As Vladimir Putin begins his third term as president of Russia, the country’s economy, and even its political system, remains as dependent as ever on the export of natural resources.

At the same time, the political system Putin built in his first two terms — dependent on increased state involvement in the economy and reliant on an inner circle of loyalists — is faced with the challenge of diversifying and modernizing the economy in the years ahead. Can it do so without moving beyond the system Putin created, asks Taehwan Kim.

ON MAY 7, VLADIMIR PUTIN was sworn in for a third term as Russian president. With a change in the Russian Constitution that extends the presidential term to six years from four years, it is now expected that his presidency could extend to 2024, assuming he succeeds in winning another consecutive six-year term in 2018. During the previous two terms of his presidency from 2000 to 2008, Putin was able to establish and consolidate a ruling system that was kept intact, and even strengthened, during the 2008-2012 presidential term of Dmitry Medvedev, during which Putin served as prime minister. Should we then expect in the coming years continuation or change of the existing ruling system? Would Putin’s third term and possibly his fourth, be a continuation of his previous two terms?

When we discuss leadership transition in Russia, our starting point should be the question: Continuity or change from what? In other words, what should be the reference point for making this assessment? It should be what I will call “Putinism,” the set of policies and institutions that were forged in Russia during Putin’s previous two terms as president. Putinism is by no means a consistent or coherent political ideology, but rather a complex of distinctive policies and institutions that have shaped Russian political-economic governance in reaction to the collapse of the Soviet Union and the chaotic Russia of the 1990s.

Among others, three elements stand out as the defining characteristics of Putinism: a resurgent authoritarianism as a political regime type, progressive centralization of the state system and state capitalism as a model of economic development. These three elements constitute Putinism as a unique Russian system of governance.

NATURAL RESOURCE RENTS AT HEART

Behind Putinism lies Russia’s deepening dependence on natural resources, and the resulting system of rent capture and distribution, which has rendered Russia a stereotypical “rentier state.” Based on empirical observations of the Middle Eastern oil-producing countries, political economists Hazem Beblawi and Giacomo Luciani defined the rentier state as one that derives a considerable portion of its fiscal revenues, usually over 40 percent, from natural resource rents emanating from abroad. ¹ A review of official Russian government import and export figures suggests that Russia has moved backwards under Putin, at least in terms of its natural resource dependency. Russia is overly dependent on the export of raw materials, especially oil and gas, but also minerals, precious metals and timber. Russia’s oil and gas sector alone has accounted for over 20 percent of Russia’s gross domestic product (GDP) since 2005, as well as almost 60 percent and 50 percent of Russian export and federal budget revenues, respectively. A decade of Putinism has left the Russian economy less diversified today than when he first came to power. The problem of the federal budget’s dependence on commodity exports was never resolved during an economically auspicious decade that began in 2000. During Putin’s first two terms, a major Russian economic disease — its chronic budget deficits of the 1990s — was replaced by another ailment, a chronic dependency on natural resource exports. Unable to shake off energy dependency, Russia looks now more like a Middle Eastern oil autocracy than a budding European democracy.

Economic rents from natural resources are a political currency. Natural resources generate
significant windfall revenues for the Russian state, which in turn are a valuable prize for those who control and have access to political power. Thus, the old dominant political coalition of the Yeltsin era has been replaced by a new political coalition that has captured economic rents generated from natural resources, oil and energy in particular. At the core of the new political class are conservative siloviki, a power group composed of former and incumbent security and military officials, with two accompanying prongs of liberal technocrats and business oligarchs loyal to Putin. The siloviki have proliferated in the state bureaucracy both at the federal and provincial levels, and reportedly fill up to 25 percent of top-level posts in the civilian ministries and state agencies. Through their occupancy of many core policymaking posts, as well as the deputy posts of almost all federal organizations, the siloviki function as the sentries of the Russian state system and as Putin’s solid power base.

The Russian state capitalism that emerged under Putin has been the central mechanism through which this newly emerged political class captures and distributes among themselves economic rents generated from natural resources. The state’s share in Russia’s GDP, once stabilized at the level of 30 percent in the late 1990s, began to rise to 40 percent by around 2003-2004.

There are three notable patterns of Russian state intervention in the economy, which at the same time are the core mechanism for generating and distributing resources rents. The first pattern, most outstanding and visible in Russia’s oil and gas sector, is outright re-nationalization of assets, as vividly demonstrated in the Yukos affair in 2003-2004. Most of the production units of Yukos, Russia’s largest oil-producing company, privatized in the mid-1990s, were taken over by Rosneft after the arrest of the company CEO Mikhail Khodorkovsky. With the takeover, Rosneft suddenly rose from being a miniscule national oil company to Russia’s leading national champion by 2005. State-controlled gas monopoly Gazprom not only took over another oil company, Sibneft, from pro-Kremlin oligarch Roman Abramovich, but also aggressively advanced into the electric power sector, grasping core assets of the Unified Electric Power System, a national monopoly in electricity production and transport. As a result, the state’s share of Russian oil and gas production jumped to over 60 percent. The state’s non-market based penetration into the oil and gas sector received keen attention from the Western media, but less widely reported was the government’s aggressive intervention in a wide spectrum of Russia’s other major industrial sectors. Targets of Russian state expansion span from energy industries to automobile, metallurgy, high-tech industries and the military-industrial complex.

Another notable pattern of state intervention is the formation of state corporations. Distinctive from state-owned enterprises, state corporations are granted and guaranteed managerial and financial autonomy and independence by specific laws and regulations. By late 2007, laws to establish eight state corporations were approved by the State Duma. Except for two of these, Olimpstroy and Fond Reformirovaniya ZhKKh, that are designated to build the infrastructure for the Sochi Winter Olympics and residential facilities, respectively, six state corporations were established as holding companies incorporating and encompassing stakes in major companies in Russia’s key industries.

Last, but not least, the Russian state intervened in the economy by appointing prominent government loyalists, particularly Putin’s closest cohorts, to key posts at strategic companies. This method of intervention in fact ensures the state quite effective control of Russia’s strategically important companies even without direct and formal ownership. In many cases, the appointees go
Many in the ruling coalition, having grown rich under Putin on the proceeds of rents and corruption, are implacably opposed both to economic reform itself and even more so to the implied political reforms that would be the backbone of an innovative economy. So far, the war against rampant corruption has failed and the promised diversification of Russia’s resource-based economy has not been fulfilled.

WINNERS AND LOSERS
These three patterns of Russian state intervention indicate that the state wields far more influence and control over the economy than the nominal 5-percentage point increase in the state’s share of Russian GDP would indicate. Formal state ownership as such may not be a precise measure of the state’s real influence and control over the economy, because state corporations and personnel appointments are not necessarily associated with direct transfer of ownership to the state. Particularly, the weightier the portion of companies or sectors in Russia’s national economy over which the state exercises solid control, the greater the state’s economic influence and the greater the likelihood that economic rents emanating from those assets will be captured by political appointees.

Through the process of Russian state intervention in the economy, rents were captured by the state coffers in the form of pensions, allowances and wages. The number of people working in state-owned corporations and companies engaged in public procurement has also grown. The private sector too has been relying more on contracts funded from the state budget, a trend that has been deepening the state’s role in the economy. In Russian state capitalism, a clear winner was the narrow ruling circle around Putin while no losers were clearly visible as long as crude oil prices remained high — until the outbreak of the global financial crisis.

Evidently, however, the Russian people have been gradually excluded from the political process with the progressive advance of political authoritarianism. Liberals have been decimated as an organized political force since the 2003 Duma election. Political infighting intensified only within the closed ruling circle. The powerful Kremlin clans are vying for power, influence and access to rent-generating resources, as clearly demonstrated by the so-called siloviki war of 2007 between Rosneft, headed by Igor Sechin, and Gazprom, headed by Dmitry Medvedev, over who would get control over the assets of oil giant Yukos. Thus, the structure of rent capture and distribution under Putinism was inseparably intertwined with an increasingly exclusionary authoritarianism.

Putin’s political coalition is rent-seeking and distributional in nature, rather than profit-seeking and encompassing. It is also patrimonial in that the coalition is based on the sweeping power and authority of the highest ruler, and that political power and position are fused with the assignment of economic rights to the personal dependents of Putin. “Patrimonial domination,” Max Weber wrote, “regards all governing powers and the corresponding economic rights as privately appropriated economic advantages.” This system of governance is thus highly prone to breed rampant clientelism and corruption, as shown in Russia. The rent-seeking bureaucracy that has virtually taken over the state is, to be sure, a phenomenon of the 2000s born under Putinism with rents from natural resources turning into bureaucratic rents.

RUSSIA’S MODERNIZATION SCHEMES
Resource rents are mostly captured by the state and distributed among those who compose the ruling patrimonial coalition and have established themselves as the vested interests of the rent-generating structure. History repeatedly shows that it is hard to break such a system without a fundamental reshuffling of the ruling elites, because they are formidable and strong opponents of any changes that would destroy their political and economic power base. In this sense, the “modernization” of the Russian economy that emerged as a hallmark of the Medvedev presidency could be a crucial test case to assess whether the rentier structure of Putinism can be changed. This is because successful modernization would require transformation of resource rents into productive economic assets and eventually, their wider redistribution to society.

Russia faces the imminent challenge of reindustrializing its economy in the 21st century. Under the lead of Joseph Stalin, Russia succeeded in achieving intensive industrialization between the 1930s and 1950s, albeit at a massive cost in terms of human life and sacrifice. That success, however, was eroded over the rest of the century by the Soviet Union’s malfunctioning centrally planned economy. In this context, the deepening resource dependency in the post-Soviet era has made economic modernization the leitmotif of the Kremlin’s policy agenda. There are, however, two contending approaches to the central agenda, which have contrasting implications for Russia’s development path, and for Putinism.

A liberal and innovation-based path to modernization, advocated by former president and current Prime Minister Medvedev, together with a
liberal group of government officials, presupposes the development of a national innovation system, competitive human capital and regional development centers. Medvedev argued that it was crucial to wean Russia from primitive dependence on energy exports, adopt political reforms and become a truly post-industrial economic power by focusing on innovation and becoming a knowledge economy. He and other advocates of this approach claimed that sources of growth should depend on increasing post-industrial sectors of the Russian economy such as services and innovation. This path requires, among others, sweeping liberal reforms, including decreasing the state role in the economy, and investment programs. Medvedev himself attempted during his presidency to pursue this, introducing tax breaks, promoting technology parks, abolishing import duties on high technology equipment and encouraging foreign investment.

But this path is encountering increasing resistance from within the ruling coalition, particularly from the silovik group. The reason is that many in the coalition, having grown rich under Putin on the proceeds of rents and corruption, are implacably opposed both to economic reform itself and even more so to the implied political reforms that would be the backbone of an innovative economy. So far, the war against rampant corruption has failed and the promised diversification of Russia's resource-based economy has not been fulfilled. Medvedev aimed high, but failed to push through wholesale changes to Russia's economic system, let alone its political system.

The other path is Putin's state-driven, resource-propelled modernization. In his final report to the State Duma as prime minister in April, Putin outlined the priorities of his future presidency — the ageing population, development of the Far East, job creation and the development of a competitive economy. He specifically stressed that the state defense sector should become the locomotive of economic modernization, recalling that nearly 23 trillion rubles were to be poured into the modernization of the armed forces and the military-industrial complex.

Citing China and South Korea as successful examples, Putin defended the state corporations created under his rule and made it clear that only the state was in a position to ensure financing for the high-risk innovation needed to reduce Russia's dependence on commodity prices. He pledged to revive the Russian Far East by setting up another state corporation as part of his re-election campaign platform. According to the newspaper Kommersant, a draft federal law has already been prepared by the Ministry of Economic Development, and the corporation will be granted the right to allot licenses to mine for natural resources such as gold — something that is currently only authorized by the federal and regional governments. The entity will be directly subordinate to the president, and other state agencies will not be able to interfere in its decisions. To facilitate the ventures, the corporation will get 500 billion rubles worth of stakes in energy, resource and infrastructure companies. The corporation would also receive unprecedented oversight authority in the decisions of major state monopolies in the energy sector such as Gazprom and Transneft. With its headquarters in Vladivostok, the corporation would get significant tax breaks, as well as the right to develop projects on land owned by other entities. The move is likely geared to promote investment opportunities ahead of the Asia-Pacific Economic Cooperation (APEC) summit to be held in Vladivostok this September.

The state-driven path to economic development and modernization seems to be more acceptable to the current ruling coalition, because it wouldn't disturb or destroy the existing rent capture-consumption mechanism or introduce disturbing economic reforms. Putin's modernization policy was formulated by former Deputy Prime Minister Igor Sechin, known as the chief of the siloviki group and Russia's energy czar, and Sergei Chemezov, the head of the state corporation Rossiiyskie Tekhnologii, and a longtime Putin associate known for designing the state corporation scheme.

Should the state-driven, resource-propelled path to modernization prevail — and it appears that it will — we should expect no fundamental economic or political reforms under Putin's new presidency, assuming that the current ruling coalition is effective in protecting and preserving the existing rentier structure.

BEYOND PUTINISM?

In the future, we may see different “Russias” emerge on the spectrum of continuity and change in Putinism, depending on the different combinations of rent capture and rent consumption. At one extreme, continuity from the old Putinism would prevail unless there were fundamental transformations in the current rentier structure. High crude oil prices would be favorable to this continuity scenario. At the other end of the spectrum would sit a liberal Russia in which the state monopoly of rent capture loosens to allow competent and competitive private actors to enter; resource rents would be dissipated more widely through the competitive process; and Russian society at large, and the middle class in particular, would become disillusioned with the implicit paternalistic social contract built throughout the first two terms of Putin’s presidency. In between, there could be, of course, numerous combinations of change and continuity of the old Putinism.

What is the most likely outcome? It will depend, among other things, on the determination and capacity of the political leadership to introduce reforms into the current structure of rent capture and distribution and to overcome the political constraints of the dominant political coalition. Patrimonial domination, Weber argued, may further develop into “rational bureaucratic” or degenerate into “estate-type patrimonialism.” The latter should be the case, particularly when the members of the dominant coalition virtually privatize the power and economic assets delegated to them by the ruler, thereby eventually becoming autonomous from the ruler. In contrast, when the ruler’s discretion prevails over the subordinates’ autonomy, patrimonialism may turn into “Sultanism,” according to Weber. Whether Putinism will remain patrimonial, become rational-bureaucratic or Sultanist is still unclear. It depends to a great extent on the relative bargaining power of the political leader and his closest cohorts.

On the other hand, Russian civil society is another critical source of change that could shape, together with the bargaining power of the ruler and his inner circle, the future contours of Putinism. Over the past decade of political stability and economic prosperity buttressed by high oil prices, a fledging Russian middle class has begun to come of age. They now connect with each other and organize through social media networks to protest against Putinism. Kommersant recently reported that, even according to the clearly inflated official results, Putin won 4 million votes fewer than he won in 2004 and 7 million votes fewer than President Dmitry Medvedev gathered in 2008. Putin in his third term will be faced with the people’s real voice of opposition — if not in the State Duma, then on the streets. So, will Putin go beyond Putinism? It remains to be seen.

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