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**RUSSIA'S POLITICAL RISK
FOR FOREIGN INVESTORS:
A SPECIAL EMPHASIS
ON KALININGRAD**

The main goal of this article is to analyse the political risk of Russia with a special emphasis on Kaliningrad. In this study, political risks are assessed using the normative model of macro political risk assessment developed by Alon and Martin in 1998. In this model, political risks are divided into government-, society- and economy-related variables.



Key words: Russia, Kaliningrad, political risk, foreign investment.

Government-related risks: Russia is still not fully mature democracy and its party system has not found its final form. A concentration of power and a lack of genuine political debate prevail in Russia. Political parties play a secondary role, whereas the political limelights are occupied by the key political figures, who do not always represent the interests of their electorate but rather the interest of the state. This elite repression does not exist in a large scale, but the prolonged hegemony of the ruling party may create situation where real political alternatives are no longer available.

Gel'man (2007, 12) summarises the transformation of Russia's party system: "*Russia's party system has swung like a pendulum from the one party control of the Soviet era, to the hyper fragmentation and volatility of the 1990s, to an attempt to restore centralized control in the 2000s. The danger of the new system is that it will cause the death of political opposition. Now Russia may be developing a 'Dresden' style political system, in which one main party controls several satellite parties that have little political power. Such a system could be in place for a long time, though it is unlikely to be permanent*".

Should the political system remain unchanged for long, pressures to change ultimately become so high that they will explode in a non-controllable way. In other words, a non-evolving political system may become an extremely high political risk for foreign firms, if it is maintained for too long.

The United Russia party won clearly the latest parliamentary elections in 2007 and the opinion polls show that the approval ratings of both the president and prime minister are high, and therefore, one should not argue that elite illegitimacy exist in Russia as such. However, the main source of the illegitimacy originates from the fact that the State Duma lacks true opposition with an alternative political direction, since both Just Russia and the Liberal Democratic Party of Russia are generally believed to be the Kremlin's satellite parties, and the Communist Party leans too much on the Soviet era instead of giving a real option for the younger generation. The absence of liberal opposition in Russia's political landscape does not allow one to be

too hopeful for future development. Even if all the parties representing the liberal opposition would join together, it is very unlikely that they would go over the electoral threshold of seven per cent. Moreover, one should not forget that the tenure of the parliamentary term and presidency have been prolonged, pushing Russia's political system towards political immobility.

The likelihood of immediate regime change is extremely low, even if the crisis has touched the Russian economy hard. *“Political risk has increased, reflecting the pressures created by the severe financial and economic crisis. The crisis, and the question of how to deal with it, is likely to put strains on the ruling ‘tandem’ between the president, Dmitry Medvedev, and the prime minister, Vladimir Putin, as well as to fuel disagreements within the government those who favour a statist solution to the crisis and those who are more liberally inclined. As prime minister, with ultimate responsibility for the economy, Mr Putin appears more exposed than Mr Medvedev to a decline in his popular standing. There is also an increased risk of social unrest. Nevertheless, given the lack of a credible opposition, it seems doubtful that social discontent could threaten the leadership”* (BEE 2009a, 3).

Despite the prime minister having been forced to take unpopular decisions, the crisis has not collapsed the prime minister's popularity. In fact, Putin is still more popular than the president. *“According to Levada Centre surveys, popular approval ratings for both Mr Putin and the president Dmitry Medvedev, remain high and are only slightly down on their ratings in 2008. In July 2009 they stood at 78% for Mr Putin and at 72% for Mr Medvedev. In any case, given the lack of a credible opposition, it seems doubtful that the rise in social discontent could threaten the leadership — Boris Yeltsin managed to survive politically through the crisis in 1998, despite being in a much weaker position. The liberal opposition in Russia is in disarray and the Communist Party of the Russian Federation (CPRF) is a declining force. ... After more than a year of the ‘tandem’ between Mr Medvedev and Mr Putin there is no significant evidence of tension between the two leaders, although there are some signs of differences between the two teams surrounding them”* (EIU 2009, 4).

Though I cannot foresee any true regime change in the near future, one should keep in mind that the statist approach has gained weight in Russia. *“The global financial crisis has strengthened the hand of Russian hardliners who want greater state control and less to do with the West, a key adviser to President Dmitry Medvedev said in an interview on Wednesday. Igor Yurgens, who chairs Medvedev's think-tank, the Institute for Contemporary Development, nonetheless told Reuters he believed the president was aligned with Russia's liberal wing and was making small, cautious steps towards reform. ‘The crisis of course fortified the positions of the statist’, Yurgens said. ‘The ideology of this wing will be fortified’”* (Guardian 2009).

In May 2008, the Russian Government passed the law restricting foreign investment into strategic sectors. The law was not prepared with sufficient time, and even Russian experts admit that there are several weaknesses in the law. For instance, the law could lead to an absurd situation where foreign-

owned oil companies stop exploring new oil fields, since if they will find too big hydrocarbon field they should donate it to the state against a symbolic compensation (Malkova 2009; Medetsky 2009b). In addition, there are loopholes in the law that allow foreign entities to flout the government when buying into strategic companies (Medetsky 2009a). Some Russian authorities have acknowledged that the law touches unnecessary sectors and ownership restrictions are too strict, and hence, the authorities may increase the ownership stakes of foreign oil firms in strategic fields. Although it would be wise to re-consider the content of the law, one may only ask whether the possible liberalisation in the law lasts only during the crisis or whether foreign firms can really rely on the law in the longer run (Argus 2009a).

Society-related risks: one can argue that Russian society has become more fragmented and nationalism grows. Pain (2007, 5) analyses the development of nationalism in Russia as follows: *“in the beginning of the 1990s, the minority non-Russian ethnic groups began asserting their rights. By the end of the 1990s, it was the majority ethnic Russians who had become vocal. Although the ethnic Russians became ethnically conscious later than the other groups, their feelings are quickly growing and now the ethnic majority considers itself to be more threatened than the minorities. From the beginning of 2000, the share of ethnic Russians who feel threatened by members of other ethnic groups living in Russia is almost twice the number of other groups. During the Soviet era, the ethnic Russians were the most tolerant of the ethnic groups in Russia.*

The Russian’s fear of other ethnic groups was particularly noteworthy after the series of terrorist acts in the summer of 1999 and the beginning of the ‘second Chechen war’ that fall. Initially, the feelings were directed against the Chechens, but after 2000, they spread to a variety of other ethnic groups. Since that time, approximately two-thirds of respondents feel some form of antipathy toward other nationalities. Anti-Semitism grew particularly quickly and now the level of anti-Semitism among Russian nationalist leaders has even outstripped their anti-Chechen and anti-Muslim feelings.

Contemporary Russian nationalists stress the idea of rebuilding the Russian empire. However, their focus on the idea of ‘Russia for the Russians’ is incompatible with efforts to bring other ethnic groups together in one political entity. The authorities support Russian nationalist ideas, in the mistaken idea that they will be able to manage nationalist forces. In fact, the rise of Russian nationalism is likely to encourage separatism among other ethnic groups”.

Russia’s increasing nationalism means increasing investment risk for foreign investors, since the authorities are not able to fully control nationalism, nationalism encourages separatism, and finally, foreign business is a stranger, i. e. a target for attack if the nationalistic waves ever overflow the dam.

Umland (2009, 13) argues that *“in recent years, various forms of nationalism have become a part of everyday Russian political and social life. Since the end of the 1990s, an increasingly aggressive racist subculture has been inflecting sections of Russia’s youth... It is generally acknowledged that a*

shrill anti-Americanism, as well as various other phobias, today characterize not only marginal groups, but also the Russian mainstream. ... Among the dozens of extremely anti-Western publicists and pundits present in Russian official and public life today, Aleksandr Dugin and his various followers stand out as a network of especially industrious political ideologues and activists who have managed to penetrate Russian governmental offices, mass media, civil society and academia. ... If Dugin's view becomes more widely accepted, a new Cold War will be the least that the West should expect from Russia during the coming years."

The prolonged and extended instability of Chechnya has turned the Caucasus into a fertile soil for Islamist fundamentalism, and therefore, it is likely that the assassinations and bombings will become more frequent. *"Responsibility for most of the terror attacks has been claimed by underground Islamic armed organisations, and especially the Chechen commander Dokka Umarov. The declared objective of the Islamic militants, who are likely associated with international terror organisations, is to overthrow the local authorities, separate the Caucasian republics from Russia and establish a Caucasus Emirate in their territories, with Sharia law as its legal system"* (EW 2009, 5).

Should the Russian Government be unable to normalise life in the Caucasus region (unemployment, for instance, in Ingushetia is around 80 per cent), one may anticipate that Islamist fundamentalism does not only spread inside the Caucasus, but fundamentalism may find its targets outside the Caucasus (BEE 2009b). With the current trend the Caucasus will soon become the Middle-East of Russia, where investments, be they domestic or foreign ones, are doomed to fail.

The world's public opinion towards Russia has become more reserved during this decade, when Russia began to rebuild its political and economic leverage in the post-Soviet territory. After three gas transit conflicts with Belarus and Ukraine the public image of Russia has particularly deteriorated in the West. After the war with Georgia and the increased assassinations of journalists investigating the Chechnya conflict, public opinion on Russia has dropped to its record low.

According to a large international survey (BBC 2009)¹, positive views have fallen 5 percentage points (30%, down from 35%) and negatives have risen sharply (42%, up from 34%). Positive views about Russia have deteriorated substantially, especially in Europe and the United States. In the United Kingdom, positive views have fallen 23 percentage points (25%, down from 45%), shifting the overall leaning to predominantly negative from positive. Negative views have worsened in France (rising from 50% to 66%) and Germany (rising from 56% to 70%). In the United States negative views have risen 28 points (64%, up from 36%), shifting overall views from mildly positive (45% to 18%) to strongly negative. The only countries to

¹ The BBC World Service Poll has been tracking opinions about country influence in the world since 2005. The latest results are based on 13 575 in-home or telephone interviews conducted across a total of 21 countries.

demonstrate significant improvement in positive views of Russia are Italy (34 %, up from 23 %) and Ghana (50 %, up from 42 %). Italy's several bilateral deals with Russia and Prime Minister Berlusconi's dominance over the media may explain a part of the aforementioned development. The survey administrator concluded that the more Russia acts like the old Soviet Union, the less people outside its borders seem to like it.

Economy-related risks: Russia's GDP per capita growth has been remarkable in this decade. Until the crisis broke, the average growth was clearly above 5 per cent annually. Though the Russian GDP has nearly doubled in this decade, some citizens have been more equal than others in amassing prosperity. The richest 10 per cent of the Russian population earn over 30 per cent of all the income distributed in Russia, while the poorest 10 per cent earn less than three per cent. On the other hand, the USA does not perform better than Russia in the Gini index (UNDP 2008).

“According to Russia's state committee on statistics, the figure for Russians living below the poverty line went up to 24.5 million during the first three months of this year [2009] — a steep increase from 18.5 million by the end of 2008” (Harding 2009).

Differences among the Russian regions are notable. The regional GDP per capita comparison does not describe the situation accurately since the natural resource rich regions seldom receive the major part of the income from the exploitation of these resources. Despite the statistical deficiencies, one can safely conclude that Russia lives in three different centuries. Moscow and St. Petersburg are hectic metropolises of the 21st century, regional capitals and several industrial centres live in the past century, whereas some regions have degenerated back to the 19th century.

The current crisis will add to regional inequality since there are hundreds of towns in which one corporation is practically responsible for the economic well-being of the whole city. The Russian Government has identified 400 towns that rely almost exclusively on one employer. The substantial increase in regional unemployment, and hence, the considerable drop in economic well-being will obviously cause social turbulence Russia has not seen since the beginning of the 1990's. In addition to unemployment, the grey economy, absenteeism and criminality can be expected to increase in these monocities (Pismennaya 2009; Vasilyeva 2009).

Besides regional inequality, societal inequality is wide. Elderly people particularly have suffered from the transformation from socialism to capitalism. One can even state that elderly people have been betrayed by both socialism and capitalism, since neither socialism nor capitalism has brought them the well-being promised. Although 'the lost generation' feels disappointed, it is too old to cause violent protests on the streets and too wise to re-elect the communists into power.

Even if the social pressure is to grow during the next winter, the social protests have so far remained mild. Lankina and Savrasov (2009, 6—8) concluded in May 2009 as follows: *“the number of social protests in Russia is growing, though the absolute number of participants remains relatively*

small. Overall, the authorities are suppressing a smaller number of protests now than they were two years ago. Political protests are more numerous than economic ones and protesters are increasingly targeting national leaders, though protests against regional leaders have increased slightly. ... Significantly, among the most active protesting regions are Kaliningrad and Primorskiy Kray in the Far East.”

The Russian leadership are sensitive towards social protests in Kaliningrad, as the leaders may be afraid that the independence movement in the region would grow in this Russian exclave sandwiched between Lithuania and Poland. A major protest in Kaliningrad in January 2010 could be anticipated, since the living costs of the citizens and the regional unemployment are increasing.

The people supporting independence represent a small proportion of Kaliningrad’s population. The young are an exception. According to Kortunov (2005), “*separatist sentiments are widespread among young people. A recent public [2004] opinion poll (conducted anonymously) revealed that almost 60 percent of the Kaliningrad Region’s population below the age of 28 favors separation from Russia.*” I would still argue that the citizens of the Kaliningrad region would like to have looser control from Moscow, instead of the region becoming fully independent.

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