

# North Caucasus: The Challenges of Integration (IV): Economic and Social Imperatives

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## *Executive Summary*

For two decades the North Caucasus conflict has been among Europe's deadliest. Victims are less, 1,149 killed or wounded in 2013 to 525 in 2014, but risks associated with growing Islamic State (IS) influence in the insurgency are high. Leaders of the former al-Qaeda associated "Caucasus Emirate", which has done attacks in the region and terrorism countrywide since 2007, are swearing allegiance to IS. Counter-insurgency remains heavy-handed. With Russia's economic crisis becoming acute, conflict may be entering a new stage. Violence is often seen as feeding on religious, ethnic and historic tensions, but causes are more complex. Russian authorities and local elites must debrutalise counter-insurgency, free electoral processes, bring accountability and transparency to government, end impunity for official corruption and bureaucratic malpractice and improve services. Islamist and jihadi projects in the region largely respond to social inequality, corruption and failing social services. Addressing these issues is essential to reduce the risk of a new surge in deadly violence and insurgency.

The region's economy was crushed by the collapse of the Soviet Union and ensuing ethnic and sectarian conflicts. The six national republics of the North Caucasus Federal District (NCFD) remain heavily dependent on central state funding. State institutions are responsible for most economic output and jobs; levels of unemployment are Russia's highest. Industry has shrivelled, insecurity and terrorism cramp economic growth, and extortion frightens off both foreign and local investors.

In recent years, the federal government has invested generously in the region's economies and social services. Government funding has ensured a certain level of consumption and social services but has not been conditioned on improving governance, so is much less effective than planned. Funds were embezzled, often fuelling conflict. In 2014, as the need to replace self-sanctioned European imports with domestic goods brought additional attention to North Caucasus agriculture and industry, the government promised to significantly increase financial support. Steps to combat corruption, clanship and organised crime in official institutions since 2013 are positive but should be reinforced prior to significant additional state investment.

The North Caucasus societies have tried to adapt to the region's economic challenges through self-employment and an informal economy. Agriculture has developed significantly but is held back by land disputes, inadequate infrastructure, corruption in disbursement of state funds and credits and a lack of processing and logistical facilities. Land privatisation would likely boost growth, though it can be a source of conflict if not carried out effectively and fairly. Large projects like hydroelectric power stations, factories and resorts fuel discontent if not carefully planned to avoid destroying local ways of economic subsistence and shifting ethnic and economic balances. Targeted support for small business is needed, especially in multi-ethnic areas with high unemployment. Special attention must be paid to improve socio-economic conditions in east Caucasus mountain areas that are underdeveloped and often home to insurgent groups.

Quality of life is much lower than elsewhere in Russia. State-organised services like heating, water and electricity are badly run. High birth rates overwhelm already under-equipped health care and education infrastructure. Recent health-care invest-

ment resulted in visible improvements, but there is still an acute lack of polyclinics, hospitals and professional medical cadres. Health care is mostly free, but patients are commonly expected to pay bribes for treatment and medicine. Along with increased religiosity, this has drawn more people to private Islamic medical centres, especially in the east of the region.

Education should play a major role in the region's integration and conflict management: kindergartens help children learn Russian, while teaching ethnic languages buttresses local cultures and defuses minority grievances. However, overcrowded North Caucasus schools must operate in multiple shifts, and parents face significant expenses despite the formal free-education policy. Religion classes can prepare children to resist extremism but often impose beliefs. Secular education is contested. Funding for education increased in recent years, but much money is diverted, and quality is falling due to corruption and de-professionalisation of teachers.

The fundamental obstacle to change – and a major contributing factor to insurgency – remains corruption at all levels of state administration. Bribes can purchase almost anything, including academic degrees, medical certificates, jobs and driver's licenses. Endemic corruption and clanship perpetuate the rule of regional elites whose main virtue is loyalty to the federal centre. This increases citizens' alienation from the state and promotes the search for alternatives, including an Islamic state and jihad. In recent years, moreover, insurgents' primary capital has come from extortion of officials and businesses linked to the public sector. Until corruption is confronted, including at the federal level, additional government funding will have little impact on socio-economic problems.

Popular frustration with this state of affairs is a major conflict driver. The authorities are perceived as unable to solve either structural concerns or daily problems. Many feel local elites have privatised the state. Those who want better services try to leave, increasing pressure on neighbouring regions and Russia's big cities. Many problems analysed in this report are serious challenges for Russia in general but visibly more dramatic in the North Caucasus. The situation is further complicated by alternative concepts of statehood. Islamists instrumentalise social problems and offer a state based on Sharia (Islamic law) that they say will be better equipped to deliver social justice. Unresolved social problems and ineffective institutions contribute significantly to the appeal of Islamist ideology, erode trust in the state and are a major reason why the conflicts are so difficult to solve.

This is Crisis Group's fourth and final report in its introductory series on the region, rounding out a comprehensive survey of the root causes of the conflicts.

## *Recommendations*

### *To improve the quality of social services*

#### **To the government of the Russian Federation:**

1. Allocate funds and control their distribution to implement federal free-education and health-care policies effectively.
2. Launch a vigorous campaign to train medical staff, including outside the region; and focus immediately on improving pre-natal health care.
3. Support secular education in state schools, while ensuring individual freedom of conscience, also in private schools.
4. Increase control over management of housing and provision of utility services.

### *To advance socio-economic development*

#### **To the governments of North Caucasus republics:**

5. Focus on legalising the shadow economy and strengthen vocational education programs.
6. Take extra care with mega-projects that shift ethnic or economic balances and destroy traditional ways of economic subsistence.
7. Design and implement a security policy that protects businesses from extortion by insurgents.
8. Pursue effective, fair privatisation of state land where it has not yet occurred.

#### **To the government of the Russian Federation:**

9. Consider allowing elements of Islamic banking in the North Caucasus so as to improve trust in banking services.
10. Continue efforts to rebuild the Chechen economy; intensify clearing of all land-mines in Chechen mountain areas close to settlements, pastures and farms; and conduct an independent feasibility assessment of current and proposed large projects in the republic supported by the state budget.
11. Adopt a federal law on remote mountain territories to facilitate their development, and support relevant republic programs, while carefully assessing their feasibility.

#### **To the governments of the Russian Federation and the regional republics:**

12. Offer long-term low-interest credits to farmers and small businesses; target more support to small and medium-size businesses in areas of ethnic conflict and tensions; and reduce administrative hurdles and simplify reporting requirements for small businesses.
13. Review the onerous laws on individual entrepreneurs' social security payments to encourage them to hire and operate openly.

*To fight corruption and criminal business activity*

**To the government of the Russian Federation:**

14. Take more vigorous, transparent, and non-partisan steps to investigate and, if necessary, prosecute officials of all ranks suspected of corruption, including in all republics and at the federal level.
15. Support security service efforts to investigate and prosecute economic crimes and increase federal investigators' involvement.
16. Make consistent efforts to ensure that recruitment to the civil service is open and based on merit and relevant laws.

**To the governments of North Caucasus republics:**

17. Root out illegal practices, including corruption, in medical universities and health care, especially in perinatal facilities; in the granting of disability status and allocation of quotas for technologically advanced treatment; and in the Unified State Exam.

**Brussels, 7 July 2015**

# North Caucasus: The Challenges of Integration (IV): Economic and Social Imperatives

## I. Introduction

The armed conflict in the North Caucasus remains among Europe's worst.<sup>1</sup> While for many years attacks by the Caucasus Emirate, recognised as a terrorist organisation by the UN and U.S. as well as Russia, were the most visible expression, the conflict has been transformed feeding on inherent contradictions and problems.<sup>2</sup>

In 2015, the Caucasus Emirate's appeal has been superseded by the ideology of the Islamic State (IS), which announced its intention to establish control over the region in September 2014.<sup>3</sup> Two months later, the leader of Dagestan's Aukh militant group swore allegiance to the IS leader, Abu Bakr al-Baghdadi, initiating a trend.<sup>4</sup> The next month, the leader of the Dagestan insurgency, Abu-Mukhammad (Rustam Asilderov), swore allegiance, followed, on 12 June 2015, by Chechnya's Aslan Byutukayev. He was followed in turn nine days later, in a joint audio-recorded statement, by Islamist insurgents from Dagestan, Chechnya, Ingushetia and Kabardino-Balkaria (KBR). On 23 June, the IS press secretary announced a new "governorate" in the North Caucasus and appointed Dagestan's Rustam Asilderov (Abu Mohamad al-Qadari) as its amir.<sup>5</sup>

The security risks associated with IS taking root in the North Caucasus are a new challenge to the social policies of the Russian government. Unlike al-Qaeda, which mainly garnered support by criticising the existing regimes, IS offers a "positive" agenda directly linked with its social project, the utopia of social justice, equality, welfare and an effective Islamic state.<sup>6</sup> In the current conditions of economic crisis, social protest may be channelled through radical Islamist ideologies, including the growing popularity of what is still only a marginally relevant IS.

The first three reports in Crisis Group's introductory series on the challenges of integrating the region into the Russian Federation analysed the root causes: tensions and historical grievances between multiple ethnic groups; disputes over administra-

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<sup>1</sup> At least 1,149 were killed and injured in 2013 and 525 in 2014 (the former figure includes victims of terrorist acts in Volgograd). "Инфографика. Статистика жертв на Северном Кавказе за 2010-2014 годы по данным Кавказского Узла" ["Infographics: Statistics of victims in the North Caucasus in 2010-2014 according to the Caucasian Knot's data"], Caucasian Knot, 17 February 2015.

<sup>2</sup> These include unresolved ethnic tensions and grievances, territorial disputes, fundamentalist-traditionalist (in the east mostly Sufi) sectarian conflict, heavy-handed anti-insurgency, bad governance, economic inequalities and corruption.

<sup>3</sup> "ISIS threatens to 'liberate' Chechnya, Caucasus", Russia Today, 3 September 2014.

<sup>4</sup> Security officials estimate Russian citizens fighting in Syria and Iraq at 2,000 to 5,000. "До 5 тысяч россиян воюют на стороне Исламского государства" ["Up to 5 thousand Russians fight in Syria at Islamic State side"], *Kommersant*, 17 June 2015.

<sup>5</sup> "Russia's Caucasus Islamists 'pledge allegiance' to IS", Agence France-Presse, 24 June 2015. "За 8 месяцев ИГ не организовало ни одной атаки на Кавказе" ["IS has not made an attack in the Caucasus for 8 months"], Caucasian Knot, 26 June 2015.

<sup>6</sup> "Контурная карта" ["Contour map"], *Kommersant-Vlast*, 29 June 2015.

tive boundaries; sectarian conflict between Sufi and Salafi Islamist believers; religious groups' creation of parallel realities and alternative institutions; the state's failure to ensure fair political representation and elections; lack of an independent judiciary and effective policing; absence of accountability, which allows local strongmen to capture power and resources; and a population caught between terrorism and heavy-handed counter-insurgency measures.<sup>7</sup>

This concluding report analyses economic and social issues, including corruption, that underlie many of the conflicts. President Vladimir Putin has acknowledged that economic development and quality of social services in the region are significantly lower than the national average; he also has noted that it has the highest unemployment, "especially among youth, and we know that this is a fruitful soil for various extremists".<sup>8</sup>

The North Caucasus has great socio-economic potential thanks to isles of growth, natural resources and entrepreneurial people. Conflict, terrorism and acute institutional problems hold it back. Chechnya's economy and infrastructure were almost destroyed during two wars, while development elsewhere has significantly lagged behind existing needs and high birth rates.<sup>9</sup> Half the region's schools operate two or three shifts per day, and only 40 per cent of the required kindergartens exist. Ingushetia satisfied only 55 per cent of its demand for schools in 2014, while Dagestan lacks one third of needed hospital beds.<sup>10</sup> Most republics are highly dependent on central government funds: the 2015 subsidy level ranged from 48.1 per cent of the republic's budget in Kabardino-Balkaria (KBR) to 85 per cent in Chechnya.<sup>11</sup>

A development strategy through 2025 was set out in 2010 by the office of Aleksandr Khloponin, then the presidential envoy in the North Caucasus Federal District, the region's administrative supra-unit.<sup>12</sup> This "Khloponin plan" aimed to support self-

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<sup>7</sup> The main indigenous groups are Adyghe, Avars, Balkars, Chechens, Circassians, Dargins, Ingush, Kabardins, Karachays, Kumyks, Laks, Lezgins, Nogays, Ossetians, Russians, Tats and Shapsugs. The most homogeneous republics are Chechnya and Ingushetia, the most diverse Dagestan, with over 30 ethnicities. See Crisis Group Europe Reports N°s 220, 221, 226, *The North Caucasus: The Challenges of Integration (I), Ethnicity and Conflict; (II), Islam, the Insurgency and Counter-insurgency*, both 19 October 2012; and *(III), Governance, Elections, Rule of Law*, 6 September 2013.

<sup>8</sup> "Путин: В СКФО похитили 6,5 млрд бюджетных средств" ["Putin: 6.5 billion [roubles] have been stolen from the budget in NCFD"], *Rossiyskaya Gazeta*, 9 September 2013.

<sup>9</sup> The region has Russia's highest birth rates, especially Chechnya and Ingushetia (29 and 27 per 1,000 persons respectively). "Замуж на Чукотку, рожать в Чувашии. По рождаемости и выживаемости в России по-прежнему впереди Северный Кавказ – таковы данные нового атласа "Здоровье России" ["To get married in Chukotka, to give birth in Chuvashia. North Caucasus still takes the lead in births and survivability in Russia – this is the information given by the new 'Health Atlas'"], *Gazeta.ru*, 2 August 2013.

<sup>10</sup> "День знаний в СКФО: в регионах отмечается нехватка школ" ["The knowledge day in the NCFD: school shortage is registered in the regions"], *Caucasian Knot*, 2 September 2014.

<sup>11</sup> "Парламент Чеченской Республики принял Закон ЧР 'О республиканском бюджете на 2015 год и плановый период 2016 и 2017 годов'" ["Parliament of the Chechen Republic adopted the ChR law 'On the republic's budget for 2015 and planned period of 2016 and 2017'"], website of Chechen Republic's head and government, 29 December 2014; "В Кабардино-Балкарии бюджет на 2015 год принят с дефицитом в 2,9 млрд рублей" ["In Kabardino-Balkaria the budget for 2015 has been adopted with a 2.9 billion roubles deficit"], *Nat Press*, 7 January 2015.

<sup>12</sup> The North Caucasus Federal District was created in 2010 to administer seven federal units: Dagestan (2.71 million people), Stavropol Kray (2.7 million), Chechnya (1.27 million), Kabardino-Balkaria (860,000), North Ossetia-Alania (705,000), Karachay-Cherkessia (469,000), and Ingushetia (464,000), North Caucasus Federal District website.



sufficiency, decrease dependence on subsidies and encourage integration into the national and world economies.<sup>13</sup> According to experts, it mainly stipulated large-scale projects, but hopes to attract investors have failed, and today it has virtually lost its relevance<sup>14</sup>. Analysts note that state funds are often wasted, embezzled or feed “the market of violence”.<sup>15</sup> Putin has acknowledged that “the situation in the North Caucasus improves too slowly”.<sup>16</sup>

Parties to the armed conflict, whether security personnel or insurgents, profit from this market of violence by selling security, including protection from themselves, or assisting in violent practices.<sup>17</sup> Police and security services receive commissions, and insurgents impose levies on officials and businessmen. Russian officials acknowledged in 2011 that over 90 per cent of insurgency funding was locally generated.<sup>18</sup> The stakeholders are entrenched in the system, support the rules of the game and block any innovation that threatens their interests. This makes real reform and conflict resolution exceedingly difficult.

Regional budget deficits had been rising since 2013, but consumer prices went up significantly when Russia’s economic crisis hit in 2014, causing cuts in welfare, social services and costly government projects.<sup>19</sup> If this trend continues to the point that the federal centre can no longer provide the North Caucasus with a sufficient living standard and buy the loyalty of local elites, tensions are likely to worsen. On the other hand, government officials argue that Western sanctions and Russia’s ban on importation of Western food products over the crisis in Ukraine could be turned into an opportunity for the North Caucasus, which is seen by the government as one of the regions with greatest potential to meet the new priority for “import-replacement” (импортозамещение). This has stimulated a public discussion on and government promise to address systemic problems in the regional economy and agriculture.<sup>20</sup>

<sup>13</sup> “Стратегия социально-экономического развития Северо-Кавказского федерального округа до 2025 года” [“Socio-economic development strategy of North Caucasus Federal District to 2025”], Presidential envoy website, 6 September 2010.

<sup>14</sup> Crisis Group interview, Mikhail Chernyshov, senior researcher, Institute of Market Problems, Russian Academy of Sciences, and Denis Sokolov, director, Ramcom research centre, Moscow, May 2015.

<sup>15</sup> Crisis Group interview, Denis Sokolov, director, Ramcom research centre, Moscow, October 2013.

<sup>16</sup> “Владимир Путин провёл расширенное заседание Совета Безопасности ...” [“Vladimir Putin held a broadened session of Security Council ...”], video available at <http://youtu.be/YjrEywOX3XA>.

<sup>17</sup> “[Ingushetia insurgents] know the republic’s financial affairs better than the finance minister”. Crisis Group interview, defence lawyer, Ingushetia, July 2013.

<sup>18</sup> “Хлопонин: На Северном Кавказе осталась тысяча террористов” [“Khloponin: About 1,000 terrorists remain in the North Caucasus”], *Kommersant* (online), 30 November 2011.

<sup>19</sup> According to presidential decree 597 (7 May 2012) “On implementation measures of state social policy”, salaries of doctors, university faculty and researchers should reach 200 per cent of the region average by 2018 and school teachers’ salaries should already have reached the region’s average by 2012. Kabardino-Balkaria’s budget deficit for 2014 was 17.8 per cent, Stavropol Krai’s 15 per cent. “Парламент КБР увеличил дефицит бюджета-2014 до 17,8% расходов с 17,4%” [“KBR parliament increased the budget deficit from 17.4 to 17.8 per cent”], Interfax, 11 September 2014; “Дума Ставрополя одобрила увеличение расходов бюджета” [“Stavropol Krai Duma approved budget increase”], *Regnum*, 25 September 2014.

<sup>20</sup> Especially promising areas are thought to be aviation, medical, pharmaceutical, radio-electronic, defence, timber and light industry. “Кавказский прорыв. Дмитрий Медведев объяснил роль СКФО в процессах импортозамещения” [“The Caucasus breakthrough. Dmitry Medvedev explained NCFD’s import replacement role”], *Rossiyskaya Gazeta*, 5 November 2014.

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## II. The Economy of the Crisis Region

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Official economic indicators rank the North Caucasus republics – especially Chechnya, Ingushetia, Kabardino-Balkaria, North Ossetia and Karachay-Cherkessia – among Russia’s most underdeveloped, with the highest unemployment and inadequate social services and infrastructure. Two wars in Chechnya and instability and conflicts in other parts of the region made the post-Soviet transition and economic crisis especially acute. Despite major federal investment and the efforts of local elites, the economy is still weak, though showed some positive signs in 2013-2014.<sup>21</sup>

The Russian government uses multimilitary Federal Programs (FPs) as a development instrument in the North Caucasus. In 2012, a new thirteen-year 2.55 trillion-ruble (\$77 billion) “North Caucasus Federal District (NCFD) Development to 2025” program was established, co-administered by the regional development, economic development and finance ministries.<sup>22</sup> The Federal Targeted Programs (FTPs), dealing with specific needs or sectors, are another instrument.<sup>23</sup> FTPs provided post-war funding for “socio-economic development of the Chechen Republic” and to support Ingushetia’s development until 2016.<sup>24</sup> A third instrument – Republican Targeted Programs (RTPs) – are used to solve specific regional issues. Karachay-Cherkessia’s youth affairs department, for example, has one to teach young people to run a business.<sup>25</sup> Ingushetia alone had 67 RTPs in 2013.<sup>26</sup>

Significant federal support has ensured stability of local economies and a certain level of social services in recent years, causing steady growth of incomes (mainly due to state-employee salaries), consumption and prices. Yet, this support has not been conditioned on improved governance. The loyalty of local elites has often reportedly been co-opted by allowing significant freedom in financial affairs, including access to loosely-controlled budget funds. Priority usually goes to big projects that, experts say, often do not support the growth of existing producers and companies and fail to

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<sup>21</sup> “Производим, но не модернизируем” [“We produce but do not modernise”]. *Kavkazskaya politika*, 19 March 2013. “Заседание Правительственной комиссии по вопросам социально-экономического развития Северо-Кавказского федерального округа” [“The meeting of the government’s commission on socio-economic development issues of the NCFD”], government.ru, 5 November 2014.

<sup>22</sup> “Госпрограмма по развитию СКФО будет стоить более 2,5 триллионов рублей” [“State program for NCFD development will cost 2.5 trillion roubles”], *Caucasian Knot*, 17 December 2012. The exchange rate used to provide U.S. dollar equivalents to figures in Russian roubles in this report is \$1:33 roubles before the end of 2014, and \$1:50 roubles from January 2015.

<sup>23</sup> For example, a transportation development FTP assists development of Makhachkala’s port, while a telecommunications FTP will be used to lay digital TV cables in the NCFD. “Стратегия социально-экономического развития Северо-Кавказского федерального округа до 2025 года” [“Strategy of socio-economic development of the North Caucasus Federal District till 2025”], *Caucasian Knot*, 6 October 2010.

<sup>24</sup> “ФЦП ‘Социально-экономическое развитие Чеченской Республики на 2008-2012 годы’” [“Federal Targeted Program ‘Socio-economic development of the Chechen Republic in 2008-2012’”]; “ФЦП ‘Социально-экономическое развитие Республики Ингушетия на 2010-2016 годы’” [“FTP ‘Socio-economic development of the Republic Ingushetia in 2010-2016’”], [www.consultant.ru](http://www.consultant.ru).

<sup>25</sup> Program for the Development of Youth Entrepreneurship, [www.molbusiness.ru](http://www.molbusiness.ru).

<sup>26</sup> “Отчет о проделанной работе отделом контроля за ходом реализации целевых программ за 2 полугодие за 2013 г.” [“Report on the work accomplished by the department controlling realisation of targeted programs in second half of 2013”], Ingushetia economic development ministry website, 29 December 2013.

create new ones, but are vulnerable to corruption.<sup>27</sup> The educated urban middle class is still small and tends to leave the region in search of more security, better opportunities and higher-quality social services. Despite visible urbanisation, the rural population is growing, especially in the east, and is largely unemployed or self-employed.

#### A. Common Features

Industrial activity in the North Caucasus shrivelled away after the Soviet Union collapsed in 1991. It has revived somewhat in Karachay-Cherkessia, Stavropol Kray and North Ossetia, but modern industrial growth is hindered everywhere by insufficient investment and market opportunity. Skilled labour is also lacking, the result of outflow of qualified local and ethnic Russian inhabitants who fled instability and conflicts, manual labour's low prestige and deterioration of vocational training.<sup>28</sup> The shortage of qualified professionals challenges both established factories and new enterprises.<sup>29</sup>

Thanks to government support and a very low base, indicators of industrial growth in the region in 2013 were the highest in the country, but actual industrial output remains the lowest.<sup>30</sup> The region's few remaining functioning defence enterprises have become a key state interest,<sup>31</sup> and companies with defence contracts, especially in the chemical industry and non-ferrous metallurgy, registered the most dynamic growth. Other large enterprises, however, have shown virtually no real growth. In July 2014, Prime Minister Dmitry Medvedev tasked the relevant ministries with preparing a new program for industrial development of the region.<sup>32</sup>

Agriculture is more developed than industry and primarily based on family households, especially in the east. Since 1991, the household farm has been a major income source for much of society. Some of the new cooperatives and other forms of unitary agricultural enterprises that partly replaced the collective farms (*kolkhoz*) abolished when the Soviet Union disintegrated, have also become drivers of growth.<sup>33</sup>

Government statistics are unreliable as many official figures are intentionally adjusted to maximise federal transfers or report regional achievements. Statistics that indicate progress in almost every field are often intentionally misleading. Indirect

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<sup>27</sup> Crisis Group interviews, Denis Sokolov, director, Ramcom research centre; Ibrahim Yaganov, horse farmer and activist, Moscow, Nalchik, July 2012. Some experts claim that these mega-projects funded by loans from government banks are the mechanism for direct embezzlement of state funds. The budgets of such projects are greatly inflated, and the projects are often never completed. Crisis Group interview, Mikhail Chernyshov, senior researcher, Institute of Market Problems, Russian Academy of Sciences, Moscow, May 2015.

<sup>28</sup> Crisis Group interview, Shakhmardan Muduev, department head, Dagestan economy ministry, Makhachkala, August 2012.

<sup>29</sup> Conference presentation, Ilya Savchenko, Stavropol Kray businessman, "The North Caucasus: The mechanisms and risks of land reform", Bekasovo, 18-19 May 2013.

<sup>30</sup> "Рейтинг социально-экономического положения субъектов РФ. Итоги 2013 года" ["Rating of socio-economic situation of the RF regions. Results of 2013"], RIA Rating Agency, Moscow, 2014.

<sup>31</sup> Dagestan's "Dagdizhel" plant produces torpedoes; North Ossetia's "Pobedit" plant will start to produce tank shells for India's army; KBR's "Gidromettelurg" plant produces tungsten. "Если бы не оборонка" ["If it hadn't been for defence"], "Expert Yug", no. 43-44 (333), 26 October 2014.

<sup>32</sup> "До конца года на Северном Кавказе будет сформирована программа развития промышленности" ["Program for development of industry will be developed in the North Caucasus till the end of the year"], ITAR-TASS, 8 October 2014.

<sup>33</sup> Denis Sokolov, "Конкуренция социально-экономических укладов: джамаат против колхоза" ["The competition of socio-economic models: *jamaat* v. *kolkhoz*"], *Frontir*, February 2013, p. 10.

indicators such as costs of housing, retail trade and real estate are more reliable.<sup>34</sup> These show that while the population is not rich, the poverty level is no longer higher than in other regions.<sup>35</sup> Quality of life varies significantly, however. Consumer monthly spending in 2014 was the lowest in Ingushetia – 4,690 roubles (\$141) per capita in September – highest in Stavropol, at 17,841 roubles (\$540).<sup>36</sup> Unemployment, the highest in the Russian federal districts, is not always adequately reflected in official statistics, but varies widely, from Ingushetia (32.4 per cent) to Stavropol Kray (at 5.1 per cent, just above the 4.9 per cent national average).<sup>37</sup>

Most rural residents are self-employed, especially in Chechnya, Ingushetia and Dagestan, where the population consists mostly of farmers or people involved in services and local transport who do not establish companies, register as individual entrepreneurs (IEs) or pay taxes.<sup>38</sup>

The official, legal economy – 1,065 billion roubles (\$32.3 billion) – depends mostly on the state, but experts say the informal (shadow) economy may be as large.<sup>39</sup> Thus, the majority of trade in Stavropol Kray's Pyatigorsk wholesale markets (Lira and Lyudmila), which serve almost the entire region, is informal.<sup>40</sup> Unregistered businesses in Dagestan manufacture shoes, produce furniture and manage nationwide transport. According to the republic's head,<sup>41</sup> its shadow sector is the country's largest. The shadow construction sector is reportedly linked to crime, including financing terrorism (jihadi groups extort money from such irregular businesses), and use of virtually slave labour.<sup>42</sup> According to Ingushetia's former deputy economy minister, 30-40 per cent of the Ingush economy is in the informal sector, including private

<sup>34</sup> "Как остановить деградацию Дагестана?" ["How to stop Dagestan's degradation?"], *Kavkazskaya politika*, 27 October 2014; "Консервированная промышленность" ["Tinned industry"], Chernovik, 15 August 2014. I.V.Starodubrovskaya and others, *Северный Кавказ: Модернизационный вызов [North Caucasus: The modernisation challenge]* (Moscow, 2011) pp. 21, 24.

<sup>35</sup> "Денежные доходы и потребительские расходы в январе-октябре 2012 года" ["Incomes and consumer spending, January-October 2012"], Stavropol Kray state statistics service; "В Дагестане взят курс на 'обеление' и выведение экономики из тени" ["A work toward ... taking the economy out of the shadows began in Dagestan"], RIA Dagestan, 10 July 2013.

<sup>36</sup> "Основные показатели, характеризующие уровень жизни населения в январе-сентябре 2014 г" ["The main indices defining the quality of life of the population in January-September 2014"], federal state statistics service. "Ставропольстат подсчитал денежные доходы населения за 2013 год" ["Stavropolstat has counted population income in 2013"], *Novosti Stavropolya*, 7 February 2014; "Минэкономразвития Ингушетии проведен анализ итогов социально-экономического развития Республики Ингушетия за 2012 год" ["The Ingushetia economic development ministry has analysed the republic's socio-economic development in 2012"], Ingushetia economic development ministry website, 5 February 2013.

<sup>37</sup> "Занятость и безработица в Российской Федерации в августе 2014 года" ["Employment and unemployment in the Russian Federation in August 2014"], federal state statistics service.

<sup>38</sup> Individual entrepreneur (IE) (Индивидуальный Предприниматель – ИП) is the status of a trader or a businessman in Russia without legal entity status. In addition to taxes an IE is obliged to make a fixed social security payment.

<sup>39</sup> Federal state statistics service. Crisis Group interview, Denis Sokolov, director, Ramcom research centre, Moscow, July 2012.

<sup>40</sup> The estimated yearly turnover exceeds 300 billion roubles (almost \$10 billion). "Министерство сельского провала" ["Ministry of agricultural failure"], *Kavkazskaya politika*, 30 May 2014.

<sup>41</sup> The chief executive position in national republics is called "head", formerly "president".

<sup>42</sup> "Послание Главы Дагестана Рамазана Абдулатипова Народному Собранию республики" ["The address of the Dagestan head, Ramazan Abdulatipov, to the Republic's People's Assembly"], RIA Dagestan, 15 January 2014. "Рабство. Современный облик Дагестана" ["Slavery. A modern image of Dagestan"], political news agency, 19 September 2014.

household activity.<sup>43</sup> Karachay-Cherkessia has a large informal wool industry, with some 2,000 workshops and turnover of more than ten billion roubles (\$300 million).

Shifting the informal economy into the legal sphere requires well-designed policy. Farmers said some of them legalised their business, hoping to receive subsidies, but while the subsidies never came heavy taxes did.<sup>44</sup> The easiest way to convince unregistered business to legalise would be to create conditions in which it is easier and at least equally profitable to do legal work. Forceful attempts would only increase alienation, unemployment and social tension.<sup>45</sup>

The federal centre and local authorities have encouraged large Russian businesses with origins in the region to invest. This works to some degree in Dagestan, where Moscow-based billionaires from the republic compete for some of its best assets, but increasingly just for sub-contracts.<sup>46</sup> Elsewhere, investors have been hesitant, due to high risks associated with the armed conflicts and administrative hurdles.<sup>47</sup>

In recent years in Dagestan, Kabardino-Balkaria and Ingushetia, the insurgency has extorted “jihad money” from businesses,<sup>48</sup> and police protection has been ineffective. A Khasavyurt resident said insurgents demanded her family to pay fifteen million roubles (\$450,000) in “jihad money”; they refused and went to police, who said they could not help and suggested a private security company (allegedly manned by the same police) at 150,000 roubles (\$4,500) per month. “We refused, and a month ago they killed my cousin, the owner of the shop, and two weeks later blew up the shop itself. Police didn’t react. It’s no surprise that most businessmen in town pay the insurgents”.<sup>49</sup> In May 2015, the Khasavyurt insurgency group published a video threatening death to all who refuses to pay them not only jihad money, but also *zakyat*.<sup>50</sup>

Extortion is a major problem for investors, a mountain region resident said:

I had a project to start a fishing farm in our village and found investors. But when this problem with the “jihad money” started, they refused ..., and honestly I was relieved. I don’t need such problems.<sup>51</sup>

Local officials see ensuring security as the main prerequisite for a favourable investment climate. “You can work for years on improving the investment climate in the region, and after each terrorist act, it goes down dramatically, and negotiations on

<sup>43</sup> Crisis Group interview, Lyubov Ozdoeva, Magas, August 2012. The informal economy also includes small business, which pays some taxes, but shows less income than it actually generates.

<sup>44</sup> Crisis Group interviews, local farmers, Ingushetia, North Ossetia, July 2013, December 2012.

<sup>45</sup> Konstantin Kazenin, “Как избавиться от кавказских ‘бумажных баранов’” [“How to get rid of the Caucasian ‘paper rams’”], Slon.ru, 20 August 2013.

<sup>46</sup> Crisis Group interview, Mikhail Chernyshov, senior researcher, Institute of Market Problems, Russian Academy of Sciences, Moscow, May 2015.

<sup>47</sup> Crisis Group interview, Eldar Tlyabichev, economic development minister, Karachay-Cherkessia, December 2012.

<sup>48</sup> Crisis Group interview, Lyubov Ozdoeva, Ingushetia deputy economic development minister, Magas, August 2012.

<sup>49</sup> Crisis Group interview, Khasavyurt, Dagestan, January 2014.

<sup>50</sup> Paying *zakyat*, the annual tax for the poor and needy, is one of the five mandatory requirements of Islam. According to this insurgent group, the tax should be paid to it, and the group would then decide on its allocation. “Ислам Абу Ибрахим закят” [“Islam Abu Ibrakhim *zakyat*”], www.youtube.com, May 18, 2015.

<sup>51</sup> Crisis Group interview, Untsukul, Dagestan, July 2013.

projects are suspended. In such circumstances Russian partners are fearful, not to mention foreign investors”, the KBR economic development minister said.<sup>52</sup>

Violence is only part of the problem. Enclaves of growth exist, and some investors are ready to come regardless.<sup>53</sup> But when security problems are coupled with high administrative costs and predatory government practices, risks become too high to bear:

Once you start making money, the predators come .... Inspection after inspection will paralyse your work; then they will tell you that for some small violation they will have to freeze your accounts for a few months during the hot season. You give up and offer a bribe.<sup>54</sup>

Understandably, private investment in the region is hardly half the national average.<sup>55</sup>

As a result of the weakening of the state’s ability to regulate economic activity and enforce contracts fairly, Islamic business principles are increasingly favoured in the eastern North Caucasus. Commercial disputes are often resolved by Sharia (Islamic law), while some land and hay fields are transferred to *wakuf* (property used for specific community needs, such as mosque maintenance). The first Islamic banking initiatives were introduced in Dagestan’s Express Bank in 2008,<sup>56</sup> which opened an Islamic Office in 2009 that followed Sharia norms. Its Islamic debit card was reportedly used by 25,000 people in 2012, mostly in Dagestan.<sup>57</sup>

The Central Bank of Russia suspended Express Bank’s license in January 2013 for incomplete and inaccurate reporting, and it was subsequently declared bankrupt. Later, however, its Islamic Office was rebranded, and two such offices reportedly now function in Dagestan, where there is much greater demand, and much cash stays outside the regular banking system.<sup>58</sup>

According to Ingushetia’s ex-economic minister, Russians do not understand that “Islamic banking is not a form of worship, but an alternative way of doing business”, and the restrictions on it block a promising regional development avenue.<sup>59</sup> This is

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<sup>52</sup> Crisis Group interviews, Aliy Musukov, Nalchik, December 2012.

<sup>53</sup> For example: vegetable and grape production in southern Dagestan, apricots in mountain Dagestan, cabbage production in Dagestan and Kabardino-Balkaria, shoe manufacturing in Makhachkala, woollen industry in Karachay-Cherkessia, orchards in Kabardino-Balkaria and cargo transport in Dagestan’s Levashi district.

<sup>54</sup> Crisis Group interview, KBR businessman, Nalchik, December 2012.

<sup>55</sup> In 2013, the region – and then only Dagestan and Stavropol Krai – received \$119 million in foreign investment, 0.1 per cent of Russia’s total. “Где в России лучше жить” [“Where life is better in Russia”], *Rossiyskaya Gazeta*, 12 March 2014. \$493.2 million of foreign investment came in 2012. “Основные социально-экономические показатели Северо-Кавказского Федерального округа” [“The main NCFD socio-economic indices”], NCFD investment website. “Рейтинг регионов РФ по качеству жизни” [“Rating of quality of life of the RF regions”], Riarating, Moscow 2013.

<sup>56</sup> Islamic principles prohibit money-lending with interest, risky and uncertain investments and investing in projects related to alcohol, weapons and cigarettes. “Исламский банкинг набирает обороты” [“Islamic banking is developing”], Sberex, 14 January 2013. “Банк по законам шариата” [“Bank by Sharia law”], *Expert*, 5 November 2012.

<sup>57</sup> Crisis Group interviews, Said Saidov, director, Islamic investment centre, Makhachkala, July 2012. “Мудариб – значит доверять” [“Mudarib’ means trust”], *Dagestanskaya Pravda*, 21 April 2010.

<sup>58</sup> Crisis Group interview, Denis Sokolov, Ramcom center, director, Moscow, May 2015.

<sup>59</sup> Magomed Yandiev, quoted in “Исламский банкинг в России может появиться раньше шариатских судов” [“Islamic banking can appear in Russia earlier than Sharia courts”], Top RBC, 14 June 2012, “Социо-экономические аспекты развития исламского банкинга в России” [“Socio-economic aspects of development of Islamic banking in Russia”], *Kavkazskaya politika*, 19 December 2012.

unfortunate, as state banks are reluctant to give loans to the region even if the state endorses a project. A regional official said, “50 billion roubles were allocated for state deposit guarantees in 2012 ... none ... to the North Caucasus .... The banks deem risks too high and refuse”.<sup>60</sup> Banks are reluctant to give even small consumer loans, a senior Moscow banker said, because “the rate of return is ten times lower than elsewhere .... We are committed to work in the region, but we need returns”.<sup>61</sup>

## B. Regional Differences

### 1. Chechnya

Regional economic development is uneven. The economy of the most troubled republic, Chechnya, was almost destroyed in two wars and plundered in the inter-war period. Its 56 billion rouble (\$1.7 billion) consolidated 2013 budget was almost fully funded by Moscow and increased in 2014 to 69 billion roubles (\$2.1 billion).<sup>62</sup> Two major FTPs completed by 2012 allowed Chechnya to rise impressively, but a real economy is yet to develop.

According to the republic’s official statistics, 2014 was a growth year.<sup>63</sup> Yet Chechnya experienced a dramatic reduction of capital investment and construction, because the 2008-2012 FTP had ended.<sup>64</sup> Despite major federal investment, the republic’s revenues grew by only 2.7 per cent compared to 2012, and the federal funding had little effect, often because newly reconstructed enterprises could not find a market niche.<sup>65</sup> Only ten of nineteen construction enterprises of the economic ministry made a profit in 2013.<sup>66</sup> The revival of Chechen industry requires well-designed strategies for the local and Russian markets, while feasibility needs to be better evaluated before new government programs are financed.

In the second half of 2013, the Chechen head, Ramzan Kadyrov, began to put considerable effort into attracting investors and announced that automobile construction, oil processing, energy and tourism would be prioritised.<sup>67</sup> Plans are ambitious.

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<sup>60</sup> Crisis Group interviews, Aliy Musukov, KBR economic development minister, Nalchik, December 2012.

<sup>61</sup> Crisis Group interview, Rosselkhozbank, Moscow, May 2013.

<sup>62</sup> “В закон о республиканском бюджете на 2013 года на плановый период 2014 и 2015 годов внесены изменения” [“Amendments introduced to the law on the 2013 republic budget and planned period 2014-2015”], Grozny-Inform, 20 August 2013.

<sup>63</sup> “Рамзан Кадыров: Чечня в 2014 году вошла в число лидеров по приросту населения, темпам роста инвестиций и вводу жилья” [“Ramzan Kadyrov: Chechnya is among leaders of population growth, investment and housing increase”], *Regnum*, 29 December 2014.

<sup>64</sup> The total FTP budget for 2008-2012 was some 124 billion roubles (\$3.75 billion). “Информация о социально-экономическом положении в Чеченской Республике за январь-ноябрь 2013 года” [“Information on socio-economic situation in the Chechen Republic, January-November 2013”], Chechen economic, territorial development and trade ministry.

<sup>65</sup> “В Чечне подвели итоги социально-экономического развития республики” [“Republic’s socio-economic development evaluated in Chechnya”], Grozny-Inform, 29 July 2013.

<sup>66</sup> “Р. Кадыров обсудил с М. Хучиевым работу по оздоровлению неэффективных и финансово слабых предприятий стройиндустрии” [“R. Kadyrov discussed with M. Khuchiev measures for rejuvenating inefficient and financially weak construction enterprises”], Grozny-Inform, 22 January 2014.

<sup>67</sup> “Привлекаем инвестиции. Турция и Чечня имеют давние исторические связи, основанные как на исламской религии, так и на относительной географической близости” [“Attracting investment. Turkey and Chechnya have long historical ties based on Islam and relative geographic

Electric power stations with a capacity of 710 megawatts are to be built on the Argun River, so Chechnya can generate its own energy instead of relying on Stavropol Kray.<sup>68</sup> A major automobile plant is to be built in Argun in 2015, with a planned 10,000 jobs and annual output of 200,000 cars. But given the crisis in the Russian automobile industry, this costly factory's feasibility is questionable.<sup>69</sup>

Some experts believe construction of a new oil processing factory, much desired by the republic's authorities, has mainly political significance, since other players have long occupied this niche.<sup>70</sup> The federal government planned to build the factory in more tranquil Kabardino-Balkaria, until Kadyrov convinced it that the plant, with a capacity of a million tonnes, should be in Chechnya, where oil is being extracted.<sup>71</sup>

Changing Chechnya's image to attract investors who could help it develop without major federal support is a key Kadyrov goal. To overcome its negative image, the republic created an investor-friendly legal framework in 2014 that stipulates state guarantees for investors, as well as special economic zones and industrial parks. Chechnya also benefits from the program of state guarantees for the NCFD.<sup>72</sup> However, most of these plans are yet to be implemented. Moreover, while the reconstruction boom, numerous government jobs, huge security and other state sectors, and pensions and subsidies provide a certain income level, businesses reportedly face regular demands to pay off local officials and law enforcement.

## 2. Dagestan and Stavropol Kray

The two largest economies – almost equal in territory and population and relatively high urbanisation – are Dagestan and Stavropol Kray.<sup>73</sup> In Dagestan, urbanisation is driven by its own rapidly growing population and resettlement of mountaineers and other rural residents into cities. Stavropol Kray attracts labour migration from else-

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proximity"], Grozny-Inform, 27 January 2014. Crisis Group Europe Report N°228, *Too Far, Too Fast: Sochi, Tourism and Conflict in the Caucasus*, 30 January 2014.

<sup>68</sup> "Схема и программа развития электроэнергетики Чеченской республики на 2014-2018 годы. [Scheme and program of electric energy development for 2014-2018], www.investchechnya.ru. "Дайте 'зеленый свет'" ["Give us the 'green light'"], *Rossiyskaya Gazeta*, 21 August 2012.

<sup>69</sup> "В Аргуне построят крупный автомобильный завод" ["A big automobile factory will be built in Argun"], Grozny-Inform, 24 January 2014. On the edge of bankruptcy in 2009, AvtoVaz, Russia's largest car producer, laid off 22,500 workers. With state support and modernisation, it survived but in January 2013 announced 7,500 lay-offs. Other car producers also faced crisis in 2013. "Почти 22,5 тыс работников 'АвтоВАЗа' были уволены из-за финкризиса" ["Almost 22,500 AvtoVAZ employees laid off due to financial crisis"], RIA Novosti, 5 February 2010. "АВТОВАЗ сократит семь с половиной тысяч человек" ["AvtoVAZ will cut 7,500 staff"], Tlt.ru, 23 January 2014. "Ford останавливает конвейер и увольняет сотрудников в России" ["Ford stops the assembly lines and dismisses employees in Russia"], RBK Daily, 1 April 2014.

<sup>70</sup> Crisis Group interview, economic expert, Moscow, July 2013.

<sup>71</sup> "Раскритикованная Кадыровым 'Роснефть' инвестирует в Чечню 2,5 млрд долларов" ["'Rosneft' criticised by Kadyrov, invests \$2.5 billion in Chechnya"], Newsru.com, 8 May 2013.

<sup>72</sup> "Об инвестиционной деятельности с применением различных механизмов предоставления государственной поддержки РФ" ["On investment activity involving different mechanisms of granting RF State support"], Chechen economic, territorial development and trade ministry. "В Чечне будут созданы особые экономические зоны промышленного и производственного типа" ["Special industry and production economic zones will be created in Chechnya"], Grozny-Inform, 7 February 2014.

<sup>73</sup> Stavropol Kray has more land, Dagestan more people; 57 per cent of population in Stavropol Kray is urban, 45 per cent in Dagestan.



where in the North and South Caucasus and Central Asia.<sup>74</sup> It is closest to average Russian economic indicators; according to official statistics, it has the region's highest private investment rate and provides better public services, quality education and health care. Administrative services, such as for obtaining pensions, unemployment benefits and other compensation, are also superior, and it costs less to get loans or rent land than in neighbouring republics. This attracts seekers of better business opportunities and quality of life. Stavropol is also reviving its defence industry; in 2014, its "Signal" radio-electronic plant had a four-fold increase in state contracts.<sup>75</sup>

In Soviet times, Dagestan employed many unskilled workers in the defence sector.<sup>76</sup> Today industry is only 6.6 per cent of the republic's economy,<sup>77</sup> but reviving defence business looks increasingly feasible due to Moscow's new interest and support. Hydropower stations have significant potential. In 2013, the republic brought in a major defence industry contract for the Kaspiysk Dagdizel plant, launched a flat-glass factory (built with support of the previous Dagestan president, Magomedislam Magomedov) and started the first stage of reconstruction of the Uytash airport.<sup>78</sup>

Oil industry activity is slowing due to old equipment and lack of new discoveries. The once prominent sturgeon and caviar fisheries are crippled. Hydroelectric power stations built in recent decades and chemical waste dumped into the Caspian Sea have destroyed the ecological conditions for fish reproduction, and illegal fishing has also taken a toll.<sup>79</sup>

Dagestan's unique geographic location – bordering on Georgia and Azerbaijan and with access to sea routes for Russia's trade with Turkey, Iran and Central Asia – could make it an important transportation and distribution hub. This requires modernisation of Makhachkala port, which has been delayed due to extended negotiations needed to balance the interests of the republic's main business-political groups. The port cannot be used to its current capacity due to central government-mandated security inspections of all cargo, introduced during the Chechen war.<sup>80</sup>

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<sup>74</sup> "Регионы России. Социально-экономические показатели 2011" ["Regions of Russia. Socio-economic indicators 2011"], Moscow, 2011.

<sup>75</sup> "Заседание Правительственной комиссии по вопросам социально-экономического развития Северо-Кавказского федерального округа" ["The meeting of the government's commission on socio-economic development issues of the NCFD"], 5 November 2014, government.ru.

<sup>76</sup> The Magomed Gadziev plant still produces spares for old ships. A big radio-electronics factory now makes furniture. Two big plants in Kaspiysk (one for mechanical engineering, the other for high-precision mechanics), where 70-80 per cent of staff were ethnic Russians, were almost out of business until a 2013 contract.

<sup>77</sup> "Address of Dagestan's head", op. cit.

<sup>78</sup> "Завод по производству листового флот-стекла запущен в Дагестане" ["A plant for flat glass launched in Dagestan"], Dagestan State Television Company, 12 December 2013; "Address of Dagestan's head", op. cit.

<sup>79</sup> "Half Sulak village has faced criminal prosecution for illegal fishing. They smoked fish ... and sold them. But the large-scale illegal fishing was by the authorities". Crisis Group interview, economic ministry expert, Makhachkala, July 2012.

<sup>80</sup> Cargo must be opened and checked: "a major impediment; we are losing profits". Crisis Group interview, Ibrahim Sungurov, deputy economic minister, Makhachkala, Dagestan, August 2012.

### 3. Ingushetia and Karachay-Cherkessia

There are big disparities in development between Ingushetia and Karachay-Cherkessia (KChR), though they have almost equal population and comparable urbanisation.<sup>81</sup> In 2014, Moscow subsidised 87 per cent of Ingushetia's budget and 61.5 per cent of KChR's,<sup>82</sup> but the former's Gross Regional Product was 45.1 billion roubles (\$1.3 billion), the latter's 62 billion roubles (\$1.9 billion) in 2013.<sup>83</sup> KChR's advantages are mainly low armed conflict, lack of displaced persons, privatised land and a developed industrial and social infrastructure that survived the Soviet collapse. Its dynamic industrial growth is unique in the region, and its "Yuzhny" agricultural complex provides 10 per cent of Russia's greenhouse production.<sup>84</sup> Ingushetia's economy suffers from lack of usable land and over-population, though federal transfers level the differences.<sup>85</sup>

### 4. Kabardino-Balkaria and North Ossetia-Alania

In 2014, 52 per cent of Kabardino-Balkaria's budget and 52.6 per cent of North Ossetia's were subsidised by Moscow.<sup>86</sup> Kabardino-Balkaria (KBR) is developing tourism, agriculture, energy and construction materials sectors, but in 2013, its industrial growth fell 90.2 per cent, the worst result of any Russian republic. Fixed capital investment, amount of construction and budget income per capita were among the country's lowest.<sup>87</sup> Official economic indicators improved in 2014: agricultural growth

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<sup>81</sup> Urbanisation is comparable: 43.4 per cent in KChR, 38.3 per cent in Ingushetia. Population density, however, is 114 per sq.km in Ingushetia, 33.5 per sq.km in KChR. The population of Ingushetia is 464,000, KChR 469,000 as of 1 January 2015. Russian state statistics service data.

<sup>82</sup> "Крым: между Чечней и Ингушетией. Полуостров финансируется на уровне самых дотационных регионов России" ["Crimea: between Chechnya and Ingushetia. The peninsula is financed at the level of the most subsidised regions of Russia"], *Nezavisimaya Gazeta*, 19 March 2015. "О внесении изменений в Закон Карачаево-Черкесской Республики О республиканском бюджете Карачаево-Черкесской Республики на 2014 год и на плановый период 2015 и 2016 годов" ["On amendments to law on the KChR 2014 budget and 2015-2016 planned period"], KChR parliament website, 18 July 2014.

<sup>83</sup> "Валовой региональный продукт по субъектам Российской Федерации в 1998-2013 гг" ["Russian regions Gross Regional Product in 1998-2013"], Federal state statistics service.

<sup>84</sup> "Если бы не оборонка" ["If it hadn't been for defence], *Expert Yug*, 26 October 2014. Chinese auto manufacturer Chery invested in the Derweys plant in KChR, which began production of its cars. "Китайская Chery инвестировала \$5 млн в свое производство на заводе в Черкесске" ["Chinese Chery invested \$5 million in its production at the Cherkessk factory"], *Gazeta.ru*, 27 August 2014; "В Карачаево-Черкессии началось строительство крупного обувного производства 'Обувь России'" ["Construction of a big shoe factory, 'Obuv Rossii', has started in Karachay-Cherkessia"], *Regnum*, 4 September 2014; "Meeting of the government commission", *op. cit.*

<sup>85</sup> After launch of an FTP for Ingushetia's socio-economic development, 2010-2016, its industrial growth increased by 116 per cent at the same time as KChR's fell 91.2 per cent. "We produce but do not modernise", *op. cit.*

<sup>86</sup> "Закон Кабардино-Балкарской Республики от 31 декабря 2013 года О республиканском бюджете Кабардино-Балкарской Республики на 2014 год и на плановый период 2015 и 2016 годов" ["The KBR law of 31 December 2013 on the republic budget ... for 2014 and planned period 2015-2016"], *Rossiyskaya Gazeta*, 1 January 2014; "В Северной Осетии снизились доходы в бюджет от акцизов на алкоголь" ["North Ossetia alcohol excise tax revenue decreased"], *Ossetia.ru*, 11 November 2014.

<sup>87</sup> "Минэкономразвития Кабардино-Балкарии прогнозирует увеличение ВРП за три года на 35 per cent" ["MinEconomy of Kabardino-Balkaria predicts GRP increase by 35 per cent in three years"], *Regnum*, 23 October 2014.

(1.1 per cent), taxes collected (20.3 per cent) and construction (20.5 per cent).<sup>88</sup> To facilitate growth, the republic parliament privatised ski resorts, while the government approved additional subsidies for farmers.<sup>89</sup> To assist with import replacement, KBR plans to revive its Soviet factories to produce medical equipment (Sevkavrentgen plant), diamond tools (Terekalmaz) and tungsten (Tyrnauzsky volframovy kombinat).

North Ossetia's metal industry produces a third of its shipped goods. The republic also produces construction materials and has light and chemical industries, but industrial production fell in the first half of 2014.<sup>90</sup> Largely due to ineffective land use, agriculture cannot meet local demand for milk, meat, dairy products and eggs.<sup>91</sup> To contribute to import replacement, there are plans to significantly increase production of trout, seeds and medical glassware and to win big new defence contracts.<sup>92</sup>

Republic officials acknowledge that extortion by the insurgency is an acute problem in KBR, where businessmen have been killed for refusing to pay "jihad money" to the "KBK": "They don't turn to law-enforcement officially, but we see that some businessmen are leaving, closing their enterprises, emigrating".<sup>93</sup> In 2014, the situation somewhat improved but the insurgency is still active.

North Ossetia hosts a significant number of refugees from Georgia and has a challenging post-conflict reconstruction situation in its Prigorodny district, the area of armed ethnic conflict between Ingush and Ossetians in 1992.<sup>94</sup> Since 1994, there has been a gradual return to some villages, but reintegration remains difficult, as some villages have ethnic enclaves in which communication between residents is very limited.

Apart from a few state-employed teachers, police and administrators, the economic orientation of the Ingush is almost entirely toward Ingushetia.<sup>95</sup> "It's hard for the Ingush to sell their goods in North Ossetia, since even in ethnically mixed settlements people still care which nationality you are when they buy", a local businessman said. Social as well as economic reintegration of the Ingush is a prerequisite for sustainable peace in Ossetia, but unemployment is a problem for both communities. Targeted support of small business is crucial for post-conflict reconstruction.

<sup>88</sup> "С начала 2014 года оборот розничной торговли в Кабардино-Балкарии составил 68 млрд рублей" ["Turnover of retail trade in Kabardino-Balkaria 68 billion roubles since beginning of 2014"], *Regnum*, 17 October 2014.

<sup>89</sup> "Парламент КБР одобрил приватизацию курортных объектов на 854.9 млн рублей" ["KBR parliament approved resort privatisations for 854.9 million roubles"], *Caucasian Knot*, 26 June 2014; "Свыше 74 миллионов выделяют на поддержку республиканских аграриев" ["Over 74 million will be allocated to support the republic's agricultural workers"], *Russian planet*, 9 September 2014. <sup>90</sup> "Strategy of socio-economic development", *op. cit.* "We produce but do not modernise", *op. cit.*; "Мамсуров спасает Северную Осетию от санкций?" ["Does Mamsurov save North Ossetia from sanctions?"], *Kavkazskaya Politika*, 20 August 2014.

<sup>91</sup> Significant arable land for an 8,000 sq.km republic remains unused: 340 sq.km in Iraf region, 110 sq.km in Digora region, 900 sq.km in Alagir region. "Мамсуров спасает Северную Осетию от санкций?", *op. cit.*

<sup>92</sup> Russia imports 85-90 per cent of its seed, considered a serious food-security challenge. "Meeting of the government commission", *op. cit.*

<sup>93</sup> Crisis Group Report, *The Challenges of Integration (II)*, *op. cit.* The Villayat of Kabarda, Balkaria and Karachay (KBK) is a section of the "Caucasus Emirate". Crisis Group interview, Aliy Musukov, economic development minister of Kabardino-Balkaria, Nalchik, December 2012.

<sup>94</sup> Almost 7,000 Ossetian refugees from Georgia stayed in the republic following the Georgian-Ossetian conflict of the early 1990s. Some 30,000-60,000 Ingush fled that conflict to neighbouring Ingushetia. "Количество беженцев в Северной Осетии выросло" ["Number of refugees in North Ossetia has risen"], *caucasianpolitics.ru*, 12 December 2014.

<sup>95</sup> Crisis Group Report, *The Challenges of Integration (I)*, *op. cit.*

An Ossetian producer whose situation is typical explained that he started from a household tomato garden and expanded to a small enterprise. Yet, he is not registered as an individual entrepreneur (IE), because his taxes and payments would be too high, so he cannot sell officially. He would like to expand but needs capital: “You can take out a consumer loan, but the interest rate is 22 per cent. I can’t afford this. If I get an agricultural loan I have to pay 16 per cent, but I have to register ..., declare all my income and pay all taxes which have become too high”, he said.<sup>96</sup>

Since 2013, monthly payments to the pension fund for IEs have risen twice, from 1,495 roubles (\$45) to 3,185 roubles (\$93). “Taking into consideration that the average monthly income of IEs in Prigorodny district is 15,000-30,000 roubles (\$450-\$900), this burden becomes unbearable”, explained Magomed Matiev, director of a centre that supports small business in Prigorodny. The inspector of the Prigorodny tax department said:

Up to 70 per cent of small businesses have deregistered this year [2013] because of the increased payments, and now they cannot sell their products officially. Mostly they go into the shadows; some are closing. It is hard for a person to do all the paperwork for his individual private company; the reporting system is very complicated. Very few people manage to get loans because the return rate is low. They need subsidies and leasing.<sup>97</sup>

To be competitive small producers need to improve packaging and storage quality; to get into retail chains, they must develop cooperation to ensure better pricing policy and stable supply.<sup>98</sup>

Bureaucracy, high dues and a lack of cheap long-term loans is just part of the problem. Corruption is another. A cattle breeder explained:

In 2009, I registered as a private business and had this status for three years. I was hoping to get subsidies from the agriculture ministry, loans from the agricultural bank or equipment. But ... you go once, twice, three times, then you give up. They are fishing for bribes: 30,000 from a loan of 100,000 roubles. But you have to pay back 100,000!”<sup>99</sup>

The problem of corruption in distributing credits and agricultural subsidies is acute across the region. In 2014, an ex-Ingushetia agriculture minister was accused of embezzling 65 million roubles (\$1.4 million) intended for paying subsidies to agricultural enterprises, but he has not been convicted.<sup>100</sup>

Moscow should offer farmers and small businesses long-term, low-interest credits, review regulations on IEs’ social security payments and reduce administrative hurdles for small business. Such support of small business and sustainable economic development in areas of ethnic conflict and tension such as Prigorodny should be a top priority: “If a person has business, he has something to lose. He will not engage

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<sup>96</sup> Crisis Group interview, small producer, Prigorodny district, North Ossetia, July 2013.

<sup>97</sup> Crisis Group interviews, Matiev, whose centre in the village of Kurtat is run by the Moscow-based NGO Memorial; district tax inspector, Kurtat, both July 2013.

<sup>98</sup> Crisis Group interview, local businessmen, North Ossetia, July 2013.

<sup>99</sup> Crisis Group interview, Murat, cattle breeder, Prigorodny district, North Ossetia, July 2013.

<sup>100</sup> “Экс-министра сельского хозяйства Ингушетии подозревают в хищении 65 млн руб” [“Ingushetia ex-agriculture minister is suspected of theft of 65 million roubles”], RBC, 3 July 2014. In 2015, he was reappointed as acting minister.

in insurgency and will ask others not to do it. When one is unemployed, he can do anything”, a resident noted.<sup>101</sup>

### C. Agriculture

Agriculture is relatively prominent in the region’s economy (15 per cent, compared to the 4 per cent national average) and has the greatest potential for growth. In nine months of 2014, the North Caucasus supplied 14 per cent of the country’s vegetables, 9.8 per cent of its grain, 8.6 per cent of its milk and 6.4 per cent of its meat.<sup>102</sup>

Agro-complexes in Kabardino-Balkaria and Stavropol Kray are large, modern enterprises that help alleviate economic hardships in local communities. Stavropol Kray in particular significantly increased agricultural output in 2014, including 15 per cent growth in potato production. As of 1 October, Moscow provided 28 billion roubles (\$840 million) to 658 agricultural investment projects in the North Caucasus, and Prime Minister Dmitry Medvedev promises more support, including, in the framework of import replacement, another 636 billion roubles (\$19 billion) for agriculture, as well as plans to plant a further 26,000 hectares of orchards and 27,000 hectares of vineyards by 2020.<sup>103</sup>

North Caucasus regional officials are enthusiastic. “Sanctions have really helped us”, said Stavropol governor Vladimir Vladimirov, who hopes for a doubling of state support and of vegetable production by 2020 and a 30 per cent increase of meat production two years before that.<sup>104</sup> Stavropol Kray has already received 870 million roubles (\$26.3 million) in federal support for agriculture investment credits.<sup>105</sup> Dagestan plans to increase vegetable and fish production and Karachay-Cherkessia to focus on greenhouses. The North Caucasus Federal District (NCFD) looks to an agriculture ministry review of 226 new projects worth 20.9 billion roubles (\$630 million) to produce a general revival of the sector.<sup>106</sup> However, some experts fear that import replacement schemes adopted under pressure from Russia’s response to Western sanctions over Ukraine will not have lasting impact unless systemic problems are faced head on.

Among those problems are land disputes; inefficient land management; inadequate infrastructure; lack of storage, processing and logistics facilities; high taxes and interest on credit; corrupt bureaucracy; and dilapidated irrigation systems.<sup>107</sup> Challenges faced by the many small-family producers include the high costs of breaking

<sup>101</sup> Crisis Group interview, Magomed Matiev, director, centre for support of small business, Kurtat, North Ossetia, July 2013.

<sup>102</sup> “Дмитрий Медведев проведет в Кабардино-Балкарии совещание по вопросам импортозамещения” [“Dmitry Medvedev will hold a meeting on import replacement in Kabardino-Balkaria”], *Regnum*, 5 October 2014.

<sup>103</sup> “Кавказ: работа над ошибками” [“Caucasus: correction of mistakes”], *Kavkazskaya politika*, 29 August 2014. “Meeting of the government commission”, op. cit.

<sup>104</sup> “Caucasus: correction of mistakes”, op. cit.

<sup>105</sup> “В бюджете Ставрополя заложено 190 млн рублей на проекты по импортозамещению в сфере АПК” [“190 million roubles for agriculture import replacement allocated in Stavropol Kray budget”], *Regnum*, 5 November 2014.

<sup>106</sup> “Meeting of the government commission”, op. cit.

<sup>107</sup> 31-83 per cent of irrigation systems required reconstruction in 2010. “Стратегия социально-экономического развития Северо-Кавказского федерального округа до 2025 года” [“Strategy of socio-economic development of the North Caucasus Federal Okrug District till 2025”], *Caucasian Knot*, 6 October 2010.

into big supermarket chains. Chechnya has specific problems, such as the prevalence of landmines in the mountain foothills.<sup>108</sup> Moreover, years of displacement have caused farmers to migrate to urban areas. The republic meets its own bread and poultry needs, but otherwise food markets are filled with imports.

According to official statistics, Dagestan contributes significantly to Russia's food industry.<sup>109</sup> The state's 2008-2012 program for agricultural development subsidised loans to producers.<sup>110</sup> Southern Dagestan can harvest two crops annually, and the government is investing in greenhouses and intensive orchards, though a modern network of fruit storage and processing facilities is still needed. Nevertheless, the deputy economic minister describes the sector as still backward. Labour is primarily manual; land is scarce, and young people prefer the cities. Problems are particularly acute in the mountain regions, where infrastructure is dilapidated, asphalt roads exist only to district administrative centres, and natural gas is limited.<sup>111</sup>

The North Caucasus authorities must plan major new steps carefully. Mega-projects that change the ethnic or economic balance or destroy traditional ways of economic subsistence without offering effective alternatives stir up ethnic and extremist strife.<sup>112</sup> In north Dagestan, a decision to build a large sugar factory in Nogay district resulted in mass protests by the ethnic majority against expropriation of land and the likely settlement of thousands of non-Nogay workers. The factory will have to be constructed in another district.

Kabardino-Balkaria farmers complain that such projects take land that is then used for personal profit, not communal benefit, and displaces local production.<sup>113</sup> Dagestan's Untsukul district mostly depended on apricot, mountain pear and persimmon orchards, until the dam at the new Irganay hydroelectric power station permanently flooded 940 hectares, mainly farmland, in 2008. Hundreds of residents from the six villages affected were left without income, land and adequate compensation. The government banned protests under the local counter-terrorism regime.<sup>114</sup>

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<sup>108</sup> Crisis Group interview, Chechen economist, Grozny, July 2013.

<sup>109</sup> Dagestan alone produces 2.9 per cent of Russia's bread, 2 per cent of its milk, 24.8 per cent of its wool, 14.5 per cent of its cognac, 12 per cent of its sparkling wines, 6.8 per cent of its vegetables, 5.1 per cent of its fruit, 39.9 per cent of its grapes. It has 4.5 per cent of Russia's cattle and 20.1 per cent of its sheep and goats. Data provided to Crisis Group by the Dagestan economic ministry, Makhachkala, August 2012.

<sup>110</sup> In 2011, the Russian agricultural bank "Rosselkhozbank" provided 3,202.4 million roubles (almost \$100 million) in subsidised credits; the republic budget allocated 588.4 million roubles (\$17.8 million) to agricultural development. Ibid.

<sup>111</sup> Crisis Group interview, Ibrahim Sungurov, deputy economic minister, Makhachkala, Dagestan, July 2013.

<sup>112</sup> For detailed analysis of a major state development project, the North Caucasus resorts, see Crisis Group Report, *Too Far, Too Fast*, op. cit., pp. 19-36. Ivan Sukhov, "Ногайский мятеж" ["Nogay Rebellion"], *Moscow News*, 5 September 2011; Denis Sokolov, "Затоленный мир койсубулинцев: электричество в обмен на абрикосы" ["Flooded world of the koysubulins: Electricity in return for apricots"], in *Society as an object and a subject of the authority. Essays on the political anthropology of the Caucasus* (Saint Petersburg, 2012), pp. 61-91; Starodubovskaya, Denis Sokolov, *The origin of the conflicts in the North Caucasus* (Moscow, 2013), pp. 78-128.

<sup>113</sup> Crisis Group interview, Ibrahim Yaganov, horse farmer and public activist, Nalchik, December 2012.

<sup>114</sup> A state of emergency was introduced in Gimry in December 2007 after the murder of Gazimagomed Magomedov, a member of Dagestan's assembly; it lasted eight months. "В Дарестане завершен режим контртеррористической операции в селении Гимры" ["Counter-terrorist operation over in Gimry, Dagestan"], *Caucasian Knot*, 1 August 2008.

Untsukul is home to the notorious Gimry-Balakhani armed jihadi group. Failure to take local interests into account while building the dam, the shift of the economic balance, the unemployment it caused and alleged embezzlement of compensation payments gave a strong impulse to extremism, according to the head of Gimry village. “The authorities spent money allocated for our social infrastructure somewhere on the sea coast, on their dachas”, he asserted, adding that 400 young men could not find jobs or land to build houses and marry because of the poor economy.<sup>115</sup> The villagers perceived the destruction of orchards and the alleged theft of compensation as an acute injustice; insurgents have attacked the hydroelectric station twice in recent years.<sup>116</sup> Economic deprivation, perceived across the region as a result of unfair government actions, contributes significantly to radicalisation of local communities.

Land disputes among farmers, villages and big agricultural holdings are another major challenge around the North Caucasus that often escalates into ethnic and religious tensions and clashes. The arrival of investors usually results in property redistribution and sometimes bankruptcy of local enterprises. Big business is believed to be closely linked with the authorities and to enjoy considerable impunity, which increases farmers’ frustration.<sup>117</sup>

The Land Code of the Russian Federation gives regions the right to decide whether to privatise land. Stavropol Kray and Karachay-Cherkessia carried out privatisation, and those who used to work on state farms received shares, though many had to do with a share of a collective plot.<sup>118</sup> Land has become a tradable asset, even if the market is distorted by administrative barriers to property registration.

The other republics did not formally privatise, but land often became a resource that in practice belongs to elites. According to Khloponin, the ex-presidential envoy, “80 per cent of corruption crimes are connected with land issues”.<sup>119</sup> De facto privatisation by farmers occurred in some places, including mountain areas where families reclaimed ancestral land.<sup>120</sup> Especially in Dagestan, *jamaat* (local Muslim community) structures ruled by elected councils replaced mountain collective (*kolkhoz*) institutions. *Kolkhoz* animals went into private households, boosting cattle and sheep breeding.

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<sup>115</sup> Aliaskhab Magomedov, roundtable presentation on “The North Caucasus: The mechanisms and risks of land reform”, Bekasovo, 18-19 May 2013.

<sup>116</sup> On 9 September 2010, security forces defused an improvised explosive device at the station; another was discovered on 31 January 2011.

<sup>117</sup> Tatyana Nefedova, “Ставропольский край: земельные и хозяйственные проблемы как предтеча этнического напряжения в сельской местности” [“Stavropol Kray: land and agriculture problems as a precursor of ethnic tension in rural area], *Frontir*, May 2013.

<sup>118</sup> “The general principle was that you got several rows of land in the middle of a big field. De facto you own it, but you cannot use it, and you cannot sell it. You can only rent it to the organisation that works this field. Mainly those who had strong, big families managed to use their land; they received compact slots and could work on it together”. Crisis Group interview, businessman, Cherkessk, December 2012.

<sup>119</sup> “Хлопонин: 80% преступлений коррупционного плана на Кавказе связано с землей” [“Khloponin: 80 per cent of corruption crimes in the Caucasus are connected with land issues”], *Caucasian Knot*, 15 March 2013.

<sup>120</sup> “Юг России. Земельные и территориальные споры” [“South of Russia. Land and territory disputes”], *Sut’ vremeni*, 13 April 2013.

Unresolved land issues fuel tensions all over the North Caucasus. Though Stavropol Kray is Russia's second-largest grain producer (7.6 per cent of the total),<sup>121</sup> agricultural modernisation led to significant cuts in jobs and increased movement to cities of ethnic Russians, who are being replaced by migrants from the neighbouring republics. Economic changes have fed ethnic and religious tensions in the countryside between Cossacks, ethnic Russians and migrants.<sup>122</sup> Rural areas are increasingly ethnically segregated.<sup>123</sup> "Privatisation of the state is strongly felt by the people ..." who look for "legitimate forms of protecting collective security".<sup>124</sup> Ethnic groups are setting up NGOs to defend their interests. In many eastern parts of the region, communities are sidelining courts by using Sharia and customary law (*adat*) to resolve land conflicts.<sup>125</sup> Moscow should increase the efficiency of courts and curb corruption in them so as to be able to better implement land regulations.

In Dagestan, numerous land clashes are linked to distant-pasture sheep and cattle breeding. In Soviet times, this involved the seasonal movements of herds between high mountain valleys and lowlands. Most mountain farms in Dagestan were also allocated significant lowland. Seasonal housing built for shepherds and their families gradually became temporary settlements (*kutans*). Most distant-pasture animal breeding collapsed with the Soviet Union, yet more than 100 *kutans* have become permanent unregistered settlements, controlling significant amounts of land. This acutely frustrates residents of neighbouring villages, while land still allocated for distant pastures is rented out by the republic authorities for profit, and much is de facto privatised.

The moratorium on land privatisation impedes agricultural growth. Few farmers want to lease, because bureaucratic contacts are essential for such transactions. A businessman said, "you'll invest your labour and money ... and then someone will come and take it".<sup>126</sup> The federal authorities should make contracts ironclad in law and also proceed with privatisation.<sup>127</sup> A leading Dagestan economic ministry expert said, "if we don't carry out land reform we will slide into serious conflicts. Carrying out a reform has risks, but it has to be done under all circumstances: fairly, decisively and based on ... economic feasibility".<sup>128</sup>

<sup>121</sup> "Итоги социально-экономического развития Ставропольского края в 2013 году" ["Results of socio-economic development of Stavropol Kray in 2013"], Stavropol Kray state statistics service.

<sup>122</sup> Tatyana Nefedova, "Сельское Ставрополье глазами московского географа. Разнообразие районов на юге России" ["Agricultural Stavropol Kray with the eyes of a Moscow geographer. Variety of regions in the South of Russia"], (Stavropol, 2012), pp. 6, 7. Crisis Group Report, *The Challenges of Integration (I)*, pp. 23-24; "Ставрополье превращается в Косово: конфликты русских и мигрантов" ["Stavropol Kray turns into Kosovo: conflicts of ethnic Russians and migrants"], *Moskovsky Komsomolets*, 12 April 2013; "Гроздь гнева. Ставрополье отказалось от роли жертвы Северного Кавказа" ["Stavropol Kray refused the role of the North Caucasus victim"], *Lenta.ru*, 20 February 2013; a federal TV show on inter-ethnic tensions in Stavropol Kray, 5 February 2013, [www.youtube.com/watch?v=VeUra1Uw7ps](http://www.youtube.com/watch?v=VeUra1Uw7ps).

<sup>123</sup> Tatyana Nefedova, "Ставропольский край: земельные и хозяйственные проблемы как предтеча этнического напряжения в сельской местности" ["Stavropol Kray: land and agriculture problems as a precursor of rural ethnic tension"], *Frontir*, p. 39.

<sup>124</sup> Sokolov, "Competition of socio-economic models", op. cit., p. 29.

<sup>125</sup> Crisis Group Report, *The Challenges of Integration (III)*, op. cit., pp. 44-45.

<sup>126</sup> Crisis Group interview, Cherkessk, Karachay-Cherkessia, December 2012.

<sup>127</sup> "Unless there is a market in land, economic growth will be constrained. [But] by delaying privatisation we were able to implement major investment projects". Crisis Group interview, Aliy Musukov, Kabardino-Balkaria economic development minister, Nalchik, December 2012.

<sup>128</sup> Crisis Group interview, Shakhmardan Muduev, Makhachkala, August 2012.



Throughout the North Caucasus, a significant part of which is mountainous, more attention must be paid to the special needs of remote agrarian societies.<sup>129</sup> Mountain territories have particular economic and social problems: very high unemployment, minimal social infrastructure, lack of cultural and sporting facilities for youth, inadequate supply of goods, services and fuel; environmental issues, such as frequent natural disasters, and erosion of soil. Many mountain areas of Dagestan, Ingushetia, Chechnya and Kabardino-Balkaria have active insurgencies and youth unemployment. Many unemployed youth have higher education but cannot get jobs or, on graduation, still must do hard, low-profit manual work.<sup>130</sup> Dagestan and North Ossetia have adopted special laws on mountain territories and relevant programs; Chechnya is developing a similar program.<sup>131</sup>

The 2012 “Mountain Dagestan” program aims to orient the mountain economy to ecological agricultural production, fresh dairy products and meat. Selling food products is a challenge for distant villages and small producers, since it is hard for them to comply with required standards and rigid delivery deadlines. Virtually no facilities exist to preserve or process dairy products, meat and fruit, so farmers must sell quickly and cheaply. Bringing mini processing factories closer to production areas is the government’s main priority, especially after Russia joined the World Trade Organisation (WTO). “We can only be competitive due to the quality of our ecologically pure products. We should be able to quickly deliver them to customers, which means storage and good roads”, a deputy economy minister said.<sup>132</sup> Experts called for a federal law on mountain territories to help meet mountain areas’ special needs and facilitate development of their unique potential.<sup>133</sup>

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<sup>129</sup> 56.9 per cent of North Ossetia is mountainous; Dagestan has Russia’s highest mountain-population density (1,200 settlements, 650 municipalities). Dozens of Chechen high-mountain villages were abandoned during the wars, but five regions are densely populated.

<sup>130</sup> “Эксперты: для развития сельхозпроизводства на Юге России необходимо менять кредитную политику” [“Experts: loan policy needed change for development of south Russian agriculture production”], *Caucasian Knot*, 26 September 2014.

<sup>131</sup> “Закон Республики Северная Осетия-Алания от 31.03.2008 № 6-РЗ ‘О Стратегии социально-экономического развития Республики Северная Осетия-Алания до 2030 года’” [“The law of the North Ossetia-Alania Republic, 31.03.2008 N 6-RZ, ‘On the strategy of socio-economic development of the Republic ... till 2030’”], *Zakonprost.ru*; “Правительство ЧР займется возрождением восстановленных горных районов” [“The government of the Chechen Republic will undertake revival of mountain districts”], *Grozny-Inform*, 2 April 2013. Crisis Group interview, Shakhmardan Muduev, Makhachkala, August 2012.

<sup>132</sup> Crisis Group interview, Ibrahim Sungurov, deputy economic minister, Dagestan, Makhachkala, August 2012.

<sup>133</sup> “По закону для гор” [“According to the mountains’ law”], *Rossiyskaya Gazeta*, 24 September 2013.

### III. Social Services and Infrastructure

Acute justice deficit is a root cause of conflicts in the North Caucasus. In the post-Soviet context, justice is a broad concept that includes social security and conditions for sustainable development. The Russian National Security Strategy to 2020 recognises that strategic national interests include, inter alia, improving quality of life. President Putin said in 2012 that “every rouble channelled to the social sphere should produce justice”.<sup>134</sup> Yet, the quality of North Caucasus life is much lower than elsewhere in Russia. Dagestan’s ombudswoman notes that 60 per cent of applications her office receives allege violations of socio-economic rights. The state program for North Caucasus development to 2025 lists inadequate social infrastructure and decayed, degraded utilities as key problems.

Traditionally high birth rates in the region increase the dramatic deficits in health-care and education infrastructure. It hosts the fewest sport venues and cultural institutions per capita in Russia, and many libraries, theatres, children’s art schools and entertainment facilities have closed.<sup>135</sup> Housing is a problem; the quality of housing utilities – a major challenge everywhere in Russia – is especially vexing in the North Caucasus, where corruption, inefficiency and deterioration are significant problems.<sup>136</sup> Russia’s prosecutor general said registered violations regarding housing utilities rose 25 per cent in the region in 2013.<sup>137</sup>

North Caucasus housing is afflicted by increasing costs, old infrastructure, dilapidated buildings and inadequate services.<sup>138</sup> Up to 75 per cent of Dagestan’s houses have utilities needing urgent repair, including water (35 per cent) and sewage (39 per cent).<sup>139</sup> In Ingushetia, lack of purification facilities means raw sewage flows into rivers and reservoirs, while self-constructed systems pollute the sub-surface.<sup>140</sup> Moreover, seismic vulnerability is often ignored during construction. Kabardino-Balkaria led

<sup>134</sup> Vladimir Putin, “Строительство справедливости. Социальная политика для России” [“Building up justice. Social policy for Russia”], *Komsomolskaya Pravda*, 13 February 2012.

<sup>135</sup> Strategy of NCFD development, op. cit., p. 15. “Дольше всех, но хуже всех живут на Кавказе” [“The longest, but the worst of all live in the Caucasus”], RIA Novosti, 18 June 2013.

<sup>136</sup> On 8 August 2013, the Russian government identified housing utilities and services as a priority issue and called for improvements to the transparency and reliability of services in the region. “Вкальвать надо’. Медведев подтянул ЕР в Сочи в преддверии ‘важного испытания’” [“It is necessary to work hard’. Medvedev gathered UR in Sochi on the eve of ‘important test’”], Federal Press, 9 August 2013.

<sup>137</sup> “Прокуратура мониторит ЖКХ СКФО” [“Prosecutor’s office monitoring NCFD’s housing utilities and services”], Rambler news, 22 January 2014.

<sup>138</sup> Crisis Group interview, Mikhail Chernyshov, senior researcher, Institute of Problems of Market, Russian Academy of Sciences, Moscow, May 2013. “Положение в системе ЖКХ: статистические данные” [“The situation with housing utility services: statistic”], Social map of the Russian Federation, 2012.

<sup>139</sup> “Австрийские специалисты изучат проблемы ЖКХ Дагестана” [“Austrian specialists will study Dagestan’s HUS [Housing Utility Services] problems”], Interfax, 23 July 2013. “Абдулатипов предложил уволиться главе Дагестанских Огней, если тот не наведет порядок в сфере ЖКХ” [“Abdulatipov suggested dismissal of the head of Dagestan’s Ogni city if he doesn’t get housing utilities and services in order”], Caucasian Knot, 22 September 2014.

<sup>140</sup> “Для обеспечения функционирования очистных сооружений нужен комплексный подход” [“Operation of purification facilities needs a comprehensive approach”], Ingushetia parliament website [www.parlamentri.ru](http://www.parlamentri.ru), 14 November 2013.

Russia in dilapidated housing in 2013, while in Chechnya, at least 3,857 residents had to be resettled as of end 2014.<sup>141</sup>

Debts to energy companies hang over the region. Gazprom claimed it was owed at least 50 billion roubles (\$1.5 billion) for gas as of April 2015.<sup>142</sup> However, according to Khloponin, the ex-presidential envoy, the population pays for a higher percentage of services – 80 per cent – than the national average, while up to 30 per cent of losses occur during transmission, due to inadequate infrastructure and theft. “It’s not a gas transmission network. It’s a sieve”, he said.<sup>143</sup>

Allegations of multi-million rouble thefts and corruption in official housing utility services persist, though some progress was made in 2013-2014: in December 2013, the internal affairs division discovered a possible four-billion rouble (\$121 million) embezzlement by “MRSK Severnogo Kavkaza”, the monopolist that controlled energy supply in the North Caucasus.<sup>144</sup> Chechnya discovered an alleged 315 million rouble (\$9.5 million) theft, while in August 2013 in Ingushetia, the head of utilities in Karabulak district was sentenced to 3.5 years for misappropriating funds.<sup>145</sup> Chechnya’s utilities are trying to recover some four billion roubles (\$121 million) in debt. Many residents complained that they received enormous bills and were being overcharged for unreliable service or even billed for the deceased. A resident of Grozny, the Chechen capital, said utilities costs account for approximately half his pension.<sup>146</sup>

#### A. Health Care

Health care is worst in the eastern Caucasus. Two wars ruined infrastructure in Chechnya, forcing many doctors to leave, displacing tens of thousands and adding to the health-care burden in neighbouring republics, primarily Ingushetia. A new republic founded in 1992, Ingushetia had to start a medical system from scratch, often with displaced doctors. In Dagestan, migrants from the mountains strain facilities in the

<sup>141</sup> The government has allocated 800 million roubles (\$32 million) for three years to resettle Chechnya residents. “В Чечне до конца года запланировано расселить жильцов 76 аварийных и ветхих домов” [Plans in Chechnya to re-settle by year’s end residents of decrepit houses], *Caucasian Knot*, 1 July 2013; “В Грозном состоялась торжественная церемония открытия жилого дома для переселенцев из аварийного жилья” [“Launching ceremony of a house for residents from dilapidated buildings in Grozny”], Russian housing ministry website, 24 September 2014.

<sup>142</sup> “Для снижения задолженности за газ на Северном Кавказе разработаны комплексные планы” [“Comprehensive plan to reduce the debt for gas in the North Caucasus were developed”], Chernovik, 4 May 2015.

<sup>143</sup> “Республики Северного Кавказа задолжали 100 млрд руб. за газ” [“North Caucasus republics owe 100 billion roubles for natural gas”], *RBK Daily*, 26 December 2012.

<sup>144</sup> “Бывшему гендиректору ‘МРСК Северного Кавказа’ предъявили обвинение в связи с хищением 4 млрд руб” [“Ex-CEO of ‘MRSK Severnogo Kavkaza’ accused of embezzling 4 billion roubles”], *Vedomosti*, 18 December 2013. He remains under house arrest.

<sup>145</sup> “В Чечне выявлено хищение 315 миллионов рублей в системе ЖКХ” [“315 million rouble HUS system theft revealed in Chechnya”], *Caucasian Knot*, 1 June 2013; “В Ингушетии суд приговорил экс-главу управления ЖКХ Карабулака к 3,5 года тюрьмы по делу о хищении” [An Ingushetia court sentenced ex-head of Karabulak’s housing utilities to 3.5 years in prison for theft”], *Caucasian Knot*, 12 August 2013.

<sup>146</sup> “Тарифы на услуги ЖКХ в Чечне выросли на 12 процентов” [“HUS tariffs in Chechnya have increased 12 per cent”], *Caucasian Knot*, 1 February 2012. “В ЧР принимаются меры по снижению задолженности за электроэнергию” [“Measures to reduce electricity debts in the Chechen republic”], *Chechnya.gov.ru*, 19 September 2014. Crisis Group interviews, Chechnya residents, Grozny, March 2013.

plains. In the last two decades, these eastern republics experienced an outflow of the ethnic-Russian population, which had supplied many specialists, doctors and nurses, and a dramatic rise in tuberculosis (TB). The region has the lowest number of doctors per capita dealing with TB, as well as very high infant mortality.<sup>147</sup> In Dagestan, where 56,000 babies are born every year, for instance, there is no pre-natal centre.<sup>148</sup>

60 per cent of women tested in Chechnya in one survey carried sexually transmitted diseases.<sup>149</sup> A nationwide measles epidemic in 2011-2012 started in the North Caucasus, and poor drinking water has caused significant outbreaks of viral hepatitis A.<sup>150</sup> A few humanitarian groups give medical and psychological help to victims of armed conflicts and capacity-building support to doctors and hospitals, filling some gaps in the state health-care system, especially following active conflict, though in recent years they have been pressured to leave or close some programs.

### 1. Regional issues

Health care is mostly free for Russian citizens who are part of the compulsory health insurance system. Funding principles and care standards were reformed in 2010, with new funds from higher employer contributions allocated to modernisation.<sup>151</sup> Employers now contribute 5.1 per cent of salaries to an insurance fund that is supported by other government spending.<sup>152</sup> Advanced treatment is limited by quotas that do not always match demand.<sup>153</sup> Expenditure also depends on the economic situation in the particular region. Since republics are responsible for co-funding health insurance to socially vulnerable groups, high unemployment and high birth rates are a heavy burden on their budgets. While health-care allocations per inhabitant have risen in the country, they fell in Dagestan in 2012 to half the national average.<sup>154</sup>

<sup>147</sup> Chechen and Ingush infant mortality – 15.1 per 1,000 in 2014 – is double the national average. “Младенческая смертность по субъектам Российской Федерации за 9 месяцев 2014 года” [“Infant mortality in Federation regions, 9 months of 2014”], federal state statistics service.

<sup>148</sup> Crisis Group interview, Dagestan health minister, Makhachkala, July 2012.

<sup>149</sup> “Российская Федерация – Отчет о деятельности. 2011г.” [“Russian Federation – annual activity report, 2011”], Médecins sans frontières, 2012.

<sup>150</sup> “О дополнительных мерах по профилактике заболеваний корью среди населения, обслуживаемого ФМБА России” [“On additional prophylactic measures against measles among the population served by the Federal Medicobiological Agency of Russia”], Federal Medicobiological Agency order no. 32, 20 February 2012. In 2006-2011, more than fifteen hepatitis A epidemics were registered in Dagestan. “О состоянии заболеваемости вирусными гепатитами в Республике Дагестан” [On the infection rate of viral hepatitis in the Republic of Dagestan], Federal Service on Customers Rights in Dagestan Republic, 2011.

<sup>151</sup> Clinics that do not meet federal requirements are not reimbursed for patients since 2013. Article 37, Part 1, Federal Law no. 323, “On the Russian citizen’s health protection fundamentals”. An earlier Health National Priority Project, 2005-2006, was heavily criticised by experts as inefficient: “Забывтые нацпроекты” [“Forgotten national projects”], *Nezavisimaya Gazeta*, 29 December 2009.

<sup>152</sup> Health-care expenses in 2013 were 3.6 per cent of GDP, 1.5 per cent from compulsory health insurance, 2.1 per cent from federal and regional budgets. “Государство экономит на здоровье” [“State saves on health”], *Open Economy*, 7 November 2013.

<sup>153</sup> “Quotas for hip replacement surgery ran out by August this year”. Crisis Group interview, Medzhid Aliyev, senior doctor, Makhachkala city clinic, July 2012.

<sup>154</sup> In 2012, 4,000 roubles (\$121) compared to the federal average of 7,600 roubles (\$240). Regions set their own funding for the unemployed. Ingushetia with the lowest employment in the country – less than 10 per cent in 2011 – allocated 646.7 roubles per person. “Обязательное медицинское страхование: итоги 2011 года” [“Compulsory health insurance: 2011”], <http://bujet.ru>, 21 September 2012. Program, “Modernisation of health care of Ingushetia Republic for 2011-2012”; “Теп-

The ex-Dagestan health minister said spending on modernisation has increased. “It used to be very bad. I got ten million roubles (\$300,000) for the whole republic for a year; now 700 million (\$21 million) comes. Many things have become better”.<sup>155</sup> But throughout Russia, many rural dwellers lack basic health care.<sup>156</sup> This is chronic in Dagestan, where the health ministry says patients often must go to clinics in the capital for even simple treatment, because 80 per cent of equipment in rural medical institutions is outdated. Rural hospitals lack specialists, and their professional competence is low. “We have had a new defibrillator for six years now, but we didn’t use it until last year, because no one knew how to make it work”, the senior doctor at the Khunzakh district hospital said.<sup>157</sup> New programs to support rural doctors in mountain areas have begun to have an impact. Since 2012, the federal government offers a million roubles (\$30,000) to young doctors who work for five years in the countryside.<sup>158</sup>

Lack of professional personnel in the North Caucasus is worse than in Russia overall, especially in Chechnya, which has 25.4 doctors per 10,000 people, not the national average of 44, with serious implications for primary diagnosis and care.<sup>159</sup> The quality of medical personnel is also low, mainly as a result of corruption in medical universities.<sup>160</sup>

Medical sector salaries are rising but remain low. In 2012, a doctor’s salary in Dagestan’s capital, Makhachkala, was 5,000-11,000 roubles (\$150-\$330). In 2013 in Dagestan, officials say, it was 16,300 roubles (\$494). Salaries are higher in rural areas, up to 15,000-20,000 roubles (\$450-\$600), which many doctors consider too modest.<sup>161</sup> To survive, they must take extra work, demand payment for services or take bribes. Another problem is “clanship” in the medical profession. Talented young doctors tend to leave the region, because they cannot find adequate employment if they are not part of nepotism networks.<sup>162</sup>

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риториальная программа ОМС Чеченской Республики” [“Territorial Compulsory health insurance program”], Chechnya, 2012. Dagestan and Ingushetia traditionally have the highest budget deficit for health care. “Ильяс Мамаев: Государственные клиники боятся конкуренции с частными” [“Ilyas Mamaev: ‘Public clinics are afraid of competition with the private’”], RIA Dagestan, 29 September 2012.

<sup>155</sup> Crisis Group interview, Ilyas Mamaev, Makhachkala, July 2012.

<sup>156</sup> “Анализ положения детей в Российской Федерации: на пути к обществу равных возможностей” [“Analysis of children’s conditions in the Russian Federation: on the way to an equal opportunity society”], UNICEF, Moscow, 2011.

<sup>157</sup> Crisis Group interview, Magomed Musayev, Khunzakh, July 2012. The region’s population is predominantly rural. National Census, 2010. “Ильяс Мамаев: Государственные клиники боятся конкуренции с частными” [“Ilyas Mamaev: ‘Public clinics fear competition with the private’”], RIA Dagestan, 29 September 2012.

<sup>158</sup> “Миллион за врача” [“Million for a doctor”], *Expert*, 28 May 2012.

<sup>159</sup> “The medical staff in Dagestan has not increased in the last eight-nine years, but from 2002 to 2010 the population has risen by more than 330,000”. Crisis Group interview, Ilyas Mamaev, Dagestan’s ex-health minister, July 2012. All-Russian population census, 2002, 2010. “В Парламенте ЧР обсудили вопрос нехватки в республике квалифицированных кадров” [“Chechen parliament discussed the shortage of qualified staff in the republic”], Grozny-Inform, 7 February 2014.

<sup>160</sup> Applicants reportedly had to pay \$10,000 in 2012 to enrol in the Chechen State University medical program, and 200,000-500,000 roubles (\$6,000-\$15,000) to enter the Dagestan Medical Academy. Crisis Group interviews, high school teacher, Grozny, December 2012; Akhmednabi Akhmednabiye, cardiologist, Makhachkala, July 2012.

<sup>161</sup> “I am a cardiologist with 30 years experience, and my monthly salary is 5,600 roubles [\$169], and my neighbour, who hasn’t got a degree, is working for the police and gets 40,000 roubles (\$1,210)”. Crisis Group interview, Makhachkala, July 2012.

<sup>162</sup> Crisis Group interview, Denis Sokolov, Ramcom center director, Moscow, May 2015.

## 2. “Enormous theft” and violations of patients’ rights

Rooting out pervasive corruption must be given top priority if health care is to be fixed in the North Caucasus. Hospital patients often must motivate doctors and buy even the most basic medicine and often their own food, though these are supposed to be free.<sup>163</sup> In January 2014, the Kabardino-Balkaria head, Yury Kokov, dismissed the senior administrator of the central municipal hospital in Nalchik due to inadequate conditions and patients being denied drugs and food paid for by the state.<sup>164</sup> According to an interior ministry official in Dagestan’s Department for Combating Crime in the Economy, “the government’s health-care programs entail enormous theft. The scale of corruption is so great that we are unable to even start investigating it”.<sup>165</sup>

Doctors and health-care officials attribute corruption to deeply engrained problems. Patients compete for space in strained institutions and are expected to show “gratitude” to doctors by paying for surgery, tests, consultations and medical documents.<sup>166</sup> Managers of health-care institutions often defend post-treatment gifts. “I tell my doctors: ‘yes, you have a small salary, but do everything possible for your patient, and he will thank you, if he can’”, a senior Dagestan doctor said.<sup>167</sup> Doctors complain of peer pressure to participate in this corrupt system: “If you work honestly, you become a problem to others”.<sup>168</sup>

Crisis Group documented dozens of accounts of alleged abuse, incompetence and corruption at maternity wards in Dagestan, Chechnya and Ingushetia. Almost every step, from pregnancy registration to birth, requires a bribe. A Makhachkala resident said that after he calculated the bribes he paid to doctors in state clinics during his wife’s pregnancy and child birth, he saw it would be cheaper to patronise a private facility.<sup>169</sup> However, private clinics do not always guarantee sufficient quality care, and it is more difficult to hold them accountable for doctors’ mistakes.

Such mistakes, negligence and sometimes crime are a major problem also in state institutions.<sup>170</sup> Two women described losing their babies and their reproductive organs while giving birth in the same maternity ward in Ingushetia. Their families, assisted by human rights groups, initiated a malpractice investigation. Despite the victims’ and activists’ claims of falsified records and a cover up, investigators eventually found no violations.<sup>171</sup>

<sup>163</sup> “Счетная палата проверила учреждения министерства здравоохранения РД” [“Accounts Chamber has checked institutions of Dagestan health ministry”], RIA Dagestan, 3 February 2014.

<sup>164</sup> “Уволен главврач больницы в Нальчике, где не кормили пациентов” [“The senior doctor of Nalchik hospital, where patients were not fed, was dismissed”], RIA Novosti, 24 January 2014.

<sup>165</sup> Crisis Group interview, Makhachkala, July 2012.

<sup>166</sup> “At hospitals we can only provide two thirds of the required beds, so patients offer money to get admitted”, Crisis Group interview, Ilyas Mamaev, Dagestan’s ex-health minister, Makhachkala, July 2012.

<sup>167</sup> Crisis Group interview, senior doctor, Makhachkala, July 2012.

<sup>168</sup> Crisis Group interview, Dagestan doctors, Makhachkala, July 2012.

<sup>169</sup> Crisis Group interview, Dagestan resident, Makhachkala, July 2012.

<sup>170</sup> The Chechen prosecutor’s office reported violations in all but one district hospital; many medical personal had no license; seven chief doctors had been dismissed by the end of 2013. “Р. Кадыров: Ситуацию в лечебных учреждениях нужно держать под постоянным контролем” [“Ramzan Kadyrov: The situation in hospitals needs to be kept under close control”], Grozny-Inform, 17 December 2013. Crisis Group interviews, Karabulak, December 2012.

<sup>171</sup> “Житель Ингушетии заявил о бездействии следователей по делам о гибели детей в роддоме Малгобека” [“Ingushetia resident reported investigators’ inaction in baby deaths in Malgobek maternity hospital”], Ingushetia.info, 4 March 2013. Crisis Group interviews, Ruslan Mutsol-

Registering a medical disability is frequently described as a corrupt process.<sup>172</sup> A Grozny resident said getting all documents for her autistic twins, which has to be done every two years, is so long and complicated that she decided not to go through it in Chechnya. Doctors hinted to her that if she wanted to get expensive medication or stay at a sanatorium for free, she would have to give a bribe. She went to Moscow and quickly received the disability registration.<sup>173</sup> In 2014, a deputy senior doctor in Chechnya was found guilty of taking a \$5,000 bribe for assigning a disability pension to a healthy person.<sup>174</sup>

Federal and regional authorities should devise legal mechanisms that enable redress for abuse of patients' rights. The absence of such mechanisms contributes to feelings of injustice, impunity and state failure and is a major reason for migration. There are documented cases of militants threatening doctors who provided poor services and violated patients' rights.<sup>175</sup>

### 3. The Islamic factor

The growing Islamist Salafi movement has influenced attitudes toward health care. Numerous Islamic medical centres have been set up in Dagestan. As trust in state medical services declines, mothers are avoiding having their children vaccinated and turning to alternative remedies known as IslamBio.<sup>176</sup> This trend is criticised not only by doctors, but also within the Salafi community, whose scholars want to fit modern medical care into their view of Islamic law.<sup>177</sup>

The Chechen authorities support Islamic medicine. In February 2009, Ramzan Kadyrov ordered the opening in Grozny of a state-funded Islamic medical centre that treats neuro-psychiatric disorders by reading Quran verses. During its first five years,

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gov, lawyer, "Mashr" human rights organisation, Karabulak, December 2012. Crisis Group examined medical and legal documents related to this case.

<sup>172</sup> A disability pension can bring a family about \$200 per month; sometimes people obtain it for bribes. "Инвалидность или возможность заработать" ["Disability or a chance to earn money"], Chernovik, 1 March 2013; "Наш джихад – коррупция", или Откуда в Дагестане столько инвалидов" ["Corruption is our jihad' or how come there are so many disabled people in Dagestan"], Ekho Moskvу, 22 January 2013.

<sup>173</sup> Crisis Group interview, Grozny resident, August 2012. "12.02.14 У жительницы Чечни вымогают деньги за сохранение инвалидности 9-летнему ребенку" ["12.02.14 Money was extorted from a Chechnya resident for maintaining her nine-year old's disability status"], Association of Russian Human Rights Lawyers, 12 February 2014.

<sup>174</sup> "Бывший заместитель главного врача медицинского учреждения осужден за взятку" ["Ex-deputy of medical institution senior doctor convicted of a bribe"], Russian prosecutor's office website, 13 August 2014.

<sup>175</sup> Dairy kitchen personnel in Mutsalaul village, Khasavyurt district, and the Derbent orphanage head were threatened. "Надира Исаева: Есть запрос на справедливость, а не на сепаратизм или национализм" ["Nadira Isayeva: There is a demand for justice and not for separatism or nationalism"], *Kavkazskaya politika*, 18 June 2012; "Дагестанские боевики заступились за сирот" ["Dagestani insurgents stood up for orphans"], *Izvestiya* (online), 14 September 2012.

<sup>176</sup> "Until someone brings real doctors here, and they replace all these fake medicines in our polyclinics and hospitals, I will use Al-hindi and khilba [tree bark and khilba tea]". Nailya Dalgatova, Salafi mother, Facebook post, 18 September 2013.

<sup>177</sup> Crisis Group interviews, Salafi women; Ilyas Mamaev, Dagestan's ex-health minister; Khalil-rakhman Shamatov, head of Dagestan's Akhlu-sunnah Salafi scholars' group, Akhmednabi Akhmednabiyev, doctor; all in Makhachkala, July 2012.

it has reportedly treated some 240,000 persons for free.<sup>178</sup> Chechnya's religious leader called the hospital a necessary response to the spread of black magic in the republic. In Dagestan, insurgents persecute and kill folk healers. In Chechnya, such healers are under pressure from the state.<sup>179</sup>

## B. Education

Education faces similar challenges, including poor infrastructure, low wages and a lack of qualified specialists. Following major public investment in recent years, the situation has been gradually improving, but the quality of education is still the lowest in Russia.

### 1. Infrastructure and staffing

Ingushetia, Dagestan and Chechnya have Russia's most underdeveloped pre-school infrastructure. State-funded kindergartens in Ingushetia and Chechnya satisfy only 10 per cent of demand. Dagestan performs slightly better at 25 per cent, but the national average is 62.5 per cent. Given high birth rates, pre-school education weighs heavily on budgets. Recently, FTPs have helped build new kindergartens.<sup>180</sup> Since most families, especially in Chechnya, Ingushetia and rural areas of Dagestan, speak their native languages at home, such pre-schools teach children Russian.

There is also an acute shortage of schools. Dagestan's infrastructure provides for 70 per cent of its children only; 866 of its 1,634 schools operated two or three shifts a day in 2012.<sup>181</sup> More than 40 per cent of schools need to be rebuilt; many are in unsuitable buildings and have no sports facilities, libraries, dining rooms or laboratories.<sup>182</sup> Since an Education National Priority Project was launched, fifteen to twenty schools have been built in Dagestan yearly, but new infrastructure still lags behind population growth. In Ingushetia, 116 schools accommodated 64,000 students in 2014; the latter number has increased by 1,500 every year in the last several years.<sup>183</sup>

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<sup>178</sup> "Центр исламской медицины отметил свое пятилетие" ["Center of Islamic medicine celebrated its fifth anniversary"], Grozny-Inform, 3 February 2014; "В Чечне откроется Центр исламской медицины" ["Center of Islamic medicine will be opened in Chechnya"], IslamRF, 29 January 2009.  
<sup>179</sup> "Чиновник заколдовал Рамзана Кадырова" ["An official bewitched Ramzan Kadyrov"], <http://youtube/2F4RZn70jBA>; "Магия преследования" ["Magic of persecution"], *Esquire* (online), 16 May 2013.

<sup>180</sup> "Анализ положения детей в Российской Федерации: на пути к обществу равных возможностей" ["Analysis of children's conditions in Russian Federation: on the way to equal opportunity society"], UNICEF, Moscow, 2011; "Основные показатели в сфере образования и науки Республики Дагестан за 2011-2012 гг" ["Main indicators in education and science of Republic of Dagestan in 2011-2012"], Dagestan education and science ministry. Crisis Group interview, Tamara Chanliyeva, deputy education minister, Ingushetia, Nazran, December 2012. "Правительство РФ выделило 50 миллиардов рублей для регионов в виде субсидий для развития дошкольного образования" ["RF Government provided 50 billion roubles in subsidies for the regions for pre-school education"], Grozny-Inform, 5 June 2013.

<sup>181</sup> "Main indicators in education and science", op. cit.

<sup>182</sup> Crisis Group interview, school principal, Kizilyurt district, Dagestan, December 2012.

<sup>183</sup> "In 1989, the village of Ordzhonikidzevskaya had 17,000 people; now there are about 65,000, and only one new school designed to accommodate 700 students has been built. As a result, schools are overloaded". Crisis Group interviews, school teacher; Tamara Chanliyeva, deputy education minister of Ingushetia, Ordzhonikidzevskaya, Nazran, December 2012. "В Ингушетии 1 сентября сядут за парты около 7 тысяч первоклассников" ["About 7,000 first-graders will start school on 1 September in Ingushetia"], LentaRI.ru, 30 August 2014.



Vigorous reconstruction over the past ten years has done much to repair war damage in Chechnya.<sup>184</sup> Still, 88 per cent of schools work two-three shifts a day; classes are often overcrowded; only 24 per cent of pupils received hot meals in 2013; and only 60 per cent of schools have sports equipment.<sup>185</sup> A former teacher in Grozny explained:

The school is designed for 840 students, and we have 1,047. Teaching has to be separated into two shifts. The quality of education for those who study during the second shift is lower. In big villages, all classes are overcrowded; there are up to 40 children in one class.<sup>186</sup>

Solving the problem of triple shifts by building 57 new schools was indicated as the first goal of the FTP “South of Russia (2014-2020)”.<sup>187</sup>

A lack of qualified educators is a great challenge, especially in the east. Chechnya in 2012 had one teacher per 20.6 students in cities, 14.6 in rural areas, compared to the national 10.9 average. This improved slightly with the hiring of young specialists, but 40 per cent of the republic’s teachers lack higher education, and physics and foreign language teachers are in acutely short supply.<sup>188</sup> Ingushetia has no shortage. Young people see the profession as reasonably paid, and in 2013, the average salary, with premiums for experience or remote locations, matched or surpassed the region’s average.<sup>189</sup> But a Dagestan principal said standards are dropping: “Teachers today are just like the police – young people who can’t make it into prestigious universities or jobs”.<sup>190</sup> There are numerous reports in Chechnya of misappropriation of funds meant for office supplies, teaching materials, furniture and repairs. Bonuses and other staff payments are often withheld, though teachers must sign receipts.<sup>191</sup>

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<sup>184</sup> 85 new schools have been built and 286 renovated since 2007 in Chechnya. “Реализация Комплекса мер по модернизации общего образования в Чеченской республике: первые итоги” [“Realisation of general education modernisation measures in Chechen Republic: first results”], education and science ministry, 2012.

<sup>185</sup> Chechen officials reported they gave hot meals to all schools by the end of 2013, but locals deny this. “В Чеченской Республике улучшены условия для обучения школьников” [“Conditions for schoolchildren have improved in the Chechen republic”], Grozny-Inform, 16 January 2014. Crisis Group interviews, Grozny, February 2014. “Realisation of general education modernisation measures”, op. cit.

<sup>186</sup> Crisis Group interview, Grozny, December 2012.

<sup>187</sup> “Правительство РФ утвердило разработанную Минрегионом России федеральную целевую программу ‘Юг России’ на 2014 – 2020 годы” [“Russian government has approved the federal target program ‘South of Russia’ for 2014-2020 developed by the regional development ministry”], Grozny-Inform, 27 December 2013.

<sup>188</sup> “Realisation of general education modernisation measures”, op. cit. “На повестке – вопрос подготовки работников сферы образования” [“The issue of staff training is on the agenda”], Grozny-Inform, 11 February 2014.

<sup>189</sup> “Региональные бюджеты скоро лопнут из-за роста зарплат врачей и учителей” [“Regional budgets will explode soon because of rising salaries of doctors and teachers”], Finmarket, 4 June 2013.

<sup>190</sup> Crisis Group interview, school principal, Kizilyurt, Dagestan, December 2012.

<sup>191</sup> “Almost every month I sign documents acknowledging that I received a financial bonus, but I never actually get it. Last month I signed for 45,000 roubles (\$1,360) and got 1,500 (\$45).” Crisis Group interview, university lecturer, Grozny, December 2012.

## 2. The “regional component”

Ethnic republics in Russia have the right to introduce “a regional component”: additional courses, such as local languages, literature, and history. In all republic schools, children can sign up for a local language, along with Russian.<sup>192</sup> Practice varies. In some places, local languages are taught along with Russian: three hours weekly in most of Dagestan’s schools. Sometimes children are taught mainly in the local language in primary schools, especially in rural areas where one ethnic group dominates.<sup>193</sup> An estimated 30-40 per cent of Dagestani students can write well in their native languages; in Ingushetia, Ingush is taught for all eleven years. The regional component is introduced at the expense of other federal curriculum subjects or as part of additional programs. In Dagestan, the regional component averages five-six hours weekly, which some parents find excessive.<sup>194</sup>

Federal curriculum standards provide for an optional course on one of the officially recognised religions; as an alternative, students can take a course on world religions and secular ethics. In addition to the federal standards, Islam is taught separately to girls and boys in Ingushetia; students learn how to pray, study basic Arabic and receive an introduction to Islam and local Sufi traditions twice a week for all eleven years. The authorities believe such courses are a way of protecting youth from extremist influence.<sup>195</sup>

Two Islam courses are taught in Chechnya by teachers drawn from the clergy. Additional “deputy principals for upbringing” positions, also filled by clergy, were recently introduced. “You will have to convey the true essence of Islam to your students. Your main and only goal is to educate the younger generation as good citizens of this country”, Ramzan Kadyrov told the new teachers.<sup>196</sup>

The Islamic dress code in schools is a visible and contested symbol of Islamisation across the North Caucasus. In Chechnya, all females must wear big headscarves, long-sleeved tops and long skirts at school or university; violation can result in expulsion. A professor noted: “Three girls were recently expelled from our university. They took off their headscarves after leaving the university and were unlucky to be seen by Ramzan Kadyrov, who was passing. The head of our department told us that anyone who comes without headscarves will be dismissed”. However, full hijab (covering the chin) is associated with Salafism and banned.<sup>197</sup>

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<sup>192</sup> Madina Minatulayeva, “О состоянии и мерах по улучшению качества преподавания родных языков и литератур в РД” [“On the situation and measures for improving the quality of native language teaching in Dagestan”], *Kumyksky mir*, 9 February 2013.

<sup>193</sup> Some rural, but especially mountain areas in Dagestan are a patchwork of predominantly mono-ethnic enclaves. Dagestan has over 30 distinct ethnic groups and fourteen state languages. “Паспорт Государственной программы Республики Дагестан ‘Развитие языков народов Дагестана на 2014-2016 годы’” [“Passport of Dagestan Republic program ‘Development of languages of Dagestan’s peoples, 2014-2016’”], education ministry, 2013.

<sup>194</sup> Crisis Group interviews, Tamara Chaniyeva, Ingushetia deputy education minister, Nazran; school principal, Kizilyurt, Dagestan, December 2012.

<sup>195</sup> Crisis Group interviews, Tamara Chaniyeva, Ingushetia, deputy education minister, Tamerlan Akiyev, Nazran, December 2012.

<sup>196</sup> Website, Chechen head and government, 13 September 2012.

<sup>197</sup> Crisis Group interviews, Grozny, December 2012. Crisis Group knows of a student wearing full hijab who was expelled from the Oil Technical Institute.

Stavropol Kray, which receives many migrants from the neighbouring republics, introduced a ban on hijab in schools in 2012. Parents challenged this unsuccessfully at the federal Supreme Court.<sup>198</sup>

Islam is not taught in schools in Dagestan, arguably Russia's most pious republic. "What kind of Islam? We are a secular school! Once an imam came here to preach, but we sent him off", a principal said.<sup>199</sup> Wearing hijab is not regulated by the authorities and usually depends on the principal. The insurgency tries to impose an Islamic dress code, and militants killed two principals for banning hijabs. A teacher in Gimry, a mountain village, said she organised festivals for children and dance classes, but behind curtains for fear of the Islamists.<sup>200</sup> Some fundamentalists do not send daughters to school after puberty. The only private Salafi secondary school, "The New Generation" set up in 2012, taught the national curriculum but separated boys and girls; it was closed in 2013 for not having a special educational license, the same year other Salafi educational initiatives were shut in the run up to the Sochi Olympics.<sup>201</sup>

### 3. Quality and corruption

The Unified State Examination (USE), introduced in Russia in 2007, is the basic requirement for school leavers wishing to attend university. Performance on it demonstrates the low quality of North Caucasus education. Almost 30 per cent of high school graduates in Dagestan failed the Russian language test in 2014, compared to 1.5 per cent nationally.<sup>202</sup> The education ministry in Chechnya, where some adults are still illiterate, acknowledged that most schools do not satisfy even basic educational standards. In 2014, 12.7 per cent of its graduates failed the USE. Several mountainous areas had worse results, for example Shatoy district, where only 54 per cent of graduates passed, and the average score for the two compulsory subjects (Russian and mathematics) was 37.7, thirteen points below the national average (50.5). Only 0.6 per cent of the 13,150 Chechen graduates passed all optional exams, which is needed to enter state-sponsored programs at the best universities.<sup>203</sup>

<sup>198</sup> "Хиджаб исключили из школы" ["Hijab is excluded from school"], *Gazeta.ru*, 10 July 2013.

<sup>199</sup> Crisis Group interview, school principal, Kizilyurt, Dagestan, December 2012.

<sup>200</sup> Crisis Group interview, kindergarten principle, Gimry, Dagestan, July 2013.

<sup>201</sup> "МВД Дагестана подозревает руководство мусульманской школы 'Новое поколение' в незаконном предпринимательстве" ["Dagestani MIA suspects the administration of the Muslim school 'New generation of illegal business'"], *Caucasian Knot*, 22 February 2013. On 12 October, the Prosecutor's office closed a Salafi kindergarten in Makhachkala for "operating without a license". On 10 October, police shut down a women's madrasa for similar reasons. At the end of November, the Anti-Extremism Department raided the children's club "Amanat", run by Salafis, in Makhachkala; on 10 December, prosecutors suspended the club's work. "Мобилизация протеста в Дагестане" ["Protest mobilisation in Dagestan"], *Caucasian Knot*, 24 December 2013; Crisis Group interviews, Salafi activists, Moscow, November-December 2013.

<sup>202</sup> "Начался резервный период сдачи ЕГЭ" ["A USE reserve period has started in Dagestan"], *Rossiyskaya Gazeta*, 16 June 2014.

<sup>203</sup> Chechen NGOs organised and supported literacy classes for adults to complete the elementary school curriculum in one year. Crisis Group interview, Lilia Yusupova, head of NGO "Sozidaniye", Gudermes, December 2012. "Минобразования Чечни: более 12% выпускников республики не смогли сдать ЕГЭ в 2014 году" ["Chechen education ministry: over 12 per cent of the republic's school graduates could not pass the USE in 2014"], *Caucasian Knot*, 21 August 2014. "Доклад министра образования и науки ЧР И.Б. Байханова" ["Report of Chechen education and science minister I. Baykhanov"], <http://ishkhoyl.ru/>, 25 August 2014. "Средний балл по ЕГЭ снизился по всем предметам" ["Average USE score in all subjects has decreased"], *Rossiyskaya Gazeta*, 2 July 2014.

The USE was designed to root out corruption and provide equal access to good universities. However, North Caucasus students are regularly accused of bribing officials to get better marks, as much, according to the investigation committee, as 210,000 roubles (\$6,400) in Kabardino-Balkaria in 2013. Parents also bribe police and prosecutors, responsible for overseeing the exams, for students to take mobile phones in or tests out.<sup>204</sup> After a recheck of 4,000 Dagestan exam papers, more than 1,000 results were cancelled and five heads of district education departments and twelve principals dismissed. In Stavropol Kray, the education department's deputy head and the chair of Stavropol city's health department were fired when children of senior officials received high marks after the same doctor allowed them to sit for the exams earlier due to need for their subsequent hospitalisation for "headaches" and "memory impairment". An ex-Karachay-Cherkessia education minister received eight years in prison for taking bribes related to the USE.<sup>205</sup>

Corrupt practices motivate hundreds of students from elsewhere in Russia to move to the region for a final year in hope of bribing their way to better results. In 2012-2013, nearly half the parents in Dagestan's capital transferred their children to rural schools seen as more corrupt.<sup>206</sup> Though education is in theory state funded, families must spend a lot on schooling. Not counting additional payments, some 6,000-10,000 roubles (\$180-\$300) is needed to equip a child, including uniform and textbooks.<sup>207</sup> Given high birth rates, this is often too much for less-privileged families. "Some children do not come to school when it gets cold, since parents cannot buy them warm clothes and shoes", a Grozny teacher explained. High costs cause many in Dagestan to look to the sixteen Islamic higher-education schools; their admission process is seen as honest, and they are often the only opportunity to study for free. Their some 1,770 students also benefit from small stipends and free food and clothing.<sup>208</sup>

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<sup>204</sup> "Отличники' с Кавказа готовятся штурмовать столичные вузы" ["A-students from the Caucasus are ready to assault the capital's universities"], Newsland, 24 May 2011. Crisis Group interview, Elena Denisenko, lawyer, Makhachkala, July 2012.

<sup>205</sup> "В Дагестане аннулировано более тысячи результатов ЕГЭ" ["Over 1,000 USE results cancelled in Dagestan"], *Rossiyskaya Gazeta*, 4 July 2013; "Коллектив отстоял главврача" ["Staff team stood up for their chief doctor"], *Gazeta.ru*, 26 July 2013. "Экс-министр образования КЧР приговорен к восьми годам заключения" ["KChR ex-education minister sentenced to eight years in prison"], *RIA Novosti*, 8 May 2014.

<sup>206</sup> "Около 40% выпускников Махачкалы перешли в районные школы перед ЕГЭ" ["Over 40 per cent of graduates of Makhachkala moved to the district schools before the USE"], *RIA Novosti*, 29 May 2013. "ЕГЭ в Дагестане: изъять телефоны значит поднять революцию" ["USE in Dagestan: taking away phones means starting a revolution"], *Publicpost*, 28 May 2013. "ЕГЭ на засыпку. Экзамен по математике подтвердил уроки русского" ["USE trick question. Math exam confirmed Russian language lessons"], *Kommersant* (online), 4 June 2013.

<sup>207</sup> Crisis Group interviews, local residents, Grozny, Nazran, July 2013, February 2014.

<sup>208</sup> Crisis Group interview, Akhmed Yarlykapov, senior researcher, Institute of Ethnology and Anthropology, Russian Academy of Sciences, Moscow, April 2013.

## IV. Endemic Corruption

Elite corruption is chronic in the North Caucasus. Experts call the region a budget “black hole”, with funding used by Moscow to buy the loyalty of its elites.<sup>209</sup> The problem, the Council of Europe’s anti-corruption report said, starts with Russia itself:

Corruption is a widespread systemic phenomenon in the Russian Federation which affects the society as a whole, including its foundations and more specifically the public administration and the business sector, as well as the public institutions in place to counteract corruption, such as the law enforcement agencies and the judiciary.<sup>210</sup>

Transparency International ranked Russia 136 of 174 countries in its Corruption Perceptions Index-2014.<sup>211</sup> Russian officials admit the link between corruption and insurgency. According to Alexander Khinshteyn, a Duma member, “the growth of terrorism is determined by ... wild corruption, when everything is on-sale”.<sup>212</sup> For over a decade, loyal regional officials enjoyed almost complete impunity for economic crimes.

Several months after Putin returned to the presidency in 2012, he launched a significant anti-corruption campaign in the region. In September 2013, he said its corruption looks “particularly dramatic” compared to the rest of the country and announced that security agencies had uncovered 6.5 billion roubles (\$200 million) of embezzlement. This resulted in the arrest of numerous officials.<sup>213</sup> An especially vigorous campaign was launched in Dagestan, whose current head announced a drive against corrupt local clans and power networks. In the first half of 2014, the republic’s prosecutors revealed over 3,300 alleged violations linked to corruption, and over 700

<sup>209</sup> “Северный Кавказ как ‘черная дыра’ бюджета” [“North Caucasus as a budget ‘black hole’”], BBC (Russian), 20 August 2013.

<sup>210</sup> Russia ratified the Criminal Law Convention on Corruption (ETS 173) on 4 October 2007 and joined GRECO (Group of States against Corruption). “Joint First and Second Evaluation Rounds. Evaluation Report on the Russian Federation”, Group of States against corruption, the Council of Europe, Strasbourg, 5 December 2008.

<sup>211</sup> “Corruption perception index 2014”, Transparency International.

<sup>212</sup> “Момент истины” [“The moment of truth”], 5th TV channel, 10 June 2013. Video available at [http://moment-istini.ru/program\\_archiv/archive2013/?vid=416&start=2](http://moment-istini.ru/program_archiv/archive2013/?vid=416&start=2).

<sup>213</sup> “Суд удовлетворил ходатайство следствия об аресте мэра Карачаевска” [“A Court accepted investigators’ petition to arrest the Karachaevsk mayor”]; “Глава Роспотребнадзора по Кабардино-Балкарии задержан по подозрению в получении взятки” [“Head of Rosпотребнадзор in Kabardino-Balkaria arrested on suspicion of accepting bribes”]; “В Ставропольском крае во взяточничестве подозревается глава отдела по борьбе с коррупцией” [“Head of anti-corruption department in Stavropol Krai suspected of bribery”]; “Дело обвиняемого в хищениях экс-министра спорта Ставрополя передано в суд” [“The case of Stavropol Krai’s ex-sport minister accused of theft transferred to the court”]; “В Чечне экс-чиновник администрации Грозненского района обвиняется в хищении 9 млн рублей” [“Former official of the Grozny district administration accused of stealing nine million roubles”]; “В Дageстане по подозрению в мошенничестве задержан председатель Унцукльского райсобрания депутатов” [“The head of Untsukul district assembly of deputies has been detained on suspicion of fraud in Dagestan”], all Caucasian Knot, 9 August, 2 August, 18 July 2013; and 30 September, 3 May, 25 August 2014. “Министр образования КЧР задержан за 650 тыс. руб. взятки за ЕГЭ” [Karachevo-Cherkessia education minister arrested for 650,000-rouble bribes involving the USE], Gazeta.ru, 7 July 2013. “Глава Назрановского района Ингушетии задержан по делу о мошенничестве” [“Head of Nazran region of Ingushetia arrested for fraud”], RIA Novosti, 15 February 2013; “В Северной Осетии замначальника колонии задержан за взятку” [“Deputy head of a North Ossetian penal colony arrested for bribery”], Grani.ru, 17 August 2013.

state and municipal officials faced administrative or criminal charges. Kabardino-Balkaria instigated 88 criminal corruption cases during the year's first nine months.<sup>214</sup>

Regional officials assert that despite their poor reputation, the situation is similar to that in the rest of Russia:

That everything is stolen is not true. Look at the roads, schools here; they are not worse than in other regions. The level of corruption is proportional to allocated funds. ... It is impossible to steal something now, when everything is automated.<sup>215</sup>

Nonetheless, residents report corruption in almost all spheres of daily life.<sup>216</sup> As described above, bribes buy diplomas, sick-leave or disability certificates and a driver's license, and reduce debt for utilities. "Everything has its price ... from a place in a maternity ward to a cemetery plot", Dagestanis joke.<sup>217</sup>

Everyday bribes probably account for only a small part of corruption.<sup>218</sup> A presidential human rights council report noted: "The management of budget funds is the most economically attractive activity, giving high returns with minimal risk to the state law enforcement and controlling agencies".<sup>219</sup> Bureaucracy in the North Caucasus is far larger than the national average: 4.6 civil servants per 1,000 in Ingushetia and 3.5 in Chechnya compared to 1.8 overall.<sup>220</sup> In 2013, auditors found financial misconduct involving 1.36 billion roubles (\$41 million) in KChR and 5.37 billion roubles (\$162 million) in KBR. Chechen authorities in 2012 spent 7.9 billion roubles (\$239 million), 11 per cent of the annual budget, in violation of rules.<sup>221</sup> Despite allocation of significant resources for regional development – about 800 billion roubles (\$24.24 billion) from 2000 to 2010 – investment projects will continue to be hampered unless an "official at any level personally benefits from it".<sup>222</sup>

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<sup>214</sup> Crisis Group Report, *The Challenges of Integration (III)*, op. cit., pp. 22-24. "Прокуратура Дагестана с начала 2014 года привлекла к ответственности более 700 чиновников" ["Dagestan prosecutor's office held over 700 officials accountable"], RIA Dagestan, 8 August 2014. "Общественная палата Кабардино-Балкарии обратила внимание силовиков на коррупцию в муниципалитетах" ["Kabardino-Balkaria's public chamber drew security officials' attention to corruption in municipalities"], Caucasian Knot, 1 November 2014.

<sup>215</sup> Crisis Group interview, Aliy Musukov, Kabardino-Balkaria economic development minister, Nalchik, December 2012, referring to the financial reporting system.

<sup>216</sup> After an October 2008 earthquake, a victim said he could get 25 per cent of the official compensation only after he agreed to sign for the full amount. Crisis Group interview, resident of Kurchaloy district, Chechnya, August 2012.

<sup>217</sup> Crisis Group interviews, Grozny, Gudermes, Makhachkala, August 2012, July 2013.

<sup>218</sup> "Самый доходный бизнес в России – это коррупция, ее рынок достиг 300 млрд долларов ежегодно" ["The most profitable business in Russia is corruption. Its market has reached 300 billion dollars annually"], NEWSru.com, 9 April 2013.

<sup>219</sup> "Роль и место гражданского общества в противодействии экстремизму и терроризму" ["The role and place of civil society in countering extremism and terrorism"], The Presidential Council on Development of Human Rights and Civil Society, Moscow, 2011.

<sup>220</sup> "Медведев оптимизирует Кавказ" ["Medvedev is optimising the Caucasus"], Gazeta.ru, 19 August 2013.

<sup>221</sup> "Счетная палата проверила исполнение представлений и устранение нарушений в КБР и КЧР" ["Accounts Chamber reviewed implementation of statements and elimination of violations in KBR and KChR"]; "Счетная палата проверила использование бюджетных средств в Чеченской Республике" ["Accounts Chamber reviewed the use of budget funds in Chechnya"], Accounts Chamber of the Russian Federation, 17 July 2013, 31 March 2013.

<sup>222</sup> "Роль и место гражданского общества в противодействии экстремизму и терроризму" ["The role and place of civil society in countering extremism and terrorism"], Presidential Council on Development of Human Rights and Civil Society, Moscow, 2011.

Misappropriation and violation of spending procedures have a dramatic impact on human security, social services and law-enforcement.<sup>223</sup> Major corruption in disbursing federal funds dramatically reduces their effectiveness.<sup>224</sup> Auditors could not evaluate the modernisation of health-care programs in Dagestan in 2011-2012 because the republic provided no information on results achieved and resources used.<sup>225</sup> Corruption and the resulting inadequate social infrastructure lead to civil unrest and violence. Land transactions are most prone to corruption and greatly contribute to intercommunal conflict.<sup>226</sup>

The North Caucasus, especially Dagestan, is repeatedly identified as a major money-laundering area, involving banks, officials and multiple “one-day” firms. More than ten regional banks were suspected of large-scale money laundering. Since 2013 in Dagestan alone, at least sixteen banks have had their licenses suspended; three were closed in North Ossetia, two in Ingushetia. Some in Dagestan were closed for allegedly financing terrorism, most others for money laundering.<sup>227</sup>

Criminal elements reportedly linked to authorities across the country exploit a large cash market.<sup>228</sup> Additional significant federal funding prior to implementing

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<sup>223</sup> The pilot of the Dagestan Airlines plane that crashed in 2010 had a fake license. Two people died, including the brother of the republic’s then president. “Пилот разбившегося в 2010 году Ту-154 не заканчивал летное училище” [“Pilot of TU-154 crashed in 2010 had not graduated from pilot’s school”], *Izvestiya*, 23 January 2014. For more on corruption and rule of law, see Crisis Group Report, *The Challenges of integration (III)*, op. cit., pp. 32-47.

<sup>224</sup> In 2012, the Accounts Chamber stated that violations during the distribution of maternity money by the Chechen office of the Pension Fund “leave room for the misappropriation of funds”, a 600-million roubles (\$18 million) loss. The head of the Ingush office was arrested for fraud involving maternity money. “Счетная палата проверила использование бюджетных средств Отделением ПФР по Чеченской Республике” [“Accounts Chamber reviewed the use of budget funds by the Chechen Republic’s department of Russia’s Pension Fund”], Accounts Chamber of the Russian Federation, 28 June 2012. “Глава Пенсионного фонда Ингушетии арестован” [“Head of Ingushetia’s Pension Fund is arrested”], *Lenta.ru*, 1 April 2012.

<sup>225</sup> “Счетная палата проверила использование средств в Республике Дагестан” [“Accounts Chamber reviewed the use of funds in the Republic of Dagestan”], Accounts Chamber of the Russian Federation, 30 May 2013.

<sup>226</sup> “В Дагестане глава села задержан за получение взятки в 1,7 млн рублей” [“Village head in Dagestan detained for taking 1.7 million-rouble bribe”], *Caucasian Knot*, 19 December 2013; “Утопить и распилить” [“Drown and siphon off”], *Kavkazskaya politika*, 15 November 2013.

<sup>227</sup> “К кавказским банкам вызвали докторов” [“Doctors’ were called for the Caucasian banks”], *Expert* (online), 3 December 2012; “Дагестанский коммерческий банк ‘Экспресс’ рухнул” [“Dagestani commercial bank ‘Express’ has collapsed”], *Chernovik*, 8 January 2013. “С 2013 года, лишились своих лицензий уже 16 дагестанских банков” [“16 Dagestani banks have lost their licenses since 2013”], *Plantox.ru*, 31 August 2014. “Цетробанк обратился в суд с заявлением о ликвидации банка ‘Дагестан’” [“Central bank applied to the court requesting the liquidation of the bank ‘Dagestan’”], *Regnum*, 28 March 2014. “Эксперт: В Дагестане необходим крупный местный игрок на банковском рынке” [“Expert: a major local player is needed in the banking market in Dagestan”], *Regnum*, 5 March 2014.

<sup>228</sup> Gadzhi Gadzhiev, economics professor, interview in “Момент истины” [“The moment of truth”], 5th TV channel, 10 June 2013. Video available at [http://moment-istini.ru/program\\_archiv/archive\\_2013/?vid=416&start=2](http://moment-istini.ru/program_archiv/archive_2013/?vid=416&start=2). Eight people linked to the head of the Ingush Social Insurance Fund were detained for reported embezzlement of 1.2 billion roubles (\$36 million) in Nazran in December 2013; unregistered weapons were found at their homes. Dagestan’s vice prime minister was arrested in Moscow. “Вице-премьер Дагестана задержан по подозрению в мошенничестве” [“Vice prime minister of Dagestan detained on suspicion of fraud”], *Lenta.ru*, 21 January 2014. “Ингушетия: спецоперация против коррупции” [“Ingushetia: a special operation against corruption”], *Kavkazskaya Politika*, 24 December 2013.

major anti-corruption efforts would be counter-productive, because “... unchecked, corrupt behaviour of representatives of regional authorities of [the North Caucasus] is a breeding ground for extremist and terrorist activity”.<sup>229</sup>

Regional officials widely viewed as corrupt have stayed in power for years. Many criminal cases are not pursued. In the first half of 2014, investigations confirmed only seven of the twenty cases of possible corruption Chechen prosecuting agencies had uncovered, which, the republic’s prosecutor said, “clearly does not reflect the real situation in the republic” and indicates that law enforcement agencies “do not work on complicated corruption schemes and build their statistics on revealed facts of common everyday corruption”.<sup>230</sup> Sources in law enforcement assert that police responsible for investigation of corruption are often themselves corrupt. In 2014, two officers in the Stavropol Kray were sentenced to seven years in prison for taking bribes.<sup>231</sup>

There have been allegations that kickbacks from the North Caucasus reportedly reach the federal level in Moscow.<sup>232</sup> “Up to 20 per cent of budget money goes [back] to Moscow”, a Dagestan official said.<sup>233</sup> However, while regional corruption is broadly discussed, the federal component is mostly taboo. Moreover, regional elites use the terrorist threat to stay in power, convincing the federal centre that “if not us, there will be a war”.<sup>234</sup>

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<sup>229</sup> Presidential Council, op. cit.

<sup>230</sup> “Итоги работы органов прокуратуры” [“Results of work of the Prosecuting agencies”], <http://vesti95.ru/>, 14 August 2014.

<sup>231</sup> Crisis Group interview, officers of department for the combat of economic crimes, Makhachkala, August 2012. “На Ставрополье главе отдела по борьбе с коррупцией вынесен обвинительный приговор по делу о взяточничестве” [“The head of anti-corruption department in Stavropol Kray sentenced in corruption case”], *Caucasian Knot*, 17 July 2014.

<sup>232</sup> Crisis Group interviews, senior police officers, Makhachkala, August 2012. “Добросовестное исполнение законов на Кавказе решит национальный вопрос” [“Conscientious implementation of laws in the Caucasus will solve the nationality issue”], *Finam*, 16 November 2012.

<sup>233</sup> Crisis Group interview, Shakhmardan Muduyev, department head, Dagestan economic ministry, Makhachkala, July 2012.

<sup>234</sup> Alexander Khinshtein, interview in “Момент истины” [“The moment of truth”], 5th TV channel, 10 June 2013. Video available at [http://moment-istini.ru/program\\_archiv/archive2013/?vid=416&start=2](http://moment-istini.ru/program_archiv/archive2013/?vid=416&start=2).



## V. Conclusion

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The unique potential of the North Caucasus for economic growth cannot be realised without continuing federal support. But that support must be coupled with serious improvement in the quality of institutions, the delivery of social and legal justice and trust in everything from high school exams to the transparency of administrative budgets.

The authorities must revamp health and housing infrastructure, improve the professionalism of medical and teaching staff, simplify tax regulations for small businesses, end violations of social rights and punish serious crimes committed by representatives of health-care and educational systems. Land privatisation would strongly aid economic growth if carried out effectively and fairly. Large projects will facilitate development and contribute to stability only if the population's legitimate interests are considered. Small business and agriculture should be supported more effectively. Corruption and money laundering must be fought so that federal funds reach beneficiaries and do not end up in the market of violence.

Continuing violence and institutional hurdles – a result of omnipresent corruption, ineffective management and unresolved land issues – produce a vicious circle that impedes the region's chance for healthy growth. To win the ideological battle against Islamic radicals, especially the IS, the Russian state has to persuade North Caucasus residents that they live in and benefit from an efficient, honest, transparent and fair secular state.

**Brussels, 7 July 2015**

Appendix A: Map of the North Caucasus



## Appendix B: About the International Crisis Group

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The International Crisis Group (Crisis Group) is an independent, non-profit, non-governmental organisation, with some 125 staff members on five continents, working through field-based analysis and high-level advocacy to prevent and resolve deadly conflict.

Crisis Group's approach is grounded in field research. Teams of political analysts are located within or close by countries at risk of outbreak, escalation or recurrence of violent conflict. Based on information and assessments from the field, it produces analytical reports containing practical recommendations targeted at key international decision-takers. Crisis Group also publishes *CrisisWatch*, a twelve-page monthly bulletin, providing a succinct regular update on the state of play in all the most significant situations of conflict or potential conflict around the world.

Crisis Group's reports and briefing papers are distributed widely by email and made available simultaneously on the website, [www.crisisgroup.org](http://www.crisisgroup.org). Crisis Group works closely with governments and those who influence them, including the media, to highlight its crisis analyses and to generate support for its policy prescriptions.

The Crisis Group Board of Trustees – which includes prominent figures from the fields of politics, diplomacy, business and the media – is directly involved in helping to bring the reports and recommendations to the attention of senior policymakers around the world. Crisis Group is co-chaired by former UN Deputy Secretary-General and Administrator of the United Nations Development Programme (UNDP), Lord Mark Malloch-Brown, and Dean of Paris School of International Affairs (Sciences Po), Ghassan Salamé.

Crisis Group's President & CEO, Jean-Marie Guéhenno, assumed his role on 1 September 2014. Mr Guéhenno served as the UN Under-Secretary-General for Peacekeeping Operations from 2000-2008, and in 2012, as Deputy Joint Special Envoy of the United Nations and the League of Arab States on Syria. He left his post as Deputy Joint Special Envoy to chair the commission that prepared the white paper on French defence and national security in 2013.

Crisis Group's international headquarters is in Brussels, and the organisation has offices or representation in 26 locations: Baghdad/Suleimaniya, Bangkok, Beijing, Beirut, Bishkek, Bogotá, Cairo, Dakar, Dubai, Gaza City, Islamabad, Istanbul, Jerusalem, Johannesburg, Kabul, London, Mexico City, Moscow, Nairobi, New York, Seoul, Toronto, Tripoli, Tunis and Washington DC. Crisis Group currently covers some 70 areas of actual or potential conflict across four continents. In Africa, this includes, Burkina Faso, Burundi, Cameroon, Central African Republic, Chad, Côte d'Ivoire, Democratic Republic of Congo, Eritrea, Ethiopia, Guinea, Guinea-Bissau, Kenya, Liberia, Madagascar, Nigeria, Sierra Leone, Somalia, South Sudan, Sudan, Uganda and Zimbabwe; in Asia, Afghanistan, Indonesia, Kashmir, Kazakhstan, Kyrgyzstan, Malaysia, Myanmar, Nepal, North Korea, Pakistan, Philippines, Sri Lanka, Taiwan Strait, Tajikistan, Thailand, Timor-Leste, Turkmenistan and Uzbekistan; in Europe, Armenia, Azerbaijan, Bosnia and Herzegovina, Cyprus, Georgia, Kosovo, Macedonia, North Caucasus, Serbia and Turkey; in the Middle East and North Africa, Algeria, Bahrain, Egypt, Iran, Iraq, Israel-Palestine, Jordan, Lebanon, Libya, Morocco, Syria, Tunisia, Western Sahara and Yemen; and in Latin America and the Caribbean, Colombia, Guatemala, Mexico and Venezuela.

This year Crisis Group receives financial support from a wide range of governments, foundations, and private sources. Crisis Group holds relationships with the following governmental departments and agencies: Australian Department of Foreign Affairs and Trade, Austrian Development Agency, Belgian Ministry of Foreign Affairs, Canadian Department of Foreign Affairs, Trade and Development, Danish Ministry of Foreign Affairs, Dutch Ministry of Foreign Affairs, European Union Instrument for Stability, Finnish Foreign Ministry, French Ministry of Foreign Affairs, Irish Aid, Italian Foreign Ministry, Principality of Liechtenstein, Luxembourg Ministry of Foreign Affairs, New Zealand Ministry of Foreign Affairs and Trade, Norwegian Ministry of Foreign Affairs, Swedish Ministry of Foreign Affairs, Swiss Federal Department of Foreign Affairs, Turkish Ministry of Foreign Affairs, United Kingdom Department for International Development, U.S. Agency for International Development.

Crisis Group also holds relationships with the following foundations: Adessium Foundation, Carnegie Corporation of New York, Henry Luce Foundation, John D. and Catherine T. MacArthur Foundation, Koerber Foundation, Oak Foundation, Open Society Foundations, Open Society Initiative for West Africa, Ploughshares Fund, Rockefeller Brothers Fund, and Tinker Foundation.

**July 2015**

## Appendix C: Reports and Briefings on Europe and Central Asia since 2012

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*As of 1 October 2013, Central Asia publications are listed under the Europe and Central Asia program.*

### Ukraine

*Ukraine: Running out of Time*, Europe Report N°231, 14 May 2014.

*Eastern Ukraine: A Dangerous Winter*, Europe Report N°235, 18 December 2014.

*The Ukraine Crisis: Risks of Renewed Military Conflict after Minsk II*, Europe Briefing N°73, 1 April 2015.

### Central Asia

*Kyrgyzstan: Widening Ethnic Divisions in the South*, Asia Report N°222, 29 March 2012.

*Kazakhstan: Waiting for Change*, Asia Report N°251, 30 September 2013.

*Water Pressures in Central Asia*, Europe and Central Asia Report N°233, 11 September 2014.

*Syria Calling: Radicalisation in Central Asia*, Europe and Central Asia Briefing N°72, 20 January 2015 (also available in Russian).

*Stress Tests for Kazakhstan*, Europe and Central Asia Briefing N°74.

### Balkans

*Kosovo and Serbia: A Little Goodwill Could Go a Long Way*, Europe Report N°215, 2 February 2012.

*Bosnia's Gordian Knot: Constitutional Reform*, Europe Briefing N°68, 12 July 2012 (also available in Bosnian).

*Setting Kosovo Free: Remaining Challenges*, Europe Report N°218, 10 September 2012.

*Serbia and Kosovo: The Path to Normalisation*, Europe Report N°223, 19 February 2013 (also available in Albanian and Serbian).

*Bosnia's Dangerous Tango: Islam and Nationalism*, Europe Briefing N°70, 26 February 2013 (also available in Bosnian).

*Bosnia's Future*, Europe Report N°232, 10 July 2014.

### Caucasus

*Tackling Azerbaijan's IDP Burden*, Europe Briefing N°67, 27 February 2012 (also available in Russian).

*Armenia: An Opportunity for Statesmanship*, Europe Report N°217, 25 June 2012.

*The North Caucasus: The Challenges of Integration (I), Ethnicity and Conflict*, Europe Report N°220, 19 October 2012 (also available in Russian).

*The North Caucasus: The Challenges of Integration (II), Islam, the Insurgency and Counter-Insurgency*, Europe Report N°221, 19 October 2012 (also available in Russian).

*Abkhazia: The Long Road to Reconciliation*, Europe Report N°224, 10 April 2013.

*The North Caucasus: The Challenges of Integration (III), Governance, Elections, Rule of Law*, Europe Report N°226, 6 September 2013 (also available in Russian).

*Armenia and Azerbaijan: A Season of Risks*, Europe Briefing N°71, 26 September 2013 (also available in Russian).

*Too Far, Too Fast: Sochi, Tourism and Conflict in the Caucasus*, Europe Report N°228, 30 January 2014 (also available in Russian).

*Chechnya: The Inner Abroad*, Europe Report N°236, 30 June 2015 (also available in Russian).

### Cyprus

*Aphrodite's Gift: Can Cypriot Gas Power a New Dialogue?*, Europe Report N°216, 2 April 2012 (also available in Greek and Turkish).

*Divided Cyprus: Coming to Terms on an Imperfect Reality*, Europe Report N°229, 14 March 2014 (also available in Greek and Turkish).

### Turkey

*Turkey and Greece: Time to Settle the Aegean Dispute*, Europe Briefing N°64, 19 July 2011 (also available in Turkish and Greek).

*Turkey: Ending the PKK Insurgency*, Europe Report N°213, 20 September 2011 (also available in Turkish).

*Turkey: The PKK and a Kurdish Settlement*, Europe Report N°219, 11 September 2012 (also available in Turkish).

*Turkey's Kurdish Impasse: The View from Diyarbakir*, Europe Report N°222, 30 November 2012 (also available in Turkish).

*Blurring the Borders: Syrian Spillover Risks for Turkey*, Europe Report N°225, 30 April 2013.

*Crying "Wolf": Why Turkish Fears Need Not Block Kurdish Reform*, Europe Report N°227, 7 October 2013 (also available in Turkish).

*The Rising Costs of Turkey's Syrian Quagmire*, Europe Report N°230, 30 April 2014.

*Turkey and the PKK: Saving the Peace Process*, Europe Report N°234, 6 November 2014 (also available in Turkish).

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