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Russia under Medvedev

by Alexander Rahr and Stefan Meister

Initially observers in Russia and the West were firmly convinced that the newly elected head of the Kremlin administration, Dmitry Medvedev, would only be a “puppet president” under the excessively powerful head of government Vladimir Putin. Meanwhile, however, most experts have changed their minds. In his speeches and interviews Medvedev announces a correction in Russia’s political and economic policies. He could—albeit not immediately—become “emancipated” from his role as Putin’s Crown Prince. Medvedev does not have his roots in the secret services, he belongs to the post-communist Perestroika generation. Medvedev wants to reinforce the constitutional state and the market economy, to promote civil society and the free press, to guarantee the independence of the judiciary system, to reduce the influence of the Central State and to improve relations with the West. Already at this early stage close confidants of Medvedev, such as the lawyer Anatoli Ivanov and the economic advisor to the presidential administration, Igor Shuvalov, are being heaved into key positions. The DGAP invited the former deputy minister of the economy, Andrei Sharonov, to evaluate potential perspectives of Medvedev’s presidency at a Russia Breakfast, which was held in collaboration with the “East Committee of the German economy” and Basic Element.

Sharonov, currently executive director of Russia’s largest investment bank Troika-Dialog, started off by presenting a positive picture of the Russian economy. Economic growth over the last eight years amounts to 8.1 percent. In 2007 investments increased by over 20 percent and have achieved an average level of 15 percent over the last eight years. The stability fund comprises 11 percent of the GDP, of which in turn 11 percent is used for investments in the infrastructure. At present the currency reserves amount to 500 billion US dollars, which puts Russia in third place behind China and Japan in the world ratings. These benchmark data clarify how much Russia had changed since the crisis in 1998. Sharonov, however, admitted that, on account of the dominance of raw materials and the relatively weakly developed production sector, the economic basis was not firm.

Sharonov predicted a successful start for the new President. Modernization of the Russian economy

would finally get underway. The world-wide financial crisis would not weaken Russia as the national credit institutes were not yet integrated in the world of global finance. On the other hand, however, the entire economy was dependent on the global market. The decline in demand for oil, gas, chemical products or fertilizers would have negative effects on the domestic producers.

Sharonov acknowledged the President’s will to strengthen private investments as opposed to state investments. In future Medvedev would increasingly focus on funding instruments such as special economic areas, technoparks and investment funds. The intention is to use investment funds in the first place in order to develop important infrastructure projects by means of private investments. So far the government has received a total of 60 enquiries from the private economy, concerning an investment sum of 63 billion euros. An example mentioned by the banker in this

context was the modernization project of a hydro-electric power station in the region of Krasnojarsk.

Sharonov attributed great future significance to the special economic areas. He mentioned three subsidy models: tax reductions for businesses, limited customs duties and administrative assistance. He reported on the first functioning special economic areas in Tatarstan (chemical cluster), Lipetsk (mechanical engineering), as well as high-tech centres in Moscow, St. Petersburg and Tomsk. Further important investment areas are the logistics businesses and ports on the Black Sea as well as on the Baltic coast (Kaliningrad). Since 2006 the state had been setting up the Russian Development Bank Wneschekonombank—along the lines of the German Reconstruction Loan Corporation “KfW-Modell.” This supports joint ventures with 51 percent private capital and 49 percent state capital.

In the following discussion about the economic perspectives under the new Kremlin boss, it was pointed out that political and commercial interests were too intricately interlinked in Russia. It would take years to break this system. And at present there is a lack of political will in the Kremlin to do so. Although Medvedev had indeed publicly denounced the fact that high-level civil servants in the Kremlin administration are at the same time chairpersons of supervisory boards of the most important state industrial holdings, it was indeed questionable to what extent he could actually slacken the vertical power structures created by Putin. The difference between Putin’s style of leadership and that of Medvedev was that Putin very much tended to use manual means to control the state whereas Medvedev would rather focus on the functioning of the state institutions and legal norms. Right from the beginning of his presidency Medvedev might want to make the middle class and broad sections of the civil society into his allies. At any rate so far he had been using the terms “freedom” and “legal certainty” rather more authentically than his predecessor Putin. Sharonov recalled the early criticism which Medvedev had publicly expressed about the divestiture of the oil concern

Yukos and the artificial rigging up of a “controlled democracy” in his country.

Observers believe that Medvedev wishes to commence his presidency not as a hard neoliberal politician like Putin (motto “dictatorship of the law”), but rather as a politician of justice (motto “no right-wing nihilism”). Whereas Putin acquired his popularity in the context of the Chechenian war, Medvedev will increasingly promote social reforms. As a fully convinced lawyer who studied the entire field of Roman law in Latin and who has worked professionally in this field, Medvedev



Andrej Sharonow (centre) at the Russia-Breakfast in the Hotel Adlon with Dr. Tessen von Heydebreck (right) and Alexander Rahr.

will develop a personal interest in the reform of the court and legal system.

Sharonov emphasized the necessity of a partial state withdrawal also from some strategic branches of the economy. The Russian economy requires deregulation, more transparency and more initiative from below. In Russia the number of so-called strategic economic areas has increased in recent months from 38 to 43. Whilst important plans for reforms relating to modernization of the economy were implemented during Putin’s first period in office, during his second period there was a marked increase in the tendency to regulate. At the same time Sharonov however also criticized the regimentation measures in the West which put obstacles in the way of Russian investments.

The most important subject in the relationships between Russia and the EU still remains the energy supply. Will Russia be able to continue supplying the promised quantities of natural gas over the next years or will the country require the subsidized energy sources to cover the increasing demand from its own domestic market? Sharonov said that Russia would liberalize its energy market by 2011. Step by step the energy prices would also be increased to world market level, also for the Russian consumers. After all, Russian businesses are already paying higher prices today and are thus contributing to the competitive situation. Furthermore it was to be pointed out that the proportion of independent producers in the country was increasing. Of 651 cubic metres of gas produced last year, as much as 100 cubic metres came from non-state concerns.

Sharonov assumed that the Russian economy would become more competitive under the presidency of Medvedev. With this in mind, it would be important to reduce the high tax burden again of the Russian energy-producing businesses, which were constantly increasing oil price. Oil companies pay 90 percent VAT from a dollar price of 28 US dollars per barrel upwards. This revenue did indeed flow straight into the stability fund, nevertheless it meant that the businesses lacked the money for desperately needed investments. The increase in competitiveness should also be supported by means of new economic areas which are not related to raw materials.

Which reforms should become a priority for Medvedev? Sharonov put the anti-monopoly policy at the top of the list. In this area correct legislation has indeed been developed, nevertheless unfair competition exists. Medvedev, according to Sharonov, could work on consolidating the social reforms, particularly in the fields of health and education. So far the social reforms in these areas have been financed exclusively out of the state budget. Involvement of private industry and even of foreign investors is also required here, however. The same problem also exists in the pensions system. Pensions are financed exclusively on the basis of tax money. Financial policies have to be developed in or-

der to create and manage the social capital. Ultimately Medvedev will have to work out a new federalization reform. The friction losses between local, regional and federal authorities are too high.

Naturally the question concerning energy efficiency—an area in which it has not been possible to implement reforms as yet on account of bureaucratic obstacles—has to be made more attractive for investors. On the local level strong interest exists in the promotion of municipal services, however there have not been sufficient financial means available for this as yet. Troika-Dialog has developed an infrastructure fund for this purpose and Gazprom and RAO-EES also announced interest in investments in this area.

Sharonov expressed his conviction that the relationship between Medvedev and Putin would not develop into a power struggle. Russia had the unique chance to create a functioning balance of power within its executive. Medvedev might act more as an adjudicator of the institutions and determine the course to be followed. Putin might advance to become Russia's strongest head of government ever. He will have control of the state finances and be responsible for implementing political decisions which had been made.

By way of conclusion, detailed reference was made to the visit paid by German Federal Chancellor Angela Merkel to Putin and Medvedev in Moscow. Angela Merkel was the first foreign head of government to congratulate Medvedev personally on his election. She expressed the hope that Germany and Russia could move towards a constructive collaboration in important aspects, although Putin confirmed that the West would certainly not experience Medvedev in the role of a "yes" man. Russia took positive note of the fact that the German Federal Chancellor does not support a third NATO east expansion round onto post-Soviet territory, as has been proposed by the USA, and also clearly emphasized the German interest in the construction of a Baltic pipeline. The West sees a real chance here of really bringing to life the strategic partnership with Russia, even in sensitive areas such as democracy and civil society under the new president.