ible. Putin's political system works well for extracting the super profits of the Russian energy sector and has benefitted from the recent high prices, but its rigid centralization is not suited for a country that hopes to compete in an information-based, innovation-focused global world economy. Whether the system can long survive a potential drop in energy prices is a real question.

About the author
Robert Orttung is a visiting fellow at the Center for Security Studies at ETH Zurich and a senior fellow at the Jefferson Institute in Washington, DC.

Suggested reading

- Vladimir Ya. Gel'man and colleagues, *Tretii elektoral'nyi tsikl v Rossii, 2003-2004 gody* (St. Petersburg: European University in St. Petersburg, 2007).
- Michael McFaul and Kathryn Stoner-Weiss, "The Myth of the Authoritarian Model: How Putin's Crackdown Holds Russia Back," *Foreign Affairs* 87, No. 1 (January-February 2008): 70–84.
- Global Integrity Scorecard: Russia 2007, http://report.globalintegrity.org.
- Freedom House, "Russia" in *Freedom in the World* (http://www.freedomhouse.org/template.cfm?page=15) and *Nations in Transit* (http://www.freedomhouse.org/template.cfm?page=17&year=2006).

Analysis

Putin's Economic Legacy

By Anders Åslund, Washington

Abstract

Putin was lucky to become president when Russia's arduous economic reforms were close to completion and high growth had already taken off. Most deregulation and privatization were done in the early and mid-1990s. However, the opposition to financial stabilization led to huge budget deficits and the 1998 crash. Luckily, the financial crisis completed the market transformation and taught the elite the need for sound budgetary policies. Putin continued the reforms for two and a half years, pushing ahead with radical tax reform, improving conditions for small business, and allowing trade in agricultural land. Unfortunately, reforms came to a screeching halt with the confiscation of Yukos in 2003. A wave of renationalizations followed, driven by extensive corruption. Oil prices rose dramatically in 2004, allowing Putin to ignore all reforms. At the end of 2007, Russia returned to deficit spending although inflation was surging. Putin formulated the goal of joining the World Trade Organization by 2003, but Russia is still not a member because he allowed protectionist interests to override the national interest. At the end of his second presidential term, Putin leaves a large backlog of badly needed reforms.

Right Place, Right Time

Fate is not necessarily fair. Some are born with a silver-spoon in their mouth, and some just happen to be in the right place at the right time. Vladimir Putin should go down in history as one of the lucky ones who happened to be in the right place at the right time, as Talleyrand said about Lafayette, but hardly accomplished anything positive.

On New Year's Eve 1999, Boris Yeltsin announced his resignation. He felt he could leave, because at long last Russia's economic reforms had been successfully completed. His big mistake, however, was to pass on power to a mediocre lieutenant-colonel in the KGB, who had been such a failure that he had ended up in the reserve in St. Petersburg.

The 1990s comprised Russia's heroic decade. Boris Yeltsin announced his market economic reforms in October 1991. Chief reformer Yegor Gaidar liberalized prices and trade, rendering Russia a normal market economy by 1994. Minister of Privatization Anatoly Chubais privatized so successfully that no less than 70 percent of GDP pertained to the private sector by 1997.

Resistance to Reform

In spite of extraordinary efforts by the reformers, the resistance against financial stabilization prevailed. State enterprise managers insisted on large enterprise subsidies. So did oligarchs, who also favored a large budget deficit to boost treasury bill yields. The regional governors diverted federal revenues to themselves, and the communists favored large public expenditures and a big budget deficit.

Because of this political resistance, Russia had an average budget deficit of 9 percent of GDP from 1993 until 1998, which inevitably led to Russia's horrendous financial crash in August 1998, with both a default on treasury bills and a huge devaluation. Half of Russia's banks went out of business.

At the time, many foresaw that Russia's experiment with a market economy was over. In reality, however, Russia's financial crash completed its market economic transformation. It taught the Russian elite that it could no longer fool around with public finances. Since 2000, Russia has had a sound budget surplus.

Russia Avoids Budget Deficits

How did this happen? First, the default forced vital fiscal reforms upon the country. As no financing but tax revenues was available any longer, the budget deficit had to be eliminated. From 1997 until 2000, the government slashed public expenditures by 14 percent of GDP. Russia's political inability to balance its budget disappeared because the only alternative was hyperinflation, which nobody wanted. All arguments about the impossibility of reducing public expenditures fell by the wayside. Enterprise subsidies of little or no social benefit were eliminated, which also leveled the playing field for Russian business.

Second, the financial crash reinforced central state power. The federal government could eliminate barter by insisting on cash payments. A new aggressive bankruptcy law imposed hard budget constraints on enterprises. Arrears of pension and state wages dwindled. The monetization also leveled the playing field. As a result, many enterprises changed ownership, which revived them. Typically, old managers were forced to sell to hungry young entrepreneurs at rock-bottom prices.

Third, the Primakov government continued the tax war on the oligarchs that the reformers had launched in 1997–98, and the newly strengthened state could beat the weakened oligarchs. The government started applying the tax laws to big enterprises, especially the oil and gas companies, which had previously enjoyed individually-negotiated taxes.

Fourth, the regional governors were also weakened by the financial crash. As a result, the federal government could undertake a radical centralization of revenues to the federal government from the regions. Federal revenues almost doubled as a share of GDP from 1998 to 2002, while total state revenues were close to constant. With the devaluation, foreign trade taxes, which were valued in foreign currency, increased sharply.

The financial stabilization, monetization, and devaluation were the main catalysts behind Russia's high and steady growth of nearly 7 percent a year from 1999. All the main requirements of economic growth that Gaidar had formulated were finally in place: "macroeconomic stability and low, predictable rates of inflation, an open economy plus access to promising markets, clear-cut guarantees of property rights and a respectable level of financial liability, high levels of individual savings and investments, and effective programs to aid the poor and to maintain political stability."

Putin Benefits from Existing Policies

At this moment in time, a previously unknown actor named Vladimir Putin entered the stage and received all the laurels for the excellent economic results that had already arrived. Cause and effect are rarely simultaneous, and in the case of a profound systemic change we would expect the time between cause and effect to be especially long. Putin is often praised for these achievements, but the financial stabilization was undertaken in 1998–99, before Putin became prime minister, and Russia was already growing fast. Putin was lucky to arrive at a laid table.

When Putin became president in 2000, he spoke of democracy, but his actions made clear that his endeavor was to build an authoritarian state. Yet, he continued the "second generation" market economic reforms that had been formulated in 1996–97, and thanks to his newly-won parliamentary majority he could legislate them as Yeltsin never could. The three years 2000–02 were characterized by substantial progressive economic reforms.

Most impressive was the comprehensive, radical tax reform. The progressive personal income tax peaking at 30 percent was replaced with a flat income tax of 13 percent as of 2001. The corporate profit tax was reduced in 2001 from 35 to 24 percent. Far more important was that most ordinary business costs became deductible, leveling the playing field. The social taxes were cut from a flat rate of 39.5 percent of the payroll to an average rate of 26 percent. Tax collection was unified in one agency. Small-scale tax violations were decriminalized. The tax reforms reduced the threat to businessmen posed by tax inspection.

Russia finally woke up to its need for small and medium-sized enterprises. They were subdued by a madness of red tape and bureaucratic harassment. Registration, licensing and standardization were simplified, and inspections were restricted. This broad effort at deregulation improved the situation, and the amelioration has proved sustainable. The number of officially registered enterprises has steadily increased by more than 7 percent a year, and by 2006 the total number of registered enterprises in Russia had reached almost 5 million, quite a respectable number. Still, the patriarchic surveillance system remains in place, and more radical deregulation is needed.

The privatization of agricultural land was the last ideological barrier to break. On July 24, 2002, the Duma finally legalized the sale of agricultural land as well. It was a compromise, requiring each region to adopt a law to make the federal law effective. As a consequence, communist regions could withhold agricultural land from sale, while more liberal regions allowed land sales to proceed. In practice, the private ownership of agricultural land developed only gradually, and good connections with regional governors were vital for land purchases. Yet, this last communist taboo was broken.

Reforms Shut Down

By 2002, Putin had established himself as a credible authoritarian reformer in the line of General Pinochet and Lee Kuan Yew. In 2003, however, his economic policy changed track. His reforms, which were only halfway, came to a screeching halt. The signal event was the confiscation of the Yukos oil company.

In 2003, Yukos was Russia's largest and most successful company. Putin clamped down on it for primarily two reasons. He wanted to emasculate Mikhail Khodorkovsky, the most independent and outspoken of the big businessmen, and his collaborators wanted to seize Yukos' lucrative assets cheaply. Putin met repeatedly with foreign portfolio investors to reassure them that Yukos would not be confiscated, expropriated or nationalized, but that was exactly what happened.

The Yukos affair started a wave of re-nationalization. State enterprises have been buying big, good private companies either at a high price in a voluntary deal, which is accompanied with rumors about sizable kickbacks, or the sale is forced and the price is low. No economic rationale is evident in any single case. The most likely purpose of re-nationalization is corruption, while ideological motives are conspicuously absent. Two of the most aggressive predators, Rosneft and VTB, sold their shares to private foreign investors in large international initial public offerings (IPOs) in London in 2006 and 2007, respectively.

The Russian re-nationalization has had a limited, but negative impact on the economy, which is most evident in oil and gas production, banking, and machine building. Fortunately, two-thirds of the Russian economy is still in private hands, including the metals, retail trade, and construction sectors. The aggregate indicator that has suffered the most is investment, with Russia's official investment ratio remaining rather low despite the economic boom

Liberal leader Boris Nemtsov commented upon the re-nationalization: "It is offensive that under Putin the state has taken on the role of plunderer and racketeer with an appetite that grows with each successive conquest…. But the greatest calamity is that nobody is allowed to utter a word in protest regarding all this. 'Keep quiet,' the authorities seem to say, 'or things will go worse for you. This is none of your business.'"

Oil Prices Leap

In 2004, international oil prices took off, filling the Russian state treasury and boosting its international reserves. Russian exports started skyrocketing, mainly because of the rising commodity prices. The consequence in Russia, however, was not a higher growth rate but aggravated repression, corruption, re-nationalization and all economic reforms stalled. During his last five years in office, President Putin has not undertaken any reform worth mentioning.

Putin has effectively condoned corruption among his friends, and it is hardly an exaggeration to say that everything is for sale in Russia. People pay bribes to enter university, to escape military service, to stay out of prison, and to land a good job. Until the late 1990s, the selling of top offices was not an issue, but by 2004 it had become endemic.

Until October 2007, Putin maintained impressive fiscal discipline with budget surpluses every year from 2000. Then, all of a sudden, he seems to have lost his nerve. In the midst of rising inflation, he abandoned that achievement as well, allowing a budget surplus of 8 percent of GDP during the first ten months of 2007 to turn into a deficit of 10 percent of GDP in November. By January, inflation had surged to 12.6 percent. The Russian government needs to return to its prior excellent fiscal policies to cool the economy down.

When Putin became president in 2000, he promised that Russia would join the World Trade Organization by 2003, but it is not likely to join even this year because Putin has allowed various protectionist interests to override Russia's national interest. This stands out as one of his most spectacular failures.

Russia in Crisis

Even worse is that male life expectancy in Russia is stuck at the miserable level of 60 years of age. Russian men are drinking themselves to death, and the government is not lifting a finger. All state systems are in crisis: health care, education, law enforcement, and the military. Russia's public infrastructure has been so neglected that Moscow's traffic has repeatedly come to a complete halt for six hours.

In naming him man of the year, *Time* magazine praised Putin for the stability he had brought to the country, but what stability? Russia's murder rate has been higher under Putin than under Yeltsin and is currently four times higher than in the U.S. The change is not in reality but in its presentation thanks to the ubiquitous censorship that Putin has imposed.

In short, what remains of Putin's economic legacy is only that he was lucky to reap the benefits from the arduous, but productive reforms his predecessor instigated in the 1990s. This analysis comes to the same conclusions as Vladimir Milov and Boris Nemtsov's report "Putin: Results."

In spite of its abundant oil revenues, Russia's growth record puts the country in 12th place among the 15 former Soviet republics since 1999, which is not very impressive. Putin's unproductive two-term presidency leaves a huge backlog of reforms that can no longer be ignored, and the greatest worry is that Putin will remain prime minister. Can Russia really afford to keep Putin in a senior position any longer?

About the author
Anders Åslund is a senior fellow of the Peterson Institute for International Economics and is the author of *Russia's Capitalist Revolution: Why Market Reform Succeeded and Democracy Failed*.

Suggested reading:
Vladimir Milov and Boris Nemtsov, "Putin: Itogi [Putin: Results]," http://grani.ru/Politics/m.133236.html#9

Opinion Poll

Putin's Russia: the Years 2000–2007 in the Eyes of the Population

Source: Opinion polls of the Levada Center conducted on 20–23 November 2007 http://www.levada.ru./press/2007120703.html

In Each Year, How Has the Situation Concerning … Changed?

	2000	2001	2002	2003	2004	2005	2006	2007
… the choice of food								
The situation has changed for the better	51%	61%	70%	60%	55%	53%	50%	66%
The situation has changed for the worse	6%	7%	8%	9%	7%	7%	9%	9%
The situation has not changed	40%	30%	22%	30%	37%	38%	38%	23%
No answer	3%	2%	1%	1%	2%	2%	3%	2%
… the choice of clothing, shoes, and basic necessities								
The situation has changed for the better	44%	57%	65%	59%	55%	52%	51%	66%
The situation has changed for the worse	8%	8%	10%	9%	8%	7%	8%	8%
The situation has not changed	43%	31%	23%	29%	36%	38%	36%	23%
No answer	5%	4%	3%	3%	2%	3%	4%	2%
… the work of hospitals, polyclinics								
The situation has changed for the better	8%	11%	13%	12%	13%	11%	16%	18%
The situation has changed for the worse	45%	52%	50%	45%	39%	41%	30%	47%
The situation has not changed	40%	32%	33%	37%	39%	40%	46%	29%
No answer	7%	6%	5%	6%	8%	8%	9%	6%
… the work of militia and law enforcement agencies								
The situation has changed for the better	11%	9%	10%	9%	10%	7%	9%	14%
The situation has changed for the worse	30%	40%	41%	36%	29%	35%	25%	39%
The situation has not changed	48%	40%	38%	40%	46%	45%	51%	36%
No answer	11%	11%	11%	14%	15%	13%	15%	11%