

# The New York Times

## The Raw Face of Capitalism, Kremlin Style

By CHRYSTIA FREELAND

NEW YORK — For anyone who ever hoped Russia could become a liberal, free-market democracy, the grim trial last month of Mikhail B. Khodorkovsky, the former oil tycoon who was once his country's richest man, offered a slender solace: it was widely and loudly condemned.

David Remnick, editor of *The New Yorker*, compared the prosecution to that of the poet and Nobel laureate Joseph Brodsky. Joe Nocera, writing about the business and economic consequences in *The New York Times* (whose global edition is the *International Herald Tribune*), described the Kremlin's tactics as "boneheaded." Secretary of State Hillary Rodham Clinton warned that the case would "have a negative impact on Russia's reputation," and particularly on its "investment climate."

What was notable about this chorus of foreign criticism was the implication that, even judged by the Kremlin's own standards of *realpolitik*, the treatment of Mr. Khodorkovsky was a mistake. Moscow's leaders want to restore Russia's wealth and greatness: Western assertions that the Khodorkovsky trial had hurt Russia's reputation and would discourage foreign investment suggested that the Kremlin was harming its own cause.

But some investors, economists and political analysts are drawing a different, and much starker, conclusion: The Khodorkovsky verdict was an inevitable and logical act of self-preservation by a regime that is fully and lucratively in control of Russia.

In this reading, there is nothing accidental about Mr. Khodorkovsky's continued imprisonment. It is, instead, the clearest possible statement of the rules of Kremlin capitalism, and of Prime Minister Vladimir V. Putin's confidence that, at least as long as Siberia has oil, there is plenty of private capital willing to play.

"Within Russia, everyone who matters understands exactly what the Kremlin is trying to say: that there is no one above the rule of the Kremlin," said Roland Nash, co-founder of Verno Capital, who is a 16-year veteran of doing business in Moscow.

The message, according to Sergei Guriev, one of Russia's leading economists and rector of the New Economic School, is this: "It is to show that Putin is fully in control. It is not a question of Khodorkovsky getting out of jail, it is a question of other businessmen not following in Khodorkovsky's footsteps."

Ian Bremmer, author of a recent book on state capitalism and president of the Eurasia Group, a global political risk and consulting firm, said the verdict was "rational" and "predictable."

"If you are in a sector the state cares about in Russia," he said, "you either play ball with the Kremlin, or you leave."

Mr. Nash did remark that the Khodorkovsky case had exacted a real, quantifiable economic cost. "The Russian equity market would be worth several hundred billion dollars more if it weren't for the critical Western perception of Russia, and the Khodorkovsky case is the principal example of that perception," he said.

Critics of Putinism, especially Western ones, like to point to this lost value as proof that the treatment of Mr. Khodorkovsky and the authoritarian politics that his case represents are a mistake. But that analysis, according to Mr. Guriev, a liberal who laments the path Russia has taken, leaves out the essential political calculus of Putinism.

“Economic growth per se is not important to a ruler, if he is not there to enjoy it,” Mr. Guriev said. “Better to stay in control of a stagnant, but large and rich, country than to be kicked out of a growing one. Everyone wants a bigger cake, but better a small cake than none at all.”

And while the Russia cake is surely not as big as it could be, it’s big enough, and growing steadily: Gross domestic product increased 3.7 percent last year, worse than China’s red hot 10.5 percent, but better than the United States’ 2.6 percent. The Russian stock market rose 22 percent in 2010.

One reason the cake is still big enough for Mr. Putin and his allies is that many foreign investors are still willing to tolerate an economy run according to Kremlin rules.

“I haven’t talked to one corporation that used the Khodorkovsky trial, as opposed to corruption more generally, as a factor in their investment decision,” Mr. Bremmer said. Companies in extractive industries, still the dominant sector in the Russian economy, are accustomed to dealing with all kinds of governments. Playing by the authoritarian logic of state capitalism, in Russia and elsewhere, is familiar, even reassuring, he suggested.

Emerging-market investors have similar experiences. As the flows of capital among emerging markets — rather than between emerging markets and the West — become more important, so does tolerance for Russian, or Chinese, or Middle Eastern state capitalism.

“There is a much better understanding of the nuances and the differences in the rules of the game in the emerging world than there is in the developed countries,” said Mr. Nash, whose biggest investor is from Abu Dhabi. “There are now sources of capital that don’t care so much about issues like the Khodorkovsky trial.”

But while the Kremlin is clearly unmoved by foreign criticism of Russia’s human rights record and even of its investment climate, it is increasingly worried about one thing: innovation. Mr. Putin’s Russia is complacent about its ability to attract capital, but it is panicked about its capacity to come up with cutting-edge technologies.

Daron Acemoglu, a Turkish-born professor at the Massachusetts Institute of Technology who specializes in the relationship between political systems and economic growth, believes that in the long run, this will be the big test for today’s swaggering, authoritarian regimes: “Can China and Russia create their own Silicon Valleys? That is the hard constraint these systems face.”

Even as Mr. Khodorkovsky goes back to jail, another oligarch, Alisher B. Usmanov, and his partner Yuri Milner are raising, via Digital Sky Technologies, their stake in Facebook. And another billionaire, Viktor Vekselberg, has been charged with constructing Skolkovo, which the Kremlin dreams will be its version of Silicon Valley. To judge the longevity of Kremlin capitalism, watch his efforts.

*Chrystia Freeland is global editor at large at Reuters.*

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