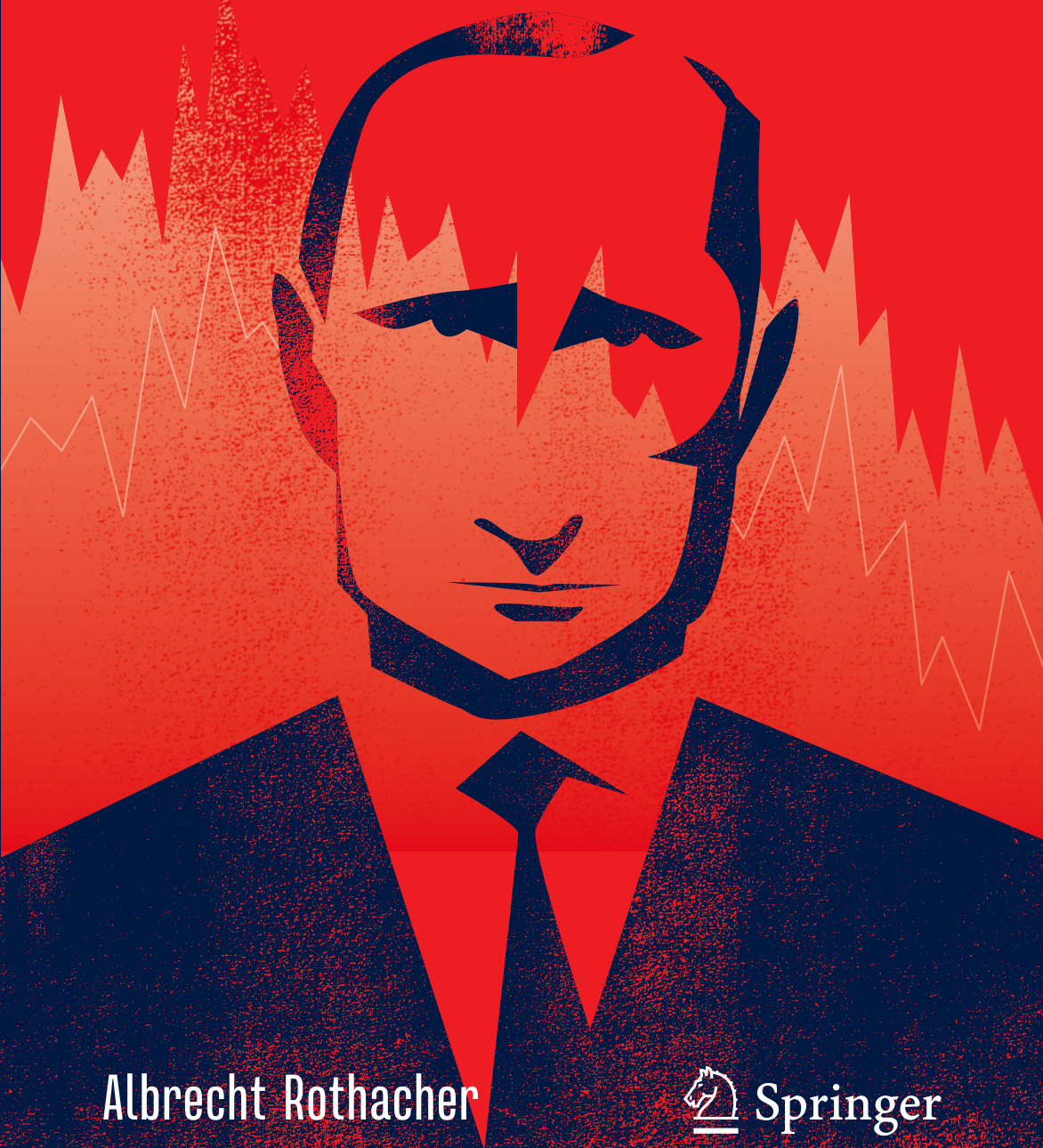


PUTINOMICS

How the Kremlin Damages the Russian Economy



Albrecht Rothacher



Springer

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Albrecht Rothacher
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“Putin knew that we knew that he was lying, and he did not give a damn”
Sir Chris Patten (2005), in: “Not Quite the Diplomat” Allen Lane. London

Preface

Abstract The introduction usefully summarizes the results of this monograph: How the narrowly based St. Petersburg clique of former KGB officers around Putin took control of the semi-privatized energy sector, muzzled or expropriated the Yeltsin oligarchs, and since three decades have set up their own state based management and control of key sectors of the Russian economy: oil, gas, minerals, armaments, banks, aviation and railways. Their self-serving and unpredictable “rule by law” continues to encourage endemic corruption and capital flight and to discourage investments, both foreign and domestic, the development of SMEs and the urgently needed diversification of Russia’s raw material based economy.

Russia is a country of surprises, positive and negative. I remember back in 1980, when flying from Niigata in Japan to Khabarovsk (Vladivostok was still a forbidden city) to take the Transib to Berlin via Moscow and Minsk—as a doctoral student I had plenty of time—a customs officer immediately fished a dissident book out of my rucksack, and judging from my East German experiences I was sure never ever to see it again. Fifteen minutes later his boss, the chief of Khabarovsk customs, came and handed the book back to me and said: “Oh, I see you read very interesting stuff. May God bless your journey!” And this was in the middle of Brezhnev’s communism.

So, Russia remained a life-long intellectual and political passion. I have dealt with Russia when posted as a Counsellor at the EU Delegation to OSCE in Vienna during 2006–2010, as an exchange diplomat at the Quai d’Orsay

during 2015–2017 and more recently as a principal administrator in charge of bilateral economic and trade issues with Russia at the European External Action Service in Brussels. During these years I had plenty of often fascinating exchanges with Russians in power like ministers, ambassadors, diplomats, lobbyists and spies, but surely more interestingly ones with those who were out of power and were often incredibly courageous and perceptive dissidents, scholars and journalists, and also with those who were in-between (like I would have been).

So for me, given Russia's intellectual and enormously rich literary heritage, the question of her belonging to Europe's civilization is not an issue, far from it. Rather, Russia conserves many of the traditional values which have become abused in the West. Yet the question is about governance. And there have to be very big question marks, as the reader will see.

This book is based on public sources which are duly quoted. Needless to say that my conclusions are all personal and do not represent the positions of my previous employer. Secrets are not revealed. So, there is no need for libel suits or for GRU-Speznaz operations to shorten my life expectancy.

Russia is by far the largest country on earth, which as various invaders, from Napoleon to Hitler, have shown, it is practically invincible. Yet, its population stagnates at 143 million, even after the repatriation of millions of ethnic Russians from Central Asia (often former deportees and their offspring) and after adding on some 2.5 million Crimeans forcefully in 2014. Two million of their best and brightest have left during the last 10 years. There was \$350 billion in capital flight for good and bad reasons. Three million businessmen were prosecuted for shakeouts. As a result of this hostile economic environment and in spite of the great talents of Russian graduates in mathematics and in the sciences, there is little innovation and economic stagnation. The country technologically simply falls further behind the West and China.

Basically, Russia now appears a corrupt petro-state with huge demographic problems, with its working population shrinking rapidly. Deaths by accidents, violence, alcohol, drugs, abortion and transmittable diseases (from hepatitis to AIDS), with which a neglected health sector cannot cope, have taken their toll. Male live expectancy still hovers around 66. Women, who are wiser, live a decade longer. By the time Putin is likely to leave his office (one way or the other), Russia will have less inhabitants than Turkey, Nigeria or the Congo, with its GDP remaining at the level of Spain and much below Italy. So much for a presumptive world power.

A total 110 individuals (including Putin's cronies, his relatives and himself) control 35% of Russia's wealth, while 50% of Russian households have a "fortune" of \$870 or lower. Again, this is not Angola or Nigeria, but happens in an East-European civilization. In short, Putin's policies have led Russia into a lower-middle-income trap, from which there is no escape, given the weakness of the manufacturing and service sector, unless competition and property protection legislation is enacted effectively, and productive FDI is genuinely encouraged. It is as simple as that.

Failing this Russia remains dependent on the unpredictable vagaries of the global commodities markets and of the fluctuations of the world oil prices in particular. At \$45 per barrel Russia's budget will be ok, but below that it has a serious problem. This surely is not a sustainable policy.

As the events of the crises of 1998, 2008, 2014 and 2020 proved, such external shocks could not be absorbed by national emergency funds alone for long. And Putin's business model of gas exports to subsidize Russian wasteful heavy industry, and of its oil industry to prop up the national budget to finance his military and private pet projects, might no longer work. His decades of abusive power have left a tragedy for the more educated parts of the workforce who after all have deserved better.

German Chancellor Helmut Schmidt once famously said that the Soviet Union was Upper Volta (now called Burkina Faso) with missiles. Unfortunately, under Putin's state monopoly capitalism fundamentally very little has changed in this mismatch, although the queues for soap and sugar have disappeared. It is still a military giant and an economic dwarf with a GDP of the size of Spain. Putin will not change his ways. He will continue to reward his corrupt friends generously and punish critics and opponents mercilessly.

Is it legitimate to personalize Putin's economic policies? After all, neither the US nor the French president can do much to change the economic fundamentals of their countries. Yet from the beginning of his presidency 20 years ago, he systematically centralized his personal power and altered the course of Russia's fragile transition economy towards a model of state-controlled monopolist capitalism and for the enrichment of the small band of his trusted personal friends and of himself—often at the expense of the old oligarchs (whom he either expropriated, drove them into exile or cut them down to size), but mostly paid for by the welfare losses of the population at large—and of other bureaucratic and secret service clans which followed the Kremlin's lead with impunity.

The results of this kleptocratic mismanagement are as striking as they were predictable. The glamour and glitter of Moscow, St. Petersburg and Sochi apart, the underdevelopment and depopulation of the regions with

their decrepit infrastructure and national poverty rates at 25–30% is palpable. And yet in spite of expensive protectionist policies Russia is persistently unable to diversify from its dependency on raw material extraction and to develop competitive services and industries, apart from armaments. Private entrepreneurship is systematically discouraged, denied credit from state banks, subject to arbitrary taxation, other bureaucratic harassment, and subjected to frequent arbitrary arrests. The Kremlin in general—and Putin in person—simply distrusts an emerging economically independent middle class, which he perceives as a threat to his autocratic rule. Hence the repression does not come by accident. With the lack of effective property protection capital flight has taken endemic proportions, since 2008 fluctuating between \$60 billion and \$150 billion per year, corresponding to 4–10% of GDP. But also people are leaving for good. 50% of the most educated and prosperous citizens and 30% of 18–24-year-olds have declared their intention to leave Russia, as they see no future, fear insecurity and the dangers from law enforcement (though many of them undoubtedly eventually will stay). In turn, the country received about 9 million mostly poorly qualified migrant workers from Central Asia and the South Caucasus. This is surely not the way to modernize a country and to diversify its economy, rather the opposite.

Basically, Putinism is about control through the state security apparatus: over the provinces, the parties, the media, the judiciary and the economy. To be fair, Russia is not China. In spite of frequent police harassment, some political opposition, critical media, NGOs and foreign thinktanks are still tolerated, provided that they don't become dangerous. The World Wide Web is freely accessible. People can travel as they like at home and abroad and courageously speak out their minds.

Putin's goal is not to present an alternative economic and political model (unlike his earlier advisers Vladimir Yakunin and Vladislav Surkov, who advocated Russia's exceptionalism and the concept of sovereign democracy to preserve its unique superior values). Rather in his foreign policies, apart from aggressively expanding Russia's influence in her "near abroad" of the old Soviet Union and the Balkans, he seeks to undermine Western democracies which he sees as a threat to his rule—as role models they had helped to overthrow Communism, had aided the colour revolutions from Georgia to Kirgizstan and to generate the Maidan revolt of 2014 against his equally corrupt but less competent puppet Yanukovich. Instabilities, which Putin like all turmoil, including the October Revolution but also democratic elections with unpredictable outcomes, instinctively abhors.

Thus like most Soviet leaders before, who learnt from their surprising success in 1917—Czarism after all had recklessly provoked and lost the

Crimean War of 1854–1855, the Russo-Japanese War of 1904–1905 and the First World War in the East (1914–1917)—Putin takes only calculated risks. He uses perceived Western weaknesses and indecision, like against his war against Georgia in 2008, the annexation of the Crimea in 2014 and the ongoing military intervention in Syria. But he conducts only limited wars which can be stopped any time at short notice, if an escalation threatens.

Putin's personal power seems unlimited being, like the old Czars, responsible only to God. In other presidential systems, like the US, the President's powers are checked by a federal system, a powerful Congress, an independent judiciary and a very free press. Putin does not have to worry about an impeachment nor about a lost election. There is a bit more analogies between Putin's Kremlin and the Elysée (as created by de Gaulle for the V. Republic). Both decide on all major policy issues, including war and peace, and the ministries are told to execute in centralist structures, with parliaments usually being weak and compliant (unless in France the President loses his majority there and has to enter into cohabitation with the opposition). Yet the analogies end here. Unlike in Russia, in France the judiciary is fiercely independent, the opposition unhindered, the press vigilant and the public does not tolerate corruption and the abuse of power. As a result, French presidents (which preside in the Elysée in royal style, *bien sur*) leave their office with an upper-middle-class wealth (usually a chic apartment in Paris and a modest house in the countryside) as before.

Gary Kasparov once famously wrote—with slight exaggeration: “Putin wants to rule like Joseph Stalin and live like Roman Abramovich”. Indeed, the obsession with status and money of the current Russian elite is striking. Why does one need to steal \$10 billion when, say, \$10 million are more than sufficient for a very comfortable life at home and abroad, especially since Putin and his friends in the Kremlin live in a money-free world? When his girlfriend wants a diamond, he does not have to check his wallet or his bank account. The answer probably lies in his insecurity. As he was afraid of the oligarchs' money and power, early on he decided to give only to his close and trusted friends. Once in place, this unchecked kleptocracy took on a life of its own and into a virility contest of who owns more and whose palaces, yachts and airplanes were bigger. In the course time—20 years already and no end in sight—an element of pharaonic delusion developed, perhaps inevitably so after two decades of absolute power. One such example is Sochi at the Black Sea, where Putin had himself build 1\$ billion palace. Like Peter the Great in St. Petersburg, the resort had to be built up to splendour out of almost nothing, regardless of the financial or ecological costs.

As a result, during goods years—i.e. with world oil prices above \$45 per barrel, which were needed to break even the federal budget—one-third of the export revenues were pocketed by some 200 people, one-third was used to increase public wages and was eaten up by inflation, and one-third was wasted, like for the 2014 Olympics, the soccer world cup of 2018 and for military adventures. With a lower oil price there will be no alternative but a new round of collective belt-tightening, to which the Russian people are accustomed and which they usually stoically accept, but given Russia's cross-social inequalities the sacrifice will equally be distributed unevenly surely not hurting Putin's cronies.

As he is about to extend his term in office until 2036, making him more or president for life, with him a brilliant tactician but not a strategic thinker, he is unlikely to change his ways and policies which so far against all odds have put him in power and kept him there, while all other world leaders whom he met early have faded in the meantime. Thus, the long-term ruin of the Russian economy in all likelihood unfortunately is set to continue.

While in real life there are sometimes positive surprises when expectations are low, yet in Russian fairy tales there are only very few happy endings.

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Albrecht Rothacher

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About the Author

Albrecht Rothacher was born in 1955 in Erlangen (Germany). After military service he studied social sciences at universities in Berlin, Konstanz, Bridgeport and Yale (Connecticut), Tokyo and at the EUI in Florence. He obtained his Ph.D. at the London School of Economics. After a stint at Deutsche Bank and as a lecturer at FU Berlin he joined the diplomatic service of the European Commission with posts in Vienna, Paris, Singapore and Tokyo, last as a Minister Counsellor. He dealt with Russia professionally for many years, lastly as a principal administrator in charge of bilateral economic and trade relations at headquarters of the European External Action Service in Brussels. He published some 25 books and numerous articles notably on economic and military history and on European, Eurasian and East Asian politics.



1

From Alexander II to Gorbachev: The Economic History of Modern Russia

One of the striking features of Russia's contemporary economy, even a quarter-century after the fall of communism, is the persistence of—ever-growing—state involvement in the economy. By 2018, 80% of banks are state-controlled and so are the all-important resource sectors, their infrastructure and their exports, as well as the armaments industry as part of a tightly controlled military-industrial complex, and the railways. Even the forests remain all (bad managed) state property. Obviously, the wild privatizations and the preaching of liberal economics during the Yeltsin years have had a little lasting impact. Not just the siloviki entourage in charge of the Kremlin's economic policy, but also the public at large seems to believe firmly that the economy has to serve Russia's policies and public interests, and not the other way around. Even if there is little nostalgia to return to the organized inefficiencies, the shortages and the pilferage of state planning, competition only appears to confuse, duplicate efforts and risk investments. Hence the popularity of state and oligarchical monopolies in the key industries, even if they go at the expense of prices, services, quality and innovation with consumers ultimately paying monopoly rents as collateral damage of the system. Ultimately the population becomes a victim of its own economic illiteracy.

The question obviously arises: Is this sorry state of play only an accident of history, the heritage of seventy years of Bolshevism, or is it the consequence of a traditional Russian way of running the economy in difference to the “West” (which many Russian interlocutors suggest)? For evidence, we need to look

at the modernizing decades of the Czarist days, until the advent of the war economy (1914–1917).

1.1 The Autocratic Czarist Era (1613–1914)

With little doubt, the co-existence of a centralized arbitrary autocracy under the Romanovs (1613–1917) with the vast majority of the people living as illiterate subsistence farmers in serfdom, from which they were only belatedly and gradually liberated in 1866 by Alexander II, with an underdeveloped urban bourgeoisie and educated middle class had lasting effects on economic and civic behaviour. People had internalized to avoid initiatives and to take decisions, to shirk responsibilities and saw virtue to live on with only a minimum effort. At the same time, a strong sense of egalitarianism was prevalent among peasants and later urban workers alike, which perceived individual efforts and differences in wealth as basically illegitimate.

In addition, there are enduring factors of geography and climate. As Trotsky puts it: “The population of this gigantic and austere plain open to Eastern winds and Asiatic migrations was condemned by nature itself to a long backwardness. The struggle with nomads lasted almost to the end of the seventeenth century, the struggle with winds bringing winter cold and summer drought continues still. Agriculture, the basis of the whole development, advanced by extensive methods. In the north they cut down and burned up the forests, in the south they ravished the virgin steppes.”¹

While the frozen Northern tundra remains impossible to cultivate, and the forest belt of the taiga, apart from slash and burn, is suitable only for hunting, fishing and forestry, further South the fertile Black earth belt made Czarist Russia in the nineteenth century—as well as Putinist Russia in 2017—the world’s foremost exporter of wheat and oilseeds. Yet vast regions of the Southern steppe remain suitable for extensive pastoral uses only. In addition, long cold winters shortened the growing season. Farming techniques remained primitive well into the mid-nineteenth century with wooden ploughs, the lack of fertilizers, strip farming and under-motivated serf labour. Hence low productivity subsistence agriculture was the base reason for Russia’s poverty well up to the beginning of the twentieth century.

One further handicap was that Russia’s continental landmass was virtually land-locked, even after its centuries of relentless territorial expansion: The Caspian Sea, the Black Sea, the Baltic Sea and the Sea of Japan were

¹Leon Trotsky. *The History of the Russian Revolution*, Vol. I, London: Penguin 1932, p. 23.

more or less inland seas whose exits were controlled by foreign powers. The Barents Sea in the North was mostly blocked by ice. In difference to the early capitalist nations of the Northern Mediterranean, the Atlantic and the North Sea, Russia did not develop through navigation, foreign commerce and banking. Rather it remained a quasi-colonial economy, exporting unprocessed raw materials and importing manufactured and luxury goods.

Most importantly, it lacked commercial law and legal codes protecting private property and inheritance and enforcing contracts. The Orthodox Church focused on spiritual values and salvation through pious works. The notion of a Protestant work ethic, valuing hard work, savings and the accumulation of capital remained utterly alien.²

Western ideas, whether religious, political, economic or moral, were seen with great suspicion and fought with censorship, travel restrictions and the promotion of anti-Western ideologies. Yet public attitudes with a mixture of envy, admiration and detestation remained ambivalent, almost schizophrenic, notably as Western technology and societal progress appeared as vastly superior to Russia's backwardness. Peter the Great (1682–1725) systematically invited Western engineers, counsellors and capital, especially to modernize the military in order to achieve Russia's aspirations for great power status. The urge for military reform according to Western patterns was felt even greater after the defeat in the Crimean War (1853–1856). Then French, British, Italian and Turkish forces fought victoriously. Russian deficiencies from tactics to armaments, naval power and logistics—in the absence of railways South of Moscow supplies were still relying on ox carts, trekking for weeks through the Southern steppe being unable to supply the Black Sea fleet with coal and the troops with modern weapons, ammunition, food and medical supplies, let alone lift the one-year-long siege—were striking compared with the Western expeditionary forces.³ In the end, the lack of Russian military reserves, financial exhaustion, an overburdened transport system and with epidemics raging among the malnourished and exhausted troops with approximately 300,000 deaths on both sides forced Russia to abandon her imperial ambitions towards the Ottoman Empire.⁴

Yet progress in the West remained stronger, and the notion to catch up turned illusionary throughout the nineteenth century.⁵ Some Czars like Nikolai I (1825–1855), shocked by the Decembrist coup attempt (1825) and by the Polish uprising (1831), sought to preserve social stability and

²W.E. Mosse. *An Economic History of Russia 1856–1914*. London: I.B. Tauris. 1996, p. 6.

³Alain Gouttman. *La Guerre de Crimée 1853–1856*. Paris: Perrin 2006 (1995) p. 84 and p. 119.

⁴Gouttman. Op. cit., p. 373.

⁵Mosse. Op. cit., p. 13.

their autocratic rule—in his case by holding back early industrialization and railway construction taking place elsewhere in Europe. His successor Alexander II (1855–1881) with the help of French capital started railway construction in earnest. In 1856, he warned the Moscow nobility that it was better to abolish serfdom from above than to wait until it was abolished from below.⁶ The issue was complicated by Russia's complex agricultural geography. In the rich Black earth zone of the South, landlords were interested to keep the land for commercial operations. They did not mind freeing the farmers, who thus far had to serve as unpaid labour at least three days a week (*bartschina*) nominally with little incentive to work hard and to hire them as cheap labourers instead. In the infertile Northern woodlands, the owners did not care about their landed property, as long as they owned the serfs, whose artisanal production they exploited as cash-based rents (*obrok*).⁷ After a struggle of four years with the conservative gentry, Alexander II in 1861 managed to liberate the 47 million serfs (38% of the population of the European part of Russia), which however remained largely landless, except for their huts, farmyards and a patch of land for subsistence and got rid of their unpaid labour obligations for their former owners only after long years of transition. However, they had to pay their landlords 16 2/3 times the value of their annual labour, with 80% of the sum advanced by the state. The farmers had to pay this debt back for 49 years including interest.⁸ Many smallholders in fact resented their liberation, being afraid of the economic risks as independent small farmers. Clearly, nearly all of them remained very poor. Due to high birth rates, the rural population grew quickly and average farm sizes remained minimal. Lacking draft animals and capital, wives often had to pull the wooden ploughs, sowing was done by hand and harvesting with a sickle.

Yet communal farming arrangements continued, through which the village collective, to whom the farmers remained tied. The local self-government (*mir*) allocated and redistributed the land for temporary use, as it was—like in traditional Asian rice economies—also responsible for the payments of taxes. All farmers as a community were collectively responsible for paying the sum allocated to the village, with the more successful and hard-working farmers paying for the lazy and drunkards. Hence the disincentives to individual initiative, innovation and land improvement continued. Yet Alexander also introduced to beginnings of rudimentary rural education with village schools and a notion of independence for the judiciary. During the tenure of finance minister Reuter (1862–1878), railway lines, financed mostly by

⁶Günther Stoekl. *Russische Geschichte*. Stuttgart: Kröner. 1997, p. 537.

⁷Stoeckl. Op. cit.; p. 539.

⁸Norbert Wein. *Die Sowjetunion*. Paderborn: UTB Schöningh 1985, p. 80.

French bonds, expanded from 2,200 miles to 14,200 miles, coal production multiplied sevenfold and external trade quadrupled. Military service also was reformed. Instead of 20 years of compulsory service, the new concept was one of a relatively smaller standing army in which conscripts served six years of active service, followed by nine years in the reserve. Yet in spite of all reforms, endemic corruption remained,⁹ the unavoidable collateral of autocratic regimes. With the murder of the “Tsar Liberator” Alexander II in March 1881 by terrorist bombs, all political and economic reforms came to a fatal temporary standstill.

Foreign wars, starting with those of Catherine II (1762–1796), the campaigns and defence against Napoleon, the Crimean war and finally the Russian-Turkish war of 1877 had always been financed by printing paper rubles. With national savings wasted on unproductive military expenditure, the tax burdens on the agricultural economy inevitably increased. One of the results of rural capital deprivation was the famine of 1891–1892.

In 1892, the successful railway manager Sergei Witte became Minister of Finance (and shortly Prime Minister during 1905–1906). Not only did he push for the development of railways and heavy industry, but with the Trans-Siberian railway for economic and military-strategic purposes achieved by 1905 also opened the country for foreign direct investment, like for French and Belgian capital to develop the coal mines and steel industry in the Donbas, British capital to invest into oil and gold exploration, and German interests in the electrical industry. My great-grandfather's company Briegleb, Hansen & Co in Gotha, for instance until 1913 became an important supplier of turbines for Russia's energy generation. Though many of them are still in operation like in Chelyabinsk in the Urals,¹⁰ *tempi passati*. In Baku the Nobel brothers developed the oil industry, and a British, John Hughes became the steel king of Russia, both in the 1870s and 1880s. Witte, however, also took the lessons of Friedrich list of tariff protection for Russia's own infant industries to heart and thus tried to promote a textile industry which he hoped would be able to push the British out of the Chinese and Mid-Eastern markets. Yet in spite of all efforts at the beginning of WWI in Russia, all indicators of heavy industrial development still lagged behind its UK, US, German and French competitors. Pig iron, steel and coal output, for instance, stood only at quarter to the levels of Germany.

Still, between 1890 and 1900 the number of factories increased from 32,000 to 38,000, while the workforce almost doubled from 1.4 million

⁹Mosse. *Op. cit.*, p. 66.

¹⁰U. Ellenberg, M. Siegmund. Briegleb, Hansen & Co. Eisengießerei, Maschinenfabrik & Spezialfabrik für Turbinenbau. Gotha: Urania Kultur- und Bildungsverein 2000, p. 27.

to 2.4 million people. They were concentrated mostly in St. Petersburg, Moscow, the Donbas, the Urals, parts of the Caucasus and of Poland, working mainly in textiles, metallurgy and railway works. Work conditions as elsewhere during early industrialization were tough and insecure, work hours were long, housing conditions and wages were poor and paid only irregularly. Discipline was tough and workers were continuously threatened by dismissal and unemployment, notably when overcapacities became evident in metallurgy once the rail construction programme had levelled off. State support to industry and high tariff protection was of little help. Witte had hoped that rapid industrialization would help to raise living standards quickly.¹¹ Instead, there was a long series of ever-increasing strikes, often instigated by revolutionary intellectuals: in the cotton mills and the metal works of St. Petersburg in 1904, the railway workshops in 1902, and the miners in the Urals in 1903. Social democratic agitation also affected foreign-owned companies. During and after 1905 mass strikes shut down half of the Russian industry. During the Russo-Japanese War strikes for an 8-hour-day and increased minimum wages spread from the giant Putilov metallurgical works nationwide. Political demands for free education, the end of the war with Japan, a Constitution, the separation of Church and State, the substitution of indirect by proportional direct taxation, etc. followed. Typically, however, the strikes were unsustainable in the long run and repressed by the military. When petitioners demonstrated in front of the Winter Palace, they were fired upon by the military with dozens of victims. The universities were closed and terrorist acts proliferated in response. Factories were typically much larger than in the West and are often located in the rural areas as single employers near the sources of raw materials. Work conditions were tough and wages were miserable as usual in the first stage of industrialization. But the fact that Russia's modernization was delayed by one generation compared to the West made them less tolerable, with more sustained and better-organized workers unrest and intellectual support.

Yet politics was not unresponsive. In 1897, a labour law limited the work hours to 10½ hours maximum, and further reduced it to 9½ h in 1905–1906. In 1903, legal responsibility for work-related accidents was introduced for employers with the obligation of free medical services, sickness pay and invalidity pensions, very much following the Bismarckian model. While the rules were strict, unfortunately, as usual, they were little respected.¹² After

¹¹Moses. *Op. cit.*, p. 119.

¹²Cyril Fitz Lyon and Tatiana Browning. *Les Russes avant 1917*. Paris: Editions Autrement 2003 (1993), p. 48.

1905 industrial wages increased substantially. Yet by 1910, they were still only at 50% of the UK's level.¹³

In sum, however, the two decades of the rule of Nicholas II (1868–1918) from 1894 to the beginning of WWI were an era of economic, cultural and artistic bloom based on a rapidly expanding middle class, the spread of elementary and higher education, and the *mecenat* of the new class of industrialists. Russia was a latecomer to industrial development. Yet with rates of 8% annual growth in industrial production after 1890, which slowed down to 6% after 1905, it seemed to catch up quickly in its more developed parts.¹⁴

Also, the agricultural crisis loomed largely. The overuse of land, over-cropping, soil erosion and the lack of fertilizers notably in the central Russian provinces led to a famine in 1901, while wheat exports continued from the Black Sea harbours to finance industrialization, railway construction and the military. In addition, farmers—counting for 80% of the population—were burdened with high taxation and increased excise taxes on sugar, vodka and tobacco, their major cash outlays. While some farmers prospered from increased agricultural production, the majority, being mostly illiterate and without access to modern farm equipment to increase productivity, remained dirt poor. Farmsteads were typically single-room wooden structures centred around a brick oven which served for heating, cooking, baking and sleeping. Benches lined the walls. Apart from a large table and shelves for kitchen equipment, there was little furniture. Grassland and forests were in communal property. Farmers remained subject to customary law, with village courts ruling on civil law cases, while the civil law codes only applied to the urban population. As the rural population grew rapidly, the hunger for land increased correspondingly. In response, the government opened up Siberian lands, and unlike in the past, it supplied migrants with credit and equipment. During the rule of Nicholas II four million settlers moved to Siberia, whose population during these decades doubled to 10 million (out of which one million were indigenous people). This was helped not only by the constriction of the Transib but also by romantic literature on settler farmers (similar to the US West), propagating the adventure, ruggedness and freedom of these tough virgin lands.¹⁵

In 1860, China ceased what is today Russia's Far East: the East Coast of Manchuria from the Amur River to the Korean border. They are the last of the Unequal Treaties forced upon the decaying Manchu dynasty which Communist China still resents and considers illegitimate.

¹³Ibid., p. 47.

¹⁴Ibid., p. 10.

¹⁵Fitz Lyon and Browning. *Op. cit.*, pp. 76.

After 1895 imperial ambitions in the Far East, notably in Northern China, Korea and Manchuria, including railway construction, with the Transib crossing Manchuria via Harbin to Vladivostok and the (Russian) Chinese Railway going South to Port Arthur (built during 1881–1896) increased, as did the military rivalry with Japan, which felt threatened. Obviously, heavy military expenditure, the costs for railway construction, for foreign—mostly French—loans and economic modernization and paid for by high taxation and customs duties, brought little immediate benefit to the mass of the people. If there was a development model it was based on cheap labour and low productivity, as capital and innovations remained scarce. Witte's policy was to curtail public discontent and opposition by lazy traditionalists by prolonging autocratic rule, often with the collateral damage of arbitrary bureaucratic decisions against which recourse was not possible and endemic corruption among the poorly paid officialdom.¹⁶

In spite of larger numbers of troops, reserves, cavalry, guns, equipment and stronger naval ships in the Russo-Japanese War of 1904–1905, incompetent and lethargic military leadership, outdated tactics and logistical difficulties gave victory at both land and sea to the Japanese. Already in Korea Russian troops were told to live off the land as supplies did not arrive. It took troops up to 40 days to move from Moscow to Mukden, as railway capacities were blocked in Siberia. As a short, glorious campaign had been expected, unlike a war of attrition which foreshadowed World War I (no lessons were learnt by neither side), there were shortages of winter clothing and food and fuses for artillery shells.¹⁷

Only after Russia's defeats in Port Arthur in 1905, at the sea battle near Tsushima and during the land campaign in Manchuria, did public mass strikes, notably in the Putilov arms factories, force the enactment of constitutional law and the promise of civil liberties. At the same time, Russia during 1906–1908 saw a threatening upsurge in anarchist terrorism, which cost the lives of some 6000 officials (and of 2000 executed terrorists), with numerous armed robberies bordering at a small civil war, with hundreds of millions of rubles stashed away abroad in a major capital flight.

P. A. Stolypin as the new prime minister, with overdue agrarian reforms and the methods of an autocratic state, began to address the fundamental problem of rural backwardness: to expropriate and to redistribute two-thirds of the large landholdings and communal lands, to develop agricultural cooperatives and to end three-field crop rotation. He also freed farmers from their

¹⁶Mosse. Op. cit., p. 138 and p. 277.

¹⁷Richard Connaughton. *Rising Sun and Stumbling Bear. Russia's war with Japan*. London: Cassell 2004, p. 67, 109, p. 233 and p. 273.

compulsory membership in the village collective (*mir*). Indeed, until 1914 three million private farms were set up as farmsteads independent from their village commune. They were often successful commercial operations mostly in the Southern steppe and in the West, run by the kulaks which Stalin would deport and murder 20 years later. By 1916, individual farmers owned 81% of cultivated land and 94% of farm animals.¹⁸ Interesting is also the development of rural cottage industries. Between 2 and 4 million households were engaged in wood processing, making wooden tools and furniture in the idle winter months, or processed linen, jute as local raw materials or cotton transported from Central Asia. Entire villages specialized in icon making, a trade sadly and quickly terminated by the Revolution. In other villages farmers were assembled as work gangs by an elected leader, who organized seasonal winter work for them in factories, distributing wages and buying food for communal living in nearby very frugal dormitories.

Yet past railway and foreign investments started to pay off with new markets being gradually developed and as access to raw materials and energy was facilitated. Also, Stolypin's industrial policies began to work. By 1908, foreign capital started to pour into Russia's industries again. Real wages and farm incomes increased (often to be spent on liquor) with a series of good harvests and high cereal prices. Textile production and construction started an industrial boom after 1912. During the rule of Nicholas II (1894–1917) coal output quadrupled, steel and cast-iron production tripled, and cotton and oil doubled. Overall the Russian economy grew by 6–8% per year during 1890–1913. Essentially, this growth was foreign-financed and was helped greatly by foreign direct investment.¹⁹ Substantial timber, wheat and paper exports serviced the foreign debts in part. This progress helped to feed a population between 1909 and 1914 that had grown from 157 million to 175 million.

The big magnates like Timofey Morozov, who ruled over textiles, railways and banks, were seen as fearsome, rigid, brutal, yet hardworking, hard-drinking, pious and paternalist at the same time. Some of them were barely literate but were also Maecenas of the arts, of splendid architecture, of literature and music. Their slightly unbalanced offspring sometimes even financed Lenin's Communists.²⁰ Religious minorities and dissident Orthodox sects were often prominent in business. After the annexation of Ukraine and Eastern Poland, a large Jewish population was incorporated. Being blocked from farming, most worked as artisans and traders. By 1903, seven million Jews lived in Western Russia, even after 1.3 million of them emigrated to the

¹⁸Fitz Lyon and Browning. Op. cit., p. 43.

¹⁹Ibid., p. 174.

²⁰Fitz Lyon and Browning. Op. cit., p. 57.

West to escape pogroms and discrimination. While a few became very rich as bankers, railway magnates and ship owners—most obviously the Brodsky as the “kings of sugar”—with Jews being very prominent in grain milling, brewing, textiles, tobacco and leather processing. Most, however, remained poor shoemakers, tailors, furniture makers, pharmacists and peddlers.²¹ For the farm economy, they played an important role as traders of cattle and cereals, as well as suppliers of agricultural tools and sometimes as usurious money lenders.

In total, there were about two million noblemen in Russia. Many of them were ennobled after reaching the rank of colonel in the army or captain in the navy—which was made hereditary after two generations—or as a decorated senior civil servant, like Lenin’s father as a principal district school inspector. Most lived on their country estates with modest means—as we know from nineteenth-century literature from Turgenev to Tolstoy, but yet trying a sometimes extravagant and hospitable way of life. As a social class with no great riches available from their agricultural holdings, gradually they were bypassed by the ascent of industrialists, bankers, traders, officers and liberal professions whose ranks they sometimes joined.

As one-third of the tax revenue was spent on the military, Russia was able to expand its army to 114 infantry divisions and to supply it with 6700 artillery pieces—nominally much stronger than the German army—and to rebuild her navy entirely which had been sunk in Port Arthur and near Tsushima in 1905. Plenty of finance continued to be provided by bonds subscribed by French banks and the French bourgeoisie, fascinated by the speculative returns on Russian war bonds—not heeding the prescient warnings of the pacifist Socialist leader Jean Jaures that they would never be paid back.²² Obviously, the spectre of a rapidly modernizing and mobile continental superpower haunted the German general staff, which saw itself sandwiched between a revanchist France and an expansionist Eastern neighbour in an unenviable two-front scenario. Russia as an emerging power was thus similarly scary to Germany, as Germany herself had been to Britain ten years earlier, as Japan had been to the US in the 1930s, or as China appears today.

²¹Ibid., p. 69.

²²Max Gallo. 1917, *une passion russe*. Paris: XO editions. 2017, p. 23 and p. 46.

1.1.1 A Case Study: von Wogau & Co

Interesting also is the role of foreign business in the rapidly industrializing Czarist empire. For enterprising Germans Russia with its huge unified market like the US for another German family, the Rockefellers, for instance, was the land of unlimited possibilities. The most successful of them was Maximilian von Wogau (1807–1880) who in 1827 moved from Frankfurt/Main to Moscow where he started as little more than an errand boy in a German-owned shop for colonial goods. He then moved into tea trading with China, which was bartered physically at a Siberian border crossing for Russian-made textiles, and managed often personally the difficult customs clearance at Siberian border crossings. And this was done in Siberia where at the time 3 million people lived without a railway, and the transport was done by horse-drawn carriages across rivers with no bridges. In Siberia, he found his Russian partners full of patience, fatalist acceptance, bonhomie, lacking ambition and needs, enjoying whenever possible comfort, sociability and drunkenness, which allowed them to forget all sorrows, and lacking the sense for time management, for organization and property, all expressed by one word: *Nitshevo!*²³

As a first sideline, von Wogau moved into sugar trading as Russian tea is drunk with a lot of sugar. Gradually drugstore merchandise, oils, pharmaceutical base products and textile colourants were added. This was to service the needs of the Russian economy, which until 1850 essentially consisted of the artisanal processing of agricultural products like leather, wool, furs, rape, silk, wood, fats and oil. Once industrialization set in after 1850, he moved into commodity trading: importing iron, copper, chemicals, pharmaceuticals, soda, paper, coal, metal products, building materials, cement and other semi-finished products for Russia's rapidly developing industry and construction trade, and in the process setting up a complex logistical network across the Eurasian continent. The secret of von Wogau's success, as the largest German-owned trading house and industrial-holding company, was the weakness of Russian merchants and industrialists: They remained local and regional in orientation, were unsophisticated in international dealings and financial techniques and rarely ventured commercially beyond its borders. Further, German and British traders—then as now—were more reliable to honour payments.

He set up a private family bank to give credits to his underfinanced Russian suppliers and customers, who like all Russian companies had difficulties in getting access to finance, as state-credit institutions were only set

²³Erik Meyer. *Wogau & Co. Das größte deutsche Handelshaus im russischen Zarenreich*. Berlin: Pro Business. 2017, p. 52.

up in 1855 and were essentially bureaucratic institutions to serve the needs of indebted landholders. When his customers ran into financial trouble, von Wogau used debt for equity swaps through which he then owned dozens of corporate participations in iron and copper making, chemicals, cotton spinning, paper production, cement works and other building materials and sugar refining. The collection of industrial interests hence went more by chance and did not reflect a purposeful primary industrial strategy.²⁴ Often then Wogau's associates or family members managed a turnaround and financed much-needed expansions and modernizations. One should remember that industries outside Moscow and St. Petersburg due to the lack of infrastructure far from any railway had to operate fairly autonomously, producing their own bricks, workers housing, hospitals, canteens, food, wood, electricity, charcoal, etc.²⁵ much like the Soviet combines for reasons of a deficient planning economy 100 years later. There remained real continuities as well: In 1874, Wogau modernized outdated iron works in the Urals with modern sinter technologies and in 1910 build his own 175 km railway to transport the output. Forced to sell in 1916, Stalin turned the plant in 1932 into the centre of the giant Magnitogorsk metallurgical complex with coal supplied from the Stalinsk, the mining town nearby. Today, Magnitogorsk remains the world's 30th largest steel company.

During 1864–1871, a series of corporate banks were founded with a larger capital basis than the private banks hitherto: The Russian Bank for Foreign Trade, the Commerzbank of Riga, the Moscow Diskontobank etc. von Wogau took minority participation in all of them, the main purpose being to maintain influence.

All remained the property of his extended family without shares ever having been issued and sell-outs being frowned upon. During WWI, his successors survived first the scapegoating for the deficiencies in Russian arms and ammunitions supplies, then the anti-German pogroms in May 1915 and even the liquidation attempts of Wogau & Co as “hostile” German property, when they were forced to “sell” strategic assets for worthless debentures, but the Revolution they did not. The company had survived and prospered for 78 years with returns on capital averaging 7.6% annually during 1873–1913 alone and as the largest German trading house in Russia had a turnover of today's equivalent of €8 billion. Yet with Revolution 50 million gold rubles were lost. Most of the family were barely able to escape alive.²⁶ Obviously, the clan had overlooked the warning sign of the 1905 revolt of social unrest

²⁴Ibid., p. 72.

²⁵Ibid., p. 83.

²⁶Ibid., p. 7.

(which also affected their factories), kept almost all assets in Russia and subsequently lost almost all of them, worth the equivalent of €2 billion, generated during the eight decades of the family holding's existence. Then they had been on a par with the Wallenbergs or the Nobel brothers with their oil business in Baku (whose fortunes started with supplies to the Russian army in the Crimean war 1853–1855 from their arms plant in St. Petersburg).²⁷

Some property was saved in Poland, like a copper mill in Głowno, or in the Baltics, like a cement factory in Riga. A successor company engaged in diffuse unfocussed trading operations in the Baltics. Its London branch lost its money in speculative ventures in South Africa. By 1952, it was declared bankrupt. One offspring, who had converted to Communism and stayed behind, was shot by Stalin in 1938.

1.2 The War Economy (1914–1917)

None of the countries which in July 1914 stumbled into World War I was reasonably well prepared. They all expected the war to be short and victorious, over by autumn and to be fought by quick cavalry offensives similar to the Franco-German war of 1870–1871. As a consequence, British colonial troops did not have heavy artillery, the French did not have machine guns, the Russian army had no telephones and the Germans wore leather hats which only protected against sabre strikes. Further, all armies were woefully under-mechanized. All had overlooked the lessons of the Russo-Japanese War which had taught the importance and temporary superiority of defensive weapon systems—compared to offensive ones—at the time, and the likeliness of trench warfare and a war of attrition. Yet as the Russian industry was booming in 1914, as we have seen, the Russian military did not face immediate shortages. Rather it faced administrative problems of logistics and inter-service coordination, like between infantry, cavalry and artillery units. Hence the alleged “shell-shortage” and the shortage of rifles were more of a political football used for intrigues between generals and for political infighting. Also, most heavy guns were used as fortress artillery in obsolete fortifications (where they were often captured in abundance by the Germans) and missed for the needs and protection of infantry.²⁸ The over-reliance on horses, both for the draught of guns and supplies and for the cavalry, meant that scarce railway stock had to be devoted to them and their voluminous fodder needs. All this restrained the mobility of troops and the difficulty to move reserves either

²⁷Bengt Jangfeldt. «Die alte Liebesgöttin trifft sich mit Merkur» *Frankfurter Allgemeine* 2.12.2019.

²⁸Norman Stone. *The Eastern Front 1914–1917*. London: Penguin 1998, p. 32.