

# Empathizing with Gogol

June 2012

*"You can't imagine how stupid the world has grown nowadays. The things these scribblers write!"... "However stupid a fools words may be, they are sometimes enough to confound an intelligent man"*

**Nikolai Gogol, *Dead Souls***

Fourteen years ago today I arrived in Moscow. I had every intention of staying only a couple of years before returning to South East Asia, from where Bernie Sucher persuaded me to leave a comfortable existence in a city where you could actually see the sun all year round, for a "Moscow adventure". Today I am a fully paid up member of that group of foreigners who came with the intention of staying only a short time but who actually found themselves addicted to the Russia soap-opera. As with all good soap-operas, you always want to see what happens in the next episode.

For all of the past fourteen years I have lived in the same neighborhood of Moscow. My first apartment had a view of the north-east section of Patriarshiy Prudi (the Patriarch's Ponds), the spot where, in Bulgakov's *The Master and Margarita*, the Devil appeared to the literary critic Berlioz and where the latter subsequently lost his head under a tram. It's amazing how one tends to look left and right a bit more often before crossing that particular junction. Also for much of those fourteen years my journey to either the metro station or, since returning to Troika Dialog late last August, directly to the office, has involved walking past the statue of Nikolai Gogol, set in the small courtyard of the house at the junction of Nikitsky Boulevard and Novy Arbat where Gogol lived his last four years and where he died.

A picture of the statue is placed at the end of this note and, as you can see, it is of a very depressed looking Gogol. It was originally placed at Gogolevsky Boulevard, i.e. further towards the river and beside the Cathedral. It is reported that people were stunned into silence when the statue was unveiled in 1909 because instead of the dignified image of the literary genius they were used to they saw what one commentator wrote at the time "a heartsick figure muffled in the raincoat and grieving on the verge of despair". During Stalin's reign the statue became such a symbol of national despair that Stalin eventually had it removed from sight in 1951. Several years after Stalin's death the statue was placed at its current location. One of the features of the statue is that, like a painting, the eyes appear to follow you as you walk around it. Not so much an admonishment to "stay off the grass" – more a "you're doomed" look.

The reason I mention this statue is that, with the exception of the coldest weeks in mid-winter, the daily sight of the writer's misery actually cheered me up. After all, is not modern Russia not a world apart from Gogol's Tsarist Russia or the Soviet-era? The rationale also extended to a firmly held conviction that despite several crises and a near relentless stream of negative headlines, at its core Russia was actually evolving relatively well and following a progression not too dis-similar to that seen in many other developing economies. Of course with accelerated volatility and excesses in such areas as corruption on account of the over \$1.7 trillion oil and gas export earnings injected into the economy in that period. A not unreasonable assumption being that if Gogol were alive in 21<sup>st</sup> century Russia he would be much more cheerful.

## Maybe Gogol had a point?

In recent months I have become less dismissive of Gogol's viewpoint and while not yet at the point of despair, the atmosphere in Moscow and also towards Russia by investors has changed. There is a lot less optimism about the future than has been the case at any time over the past fourteen years. There is a sense that what we saw over the winter months, i.e. the protests and political changes, is just the first phase of the next major transition in the country. Despite the Kremlin's expected efforts to maintain stability and a status-quo, conditions are now in place to force further changes in the coming years. While the consensus view is that Russia faces another crisis, indeed needs another crisis, in my opinion it is not that clear whether the next transition phase will be as the result of an economic-political crisis or whether the measures adopted to avoid a crisis will actually provide the route-map for transition.

The one thing that both pessimists and optimists agree on is that simply relying on a 'muddling through' strategy probably has a shelf-life of three to four years before conditions for another political crisis arise.

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## Putin returns to a different Russia

My time in Russia has roughly over-lapped with Putin's presidential terms, including his sabbatical over the past four years. Sabbatical is hardly the correct description as he clearly continued to call the shots concerning all major decisions. Now he is formally back in the Kremlin but with a changed situation to deal with. There are very obvious differences between Russia in the aftermath of the 1998-'99 crisis and where we are today but in many ways what's at stake is just as important. Critics of my viewpoint will quickly, and quite correctly in many instances, point out areas of the economy that are booming and where investors are making good money. Even in the much publicized BP-AAR dispute, BP, from an investment of \$7 bln in 2003, has already taken out \$19 bln in dividends and may sell its equity for \$25 - \$30 bln according to recent reports. For sure the rising oil price in the period has been a very significant factor in that gain but still, BP's Russia investment has been much more profitable than may have been achieved anywhere else on that scale. Companies operating in Russia's auto sector and across other parts of the consumer and services economy also have mainly positive experiences to relate.

But the main factors that have changed are people's expectations and tolerance and investor's perception of Russia risk. In 1999 the country was still coming out of the post-Soviet period, average monthly wages were \$50, inflation was in double digits and the total value of the economy was just under \$200 bln. Today average wages are close to \$800 p/m, inflation is on course to end this year either side of 5% and the economy is valued close to \$2 trillion. Balanced against that success is the huge growth in corruption, relatively little political development, a surge in crony capitalism, a much more dominant state and a still difficult business environment (on average).

## Needs a new economic model

People expect more and investors fear that further economic and political instability. The problem is that the "old" economic model, i.e. which sustained the strong economic revival from 1999 and strong public support for Putin, relied heavily on extractive industries. That model is no longer capable of delivering the annual growth of 5-5.5% required to meet people's expectations over the next six years. The economy now needs a new model based on a broadening of growth in industries outside of extractive industries, greater efficiency gains and an easier environment to foster the development of small and medium sized enterprises (SMEs).

The equation to facilitate that is reasonably straight forward; there needs to be an end to capital flight and an increase in FDI and Russia sourced investment; there needs to a greater involvement of foreign companies in the economy. For that to happen there needs to be an improvement in the perception of Russia risk and of the actual business environment. For that to happen there needs to be progress in reducing corruption and improving the rule of law. As straight forward as it is difficult.

That's not to say that I believe, as undoubtedly Gogol would, that this is all going to end in tears. Far from it. The pressure for change may just as easily finally force accelerated reforms and a breakthrough in tackling such seemingly entrenched problems as corruption, poor legal enforcement and the often difficult business climate, especially for the SMEs.

## Current phase of evolution in context

The pros and cons of that argument are well thrashed out in our regular formal publications so I am not going to re-state them here. That is not the purpose of my small reminiscence of fourteen years. More detailed reminiscences and thoughts will have to wait for the book. This is more an attempt at placing the current phase of Russia evolution into a better big-picture context. And in that regard there are plenty of positives and negatives to balance off against each other. Right now the stock market is betting heavily on a negative outcome or, at least against a positive outcome. In that past that has always been a dangerous assumption. One afternoon in January 1999 I recall stubbornly pounding the streets of central Moscow in search of a Mars chocolate bar. Optimism on that bitterly cold Saturday afternoon was in very short supply. These days one would simply take solace in the coffee shop of the Ritz-Carlton or another of the many well-appointed hotels, restaurants and bars in the city.

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## Does Putin's return ensure crisis or reform?

So what of Putin's return? That factor is certainly the top of the pessimist's list of negative issues. That list assumes no real reform progress; continued crony-capitalism; no reduction in corruption; no material improvement in how investors view Russia risk and a government policy agenda aimed solely at maintaining the status-quo via higher budget spending for social projects, public service worker salaries and pensions.

That essentially is the basis of the pessimist's assumption that Russia is now on a course that will see the next, and more serious, wave of political crisis. The further assumption being that "muddle-through" economic management cannot be sustained for more than a few years, especially if oil were to trade below the budget break-even price for an extended time period. The crisis scenario also assumes that the political opposition, which was not much more than a collection of opportunists in the December-March period will be better organized in time for the next Duma elections in December 2016. Also, from January next, Russia returns to the direct election of regional governors. Those governors recently appointed by the Kremlin will start to face re-election from late 2015. The next phase of political opposition may well be in the regions and associated with these elections.

## There is another side to the argument

The other side of the coin is that the removal of the oil comfort-blanket will actually act as a catalyst for faster change because the need for significant reforms is now much more obvious and the consequences of not delivering them are also a lot clearer.

I also believe it is wrong to assume that Putin is not in favor of change. It is important to recall the few strong convictions that we have consistently heard from Putin over the past thirteen years. Let me say straight up that this is not to imply that I believe that Putin's administrations have been following any sort of worked out plan over those years - far from it. The evidence is more compelling that that more often than not government actions have mainly been a knee-jerk response to a series of external events and domestic crisis.

But there are a number of convictions which can be observed from Putin's speeches and actions over the past thirteen years and which offer some guidance on what we may expect next

- Putin said he believes that the shock-treatment tactics of the 1990's were a complete disaster. He has repeatedly said that Russia's evolution should be carefully managed with only small steps and in a pre-determined sequence. No great leap-forward here.
- He said in 2002 that he believes Russia needs to evolve towards a European style economic, social and political model but over a 20 to 25 year time frame.
- He also stated during his first presidential term that it is important that there should be a stable political leadership during the country's transition and repeatedly stated/implied that he believed this was one of the reasons why such countries as Singapore had developed so successfully. Lee Kuan Yew served as Prime Minister in Singapore from 1959 to 1988 and Senior Minister, later Minister Mentor, since 1988 until mid-last year.
- Putin also stated – during his first trip to China - that he believes that the state should have strong control, either regulatory or by direct ownership, in the industries/companies most important to the country's strategic political and economic interests. In particular he has harbored an ambition to create one large state-controlled holding in the energy sector. That was attempted in late 2003 and now is back on the table with Rosneftgaz.

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## Is there an evolutionary sequence?

So, while the pessimist is now fully convinced that nothing material will change until the inevitable next crisis occurs, most likely in 2016, the optimist may set out a different rationale based on the sequence of priorities from Putin's previous presidential terms and then extrapolating forward based on Putin's 20-25 evolutionary conviction.

**Term 1:** the only priority was to restore state control and to rid the system of the influence of political opposition, the oligarchs and foreign NGOs. The major economic achievement, i.e. apart from creating domestic stability, increasing budget spending and sharply cutting sovereign debt, all of which led to steady economic growth, was the simplification of the tax system. We also got crony-capitalism, an increase in corruption and an increase in reported incidents of aggressive actions against foreign direct investors

**Term 2:** the originally stated objective for term 2 was to start using the sharply higher oil and gas tax revenue to help foster growth across the rest of the economy. That didn't happen. Instead we got Yukos, Sakhalin and a focus on state control over so-called strategic industries. There was actually almost no economic pressure to push ahead with other reforms as the strong surge in the oil price blanketed everything else. Problems with corruption and the business environment generally got a lot worse and were mainly unchecked.

**Medvedev's term:** that was heralded as the start of the phase to finally develop the broader economy and to attract a larger volume of investment and active direct foreign investors. The premise being that, albeit in a clumsy fashion, the rules of the game for investing in Russia had now been clarified. Medvedev's plan was certainly expansive, comprehensive and probably unrealistic. As it turned out we never got a chance to find out as the quick collapse in the oil price and the global economic crisis first led to a serious debt crisis in Russia and then recession. Since then it was a case of batten down the hatches and waiting.

No doubt the fact that optimism increased so much during the 1<sup>st</sup> of 2008, as oil revenues surged and people assumed that the Medvedev presidency would mark a real turning point, but was so quickly reversed is one of the contributory factors to the high level of pessimism today. The RTS hit a peak of around 2,550 in May of that year only to fall below 500 by end the following January.

## Several very important events during Medvedev's term

Apart from the stock market collapse and the recession, the more important events that took place during the Medvedev term, i.e. in terms of affecting policy priorities for this government (hopefully) included the worker protests against the lack of state reforms in 2009 (St Petersburg, Tolyatti, Far East) as they lost their jobs or had wages cut/delayed; the explosion at the hydro-electric plant in August that year, which exposed just how fragile is the country's infrastructure and how little investment had been made for the past thirty years; the agriculture failure the following summer, which also showed almost medieval practices in the sector and caused a shock as people realized just how much food was being imported into a once food exporting country; and finally the public frustration against corruption and slow political reforms from last December.

In my opinion, these are amongst the important factors that have shaped a different Russia at the start of Putin's new term. One can read into that a justification for pessimism, i.e. nothing will materially change and people's frustration will boil over again whether quickly or in 2016. The Gogol scenario. One can also interpret these events as a reason to hope for real change, i.e. as otherwise those in power today can also calculate the threat down the road. That is one reason for the much softer police handling of the June 12<sup>th</sup> protest. The Kremlin does not want to provoke another, potentially more serious, round of street protests.

Only time will tell us. But, as is the case in all addictive soap-operas, you can't assume anything and you are compelled to tune into the next episode.

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## There's always a demon

Demonic figures have been a regular feature of Russian literature. Apart from Bulgakov's *Master and Margarita*, Gogol used this theme in his work *Petersburg Stories*, Dostoevsky in the *Brothers Karamazov* and Lermontov in *The Demon*. It is fitting somehow that the devil should also have had a role in Gogol's death. Gogol blamed the devil for forcing him to burn the only manuscript of the second part of *Dead Souls* in February 1852. In the house next to where the statue sits today. He was so distraught at what he called the devil's practical joke that he refused all food and water from that day and died nine days later.

The image on the statue, therefore, is a very fitting reflection of how the mood of the writer changed in the ten years since he published the *Dead Souls*. He was in self-imposed exile at the time, in Rome, to where he fled after the Tzar commented, reportedly with no menace intended, that Gogol's famous play, *The Inspector General*, "*Gets at everyone, and most of all at me!*"

That was the trouble with Gogol; he took such events and comments far too personally.

## Gogol's 'verge of despair' statue outside the house in which he died



**Bad omen?** The start of summer in Moscow 2012 – the green mist (below) is concentrated pollen as the trees and flora came to life at the same time. May is usually such an optimistic month in Moscow. This year it was a miserable place. Meantime the weather in South East Asia remains pleasant as always. Bernie Sucher has a lot to answer for!

