Anti-Crisis Measures?

By Andrei Yakovlev (Freie Universität Berlin)
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Abstract
Faced with tough international sanctions in reaction to its war against Ukraine, the Russian government has resorted to measures developed during the COVID-19 pandemic in order to stabilize the economy. This short analysis discusses the rationale behind this approach and demonstrates its limits.

Introduction
Against the background of the harsh international sanctions imposed since late February, the Russian government began to make active use of the set of anti-crisis measures that had been applied in 2020, during the Covid-19 pandemic. These measures included tax deferrals, subsidies for small enterprises, preferential loans to help small and medium firms continue their operations, and specific measures for individual industries. On the whole, these measures have proven quite effective at counteracting the pandemic-induced recession: contrary to very pessimistic initial expectations, the decline in Russian GDP as of the end of 2020 was 2.5%, compared to 3.4% in the US and 6.5% in the Eurozone.

The reason for resorting to these measures in the current situation may be that, like the 2020 shock, the 2022 one is external for Russia. The large-scale restrictions on exports from and imports to Russia imposed since late February by the United States, the EU, and other developed countries—combined with the shutdown of hundreds of international companies—have affected the activities of Russian firms in much the same way as the quarantine restrictions in the early months of the COVID-19 pandemic. In both cases, we could observe an abrupt break in established supply chains—and this may be why the Russian government is again trying to use the tools that it tested with such success two years ago.

Factors Promoting Economic Stability during the Pandemic
However, in order to accurately assess the possible effects of these measures, it is worth looking at the whole range of factors that made it possible to mitigate the effects of the coronavirus pandemic on the Russian economy in 2020. Based on the results of a project of the Higher School of Economics and the Russian Union of Industrialists and Entrepreneurs about business’ reaction to the COVID-19 pandemic and its evaluation of the government’s anti-crisis measures, we can highlight the following factors:
• Experience with serious downturns in the economy every 4–5 years since 2008 meant that Russian firms were psychologically more prepared for “black swan” events; maintained a lower level of debt and had financial reserves in case of crises; and had developed schemes to retain key personnel.

• Unlike firms in developed countries, Russian companies were less affected by disruptions in global value chains due to their less sophisticated logistics. Because of the higher risks of supply delays, they have traditionally maintained a higher level of inventory, which had a positive impact during the pandemic.

• The initially very negative expectations regarding the consequences of the pandemic led to “bureaucratic mobilization,” or the increased efficiency of the state apparatus during the crisis. One manifestation of this was the active communication of officials with business, which made it possible to develop support measures tailored to specific industries.

• Since 2014 (when the Kremlin increasingly demanded from the bureaucracy not only loyalty, but also performance), we have seen the emergence of new industrial policy institutions capable of providing state support based on objective selection criteria and the monitoring of implementation. One example is the Industrial Development Fund.

What Is Different Now
These factors continue to play a role in the current crisis. However, the fundamental difference is that in 2020 all state support measures were implemented on the understanding that after several months the situation with supplies would return to normal—and the government tried to help firms to keep employees and not to stop production, primarily using financial incentives for business, as well as instruments of direct support for the population. Now, given the protracted nature of the war with Ukraine and the growing confrontation with the United States and the European Union, it is increasingly clear that there will be no “return to normal.” Through its actions, the Kremlin has convinced the West that Putin’s Russia poses a serious threat to global security. But since the West is not ready to go to war with Russia, the goal of weakening Russia’s military potential will be achieved by ratcheting up the pressure of sanctions, with the ultimate goal of destroying the Russian economy’s ability to support possible aggression.

Outlook
What effect can the Russian government’s anti-crisis measures have in this situation? Measures taken by the Central Bank to stabilize the currency market had an important psychological impact, preventing short-term panic. At the same time, a sharp increase in the Central Bank rate in March 2022 was almost immediately accompanied by the launch of concessional lending schemes for strategic enterprises and small and medium-sized businesses. These measures, which worked successfully in 2020, also contributed to a relative stabilization of sentiments in business—especially in the context of the perception, which prevailed among entrepreneurs in March and April, that it would be possible to find alternative channels for the supply of necessary components fairly quickly.

Judging by various circumstantial data, these perceptions proved to be illusory. Compared to 2014, the current sanctions are not simply more extensive. The control over their implementation will also be different, with much greater risks of secondary sanctions for companies and countries that engage in circumvention schemes. Telling in this regard are the measures of the Kazakh authorities against attempts by Russian and Belarusian companies to import sanctioned products via Kazakhstan.

Also quite revealing are the decision to no longer publish information about state budget revenues and expenditures, the discussion among key officials of the economic cabinet at the St. Petersburg International Economic Forum about “forecasts that are harmful for the country,” and news of large enterprises going into extended downtime due to a lack of components, as well as about strikes in reaction to delayed wage payments. It is telling that such news are published by the regional media, which find it difficult to ignore events in their own region, but are not reported in the national business media.

To summarize, the anti-crisis measures implemented by the government—which are analogous to those employed in 2020—have made it possible to stabilize the situation in the short term and to limit negative expectations, but they do not help at all to solve the longer-term problem of a lack of critical imported components for industrial production. It is therefore highly likely that in the coming months, the number of forced outages at enterprises will increase and industrial production will drop on a much higher scale than currently expected in macroeconomic forecasts. At the same time, it remains absolutely unclear how the government intends to tackle these problems.

About the Author
Andrei Yakovlev is one of the leading Russian experts in the field of state-business relations, industrial policy, and the political economy of reforms. In 2017 he was awarded the Gaidar Memorial Prize in economics. Since June 2022 he has been a visiting researcher at the Institute for East European Studies at Freie Universität Berlin.
Russia’s Economy under Sanctions: Early Impact and Long-Term Outlook

By Janis Kluge (German Institute for International and Security Affairs—SWP, Berlin)

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Abstract

Four months after a coalition of Western states imposed unprecedented sanctions on Russia, the Russian economy seems to be holding up better than expected. The Central Bank has managed to stabilize the country’s financial system and Russian officials are trying to project optimism about the future. However, this optimism is likely to be short-lived. The sanctions’ effects are only just beginning to unfold: supply-chain problems are intensifying and demand is falling quickly. In the longer run, Russia’s economy will become more primitive as it partially decouples from international trade. To avoid social tensions, the government will intervene to support Russian businesses, leading to more protectionism and a larger state footprint in the economy.

Introduction

During his speech at the plenary discussion of the St. Petersburg International Economic Forum on June 17, Russian president Vladimir Putin claimed that “The dire forecasts for the prospects of the Russian economy […] have not materialized.” That month, the consensus forecasts published by the Russian Central Bank improved, predicting a slightly less devastating crisis than previously anticipated: a fall in GDP by 7.5 percent instead of 9.2 percent in 2022. Russian top officials have been busy showcasing even stronger optimism: Economy Minister Maxim Reshetnikov said he is expecting a contraction of 5–6 percent, while presidential advisor Maxim Oreshkin stated that the decline will be below 5 percent, only to be trumped by Vice Prime Minister Andrey Belousov, who is speaking of a 3–5 percent decline in GDP. Survey results from Levada appear to show recovering sentiment among the Russian population, too: the share of respondents stating that sanctions are creating problems for them personally fell from 29 percent in March to 16 percent in May.

Russia was unquestionably successful in stabilizing its financial system after a short period of panic that included some bank runs and acute liquidity shortages among banks. With the help of strict capital controls and a steep interest rate hike (from 9.5 percent to 20 percent), the Central Bank managed to control the ruble exchange rate and the inflation rate, two economic indicators that play a big role in ordinary Russians’ perceptions of the health of the economy. After spiking to 150 rubles/euro in mid-March 2022, the exchange rate was converging on 50 rubles/euro by June. The inflation rate raced to almost 18 percent in April 2022, but prices began to fall thereafter, with annual inflation retreating to 16.7 percent in June. Containing inflation and the strengthening of the ruble have helped to uphold an illusion of economic normality within Russia. At the same time, both developments hint at problems to come.

Before the introduction of capital controls, ruble fluctuations were indeed a good indicator of the optimism or pessimism of local and international investors regarding the future of the Russian economy. When sanctions risks were on the rise, as in August 2018, the ruble usually fell. Under the new rules, however, the meaning of the exchange rate has changed: It now simply reflects the balance of imports and exports. Due to Russia’s structural trade surplus, capital controls were bound to result in a strong ruble, even without the high energy prices and large export volumes in the first months of the war. To some degree, Russia’s struggle to import has also contributed to the appreciation of the ruble. However, already by May 2022, the strengthening of the ruble had turned from a success to a concern due to its negative effects on both exporters and budget revenue, sparking a debate among Russia’s economic policymakers about whether and how to effectively weaken the ruble.

Similar to the ruble, the inflation rate has partially lost its meaning after February 2022: While it represents the price changes of a certain basket of goods and services, it does not directly account for disappearing choices. Sanctions and the retreat of Western companies have made many consumption options simply unavailable. At least for better-off Russians, this has affected their living standard more than the rising prices. Furthermore, while inflation may be the result of a stronger ruble putting pressure on the prices of some imported goods, it is more likely to result from falling demand, an unequivocally bad sign for Russia’s economy in the coming months.

Optimism Will Be Short-Lived

Very early in the crisis, several car manufacturing plants came to a standstill due to a lack of parts and the retreat of foreign brands from Russia. The industry, which employs around 600,000 workers in Russia, plays the
Although Russia started 2022 with much higher industrial production, the sector’s dynamics had already reversed by April: According to Rosstat, output was 1.6 percent below the previous year, with the auto sector contracting by a whopping 61.5 percent. Similar to the supply chain issues, the effect of sanctions on unemployment is delayed because some producers still have a few months’ worth of Western supplies on their shelves, but the problem is adding up each month and will eventually be a serious constraint on output. Some sectors, especially in the natural resources industry, are squeezed in a sandwich, facing constraints on both technology and export markets. Oil production has shrunk by 10 percent as some Western importers shun Russian energy shipments. According to steel magnate Mordashov, steel production has declined by 25–30 percent due to sanctions, while lumber production is down 80 percent. Although Russia started 2022 with much higher industrial production than in 2021 (+8.6 percent), the positive dynamic had already reversed by April: According to Rosstat, output was 1.6 percent below the previous year, with the auto sector contracting by a whopping 61.5 percent.

The effect of the sanctions on Russian industry is delayed because some producers still have a few months’ worth of Western supplies on their shelves, but the problem is adding up each month and will eventually be a serious constraint on output. Some sectors, especially in the natural resources industry, are squeezed in a sandwich, facing constraints on both technology and export markets. Oil production has shrunk by 10 percent as some Western importers shun Russian energy shipments. According to steel magnate Mordashov, steel production has declined by 25–30 percent due to sanctions, while lumber production is down 80 percent. Although Russia started 2022 with much higher industrial production than in 2021 (+8.6 percent), the positive dynamic had already reversed by April: According to Rosstat, output was 1.6 percent below the previous year, with the auto sector contracting by a whopping 61.5 percent.

Similar to the supply chain issues, the effect of sanctions on unemployment is delayed, as Russian businesses avoid laying off workers until it becomes inevitable. Instead, many companies have introduced part-time work and/or partial shutdowns of production with minimal pay. Many foreign companies—which, according to some estimates, directly and indirectly employ 6–8 million Russians—have continued to pay workers even after shutting down their businesses. This has kept the official unemployment rate at a historic low of 4 percent. However, according to the popular Russian career portal HeadHunter, the number of job vacancies is down by 21 percent in comparison to last year, with job postings in some fields (especially in insurance, banking, and finance) plummeting by 89 percent. Despite the departure of many highly skilled specialists and guest workers from Russia, the unemployment rate is expected to rise to over 7 percent by the end of the year, with industrial regions like Kurgan, Ulyanovsk, and Kaluga most affected by layoffs.

While the effect of the sanctions on different sectors of the Russian economy was initially very uneven, the decline in production and rising unemployment (or underpayment) will in the coming months lead to broad-based demand contraction, pulling down other businesses that were initially not directly affected. These second-round effects are likely to be the dominant reason for the current decline in prices. Retail turnover, which was 5.7 percent higher year-on-year in February, was already 9.7 percent below the previous year by April, according to Rosstat. Credit card data for June, published in an analysis by Sberbank, confirm this steep decline. The situation in industry looks similar: According to surveys carried out by Rosstat, businesses are disappointed by the demand in June 2022 and optimism has fallen to the lowest level since the coronavirus lockdowns of April 2020.

A Look Ahead
It is impossible to predict at what point Russia’s economic decline will bottom out quantitatively, as key variables such as the future dynamic of imports and possible cascading effects caused by a lack of critical parts are uncertain. However, some qualitative trends that will shape the country’s longer-term development are already visible.

Russia’s future development critically depends on a number of key assumptions. Here, it is assumed that neither will sanctions be lifted nor will the political regime in Russia face an immediate collapse. Under these conditions, Russia’s economic crisis under continuous sanctions will be “L”-shaped, meaning that it will not result in a quick bounce-back like the previous crises in 1998, 2009, 2015, and 2020. Instead, Russia’s economy will permanently shift onto a less internationally connected and less technologically sophisticated development trajectory. This will not necessarily result in high unemployment, as modern machinery and investment are becoming scarce and will to some degree be replaced by labor. However, labor productivity will be much lower, leading to a significant decline in average real incomes.

The government’s response is likely to consist of well-known policy reflexes. The automobile industry is a case in point: The government is already trying to artificially create demand for technologically inferior cars “Made in Russia” through state procurement, on the one hand, and protectionist measures that keep international competition out, on the other hand. Stricter protectionism is effectively a tax on the Russian consumer, as it results in higher inflation and a further decline in real incomes. This effect was particularly pronounced after Russia’s “countersanctions” on Western agricultural goods following the annexation of Crimea, which led to high food inflation in 2014/2015. As the crisis deepens, the Russian state will also have to subsidize or take over strug-
gling businesses to keep their workers employed and avoid social tensions, particularly in industrial regions and Russia’s “monotowns.” Similar to the aftermath of the 2009 financial crisis, this means that the state’s footprint in the economy is set to increase. Nationalization of the most affected sectors has already begun where foreign investors are withdrawing: Renault’s 67.7 percent share in car manufacturer Avtovaz, for instance, has been taken over by the state-owned institute NAMI.

As a consequence of falling incomes and a larger state role in a less productive economy, the distribution of energy rents will play an even larger role in Russia’s political economy. A larger share of Russia’s budget will consist of subsidies and social policy expenditure. Although oil extraction is expected to decline by up to 30 percent as a result of the combined effect of technology and energy embargoes, the relative significance of oil and other commodity exports for the state budget has been growing in recent months. In contrast, Gazprom will no longer be able to cross-subsidize Russian businesses and households with cheap energy in the coming years after losing its key high-price export market: the EU. Instead, the gas behemoth is likely to become a liability for the Russian budget.

Finally, Russia’s economy will become less transparent and the informal sector will likely grow. Access to statistics about trade, production, and budgetary spending has already been curtailed, ostensibly to make sanctioning Russia harder, but more likely to hide negative developments from the public eye. Public scrutiny about the distribution of rents by the Russian state will become even harder, creating fertile ground for embezzlement and misappropriation of funds in the coming years.

Meanwhile, sanctions and the retreat of Western companies are creating strong economic incentives for parallel import and shuttle trading. Sanctions evasion could even become a significant business model in the Russian economy. Shuttle trading will mainly be a boost to Russia’s informal economy. Because transit countries are trying to avoid the risks of secondary sanctions, sanction evaders will often operate in a legal grey zone, making it likely that organized crime will try to get its share of the sanctions arbitrage business as well.

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### Why Russia Is Lacking an Economic Strategy for the Future

By Michael Rochlitz (University of Bremen)

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**Abstract**

Even before the economic crisis caused by Russia’s full-scale attack against Ukraine and the ensuing sanctions, the Russian economy was plagued by a number of growing problems. As a result, Russia’s economy has hardly grown for almost a decade, with an average annual growth rate of just 0.5% between 2013 and 2021. However, the Russian government does not have a strategy for addressing the fundamental economic challenges that are looming just over the horizon. There also seem to be no public debates about these challenges, whether in the policy circles around the government or among the wider public.

**Introduction**

Even before the economic crisis caused by Russia’s full-scale attack against Ukraine and the ensuing sanctions, the Russian economy was plagued by a number of growing problems. The attempt to reform the education system had produced mixed results, with many of Russia’s regional schools and universities failing to equip their students with the necessary skills for a modern economy. In many parts of the country, the transport infrastructure, energy grid, and healthcare system remain outdated and are slowly decaying. After some small demographic policy successes in the mid-2010s, Russia’s population is
now again declining. Insecure property rights are keeping investments and firm entry far below their potential. At the same time, large amounts of resources are being pumped into the bloated state sector and an inefficient military industry. As a result, Russia’s economy has hardly grown for almost a decade, with an average annual growth rate of just 0.5% between 2013 and 2021.

**Russia’s Economic Challenges**

However, the Russian government lacks a long-term economic strategy and the country lacks even a public debate about the issue. This is a serious problem, as the challenges Russia will have to face in the near future were daunting even before the onset of the current crisis. Now, Russia’s renewed attack on Ukraine and the start of a full-scale confrontation with the West have exacerbated many problems, making it even more difficult than before to prepare a strategy for the future.

What challenges is Russia facing? The most important is to create an alternative model of wealth creation for the time after oil and gas. For the last 20 years, the budget of the Russian government has been heavily dependent on the export of hydrocarbons, a source of income that—even before the current sanctions—was destined to decline in the near future. Russia’s war in Ukraine has only accelerated this process. Russia would need to urgently diversify its industry to avoid a severe economic crisis, but despite numerous calls to action (see, e.g., EBRD 2012), almost no economic diversification has taken place over the last 15 years.

Another challenge will be climate change. With the number and intensity of Russian forest fires increasing every summer, as well as the thawing of the permafrost and the resultant damage to infrastructure in Russia’s north, the country will be heavily affected by warming temperatures. Yet compared to the centrality of the topic in European societies, and considering Russia’s role as one of the world’s most important exporters of carbon-based energy, climate change has played almost no role in Russian debates, whether within the government, in the media or among the general public. When the topic has been addressed, it has been in the form of sarcastic comments about Swedish activist Greta Thunberg on state media; the teenager has been treated as a symbol of everything that is going wrong in Western societies (Konyaeva and Samsonova 2021).

A problem that has been less visible in recent years, but which the current sanctions have made painfully apparent, is Russia’s technological backwardness. Despite President Putin’s claims about the technological achievements of the Russian defense industry, Russia seems to lag behind other countries technologically far more than most observers assumed. The war in Ukraine has demonstrated that most of the presumed technological achievements of Russia’s defense sector have not yet reached the stage of mass production, with Russia’s army fighting mainly with equipment from Soviet times. At the same time, Western sanctions have revealed that Russia’s manufacturing sector depends not only on high-tech imports, but also—to a large extent—on intermediate imports of lower technological sophistication. Over the last couple of weeks, I have had a number of conversations with representatives of German small and medium companies, who have repeatedly emphasized that even many relatively simple components used to be imported and that until the start of the war, Russian clients relied heavily on the expertise of—mostly Western—suppliers to keep their equipment functional.

The problem of technological backwardness is exacerbated by a science and technology system that lags behind its Western and Asian counterparts. With the exceptions of some leading universities in Moscow and St. Petersburg, most Russian research institutions are not on the same level as their foreign peers. The race for primacy in such technologies as artificial intelligence is between the United States and China, with Russia not playing any visible role (Lee 2019; Karpa et al. 2021). The situation is similar in biotechnology, automation, medical research, and technologies such as virtual and augmented reality or the internet of things. Quantum computing is one exception where Russia is trying to keep up with international developments (Schiermeier 2020). Here, too, however, it is doubtful if the first successes of Russia’s quantum program will survive the crash and international isolation of Russia’s science system after February 24, 2022.

The lack of a scientific base, in addition to an industry that largely relies on foreign expertise and imports, will make it very difficult to develop an independent Russian manufacturing sector that could one day replace oil and gas as the country’s major source of income, particularly as Russia is now completely isolated from most of its traditional economic partners. It will also prevent Russia from maintaining even a semblance of military parity with such powers as China or the US. However, there does not seem to be any visible debate within the Russian government and Russian elites about the challenges the country is facing. Why is Russia steering into an economic abyss, without any economic strategy for the future?

**Development Strategies in Other Oil-Dependent Autocracies**

To put the absence of an economic vision into perspective, it is instructive to look at other authoritarian states that also depend to a large extent on the export of hydrocarbons, like Saudi Arabia or the United Arab Emirates (UAE). Saudi Arabia is even fighting a bloody war in
Yemen and is entangled in a struggle for regional supremacy with Iran. And yet, both governments committed a couple of years ago to a strategy for structural transformation towards a post-hydrocarbon future.

In the UAE, the emirates of Dubai and Abu Dhabi have invested heavily in higher education and have managed to build an internationally competitive university system over the last 10 years, with sustainability as one core objective (Wilkins 2019). Dubai has also managed to become a major transport hub and well-known international tourist destination; today, it no longer depends on hydrocarbon exports.

While Saudi Arabia is lagging a couple of years behind the UAE, the Saudi government has also committed substantial resources to prepare the country for the time after oil and gas. The country's current development strategy has a clear focus on upgrading the quality of human capital and shifting Saudi Arabia’s economic structure toward that of a knowledge economy based on science, services, and tourism (Rundell 2021). It remains, of course, unclear whether these strategies will be successful, and history is full of examples where state-led strategies of economic transformation ultimately failed. One also has to remember that Saudi Arabia, in particular, remains a repressive autocracy, which might or might not be compatible with a development strategy based on improving human capital. Nevertheless, the fact that many of the authoritarian oil-producing nations in the Gulf are now trying to diversify their economies away from oil and gas, while Russia has made no attempt to do so, raises the question of why Russia is not even trying.

**What Factors Determine a Push Toward Economic Diversification?**

One major explanatory factor is political leadership. In the UAE and Saudi Arabia, the decision to build a post-hydrocarbon economy based on raising the quality of human capital was forcefully imposed by the countries' political leaders, often over strong resistance from the religious establishment, as when women were offered equal opportunities in university education (Rundell 2021). Neither country had a democratic public debate about the question. Instead, the decision was imposed from above by the countries’ leading politicians—Mohamed bin Zayed in the UAE and Mohammed bin Salman in Saudi Arabia—who then coopted pro-reform groups in their societies. Both politicians were relatively young and influenced by Western ideas when they came to power, and believed in the necessity to push for economic transformation, albeit without intending to liberalize their countries politically.

In Russia, the political leadership around President Putin is old and has been in power for over 20 years. Most of Putin’s close associates share the worldview of the siloviki, namely that Russia is a powerful nation with abundant natural resources that are the envy of the rest of the world. The siloviki believe that they are the only political actors within Russia that really understand this threat and that—in a world dominated by hard-core realist politics—it is their geopolitical mission to defend Russia against outside aggression (Soldatov and Rochlitz 2018).

At the same time, however, they lack an understanding of how a modern economy and science system work, as well as an awareness that openness to new technologies and ideas are fundamental ingredients of economic and technological progress. This, as well as oil prices that have remained reliably high, has prevented them from grasping the urgency of economic reform. This lack of understanding has been exacerbated by the overcentralization of a system that relies on ever fewer sources of information. Similar to President Dmitry Medvedev between 2008 and 2011, both Mohamed bin Zayed in the UAE and Mohammed bin Salman in Saudi Arabia frequently visited Western countries and technology companies to encourage the exchange of new ideas. Following Putin’s return to the presidency in 2012, such visits became less and less frequent in Russia, then stopped altogether after the annexation of Crimea. With increasing control over the media, Russia’s authorities now mostly rely on information from the security services and the bureaucracy, severely limiting their understanding of the real situation of Russia's economy. This lack of feedback channels—in particular from the business community—makes it very difficult for Russia’s government to design a sensible long-term economic strategy and to grasp the real economic cost of Russia’s attack on Ukraine.

While Russia’s top leadership seems to lack the necessary economic understanding to address the country’s challenges, Russia’s ruling elites more broadly are characterized by a surprising lack of will and urgency, and increasing political apathy. With the failed modernization attempt under President Medvedev, Russia’s elites missed the opportunity to negotiate a new redistribution of economic rents, which could have provided the basis for an economic transformation of the country (Rochlitz et al. 2020; Yakovlev 2021). Instead, the siloviki gradually imposed their control. They were able to do so because of the weakness of Russia’s political opposition and of organized business, as well as through selective arrests of Russia’s economic, political, and administrative elites (Petrov and Rochlitz 2019; Buckley et al. 2022). As a result, Russia’s remaining elites seem to have accepted the status quo, probably out of fear that any attempt to challenge it would endanger their economic situation immediately, a more threatening pro-
spect than slow economic decline resulting from a lack of economic reform.

Since 2012, the rise of new politicians and ideas has also been successfully prevented by the siloviki, who have managed to restrict access to political office further and further. Finally, since February 2022, any attempt to criticize current policies—whether about the war in Ukraine or economic policy in general—seems to have become a criminal offense, as, for example, when the police visited the office of well-known economist Natalya Zubarevich in June 2022 (Zubarevich 2022).

Under these conditions, a debate about economic policy no longer appears possible. Those among Russia’s liberal economic elites who have decided to remain in the country—such as Central Bank director Elvira Nabiullina, Finance Minister Anton Siluanov, and presidential economic advisor Maxim Oreshkin—seem to have limited themselves to the role of firefighters, trying to save what they can without speaking out on issues of foreign or economic policy. In the process, they become ever more complicit with a system that seems geared toward self-destruction, without being able to prevent what is happening. At the end of the day, the story of lacking economic reform in Putin’s Russia has come to resemble that of the frog in the pot who refused to act when the temperature was still bearable, until the water became so hot that it was too weak to jump.

About the Author

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References

The Political Economy of Waste Management in Russia

By Olga Masyutina and Ekaterina Paustyan (both University of Bremen)

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Abstract

The problem of household waste is one of the numerous environmental challenges facing Russia today. The 2019 nation-wide waste management reform was designed to tackle this problem by promoting recycling. However, the reform is stalling, due in large part to the nature of state-business relations in Russia. The lack of transparency in the public procurement process and the importance of personal connections between businesses and the federal and regional authorities undermine the implementation of the reform and produce suboptimal outcomes in the fight against waste.

Introduction

At stake in all environmental issues, from air pollution to deforestation, are various political and economic interests. The industrial lobby may advocate lower environmental taxes, while Green political parties may push in the opposite direction. Waste management in Russia is no exception: it is a highly controversial issue involving multiple actors. The state of municipal solid waste management in Russia is lamentable: more than 90% of household waste is transported to poorly operated landfill sites without any treatment. In dozens of regions, existing landfills are at capacity, making the waste problem particularly urgent. The federal government finally recognized the severity of the problem and initiated a nation-wide waste management reform in 2019. Its objective is to limit the use of landfills and to increase the share of waste recycled by adopting modern eco-friendly technologies. However, as is often the case in Russia, both the design and implementation of the reform have so far fallen short of expectations. Some of the problems with the reform lie with the nature of state-business relations in Russia.

The Waste Management Business in Russia since 2019

It had become abundantly clear by the 2010s that the system of waste management in Russia—a legacy of the Soviet Union—was highly inefficient and needed changing. The generation of household waste has been steadily rising over the years (336,000 m³ in 2020 compared to 210,000 m³ in 2007) due to increased consumption and urbanization. Overflowing landfill sites, the absence of waste recycling, and recurrent problems with waste collection and disposal in multiple Russian towns were evidence of poor management by the waste businesses and the authorities alike. Dozens of environmental protests across Russia in recent years signaled people’s concern about the mounting waste problem.

The waste management reform officially began in 2019. At the outset, all Russian regions were required to choose one or several regional waste operators—companies that would be responsible for the entire process of collecting and disposing of household waste in the region. As of May 2021, there were 189 operators in Russia’s 83 regions (excluding Crimea and the city of Sevastopol). Waste operators are selected via the public procurement process and those that win the tender get a long-term contract (usually 10 years) for billions of rubles. Waste management in Russia is indeed a very large business with a lot of money involved. By mid-2020, contracts signed with regional operators amounted to 2 trillion rubles. However, public procurement in Russia is notoriously flawed, both in terms of corruption and a lack of transparency. It is therefore no surprise that there are concerns about the quality and efficiency of those companies that win public tenders to become regional waste operators. A lack of competition is apparent: as of November 2020, only 15% of the 227 public tenders in 80 regions had more than one competitor. In addition, at least in 11 regions, the companies that won the tender had no prior experience of waste management. For example, Arkhangelsk waste operator “Eko-integrator” received a 10-year contract for 28.3 billion rubles from the regional government in 2019 in spite of the fact that the company was newly established and had only 4 employees. As a result, there are recurrent waste crises in different Russian regions when waste operators fail to fulfill their contractual obligations to regularly collect and utilize household waste.

This lack of competition is also reflected in the tariffs for waste collection set by regional operators, which are often higher than they might have been were public tenders more competitive. Since the overhaul of the regional systems of waste management began in 2019, people have been charged much more for waste collection. There is significant regional variation in the amount of money the population has to pay regional operators...
for waste collection. Depending on the region, people were charged from 244 to 1,411 rubles per one m³ of waste collected in 2019. The highest tariffs are now in Moscow and Leningrad Oblast, as well as in Yamalo-Nenets Autonomous Okrug. In 2021 the fee increased by 4% on average. While in a number of regions the tariff was reduced (e.g., by 9.2% in Magadan Oblast), some faced significant increases—in Novosibirsk Oblast residents had to pay 39.2% more than in the previous year, and in the Republic of Tatarstan 24.8% more. The public also lacks an understanding of how the tariff is calculated and why they are being charged more than before for the same service despite often seeing no signs of improvement in the waste situation. Consequently, about 25% of the population did not pay the fee in 2019, putting the regional operators in a rather precarious position, as these fees are their main source of revenue. This becomes a vicious circle: people refuse to pay the increased fee, with the result that the regional operator has no means to run its services, hence people remain frustrated with the state of waste collection in their neighborhood and see this as further justification for withholding payment.

The Problem of Financing Recycling Infrastructure

The proclaimed objective of the 2019 reform is to promote recycling. However, there is a question of who is going to build and pay for the required infrastructure. Regional operators are not keen to invest in building recycling facilities because there is no extra profit to be gained from recycling. Meanwhile, those companies that utilize recovered recyclables are usually SMEs that do not have resources to invest; regional budgets are also overstretched. Although the importance of private-sector investment in the waste management system is emphasized, there is also clearly a need for various measures of federal support for investors. Even the first stage in the recycling process—waste sorting—seems difficult to establish. There is insufficient effort on the part of the regional authorities and the waste management industry to raise public awareness about the benefits of waste sorting and recycling. Analysis of regional programs for waste management revealed that half of them do not include policies that would encourage waste sorting. Besides, waste sorting facilities are often not easily available, although there are significant differences between regions: whereas in Penza 60% of locals had recycling bins in the vicinity of their homes in 2019, in Khabarovsk (a city of the same size) this figure was 11%. Still, an opinion poll by the Levada Center showed that the main reason why people did not or would not sort their household waste was the perceived futility of doing so: 29% believed that the collected waste would be dumped in landfills and not recycled.

Another stumbling block on the way to increasing recycling is active promotion of waste incineration by both business and the federal government as a way to tackle the waste problem. The initial focus on high-tech waste recycling shifted to waste incineration in December 2019 when Vladimir Putin signed a law that formally made waste incineration equal to recycling. One explanation for this shift is that the government realized that it would otherwise not be possible to reach the 36% recycled waste target laid out in the national project “Ecology” for 2018–2024. Besides, there is a powerful industrial lobby for waste incineration, including RT-Invest, an affiliate company of the state-owned holding conglomerate Rostec. RT-Invest is currently building 5 waste incineration plants in Moscow oblast and the Republic of Tatarstan and plans to build 25 more in Russian regions in collaboration with the state corporations Rosatom and VEB. The incineration policy has been heavily criticized by environmentalists and scientists, who point out numerous disadvantages of waste incineration compared to recycling.

State-Business Connections in Waste Management

The issue of state-business connections—i.e., links between regional operators, and the waste management business more generally, and the authorities—features prominently in discussions of waste management in Russia. It has been alleged that the main beneficiaries of the waste management reform are businesses with personal connections to federal or regional political elites. In May 2021 we compiled a database of all regional waste operators in Russia that featured basic company details. We also searched different Internet sources (e.g., local media outlets) for information about their ownership structure and links to local, regional or federal officials. Although in a number of cases it was impossible to find the relevant information, we still got a general picture of the ownership structure and connections of regional waste operators. While the policy of creating waste operators was top-down, there are different constellations of ownership types even within a given region. As Figure 1 (overleaf) shows, some waste operators are companies that are wholly or partly owned by the authorities. For example, the regional government owns a 100% stake in the regional operators in Smolensk and Tambov oblasts. In Leningrad oblast, a 25% stake in the regional operator belongs to the regional committee for the administration of state property, with the rest owned by a private investor, “AneksFinans.”

In about 30 regions, waste operators are owned by businesspeople with personal ties to the local or regional authorities. For example, in the Komi Republic, two former deputies of the regional legislature, Vitaly
Gabuev and Evgeny Lyadov, are co-founders of the only regional waste operator “Ukhtazhilfond.” In Orenburg Oblast, one of the directors of “Priroda,” the local waste operator, is Anatoly Kilanov, who was the head of the regional Federal Penitentiary Service and then deputy mayor of Orenburg. It is also suggested that one of the owners of the company is Anatoly Chernyavsky, a son-in-law of Orenburg vice-governor Oleg Dimov.

Moreover, some of the major players in the solid waste business in Russia are well connected to federal elites. For example, “Khartia,” a regional operator in several Russian regions, is one of the biggest players in the waste business in Russia. The company is owned by Igor Chaika, a son of Yuri Chaika, who is currently Presidential Envoy to the North Caucasian Federal District and served as Prosecutor General of Russia from 2006 to 2020. “Khartia” runs waste collection and disposal in two of the 12 districts of Moscow—a major producer of household waste and one of the main “waste markets” in Russia. Another two districts in Moscow are serviced by “Ecoline,” a company that allegedly belongs to Arkady Rotenberg, a Russian oligarch and a close friend of Vladimir Putin. These tight informal connections between the waste management business and the federal and regional authorities often result in fighting and local conflicts that in turn lead to disruptions in waste collection and utilization, as in Kirov Oblast over the past two years.

Conclusion

Although the federal waste reform started with the good intention of ridding the regions of their waste problem, there have been very few positive developments in this field so far. It is difficult to claim, without conducting a proper statistical analysis, that firms connected with the authorities or those that won public tenders without competition perform worse or better than other waste management companies. Still, the case of waste management offers a vivid example of how business is done in Russia. It demonstrates how features of “bad governance” and “limited access order”—such as corruption, persistent informality, and rent-seeking—play an important role in the field of waste management. Such waste (mis)management has multiple consequences: people have to bear a heavier financial burden by paying more for waste collection, financial resources allocated to new recycling facilities are wasted, and towns are swamped with uncollected garbage.

The ongoing war in Ukraine will only exacerbate the waste problem in Russia. First, investments in hi-tech recycling facilities will be cut. Second, there will be few possibilities for acquiring foreign recycling equipment or waste collection trucks. Third, people will have trouble paying the fee for waste collection due to the decline in their income. As a result, environmental issues will be moved further down the policy agenda, with a negative effect on environmental protection and people’s quality of life and health.

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A more detailed analysis of the waste management system in Russia can be found in the authors’ IERP discussion paper, “Environmental Politics in Authoritarian Regimes: Waste Management in the Russian Regions,” available online at https://media.suub.uni-bremen.de/handle/elib/5929?fbclid=IwAR29_rNUwSiaA_33GMLHa6MtQ8wEn6nkZU2H1JFvKetSPAfQhcWUtUWr-A.

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