Peterson Perspectives
Interviews on Current Issues

Edited Transcript

Russian Outlook with Medvedev at the Top and Gridlock in Ukraine

Anders Åslund offers litmus tests for the strength of the new Russian president and comments on inflation and privatization in Ukraine.

© *Peterson Institute for International Economics.*

Sherman Katz: Welcome to the third Peterson Perspectives interview. We are delighted this morning to have with us Anders Åslund. He's one of the senior fellows at the Institute and our expert on Russia, Central Europe, and Central Asia. He is a former economic advisor to the governments of Russia, Ukraine, and Kyrgyzstan. We're going to talk with him this morning about the transition in Russia. He has also recently visited the Ukraine, and we'll discuss the economic and political circumstances that he found there.

Anders is also the author of two excellent books published in 2007 by the Institute. The first is *Russia's Capitalist Revolution: Why Market Reform Succeeded and Democracy Failed.* The second is *How Capitalism Was Built: The Transformation of Central and Eastern Europe, Russia, and Central Asia.*

Anders, many outside commentators have said or written that Vladimir Putin remains, and will remain, firmly in charge even though he is no longer president. Mr. Medvedev, his hand-picked successor, is now in office. There are some Russian insiders who, of course, would agree, but others say that Putin might fade away within a year because presidential powers are so great, because Putin is tired, and because many economic and social problems are piling up. Which school do you think is correct?

Anders Åslund: I think that Putin's role is likely to decline for these and many other reasons, but the short answer is that we can't know as yet. So, this is a very sensitive period when things can go in either direction. But a few outstanding features of Russia really stand out. One is that there is only one country in the world today that is richer than Russia in terms of GDP and is more corrupt. That is equatorial Kenya. This is not really the kind of company you want to be in. There are only eight countries in the world that are also authoritarian and richer than Russia, and those are seven small oil states and Singapore.

So, Russia today is really an outlier. Of course, it is Vladimir Putin who has pushed Russia in the direction of more authoritarianism and more corruption. This stands out against a strong middle-class society that is coming into being. So, Putin is simply becoming too obsolete, too corrupt, too centralized, and too authoritarian. If he wanted to stay the same, why didn't he remain president? Putin is not a man who bothers about law.

If the first article of the Russian Constitution says that Russia is a democracy and a federal state, and Putin violates both, why should he bother about the term limit?

Sherman Katz: Just to clarify, the term limit is what?

Anders Åslund: Two terms as president is the maximum that is allowed, that is two consecutive terms. There is much speculation that Putin will come back after a short time for another term, which will then not be consecutive.

Sherman Katz: And these are each four-year terms?

Anders Åslund: Yes, there's also a lot of discussion among Putin's people in public that the presidential term should be prolonged to seven years.

Sherman Katz: Okay, let's look at some of the internal economic situation that may, in fact, have had some impact on his thinking. As you know, inflation is becoming an increasingly important problem in Russia. It hit 14 percent in April. Some think that neither incoming President Medvedev nor Putin as prime minister will be particularly taking responsibility for this problem. Do you think that this could be a barometer for the way issues will be sorted out between these two leaders?

Anders Åslund: Well, I think that the pressure from the population will grow much stronger because it's the ordinary man in the street who suffers from inflation. Therefore, they are not likely to give the government a pass as they have done until now. Russia's economic policy is quite good.

So, I think the economic growth will continue but it will become more a matter of redistribution, if ordinary people feel they are not getting a fair share of the very fast increasing wealth in Russia.

Sherman Katz: Do you see Medvedev as prepared to take this on as one of his priorities?

Anders Åslund: Well, for the last five years, Russia has essentially had no reforms. This means that Russia, because of its high growth, has simply outgrown its pursuit; the roads are crowded with cars, the healthcare system has not been reformed, and the labor market is overheated.

So Russia is, in so many ways, overheated because the state hasn't done its part. Everything that has been a conflict in Russia has been done by private businessmen.

Sherman Katz: In your writing, you've suggested that reforms have long been prepared and are much needed: education, healthcare, pension reform and, as you've just mentioned, renewing Russia's infrastructure. Aren't these typically problems that a prime minister rather than a president would be responsible for? In that context, you still see Medvedev as, perhaps, moving forward on those.

Anders Åslund: Well, I think that will expose Putin and that this will give him a reason to pause and consider it, perhaps he should dwindle away, or it would simply show his limitations. Also, the prime minister is much more exposed in Russia. You are allowed to criticize the prime minister; you are not allowed to criticize the president.

Already, the first day when Putin appeared as prime minister in the Duma, the Communist Party leader, Gennady Zyuganov, was allowed to give him sharp criticism, which would not have been allowed when Putin was president. Moreover, this was televised on the main Russian television channel.

Sherman Katz: Did Putin respond?

Anders Åslund: No.

Sherman Katz: Is that typical in that context for the prime minister to simply accept criticism?

Anders Åslund: No, but this is Putin. He's not used to responding to criticism. So, the prime ministers in Russia have been massively criticized all along while the president has not. So, I think that Putin will be increasingly exposed. Also, of course, we have the big corruption issues around Putin.

This is a person who, since the end of 1991, has been known for one big corruption story after the other. The amounts of property that he controls that are now mentioned are in the tens of billions of dollars. He can't get away with that in a more public position as prime minister.

Sherman Katz: Are there some litmus tests that you would suggest regarding Medvedev's capacity to take charge? Some people mentioned the jailing of Khodorkovsky, freedom of expression, and the media more generally. Fourteen journalists lost their lives during Putin's days. You think these are worth watching in terms of what they tell us about how Medvedev is preceding?

Anders Åslund: Yes, this question appeared in the European Parliament on the fifteenth of May. Other people who were there were former Prime Minister Mikhail Kasyanov and the editor-in-chief of Novaya Gazeta, Dimitri Murat, that's the newspaper for which the murdered Anna Politkovskaya wrote.

Both these men, who are strongly in opposition, argued that they should give Medvedev half a year of relief, when he would be allowed to try to do something. Of course, what is very easy to do is to give amnesty to the political prisoners. This is to clean the hand of the president; new legislative work is required. He could simply ask certain laws to be imposed.

The first thing that we are watching now is that Medvedev has emphasized his struggle against corruption. He has set up an anticorruption commission that contains both his people and Putin's people, and the question is now will they do something serious. If we have pervasive corruption at the top of the Russian government, of course, you have to start at the top if you are serious.

So, this is the first litmus test that Medvedev has put up for himself. But the most spectacular would of course be, as you mentioned, if he gave amnesty to Mikhail Khodorkovsky. That would be like Andre Sacharov coming back from Gorky in 1986.

Sherman Katz: Just to help any listener catch up with events, would you be kind enough to describe briefly who Khodorkovsky is.

Anders Åslund: Well, Khodorkovsky was the richest man in Russia, one of the young oligarchs who took over and reinvigorated Yukos Oil Company, which became the biggest Russian oil company. In 2003, Putin and his men arrested Khodorkovsky, sentenced him to eight years in prison on totally flawed charges and effectively confiscated the oil company through flawed tax charges.

So, this was a confiscation of property worth about $100 billion today, which was transferred to Rosneft, a state-owned oil company, which was quite small at the time. The chairman of this oil company is Igor Sechin, one of Putin's closest collaborators, a KGB man from St.

Petersburg who is now deputy prime minister, fortunately no longer in the Kremlin.

Sherman Katz: Let's look at another aspect of some things that Putin did or did not accomplish; one of those was failure to complete Russian accession to the World Trade Organization (WTO). Are there any signs of Medvedev's interest in tackling this problem?

Anders Åslund: Yes, there are. It should be said that WTO accession was one of the big goals that Putin set out for himself when he became president in 2000. His aim, as he then told us, was that he wanted to complete the WTO accession by 2003, during his first term. Indeed, he failed.

Now, Russia has very little left to do. It's really to agree with Georgia on their border issues, with the European Union of export of lumber to Europe, and Saudi Arabia on certain conditions in the Russian energy sector. That's about it. So, there's very little left, which is a good reason for Medvedev to push it. Medvedev has said that he wants Russia to join the WTO as soon as possible, though he has not put a clear deadline.

Interestingly, he has raised the issue on the WTO accession from being the responsibility of the deputy prime minister to being in the hands of the first deputy prime minister, Igor Shuvalov, who's a reformer and also known to be a good fixer. He has also a chance on the WTO issues to be considered stronger than his predecessor.

Sherman Katz: On the subject more generally of improving economic relations with the rest of the world and the economy, a good bit has been written about Russia using its energy resources in a way that makes life difficult in the European Union. Do you see signs, or is it too early to say, that Russia might be interested in more energy cooperation with the West?

Anders Åslund: Right now, we are seeing the opposite, that Russia is becoming more nationalistic about its energy resources, which is quite natural with the very high current energy prices. But in the long run, we are likely to see an opposing trend because Russia's oil production is now falling and gas production has long been stagnant.

So, Russia will need to improve its production of oil and gas. It can do so either by putting it into the private sector to a greater extent, or to allow foreigners in. My suspicion is that they will first go for private domestic businessmen and that foreigners might continue to lose out for some time. But Russia is becoming increasingly seen as unreliable

as a gas supplier—not as an oil supplier but as a gas supplier, because we don't know what they are doing. It's nontransparent.

We have seen two brief interruptions of deliveries to Europe through Ukraine and Belarus. Last year, after many years of increase, Russian gas deliveries to Europe actually fell. Moreover, the value didn't increase as it should have because of the much higher prices, which suggest that we are seeing huge transfer pricing in these gas deliveries.

So, there are too many strange things happening in the Russian gas sector to make foreigners believe that it's reliable. The demand is simply falling, not because people don't want natural gas but because they don't try to deal with Russia's gas drama.

Sherman Katz: Do you see any prospects for greater cooperation with the West on other issues such as the Middle East and Iran?

Anders Åslund: If you ask the American government, they say that they have good cooperation with Russia on Iran, and we've said the same about the Middle East for a long time.

Sherman Katz: Let's turn to Ukraine where you were recently a visitor. I gather that inflation is an enormous problem there. In March, it was 26 percent higher than the previous year, and in April, even 30 percent higher than the previous year. President Yushchenko is insisting that the National Bank maintain a peg between the Ukrainian currency and the US dollar. Can you explain the background and what you recommended to Ukraine's leaders while you were there?

Anders Åslund: Well, this is quite an abnormal situation that Ukraine has 30 percent inflation; 10 percent inflation is sort of natural in the area, given higher energy prices and given rising food prices, but 30 percent is just too much. Why does this happen?

The euro, which dominates this region, has risen 13 percent in relation to the dollar in the last year, which effectively means that a very open economy as the Ukraine has imported 13 percent of additional inflation by sticking to a dollar peg. This makes no sense.

So is this sheer ignorance, or is it sabotage of the government policy, or is it a mixture of the two? Another consequence of this is that Ukraine today has highly negative interest rates. The National Bank has not increased its interest rate with the rising inflation. As a consequence, Ukraine has had a monetary expansion of 56 percent in the last year, when you should have 30 percent inflation.

So, the fault lies very clearly with the National Bank, while the state value is actually balanced. You shouldn't be allowed to get away with such an economic policy. So, the natural demand is that the leadership of the National Bank should be changed if they don't know how to fight inflation or don't care about doing it.

Sherman Katz: From your discussion there, how would you gauge the consequences of improving the policies?

Anders Åslund: The strange thing is, now that they are officially maintaining the peg to the dollar, they're letting the exchange rate go. So there is no difference between the official exchange rate and the real exchange of over 9 percent, which means effectively we introduce two different exchange rates, which is even worse. The strange thing is also that the International Monetary Fund (IMF), which should stand up and complain about this situation, is pretty quiet and, in particular, does not criticize the National Bank. But, instead, the IMF presents a long laundry list of small measures that should be improved, which does not include abandoning the dollar peg.

Sherman Katz: So, what comes next?

Anders Åslund: Well, something has to be done. The consequence then would probably be some political changes. Ukraine in politics is now a wild fight between President Yushchenko and Prime Minister Yulia Tymoshenko. It comes with several blows each day where they're trying to fight each other. Probably, this will result in some constitution changes. President Yushchenko wants to strengthen the presidential powers in the new Constitution. He managed to do so in lower House of Parliament. Prime Minister Tymoshenko voted for this change but she's basically opposed to it.

So, this is a very complicated political intrigue that is almost impossible for anybody but the most closely concerned people to understand.

Sherman Katz: Evidently, Tymoshenko and Yushchenko have come to blows on the privatization program that Tymoshenko is trying to run. In general, in the West, we get an impression that privatization in these economies has been a good thing because so much was held in the public sector. Can you add anything about the prospects for the privatization program going forward?

Anders Åslund: The privatization program that Yulia Tymoshenko has formulated now is very good from my point of view. It's substantial; it contains big companies that have never been privatized: a big turbine factory, a big

ammonium plant, the big state telecommunication companies, and a lot of electricity companies. Her idea is to sell them, more or less all of them, make sure that you get strategic investors who can handle them, sell them in open auctions, with as few conditions as possible, to the highest bidder**.** Then, in order to make it politically acceptable, distribute the money as compensation for lost Soviet time savings in the old Soviet Savings Bank, which I think is a good idea. It's new for the budget, and it makes it politically easier to privatize.

Then all of a sudden in the second half of April, President Yushchenko blocked each and every of these privatizations with pretty bizarre arguments. One was that Ukraine has too little public property, which is quite regional, in particular, although Yuschenko has previously been very sound on privatization and has argued that this would be against Ukraine's strategic interest. A second is that Ukrainian Energy Company would go bankrupt if so much was privatized, and a third argument is that the Ukrainian government tried to privatize without a privatization strategy.

None of these arguments made any sense. So it makes the impression that Yushchenko just wanted to sabotage the work of the government. This is all strange since this is a coalition government, where half of the ministers come from his party and half come from Yulia Tymoshenko's.

Sherman Katz: So, he's effectively blocked the privatization program. Going forward, what would you say are the prospects in Ukraine for these two, president and prime minister, to work together? Or will the coalition collapse?

Anders Åslund: Clearly, Yulia Tymoshenko wants to stay on; she is utilizing this in order to strengthen her position in the public opinion. Ukraine is a democracy, and so I think that public opinion will eventually win. Therefore, I think that Ukraine is likely to come out quite soundly out of this. The growth is still strong, and when you go to Kiev, you're just amazed by how bustling and dynamic the city has become.

Sherman Katz: So you think it'll be Yushchenko out and Tymoshenko in.

Anders Åslund: I don't know in any event, but I think that Ukraine, as a democracy and as a market economy, will do well. What I'm most worried about is the inflation right now; something has to be done.

Sherman Katz: Anders, thank you very much for joining us this morning. Excellent discussion.