ANALYSIS

The Political Economy of Putin 3.0

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Abstract
President Vladimir Putin has been extremely active since returning to the Kremlin in May 2012. However, he has been unable to turn his plans for economic reform into real change on the ground. Rather than prioritize economic reform, Putin has instead sought to strengthen the "power vertical" in the executive branch.

The Putin System

During his first two terms in office, Vladimir Putin forged a curious hybrid economic system, standing on two legs. One leg was a strong state with a controlling stake in important sectors such as oil, gas and the defense industries, and no compunction about intervening in defiance of rule of law in other sectors of the economy. The second was a cluster of wealthy and feisty oligarchs who controlled perhaps one third of the country's economic activity through corporations under their personal control.

Alena Ledeneva has characterized the Putin model as elements of the Soviet system adapted to the conditions of a market economy.[1] There seems to be no contradiction between authoritarian rule and capitalism, neither in Russia nor China. On the contrary, Lilya Shevtsova argues that "Economic liberalism has served as Viagra for Russian authoritarianism."[2]

During the years 2000–08 Putin's model seemed to be working, with the economy growing at an average of 7% per year and real wages rising at a still faster rate. Skeptics argued that this growth was driven by the rise in the world oil price, and that the underlying inefficiencies in the model would ultimate lead to economic stagnation and subsequent social unrest.

There was also the problem of mounting social and regional inequality. There is a fundamental mismatch between the industrial society which Russia inherited from the Soviet Union and the extractive economy which generates huge wealth from a handful of resource-rich provinces. (The top 10 of Russia's 83 regions alone account for 52% of national GDP.[3]) Putin seemed to be offering Russians a new social contract: rising living standards and a robust social safety net in return for them giving up on Western-style democratic participation. But did the state have the capacity—and the will—to redistribute sufficient resources to keep the masses content?

The 2008 global financial crisis hit Russia harder than most countries, with the double-whammy of a collapse in the world oil price and a massive outflow of private capital from Russia's over-extended banking and construction sectors. The state spent down one third of its $600 billion reserves stabilizing the ruble, rescuing Russian banks and bailing out manufacturing enterprises. But when the dust had settled, in 2010 the economy resumed its growth path. While a decade earlier the 1998 financial crisis had caused a massive restructuring of Russia's political and economic system, in contrast the Putin regime survived the 2008 crisis unscathed.

Political Vulnerability

In 2008–12 Russia was ruled by the uneasy "tandem" of President Dmitry Medvedev and Prime Minister Putin. Medvedev made halting efforts to "modernize" the Russian economy. This ranged from introducing more open electronic government to a series of expensive infrastructure projects, such as the East Siberia–Pacific Ocean oil export pipeline and the Skolkovo innovation park.

In 2011 we learned that the threat to Putin came not from the economy, but from the inadequacy of the ruling political institutions. In September 2011 Putin announced that he was returning to the presidency. This exposed the phony nature of Russia's "managed democracy," triggering large-scale street demonstrations in Moscow in the wake of the December 2011 State Duma elections, widely perceived as rigged.

Putin's re-election as president in May 2012 was never in doubt. But Putin saw the need to overhaul the political system, combining tighter authoritarian controls over the opposition with a series of speeches and articles in which he laid out an ambitious agenda for his return to the presidency. The economic system was to be left more or less as it was, while the role of the "power vertical" in managing the economy was strengthened.

Renewed Vigor

Putin seemed to be energized by his brush with political mortality in the winter of 2011–12. During the first year of his third term he applied the same sort of vigor to ruling Russia that he had brought to the office back in 2000–01. When he moved from the prime minister's office to

1 Interview by Tonya Samsonova, "Tekhnologiya stabili'nosti," slon.ru, 22 April 2013. http://slon.ru/russia/tekhnologiya_stabilnosti_kak_privy azat_elitu_k_kormushke-934775.xhtml
2 Lilia Shevtsova, "Russia XXI: the logic of suicide and rebirth," Carnegie Endowment, January 2013. http://carnegie.ru/publications/?fa=50874
3 Vedomosti, 23 January 2013.

the presidency, he brought half-a-dozen former ministers with him as aides, forming what Yevgeny Minchenko dubbed a new Politburo.[4] The presidential administration, headed by Putin's long-time confidante Sergei Ivanov, is the nerve-center of the new political regime.[5]

The notion of Putin exercising "manual control" over the economy first came to attention during the 2008 crisis, when Putin was a flurry of (televised) activity, prodding bureaucrats and businessmen to action. The iconic event was when he "threw the pen" at Oleg Deripaska, owner of Basic Element, while persuading him to reopen a bankrupt factory in Pikalevo in June 2009.

Soon after resuming the presidency in May 2012 Putin issued a series of decrees ordering his ministers to draw up plans to implement a broad range of spending programs aimed at improving government services. Even though Medvedev had replaced Putin as prime minister, Putin was effectively taking direct command of the government.

Putin's decree no. 596 "On the state's long run economic policy" of 17 May 2012 laid out a dozen ambitious long-term goals, including: 25 million new job places by 2020; investment to reach 25% of GDP by 2018; a 30% increase in high tech products; a 50% increase in labor productivity; and increase Russia's World Bank ease of doing business rating from 120th place to 50th by 2015 (and 20th by 2018).[6] He even included goals for increasing the average lifespan to 74 years and birthrate to 1.753 per woman by 2018. The government was tasked with preparing a strategic plan and new budget policies by October 2012; creating an ombudsman for the defense of small business by December 2012; and reviewing the status of state corporations by March 2013.

Many of these programs focused on increased delivery of services in health and education at the regional level. Former banker Oleg Govorun was appointed regional development minister in May 2012. He was reprimanded by Putin for failing to implement the May program, and replaced in November 2012 by Kostroma governor Igor Slyunyaev.

Reporting to the State Duma in April 2013, Medvedev said that the government had fulfilled 73% of its targets.[7] Putin had issued 218 instructions, and 110 of the 150 tasks which were to be met within one year had been fulfilled. This included the passage of 29 new laws, with 25 more working their way through the State Duma. Spending on wages in education and health care rose by 18% and 20% respectively. In January 2013 the Ministry for Regional Development prepared a draft program "Regional Policy and Federative Relations" to promote a new vision of "competitive federalism" combining independence with accountability.

However, Putin told the government meeting on 7 May 2013 that many of these measures were mere formalities ("ticking boxes"), lacking concrete goals for implementation.[8] Deputy Prime Minister Vladislav Surkov, co-chair of the commission for implementing the presidential decrees, responded "After what you have just said, there is almost no point in my reading my report."[9] Surkov resigned the next day. Putin gave the ministries two weeks to draw up new plans, and explained he will meet personally with each minister to assess their performance.[10]

Another measure aimed at increasing oversight was new legislation prohibiting Russian officials (and their immediate family) from holding bank accounts abroad or owning foreign-issued shares and bonds, which came into force in May 2013.[11] (Officials had been required to report their incomes since 2008, but not assets.)

Meanwhile, the state's role in the economy continued to expand. Rosneft's $55 billion takeover of TNK-BP was announced in October 2012 and completed in March 2013, with much of the money to finance the acquisition having been borrowed from China. Spending on the infrastructure for the 2014 Sochi Olympics will reach $50 billion, providing a rich source for corruption and incompetence.[12]

The state and oligarchs have achieved a modus vivendi. In the words of political guru Sergei Markov, "the oligarchs of the 1990s spit on the state, while those of today respect it."[13] According to Stanislav Belkovsky's latest report on the oligarchs, there has been no 'statization' of the economy under Putin 3.0 because the state itself consists of an agglomeration of private interests.[14] How is one to categorize figures such as Igor Sechin,

4 Yevgeny Minchenko, "Vladimir Putin's Big Government: Politburo 2.0," August 2012, http://minchenko.ru/netcat_files/File/Big%20Government%20and%20the%20Politburo%202_0.pdf

5 Elizaveta Surnacheva, "V apparatnom stroyu," Kommersant Vlast, 8 April 2013 http://www.kommersant.ru/doc/2156014

6 http://graph.document.kremlin.ru/page.aspx?1610833

7 Maksim Tovkailo, "Medvedev otvetit za predvybornye obeshchaniya Putina," Vedomosti, 29 April 2013.

8 Andrei Kolesnikov, "Rukovosyashchie prikazaniya," Kommersant Vlast, 8 May 2013.

9 http://www.business-gazeta.ru/article/79859/; http://президент.рф/%D0%BD%D0%BE%D0%B2%D0%BE%D1%81%D1%82%D0%B8/18039#sel=

10 "Putinu ne khvatilo konkretiki," RIAN, 7 June 2013.

11 Kira Latukhina, "Shchet, pozhaluista!," RG, 4 April 2013. http://www.rg.ru/2013/04/04/schet.html

12 Boris Nemtsov and Leonid Martinyuk, "Zimnyaya Olimpiada v subtropikakh," http://www.nemtsov.ru/?id=718789&PHPSESSID=13c7a42a3061422d0aa0f559163b74e9

13 Natella Boltyanskaya, "Skol'ko prozivet vlast?," Ekho Moskvy, 25 July 2012.

14 Stanislav Belkovsky, "Gosudarstvo i oligarkhiya: 10 let spustya," slon.ru, 4 June 2013. http://slon.ru/russia/embargo_do_21_gosudarstvo_i_oligarkhiya_10_let_spustya-949243.xhtml

simultaneously CEO of Rosneft and head of the presidential energy commission? The new program to privatize some of the remaining assets in state hands is seen by skeptics as motivated not by the pursuit of efficiency, but by a desire to reward members of the elite.[15] For example, between them the oligarchs Mikhail Prokhorov and Suleiman Kerimov have bought nearly $1 billion stock in the state-run VTB Bank as it was privatized in early 2013. Oligarchs who run into trouble can still expect assistance from the state. For example, in November 2012 Rusal won a 75% discount on its electricity from Rosatom to prevent it from closing the Bogoslavskiii aluminum plant in Sverdlovsk oblast.[16]

Economic Growth Slows Down

While Putin was re-establishing his position at the apex of the "power vertical," Russia's sluggish economic growth was worrying observers. The economy's lackluster performance was dissected in two thorough reports from the World Bank and the World Economic Forum.[17]

At first glance Russia's macroeconomic outlook looks stable. The growth rate for 2013 is expected to be in the range of 2.4–3.4%.[18] The higher estimate is from the IMF, the lower estimate is from the Russian economics ministry, and reflects a slowdown in the first three months of 2013. Unemployment is a modest 5.4%, and inflation is running around 7.1%. With the oil price on a plateau of around $100 a barrel, Russia's foreign trade current account shows a sizeable surplus, and the federal budget is even close to the break-even point.

This growth rate is respectable enough by the anemic standards of contemporary Europe—but it falls below what Russia needs if it is to rebuild its infrastructure and establish an internationally competitive manufacturing base. In the 2000s the country had been growing at 7% a year—and now it has to settle for growing at half that rate. Dreams of doubling GDP by 2020 have receded.

There are also clear signs that Russia's short-run stability may be coming at the cost of long-term economic performance.

The labor force is already emerging as a serious constraint on growth. Due to the aging of the population, the labor force is shrinking by about one million a year—and the influx of 200,000–300,000 migrant workers per year is already causing a rise in inter-ethnic tensions in some Russian cities. The national unemployment rate of 5.4% conceals substantial regional imbalances: unemployment is a mere 3% in the central federal district, including Moscow.

In the longer term, Russia is set to see its elderly dependency ratio rise from 18% to 36% by 2050, which will increase the burden on the federal budget—especially given the failure of the attempted privatization of the pension system.[19] A decision on what to do with pension reform has been pushed back to 2015.

Russia remains heavily dependent on its oil and gas industry, which accounts for about 20% of GDP and 50% of federal budget revenue. Perhaps even more of a problem than the budget's dependence on an oil price above $100 is the squeeze on investment in developing new fields. The government gets $78 for each $100 per barrel of oil—leaving little incentive for companies to expand output, especially given the higher costs of developing East Siberia or Arctic offshore fields. Gazprom's rosy future has been cast in doubt by the tumbling international gas price in the wake of the U.S. shale revolution, which has forced it to pay over $4 billion in rebates to its European customers.[20] Gazprom suspended development of its giant offshore Shtokman field in 2010. But in late 2012 Putin decided to go ahead with the Chayadinsk field in Yakutia, building a pipeline to Vladivostok, and to build the South Stream export pipeline across the Black Sea.

Diversification of the economy away from oil and gas is not happening. January 2013 saw a monthly decline in industrial output for the first time since 2009. Capital flight amounted to $76 billion in 2011 and $46 billion in 2012. The business climate is still poor—the World Bank ranks Russia at 112 out of 185 in its ease of business rating for 2013,[21] while the World Economic Forum Global Competitiveness report places them at 67 out of 144 countries surveyed.[22]

Russia did finally join the World Trade Organization in 2012, but the impact of WTO entry is likely to be modest. Predictions of a 2–3% annual boost to GDP are based on heroic assumptions about the possible impact of liberalization on Russia's domestic financial markets. Putin seems more interested in turning the Eurasian Economic Union into a fully-integrated economic entity, building on the Common Economic Space introduced between Russia, Belarus and Kazakhstan

15 Minchenko, op.cit.
16 Sergei Aleksashenko, "Spasenie oligarkhov," Ekho Moskvy, 4 November 2012.
17 World Bank, Russian Economic Report 29, Recovery and Beyond, 26 February 2013; http://www.worldbank.org/en/news/press-release/2013/02/26/russian-economic-report-29; World Economic Forum, Scenarios for the Russian Federation, January 2013; http://www3.weforum.org/docs/WEF_Scenarios_RussianFederation_Report_2013.pdf
18 Isabell Gorst, "Russia and less than $100 oil," Financial Times, 17 April 2013. http://blogs.ft.com/beyond-brics/2013/04/17/russia-and-less-than-100-oil/#axzz2QomXKvEv
19 World Bank 2013, p. 26
20 Guy Chazan and Neil Buckley, "A cap on Gazprom's ambitions," Financial Times, 6 June 2013.
21 http://www.doingbusiness.org/rankings
22 http://www.weforum.org/issues/global-competitiveness

in January 2012 (following the 2009 Customs Union). However, there are only modest efficiency gains for Russia from integrating with those two much smaller economies, and the prospects for significant new members such as Ukraine joining the project appear to be slim.

One dramatic development which showed the perils of international integration Russian-style was the financial crisis which erupted in Cyprus, a member of the Euro-zone, in March 2013. As a condition for a $10 billion bailout, the European Union forced Cyprus to freeze €5.8 billion in accounts larger than €100,000 in selected banks. Half of those accounts were thought to belong to Russian companies and individuals, who have longed used Cyprus to hide their earnings from prying tax authorities. The Russian government was furious, but decided not to intervene (by offering its own rescue package to the Cyprus government, for example). Putin described the EU plan as "unfair, unprofessional and dangerous."[23]

Russian government leaders are all too aware of these structural problems: Putin published an article in *Vedomosti* on 30 January 2012 titled "We need a new economy."[24] The problem is that Putin has been calling for a new economy year in and year out since 1999—but he does not explain the lack of progress after his 13 years in power. A combination of bureaucratic resistance and political caution in the face of potential social unrest means that Putin is unable to translate his rhetorical commitment to economic modernization into policies that actually change the situation on the ground. He is relying on an old Soviet style mobilization campaign, transmitted through the ministerial apparatus, to improve state performance while somehow trying to encourage the oligarch-run economy to invest in Russia's long-term development.

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23 Ilya Arkhipov, "Putin says Cyprus bank-deposit levy is dangerous," Bloomberg, 18 March 2013.
24 http://archive.premier.gov.ru/eng/events/news/17888/

ANALYSIS

Economic Growth and Strategies for Economic Development in Russia

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Abstract
Recent evidence indicates that economic growth in Russia has begun to slow. While some of this slowdown may be attributed to exogenous factors, it is also possible that Russia may be entering a period of slower growth due to domestic constraints on growth that may be structural in nature, or caused by defects in economic policy. This article considers recent forecasts for Russian growth rates, the potential for faster growth in Russia, and the role that longer term strategic plans for economic development might have in promoting faster growth in the future.

The Economy Begins to Slow…
A near decade-long period of economic expansion between 1999 and 2008 in which the annual growth rate averaged around 7 per cent was rudely interrupted by a severe contraction of nearly 8 per cent of GDP in 2009, the most severe recession of any G20 country during that period. Nevertheless, although post-crisis growth rates failed to reach pre-crisis highs, annual growth rates of 4.3 per cent in 2010 and 2011 were considerably faster than in Russia's richer European neighbours, and higher than many other middle-income countries, such as Brazil and Turkey, during the same period. Even as global growth slowed from 4.3 per cent in 2011 to 3.2 per cent in 2012, growth in Russia slowed to a still respectable 3.5 per cent in 2012. However, economic growth in Russia has slowed significantly in recent months. With an annualized growth rate of just 1.6 per cent in the first quarter of this year, fears are rising that Russia is in the midst of a more serious and possibly protracted slowdown. Projections for economic growth in 2013