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Russia: Shades of difference

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Not much love, according to most Kremlin watchers, is lost between Russian President Dmitry Medvedev and Igor Sechin, deputy prime minister. On their few appearances together on television the disdain has been obvious, right down to bulging neck veins. Higher-ups at **Rosneft**, the state oil company of which Mr Sechin was chairman, have been known to refer to the president's circle derisively as "the boy scouts" behind their backs.

So it may have been especially satisfying for Mr Medvedev to force Mr Sechin out of his eyrie at Rosneft. On March 31 he issued a decree that cabinet ministers had to vacate board seats they occupied at state companies, eliminating untold privileges and conflicts of interest. A few weeks later, Mr Sechin duly stepped down.

It was a rare victory for Mr Medvedev. As the junior associate in the ruling "tandem" with Vladimir Putin – his more powerful, and more conservative, predecessor and mentor, who is currently prime minister – making good on his reform pledges has not always been easy.

Without liberalisation and a scything of bureaucracy, state ownership and corruption, many economists hold little hope that the world's 10th largest economy will realise its potential as one of the prime growth markets of the future. That would leave it to languish in its current state as a marginal supplier of raw materials for the developed world.

Where possible, Mr Medvedev has been combining the struggle to reform an economy he accepts is inefficient and opaque with the fight to broaden his own political power. Over the past few months this has had some noteworthy successes, which both weaken rivals such as Mr Sechin and tackle some of the more blatant problems with economic management.

In some ways the Medvedev strategy is reminiscent of the approach taken by Mikhail Gorbachev. The Soviet leader, faced with an entrenched Communist old guard in the 1980s, identified himself with inevitable economic and political reforms and used these as a tool to empower himself against the Politburo establishment. "Medvedev is using the slogan of modernisation as a way to grab political decision-making over the economy away from the government," says a former Kremlin official.

Like Mr Gorbachev, Mr Medvedev is the relative liberal in a field of grey-suited apparatchiks who owe their jobs and their perks to Mr Putin. The two Putin terms as president were an all but unmitigated economic success: he reasserted the role of the state in an economy left in turmoil by the fast-and-loose privatisations of the 1990s, while Russia's gross domestic product doubled during his eight years in office.

But the economic collapse of 2009, when GDP fell 8 per cent, has brought home to many that the Putin economic model, dubbed "Kremlin Inc", is nearing exhaustion.

Mr Medvedev is now struggling to make his mark as the next presidential election approaches in 2012. Although the president would clearly like a second term, it was only to fulfil a constitutional requirement that Mr Putin stepped down a rung three years ago. He will once more be free to stand, seems to have right of first refusal and has not yet made his choice clear. But for Mr Medvedev, positioning himself for re-election means having a stable of accomplishments to his name.

Their relationship is delicate – the two are old friends from St Petersburg, where Mr Medvedev was Mr Putin's lawyer, and they appear to get along in public. But Mr Medvedev's staff chafe at having their memos ignored by cabinet officials and at being shut out of the higher echelons of power.

Although the constitution gives the president a nearly omnipotent executive decision-making ability, since 2008 the punching weight of the Kremlin, where Mr Medvedev sits, has fallen sharply vis-à-vis the White House, across the Moscow ring road. Now, all instructions from the Kremlin go via Mr Putin's office and the stern ex-KGB colonel has made it clear that he has a veto over important decisions.

Mr Medvedev has had to tread a fine line between carving himself a separate identity as a politician and not alienating the kingmaker who stands between him and a second presidential term. His criticism of Mr Putin has been carefully structured and oblique – notably calling the economy he inherited (without naming names) "primitive" for its reliance on raw materials exports.

Indeed, Russia's economy looks more like that of a Middle Eastern oil autocracy than a modern European state: oil sales fund roughly half the federal budget, while 70 per cent of federal expenditure goes on social spending and pensions. With its economy limping along since the 2009 collapse, economists reckon Russia's 4 per cent growth rate is far below what it could achieve if reforms were made that cut social spending and increased both state and private investment.

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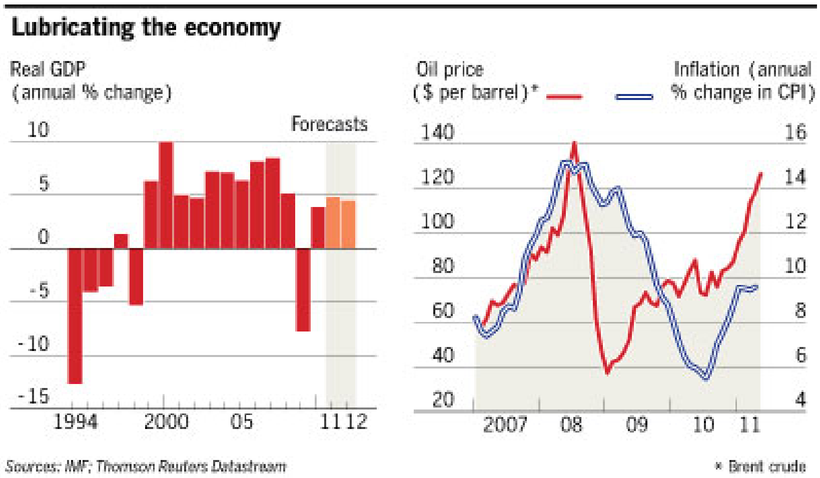
Mr Medvedev has sought by stealth to gain leverage over economic policy. An otherwise unremarkable commission on modernisation, created in 2009 and consisting of 23 people including five cabinet ministers, has been transformed into a "sort of parallel government" where Mr Medvedev can directly issue instructions and quiz members on their fulfilment, according to Sergei Guriev, rector of the New Economic School in Moscow.

"Unlike other commissions, this one meets every month, and on time," says Prof Guriev. "It provides Medvedev direct access to ministers which he wouldn't get otherwise."

Many of Mr Medvedev's instructions to the government have fallen on deaf ears: the finance ministry under Alexei Kudrin, a close Putin ally, is legendary for its unresponsiveness, say a number of insiders and former officials. Mr Kudrin is himself a respected reformer and economic manager, but clearly his loyalties lie with Mr Putin rather than Mr Medvedev, as do those of most of the cabinet. "The deputy ministers don't see Medvedev as their boss, they see it as Putin," says one economist.

Mr Medvedev's 2009 order to establish a unified national payment system, to expand the use of consumer credit and debit cards, took 17 months before the finance ministry made it into legislation. The ministry maintains that the delay was due to problems in co-ordination with other ministries, not to lack of will or interest.

Persistently, Mr Medvedev uses the commission to prod ministers into doing his bidding. At its last meeting on April 25, he took Andrei Fursenko, education minister, to task for poor co-ordination between academia and the private sector. "The ministry should work – not sleep but work seriously," he said, apparently noting that Mr Fursenko had been nodding off during the four-hour long session. "Maybe you should do some 'doping'," joked the boyish-looking president – slang for a brisk shot of espresso or vodka to get the blood flowing.



He also admonished Mr Kudrin, the finance minister, urging him to "work together with the administration, so the results are useful to all" – a swipe at Mr Kudrin's evident lack of co-operation with the Kremlin.

Targeting the cosy relationships between cabinet ministers and state companies was the most noteworthy of 10 points on a reform agenda that also promises to strengthen corporate governance and weed out corruption by empowering whistleblowers. Outlined by Mr Medvedev on March 31 at a meeting of the modernisation commission in the industrial city of Magnitogorsk, it led not only to Mr Sechin's departure from Rosneft but the resignation of Mr Kudrin from the board of VTB, the state-controlled bank, though those close to him say the finance minister agreed with the president's action.

"Medvedev's decision clearly had a political aspect to it," says Alexei Makarkin of the Centre for Political Technologies in Moscow. "Most of the cabinet ministers covered by the decree were appointed by Putin, loyal to Putin, and Medvedev was interested in a way to weaken their influence." He says it was clear the man Mr Medvedev was really going for was Mr Sechin, leader of the group in Mr Putin's circle known as the *siloviki*, literally "strong guys", with security backgrounds whom Mr Putin brought with him into the Kremlin in 2000. Mr Sechin's ousting was widely seen as a blow to *siloviki* power.

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Yet while the episode allowed Mr Medvedev to flex his muscles, it also demonstrated graphically the limits of his powers – namely that he is clearly not allowed to fire ministers, only to whittle away at their perks. And although Mr Putin reportedly supported the new rules on state company boards, it is unclear where he will stand on replacing the ministers, some of whom have tried to nominate their replacements.

The frontrunner for Mr Sechin's Rosneft seat is Sergei Shishin, a vice-president at VTB and a former general in the Federal Security Service who is rumoured to be close to both Mr Sechin and Mr Putin. "Medvedev's great idea has turned into a saddening fiasco. What difference does it make who sits on the board if he votes on orders anyway?" asks Alexei Navalny, an opposition blogger and activist shareholder.

Mr Putin supports Mr Medvedev's efforts at modernising the economy but his backing appears tempered by a desire to keep hold of all levers of control. "The government understands that state companies are very important to political power," says Prof Guriev. "Putin has no ideological preference for state capitalism but the government knows that private companies are harder to boss around."

The reform drive has been somewhat blunted by the high price of oil, which has flooded the state's coffers and made measures such as the sale of stakes in banks seem unnecessary. Oil at $120 a barrel has bought the government time to delay hard questions such as pension reform – Russia's pension system is already running at a loss and on its present course is expected to go broke in 2018.

Mr Putin remains lukewarm on liberalisation, tending to err on the side of political stability. He told the state Duma, or lower house of parliament, last month that the country would have "no radical economic experiments", which resonates with most Russians' negative view of the "shock therapy" reforms of the 1990s under Boris Yeltsin. One economist close to the prime minister says bluntly: "I think Putin wants to know how long he can afford to do nothing."

Led by Arkady Dvorkovich, Kremlin adviser, the Medvedev team thinks that hard choices cannot continue to be put off. "There is a risk that if we do not bring spending under control, we will have to raise taxes," says Mr Dvorkovich. A payroll tax imposed to pay for a 10 per cent rise in pensions this year has embroiled the cabinet and the Kremlin in another row. Mr Dvorkovich and others close to Mr Medvedev believe it places too much of a burden on small and medium-sized enterprises. But so far, Mr Putin has successfully defended his tax increases.

The question of the 2012 election remains paramount, however, and it is unclear whether Mr Medvedev has begun to assert himself too late in his term to do any good. Igor Yurgens, a key member of the Medvedev economic camp, says there was an opportunity about two years ago for Mr Medvedev to start building his own political support base; the two men might then have competed for the presidency. Since that was not done, the president's only route to the nomination is through Mr Putin rather than an independent bid.

"Anyway, it's a little too late now for that," Mr Yurgens adds. "But I think that he is rehearsing and maturing himself and positioning himself for the election. I think it's pretty obvious."

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Warnings about the need to wean a nation hooked on hydrocarbons

Alexei Kudrin, Russia's finance minister, startled economy-watchers last month with a sobering prediction: a further increase in oil prices might "have a depressive effect", *Charles Clover reports*. The rising price, he said, "used to act as an economic stimulus. Now, however, this model is exhausted."

As prices wobbled and dipped as much as $15 a barrel in a matter of days this month, many of his compatriots have joined him in taking a more critical look at oil's dominance.

The economy has long been linked to oil and gas. The Kremlin floated for most of the previous decade on a cushion of steadily rising oil revenue; it has earned about $1,500bn from oil and gas exports since 2000. They are today the source of roughly 50 per cent of federal budget revenues and made up 25 per cent of gross domestic product in 2010.

But rising oil prices "played a cruel joke on us", according to Mr Kudrin, who says it fuelled inflation and created bubbles in economic sectors such as trade, finance and property, while more fundamental areas failed to develop.

"We paid for growth with inflation," he said, adding that some years the money supply rose 50 per cent per year, compared with GDP growth of about 8 per cent annually. To fight price rises, the central bank was forced to strengthen the rouble, which hurt trade in all sectors but oil and gas. This in turn further concentrated dependence on energy, he said.

Despite Mr Kudrin’s sometimes adversarial relationship with President Dmitry Medvedev, the two are agreed when it comes to reforms. Mr Medvedev has frequently called for an end to dependence on energy exports. He called this economic model “primitive” in a 2009 article, seeming to contradict Vladimir Putin, the former president and now prime minister who praised Russia in 2007 as “an energy superpower”.

Still, weaning the country off oil and gas will not be easy. It will require pervasive economic reforms, principally tackling endemic corruption and mismanagement, and liberalising the state-run economy – a feat many in the government say they are already struggling to pull off.