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Rigid Policies Underpin the Political Risks

By Konstantin Sonin

There are various measures that can be used to assess the effectiveness of a president or government. During the six years President Vladimir Putin has been in office, Russians' real incomes and consumption levels have risen and are now at all-time highs. Life expectancies have increased as well.

But this good news has been accompanied by a rise in crime since the late 1990s. There has been a rise in the number of violent deaths in particular, including the murders of politicians, businessmen and journalists.

It's a good thing that most of the economic indicators are good. Last year, growth in fixed capital levels outstripped the pace of liquidation for the first time. Foreign direct investment continues to grow with every year and all federal budget indicators are in a lot better shape than they were just six years ago.

But there is at least one thing that cannot be assessed using current indicators: levels of risk. There is no direct relation, unfortunately, between higher growth rates and lower levels of risk. If anything, the opposite is more likely the case. Historical evidence suggests that politicians are faced with a basic choice between a course favoring rapid growth, and generating a higher level of risk as a result, or one geared less toward growth and more heavily toward minimizing risk. The current course -- toward little or no competition or freedom of information in the fields of business and politics -- is a high-risk one.

Does this mean that the risk level is higher now than it was for the country and its residents at the end of the 1990s? Providing an answer to this question requires taking a closer look. The major economic crisis following the default of August 1998 was the result of both external factors -- global investor flight from emerging markets -- and internal ones such as the inability of the government and the State Duma to reduce the budget deficit (including the inability to curb the appetites of special interests). If not completely paralyzed, some state bodies, such as the presidential administration, appeared to be at a loss to show any initiative at all. But the system as a whole, including the parliament, the press and the business elite, proved flexible enough to form a government that continued to work and maintained macroeconomic responsibility.

If a political crisis of this magnitude were to occur today, would the current centralized -- rigid and sclerotic, or in other words brittle -- power structure be able to react with the same flexibility and efficiency?

The differences between then and now mirror the differences between the personalities of the two presidents in question. Whereas former President Boris Yeltsin was used to making decisions spontaneously and then adjusting them on short notice, Putin tends to think things over for a long time, but once the decision has been made it is implemented in an unaltered form, even when there is an obvious need for correction. A good example is the nightmare unfolding as a result of the conflict with Georgia, which is the visible result of the two countries' foreign ministries squaring off.

If I lived in London and were running a major hedge fund, I would be selling shares in Gazprom or Rosneft short, based on the increasing risk associated with Russia's current course. When the crisis finally hit, I would be able to buy them up cheap.

But I live in Moscow and do not run a hedge fund, so instead I just get to explain that it is imprudent for the president and the government to assume that the fact that the risks have paid off so far doesn't mean that they will continue to do so in the future. They should be interested not only in rapid growth, but also in the stability that greater flexibility affords.

That is, of course, as long as they themselves are not thinking of selling short.

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