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The Great Transformation: How the Putin Plan Altered Russian Society

As president of Russia, Vladimir Putin's most obvious accomplishment has been to transform the Russian economy from a bankrupt relic of the USSR into a global giant. The past ten years of 7% annual GDP growth have pushed the Russian economy well over the \$1 trillion dollar mark, from 22nd to 9th in the world.

The growth in prosperity has led to a profound shift in the dynamics of Russian society. One way to grasp the magnitude of this shift is suggested by the late economist Karl Polanyi. Polanyi wrote of «the great transformation» that results from the planned introduction of *laissez faire* principles, and the instinctive social reaction that it provokes. As markets release the energy necessary for dynamic economic growth, the traditional culture defends itself, eventually forcing the compromises necessary for social stability. He called the outcome of this process, «the greatest human invention of all time – Market Society».

Polanyi's unusual view of economic *laissez faire* as «artificial», and socio-cultural constraints on them as «natural», have not been popular in recent years. Perhaps if they had been, more observers would have recognized the carefully constructed nature of the social changes underway in Russia, and recognized them for what they are – a project designed to transform Russia from a mere vestige of the USSR into a

modern and prosperous contemporary society.

For too many years, Western pundits could not even imagine Russia's political leaders coming up with anything so ambitious. Even after Alexei Chadaev connected all the dots in his 2005 book *Putin: His Ideology*, and even when, as a presidential candidate, Dmitry Medvedev mentioned publicly that, as early as 2000, the government had begun to «think seriously about how we might work for decades ahead thinking also about morality and values»¹, it seemed too fantastic to believe that the successor to Yeltsin's corrupt and inept government could come up with a recovery strategy that would span decades. A brief summary of what has since become known as the Putin Plan, however, reveals why this transformation has been so successful, and offers insights into how Russia will emerge from the current economic crisis.

The Two Pillars of the Putin Plan

The Putin Plan rests on two pillars: (1) stable economic growth; and (2) a stable legal

¹ D. MEDVEDEV, *Vstuplenie pervovo zamestitelja predsedatelja pravitel'stva RF Dmitrija Medvedeva na II obstersijskom grazhdanskom forume*, VIPerson.Ru, January 22, 2008.

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Abstract

Although Vladimir Putin is widely credited with having restored Russia to economic growth, this is but one result of the much more ambitious «Putin Plan» for the social reconstruction of Russian society through stable economic growth and a sound legal environment.

The Putin Plan originally had two phases, of which Putin managed to finish only the first, consolidation phase during his presidency. The second, reconstruction phase, currently being overseen by Dmitry Medvedev, is meant to create Russia's first truly liberal society, but its full implementation has been delayed by the collapse of the global economy.

While many challenges remain for Russia, the enormous popularity of the «Putin Plan», especially among young people, should allow Russia to emerge from the current global economic crisis in a good position for the future.

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environment. Each one is in turn divided into two phases, the first of which is “consolidation” and the second “reconstruction”. The consolidation phase is now largely complete, while the reconstruction phase had only just begun before the 2008 collapse of global investment.

Within weeks of his election in 2000, Putin proposed a comprehensive package of reforms that eliminated fuel and sales taxes, reduced the corporate tax rate, and introduced a 13% flat tax on personal income.

Within just one year the Russian government moved from having regular budget deficits to having regular budget surpluses². With stable revenues, tax inspections were curtailed³, and in 2006 a comprehensive tax amnesty allowed citizens to legalize all prior undeclared income⁴.

While tax reforms stabilized government revenues, the massive privatization of state assets funded economic reconstruction. Fifteen years ago Russia's industry was fully state-owned. By 2002 it was 90% privately owned⁵.

As the value of Russian assets has increased, the rate of privatization has gradually slowed, although it remains an essential element of the

government's economic recovery strategy. During the past decade, employment in private enterprises has grown by 41% and declined 15% in state enterprises. Overall, by 2007, state-owned enterprises shrank by 10%⁶. Indeed, that year Finance Minister Kudrin reported that federal budget support for industry in Russia was 11%, compared to 10% in the United States⁷.

The government's commitment to privatization can even be seen in the energy sector, where, despite having increased the state's stake in oil production from 10% to 27% in recent years, it has also opened up coal production, and parts of the gas market to private investors⁸. The past decade's experience auctioning off mid-sized airlines, banks, car plants, has also been invaluable in helping to successfully carry out what *Business Week* called, «one of the most radical electricity reforms anywhere in the world» – the privatization of the country's electricity monopoly, completed in July 2008⁹.

The high price of oil and natural gas allowed the Russian government to stash away \$600 billion in currency reserves and a national Stabilization Fund for long term reconstruction¹⁰. But while the government budget remains heavily dependent on this revenue, it should be noted that, since 2004 oil and gas production have accounted for an ever decreasing percentage of Russia's GDP (now about 20%), and less than a third of its annual economic growth¹¹.

At the beginning of 2008, Russia's basic indicators appeared so good, that many observers thought it might even become a “safe haven” in the gathering economic storm. Not so. The Russian stock market fell by almost 70% in 2008. The dramatic fall in the price of oil has forced the government to adopt extraordinary anti-crisis measures estimated at as much as 12% of GDP in 2009, and to contemplate the first federal budget deficit in more than a decade. In the past year alone, the ruble has lost nearly a third of its value, and the resulting crisis of confidence has led to a \$200 billion drop in available reserves.

As dramatic as this turnaround in fortunes has been, however, some analysts see Russia as potentially being one of the first to emerge from this crisis¹². They cite the following reasons:

⁶ C. WOLF, *Where does Russia's economy lie on the spectrum of “transition”?*, in «Taipei Times», January 8, 2007.

⁷ *Pravitel'stvo Rossij dolzhno sokratit' ob'em gospodderzhki ekonomiki (Kudrin)*, in «Russkiy zhurnal», June 9, 2007.

⁸ *Experts Debate Efficiency, Industry Share of State Energy Companies*, in «Nezavisimaya gazeta», July 3, 2007; *Sostoiialis' perv'e v Rossij birzhev'e torghi gazom – tsena na 15 dollarov v'she gosydarstvennoi*, NEWSru.com, November 22, 2006.

⁹ J. BUSH, *Electric Shock in Russia*, Businessweek.com, March 22, 2007; E. GRISHKOVETS - I. BULAVINOV, *Chubais: Don't Privatize Everything*, in «Kommersant», June 30, 2008.

¹⁰ C.G. GADDY - B.W. ICKES, *Putin's Third Way*, in «National Interest», January 6, 2009.

¹¹ WOLF, *Where does Russia's economy lie on the spectrum of “transition”?*, cit.

¹² M. GILMAN, *A Few Economic Truths to Ease the Misery*, in «Moscow Times», April 8, 2009; L. HALLIGAN, *Is the Russian bear over-bearing?*, BusinessNew Europ e.eu, March 12, 2009; A.

² N. REYNOLDS, *Tax reform, not oil, fuelled Russia's revival*, in «Johnson's Russia List», 98, 2007.

³ T. PANINA, *Nalogoviki ostanutsia bez vnezapnosti: im razreshat provodit' proverki ne chashe dvuh raz v god*, in «Rossiiskaya gazeta», April 30, 2005.

⁴ D. DOKUCHAEV, *State Duma Has Voted for Tax Amnesty. At Last!*, in «Moscow News», December 29, 2006.

⁵ A. ASLUND *et al.*, *Russia's Surprise Economic Success*, in «Financial Times», October 9, 2002.

- Russia faces no major debt problems. Government debt is low, corporate debt is moderate, and household debt is still miniscule at 9% of GDP. Russian companies have cut their total foreign debt by more than 1/3 in recent months. The peak of foreign debt repayments for 2009 has already passed. Russia simply does not face the huge solvency problem that Western countries face.
- There is little chance of a balance of payments crisis. The Central Bank is running a surplus, capital outflows have slowed, and, after managing the rubles fall last year, in April 2009 the Central Bank had to intervene to prevent a too precipitous strengthening of the ruble. According to Richard Hainsworth, head of the bank rating agency RusRating in Moscow, Russian banks are in a fundamentally healthier state than their Western counterparts¹³.
- Despite the high cost of the government's anti-crisis initiatives, overall state expenditures remain at 19% of GDP, much lower than the 40% that is typical of most Western economies¹⁴. And, although

Finance Minister Kudrin expects the Stabilization Fund to be exhausted by the end of 2010, so long as the price of a barrel oil remains above \$50, he says, it will be replenished¹⁵.

That is why, despite projections that the economy will shrink anywhere between 2-5% in 2009, in its latest revision of the budget, the Russian government actually raised total spending more than 7%, with social programs showing the biggest gains. «The worst is over for Russia», according to Grant Shotter, citing as proof Russia's MICEX stocks index which, after being the world's worst performer in 2008, has been the world's best performer in 2009¹⁶.

Russia's Legal Evolution

The second pillar of the Putin Plan involves the creation of a stable legal environment for the application of the rule of law. During his first term as president, Russia introduced a new criminal code, *habeus corpus*, a juvenile justice system, trial by jury, legal aid for the indigent, and a nation wide system of bailiffs, all institutions that have taken other countries decades, if not centuries, to put in place.

In Putin's second term, emphasis has shifted to the courts who must interpret these new laws. Landmark court decisions on individual rights have struck down compensation limits

in the case of government disasters, like Chernobyl¹⁷, and strengthened the rights of defendants to gather evidence, alibis and witnesses¹⁸. Courts have provided guidelines on what can and cannot be deemed "secret"¹⁹, and ruled that the State must pay compensation to everyone whose arrest is found to have been without merit²⁰. The government has also introduced legislation that all but eliminated closed judicial proceedings, and the pretrial detention centers run by the Federal Security Service, and added many new privacy protections for individuals²¹.

Since March 2005, the Ministry of Justice has been experimenting with free legal aid programs in ten regions. This has proved so popular that, with government funding, the Russian Association of Lawyers is working to set up more than 24,000 free legal aid centers across the country²².

¹⁷ M.E. BAUDOIN, *The Constitutional Court: Counterweight to Authoritarianism?*, in «Europe-Asia Studies», July 2006.

¹⁸ F. STERKIN, *Sledstvie obyazali dokazyvat' alibi obvinyaemogo*, Strana.Ru, June 30, 2004.

¹⁹ V. KULIKOV, *Verhovn'j sud snimaet grif sekretno i pogon' s voenn'h sudei*, in «Rossiiskaya gazeta», February 1, 2006.

²⁰ N. KORCHMAREK, *Femida vzrosleet*, Strana.ru, December 28, 2006; V. KULIKOV, *Minfin rasplatitsia za vseh*, in «Rossiiskaya gazeta», June 21, 2007.

²¹ V. KULIKOV, *Vas zasekretiat*, in «Rossiiskaya gazeta», January 21, 2006; *Putin podpisal zakon "O personal'n'h dann'h*, Strana.ru, July 28, 2006; *Putin Signs Law to Strip FSB of Detention Centers*, RIA Novosti, April 17, 2006, in «Johnson's Russia List», 91, 2006.

²² V. MOTYASHOV, *Mest' i samosud - est' li im opravdanie?*, in

BLOMFIELD, *Has Russian got its groove back?*, in «The Daily Telegraph», March 21, 2009.

¹³ J. BUSH, *The Worries Facing Russia's Banks*, in «Business Week», April 13, 2009.

¹⁴ L. HALLIGAN, *Is the Russian bear over-bearing?*, cit.

¹⁵ A. KUDRIN, *Rossija gotova k v'pusku dolgov'h bumag*, April 28, 2009.

¹⁶ T. FARRAND, *Worst is Over' for Russia, Hexam Emerging Market Fund Says*, Bloomberg, March 25, 2009.

The conventional wisdom has it that the Russian judiciary is far from independent. Yet, if one gauges independence by the number of times that courts rule against the government in favor of private citizens, then Russian courts are independent nearly 80% of the time²³.

Although the government has promised to inject US \$2 billion into the legal infrastructure over the next five years²⁴, Russia is still a long way from having a smoothly functioning legal culture. But while dwelling on its many flaws, perhaps critics should also consider how much has been accomplished in just a decade, including, for example, that the number of persons turning to the courts for redress of grievances has increased six-fold²⁵.

Surely, one of the most impressive aspects of Putin's legal reforms is that, in the face of terrorism and secession, Russia not only created a new legal system, but very deliberately sought to humanize it. For instance, since Putin introduced the new code of

criminal procedures, acquittal rates have jumped from 0.8% to 10% overall, and almost 20% in jury trials²⁶. All the while, the government has never used the excuse of war, or terrorism, to refuse to comply with judgments of the European Court of Human Rights. In a world prone to cynicism about respect for the law, this is enormously inspiring.

Phase II: the Medvedev Liberalization

Although significant progress has been made in laying the foundations for long-term prosperity²⁷, two terms have not been enough to institutionalize the transformation of Russia into a modern economic and political system. Putin therefore backed his chief legal advisor and later first deputy prime minister, Dmitry Medvedev, to be his successor. Running on a platform of continuing Putin's policies (even pledging to appoint Putin as his Prime Minister), it is hardly surprising that Medvedev won by large margin.

Despite the overall continuity, however, there have been some significant changes in emphasis under Medvedev. Perhaps the most notable has been the emphasis on personal opportunity and responsibility. According to Medvedev, the state has only two positive economic obligations. First, to assist Russian companies to

become more globally competitive. Second, to combat poverty. Beyond that, he says, «if government participation is not essential, then the government should not be involved»²⁸.

Time and again, Medvedev has proposed solutions for Russia's social problems that reflect his preference for market-based solutions. He has forced regions to compete with each other for federal funding. In education, healthcare and pension reform he has championed the idea that government funding ought to follow individuals rather than institutions. He lobbied hard for, and finally won, changes in the law to allow universities to set up their own small businesses and create endowments to ensure funding independent from the state.

Market and legal terminology also suffuse Medvedev's description of the relationship between government and civil society. He depicts it as a contract that government "offers" to civil society in the form of specific national priorities. Non-governmental organizations (NGOs), he says, must play a more important role at every level of government. Without their feedback, «the government is blind and winds up working only for itself»²⁹.

The view of Medvedev as a lackey blindly carrying out Putin's bidding is therefore simplistic. Rather, Medvedev argues, the time has come to shift the focus from

«Rossiiskaya gazeta», July 27, 2007; *Glava Miniusta raschit'vaet, sto v 2008-2010 gg. vse maloimustie poluchat besplatnuju pomost' iuristov*, Vesti, May 25, 2007A. KORNIA et al., *The Legal Advice National Project*, in «Vedomosti» (December 13, 2006), in «Johnson's Russia List», 279, 2006.

²³ P. SOLOMON, *The Sutyagin case doesn't indict all Russian justice*, in «Globe and Mail», April 14, 2004.

²⁴ *Verhovnij sud Rossij podgotovil zakonoproekt ob informacionnoi otkr'tosti deiatel'nosti sudov*, NEWSru.com, April 25, 2007.

²⁵ Y. KOLESOV, *The Shadow of Judgement*, Vremya novostei, October 19, 2004; V. SIMONOV, *Little Guy Defeats Russian Giant in Court*, RIA Novosti, October 20, 2004.

²⁶ V. KULIKOV, *Verhovnij sud*, cit.

²⁷ A study by German banks found, much to the authors' own surprise, that Russia was outpacing the US, UK and Germany in securing long-term economic and environmental prosperity for its population. See H. WILLIAMSON, *Russia surprises in sustainability league*, in «Financial Times», September 13, 2007.

²⁸ E. GRIGORJEVA, *Dmitrij Medvedv: V istorij dolzhn' b't svoi geroi*, VIPerson.Ru, January 29, 2007.

²⁹ D. MEDVEDEV, *Bez kommunikacij s institutami grazhdanskogo obshchestva gosudarstvo slepo*, VIPerson.Ru, February 4, 2008.

consolidation to liberalization. If, during the 1990s «screws were, perhaps, screwed on too tight», now they should be relaxed. Medvedev's rise thus signals the beginning of the next phase of the government's efforts to create Russia's first truly liberal society. But will global economic conditions allow Russia to proceed on its course, or throw it back to the past?

Crisis or Continuity?

The Putin plan is a densely woven web of initiatives, none of which can be gauged properly without understanding their broader purpose. The persistent inability, or unwillingness, to see the broader picture has condemned many analysts to a fragmented and often incoherent analysis of Russia.

For example, dramatic value changes have taken place under Putin that have created a broad base of support in favor of the Putin Plan. Some sociologists, like Alexander Oslon, have highlighted in particular the fact that young people today have values so different from their predecessors, that they deserve a distinct label. He calls them «The Putin Generation»³⁰.

This generation tends to be bolder than their parents, and to view aggressiveness as a manifestation of self-confidence and initiative. Unlike their parents and grandparents who are appalled by emergence of the «super rich», they take pride in the fact that Russia has the

world's second largest number of billionaires, and hope to make the list of Russia's richest individuals themselves, or at least to see their children on it³¹. They have little nostalgia for the Soviet era, and take capitalism, political and media pluralism, and travel abroad for granted³². They are quite comfortable shifting primary responsibility for economic welfare from the state to the individual³³.

The Putin Plan appeals directly to them. According to pollsters, the 20% rise in the number of Russians who, since 2005, say that the country is moving in the right direction can be attributed mainly to the coming of age of this new constituency, which began to vote after 2003³⁴. These young voters, who came out in record numbers in the 2007 parliamentary and 2008 presidential elections, form the core of what some pollsters are calling «the Putin majority»³⁵.

But if, as Kremlin advisor Gleb Pavlovsky puts it, Russia today is «the house that Putin built»³⁶, it is still far from fully furnished. That task will fall to the Putin Generation. Although still very skeptical of politicians and political parties, these young people are nearly twice as likely to join a political

organization than any other age group³⁷. By a significant margin (73%), those who voted for Dmitry Medvedev expect him to further promote democracy in the country and, like most Russians, they regard the political system constructed under Putin to be more democratic, and a better safeguard of human rights, than what the country had under either Gorbachev or Yeltsin³⁸.

Some of these ambitious plans will have to be put on hold if the economy continue to decline in 2010, but it is highly unlikely that they will be entirely abandoned. Even in the present economic climate, Medvedev has gone ahead with several items on his agenda, including: easing the limits on political participation and media access imposed on small political parties, strengthening the public oversight role of the public chamber, extending the electoral terms of the president and the Duma, reforming the upper house so that only locally elected officials can become senators, allowing local city councils to remove mayors, ordering amendments to the laws on state secrets and treason to prevent them from being interpreted «too broadly», and signing into law a decree expanding public access to

³⁰ *Nostalgia for USSR Declines - Public Opinion Poll*, Interfax, December 24, 2007; G. ILYICHEV, *Slogan of the Day*, in «Izvestia», June 7, 2007.

³¹ D. POLIKANOV, *Russia's Youth*, in «Russia Profile», April 5, 2006.

³² *Nostalgia for USSR Declines - Public Opinion Poll*, cit.; G. ILYICHEV, *Slogan of the Day*,

³³ D. POLIKANOV, *Russia's Youth*, cit.

³⁴ G. ILYICHEV, *Slogan of the Day*, cit.

³⁵ S. BELANOVSKY, *V massah Medvedev vosprinimaetsia kak politik levj*, in «Russkiy zhurnal», December 13, 2007.

³⁶ M. GLIKIN, *Putin Will Remain Leader Even After 2008*, in «Nezavisimaya gazeta», April 8, 2005.

³⁷ *Young Russian Businessmen Move to Politics*, in «Izvestia», June 7, 2005.

³⁸ L. IVANOV, *Dmitrij Medvedev I demokratia*, VIPerson.Ru, March 15, 2008; *Demokratiya v Rossii*, March 23, 2005 opinion poll conducted by the Public Opinion Fund (FOM), <http://bd.fom.ru/report/map/tb051313>; *Perestroika 20 let spustya: proryv k svobode*, Gorbachev Fund, 2005; V. PETUKHOV, *Good Bad Dictator*, in «Vremya Novostei», 2006; D. POLIKANOV, *Russia's Youth*, cit.

government activity as part of his anticorruption initiative³⁹.

Many critical challenges remain: declining birth rates, the need to diversify industry and create high tech jobs, and reduce the gap between rich and poor. The gradual approach to political and economic transition taken by the Putin Plan, however, has proven to be a popular solution to an unpopular task. In a survey taken at the end of 2008, 80% cited the Putin era as the best Russia has had in a century⁴⁰. That is why Medvedev, Putin, or whoever succeeds to the presidency next will most likely continue with the Putin Plan, moving in the direction of creating, as Medvedev puts it, «an effective civil society composed of mature individuals ready for democracy»⁴¹.

How should the West respond to this goal? A bit more humility and self-criticism would be a very good start. I concur with George F. Kennan's view that «this whole tendency to see ourselves as the center of political enlightenment and as teachers strikes me as unthought-

through, vainglorious, and undesirable»⁴².

It ought to be obvious by now that Russia does not wish to be remade in anyone else's image. Consequently, it cannot possibly benefit the West to foist its own political standards, typically in a highly selective fashion, upon a country whose foreign policy toward the West has so far been remarkably benign, in that Russia defines itself as a country fundamentally within the European political tradition.

We should not assume that this benign attitude will persist regardless of Western policies. If Western politicians continue to assume that Russia has no choice but to submit to their judgments and to policies that it considers unfair, then our children may very well one day be asking us: «Mommy, who lost Russia to China?»⁴³.

³⁹ E. FOMINA, *Medvedev poradoval oppositsiju*, Strana.ru, March 2, 2009; *V Dumu napravlen presidentskij zakonoproekt o sud'be partij, ne preodolevshih bar'er v 7%*, Polit.Ru, February 25, 2009; E. DENISOVA, *Efirmoe ravenstvo*, SMI.ru, March 2, 2009; B. ARIS, *Moscow Blog: Medvedev to build model democracy*, BusinessNewEurope.eu, April 30, 2009.

⁴⁰ *Rossiane schitaiut Vladimira Putina lutshim pravitelem za poslednie 100 let*, in «Obshchaya gazeta», November 6, 2008.

⁴¹ N. ALEKSEEVA, *Dmitrij Medvedev: "Stabil'noe razvitiie v svobodnoi strane"*, VIPerson.Ru, February 12, 2007.

⁴² G. KENNAN (obituary), *Boston Globe*, March 19, 2005.

⁴³ The author of this memorable phrase is Eric Kraus. See his *Truth and Beauty (... and Russian Finance)*, *Russia's New Asian Century*, October 3, 2006, in «Johnson's Russia List», 223, 2006.

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