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## What Does Putin Want?

PETER LAVELLE

With Russia seemingly returning to its opaque Soviet-like state, many Western journalists and analysts have also returned to their favorite Russia-watching pastime: asking the question, “Who is Putin?” Attempts at answers have rendered limited results, and they mostly overlook what is happening in Vladimir Putin’s Russia. More times than not, perceptions of Russia remain at sharp variance with reality. Asking a better question—“What does Putin want?”—may tell us something about the Russia he intends to create.

President Putin’s agenda is, if anything, straightforward. What may seem a lurch back to the Soviet past or a lunge forward to a new form of authoritarianism is in fact Russia overcoming the chaos of the first decade of postcommunism. Putin wants to develop a modern economy, end economic oligarchy, and assure that Russia’s energy resources serve the national interest. He is willing to strengthen the state at the expense of democratic institutions if necessary. He wants to protect property rights, attract foreign investment, and restore an image of strength in the world. His pragmatism is evident for anyone who wishes to see it.

### THE ECONOMIC REFORM AGENDA

Recently, much of the mainstream media and a number of academics have cast doubt on Putin’s commitment to the development of a modern market economy in Russia. When Putin entered office, his support for liberalizing economic reform was clear to anyone who had taken care to note his past as a key aide to St. Petersburg Mayor Anatoly Sobchak, as well as his statements in his early days as acting president. Putin saw market reforms then

as Russia’s only credible future. A reasonable assessment of his economic agenda suggests he still does today—albeit to further the political goal of more broadly dispersed prosperity.

The economic reality presented to Putin when he assumed office in 2000 essentially consisted of competing claims made by the oil sector and the much weaker industrial lobby. The top five oil producers early on announced a plan to significantly expand capacity, aggressively pushing for almost uninterrupted growth in oil production and exports. Market observers and analysts assessed the oil lobby’s strategy as the “easy money” option. An eager and prepared market for oil and gas exports awaited in the United States, as well as in Russia’s European and Asian neighbors, all seeking another source of energy besides the volatile Middle East.

The counterpoised agenda came from the weak but resurgent industrial lobby, which has been campaigning hard to have the Russian government diversify away from a dangerously high reliance on the oil and gas sector. This lobby petitions for government special preferences and investment incentives for Russia’s other traditional industries, including aerospace, aviation, defense, and steel fabrication. Advocates argue that Russia still has a chance to develop global leadership in these areas, and they also push for building a domestic financial services industry.

Both lobbying groups have been forceful in the media in conveying their respective agendas to determine Russia’s economic future. During Putin’s first term the oil lobby appeared ascendant, and it has remained so to the present. But this ascendance may prove temporary.

Another plan for Russia’s longer-term economic future has been aired, and repeatedly supported by none other than President Putin, yet analysts often neglect it. Announced at the start of 2000, this bud-

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getary and economic policy calls for exploiting high inflows of cash from oil and gas exports to aggressively push broad-based growth across all economic sectors. Putin's objective, clearly and consistently stated over the past four years, is to eventually achieve a more diversified and balanced economy—an economy, that is, along lines seen in most European Union countries—with the intent of creating a greater and more egalitarian dispersion of wealth across the entire population.

A June 2004 study by the World Bank confirms Putin's political instincts. The report concludes, insofar as international comparisons are possible, that Russia has one of the most concentrated economies in the world, if not the most concentrated. A group of billionaires called the "oligarchs" largely controls the economy. Furthermore, ownership concentration is highly sector-specific: major owners dominate large industrial and raw materials sectors. Clearly, with these sectors constituting the Russian economy's main pillar (and primary source of exports), their owners can dominate the economy and, ultimately, politics and economic strategy. The World Bank analysis notes that, because of the immature market for ownership rights, "ownership in Russia's economy has not yet gone through the sort of 'remixing' which would have eliminated the most obvious traces of the transition from state to private ownership."

One key to creating a modern market economy in Russia is to reform, and in many cases gut, outdated and economically dysfunctional Soviet social services. To achieve this goal, Putin has risked his stellar public opinion ratings. He also has embarked on these structural changes while trying to break up economic and political oligarchy. This is no coincidence.

At the center of attempts to purge the Russian economy of residual Soviet elements is the monetization of the country's social benefits. Although Russia's economy was largely monetized between 1991 and 1992, it is often overlooked that the system of social benefits remained virtually unchanged from the Soviet era. The government continued to mandate discounts on pharmaceuticals, transportation, communications, and housing for retirees, military personnel, the disabled, and other dependent groups. As in the Soviet system, programs of in-kind benefits remained rife with corruption.

Putin's response has been to dismantle and remove the Soviet social programs, even though the political costs in doing so may rise as new benefit programs are put into place between now and 2006

and as the transition costs pile up. Thus far the reform project has been highly unpopular among recipients of outdated Soviet benefits, with Putin's popularity taking a strong hit for the first time during his presidency.

### CUTTING DOWN THE OLIGARCHS

This is where the Yukos affair comes in. It would have been politically irresponsible, even dangerous, for Putin to impose additional sacrifices on ordinary Russians as part of structural reforms effected over the next few years without the recent demonstration of state power against the oligarchs. The prosecution of Mikhail Khodorkovsky, the head of Yukos Oil and Russia's richest man, has added to Putin's public support. The oligarchs, after all, are the personification of what went wrong during the 1990s, when a group of super-wealthy individuals essentially ruled Russia, and economic and political power was intensely concentrated as it had been during the Soviet era.

While trying to reduce the state's role in mandating costly entitlements, Putin has sought to increase the state's ability to govern by taking in more tax revenue than the growing economy generates. Only with effective tax collection can Moscow deal with the country's pervasive poverty and gross income differentials. And this, too, is related to the Yukos affair. The Kremlin has put on display an enormous legal arsenal in going after billions of dollars in taxes allegedly owed by Yukos. Other major tax offenders are unlikely to challenge the Kremlin again.

The effect is not lost on the public. Public opinion has long regarded the oligarchs as gross tax avoiders. Putin is attempting to completely reorder Russia's tax payment and collection system as part of his plans to modernize the economy. To convince ordinary Russians to honor their tax obligations, a public example had to be made of the oligarchs—with Yukos, Russia's largest privately held company, the signature demonstration. In this respect, Moscow is employing a strategy similar to one used by governments to prosecute organized crime. Since the state's resources are limited, it pursues the offender with the highest profile, hoping that others, along with ordinary Russians, will get the message and act accordingly.

The message appears to be working. Russian oil companies such as Tyumen Oil-British Petroleum, Sibneft, and Slavneft have announced that they will increase effective tax rates. In addition, as with most governments in oil-exporting nations, higher effec-

tive tax rates are expected during a time of extraordinarily high international petroleum prices. Overall, Russia's tax revenues during the first half of 2004 rose by 23 percent. Increased tax collection in the oil sector has allowed the government to lower tax obligations elsewhere.

With Yukos and its core shareholders serving as a test case, Russia's oligarchs will find themselves either cut down to size or allowed the kind of role that big business plays in other modernized economies. This outcome should not be regarded as regressive. Almost by definition, oligarchy represents a manner of fusing economic and political power within one person that institutions in the West have precluded since the 1920s.

In Russia, the concentration of both economic and political power in the hands of a few natural-resource oligarchs has been a brake on economic growth and diversification. Through their political influence, and in the face of weak state oversight and a weak industrial sector lobby, the oligarchs were generally able to divert public economic resources toward their own core business concerns and away from other parts of the investment-starved economy. The outcome of this arrangement has been all too obvious: cash generation, in the form of largely untaxed profits, was transferred abroad to avoid the tax authorities and the Russian public, should the state ever start questioning the legitimacy of the gains.

The Yukos affair represents a strong effort to alter the correlation of power between the regime and the oligarchs, designed to turn them into allies and servants rather than competitors and opponents of the state. Putin's thinking on the subject was revealed in a remarkable statement in 2003. "We have a category of people who have become rich and billionaires . . . overnight," he said. "The state has appointed them billionaires, simply by giving away its assets practically free."

While more cases similar to the Yukos affair may occur, a comprehensive annihilation of the oligarchs appears unlikely. Putin wants a partial "nationalization" of the oligarch class, not the complete re-nationalization of their assets. Moving forward, the Kremlin will in effect appoint or dismiss or tolerate oligarchs-cum-big-businessmen based on their performance and their compatibility with national economic goals.

### ENDING BIG OIL'S SELF-SERVICE

Seen in this light, the Kremlin's assault on Yukos is hardly an impulsive act of political and economic

terrorism against property rights in the oil industry. Compared internationally, Russia is the only major oil exporter (and the only major oil-producing country with the two exceptions of the United States and United Kingdom) where the state is not the major operator drilling and lifting crude for production and export. The Kremlin is reordering the oil sector to roughly match international norms.

Putin is also looking to the future. Since 1999, Russia's petroleum production has increased 48 percent, primarily because of new wells. Turning out 9 million barrels of oil a day, Russia competes with Saudi Arabia as the world's largest exporter. Now Putin has called on his oil ministers to finalize plans for adding export pipelines to boost output to 11 million barrels per day by 2009. Russia's expected export increase, in conjunction with other world suppliers, could lower the cost of crude oil as early as 2006.

Because of almost unprecedented global demand and equally unprecedented high oil prices, the Kremlin's coffers receive an additional \$1.5 billion per month over budget projections. A number of experts claim high petroleum prices last year accounted for almost half of Russia's 7.3 percent growth in gross domestic product. But who benefits from this? Putin has stated that "The government must base its decisions on the interests of the state as a whole and not on those of individual companies." And these are not just words; Russia's oil giants Lukoil and Sibneft are acutely aware that Putin means business.

Lukoil, Russia's second-largest petroleum firm, already has expressed its willingness to pay more taxes and work as a loyal foreign policy conduit on energy matters for the Kremlin. Sibneft, the third-ranked oil producer owned by oligarch and English football enthusiast Roman Abramovich, has also caught the Kremlin's attention. With investigations of Sibneft and Abramovich mushrooming, it appears only a matter of time before Sibneft will be under the Kremlin's heel as well.

The fate of Yukos's assets if it is forced into bankruptcy is open to speculation. The government-owned Rosneft Oil Company is rumored to be the Kremlin's favorite—some of Putin's key aides sit on Rosneft's board of directors. The natural gas monopoly Gazprom, government-owned as well, is also thought to be in the running. In the end it does not really matter. Yukos's transformation will essentially create what has been the Kremlin's goal from the advent of this affair: the creation of what could be called "KremPEC," the Kremlin

Petroleum Export Corporation. This outcome would increase revenues and restore a large chunk of the economy under the state's purview for market reforms.

In addition to benefiting ordinary Russians, Putin wants the energy sector to serve the country's international political and economic interests. Russia has never had a meaningful relationship with the Organization of Petroleum Exporting Countries because independent domestic producers have been able to make petroleum policy without Kremlin consent. The impending breakup of Yukos and changes in ownership of the company's assets will allow the Kremlin to speak with a single voice when making international strategic petroleum alliances.

The international environment would appear to support KremPEC's ambitious goals. Terrorism threatens oil export giant Saudi Arabia, the cost of oil hovers around \$45 a barrel, a gallon of gasoline costs up to \$2.50 in the United States and far more in Europe, and continuing turmoil in Iraq limits the prospect of Iraqi oil significantly affecting international oil markets any time soon. Meanwhile, energy-hungry China and India are eager to find new and secure energy export markets to support their rapid economic growth.

The Kremlin has carefully thought out what the future might hold if Saudi Arabia, OPEC's powerbroker, becomes a target of larger and increased terrorist attacks. As the largest producer in the world, Russia might rethink its position concerning membership in the international petroleum cartel if Saudi exports were to face long-term risk.

In any event, the Yukos affair will quickly become part of history, its lessons absorbed. When that happens, Russia's oil patch will become more secure, attracting international petroleum investment, as well as providing Russia with needed cash flow to continue the reform of its economy. The difference is that energy negotiations and strategizing will take place behind Kremlin walls, instead of with oil oligarchs. For an energy-hungry world, doing business with KremPEC will become almost risk-free and eventually will make OPEC's current hold over world petroleum markets irrelevant. OPEC is about to be dethroned, with Putin's KremPEC its successor.

## PROTECTING PROPERTY RIGHTS

The high-profile legal assault against Yukos has encouraged the perception that Putin is indifferent to property rights in Russia. But, beyond the state bureaucracy's sometimes aggressive, inefficient, or selective application of property rights law, the legal protection of private property is in fact being strengthened.

On June 10, 2004, Russia's parliament, the State Duma, adopted in the first of three readings 27 new bills introducing changes to the existing housing code, confirming the principle of private property by emphasizing the centrality of the state registry of property titles and by easing the property registry process and making it more transparent and affordable. The Kremlin designed all of these bills for the legislature. When the Western media comment that

Putin is forcing legislation through without debate, these are the kinds of laws that are being passed.

Many observers claim that the Kremlin is most interested in asserting the "property rights" of

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the state, but this focus is overplayed. Putin is trying to redress the claims of property of the average Russian, which ultimately will create more confidence in property rights generally. Indeed, in Russia the government's treatment of Yukos is perceived as a reassertion of property-rights principles that were violated during the free-for-all privatization of public property in the 1990s.

Protecting property rights is one way Putin hopes to draw more foreign investment to his country. During five straight years of robust economic growth, Russia became an attractive investment target. Today, according to Western media, the Yukos affair has caused enormous concern that Putin is indifferent to minority shareholders in Russian companies. But the reality paints a different picture. Even though Russia is again experiencing net capital outflows (primarily from Russian nationals' expatriating funds), foreign investment has not stopped or reversed, and foreign companies continue to funnel money into Russia.

Final resolution of the Yukos affair could invite renewed interest in Russia as an investment target. If in fact smallish Kremlin-owned Rosneft becomes the flagship of Russia's oil sector, absorbing most of Yukos's lucrative assets, there is every reason to

believe a company such as ExxonMobil would be interested in partnering with it or creating a joint venture. Such an arrangement would carry little if any political risk. Most analysts fail to understand that in Russia, just as with other emerging markets, the most solid and profitable business partner is the state. A number of Western oil giants have recognized this and are knocking on the Kremlin's door.

### **RUSSIA'S IMAGE IN THE WORLD**

Since becoming president, Putin has demonstrated flexibility on a number of foreign policy issues that past Russian or Soviet leaders would have deemed unthinkable. Arms agreements can be concluded with a handshake. Expensive bases around the world are closed. Understanding and patience are shown when America establishes bases in parts of the former Soviet Union. Putin's foreign policy has emphasized constructively joining international institutions.

Yet the Kremlin's image in the world continues to suffer from charges of authoritarianism and revisionist imperialism. As mainstream analysts see it, the former KGB official has lived up to their expectations that he would clamp down on the "exuberance" of the 1990s; having established his "controlled democracy," Putin proceeds to choke Russia's nascent freedom to death.

A fairer assessment is that Putin will not be deterred from his domestic reform agenda, which includes a liberalized economy. The Russian leader has consistently adhered to the belief that his country can enjoy a good and strong image in the world only when it is economically competitive at home and abroad. Putin's regime is sending unambiguous signals that it is prepared to go to any length—including undermining its international reputation in the short term—to pursue its objective of rearranging the oligarchic economy inherited from the 1990s.

Putin also wants Russia to have strong neighbors and meaningful trading partners. What many call "Kremlin meddling" in the "near abroad" more often than not reflects efforts to promote political and economic stability on Russia's borders. It is often overlooked that millions of ethnic Russians live beyond the country's borders. Destabilized regimes and distressed economies in the countries that make up most of the Commonwealth of Independent States often negatively affect Russia's diaspora.

It is also often overlooked, and strangely so in light of the imperialist tendencies of czarist and Soviet forebears, that Putin is far more interested in promoting Russia's economic interests with neighboring countries than in pursuing heavy-handed military

ambitions. Putin's Kremlin has learned well the cost of empire and is trying to avoid it.

### **THE NECESSARY AUTHORITARIAN?**

All too often Russia watchers focus their analysis on what is called Russia's "managed democracy." Commentators are not wrong to worry about the present state of the country's political parties and weakened opposition, the Duma's tendency to rubberstamp Kremlin initiatives, the lack of checks and balances in government, and the electronic media's insufficient independence. Putin's decisions in September to abolish direct popular election of regional governors and to introduce legislation clearly designed to create Kremlin super majorities in the federal parliament have nothing to do with democracy in a Western sense. However, for democracy to have any meaning in Russia, the Kremlin must first create conditions in which the majority of Russians feel they have a stake in the country's destiny. This can come about with the kind of "managed capitalism" Putin is promoting. "Managed capitalism" is not state capitalism. The state does not want complete control of the economy. But Putin's government does want to help the economy find a more equitable and competitive balance.

Putin's crackdown on electronic media makes clear that the Kremlin will forgo public discussion of its policies as it reorders the country's economic priorities. Indeed, it is not hard to see Putin as an authoritarian. In most ways he is, based on Western standards. But, given Russia's current development trajectory, he probably has to be. Russia is at an extremely important juncture. Either the Kremlin continues its very hard-handed approach to restructuring the economy or Russia risks becoming in effect a Burkina Faso with nuclear weapons. It is very clear which future Putin wants.

Time is not on Russia's side. During Putin's presidency the country has experienced a remarkable economic recovery, but its infrastructure remains in a perilous state of disrepair, its demographic trends portend enormous difficulties, and domestic terror—the September hostage crisis in Beslan being the most horrific example—appears on the rise. This is why Putin is pushing the clock as hard as he can without engendering the kind of chaos that Russia experienced during the first failed decade of reform away from communism. The historical question—"Who is Putin?"—ultimately will find an answer. In the meantime, the Kremlin's economic-reform juggernaut continues its course, right on schedule. ■