

Russia

Status Index (Democracy: 5.70 / Market economy: 6.57)		6.14	Management Index		3.87
HDI	0.795		Population	144.6 m	
GDP p. c. (\$, PPP)	9,230		Population growth² (in %)	0.3	
Unemployment rate¹ (in %)	7.1		Women in Parliament	8%	
UN Education Index	0.96		Poverty³	n/a	
			Gini Index	31.0 (2002)	
<small>Source: UNDP: Human Development Report 2005. Figures for 2003 – if not indicated otherwise. ¹Unemployment rate according to ILO data. ²Annual growth between 1975 and 2003. ³Population living below \$ 1 per day (1990-2003).</small>					

A. Executive summary

Russia's political and economic development has been greatly influenced by the policies of Vladimir Putin, who was elected president at the beginning of 2000. When he took office, the parameters for the development of a market-based democracy were in place, albeit incomplete and not enforced. A tradition of the rule of law, civil society and democracy was lacking, which also hampered progress in the establishment of a market-based democracy.

In democratic transformation, no substantive progress was achieved during the period examined. President Putin consolidated his power in 2000 through measures that do not reflect democratic standards. The list includes marginalizing political actors outside the federal executive, asserting control over nationwide mass media, harassing politically relevant NGOs and violating human rights in the fight against Chechen rebels in the Northern Caucasus. These practices persist today.

This is due to the fact that the political leadership obviously does not consider a qualitative enhancement of democratic transformation one of its key tasks. Nevertheless, President Putin has stabilized the political system. Fair elections are largely guaranteed, albeit with heavily manipulated campaigns in favor of pro-presidential forces.

Transformation toward a market economy progressed in Putin's first term (2000-2004).. Reforms of the tax code and land ownership laws have been achieved. However, implementation has been rather inefficient due to growing bureaucracy, corruption and political interference. The social security system remains poorly financed and insufficient. Despite these shortcomings, Russia is experiencing an economic boom.

At the end of Yeltsin's presidency (1998-99), political actors moved to consolidate power for the short term. Once Putin took office, a long-term development strategy was quickly drawn up and has been transferred smoothly into legislation. More recently, and especially in 2004, liberal market reformers appear to have lost influence in the Kremlin. Internal conflict connected to this shift has hampered economic reforms.

It should be stressed that Russia's political leaders are concerned primarily with stabilizing the political system and generating significant economic growth. The violation of fundamental democratic rights and market principles appear to be acceptable byproducts of this policy. Moscow considers its record thus far successful. However, when measured by the normative standards of a market-based democracy, there remain considerable deficits in both political and market economy development.

B. History and characteristics of transformation

Russia's economic and political transformation process began in the second half of the 1980s with the reforms of Soviet General Secretary Mikhail Gorbachev. But the defining influences for post-Soviet Russia were the reforms of Russian President Boris Yeltsin.

One of the first milestones in democratic transformation was the Russian presidential election in June 1991, which Yeltsin won. Afterwards, conflict arose between the reform-oriented Yeltsin and the rather conservative parliament. In the fall of 1993, Yeltsin ended the political stalemate with the violent, unconstitutional dissolution of parliament. In addition, a commission close to the president drafted a constitution calling for a federal presidential republic. The constitution was approved by a referendum of the Russian people in December 1993. Parliamentary elections were held at the same time as the referendum. Outspokenly antidemocratic parties won 43% of the vote. During the next six years, there was no significant change in this balance of power. Considerable resistance to democratic trends was observed at the regional level, where a variety of political constellations developed. Some exhibited authoritarian traits often exceeded the broad authority granted to them by the constitution.

While the Russian constitution expressly provides for a democratic rule of law, the reality under President Yeltsin was characterized by significant democratic deficiencies. This resulted not only from anti-democratic forces that blocked reform projects in Parliament and ignored democratic requirements at the regional level, but also from executive policies of the Yeltsin administration characterized by political

manipulation and pressure on the mass media. This environment allowed non-democratic actors such as the so-called oligarchs to gain considerable influence in political decision making.

The first milestone in Russia's transformation toward a market economy was the 1992 reform package. Its core components were the liberalization of prices and mass privatization. However, instead of the anticipated upswing, Russia found itself facing a prolonged economic crisis. GDP declined by more than 60% by 1998. Russia was competitive on the world market only as an exporter of raw materials. Imported goods dominated many sectors of the domestic market. Capital spending shrank dramatically while capital flight remained high. Core economic reforms, such as a new tax code and land ownership laws, languished in the legislative process. The protracted economic crisis also adversely affected the population's standard of living. Social inequality increased considerably. Economic problems culminated in a dramatic financial crisis in August 1998.

Yeltsin never enjoyed the approval of more than 10% of the population after 1996. In a move to groom his successor, Yeltsin appointed Vladimir Putin as prime minister in 1999. The new Yedinstvo party, with close ties to Putin, achieved unexpected success in the December 1999 parliament elections to the State Duma, placing a close second to the Communists. Yeltsin resigned at the end of the year, and Prime Minister Putin took over as acting President as prescribed by the constitution. In the March 2000 presidential elections, Putin won an absolute majority in the first round. He was re-elected in March 2004 with an even stronger mandate.

More than half of the Russian population approves of Putin's leadership. He is seen as a decisive actor. His military campaign against separatists in the Northern Caucasus and his tough stance on business oligarchs has won him support. The political reforms of 2004 increased central control over regional governments raised constitutionality questions. Extensive violations of human rights in the Chechen war and new constraints on press freedom and NGOs were also part of Putin's policies.

C. Assessment

1. Democracy

1.1. Stateness

Russia's stateness is seriously questioned only in the northern Caucasus. Since the beginning of the second Chechen war in September 1999, the Russian army has been unable to achieve full control of the region. Rebels regularly attack representatives of Russia's central power throughout the region, and have committed several terrorist acts in the region of the northern Caucasus and in the Russian capital. Apart from the northern Caucasus case, there are no serious limitations on the state's monopoly on the use of force.

All citizens have the same civil rights. However, there are many cases of discrimination by representatives of state agencies against Russian citizens belonging to ethnic minorities from the north Caucasus region.

There is separation of church and state. However, the Russian Orthodox Church holds a privileged status and other religious groups, including the Catholic Church, have occasionally complained about discrimination. The political process is secularized.

Apart from Chechnya, the state has established basic infrastructure throughout the country, including administrative institutions, fundamental administration of justice, and implementation of political decisions. However, bureaucratization, corruption, and a lack of funds have caused performance to be uneven.

1.2. Political participation

Outside Chechnya, there are no serious restrictions on the voting process. However, election campaigns are heavily manipulated in favor of pro-presidential forces.

In the formal political decision-making process, elected representatives have full power to govern. The power of the elected president to govern is undisputed, as well as the parliament's decision-making competencies, as outlined in the constitution. However, the actual imbalance between the elected representatives in favor of the President weakens parliamentary control. Especially in the second half of the 1990s, so-called oligarchs, who lacked any democratic legitimization, were seen as powerful forces behind the president. As Putin's reaction to political interference by oligarchs

has shown on already three occasions (the Gusinsky-Affair, the Berezovsky-Affair and the Yukos-Affair), he is not willing to accept this interference. It can now be observed that members and former members of the secret service are gaining influence under Putin. As they receive formal positions within the state executive branch, their participation in the formal political decision-making process is legitimate and in line with the democratic institutions, though their intention may be – and on some occasions definitely is – anti-democratic.

However, considerable restrictions on rights to organize and communicate politically exist. The national government largely accepts freedom of association and freedom of assembly, but there have been substantial violations of these rights in some regions. As the demonstration against social welfare reforms in January 2005 indicated, even spontaneous demonstrations against the government, which violate the registration rules, are tolerated in many regions. However, flexibly arranged construction sites and considerations about security concerns are commonly used to prohibit demonstration. The effects of a number of demonstrations have been minimized by state-organized "counter-demonstrations."

NGOs critical of the national or regional government have on many occasions been subject to harassment by state agencies. This harassment is not the result of insufficient legislation, but of informal pressure. It takes the form of extensive controls by state inspectors (tax, fire, etc.), which often use their power to hamper the work of NGOs with the use of extensive visits, confiscation of documents and sanctions or fines. On several occasions, NGOs claimed that burglaries in their offices had been committed by state representatives with the primary aim of destruction or theft of work-related documents. The mass media are subject to influence from the executive branch. During Putin's first term, private media with nation-wide reach have systematically been brought under (at least indirect) state control. Media coverage of elections is systematically manipulated. There are extensive restrictions on freedom of the press in covering the war in Chechnya.

1.3. Rule of law

Serious deficiencies exist in the checks and balances among the executive, legislative and judiciary branches, even though the powers are institutionally differentiated. As the president has a stable majority in parliament, the legislature exercises its review functions only to a very limited degree. The upper chamber of Parliament will be additionally weakened through the appointment of governors by the president, as half

of the chamber consists of representatives of the governors. There are serious indications that the executive branch influences decisions by the judiciary on a regular basis.

The judiciary is fundamentally independent, but lower-court decisions in particular are often influenced by corruption and political pressure. In specific high-profile cases like the Yukos affair, principles of equal treatment and formal court proceedings have been violated in the interest of the national government.

Political and bureaucratic corruption is perceived as high in Russia. Corrupt officeholders with political connections often elude adequate prosecution.

Civil liberties are affected to some degree by the lack of legal constraints on government action, and by the bureaucracy's sometimes selective application of the laws. Since the beginning of the second Chechen war in September 1999, all parties to the conflict have continuously engaged in massive violations of human rights there. Arbitrary arrests and abductions, torture, rape, extortion and looting by Russian security forces are hardly ever prosecuted. So far, there has only been one high-profile case where a Russian officer has been sentenced for abductions of Chechen civilians.

1.4. Stability of democratic institutions

Apart from the limitations on the rule of law described above, democratic institutions are stable. However, the bureaucracy's implementation of legislated provisions often remains a serious problem. Most relevant actors view institutions of the democratic state as legitimate.

There is no serious opposition to the political system as it is being reshaped by President Putin. However, specific democratic institutions have on several occasions been ignored when they were perceived as hampering the realization of concrete political goals. In summary, the acceptance of democratic institutions is for most actors more a pragmatic consideration than one of principle.

1.5. Political and social integration

So far, Russia has been unable to establish an organizationally stable, socially rooted party system. The relevant political parties are predominantly personality-oriented voting associations. The Communist Party is the only party with an organized mass

base—a state of affairs that is probably not helpful to democratic consolidation. The party with the biggest faction in parliament, United Russia, was founded in 2001 by a merger of the two main rivaling parties of the prior elections, which both of which had been founded only in 1999. Of the nine factions formed in the Parliament elected in 1999, only three are represented in the Parliament elected in 2003. As a result of weak political parties and of the election victory of pro-presidential United Russia, Parliament has ceased to function as an efficient check on the executive power. In the Parliament elected in 2003 the political opposition has been permanently marginalized. Accordingly, political reforms meant to strengthen the party system – mainly by favoring bigger parties – are unlikely to have an impact in the short run.

The range of interest groups in the political sphere is limited. Important social interests are underrepresented. The political leadership's reaction to the interest groups' work has essentially been no more than symbolic. Putin has stressed the need for a strong civil society in several well-publicized speeches, but at the same time he has blamed Russian NGOs for accepting support from foreign donors. NGOs critical toward the government have been excluded from the dialogue between state executive and civil society and they have on several occasions been harassed by state agencies. The successor to the socialist labor union, which traditionally cooperated closely with the state and the management, has retained dominance. As a result, labor unions seldom adopt a critical stance toward government policies. Moreover, they lack financial and organizational potential to act independently. Organizations representing business interests had to be created from scratch after the end of the Soviet Union. As the biggest entrepreneurs, the oligarchs, represented their interests individually, the main business organization, the Russian Union of Entrepreneurs and Industrialists, remains weak. Its critical stance on the Yukos affair has recently confirmed that it can be sidelined by the state.

The population's approval of democracy per se as voiced in representative polls is moderate to high depending on the wording of the question. In an opinion poll, conducted by the Moscow-based Institute of Interdisciplinary Social Studies (IKSI) in summer 2004, 40% of the respondents gave a positive evaluation of the term "democracy" and 25% a negative one, with the remaining 35% opting for a neutral evaluation. Moreover, when asked about specific democratic principles, including democratic elections, accountability and civil rights, the majority of the Russian population does not consider any of these principles to be important, as polls by institutes like the Public Opinion Foundation (FOM), the Russian Public Opinion & Market Research Group (ROMIR) or the Levada-Center regularly indicate. When asked which rights and freedoms they personally considered to be important, only 6% of the respondents opted for freedom of expression, 5% for religious freedom, 3% for the right to elect representatives to the state organs of power, 2% for press freedom,

1% for freedom of assembly. In the same opinion poll, social and economic rights, like the right to medical care and the right to housing or work, all gained the consent of more than a third of the respondents (FOM polls in summer 2004). In summary about a quarter of the population is openly opposed to democracy, whereas not much more than 10% can be counted as strong democrats. Accordingly, the huge majority of the Russian population has no strong opinion on democracy. This implies a sort of silent consent to democratic norms, but no principal opposition to undemocratic norms.

Self-organization in civil society encounters strong barriers, namely a burden of the Soviet past, where NGOs did not exist, and harassment by the state executive. Typically, it takes the form of legal controls by state inspections for tax and fire, etc., which often use their powers to hamper the work of NGOs. NGOs are unevenly distributed, flourishing mainly in the mega-cities of Moscow and St. Petersburg, and are often spontaneous and temporary. Many Russian NGOs have been brought into existence only by the engagement of international organizations and sponsors. According to the World Value Survey from 1999, two-thirds of the Russian population does not belong to any voluntary organization. General trust is also relatively low developed with only 35% of the population agreeing that people in general can be trusted.

2. Market economy

2.1. Level of socioeconomic development

The key indicators show a relatively high level of socioeconomic development for Russia. Measured in terms of HDI, the country's level of development permits adequate freedom of choice for almost all citizens. There is no indication of fundamental social exclusion on the basis of poverty, education or gender discrimination. The economic boom, which started in 1999 and led to a rise in GDP of about one-third until 2004, has been accompanied by a doubling of average wages. An important contribution to the income of the rural population comes from household plots used for agricultural production. Most of their output does not reach the market because it is consumed domestically. The dimension of this subsistence economy is hard to estimate. According to Russian statistics, its share in Russian agricultural production is up to 40%.

However, at the same time social inequality as indicated by the Gini coefficient has increased markedly. Reasons for this are among others long-term unemployment, an insufficient pension system and a flat income tax rate. There are considerable regional

differences in levels of socioeconomic development within Russia. Financial readjustments among regions do not materially reduce these discrepancies. As many Russians have additional unofficial income and as definitions of the poverty line differ, there are various estimates of the amount of Russians living in poverty. According to official Russian data, 24% of the population was living in poverty in 2002. The World Bank, using its own calculation, quoted 20%. In both cases, there is a marked decline over recent years. For 1999, the official Russian figure was 42% and the World Bank figure 28%.

2.2. Organization of the market and competition

The foundations of market economy-based competition are assured by the institutional framework. Prices on the domestic market were decontrolled in 1992. By now, price regulation by the state is restricted to utilities. The state also subsidizes prices for agricultural products. The national currency is not freely convertible and there are restrictions on cash exports. However, they do not form a serious problem for the transfer of profits. Foreign trade has been liberalized and at present, remaining restrictions are not more extensive than in Organization for Economic Co-operation and Development (OECD) countries. Russia expects to join the World Trade Organization (WTO) soon; agreement on WTO entry with the European Union was reached in spring 2004. However, state economic policy remains skewed in favor of politically influential large corporations. The Yukos affair demonstrated that competitive companies can be eliminated by bureaucratic means for reasons not related to economic policy.

Additionally, broad sectors of the economy defined as significant to national security are shielded from competitive pressure. The “natural” monopolies in the natural gas, electricity and transportation industries have not yet been reformed despite year-long debates. However, for the liberalized part of the economy the anti-monopoly agency functions rather efficiently with exceptions on the regional level, where some administrations have blocked competition. The informal sector amounted to 30% to 50% of GDP in the late 1990s. According to the Russian government its size has been reduced considerably with the economic reforms under President Putin. However, empirical studies are not yet available.

Foreign trade has been liberalized in principle, but substantial regulatory exceptions remain, such as imports of agro-food products or cars and on exports of some metals. Russian tariffs have presented stumbling blocks in negotiations to join the WTO.

Though the liquidity of the Russian banking sector has improved remarkably since the financial crisis of 1998, it remains severely underdeveloped and is still not able to perform its economic function as a financial intermediary. Russian banks are not yet able to compete internationally. In the wake of Russia's WTO negotiations, they have been assured that they will get protection from foreign competition. At the same time, differentiation of the Russian banking sector is increasing and seems to be functioning. State regulation of the banking has some deficits, but by and large seems to be adequate. Banks have been forced to adopt international standards, though at a lower pace than originally planned. However, there is a lack of supervision. The Central Bank is rather inefficient and according to World Bank surveys of Russian entrepreneurs in 1999 and 2002, considered to be highly corrupt.

2.3. Currency and price stability

After the 1998 financial crisis, which caused significant inflationary pressure as the ruble lost around 70% of its value against the U.S. dollar, the government and the independent central bank were able to bring inflation under control and stabilize the exchange rate through a consistent budgetary and monetary policy.

Since Putin took office in 2000, the country has adhered to a austerity policy that regularly leads to budget surpluses. These made a significant reduction of foreign debt possible. The fact that monetary policy is integrated into a general economic policy concept is also indicated by the stability fund, which was introduced to save the state budget's windfall profits from high oil prices for the future. This fund has successfully been defended against demands for increased state subsidies.

2.4. Private property

There are formal property rights and the regulation of the acquisition of property is defined formally in law. With the exception of the sale of farmland, the legal provisions are practical. However, they are not consistently implemented or adequately safeguarded by law, especially against state intervention. For example, high level state officials have repeatedly cast doubt on the validity of the privatization auctions conducted in the 1990s. In another example, in 2004 the oil company Yukos was deprived of its right to trade Sibneft shares that it had acquired legally. Critical observers described the Yukos affair as re-nationalization. Some property rights, especially copyrights, minority shareholders' rights, and creditors' rights in bankruptcy proceedings are ignored on a regular basis.

Private enterprise is the backbone of the economy, but state enterprises continue to exist alongside private businesses, as do market concentrations tolerated by the state, especially in the “natural” monopolies such as natural gas, electricity and railroads.

2.5. Welfare regime

Parts of the social security system, especially health care, are well developed in Russia, but they do not cover all risks for all strata of the population. There is almost no state support for the unemployed. Though they have been increased considerably in recent years, pensions are still insufficient to survive on. Without additional income, such as a job in the shadow economy, private farming or family support, these social groups are at risk of slipping into poverty. The big cities have large numbers of homeless people whom state social facilities completely fail to reach.

The state-organized health care system suffers from a lack of funds, especially in rural areas, leading to significant shortages of care delivery. Economic improvement since 1999 has mitigated the country’s social problems, but with only limited improvement so far in the state’s social insurance systems. Under President Putin the reform of the state’s social welfare system has aimed at liberalization. However, most Russians lack the financial means for private insurance and especially in the pension system private companies are underdeveloped.

Equality of opportunity is not fully assured. There are substantial differences from one region to another. Members of non-Russian ethnic groups, especially those from the Caucasus, suffer systematic discrimination in the educational system and on the job market. Social exclusion extends to people living in the Northern Caucasus, where in some regions living standards are far below the Russian average and a quarter of the population is unemployed and wages are far below the national average. There are considerable communities of homeless individuals in large Russian cities. In the whole of Russia, women have equal access to education but are underrepresented in the political system and in business management.

2.6. Economic performance

After the dramatic deterioration in macroeconomic fundamentals caused by the 1998 financial crisis, an improved economic environment - characterized by an undervalued ruble, rising prices for Russian exports of raw materials in the world market, and low real wages - laid the foundations for significant economic improvement. Since Putin took office in 2000, the state’s economic policy has attempted to maintain this upswing with comprehensive economic reforms. During

the period from 1999 to 2004, Russia's economy has grown on average by 7% a year. At the same time, all key macroeconomic indicators have improved considerably, apart from the unemployment rate which remains close to 10%. Inflation has been brought down to 10%. Due to high world market prices for Russian raw material exports, the foreign trade balance is positive and the state budget runs a surplus. Russia has used this surplus to reduce its sovereign debts.

2.7. Sustainability

Russian economic policy is focused on medium-term economic growth. President Putin has set ambitious goals for GDP growth over the next years, which he presents as top priority. Ecological concerns are entirely subordinated to growth efforts, despite a considerable legacy of environmental damage from the Soviet era. Accordingly, environmental aspects are only on the political agenda when they promise to deliver economic gains, as in the case of emissions trade (Kyoto protocol) or marketable innovations. The long-term political effort to reduce the economic dependence on raw material production would also reduce negative environmental effects. However, environmental concern is hardly ever mentioned as a reason for this strategy. The limited institutional base for environmental protection, in both state and NGO settings, has been weakened further by administrative reforms under Putin. Most of the responsibility for environmental questions has been transferred from a now dissolved separate ministry to the ministries dealing with the respective branches of industry.

Russia inherited from the Soviet Union an educational system with comparatively high standards, able to compete on a world scale in some segments. Under post-Soviet conditions, however, the country has been unable to put this educational potential to good economic use. Rather, Russia has faced mass emigration of top personnel. Funding shortages have now greatly reduced the quality of the state educational system. The private educational sector has not developed far enough to make up this deficiency. Research and development is still up to world standards in some areas, e.g. space technology, but in general, Russia is below the level of OECD countries in quantitative as well as qualitative terms. Russia spends 1.2% of its GDP on research and development and 3.1% on education.

3. Management

3.1 Level of difficulty

The level of difficulty of the transformation tasks faced by Russia's leadership can be considered moderate. Structural socioeconomic conditions that will dominate the

political process for the long term are comparatively positive, with a high level of education, a moderate level of economic development, and quite a homogeneous and conflict-free society, apart from the Northern Caucasus. Weak traditions of civil society and deficits in the rule of law and in governmental administration have an adverse impact on transformation into a market-based democracy.

Profile of the Political System

Regime type:	<i>Democracy</i>	Constraints to executive authority:	4
System of government:	<i>Semi-presidential</i>	Electoral system disproportionality:	16.3
		Latest parliamentary election:	07.12.2003
		Effective number of parties:	2.7
1. Head of State:	<i>Vladimir Putin</i>	Cabinet duration:	05/00- 02/04
Head of Government:	<i>Michail Kasyanov</i>		
2. Head of State:	<i>Vladimir Putin</i>	Cabinet duration:	02/04- present
Head of Government:	<i>Michail Fradkov</i>	Parties in government:	1
Type of government:	<i>single party majority</i>		
		Number of ministries:	15
		Number of ministers:	15

Source: BTI team, based upon information by country analysts, situation in July 2005. Constraints to executive authority (1-6 max.) measures the institutional constraints posed by a federal or decentralized state, a second parliamentary chamber, referenda, constitutional and judicial review and the rigidity of the constitution. Electoral disproportionality (Gallagher index) reflects the extent to which electoral rules are majoritarian (high values) or proportional: $\sqrt{\frac{1}{2} \sum (v_i - p_i)^2}$; v_i is the share of votes gained by party i ; p_i is the share of parliamentary mandates controlled by party i . For presidential/ semi-presidential systems, the geometric mean of presidential election and parliamentary election disproportionality is calculated. Effective number of parties denotes the number of parties represented in the legislature, taking into consideration their relative weight (Laakso/Taagepera index) = $1 / (\sum p_i^2)$; p_i is the share of parliamentary mandates controlled by party i . Number of ministries/ ministers denotes the situation on 1 January 2005.

3.2 Steering capability

While Russian policies under President Yeltsin (1993-99) presented a largely desolate picture of incompetence and short-term power grabs, after President Putin took office in 2000, he immediately defined clear, long-term priorities that have dominated the policies of his administration until today. However, these long-term priorities are not consistent with the idea of a transformation to a market-based democracy. Politically, the main aim is control by the state executive over the legislative process and over the implementation of policy measures.

Accordingly, political reforms have served to consolidate the power of the presidency by improving control over parliament and over regional administrations. It has to be noted here, that contrary to many claims by Western observers, these political reforms as such are not undemocratic. Many of the measures proposed by Putin in

2004 have been demanded by Western analysts in the 1990s to promote a stable political system, especially the election of all Duma deputies through national party lists. This would mean the abolition of single-mandate districts. Other proposals are to strengthen the party system and parliamentary factions as well as develop stronger control by the center over regional governors in order to force the regions to accept the supremacy of national legislation. The increased control over regional administrations threatens Russia's federal system but not democracy, which can exist in centralized states like France as well.

The main problem with these political reforms is that they increase the power of a president who is willing and able to use informal ways to circumvent the checks and balances of weak democratic institutions. Accordingly, the real threat to Russia's democracy is the use of informal political pressure to increase state control over mass media, NGOs and interest representation by business elites. Informal pressure is probably also applied by the state executive to influence the judicial branch. This pressure indicates more than everything else that Putin's main goal in the sphere of politics is control and with that stability and predictability but not democracy as such.

In the economic sphere, the state executive under President Putin has initiated a number of reforms aimed at the introduction or strengthening of market mechanisms; the land market has been liberalized, the tax system has been rationalized and the social welfare system is being liberalized. Negotiations over WTO membership are being pursued seriously. In most cases members of government are directly responsible for these reforms because they want to transform Russia into a market economy. However, for President Putin, the strengthening of market mechanisms seems to be more a means than an end in itself. His declared major long-term economic goal is dynamic GDP growth. A considerable part of the Russian political leadership is not convinced that market mechanisms are the best way to achieve economic growth. Moreover, when economic aims collide with political ones, the latter seem to dominate. A good example for this is the Yukos affair. Excessive tax demands, fines and the initiation of legal proceedings against major shareholders and the management have been used to destroy one of Russia's best performing companies. The affair is also bad for the general investment climate as it demonstrates how vulnerable even big business is to political pressure.

Thus, it can be stated that the Russian political leadership prioritizes and organizes its policies according to strategic aims. However, these strategic aims do not focus on the development of a market-based democracy and in practice they quite often hamper the development of a market-based democracy, especially in the political sphere.

The executive branch has responded flexibly and has proved that it is able to learn to organize the political decision-making process. With its talent for power politics and the President's great popularity, the executive branch has enough political authority to push its reforms through the legislative process. It remains to be seen whether it also has enough control over government administration to implement reform policies nation-wide. In this case, a learning process can be observed as the attention of the state executive is increasingly being devoted to administrative reform and the fight against corruption. However, so far it is not clear whether the political leadership will be up to this challenge.

3.3. Resource efficiency

Although the reforms under President Putin have improved resource efficiency considerably, Russia is still far from having achieved an effective use of resources. While a stringent austerity policy has yielded significant progress in the use of government funds, the use of staffing and organizational resources continues to languish because of the problems of an oversized, often corruptible and only modestly competent administrative apparatus.

The state budget has been consolidated and is showing a surplus since the beginning of Putin's presidency. The level of state debt has been considerably reduced, leading to regular upgrades in the investment ratings of Russia's sovereign debt. The processes of budget planning and spending discipline have been improved considerably. Whereas in the 1990s the state budget was often agreed only long after the beginning of the relevant year, this has never happened under President Putin. Spending targets have normally been met. However, there is no effective audit process and reports by the parliament's audit chamber have, on most occasions been ignored.

With a share of 2% in total employment, the bureaucracy of the Russian state executive is not oversized in international comparison. However, its organizational structure and code of behavior is generally assessed as leading to considerable inefficiencies. The Russian government has reacted by instituting administrative reforms in 2003. As complete restructuring necessarily usually leads to short-term inefficiencies, it is still too early to assess the reform. What can be said is that Russia does still not have an efficient state administration. As a result, the coherent strategy of the political leadership that is being translated into legislation is regularly distorted during implementation. In the wake of reorganization, new conflicts between governmental agencies have emerged.

The implementation of policies is also hampered by a considerable degree of corruption. According to a World Bank survey from 2002, a third of Russian companies regularly bribes state officials. On the basis of representative polls in 2001, the Russian INDEM institute has estimated that more than \$30 billion are annually paid as bribes in Russia. The government has reacted to this problem with a far reaching administrative reform. One of the main aims of this reform is to reduce the leeway of bureaucrats and to simplify business regulation in order to reduce opportunities for bribe extortion by state officials. As this reform is still ongoing, it is too early to assess its results.

Another obstacle to resource efficiency is a serious division of the Russian government into two ideologically opposed camps. The liberal reformers who were initially in charge of economic policy under President Putin have increasingly been sidelined by politicians with a secret service or law education background. Some of the liberals' major reform projects, aimed at reforming companies close to the state like the gas or electricity monopolies, have been repeatedly delayed. The political pressure on Yukos has also been heavily criticized by members of the liberal camp. Putin's economic adviser called it the scam of the year and spoke about Russia's transition to a model of state interventionism at a press conference in December 2004. In summary, the views of both government camps are consistent with the strategic policy goals set by Putin. However, their ideas about ways to realize these goals are on many occasions incompatible and as a result some policies have counterproductive effects on other policies. Even more importantly many policies are not implemented properly due to bureaucratic inefficiency and corruption.

3.4 Consensus-building

Putin has achieved considerable progress in consensus-building compared with his predecessor Yeltsin in the 1990s. The notion of the "Putin majority" has now become a fixture in the country's political vocabulary. Parliamentary opponents of reform have been successfully marginalized. Putin's opponents in the regions have also seen their position weakened. A large majority of the population supports the president.

The appeal for broad-based collaboration to overcome the "state of emergency" has been a core component of Putin's political rhetoric. Thus, the political leadership has been successful at depolarizing conflicts and has managed political cleavages in a way that makes escalation highly unlikely. For example, a partial transfiguration of the past has been taking the place of a social processing of historical acts of injustice. However, it should again be noted that the consensus developed under Putin is not primarily oriented to creating a market-based democracy. The major political actors

agree on the Putin model of a 'controlled democracy' and a limited market economy. That means they accept the existing political and economic system, including democratic elections, as the primary means of transferring political power. However, they do not agree on market economy and democracy as strategic long-term aims and they do not object to violations of democratic standards, as in the case of biased election campaigns, and to violations of market principles, as in the case of the Yukos affair.

Strong supporters of reforms toward higher democratic standards are no longer represented in the political system. Strong supporters of liberal economic reforms have influential posts in the state executive, but they are not able to determine policies on their own.

As the development of politically active NGOs is seen as a potential threat to state control, the political leadership has only made very limited efforts to develop social capital among citizens and social groups. These efforts focus on apolitical forms of social organization and are mainly symbolic in nature. However, highly publicized meetings of leading politicians with representatives of NGOs may have a positive impact on public opinion. At the same time, NGOs engaging in politics or receiving support from abroad are being criticized by the leadership and are often subject to harassment by state agencies. The political leadership has in some spheres tried to create pseudo-NGOs under state sponsorship.

The political elite has increasingly restored symbols of the Soviet past. The reform of state symbols has returned Soviet symbols that had been rejected in the 1990s. Even the Stalin era of most severe repression is increasingly represented in a positive light. On the surface, this is due to the preceding 60th anniversary of the victory over fascist Germany. However, the underlying trend is the rise of political elites close to the former Soviet secret service and the military to political power. A critical assessment of the Soviet system and an examination of human rights violations of the past is nearly exclusively conducted by NGOs, which often face indirect harassment or at best ignorance from representatives of the state executive.

3.5 International cooperation

While Russia under Yeltsin cooperated with international partners like the World Bank or the International Monetary Fund (IMF), it often misused international aid for inappropriate purposes, and applied it only to a very limited degree toward improving policies. President Putin, by contrast, rejects international aid. His public explanation is that Russia does not need foreign help in order to develop. It can arrange the

necessary measures on its own. First, this idea fits in with the president's rhetoric of "national self-awareness." Second, it makes Russia less vulnerable to foreign criticism of how it deals with basic democratic rights.

Nevertheless, within its conceptual framework, the Russian government behaves consistently in international politics, and is therefore considered reliable by its foreign policy partners in the West. Russia has been included in the G8, although economic indicators do not support this decision. Russia has also made progress toward joining the WTO, especially through an agreement with the European Union. Russia joined the Kyoto protocol in 2004. For foreign investors, Russia still poses a higher political risk than Western countries. This is reflected in the ratings of international organizations like Moody's and Standard & Poor's. They have increased Russia's ratings but the country still ranks below Western market economies. The country's risk for foreign direct investors was highlighted in 2004 by the Yukos affair. Nevertheless, foreign direct investment in Russia reached a high point in 2004. The logical conclusion is that most foreign investors are willing to accept the higher country risk in order to participate in Russia's economic boom. Thus, foreign investment is not attracted by a credible government policy but by economic prospects. The government's policy has been contrary to business interests on many occasions, leading to critical remarks from Western politicians including the EU Commission and the ministries of foreign affairs of Sweden and Norway.

In relations with neighboring countries, Russia still applies a foreign policy concept based on ideas of regional hegemony. However, Russia has been unable to transform the CIS into its own "backyard". It has accepted a U.S. military presence in Uzbekistan. It has not been able to pressure Turkmenistan into closer economic or political cooperation. Most importantly, Russia has not been able to prevent the political changes in Georgia and Ukraine in 2003-2004, although it was heavily opposed to them. In both cases, a political leadership closely connected to Russia was replaced by a political opposition critical of Russia's role in the region and interested in closer relations with the European Union. International cooperation has been selective and rules set by regional and international organizations have sometimes been ignored when they were perceived as being contrary to Russia's national interest.

4. Trend of democratic and economic development

4.1 Democratic development

Even before the period under review, the core characteristics of a democratic system had been formally established in Russia. There were especially significant deficiencies at the beginning of the period in the freedom of the press, an independent judiciary, combating corruption, and the social rooting of political parties and interest groups. There has been no visible progress in these areas during the period although the government appears to have serious intentions to reform the judiciary and to fight corruption. The development of the mass media and of NGOs, on the contrary, has been hampered by pressure from state agencies.

The massive human rights violations and restrictions on freedom of movement and freedom of the press, all of which have been associated with the second Chechen war since 1999, have been a considerable setback for the country's democratic development.

Irrespective of these setbacks, the political system has remained stable under President Putin. The majority of the Russian population is not opposed to democracy as a system of government and supports the "Putin system." In summary, Russia's stateness and the quality of its political system have not changed significantly since President Putin consolidated his political power in 2000.

4.2 Market economy development

The socioeconomic situation improved slightly during the period under review. This development is mainly the result of economic recovery and less of state-sponsored measures. Accordingly, the improvement has been especially significant since the effects of the economic boom reached society in 2000. The dimension of this boom is described in the table below. It is noteworthy that unemployment has not been reduced substantially despite of high economic growth in a stable macroeconomic environment.

Table: Development of macroeconomic fundamentals (2000-2004)

	2000	2001	2002	2003	2004
Growth of GDP in %	10.0	5.1	4.2	7.3	7.1 ¹
Export growth in %	39	- 3	5	25	-
Import growth in %	14	20	13	23	-
Inflation in % (CPI)	20	19	15	12	10.9 ¹
Investment (FDI) in % of GDP ²	2.7	2.5	3.0	8.0	11.7
Tax Revenue in % of GDP	-	-	-	-	-
Unemployment in % (ILO)	10,2	9,0	7,1	8,3	8,0 ¹
Budget deficit in % of GDP	1,2	2,9	1,4	2,6	2,9 ¹
Current account balance in billion \$	46.8	35.0	32.8	39.1	60.1 ²

Sources: EBRD – Transition Report 2005; Russian Federal Service for Statistics; Bank of Finland Institute for Economies in Transition. ¹estimated; ²Citibank Russia

The economic reforms initiated under President Putin substantially improved the formal institutional framework for market-economy action in several segments of the economic system. However, despite the strong quantitative and qualitative improvement in overall economic development serious problems remain in the economic regime. Regulatory deficiencies exist are still found in the banking system and capital market or the social system. Deficiencies in implementation are to be found in many areas of policy. Most importantly, the changes in the formal institutional framework have not been implemented in full in many policy areas because of bureaucratic inefficiencies, corruption or political interference.

D. Strategic perspective

As president Putin has successfully consolidated his power, any major changes in Russia's political and economic development are unlikely before the end of his second term in 2008. Putin has made his political and economic aims clear, which allows for a solid prognosis.

In the political sphere most of Putin's reform projects will go unchallenged. A change in the laws governing political parties and elections will lead to fewer relevant political parties. Regional governors will be appointed by the president and no longer elected. This will weaken the governors' powers and strengthen the Kremlin's in regional affairs. Reforms will also mean that regional governments will lose certain authorities to the national government. Political pressure on mass media and

politically active NGOs will persist. The armed conflict in Chechnya will continue, as will the massive human rights abuses committed by the Russian military.

In the economic sphere, the executive branch will focus on the promotion of growth. However, it is presently unclear at present whether that means further liberal market reforms, like the break-up of natural monopolies and the reform of utilities, or whether the government will focus exclusively on control measures like the fight against corruption and administrative reform. It is also not clear how often the government will intervene directly in economic activities as it did during the Yukos affair. Russia's economic policy seems to be standing at a crossroads.

However, an abrupt change in policy seems unlikely, as does a sudden recession. The government will continue to profit from the large revenues generated thanks to the high price of oil. There is no opposition to a continued policy of austerity. Therefore, economic growth is likely to continue, and development of the market economy will be limited.

Putin's goals are clear and he is unwilling to alter his position in reaction to international criticism. External supporters of Russia's development can either try to find a niche within the current system or withdraw altogether from Russia. It is not possible—at this juncture—to predict any significant changes when Putin's second term ends in 2008.