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Mr. Chairman and Members of the Commission.

Thank you for inviting me to take part in this hearing on Russia. It's a great honor to be here.

My comments will focus on key domestic and foreign policy drivers and challenges Russia is facing today.

The Vladimir Putin era is nearing the end of the line, and the Russian political class is now preparing to jump aboard a new train. Before the new election frenzy begins, we ought to reflect on the framework of the Russian political system, its potential in domestic and foreign policy, and where it will take Russia in the future.

Grasping a Moving Target

Studying Russia is sometimes a thankless task. How can one possibly grasp this moving target— this hybrid society that combines incompatible trends and interests and sees itself with intentionally blurred vision? Understandably, both Russian and Western observers simplify the situation, gathering only the facts that fit their preconceptions and ignoring inconvenient truths. The result, of course, is a dangerously incomplete picture.

The observers generally break down into two camps. First are the “pessimists” and critics of President Vladimir Putin. In the mythology of the critics, Boris Yeltsin’s tenure was a success story of liberal reform, a legacy that Putin betrayed. Taking up the mantle of the doomsayer, some pessimists contend that Russia’s long history of autocratic rule has left its people incapable of living in a democratic system. As Richard Pipes puts it, “Russians tend to view one another as enemies. . . .They are not only depoliticized but also desocialized.”¹ If Pipes and the others in this camp are correct, the West would do well to protect itself by throwing up a new iron curtain.

In the other camp are the “optimists,” mostly crowding around the Kremlin, who praise the current regime. This praise, however, is a thin disguise for a condescending belief that Russians have got what they deserve and are not mature enough to live in a free society. This school of “optimists” includes those who maintain that authoritarianism is Russia’s only path to modernization (despite the fact that the increasingly powerful Russian regime has abandoned reforms altogether.) There are also analysts who counsel patience, arguing that a healthy market and middle class must arise before Russians can begin to think about an open and independent civil society. (This group struggles to explain why the Russian economy grows even as political freedoms shrink, or why the middle class doesn’t feel very “middle” these days and dreams about being ruled by an “iron hand.”)

These opposing camps of Russia analysts contend over three issues. The first concerns where Russia is headed (boom or doom) and what role Putin is playing (Jekyll or Hyde). The second issue concerns how Russia’s recent history should be divided: the good years (or bad, depending on the analyst) of the Boris Yeltsin and early Putin administration, followed by the bad years (or good) of the late Putin administration. On the third battleground, the contending camps compare today’s Russia with that of the Soviet era in an attempt to determine whether or not Russia is in fact freer now than it was back then.

None of these points of contention get to the essence of the Russian political system, however. They offer no insight into Putin’s reasons for backsliding on democracy, no analysis of the Russian people’s preparedness for life in the free world, and no predictions about which path to modernization Russia will take.

Analyses of Russia are notoriously impervious to reality. Thus, some intellectuals in Russia and the West have called for an

end to Russia-bashing, arguing that Western society itself has difficulty managing democracy. Quite often political correctness replaces objective analysis, as demonstrated by the statements of a number of Western participants of the Valdai forum, a series of meetings organized by the Kremlin to woo Western pundits. Many of these pundits are now toning down their criticism of Russia after having hobnobbed with Putin. Understandably, it is harder to criticize a leader with whom you have shaken hands.

Does the inadequacy of analysis mean that Russia defies explanation? Fortunately, that is not the case. I believe that today there is a better sense of the fundamental challenges Russia faces, and a clear understanding of the capacity of the Russian elite to cope with them. Armed with this insight, we must seek to answer two major questions: What will happen when the factors currently holding Russia together stop working? And how far off is this moment of truth?

Bureaucracy's Victories over the Leadership and the State

Those who argue that Putin made a sharp break with the Yeltsin era have a hard time proving it. To be sure, Putin has torn down some elements of Yeltsin's rule. But by doing so, he bolstered the principle of personified power, a principle which Yeltsin set in motion with the 1993 Constitution. Thus Putin showed himself truly to be Yeltsin's successor: Both leaders contributed to maintaining a system that survives by succeeding one set of arbitrary rules with another, each accompanied with a new rhetoric substituting for a nonexistent ideology.

Under Putin, personified power has assumed the form of a bureaucratic-authoritarian regime. Yeltsin's 1993 Constitution was more instrumental in setting this development in motion than any personal convictions Putin might have held. That does not mean that Putin couldn't change Russia's trajectory with a 70-75 percent approval rating, he could risk it, but he never tried. The concentration of power in the hands of a president has led many to conclude that the current regime is autocratic. Appearances are deceiving, however: The Russian president is increasingly dependent on his base, which is comprised of the apparatchiki, the so-called siloviki, i.e. power structures (military, law enforcement and security services), big business and liberal technocrats. These disparate groups have congealed into a bureaucratic corporation. Personified power merely provides the means for the corporation to pursue its interests. Its core, however, is not siloviki, who have failed to govern, but the apparatchiki (federal and local) who have restored control over the state they lost in the 1990s.

Ironically, liberal technocrats constitute a vital element of the corporation, by injecting a spirit of dynamism and by discrediting liberalism by the very fact of being part of the non-liberal political regime.

The Russian political system has devoted all its resources to maintaining the status quo during the next election cycle in 2007-08. It will succeed in doing so, as long as it manages to prevent a schism from developing within the elite. Putin's successor will most likely have to follow in his footsteps, consolidating the new rule by denouncing his predecessor and forcing today's Kremlin team into early retirement. It would be a gross underestimation of Putin's intelligence to assume that he intends to remain in the Kremlin beyond the end of his second term. He surely understands that, if he were to stay on, he would become a puppet of the new administration, thereby undermining its legitimacy and destabilizing the political system. It is unclear, however, whether Putin will successfully avoid this trap and guarantee a smooth succession. The experiment with two presidential hopefuls, Dmitri Medvedev and Sergei Ivanov, has not been convincing so far, but the real game will start in 2007. It remains to be seen how inventive the Kremlin team is and how it will choose to perpetuate itself.

Bureaucracy's Victories over the Market

Having gained a sense of self-confidence, the bureaucracy no longer requires intermediaries to run the economy. This does not necessarily imply nationalization or redemption of property, as happened with Yuganskneftegaz and Sibneft. The bureaucratic corporation has devised several ways to control assets, particularly by installing its representatives on the boards of private companies. The ruling elite will undoubtedly tighten its grip on the economy, although some private companies under Kremlin control—the telecommunications sector, for example—will be preserved. There are signs that the recent redistribution of assets from the oligarchs to the bureaucracy could be followed by a fresh round of privatization, creating a new oligarchy. (Some staunch liberals even recommend re-nationalization as the best way to bring about and legitimize a new round of privatization.) The regime has jeopardized itself, however. By redistributing assets and undermining property rights, it has left itself with no guarantee that the new ruling team will not start the cycle again and do the same thing to them.

Some pundits point to the development of state capitalism in Southeast Asia to justify Russia's bureaucratic capitalism. Is this naïveté or an intentional misreading of history? State capitalism in Southeast Asia was intended to create a level of industrialization that Russia had achieved under Stalin. And furthermore, at a certain point state capitalism begins to degrade the state itself, as the experience of South Korea's chaebols show. No country attempting to marry state power and business has ever been able to meet the challenges of the post-industrial world. The limits of Russian bureaucratic capitalism are now becoming clear too. Despite extremely favorable global economic conditions, economic growth in Russia slowed from 7.3 percent in 2003 to just 6.3 percent in 2005; industrial production in 2005 increased 4 percent after growing 8.3 percent in

2004; mineral resources extraction grew just 1.3 percent in 2005 compared with 6.8 percent in 2004; oil output has grown by 47 percent in the private sector since 2000, whereas public-sector growth was just 14 percent; independent producers of natural gas have doubled their output, whereas state-owned Gazprom has increased output by just 2 percent.

As the Russian economy loses steam, the government is torn by internal rivalries, a search for scapegoats, and vain attempts to imitate genuine self-confidence. Meanwhile, arbitrary, interventionist state behavior is scaring off potential investors. Foreign investment is still coming in, to be sure, but Russian cash is getting out. The state that makes a show of being mighty and powerful has proven too weak to keep its commitments to business and society, and too feeble to maintain a rule-based order.

The Nuclear Petrostate

As bureaucratic capitalism has no interest in diversifying the economy, Russia is beginning to resemble a petrostate. Natural resources account for 80 percent of total Russian exports, and energy accounts for 60 percent of resource exports. More than 50 percent of investment flows into the natural resources sector. Other characteristics of the petrostate are becoming increasingly pronounced in Russia: the fusion of business and power; the emergence of a rentier class that lives on revenue from the sale of natural resources; endemic corruption; the dominion of large monopolies; the vulnerability of the economy to external shocks; the threat of a “Dutch disease”; and a large gap between rich and poor.

A new phenomenon, the “nuclear petrostate,” that is the state relying on commodities and at the same time having the ambitions of the nuclear superpower, may yet surprise the world.

Until recently the Russian elite considered overreliance on natural resource exports to be a weakness. Not anymore. Today, the Kremlin is attempting to turn this liability into a strength by transforming Russia into the “energy superpower.” It is a strategy that testifies to the government’s failure to develop a competitive, high-tech economy, such as the one India is forging. It also raises difficult questions. How can Russia aspire to become the world’s energy supplier when Gazprom’s output grew by just 0.8 percent in 2005; when oil output growth is not expected to exceed 2 percent this year, the smallest increase in five years; when half of Russia’s gas pipelines are more than 25 years old and 80 percent of the equipment used by the oil industry is out of date; when the average age of equipment in the electrical grid is 25 years; when 75 percent of Russia’s proven oil and gas reserves are already in production; and when the most of the country’s oil reserves are expected to run dry in 25 years?

By ignoring these questions and making Russia the peddler of natural resources to more developed countries, the ruling elite consigns Russia to a future of obsolescence.

Russia in the Global Arena

After 15 years of retreat in its foreign policy, Russia is regaining confidence. This confidence stems not only from high oil prices and the Kremlin’s attempt to overcome the humiliation of the 1990s, but also from purely external factors: the confusion surrounding European integration; U.S. difficulties in Iraq; and world resentment to U.S. hegemony. However, the most powerful factor explaining Russia’s new assertiveness is necessity. The Russian system can’t consolidate itself without a global presence. Russia’s ability to flex its muscles internationally has always proven to be a powerful instrument for domestic control. Maintaining Russia’s superpower ambitions and its domination of the former Soviet space are crucial to the reproduction of its current political system and self-perpetuation of power. Hence Russia’s message to the world: “We’re back!”

During Putin’s first term, the Kremlin developed a multi-vector approach to foreign policy, which amounted to simultaneously moving west and east, but refusing to make a final commitment to either direction. Until recently, this multi-vector approach, a substitute for the old geopolitical agenda, was essential for Russia’s survival in light of its diminished power and failure to integrate with the West.

For the first time since perestroika, the Kremlin has publicly declared through its foreign affairs minister, Sergei Lavrov, that Russia cannot take sides in global conflicts, that it must act as a mediator. In other words, Russia is not going to join the West.

So far, Moscow’s attempts to mediate between the West and North Korea, not to mention the West and Iraq, have met with little success. Nor can Moscow boast of much success in resolving conflicts in the former Soviet republics (Transdnister, South Ossetia, Abkhazia, Nagorno-Karabakh). The manner of the Kremlin’s intervention in the West’s dispute with Hamas illustrates that the Russian leadership is more interested in showing off its regained strength than in producing results. The case of Iran is far more serious, showing the extent to which the Russian elite is willing to sacrifice its national security and partnership with the West in order to pursue the agendas of its interest groups that stand to profit from nuclear contracts and arms deals with Iran. It also demonstrates the Kremlin’s concern that Iran may become a repetition of the Iraqi debacle. Regardless of how it might be spun, Russia’s relationship with the West is now one of “partner opponent”—cooperation in certain areas and obstruction in others. On the one hand, Russia participates in the NATO-Russia Council, undertakes joint

military exercises with NATO troops, and cooperates with Western leaders within the framework of the G-8. On the other hand, the Kremlin works to eliminate Western influence in the former Soviet republics and consolidate Russian society around an anti-Western sentiment. Russian defense minister Sergei Ivanov stated that the main threat to Russian national security is “interference in Russia’s internal affairs by foreign states—either directly or through structures that they support.”² There is no mistaking the intended target of these remarks.

Ukraine’s Orange Revolution has proved to be a watershed in the evolution of Russia’s post-Soviet identity and foreign policy by provoking the Kremlin’s desire to recover lost ground. The Russian elite now seeks to persuade the West to endorse a new “Yalta agreement,” under which the West would recognize the former Soviet space as Russia’s area of influence, and its role as the energy superpower. Regarding the latter role, Vladimir Putin has offered the world an energy security bargain—a trade off between “security of demand” and “security of supply.” There are two parts to the bargain: First, Russia would give foreign investors access to its major deposits in exchange for allowing Russian companies access to foreign pipelines and retail networks. Second, the West would legitimize the fusion of state power and business in Russia by letting state companies like Gazprom act as transnational majors. Both parts of the bargain undermine key liberal principles. From now on, its elite has made clear, Russia will only cooperate with the West on its own terms.

This gambit immediately alarmed Western governments, raising concerns regarding Russia’s expansionism. It has accelerated a split within the Commonwealth of Independent States and drove some of these states to hide under the Western roof. Putin’s energy bargain has triggered a dispute between the European Union and Gazprom that has sent shock waves around Europe.

How far is Russia ready to go to pursue this ambitious, neo-Gaullist agenda? Is the Russian elite ready for confrontation with the West? A significant portion of the Russian elite is trying to have it both ways: integration with the West for themselves and their families, but not for the rest of society. These representatives of the ruling class, such as the oligarch and governor Roman Abramovich, live in the West with their families, hold accounts in Western banks and even manage their Russian assets and perform their jobs from abroad. Yet they make a big show of nationalism when back in Russia. There is a logic to this seemingly schizophrenic behavior. The Russian elite can only maintain its privileged status in a society that is hostile to the West, but not too hostile, lest their personal fortunes be threatened. That means that a major portion of the Russian elite are not ready for serious conflict with the West over any of the above mentioned goals. And they will be ready to soften their assertiveness to strike a deal with the West, including on energy issues. At the same time, another portion of the Russian elite who lack similar personal connections with the West may be prepared—may even long for—a conflict they could use to oust the pragmatists of Putin’s type from the Kremlin. This faction has not yet emerged as a major political force in Russia, but the balance of power might shift in the future, especially in times of crisis, for which the elite has shown little inclination to prepare.

It would be wrong to assume that the only reason for suspicion between Russia and the West is the “value gap”. Their differences on terrorism and energy security prove growing divergence in their geopolitical interests. Though, Russia and the U.S. are expanding their cooperation on protection and control of nuclear materials. In any case, new situation creates tough challenges for pragmatists on both sides who understand the consequences of Russia and the West drifting too far apart. Russia’s tougher line, designed to secure greater leverage on the international arena, and especially in the energy field, could set in motion a process over which both Russia and the West would lose control.

What Do the People Think?

Russian society supports Putin, but this does not mean that people are happy with his policies. According to polling by the Levada Center, 72 percent of Russians say they approve of the president’s actions, yet only 19 percent consider him a successful leader. 75 percent say “order” is Russia’s most important priority, while just 13 percent opt for “democracy” above all. However, it would be wrong to make any conclusions about the state of Russian society on the basis of this poll alone. Only 12 percent of those polled believe that the interests of the state outweigh human rights; 15 percent say that human rights could be sacrificed to the state’s interests; 44 percent insist that people have the right to stand up for their rights, even if these conflict with the state’s interests; and 21 percent hold that the rights of the individual are more important than the interests of the state. When asked about Russia’s relations with the West, 52 percent of those polled expressed a favorable view of the United States (39 percent expressed a negative view). 66 percent expressed a favorable view of the European Union, versus 17 percent unfavorable.³ As these results suggest, a solid majority is favorably disposed to the West.

Russian society is subject to manipulation, like any society that has not yet learned to live in freedom, but for the first time in its history there are no insurmountable barriers preventing its progress toward liberal democracy. Russia has never elected a nationalist or communist president; it has elected pro-Western leaders—Yeltsin and Putin—who declared their intention to modernize the country. Russia’s ruling elite, by contrast, continues to live in the past. The possibility cannot be excluded that a crisis will prompt the elite to turn to nationalism and xenophobia, and that a part of society will follow.

An Uneasy Balance

Situational factors help explain the lethargic state of Russian society. High oil prices keep the economy stable. Continued economic growth contributes to a positive outlook in society. The Russian people are still recovering from the turmoil of the Yeltsin years, and they remain disenchanted with the political opposition. Political strategists have managed to fill the vacuum left by the opposition with virtual political forces that leave little room for genuine social movements. The current regime strengthens itself by coopting popular ideas from the opposition. The ruling regime has also caught the favorable end of the political cycle: stabilization and restoration always follow periods of revolutionary upheaval.