Recently, I met a very wealthy Russian. When I asked how things were in Russia, he responded with a big laugh: “The situation is completely predictable. Everything develops according to the worst possible scenario.” He went on to discuss his investments in Ukraine, the current pet idea of rich Russians.

This lack of belief in Russia even among the rich and mighty reflects a remarkable apostasy between President Vladimir Putin’s first and second terms. This decline is not a matter of sudden bad luck. Putin succeeded during his first term because he tried to satisfy a broad public opinion and balanced various power centers in order to consolidate his power. The goal of his second term has been to remove all centers of power but his own, to the point where his regime is now utterly dysfunctional because of overcentralization and secrecy, leaving too few and poorly informed decision makers. The question is no longer whether President Putin will hang on to power after his second term expires in 2008 but whether he will survive that long.

A related problem is that during Putin’s reign, Russia has gone from being partially free to unfree, according to the authoritative classification by Freedom House. It is actually the only country in the world that has become authoritarian during President George W. Bush’s tenure. Yet, as Bush pointed out in his key democracy speech in Riga on May 7, “The advance of freedom is the great story of our age.” If the United States is serious about democracy building, it cannot ignore what is happening in Russia and the former Soviet Union. This region is approximately as wealthy as Latin America, and it has a much higher rate of economic growth. But while Latin America is largely democratic, Russia and the other new states in Eurasia are by and large authoritarian. This absence of democracy—particularly in relatively wealthy, pluralist, and dynamic Russia—is an anomaly not likely to last.

The demise of democracy in Russia has had a natural impact on the country’s foreign policy. In Riga, President Bush continued: “We have learned that governments accountable to citizens are peaceful, while dictatorships stir resentments and hatred to cover their own failings.” Indeed, at the same time, President Putin offered a splendid illustration of Bush’s point by praising the odious Molotov–Ribbentrop Pact of 1939, which condemned the Baltic states to Soviet occupation—the reality of which the Kremlin denied. Last November, Putin came out with...
openly anti-American sentiments because of the democratization in Ukraine.

It is time to realize that the Russian regime has changed profoundly under President Putin. If the United States is serious about democratization, it should concentrate more energy and resources on nurturing the democratic potential of the states of the former Soviet Union, where peaceful revolutions in Georgia, Ukraine, and the Kyrgyz Republic have shown people’s hunger for democracy. Because democracy matters, an authoritarian Russia cannot be as close to the United States as was a nearly democratic Russia. Yet Russia nevertheless remains an important country; so while pushing for a change of direction there, the United States must also do all it can to maintain cooperation with Russia in specific areas of vital shared interest.

A Successful First Term

Rising out of obscurity, President Putin was highly successful during his first term. Gradually, he consolidated power. Having set the goal of doubling Russia’s gross domestic product in a decade—which would mean an annual economic growth rate of 7 to 8 percent—he sensibly pursued impressive market-friendly economic reforms. As a trained lawyer, he advocated the rule of law and spurred comprehensive judicial reform. His realist foreign policy raised Russia’s international standing at little cost.

Impressive and comprehensive economic and legal reforms were passed. In particular, a new tax code was adopted, introducing a flat personal income tax of 13 percent, and the new Land Code sanctified private ownership of land. The country enjoyed political and economic stability, and its economy grew at a solid annual average rate of 6.5 percent. As an avid reader of opinion polls, Putin tried enigmatically to be everything to all voters.

Thanks to his many policy successes, Putin became genuinely popular, which allowed him to reinforce his personal power. In the December 2003 parliamentary elections, his United Russia Party won a majority of two-thirds of the seats. He won the presidential contest in March 2004 with 71 percent of the votes cast in an election that was deemed free but not fair by the Organization for Security and Cooperation in Europe (OSCE).

Yet blemishes were not absent. Putin had risen to power on the strength of a ruthless war in Chechnya that bred ever worse terrorist attacks, against which his government stood helpless. Another negative trend was a slow but deliberate reduction of freedom. Independent media were reined in or taken over by Putin loyalists. Regional elections were increasingly tampered with. State power was systematically centralized.

President Putin’s central goal of political control contradicted his other objectives, but his concentration of power was so gradual that his different goals appeared to be reasonably balanced. From 2000 through 2003, oligarchs, Yeltsin-era big businessmen, countered Putin’s rising friends from his days in the KGB in St. Petersburg, permitting a small group of liberal reformers—notably the minister of the economy, German Gref, and the minister of finance, Alexei Kudrin—to exert inordinate influence, although they had no independent power bases. Putin appeared to be a benevolent and fortuitous ruler.

One Failure after Another

Alas, since he consolidated power, President Putin has done little good. His failures have not been incidental but reflect the inadequacy of his new system. Four disasters stand out: the Yukos affair, the Beslan hostage drama, the Ukrainian elections, and social benefits reform.

On October 25, 2003, Mikhail Khodorkovsky, the richest man in Russia and chief executive of the Yukos Oil Company, was arrested. Though denying that he had instigated this arrest, Putin explained that it had to occur because Khodorkovsky was buying up Russian politics. Putin’s key motive was to enhance his political control by arresting the most politically active oligarch, while some of his aides wanted to seize Yukos’s assets.

Khodorkovsky’s arrest changed Russia’s political system. Other oligarchs heeded
Putin’s warning and withdrew from politics. Hence, the balance between oligarchs and KGB officers ceased. Putin can no longer claim to represent the population at large, because his power base has shrunk to a small group of KGB officers from St. Petersburg. In the Yukos case, Russia’s legal authorities have persistently violated every rule in the book, jeopardizing Putin’s ambitious judicial reform. Yukos appears to have utilized tax loopholes aggressively, but possibly in line with the law. Even so, biased tax authorities and courts have imposed an incredible total of $28 billion in additional taxes and penalties on the company, forcing it into bankruptcy. As a result, the once-promising tax reform has become a joke. Contrary to repeated public promises, Putin has allowed Yukos to be confiscated through arbitrary taxation and kangaroo courts. With characteristic stubbornness, he has made no concessions whatsoever.

The next big scandal was the hostage drama in Beslan. On September 1, 2004, a group of terrorists seized a school in Beslan in Russian Northern Ossetia. Russia’s finest special forces were sent there within hours, but they were given neither battle plans nor operational command, and neither ammunition nor body armor. At no time was the school cordoned off. The chairman of the Federal Security Service (FSB), Nikolai Patrushev, and the minister of the interior, Rashid Nurgaliev, both KGB officers close to Putin, arrived in Beslan soon after the siege started. But they just hid, undertaking no public action. The regional governors of North Ossetia and neighboring Ingushetia, both recent Putin appointees (though formally elected), even refused to go to Beslan. The federal government simply ignored the crisis except to minimize news coverage. On the third day, the brave local Ossetians took out their Kalashnikovs from their closets and stormed the school themselves, shooting several useless special troops in the process. No fewer than 330 hostages were killed.

Russians are used to excessive brutality by law enforcement officers. Notably, in the musical theater hostage drama in Moscow in the fall of 2002, 129 hostages were killed with poisonous gas by Russian special troops. But in Beslan, the Russian state deserted. The government possessed no relevant intelligence. Police officers accepted bribes to let the terrorists through. Law enforcement did nothing. And Putin refused to accept any criticism for the catastrophe. Instead of sacking any of the culprits, he fired the editor in chief of the private newspaper Izvestiya, who had committed the crime of accurate reporting.

The third recent policy mistake was Russia’s conspicuous involvement in the Ukrainian presidential election. Characteristically, this question was deemed so important that it was centralized in the Kremlin and handled by nobody but the president and his chief of staff. At the end of July 2004, these two men decided to support Prime Minister Viktor Yanukovich’s campaign, accepting the choice of President Leonid Kuchma and his chief of staff. According to the campaign of the democratic candidate, Viktor Yushchenko, Putin promised Russian enterprise financing of no less than $300 million for the Yanukovich campaign. Russian television, which is widely viewed in Ukraine, praised Yanukovich and slandered Yushchenko. Dozens of Russian political advisors, paid by the Kremlin, descended on Ukraine, promoting Yanukovich. In the last month before the election, Putin himself went twice to Ukraine to campaign for Yanukovich. Putin’s choice made him appear poorly informed, antidemocratic, anti-Western, and ineffective. In one stroke, he managed to unite the United States and the European Union against him, leaving much of his foreign policy in tatters. Whereas Putin’s regime thus has proven its bad intentions in Ukraine, its policy is too inadequate to qualify as a threat of neo-imperialism.

The fourth big policy failure has been the recent reform of social benefits. Russia has myriad old social benefits, primarily for the privileged, many of which have never been paid out. This system needed to be sorted out, to target those in true need, but the execution of the reform was remarkably inept.

### Russia’s Oil Curse

**Reforms Appear Superfluous:** Because of Russia’s huge oil revenues, which particularly enrich the corrupt top of the state administration, top officials perceive little need to pursue market reforms that enhance economic efficiency.

**Danger of Renewed State Energy Monopoly:** State energy monopolies have been the bane of the OPEC states, because they have blocked dissipation of oil wealth to the rest of the economy.

**Oil Rents Corrupt the Elite:** Oil wealth is as large as it is concentrated, and a small elite can easily seize that wealth for themselves.

**Dutch Disease:** High real exchange rate makes other production less profitable.
The reform was presented as the monetization of in-kind benefits, when in fact many were simply abolished. Full compensation was promised for the actual in-kind benefits, but initially only about one-third of them were compensated for. Proper calculations were not done, and the federal and regional governments did not agree on who should pay for what. Although the benefit reform affected about 40 million people, it was not explained. To add insult to injury, the 35,000 highest officials, including the president, had their salaries quintupled at the same time, and none of their substantial in-kind benefits was taken away.

The social benefit reform seemed directed against the poor, and it was undertaken in the midst of Russia’s oil boom, as the budget surplus attained 5 percent of gross domestic product. To great surprise, widespread spontaneous popular protests erupted against this reform, and for the first time Putin himself was the center of public scorn. To cool down the protests, the government was forced to reverse most of its actions and raise pensions substantially.

**The Nature of Putin’s New Regime**
The four policy blunders described here were not accidental but systemic. They reveal how Russia’s new system of governance really works. President Putin has changed not only policies but also Russia’s political regime, and its dysfunction may cause his fall.

First, Putin has unwisely concentrated far more power in his own hands than he can manage. Most strikingly, he appointed as prime minister Mikhail Fradkov, a man famous for never making any decisions. As a consequence, the government has become petrified. Rather than creating a strong vertical chain of command, Putin has paralyzed his own government by trying to micromanage everything himself. In effect, he has transformed himself from a strategic policy maker into a firefighter unsuccessfully attempting to put out bushfires.

By strangling independent information, the president is allowing himself to be increasingly misinformed by his own bureaucracy. Being a true secret policeman, Putin is preoccupied with secrecy and conspiracy theories, and he seems to rely more on intelligence from his old circle of KGB men from St. Petersburg than on real information. When a French journalist asked aggressively about the arrest of Khodorkovsky, Putin suggested that he knew the journalist had been paid by Khodorkovsky: “We know where [the oligarchs’] money is being spent, on which lawyers, on which PR campaigns, and on which politicians, and on the posing of these questions.”

Checks and balances have been minimized. By depriving the parliament, the council of ministers, and the regional governors of most of their power, Putin has emptied these formal institutions of any real content. Instead, he is busy setting up informal advisory institutions, such as the State Council and the Public Chamber, which are of little or no consequence. Therefore, no institution can lend legitimacy to Putin if he starts faltering. His only source of legitimacy is his personal popularity, which is falling fast. According to the Russian Public Opinion Foundation, 68 percent would have voted for Putin in presidential elections in May 2004. One year later, this number had fallen to 42 percent, a drop of more than one-third. One more blow and his popularity could be in free fall.

As the regime has changed, so have its interests. Putin’s KGB friends dominate the state administration and the big state-owned enterprises, which should be the focus of reform. But reforms cannot occur against the ruling interests. Even during Putin’s first term, the share of public expenditures devoted to state administration, law enforcement, and the military steadily increased at the expense of social expenditures.

The strength of the Putin regime lies in its skilled manipulation of the elite, the media, and civil society. But if its propaganda deviates too much from reality, it will eventually lose its credibility and thus authority. That threshold may already have been crossed. Putin’s regime is too rigid and cen-
tralized to handle crises, which always occur. Therefore, it can hardly be very stable. Analysts and policy makers concerned with Russia should turn their attention to how this regime may crumble.

Paradoxically, Russia's economy is doing very well, with a growth rate of 7 percent in 2004, and the standard of living is rising even faster. This growth is being driven not only by high oil prices but also by the extensive market reforms of Putin's first term. Admittedly, no new reforms are in the offing, but the petrification of decision making also safeguards most of the reforms already adopted, even if the Yukos affair has undermined much of the tax and judicial reforms. However, neighboring Ukraine has just gone through a popular revolution, although its economy grew by 12 percent in 2004, and real wages increased twice as fast, showing that a rising standard of living is no guarantee of stability.

How Can This Regime End?

Until recently, Moscow debated whether the popular Putin would really leave when his second term ends in March 2008 or whether he would change the Constitution or transfer more power to the prime minister and assume that office. But Russia's political system has become so dysfunctional that Putin will be lucky if he can stay in power that long. The positive status quo ante can hardly be restored. Putin has obtained what he wanted, and so far he has proven too stubborn to learn from his mistakes. Nor will Russian politics allow him to reinvent the unpopular oligarchs as a major political force that he can campaign against. Yet no political threat is apparent, and the question is where one might come from.

At present, Russia is afloat with oil revenues, securing a huge current account surplus and massive international reserves. At an oil price exceeding $27 per barrel, 90 percent of the revenues goes to the state treasury. As long as oil prices stay high, the regime can throw money at multiple problems. However, these oil rents also breed corruption and have contributed to bringing reforms to a halt.

Putin has little to fear from the oligarchs. They are wealthier than ever but also vulnerable. They hope they can continue making fortunes as long as they keep a low political profile and pay the authorities on request. The liberal opposition is too demoralized and disorganized to recover on its own. The Putin regime is as good at political management as it is poor at policy making. It shepherds the intelligentsia, the middle class, nongovernmental organizations, and the media with sophisticated political control. The elite and official organizations have been co-opted, intimidated, or manipulated. Many media outlets function as safety valves for the disaffected, and the FSB surveys everything. Therefore, any premeditated, planned opposition movement is unlikely to succeed.

Pessimistic Russian observers and Putin's best Western friend, German Chancellor Gerhard Schröder, warn of the threat to Putin from hard-line nationalists, but that is what Putin wants the world to think. All rulers in the Kremlin since Joseph Stalin have warned about hard-liners in the wings.

Instead, the challenge to President Putin is likely to come from the very top or the bottom of society, that is, from his KGB cronies or the people. Because his presidency is turning into a disaster, some KGB men may start noticing it as well. A former senior Russian official told me recently that within Putin's KGB circle, Putin is not considered the leader. After all, he was sidelined in his KGB career and never rose higher than lieutenant colonel. The powerful men surrounding Putin may conspire in a putsch against him. The parallel of the August 1991 coup against Mikhail Gorbachev comes to mind; but because it had devastating consequences for its hard-line initiators, it may be more of a deterrent than a model.

Another possibility is a popular uprising through escalating spontaneous protests. Putin's political management is reminiscent of Poland in the 1970s under the communist leader Edward Gierek, whose initially successful rule ended with spontaneous strikes in big industrial cities on the periphery, leading to the formation of the trade union Solidarity.
Since the mass protests by pensioners throughout much of Russia against the botched social benefit reform last January, demonstrations have erupted in various localities against specific regional complaints, from Bashkortostan in the Urals to Ingushetia in North Caucasus. The population is evidently uncommonly irritated, and it has been inspired by the recent revolutions in Ukraine and the Kyrgyz Republic. A broad popular protest suddenly looks like a distinct possibility.

If such a credible protest erupts, other forces would dare to act. The disenchanted regional governors potentially could form the backbone of a protest movement, and many big businessmen might join them. Russia is home to many wealthy, self-made young men who want to break the corrupt links between the Kremlin and the oligarchs. Similarly, the multimillionaires’ opposition against the billionaires was one of the forces behind Ukraine’s Orange Revolution. In Russia, no obvious leader is apparent, but that is hardly central. The most authoritative name to surface so far is former Prime Minister Mikhail Kasyanov.

Throughout the postcommunist world, the main popular complaint is corruption, and the unanimous judgment of Russian insiders is that the Kremlin has never been as pervasively corrupt as it is today. Virtually all high offices are being sold by the Presidential Administration. The prices cited for governorships, for example, are huge—multiples of $10 million. Specific complaints that might break the regime, however, are hard to predict and bound to surprise. One of the most obvious conflicts is that the military wants to force middle-class students to serve two years in the military, while they are exempt today.

The lesson from the recent democratic revolutions in Georgia, Ukraine, and the Kyrgyz Republic is that elections are critical for regime change. But this is hardly a necessary precondition for Russia, because an election is not necessary to unleash either a coup or a protest movement. Most of the recent public protests have been unrelated to elections.

There is nothing uniquely Russian about this state of affairs. On the contrary, it is common in not-quite-mature middle-income states. Alberto Fujimori in Peru and Carlos Menem in Argentina come to mind. Like them, Putin is more likely to destroy himself politically than to find any way out of the political dead end he has created for himself. Russia’s problem is one of insufficiently strong checks and balances, which could have stopped Putin from harming himself. The demise of the Putin regime would deal a great blow to the Pinochet model of authoritarian reform.

**Implications for the United States**

The radical deterioration in the functioning of Russia’s regime has serious implications for the United States. No illusion can persist about shared democratic values between the United States and Russia. Putin’s repeated policy disasters show that his regime has become less effective because of its rising authoritarianism. Key changes, such as military reform, have been shelved. This also means that Russia is less effective as a partner of the United States.

The dominant U.S. interest in Russia and the newly independent states in Eurasia should be to support democratization. As President Bush put it in Riga: “All the nations that border Russia will benefit from the spread of democratic values—and so will Russia itself. Stable, prosperous democracies are good neighbors, trading in freedom and posing no threat to anyone.” This should be the guideline for U.S. policy on Russia, and U.S. assistance to Russia should concentrate on democracy promotion. The United States has spent substantial amounts on democracy building, monitoring elections, independent media, and support for civil society in other Eurasian states, but hardly any in Russia. Specific policy recommendations include:

- Given that the recent democratic breakthroughs in Russia have been connected to elections, their monitoring should be a focus of U.S. support, and the best monitors have proven to be nongovernmental organizations. It is a serious sign of concern that the Kremlin
does not complain about anything the United States does in this regard, which suggests that nothing of significance is being undertaken. Russia has many elections at different levels all the time, which need monitoring.

- The new Russian election law does not permit independent election monitoring, which runs counter to the standards set by the OSCE, whose conventions Russia has ratified and is thus legally bound by. The OSCE is the natural forum for the United States to protest against these legislative malpractices.
- The United States should also insist on effective international monitoring of elections.
- The United States can assist in setting up independent exit polls for elections.
- The most effective protests in the region have been those led by student activist organizations: Otpor in Serbia, Kmara in Georgia, Zubr in Belarus, and Pora in Ukraine. Their techniques are well known, and can and should also be disseminated in Russia.

As President Putin showed so clearly in Ukraine, he prefers incumbent authoritarian rulers to democracy. Russian policy in the states of the former Soviet Union appears to have been reduced to knee-jerk reactions against any democratic tendencies and anything the West does. The United States cannot accept this quietly. As people in the region rise against their dictators, the United States must stand firmly on the side of democracy against Putin. Even if Russia’s intent is malign, there is little reason to fear Russian neo-imperialism, considering how inept Russian foreign and military policies have become.

Among the many common interests that the United States and Russia share, which must not be sacrificed, the biggest and most important is the nonproliferation of weapons of mass destruction, both globally and in the crisis countries of Iran and North Korea. In this matter, fundamental Russian and American interests coincide, and Russian assistance can be vital to the United States—especially vis-à-vis Iran.

Regardless of political developments in Russia, the United States has a permanent interest in promoting the country’s economic integration into the world economy and thus into the international system. The United States has rightly acknowledged Russia as a market economy, which is of importance for antidumping cases. America should also facilitate Russia’s accession to the World Trade Organization, which will force Russia to comply with multiple international standards and help the country to harmonize its commercial legislation with that of the West. Russia’s upcoming chairmanship of the Group of Eight means that the West is likely to impose higher demands on Russia’s performance, and it gives Putin a good reason to comply.

Similarly, the West should encourage Russia to cooperate with the West in the energy sphere. Most big Western energy companies have invested heavily in Russia, but the room for cooperation appears to be shrinking, because Putin’s friends have seized control over Russia’s state-owned energy companies, trying to exploit their assets without external interference. The reinforced state oil pipeline monopoly precludes the construction of private pipelines. Soon, however, the space for international cooperation may expand again. After several years of strong production growth in Russia’s private oil companies, growth is plummeting due to state intervention, and production soon may start falling. Then Russia will truly be in need of international cooperation, a state of affairs that should be welcomed given the increasing global scarcity of oil.

The unanimous judgment of Russian insiders is that the Kremlin has never been as pervasively corrupt as it is today.
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