

BTI 2008 | Russia Country Report

Status Index	1-10	5.94	# 59 of 125	
Democracy	1-10	5.35	# 72 of 125	➔
Market Economy	1-10	6.54	# 44 of 125	➔
Management Index	1-10	3.88	# 97 of 125	

scale: 1 (lowest) to 10 (highest) score rank trend

This report is part of the Bertelsmann Transformation Index (BTI) 2008. The BTI is a global ranking of transition processes in which the state of democracy and market economic systems as well as the quality of political management in 125 transformation and developing countries are evaluated.

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Key Indicators

Population	mn.	143.1	HDI	0.80	GDP p.c.	\$	9,648
Pop. growth ¹	% p.a.	-0.5	HDI rank of 177	65	Gini Index		39.9
Life expectancy	years	65	UN Education Index	0.95	Poverty ³	%	12.1
Urban population	%	73.0	Gender equality ²	0.48	Aid per capita	\$	

Sources: UNDP, Human Development Report 2006 | The World Bank, World Development Indicators 2007 | OECD Development Assistance Committee 2006. Footnotes: (1) Average annual growth rate 1990-2005. (2) Gender Empowerment Measure (GEM). (3) Percentage of population living on less than \$2 a day.

Executive Summary

Russia's political and economic development has been highly influenced by the policies of Vladimir Putin, who became president at the beginning of 2000. At that time, the conditions for the development of a market-based democracy were heterogeneous. Formally, the core rules of the game were already in place. Yet these rules were often incomplete and obeyed only sporadically. In addition to this, the lack of embedded traditions in rule of law, civil society and democracy hampered rapid development toward a market-based democracy.

With regard to democratic transformation, no material progress was achieved during the period under review. President Putin consolidated his power in 2000 through measures inconsistent with democratic standards. These measures, namely the marginalization of political actors outside the federal executive, the centralization of control over nationwide mass media, the harassment of politically relevant NGOs and the committing of massive human rights violations in the struggle with Chechen rebels in the northern Caucasus, have persisted until today.

In 2005 and 2006 these tendencies were highlighted among others by the final stage of the Yukos affair, which saw Mikhail Khodorkovsky, the majority owner and former CEO of the Russian oil company Yukos, sentenced to nine years in prison in a trial inconsistent with legal standards. The adoption of new legal regulations for the registration and control of NGOs increased the potential for administrative harassment of opposition forces. Regular restrictions on protest actions and election campaigns by oppositional forces (from the liberal as well as from the nationalist camp) also indicated the growing intolerance of the political leadership.

This is due to the fact that the political leadership clearly does not consider advancing democratic transformation as among its priorities. Nevertheless, President Putin has

stabilized the political system, and major democratic essentials, such as free and fair elections – but not election campaigns – are by and large guaranteed.

With regard to transformation toward a market economy, Putin's first term (2000 – 2004) showed some progress. The macroeconomic situation was stabilized and the regulation of some important policy fields, like taxation and land ownership, was completely reformed. However, bureaucratization, corruption and political interference have rendered implementation rather inefficient. The social security system is still full of gaps and under-financed. Despite these deficits however, Russia is experiencing a long-lasting economic boom.

While the political actors at the end of Yeltsin's presidency (i.e., 1998 – 1999) seemed unable to act and concentrated on consolidating power for the short term, upon taking office President Putin quickly developed a consistent long-term development strategy, which has been smoothly transferred into legislation. This strategy focuses on state-promoted industrial policy and large-scale projects in the social sphere.

It should be pointed out once again that the transformation strategy of Russia's political leadership aims primarily at a stable political system and notable economic growth. Violations of some fundamental democratic rights – and increasingly of market principles as well – are apparently considered acceptable. Measured in terms of its own goals, then, the political leadership has been quite successful. Measured by the normative standards of market-based democracy, significant and chronic deficiencies persist in the political sector and increasingly in the economic sector as well.

History and Characteristics of Transformation

Economic and political transformation began in Russia in the second half of the 1980s with the reforms of Soviet General Secretary Mikhail Gorbachev. But it was the reform measures of Russian President Boris Yeltsin that defined post-Soviet Russia.

Presidential elections of June 1991, won by Yeltsin, marked one of the first milestones of democratic transformation in Russia. Afterwards conflict arose between the reform-oriented Yeltsin and the rather conservative parliament. In the fall of 1993 Yeltsin terminated the resulting stalemate with a violent, unconstitutional dissolution of parliament. Concurrently, a commission close to the president drafted a constitution outlining a federal presidential republic. The Russian people approved the constitution in a referendum in December 1993. Parliamentary elections were held at the same time as the referendum. Outspokenly antidemocratic parties won 43% of the vote. Until 1999, there was no significant change in this balance of power. In addition, considerable resistance to democratic trends could be observed at the regional level where a variety of political regimes, some of them with authoritarian traits, developed,

often exceeding the already broad authority granted them by the constitution. While the Russian Constitution expressly provides for a democratic rule of law, constitutional realities under President Yeltsin were characterized by significant democratic deficiencies. These resulted not only from anti-democratic forces that stalemated 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. In this context actors without democratic legitimacy, like the so-called oligarchs, gained considerable influence on the political decision-making process.

The first milestone in Russia's transformation toward a market economy was the reform package that took effect in 1992. Price liberalization and mass privatization were its two core components. But instead of the anticipated upswing, Russia found itself facing a prolonged economic crisis. GDP had declined by more than 6% 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 code, were stalemated in the legislative process. The protracted economic crisis also adversely affected the population's standard of living, and social inequality increased considerably. Economic problems culminated in a dramatic financial crisis in August 1998.

Although Yeltsin himself did not win the approval of more than 10% of the population from 1997 onward, he was able to groom Vladimir Putin, whom he appointed to the post of prime minister in summer 1999, as his successor. In the December 1999 elections to the State Duma, the lower house of parliament, the new Yedinstvo party, with close ties to Putin, achieved unexpected success, placing a close second to the Communists. Yeltsin resigned at the end of the year, and Prime Minister Putin took over as acting president in conformity with the constitution. In the March 2000 presidential elections, he won the absolute majority vote in the first round. He was re-elected with an even better result in March 2004.

Putin has earned the permanent approval of significantly more than half the population. One of the core reasons for this was his decisive action in combating the country's "state of emergency." Here he won particularly great approval for his military campaign against Islamist separatists in the northern Caucasus and for tough government measures against business tycoons, the so-called oligarchs. Politically, new constraints were imposed under Putin on democratic principles, especially through interventions against press freedom and NGOs, as well as through extensive human rights violations in the Chechen war. The political reforms of 2004 increased central control over the regions in a way inconsistent with the federal principle foreseen in the constitution. Whereas authoritarian tendencies could be observed in the political sphere from the beginning of Putin's first term, liberal ideas dominated economic policy for a long time. An economic boom started in 1999 and also contributed to Putin's

popularity. By 2006 Russia's GDP had risen by nearly 70 %. In Putin's second term economic policy increasingly focused on industrial policy, state control over "strategic" sectors of the economy and large-scale projects in the social sphere. However, widespread corruption, an extensive shadow economy, and the manipulation of the judiciary by the executive branch remained serious obstacles for economic and social development.

Transformation Status

I. Democracy

1 | Stateness

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

Monopoly on the use of force

Apart from the separatist conflict in Chechnya, defining citizenship and who qualifies for it is not a politically relevant issue. The majority of the population defines the Russian state as based on the nations historically living on its territory, with a dominant role ascribed to the Russian nation. Xenophobia is rather widespread and directed primarily at individuals from the Caucasus, Central Asia and Africa. Racial violence has led to several deaths. There are also many cases of discrimination by representatives of state agencies against Russian citizens belonging to ethnic minorities from the northern Caucasus region.

State identity

The Russian Constitution stipulates a separation of church and state. The political process is secularized. However, the Russian Orthodox Church has a privileged status whereas other religious groups, including the Catholic Church, have occasionally complained of discrimination. Islamic movements perceived by the state authorities as extremist have complained of unjustified harassments. At the same time the Russian government has adopted an explicitly pro-Islamic stance in international scandals, most recently the affair of the Danish cartoons of Mohammed, and has banned publication of similar cartoons. President Putin has attended international meetings with Islamic states and stressed that, in absolute terms, Russia has one of the largest Muslim populations in the world.

No interference of religious dogmas

Apart from some regions of the northern Caucasus, the state has a basic infrastructure (i.e., administrative institutions, fundamental administration of

Basic administration

justice, apparatuses to implement political decisions) in place throughout the country, but bureaucratization, corruption and a lack of funds have made its performance erratic.

2 | Political Participation

At the national level there are no serious restrictions on free and fair elections. However, there are instances of minor manipulations in some regions. As an exceptional case, elections in Chechnya do not meet any democratic standards. Election campaigns, however, are regularly manipulated by the state administration throughout the country. This includes heavily biased media coverage, the use of state resources in support of specific parties or candidates and administrative discrimination against opposition candidates, sometimes leading to questionable exclusions of such candidates from the ballot. As a result of manipulated election campaigns, the election result can be seen as unfair despite a voting process that is by and large free and fair (outside Chechnya).

Free and fair
elections

In the formal political decision-making process elected representatives have full power to govern. Informal influences by non-state actors have been successfully reduced under President Putin. However, it is generally assumed that representatives of secret services and the military (put together under the Russian label of “siloviki”) have gained broad political influence. This influence is mostly formalized through appointments to official positions in government agencies and state-owned companies.

Effective power
to govern

There are considerable restrictions on rights to organize and communicate politically. The national government largely accepts freedom of association and freedom of assembly, but there are substantial violations of these rights in some regions. NGOs critical of the national or regional government have on many occasions been subject to harassment by state agencies. In the run-up to the 2007 parliamentary elections, state administration and the media have systematically discriminated against liberal parties. Especially in Moscow, several demonstrations planned by opposition parties and movements have been banned.

Association /
assembly rights

The mass media are subject to influence from the executive branch. During Putin’s first term, private media with nationwide reach have systematically been brought under (at least indirect) state control. In his annual report, the Russian Ombudsman for Human Rights stated in February 2006: “The main mass media, and first of all the leading electronic media, accounting for 90% of the information segment of the country and forming public opinion, are under the very strict control of state organs.” Media coverage of elections is systematically manipulated. There are extensive restrictions on freedom of the press in covering the war in Chechnya. As a result, opinions critical of the government are on many

Freedom of
expression

occasions restricted to a handful of newspapers and radio stations with very limited distribution, aimed first and foremost at the political and business elite, and to the Internet.

3 | Rule of Law

Serious deficiencies exist in the checks and balances among the executive, legislative and judiciary branches. As the president has a stable majority in parliament, the legislature exercises its review function only to a very limited degree. 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.

Separation of powers

Political interference and corruption lead to the manipulation of how laws are applied. A high profile example of political interference is the Yukos affair. The Moscow Helsinki Group commented on the Yukos affair in its annual report on 2005: "The prosecution became a classical machinery for repression on behalf of the political power, and the judiciary demonstrated an absolute lack of independence when reviewing a case of political relevance." In May 2005, the European Parliament passed a resolution on Russia voicing concern, among others, about the misuse of the judicial system for political purposes. Corruption in the judicial system is common. According to a representative poll of the Russian population conducted by the Russian Information Science for Democracy (INDEM) Foundation, Russians spent \$210 million bribing courts in 2005 (down from \$275 million in 2001) and \$30 million bribing policemen (unchanged from 2001).

Independent judiciary

The Russian leadership, including President Putin, repeatedly names corruption as one of the main challenges facing the Russian state. However, most anti-corruption efforts are largely symbolic in nature. Official accusations of corruption are still perceived as a sign of PR campaigns resulting from political power struggles. Judicial prosecution of corruption charges has not improved quantitatively or qualitatively. There are thus no indications that corruption in Russia has decreased under President Putin.

Prosecution of office abuse

Russia's political leadership often sacrifices certain democratic standards, such as freedom of the press, freedom of assembly, the right to a fair trial and the rule of law in order to strengthen its own political power, which is seen as a precondition for providing stability. In the case of the war on terror and the situation in the northern Caucasus, the security forces have decided at least implicitly that "stability" trumps the local population's basic human rights. They are encouraged in this approach by the fact that human rights violations by Russian security

Civil rights

forces are rarely investigated and hardly ever punished. President Putin seems to support this approach, at least verbally, in his repeated urgings (in rather colloquial language) to “kill terrorists like rats.” The state prosecution has also initiated biased and selective investigations against a considerable number of independent journalists and NGOs. As Greenpeace Russia Executive Director Sergei Tsyplenkov believes, the new NGO law of 2006 requiring all NGOs to repeat the registration process, an expensive and time-consuming endeavor, “was introduced in order to get rid of unwanted social organizations.” It “introduces many new clauses” which can be interpreted broadly, so that “the interpretation of each clause of the law in each case will depend on the bureaucrats in the state registration service. Much will depend on the application of the law. In Russia, there are many laws that are simply not applied, while at the same time, there are many laws which offer the opportunity for bureaucrats to interpret them as they wish.”

However, observers agree that there is no systematic purge of unwanted opposition and there is no clear pattern of general pressure on specific NGOs. Instead, bureaucratic harassment is sporadic and voluntary. If there is any master plan at all (and not only bureaucratic zeal at a lower lever), the idea seems to be to frighten off potential opposition through showcases. One notable exception was the public demonstrations by the political opposition in the lead-up to the 2007 parliamentary elections. The authorities regularly suppressed such demonstrations, at which the police arrested or beat some of the demonstrators.

4 | Stability of Democratic Institutions

Although subject to limitations on the rule of law, including political interference and corruption, democratic institutions are stable. However, the bureaucracy’s implementation of legislated provisions often remains a serious problem due to inefficiency. Another obstacle to the adequate performance of democratic institutions is the weak party system.

Performance of
democratic
institutions

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 the Putin administration perceived them as obstructing the realization of concrete political goals. In summary, the acceptance of democratic institutions is for most actors more a question of pragmatic consideration than of principle.

Commitment to
democratic
institutions

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 likewise not helpful to democratic consolidation. The party with the biggest faction in parliament, United Russia, was founded in 2001 through a merger of the two main rivaling parties of the prior elections, which both had been founded only in 1999. Of the nine factions formed in the parliament elected in 1999 only three were 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 executive power. The parliament election in 2003 left the political opposition permanently marginalized. Accordingly, the new election law of summer 2005, meant to strengthen the party system by favoring bigger parties, is unlikely to have a positive impact on the short term and will much more likely strengthen the dominance of the present voting association United Russia.

Party system

The ecology of interest groups in the political sphere is sparse. Important social interests are under-represented. The political leadership's reactions to accomplishments of the interest groups has been symbolic at best. Putin has stressed the need for a strong civil society in several well-publicized speeches, but at the same time he has impugned Russian NGOs for accepting support from foreign donors. The current administration has excluded NGOs critical of the government from the dialogue between state executives and civil society, and state agencies have harassed them on several occasions.

Interest groups

The population's approval of democracy as voiced in representative polls is moderate to high depending on the wording of the question. However, about a third of the Russian population is not able to give any meaningful definition of democracy. 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 FOM, ROMIR or the Levada-Center regularly indicate. About a quarter of the population openly opposes democracy, whereas barely 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 principled opposition to undemocratic norms.

Consent to democratic norms

Self-organization in civil society encounters strong barriers, namely the burden of a Soviet past in which NGOs did not exist, and harassment by the state executive

Associational activities

power. Accordingly, NGOs are unevenly distributed, flourishing mainly in the mega-cities of Moscow and St. Petersburg, and are often spontaneous and temporary. Many Russian NGOs owe their existence only to the engagement of international organizations and sponsors.

II. Market Economy

6 | 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. Household plots used for agricultural production have made an important contribution to the income of the rural population. Most of their output does not reach the market because it is consumed domestically, making the dimension of this subsistence economy hard to estimate, but according to Russian statistics its share in Russian agricultural production has risen to 40%. However, at the same time, social inequality as indicated by the Gini coefficient has increased markedly as a result of long-term unemployment, an insufficient pension system and a flat income tax rate, among other reasons. There are considerable regional differences in levels of socioeconomic development within Russia and financial readjustments among regions do not materially reduce these discrepancies.

Socioeconomic
barriers

Economic indicators		2002	2003	2004	2005
GDP	\$ mn.	345,471	431,487	588,907	763,720
Growth of GDP	%	4.7	7.3	7.1	6.4
Inflation (CPI)	%	15.8	13.7	10.9	12.7
Unemployment	%	8.6	7.9	7.9	-
Foreign direct investment	% of GDP	1.0	1.8	2.6	2.0

		2002	2003	2004	2005
Export growth	%	10.3	12.5	11.8	6.3
Import growth	%	14.6	17.7	22	17.3
Current account balance	\$ mn.	29115.9	35410.0	58591.7	83184.3
Public debt	\$ mn.	96,069.1	99,054.4	102,912.0	75,359.0
External debt	\$ mn.	147,383.1	175,702.1	196,800.6	229,041.9
External debt service	% of GNI	4.2	4.6	3.7	5.6
Cash surplus or deficit	% of GDP	7.0	2.2	5.3	9.9
Tax Revenue	% of GDP	13.6	13.3	13.3	16.6
Government consumption	% of GDP	17.7	17.6	16.5	16.5
Public expnd. on edu.	% of GDP	3.8	3.7	-	-
Public expnd. on health	% of GDP	4.0	3.9	3.7	-
R&D expenditure	% of GDP	1.3	1.3	1.2	-
Military expenditure	% of GDP	4.3	4.3	3.9	4.1

Sources: The World Bank, World Development Indicators 2007 | UNESCO Institute for Statistics | Stockholm International Peace Research Institute (SIPRI), Yearbook: Armaments, Disarmament and International Security

7 | Organization of the Market and Competition

The institutional framework assures the foundations of market-based competition. Prices on the domestic market were decontrolled in 1992. At present, state price regulation is restricted to utilities. The state also subsidizes prices for agricultural products. The national currency became freely convertible in summer 2006. Foreign trade has been liberalized, and at present the remaining restrictions are no more extensive than in OECD countries. However, state economic policy remains skewed in favor of politically influential large corporations, especially state-owned ones. The Yukos affair demonstrated that competitive companies could be eliminated by bureaucratic means for reasons unrelated to business. 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, independent empirical studies are unavailable. Moreover, red tape presents a serious obstacle to running a small- or medium-sized business. According to the World Bank study on Obstacles to Doing Business, setting up a business is relatively easy and inexpensive. In a

Market-based
competition

worldwide comparison, Russia ranks 33rd, while for comparison Germany ranks 66th and Poland 114th. However, dealing with licenses, getting credit, paying taxes and trading across borders are all problems where Russia ranks close to the bottom. As a result of unattractive conditions for business, capital flight has been a serious problem for the Russian economy. While the recent economic boom has led to a net capital inflow, investments are still insufficient to fuel the rate of modernization that the Russian economy needs.

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 substantially reformed despite year-long debates. However, for the liberalized part of the economy the anti-monopoly agency functions rather efficiently, with exceptions at the regional level, where some administrations have blocked competition.

Anti-monopoly
policy

Foreign trade has been liberalized in principle, but substantial regulatory exceptions remain on, for example, imports of agro-food products and cars, and on exports of some metals, resulting in regular trade disputes, especially with the European Union. By the end of 2006 Russia had reached bilateral agreements on WTO membership with all relevant parties.

Liberalization of
foreign trade

Though the liquidity of the Russian banking sector has improved remarkably since the financial crisis of 1998, it remains severely underdeveloped and still cannot perform its economic function as a financial intermediary. Russian banks cannot yet compete internationally. Moreover, state-owned banks dominate the banking sector. At the same time, differentiation of the Russian banking sector is increasing and seems to be working. State regulation of the banking sector has some deficits, but seems adequate by and large. Banks have been forced to adopt international standards, though at a slower pace than originally planned. However, a strong criminal element, devoted to money laundering, remains, as indicated by the murder of the central bank’s vice president in autumn 2006.

Banking system

8 | 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. The national currency became fully convertible in summer 2006.

Anti-inflation /
forex policy

Since Putin took office in 2000, the country has adhered to a consistent austerity policy that regularly leads to budget surpluses, which made possible a significant reduction of foreign debt. The fact that monetary policy is integrated into a

Macrostability

general economic policy concept is also indicated by the stability fund, which was introduced to protect the state budget's windfall profits from high oil prices in the future. This fund has been defended successfully against demands for increased state subsidies.

9 | Private Property

Property rights and the regulation of the acquisition of property are defined formally in law. With the exception of the sale of farmland, the legal provisions are practical. However, they are not consistently implemented and not 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 "strategic sectors" like the oil industry the state seems systematically to reduce the share of private owners through administrative pressures, which leads either to confiscations or to negotiated sales. Some property rights, especially copyrights, are being ignored on a regular basis.

Property rights

Private enterprise is the backbone of the economy, accounting for about two-thirds of economic activity. However, in 2005, for the first time since the end of the Soviet Union, its share decreased. This seems to be a result of the Russian government's attempts to bring "strategic" enterprises back under state control. The state also tolerates a number of market concentrations, especially in the "natural" monopolies such as natural gas, electricity and railroads.

Private enterprise

10 | Welfare Regime

Parts of the social security system (especially health care) are relatively well developed in Russia, but they do not cover all risks for all strata of the population. Moreover, their efficiency and availability is reduced by widespread corruption. There is almost no state support for the unemployed. Though 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 help. Economic improvement since 1999 has mitigated the country's social problems, although the state's social insurance system has yet to follow suit. Under President Putin, the reform of the state's social welfare system has aimed at liberalization. However, most Russians lack the financial means to buy private insurance, and especially in the pension system, private companies are underdeveloped. In summer 2005 so-called national projects were introduced and allotted considerable funding to improve, among other elements, the health

Social safety nets

care system, and to develop rural areas. So far they have not led to substantial changes in the situation.

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, a quarter of the population is unemployed and wages are far below the national average. There are sizeable communities of homeless people in the big Russian cities. Throughout the country, women have equal access to education but are under-represented in the political system and in business management.

Equal opportunity

11 | 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. In the period from 1999 to 2006 Russia's economy has grown by nearly 70%. At the same time, all key macroeconomic indicators have improved considerably, apart from the unemployment rate, which remains close to 10%. Inflation has been reduced 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.

Output strength

12 | Sustainability

Russian economic policy is focused on medium-term economic growth. President Putin has set ambitious goals for GDP growth over the coming 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 issues only appear on the political agenda when they promise to deliver clear material short-term advantages or when they cause public concern. For example, environmental concerns were cited to put pressure on unwanted investors, as in the case of the Sakhalin oil consortium in autumn 2006. In the case of the pipeline next to Lake Baikal, which prompted public debate, President Putin changed the route at the last minute. The long-term political effort to reduce the economic dependence on raw material production

Environmental
policy

would also reduce negative environmental effects. But again, environmental concern is hardly ever mentioned as a reason for this strategy. Administrative reforms under Putin have weakened further the limited institutional base for environmental protection, in both state and NGO settings. 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, for example in space technology, but in general Russia is below the level of OECD countries in quantitative as well as qualitative terms. In 2005 the Russian government reacted to this by declaring education a top priority as one of the four national projects that would receive considerable additional funding. However, substantial results should not be expected in the short run. The government has also designed programs to improve research and development as well as to reduce academic tuition. Russia has joined the Bologna process, which aims to create a common European academic education system. Government spending on education is now slightly below 5% of GDP and spending on research and development stands at slightly below 2%.

Education policy
/ R&D

Transformation Management

I. Level of Difficulty

The structural constraints on governance in Russia are moderate as the key indicators show a relatively high level of socioeconomic development. The country has an educated workforce. There are no serious geographic or infrastructural deficiencies, which could not be overcome by good political management. However, the production of raw material in northern regions poses a real challenge. Also, a decline in health care standards and alcoholism are causing a serious demographic problem.

Structural
constraints

Throughout most of Russia's history civil society was heavily suppressed. Independent NGOs started to develop only in the late 1980s. The only older tradition they can refer to is that of the dissidents and human rights activists of the Soviet period. Trust in institutions and social trust are extremely low in Russia. A civic culture of moderate participation in public life has not yet been developed.

Civil society
traditions

In the northern Caucasus ethnic conflicts have the character of a civil war and are associated with terrorist acts. They also have a religious dimension. Apart from this, visible divisions of Russian society have not transformed into conflicts. The non-Caucasian ethnic communities traditionally living on Russian territory have been accommodated within the federal system. The same applies to religious communities. However, xenophobia and anti-Semitism are widespread among the population. In the Russian public debate, the social protests and violence of illegal work migrants have been discussed as possible causes of social conflicts. Whereas the former took the form of mass demonstrations in early 2005 (and only then) the latter has not yet materialized at all.

Conflict intensity

II. Management Performance

14 | Steering Capability

While Russian policies under President Yeltsin (1993 – 1999) 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 of the government are inconsistent with the goal of transformation toward a market-based democracy. On the political side, the main aim is state executive control over the legislative process and the implementation of policy measures. On the economic side, the state aims to promote economic growth through direct intervention. The state increasingly aims at direct ownership of enterprises in sectors of “national strategic relevance.”

Prioritization

The government’s priorities are not consistent with the goals of transformation to a market-based democracy. Politically, the government’s main aim is to consolidate the executive branch’s control over the legislative process and the implementation of policy measures. Economically, the government aims to promote economic growth through direct intervention. The government is increasingly seeking direct ownership of enterprises in sectors of “national strategic relevance.” This policy is rather consistently translated into legislation. However, implementation suffers from administrative weaknesses.

Implementation

In response to administrative and political resistance to reform, the government has increasingly resorted to control and pressure tactics. At the same time, criticism of reforms is met with increasing arrogance. As a result, independent decision makers, advisory bodies and civil society organizations are increasingly brought under Kremlin control and oppositional voices are repressed or ridiculed.

Policy learning

15 | Resource Efficiency

Although reforms under President Putin have improved resource efficiency considerably, Russia is still far from achieving 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

Efficient use of assets

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 often was only agreed upon long after the beginning of the relevant year, this has never happened under Putin. Spending targets have normally been met. However, there is no effective audit 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 often leads to considerable inefficiencies. The Russian government has reacted with administrative reform, which started in 2003 and still lingers on. In the wake of reorganization new conflicts between governmental agencies have emerged. As a result, the coherent strategy of the political leadership, which is regularly being translated into coherent legislation, is regularly being distorted at the implementation level.

There is a serious division of the Russian government into two ideologically opposed camps. Putin has increasingly sidelined the liberal reformers who initially were in charge of economic policy in favor of politicians with a secret service or law background. Some of the liberals' major reform projects, aimed at reforming companies close to the state, like the gas or electricity monopolies, have been delayed – as it seems, infinitely. 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 others. Even more importantly, many policies are not implemented properly due to bureaucratic inefficiency and corruption.

Policy coordination

Corruption is widespread in Russia. This is indicated by polls among the Russian population as well as among business people active in Russia (polls referring to 2005 – 2006 have been conducted by INDEM, FOM, Levada-Centr). International expert opinion as measured in the CPI of Transparency International confirms this impression. This situation can be explained with the nearly complete lack of functioning integrity mechanisms. State auditors are often competent, but lack enforcement powers. Rules to hold politicians or bureaucrats accountable are underdeveloped and not enforced. Procurement is still open to manipulation, so regulation has been improved. Corruption is not systematically prosecuted and courts themselves are highly corrupt. Civil society is too weak to have a real impact on the situation and NGOs are systematically discouraged from engagement in corruption and public integrity issues.

Anti-corruption
policy

16 | Consensus-Building

The elite consensus developed under President 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. This means that they accept the existing political and economic system, including democratic elections as the main way of transferring political power, but they do not agree that a market economy and democracy are strategic long-term aims and they do not object to violations of democratic standards, as in the case of biased election campaigns, nor to violations of market principles, as in the case of the Yukos affair

Consensus on goals

There are no relevant pro-democratic reformers represented in the ruling elite. Representatives of genuinely democratic movements have been marginalized in Russian politics.

Anti-democratic veto actors

Putin has achieved considerable progress in consensus-building compared with his predecessor Yeltsin. 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 region 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 managed political cleavages in a way that makes escalation highly unlikely.

Cleavage / conflict management

Officially, the state executive aims at a dialogue with civil society. For this purpose, President Putin signed the law on the Public Chamber in April 2005. The Chamber, consisting of citizen representatives and civil society organizations, is intended to advise political decision makers on a wide range of public issues. Independent NGOs have criticized the makeup of the Chamber as having been heavily influenced by the political leadership. President Putin handpicked one-third of its 126 members, leading public associations recommended another third, and pre-existing Chamber members chose the remaining third, which consisted of representatives of regional and local civil society organizations.

Civil society participation

Drawing attention to the fact that not a single human rights organization is represented in the Public Chamber, several NGOs characterized the Public Chamber as an unacceptable substitute for a genuine civil society. Even this kind of Public Chamber was deprived of the chance to discuss the reforms to NGO legislation, which parliament passed a week before the chamber’s inauguration. Both civil society and the mass media risk serious harassment from state organs when they engage in unwelcome criticism of the state. Most mass media have

been brought under state control, and the creation of the Public Chamber, in combination with the more restrictive new NGO law, which requires all NGOs to re-register – a time-consuming and expensive process – seems to be an attempt to bring civil society under control as well. Those remaining outside state control are often oppressed or ridiculed. One way of accomplishing this is to associate critical voices with extremism.

In 2005 and 2006, leading state officials, including President Vladimir Putin, repeatedly linked NGOs that received foreign funding to revolutionaries and terrorists. In reaction to alleged British espionage activities, the Russian State Duma passed a resolution in January 2006 condemning the financing of Russian NGOs by foreign secret services. In February 2006, the state prosecutor saw fit to accuse the human rights organization Memorial of supporting terrorism for publishing an academic treatise on Islamist writings. Ridicule or association with hooliganism is another governmental tactic for discrediting organizations that criticize the state. For example, in July 2006, two German students documenting protest actions during the G8 Summit in St. Petersburg were arrested for “urinating in public” and imprisoned for the full duration of the summit. Pro-Kremlin or extremist troublemakers, to whom the police often turn a blind eye, regularly spoil public appearances of leading liberal politicians as well as demonstrations by opposition groups. Journalists and NGOs are frequently harassed under an administrative pretext. For example, the Moscow Center for Human Rights was threatened with liquidation in December 2005 because it allegedly failed to fully document its activities. Many NGOs perceive the political leadership’s desire to ban the opposition on flimsy technical (and ostensibly apolitical) grounds as the main impetus for the new NGO law.

Dealing with past injustices is not a major topic in Russia’s public debate. Attempts by civil society organizations to initiate a public debate on Soviet human right abuses are hampered by a government policy that wants to celebrate Soviet successes and forget Soviet repressions.

Reconciliation

17 | International Cooperation

While Russia under Yeltsin cooperated with international partners like the World Bank or the IMF, it often used international aid for inappropriate purposes, and applied only a very limited amount 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. Rhetorically President Putin defends the Russian “way of (or to) democracy” with increasing self-confidence as being in line with Russian traditions and denies the moral right of foreign actors to make judgments concerning Russia’s political system and human rights record.

Effective use of support

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 reached bilateral agreements on WTO membership with all relevant parties. The final deal was reached with the US in late 2006. However, tensions have been rising for three reasons. First, Russia increasingly assumes attitudes of a great power, using its permanent seat at the UN Security Council and its good relations with some states that face pressure by a U.S.-led coalition (like Iran or Uzbekistan) to hamper international conflict resolution. Second, there have been serious conflicts about Russian energy exports that have led to supply interruptions in the European market and have caused worry, especially in the European Union. Third, the attempts by the Russian government to bring “strategically important” sectors of the economy under closer state control have on some occasions violated the interests of foreign investors. In addition foreign NGOs, including Western ones, face increasing pressure since President Putin has started accusing them of supporting revolution and terrorism.

Credibility

In its relations with neighboring countries Russia still applies a foreign policy concept based on a concept of regional hegemony. However, Russia has been unable to transform the CIS into its own “backyard”. Whereas some CIS countries, like Kazakhstan or Belarus, have accepted Russian dominance in return for preferential economic treatment, other CIS countries, most notably Georgia and Moldova, openly oppose Russia’s foreign policy and military conflicts in the two regions are “frozen” due to Russian interference. A third group of CIS countries, including Ukraine and Turkmenistan, has opted for pragmatic cooperation with Russia but refrains from closer integration. The three Baltic states have considerably weakened their ties with Russia through integration into the European Union and NATO. In dealing with neighboring countries critical of its foreign policy Russia regularly provokes the escalation of single-issue conflicts into broader state affairs. In May 2007 the Russian leadership used the transfer of a memorial for Soviet soldiers from the center of the Estonian capital Tallinn to a nearby cemetery to level accusations of disrespect for the Soviet “liberators” and for the Russian minority in Estonia. The leadership reacted with public accusations, which were accompanied by violent attacks of demonstrators from the pro-government party youth organization on the Estonian ambassador to Russia, and with some economic sanctions. From 2005 to 2007 the Kremlin politicized the economic question of prices for gas exports to Ukraine, Georgia, Moldova and Belarus and linked it to foreign policy issues. The economies of Georgia and Moldova faced severe problems after Russia imposed import bans for their main products. Russia also deported native Georgians back to their homeland and stopped passenger transport connections with Georgia.

Regional cooperation

Strategic Outlook

As President Putin has successfully consolidated his power, any major changes in Russia's political and economic development are unlikely until the end of his second term in 2008. In the political sphere, Putin can realize most of his reform projects unchallenged. This means that the number of relevant political parties will be reduced (due to changes in the laws on political parties and on elections), as will the power of regional governors, and the regions will lose some of their competencies in their relations with the federal center. At the same time, political pressure on mass media and politically active NGOs persists. The armed conflict in Chechnya and with that, massive human rights abuses by Russian military and law enforcement bodies, continue. In the economic sphere the state executive focuses on increased control over strategically important enterprises. Structural reforms or genuine improvements in the state bureaucracy efficiency, including advances in the fight against corruption, are not on the agenda. The government will continue to benefit from the already collected windfall profits caused by high oil prices. There is no opposition to a continued austerity policy. Accordingly, economic growth is likely to continue but without major advances (or drawbacks) for the development of a market economy.

Putin's aims are clear and he has proven unwilling to change his position in response to criticism from abroad. As Russia is strong enough to ignore foreign pressure, external supporters of Russia's development toward a market-based democracy can either opt to accept Putin's conditions and find a niche for specific support programs, or decide to withdraw from relations with Russia.

Russia has become very self-confident in recent years. Invitations to join high-level organizations and positive remarks about the state of its democracy are taken for granted and do not lead to any efforts from Moscow for improvement. However, clear refusals and outright criticism are interpreted as a lack of understanding for the specific Russian situation and are met with insults and aggression. Because this defensive reaction indicates a desire for acceptance by the West rather than blunt ignorance of democratic standards, as seen in neighboring Belarus, it seems prudent to engage with Russia in a more diplomatic debate on the tenets of democracy as well as the prospects for the development of Russia's political system and society. It is at present impossible to foresee whether the end of Putin's second term in spring 2008 will lead to any relevant changes.