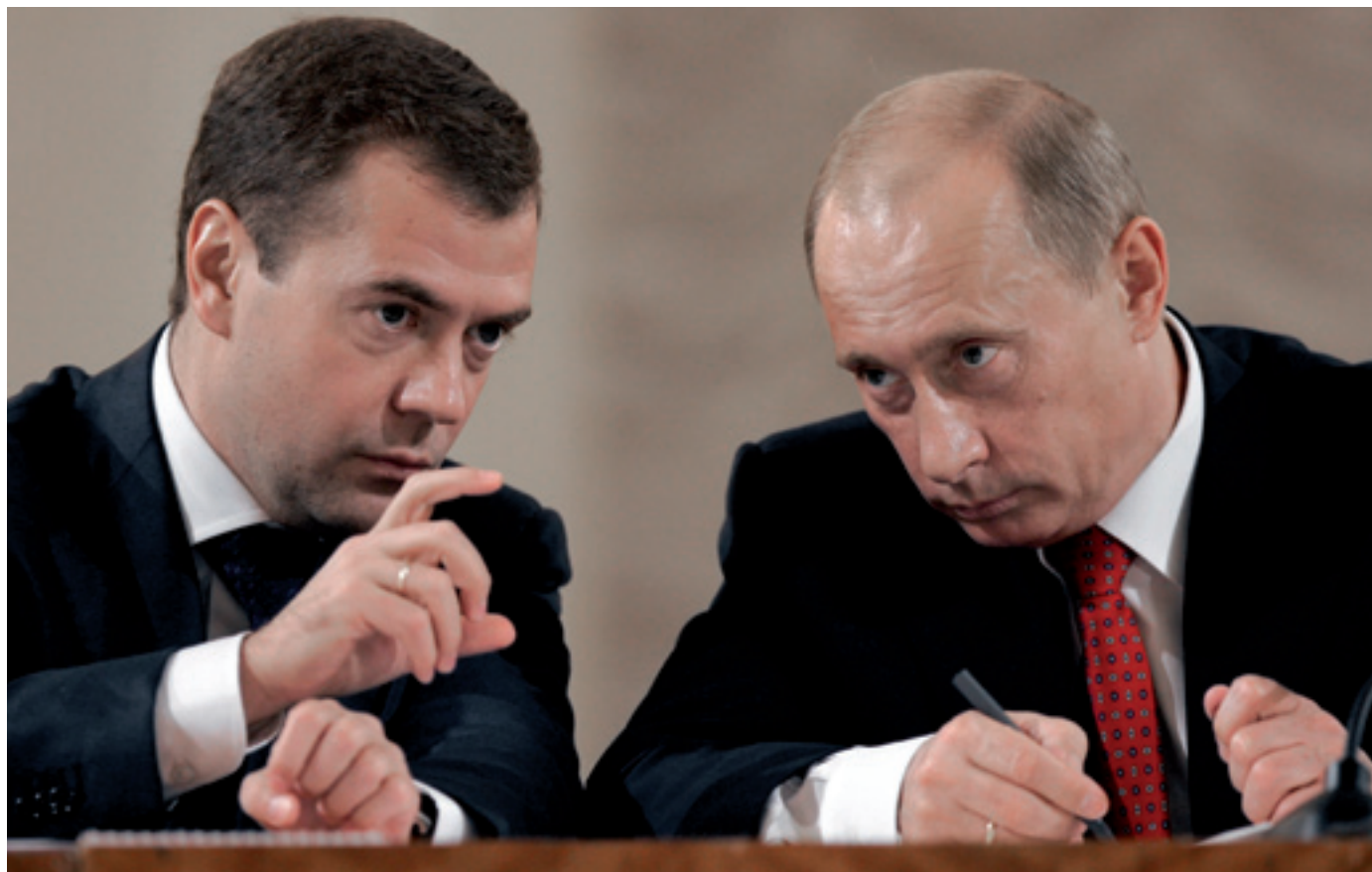


Russia

Between state power and liberal reform

The well-orchestrated succession of Vladimir Putin by Dmitry Medvedev occurred without a hitch. But Medvedev still faces a formidable task: to find a new balance between government interference and a market economy.



Russia's new President Dmitry Medvedev and former Russian President Vladimir Putin at the conference of the Unified Russian Association of municipal units in The Hall of Columns. Photo: Astakhov Dmitry/ITAR-TASS/Corbis

| by Hans van Koningsbrugge

Anyone analysing the eight years of the Putin regime cannot deny that there has been strong economic growth in Russia, mainly due to revenue from oil and gas sales. Not all sectors of Russian society have benefited from this growth. The rise in the standard of living of retired Russians, for example, has lagged far behind that of the working population. Healthcare and military reforms have barely been implemented and yet have already been delayed by various bureaucratic obstacles. On top of that, the privatisation of state enterprises has been largely suspended because priority is now shifting to the creation of national industrial champions. This does not only concern the oil and gas industry, but also aviation and mining.

It is obvious that the Kremlin has tried to sell the present economic growth as the ultimate evidence of the success of its own policies. But a few things ought to be discounted from this claim. It was the constant price increases by the energy suppliers that provided the financial latitude to fill the treasury and pay off foreign debt. Thus, during the period of 2003 to 2006, there was talk of a debt reduction from \$98 billion to \$66 billion. However, the debts of state-connected enterprises and banks owed to foreign entities during that period increased from \$31 billion to \$167 billion. The question remains whether national industrial champions like Gazprom and Rosneft will be able to continue to develop sufficient dynamic potential and translate it into successful economics and management. "Big" does not always translate into "efficient and innovative". The issue is not whether the Russian social and political stability has improved under Putin's administration. Under Boris Yeltsin, after the end of Soviet rule in Eastern Europe and after the implosion of the Soviet Union, even Russia itself did not appear to be immune to fragmentation. In the face of a weakening centre, there was an increasingly assertive periphery. Some segments of the Russian Federation,

like Tatarstan, obtained an advanced form of autonomy, and Chechnya was able to break away and acquire de facto independence. Under Putin, Russia was divided into seven administrative regions where a Kremlin-appointed super-governor held the sceptre. It is abundantly clear that the prevention of a return to the chaos of the nineties is of particular importance for the majority of the Russian population.

State enterprises |

The increased revenue made the Russian state less economically vulnerable than at the end of the nineties. This also meant that the Russian leaders could adopt a more assertive attitude towards foreign countries. The nature of this assertiveness, however, was different from that of the Soviet period. Soviet thinking focused on a self-imposed isolation, whereby the ideological myth of a future workers' paradise formed both an internal unifying force and an external international political obstacle. This type of isolationist foreign policy, however, is now associated by the vast majority of Russians with a planned economy that was characterised by poor technological development and a collective low standard of living.

It should be noted, however, that a substantial segment of Putin's elite received its educational training during the aftermath of the Soviet Union. The outlook of the time consisted of a sharp distinction between good and evil: a viewpoint that placed more emphasis on old risks than new possibilities. Now that the ideology of communism is no longer satisfying, many are returning to the Russian ideology of the 19th century, when Russia had a specific historic mission in the world. What exactly this mission consisted of, however, remains obscure. Just like then, reference is now being made to "national glory" and the idea that Russia's accomplishments are inherently of higher value than those of other states. This in turn yields the "moral right" to demonstrate a "natural

leadership" over other countries, particularly neighbouring ones.

Another characteristic of Putin's elite is the large overlap with state enterprises. Numerous ministers and top bureaucrats are also on the boards of directors of various government-connected companies. All of this has substantially increased the level of corruption and it tarnishes the image of the present Kremlin to a considerable extent; something that even President Putin has recognised. Part of the problem is state ideology as perceived by the elite. It is not only interested in strengthening the state but also in the preservation of its own position and interests. That's why this same elite did not concentrate on solving social problems during Putin's administration but rather on building its own national network of persons and institutions that, above all, are loyal to the Kremlin. That's why consequences in the face of serious failure did not materialise. An example of this is the impunity with which incompetent government officials can act, as in the example of the disastrous way the hostage-taking in Beslan was handled in September 2004.

Freight traffic |

The Russia of the early nineties saw massive privatisation, coupled with de-industrialisation. Companies privatised at the time were mostly led by former communist managers. These new owners were educated during the planned economy, when the state took care of

Healthcare and military reforms have barely begun

financing, capital goods and labour forces, and they had little knowledge of modern Western management and business strategies. In addition, they faced competition from Western

products, which were frequently of much better quality and soon dominated the Russian market. In fact, this led to de-industrialisation. In 1989, oil, gas and minerals represented 58% of Russia's exports. In 2005, this had increased to 78%. It is also noteworthy that oil and gas production did not show a significant increase during that period. In 2005, Russia produced 469 million tons of oil and 637 billion cubic metres of gas, which was about the level in 1991. It will be more difficult for Russia to maintain the current production level, especially after 2010. For that level to be reached, substantial investments would be required. If they are not obtained, then a drop in the export volume will be inevitable, which is sure to have a negative effect on the Russian economy in general. At the same time, Russia will further cultivate its unique position as a bridge between China and Europe, a necessary move given that the volume of freight traffic via the Trans-Siberian Railroad dropped by 40% during the Putin years.

The high oil and gas prices during Putin's reign have enabled an accelerated payback of the Russian national debt. Since 2002, the state-connected enterprises have gained in importance. Gazprom alone represents 25% of the Russian GNP, although the formation of national champions has taken its toll. The forced break-up of Yukos in 2004, for example, led to a series of take-overs, including that of Sibneft by Gazprom. However, all of this could not be financed without the help of foreign capital. Partly because of this, the foreign debt of Russian state enterprises rose from \$31 billion in 2003 to \$167 billion in 2006.

Elections |

The Russian elections turned out exactly the way everyone had expected. Putin's designated successor, Dmitry Medvedev, won with an overwhelming majority of the electorate and a second round was superfluous. Medvedev's opponents, the communist Gennady Zyuganov and Vladimir Zhirinovskiy of the Liberal-Democratic Party had already been

candidates in previous presidential elections and lost, while the fourth candidate, Andrei Bogdanov, remained a total unknown.

The election result may have been predictable, but that does not mean that its legitimacy must be doubted. Most of the criticism – also from the West – was directed at the both the election campaign and the result. The ruling regime successfully played the stability

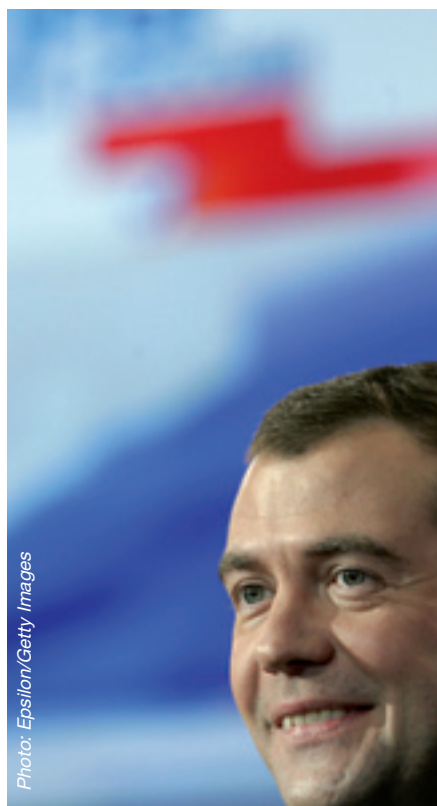


Photo: Epsilon/Getty Images

card, while the opposition appeared rather fragmented and disorganised, mainly because Medvedev's opponents did not speak with one voice. Only a combination of Zyuganov and Zhirinovskiy in one candidate could have represented a certain electoral danger to the Kremlin. Besides, those who expressed political and economic opinions reminiscent of the beginning of the nineties stood no chance right from the start. The majority of the Russian population is still not taken with abstract ideas like freedom, equality and democracy. There is a good reason why a majority of respondents in a recent opinion survey described democracy as a 'good salary'. The problem is also that the West barely

considers Russia a democracy, let alone a developing one, while the presidential entourage does. At any rate, it is a rare phenomenon in Russian history that a leader at the pinnacle of his power voluntarily surrenders an important part of his power. This is even more remarkable because it would have taken little effort on Putin's part to receive parliamentary approval for amending the constitution in favour of a third presidential term.

Who is Medvedev? |

The vast majority of the Russian electorate may have elected Dmitry Medvedev but it remains unclear to many who he actually is and what he really stands for. An opinion survey, conducted by the Lavada Centre, right after the elections, demonstrates this quite clearly. 35% of the respondents said that they did not know why they liked Medvedev and 67% could not say what they did not like about the new president. Curiously enough, 97% did know where Medvedev's priorities should be, namely at economic development, combating rapidly rising inflation and fighting corruption.

Who is Medvedev? Originally he was a barrister who, in the nineties, combined an academic position with a job in the city government of St. Petersburg. At the time, Vladimir Putin was his boss. When Putin departed for Moscow, Medvedev came along. He also led Gazprom and was the campaign director during the 2000 presidential elections. His appointment to vice-premier, together with Sergey Ivanov, formally made Medvedev one of Putin's crown princes.

The selection of Medvedev as successor to the sitting president was not generally expected. The Kremlin elite can roughly be divided into two groups. On the one hand, there are the siloviki: policy makers originating from the armed forces and security services. Their leader was Sergey Ivanov, a former KGB director and the minister of defence until 2007, when he became vice premier. Medvedev does not belong to the siloviki but is representative of the energy-industrial complex. These groups have different priorities. Ivanov,

for example, is an obvious proponent of a tough Russian foreign policy. Medvedev's tone and demeanour are less severe, although his statements disapproving of the potential admission of Georgia and Ukraine to Nato were quite harsh. Medvedev places emphasis on healthy economic development, for which intensive economic contact with the West is indispensable. However, this requires adequate legislation and a commitment to fighting corruption, something of which the new president is very much aware. The dichotomy in the presidential entourage was a little problematic during the Putin years because the Kremlin elite was a clear creation of Putin himself. For that reason, his authority was not questioned. One wonders if Medvedev will be able to demonstrate the same degree of authority. It will undoubtedly be of help that the sitting president has offered to stay on as prime minister. Nevertheless, Medvedev needs to distinguish himself



Former Russian president Vladimir Putin and his successor Dmitry Medvedev light candles in the Ascension Cathedral, in Novocheerkassk. Photo: Astakhov Dmitry/ITAR-TASS/Corbis

Before long, a move will be made towards a Russian National Oil Company (RNOC)

explicitly by building his own governing entourage, essential for one holding the office of president. After all, the Russian governing model is deeply rooted in a clearly defined hierarchy with presidential representatives at all levels.

Medvedev's challenges |

At the economic level, the new president needs to find a balance between renewed government influence and a free market economy. The drift is clearly towards more state influence in a number of sectors but this cannot be applicable to the entire Russian economy, otherwise the old communist system would be restored in all of its glory, making it impossible to acquire foreign investments. At the same time, however, a social state needs to be built. Here lies quite clearly the weakness of the Putin regime. Hardly

any sweeping social changes have taken place. Putin himself admitted this at the time of his last press conference, indicating that his administration had failed in the area of fighting poverty. As an extension of that, Medvedev needs to pay urgent attention to health care, education, housing, social welfare, military reforms, fighting corruption, and legislation, with emphasis on the development of a juridical system able to function independently of the politics of the day. Many of these topics also have a direct bearing on the demographic crisis Russia finds itself in at this moment. The population is decreasing – by an average of 800,000 to 1 million per year – and this is correctly seen by the Kremlin as a top priority problem. It is clear that married couples will only be willing to raise more children if the standard of living rises to a higher level than that of today. In a recent speech in Krasnoyarsk, Medvedev hinted at his reform plans regarding this issue and it appears that the proposals are going in a liberal direction. In this respect it is noteworthy that the ideas resemble much of the program of the Yabloko party in the Duma election of last December, although it is yet to be seen how the chips will fall.

National oil company |

It is widely expected that the same consolidation that occurred in the gas

sector will take place in the oil sector. Before long, a move will be made towards a Russian National Oil Company (RNOC), following the example of a few Arab countries. Besides Gazprom, partners in this company will be Lukoil, TNK and Rosneft. Such a consolidation has already occurred in the gas sector. Similarly, Putin has made plans to create a supranational vehicle with governing capabilities with regard to the price and supply of gas. The most important participants in this would be the former Central Asiatic Soviet Republics and Russia itself. Not only can this become one of the means by which Russia will be able to hold on to its sphere of influence in Central Asia, it can also serve to exert pressure on the West. Medvedev will undoubtedly continue on this course because energy and foreign policy have become solidly intertwined with each other since Putin's rise to power. Medvedev will also make a powerful effort to diversify the Russian economy. Russia must thereby not only export oil and gas, but also process these, as well as other minerals, into semi-finished and finished products. To this end, foreign capital will have to be attracted. The question is whether this will be permitted in the oil and gas processing industries, or if this is only possible in those sectors that are less sensitive politically and strategically. One way or another, the success of Medvedev's plans will depend greatly on stable and high oil and gas prices. ■