

# **Russia 2006**

Report on transformation

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## FOREWORD

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I have a great pleasure to present the fourth edition of the report „Russia 2006. Report on Transformation,” prepared by Economic Forum’s experts and edited by Konstantin Simonow, the President of Centre for Current Politics in Moscow.

Centre for Current Politics was created in 1992 and was initiated by a group of scholars from Russia Academy of Science and Russian-American University in Moscow, as an independent think tank. Its mission is to provide precise and accurate information and expertise.

The report is the Third Europe-Russia Economic Forum’s publication, published by the Institute for Eastern Studies. The Institute also publishes reports on Central Asia region, Energy issues and European affairs. The last one, analyses economic, political and social situation in 27 countries of Central, Eastern, Southern Europe and CIS countries.

Europe-Russia Economic Forum is a part of the Economic Forum agenda. The Forum has been held for the last 16 years in Krynica. In order to continue the debates initiated during the meeting in Krynica, the Institute organizes conferences on selected topics, in which internationally acclaimed politicians and experts take part. The aim of the Forum is to create a conducive atmosphere for the development of political and economic cooperation between the EU countries and their neighbours. The Forum is independent and impartial in fulfillment of its mission.

I would like to thank the editorial team, Centre for Current Politics and all those, who supported the preparatory works.

Zygmunt Berdychowski



Chairman of the Economic Forum Program Council

Chapter 1.

**“RUSSIA 2006. REPORT ON TRANSFORMATION”  
– MAIN THESIS**

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2006 proved to be a year confirming all the previously observed trends in the development of the state. A break-up in the Russian political elite led to the formation of alternative ways of the country's development, to the emergence of entirely different pictures of the country's future. The existence of competing nomenclature and political groups in Putin's entourage, on the one hand, enables President Putin to stay in control without allowing a destabilization of the situation. On the other hand, it increases the risks of the system. Putin is most likely to leave office in 2008, the country will have a new president. On the other hand, everybody understands that Putin will remain the most influential figure. But what power configuration will safeguard him against the risk of his successor's unauthorized behavior? How to satisfy the political ambitions of the two major nomenclature and political groups in Putin's entourage which we defined yet in our previous reports as "siloviki" and "liberals"? The duality of the Russian system remains in place, the country increasingly resembles its national coat of arms, depicting a double-headed eagle that looks in different directions.

Let us remind you that by nomenclature and political groups we understand cohesive administrative unions, "invisibles" that are not institutionalized. They act as informal alliances within which it is not vertical (i.e. relationship of subordination within a specific power institution) but horizontal relations, based on the factor of belonging to a single team of officials who may work at different government bodies, that happen to be stronger.

That is why we are speaking of two influential nomenclature and political groups, nominally termed by us as "Petersburg liberals" and "Petersburg siloviki". Even among members of these NPGs there can be disputes over tactical issues. Not infrequently they conflict over individual subjects. But strategically they act as a single team. They are united by a single goal – victory at the 2008 Elections. And either camp proposes its own variant of Russia's development.

We see a competition of the projects of Russia's future. And it is quite an interesting and novel phenomenon – the national elite is learning to think about the future and to manage it – importantly, we are talking not only their personal survival but variants of the country's development. While going through 2006, all thoughts of the political and economic elites were in fact only on the future – everything that was happening in the country was judged against the problem of continuity of power and the year 2008. Obviously, in the new year of 2007 this tendency will become even more evident. Tension in the elites is growing, there become increasingly more questions but fewer answers. At the same time, while focusing on the successor and continuity problem, the executive power forgets

about the need to address a number of socially important tasks in the economy that increase the system's risks in the mid-term. Understandably, no one wants to start painful reforms right before the elections. After the miscarriage of benefits monetization, serious innovative projects were rejected in favor of inertial development aimed at maintaining stability. Curiously, the word "modernization" in 2006 as if disappeared from the political vocabulary. Though its delay is fraught with grave negative consequences in not so distant future.

"Color revolutions" in the post-Soviet space ran out of steam, and the coming to power of a counter-elite in Russia looks highly unlikely. The financial stability of the state, thanks to high hydrocarbon prices, makes it possible to go through the pre-election season without serious social unrest. In the economy Russia's year-end results, because of oil and gas revenues, look quite optimistic. The ruble kept gaining against the dollar. The rate of industrial growth was fairly high (6-7% annually, inflation was rather high but stayed within the 10-percent limit). The country experienced a credit-consumer boom, retail trade showed unheard-of growth rates, real estate prices in Moscow easily exceeded the figures of the vast majority of world cities, similar processes were observed also in other million-plus cities, the stock market was on the rise throughout the year as well.

Thus the active clans found themselves safeguarded against a possible radical change in the elites – off-system oppositionists are still clear-cut outsiders of the political process without the slightest chance of public support or success.

Interestingly, the sentiments of panic and imminent "exile" prove to be more typical of the business community than the political elite. That is why we see a sharp increase in the volume of IPOs which can be viewed, if anything, as a form of sale of your own business to non-residents, while officials were in no hurry at all to "escape with booty". A positive result of that was that last year they managed to avoid splitting the Stabilization Fund and launch large-scale capital intensive projects at the expense of the budget. The major groups were actively involved in "fundraising" – sought funds for financing of their political projects. But in doing so, they used first of all an expansionist strategy rather than that of leaving the markets. As a result, the redistribution of property was underway not only in traditional segments of the economy, but also in rather specific markets. In most cases, the "siloviki" were particularly active – it is also true for the scandal associated with the introduction of a new system of marking alcohol products, and redistribution in the cashing market, and showdowns over control of "gray" phone supplies.

Struggle inside the elite itself will be tough and heated. All this may lead to further intra-elite fractionating – "factions" have already appeared inside major

“political parties” pushing their own agendas and showing their political and economic ambitions. New candidates for the role of an independent center of power (Yuri Kovalchuk, Vladimir Yakunin) keep coming onto the scene. Such a case scenario may unbalance the system. The elite fractioning is reflected even in the public field – 2006 saw the launch of a “second power party” project – Fair Russia which became United Russia’s major rival on the party field. Though, possibly, over time through the second power party competition between the nomenclature groups will become more open and public, and non-public politics will be reflected in public politics.

Some experts viewed even a series of high profile killings in the mid year through the lens of elite competition – the losing shadow “party” could have tried to set off a situation destabilization scenario if it had realized that Putin denied it the right to nominate a successor. But Putin not only did not sum up the results of this contest – quite the opposite, he sought to make it more intense and heated.

This being the case, Putin always has an opportunity to try and reach an administrative compromise, for example, by appointing a neutral politician who has not joined any of the groups as his successor. He took this approach, for instance, when installing Mikhail Fradkov as Prime-Minister in 2004. Perhaps, it is this scenario of the future that is most likely to materialize. Then Putin will be particularly important – it is him and not his technical successor that will be the ultimate judge. In this respect, the coming to power of a “successor” comparable in clout and power with the incumbent Head of State seems unlikely. Quite possibly, both V.Putin and most of the elite will prove interested in having two-round elections in 2008.

Part of the policy of elite management of the future is the build-up of an energy superpower which is gradually becoming a truly national idea and the ultimate task. This idea was deliberately hyped up “towards the G8 Summit” in Saint-Petersburg which became one of the most significant events of the past year. It is both the country’s and Putin’s personal project who intends, on the basis of Gazprom, to build the largest and most expensive public energy corporation in the world. And, perhaps, become Chairman of its Board of Directors after 2008. On the whole we see that Putin has shifted his attention to the energy industry, including foreign political support for creating the energy super-corporation.

It actually is a unique project – the corporation, nominally called Gazprom+, could become the only one with excellent upstream and downstream positions. Gas reserves – essentially, Russia’s trump card in XXI century, and it would be stupid not to make use of it. Putin, too, understands it perfectly realizing that Europe’s



supply diversification games are just a method of putting political pressure on the Russian Federation. In reality the possibilities of finding alternative types of fuel or alternative-to-Russia hydrocarbon suppliers are extremely scarce. And therefore Putin is offering Europe a simple deal – access to Russian production but solely in exchange for Russian concerns' obtaining interest in sales and transportation companies. It is through this mechanism that Gazprom will be making its way into the European downstream market. And without an exchange of assets foreign corporations will not be able to operate in Russia. Hence comes a review of the terms of operation of the consortium developing the Sakhalin-2 field, and Gazprom's stance on Shtokman. If you wish to participate in production projects in the Russian territory – you should open access to the direct consumer. This simple idea is perfectly consistent with the main ideological invention of 2006 – the concept of sovereign democracy. It says that Russia is building a democratic society but will be doing it on its own and will suppress any forms of meddling with its domestic affairs, breaching its security, including energy security.

At the same time Europe is trying to do some hard bargaining with Russia, getting out of its way to paint it not as a partner but an energy aggressor. It was also shown by the reaction to the gas conflicts with Ukraine in early 2006 and with Belarus late in the same year. As a result Putin is trying to split the EU unity by making special offers to two countries – Germany and Italy. In essence, we are talking about an attempt to form a tripartite gas alliance. Germany and Italy will get an opportunity, upon completion of the construction of the Nord Stream and Blue Stream-2 pipelines, to purchase large amounts of Russian gas becoming its largest distributors in the north and south of Europe, respectively. This idea is enthusiastically embraced by the energy business of these countries, but not their political leaders. The position of Angela Merkel during Putin's visit to Dresden in the autumn, when she rejected the plan for laying a pipeline to Germany from the Shtokman Field, caught Putin unawares. Merkel is still demonstrating her commitment to the Common European energy policy, not considering even the interests of her national energy companies.

It is worth noting that it is not only Russian energy companies that in 2006 were very actively expanding into foreign markets. Metallurgists were by far more successful. Particularly aggressive were Severstal, MMK and Russian Aluminum which, through merger with SUAL, announced plans for creating the world largest aluminum corporation which would hold assets in a considerable number of countries.

On the whole, it was the energy industry that completely carried away the Russian elite last year. The development rate of other economic processes was not that impressive. The state economic policy proved highly controversial. On the one hand, there was strengthening of Keynesian tendencies, which materialized, first of all, in increased funding of the so-called national projects. Expenditure on the national project 'Health' was up from 62.6 to 88.4bn rub. Expenditure on the national project 'Education' was up from 30.8 to at least 40bn rub. The expenditure increase for the national project 'Affordable Housing' in 2006 was up from 48.5bn to 212.9bn rubles. Expenditure was down in 2006 only for the national project 'Agro-Industrial Complex' - from 19 to 16.2bn rub., but in 2007 it will sharply rise.

On the other hand, the position of the Ministry of Finance, proposing to limit budget spending and not to "throw parties", also received the tacit support of the President. At the end of 2006 Alexei Kudrin successfully presented the idea of a non-oil and gas budget, according to which the bulk of excess revenues from hydrocarbon sales must be accumulated at special future generation funds rather than allocated to current expenses. Vastly helpful to Kudrin were also failures in the implementation of the national projects. A scandal around the Mandatory Health Insurance Fund revealed a high level of corruption in the utilization of budgetary funds. Many higher educational institutions, having received additional funding within the national project 'Education', proved entirely incapable of spending it efficiently. While the housing market throughout the year saw an unheard-of-for-Russia growth of real estate prices caused by failure to liquidate the corrupt system of developers close to the local authorities obtaining areas for construction for immense payoffs and artificially holding back market supply.

Apart from that, the list of national projects came to be perceived as "closed". Initiatives under the new national projects (even if approved at the top level – for example, gasification) were not declared as national priorities. The only exception was, perhaps, demography – but here Putin spoke rather about future budget spending related to the so-called mother's capital – payments of 250 thou. rubles for every second child that can be used for its education or housing purchase.

The regional policy found itself on the sideways, while the governors proved to be a "forgotten regiment". The level of interest of the Federal Center in the regional processes markedly waned. It is accounted for by the fact that the regional policy hardly has much bearing on the problems of either continuity of power or building the energy superpower – and these are the two crucial subjects of Russian politics and economy.

The policy of maintaining the “status quo” prevailed in the enlargement of regions. The enlargement of the Irkutsk Region and Kamchatka is going without a hitch, a “peaceful” accession of the Aginsk-Buryat District to the Chita Region is possible. However, in the Republic of Altai, the Nenets, Yamalo-Nenets and Khanty-Mansi Districts, the idea of liquidating the autonomies causes growing social tensions.

For United Russia the regional elections were rather successful. However UR suffered defeats at the Mayor elections in Orel and Samara and could not get the desired results in Adygeya, the Republic of Altai, Tuva, Kaliningrad, and Kirov Regions. In more than half of the regions, their heads were granted the “President’s mandate”, however there was no pushing of the process - it was even halted for a few months. As the autumn appointments show (Lisitsyn in the Yaroslavl Region and Shtyrov in Yakutia), the Federal Center is disposed towards achieving consensus even with “disputable” governors. It makes the pre-election “purging” of the Governors unlikely.

2007 – is Putin’s penultimate year in office. And the year of the State Duma elections which will anyway be perceived as a warm-up of the electorate before electing the President in 2008.

It can be forecast that the next president of Russia will not hold office more than once and that he will prove a relatively a weak and “light-weight” political figure. Moreover, the successor will not be elected triumphantly, in the very first round, but, to all appearances, only in the second with a slim advantage over his rivals. It is required as a safety net for Vladimir Putin, who will continue to actually run the country even after his official resignation, against excessive ambitions of the third President of the Russian Federation. By the way, it cannot be ruled out that in the course of such electoral “casting” both official candidates – Dmitry Medvedev and Sergei Ivanov – will cross swords to determine the winner in a head-to-head showdown.

However, the most important problem facing Vladimir Putin will be to maintain the intra-elite balance and prevent a direct clash of interests of the leading elite groups – “siloviki” and “liberals”. It will prove an uphill task, since each of them fears that in the event of Putin’s leaving office, the “status quo” will be radically upset to be followed by a “black redistribution” of administrative and business resources based on the “winner takes it all” principle.

Therefore, in terms of the 2007 prospects, two scenarios – a compromise and a conflict one, are worth consideration.

The first variant presupposes a relatively seamless exit from the process of power transfer in 2007-2008. It will happen if a “compromise” figure of Vladimir Putin’s successor is picked or the incumbent President of the Russian Federation for whatever reasons will extend his tenure. In which case, the national establishment will continue to put pressure on the nomenclature groups, whose status will be directly dependent on their “capitalization”, that is possession of power resources (first of all, economic and information ones). By the way, it is not ruled out that in this case, going by the principle: “if you can’t beat your enemy – embrace him”, the NPGs will enter into a kind of inter-elite “non-aggression treaty” which will be pinned up by the foreign policy challenges and interests of joint business expansion overseas. The concept of “sovereign democracy” taken as the ideological basis for the forthcoming Duma campaign can also prove “conciliatory” – its provisions (interpreted, though, differently) are by and large consonant with the ideological and political priorities of practically all elite groups.

There will be a completely different scenario of the administrative situation development, if the tough confrontation between the nomenclature and political groups continues. It is not ruled out that in the absence of a clear-cut leader and uncertainty over the successor candidate for Vladimir Putin, the inter-elite struggle will enter a maximally conflict-prone phase accompanied by a sharp increase in the political activity of the opposition forces, growing instability in the country, high-profile assassinations designed to drive a wedge into the elite political community, play its different elements against each other, trigger a surge of violence. In which case, a significant role in the instigation of intra-elite struggle will be played by “anti-system” internal and external forces, since a disintegration of the “double lineup” team of Vladimir Putin will largely mean also a collapse of the governance “power vertical” and total chaos in the country.

Even if during these troubles, the current political regime manages to cling to power, it will suffer substantial image and resource damage. Moreover, in the event of a total victory of one of the NPGs over its rivals it will be followed by a severe purge of the “rival’s” representatives holding government offices and belonging to the business community.

As for the party and political prospects, here election of the fifth State Duma of the Russian Federation will become the most important event, which in many ways (at least, in administrative terms) will turn into a competition of the two “power parties” - United Russia and Fair Russia. Yet, it cannot be ruled out that their confrontation will be largely an imitation, while on the whole they will work to get as many electoral votes as possible. In the end, the first place will be taken

by UR though it will hardly have a constitutional majority at the State Duma, while the second place will be in the sights of several structures at once - Fair Russia, CPSU and LDPR. As far as the “right” forces are concerned (SPS, Yabloko), they are most likely to get the right to participate in the elections but will fail to agree on a common list and will run in two “columns”. Furthermore, in their striving for a *carte blanche* to be among the winners, they will reduce the level of opposition rhetoric, but eventually they will hardly be allowed to overcome the 7% barrier.

Such a balance of power in the Lower Chamber of the Russian Parliament will make it possible to perform the “Successor” operation relatively quietly and “according to plan” and later legitimize the new President through the “pro-authorities” majority of the State Duma.

Having said that, in 2007-2008 public protest activities will be growing. It is due to several factors. Firstly, the very heat of the election struggle will provoke growing demands of different categories of the population who will try to capitalize on the “favorable” conditions in order to make their claims heard by the authorities. Secondly, “public politics” may intensify resulting from attempts of individual political structures to try and play the “populist card.” At last, thirdly, Russian authorities represented by the leading nomenclature groups must be prepared for the attempts by the radical opposition and certain external forces to destabilize the situation in the country, or even have a go at the “orange scenario”. In other words, in any event underestimation of the “olchocratic” factor in modern Russian politics, treatment of the population solely as an “electoral biomass” may lead to absolutely unplanned results.

Nevertheless, the availability of significant financial resources (as a result of high energy prices) allows the authorities to, by and large, successfully curb protest sentiments. It is true not only for such key areas as politics and economy, but also for the related fields. For example, increased financing of science, education, medicine, military and industrial complex not only enables their development but also secures the loyalty of the employees involved in these industries. Moreover, individual categories of the population (doctors, teachers) may become “advocates” of the official course during the 2007-2008 elections.

At the same time it can be predicted that economic problems in 2007 will pale into insignificance. The leadership of the country will totally give up on carrying out “unpopular” infrastructural reforms in favor of a “socially oriented” policy. Accordingly, economic risks will grow (communications depreciation, energy supply problems, workforce shortage, etc.) whose exacerbation later may seriously compromise Vladimir Putin’s successor.

Private business is unlikely to suffer as well: most Russian “oligarchs” have already pledged allegiance to some or other influential administrative groups and “successors”, domestically there are almost no lucrative “available” economic assets left, therefore, to all appearances, 2007 will become a period of relatively peaceful co-existence of the entrepreneurial community. This being the case, part of them will make use of the situation to consolidate its positions inside Russia, while others – on the contrary will make attempts to export capitals abroad so as to avoid post-election risks. It is largely in this context that the IPOs of some Russian business structures may be viewed in the future.

It is safe to say that on the eve of the new election cycle, both the NPGs and official successors will be actively promoting the idea of creating an “energy superpower” and expansion of leading Russian companies into foreign markets. In this respect, state-owned companies Rosneft and Gazprom will prove the most active.

As for the foreign policy, on the eve of the commencement of the power transition process it will find itself almost in the spotlight of the Russian political leadership. The point is that in any case international legitimization of the past parliamentary, and later – presidential, elections will be required. That is why it is not on Putin’s agenda to exacerbate the relations with the West (above all, the US) which are currently setting the democracy criteria for this or other election campaign as well as for this or other regime on the whole. Furthermore, after leaving his office Putin plans to retain not only domestic but also foreign policy influence, therefore he will do all it takes for the results of the “Successor” operation to be recognized at the international level.

The regional policy till the end of 2007 will prove to be among rather peripheral activities of the leading administrative groups, since there are no serious electoral threats coming from the constituent entities of the Russian Federation in sight. Except, maybe, Chechnya, whose leadership (and, first of all, Ramzan Kadyrov) will try to reap maximum benefits from the favorable political conditions: in view of the willingness of the Federal authorities to demonstrate to the Russian public the “ultimate establishment of peaceful life in the Chechen Republic”. Therefore the Federal Center will have to make serious political and economic concessions – only to avoid an exacerbation of the situation in this North-Caucasian republic. Less important but anyway rather significant preferences will be granted also to the regional “heavy-weight” leaders, like President of Tatarstan Mintimer Shaimiev and Moscow Mayor Yuri Luzhkov.

While on the whole, on the eve of the elections the governors are hardly in for a serious rotation. Perhaps the only exception will be Head of Buryatia Leonid Potapov who will lose his office in the spring of 2007 - officially due to the expiration of his tenure but unofficially - due to his active play against the regional enlargement process.

Chapter 2.

## **POLITICAL SITUATION**

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## 2.1. The Problem of Power Continuity as a Key Issue of Russian Politics

Practically during the whole year the elite was expecting an answer to the question which was eventually becoming more and more «strategic» - how will the power continuity be provided? Despite the numerous statements Putin made earlier about the undesirability of amending the existing Constitution regarding revocation of the norm on the impossibility to hold the presidential post more than two terms in succession, the variant of «prolongation» of Putin's stay in power had been considered as one of «working» variants till the autumn. Judging by the indirect signs, *the «power» part of the elite was exerting certain pressure upon President with the purpose to make him remain for the third term* (different variants were offered, including the ones which formally did not breach the Constitution). One can explain this persistence by the fact that this elite subgroup (especially its «Sechin's» segment) does not have its own «promoted» candidate for the successor's position and faces the risk of losing its main assets after the change of power, since the bigger share of them (in particular, Yuganskneftegaz) has been acquired by means of purely administrative «power» methods without further legitimation by means of mass media in the eyes of population and international community.

October 25<sup>th</sup> became the «Zero hour», when [President] during his annual «hot line» with population has finally declared about the impossibility to change the Constitutional law. In the result, *the issue on the successor has immediately become the actual one*. Vladimir Putin, by virtue of his high public rating, will play a significant role during promotion of his successor; however, one should not write off the lobbyist opportunities of elite groups. President, in turn, is not in a hurry to officially confirm his «Lame duck» status, and back-pedals with the official announcement of the nominee, which results in certain nervousity in the Russian elite environment. This «silence» is not in unison with the interests of the main elite groups which are interested in the certainty and predictability of political process, and it provokes weakening of Putin's regulating role in the intra-elite conflicts. The persisting uncertainty concerning the successor's candidature is also provoking elites for their independent search of him. In particular, in December there appeared rumors that the nomenclature and the political group of «radical force politicians», led by the assistant to the head of the Presidential Administration Igor Sechin, which was considered to be the firm apologist of the third term, while maintaining such positioning in the information realm, has

actually reoriented itself onto the search of President's successor who would become the most acceptable to the group.

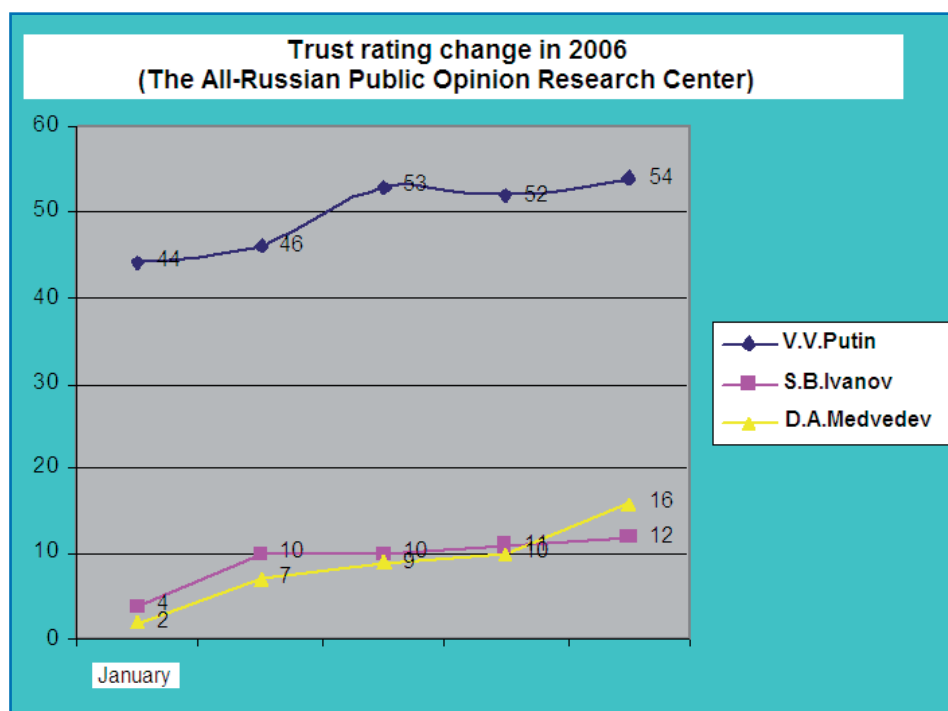
**«Officially» it is accepted to consider that now there exists a competition between the two successors** – the first Vice Prime Minister Dmitry Medvedev («liberal») and Vice Prime Minister, Minister of Defense, Sergey Ivanov («silovik»). Apart from the presidential support, the basis for their status of «successors» is their performance at the top levels of the executive power with significant volume of powers and responsibility, which is considered to be the necessary condition of the candidate's «socialization». Prime Minister Michael Fradkov occupying a higher position has the status of the «technical» Prime Minister and cannot be considered as a serious candidature.

**It is possible to separate two aspects among the peculiarities of this «competition».** First, both candidates stress in the public space that they are called to resolve specific tasks in the areas of activity assigned to them; therefore they have no time (nor wish) for competition. Both Medvedev and Ivanov keep on repeating that they are too busy to be engaged in such sort of rivalry, and Medvedev has even declared in his interview to NTV about his concern on the occasion that he has been added on to the participants of presidential race and he narrated about his friendly relations with Sergey Ivanov. This «race» looks very contrasting compared to the competition of the two «ruling parties» - United Russia and Fair Russia, leaders of which frequently «out of principle» take opposite positions on various issues of public resonance. Such tactics of the two «successors» is caused by the second feature of the competition – specifics of the target group which is the aim of their actions. This group is represented by only one person – Vladimir Putin, whose public support will largely define the success of the presidential candidate during elections.

Trust ratings of both politicians (by the results of interviews performed by the All-Russian Public Opinion Research Center) has been slowly growing in 2006; insignificant rating fluctuations were of the situational character, in many respects they depended on the politicians' exposure in mass media. Generally, the ratings were fluctuating around 10%, though D.Medvedev's rating in December reached 16%, and on the whole in 2006 the first Vice Prime Minister's positions looked more advantageous. All these figures look modest enough: they show that not only there is no leader in the competition of successors, but there is not even a person enjoying essential confidence and authority with the population.

Judging by the interviews and by the general public mood, Dmitry Medvedev, who is at present the «uniform» candidate from the «liberal» grouping, is winning

at the edge in the race of successors in 2006. He was actively engaged in 2006 into promotion of his main resource – the national projects, in which connection he made trips around the country and CIS states and made political statements.



*Medvedev's speech at the international economic forum in St.-Petersburg in June, 2006, was actually the program speech. On the one hand, it was the program of the candidate for the post of President-2008, on the other hand – the plan of strategic development of Russia.* Medvedev was even ahead of Vladimir Putin on the eve of the Security Council's session. It strikes the eye that the first Vice Prime Minister, considered to be the candidate from the «liberals», oriented, in the first place, towards the «the Big Eight» countries, in his speech paid a lot of attention to promotion of the Russian interests in the East. He mentioned, in particular, India and China as partners – i.e., the countries, the contacts with which are in the focus of the «power» grouping. And on the whole, Dmitry Medvedev's message was rather aimed at the foreign audience, than at the Russian elite.

On June 20<sup>th</sup>, 2006, the session of the Security Council of the Russian Federation was held; it was devoted to the issues of the long-term strategy of the country's development, such as Russia's technological inferiority compared to the

developed countries, the demographic crisis and the threat to national security. The issues considered at the enlarged session of the Security Council have already been mentioned by Vladimir Putin in his Message to the Federal Assembly. Discussion at the Council's session, in its turn, was called to develop the program of specific measures for their implementation, and two of the three key issues on the session's agenda were within the direct competence of Dmitry Medvedev and Sergey Ivanov.

Medvedev, to whom Vladimir Putin entrusted in May supervision of all provisions of the presidential message connected with implementation of the demographic program, was in a better position originally. He has got the opportunity to appeal to the fact that national projects are «long-term», and it takes certain time for the first improvements to appear in the process of their implementation. Medvedev is responsible for the intra-Russian aspect, including the birth rate increase and the death rate reduction, while there is also another component of the demographic program – creation of favourable conditions for compatriots who express their voluntary desire to return to Russia. The program on rendering assistance to them envisages compensation of their migration expenses, the lump sum allowance for settlement and the monthly allowance (during six months), as well as the social services' package. Assets will be allocated for implementation of this program, and the interdepartmental commission headed by the assistant to President Victor Ivanov, traditionally belonging to the power block opposing «liberals», will have to administer the funds.

Improvement of the demographic situation, according to the plan of Vladimir Putin who, by the way, suggested to transform the National Projects Implementation Council into the National Projects and Demographic Policy Implementation Council, should become the fifth national project. Medvedev considers the demographic program to be a quite expensive mega project. He made the statement at the Security Council's session that the additional target financing in the amount of 195 billion rubles without consideration of indexation is needed to improve the demographic situation.

And although the first Vice Prime Minister did not name the source from which these assets will be allocated, nor he specified the period during which they should be spent, and whether the emphasis will be made on the increase of the birth rate in the country or on the reduction of the death rate, too, – now not only he is responsible for implementation of long-term social programs – actually the function of «the rescuer of the nation» is entrusted to him. However, he did not suggest a concrete actions' plan for which this money could be allocated. Though, the «responsible for demography» can write down as his achievement the

acceptance by the State Duma in the first reading of the bill on «mother's capital» which should be referred to the category of rather «populist» bills.

On the next day after the Security Council's session, Dmitry Medvedev at the meeting of the governmental commission on development of TV and radio broadcasting, where he is the chairman, made another «socially oriented» statement: he demonstrated his care of needy citizens who might not find money to buy new equipment during the expected transfer of the Russian television to the digital broadcasting format.

Thus, with his summer statements Dmitry Medvedev has demonstrated his vision of the problems the country is facing and his intrinsic realism in his approach to their solution to people, and, what is more important, – to President.

***The chairman of the Audit Chamber Sergey Stepashin turned out to be almost the only «large scale» critic of Dmitry Medvedev in 2006.*** In one of his speeches he called into question the success of implementation of Priority National Projects, the money for which, in his opinion, in most cases so far has not even been allocated at all. The Affordable Habitation project, according to the head of the Audit Chamber, exists only on paper; at that «doubtful» schemes already appear around it. Stepashin considers the project connected with optimization of the public health care system in Russia to be problematic, too. Negative and hard enough estimation of any activity connected with implementation of national projects has been sounded for the first time by the official of such high level as Sergey Stepashin. Although Medvedev, who is supervising national projects, is not mentioned in this context, the criticism by the head of the Audit Chamber should be put down exactly on his account. By the way, in the expert environment the version was put forward that the purpose of such severe criticism is to weaken Dmitry Medvedev's positions, and thus Stepashin is acting in favour of the other candidate for the position of the successor – Sergey Ivanov.

The address of organizations of the Russian manufacturers of agricultural produce to President in which it was stated that the national project «Agroindustrial Complex Development» does not meet expectations and is under the threat of failure became another disappointment for the first Vice Prime Minister. And on September 30<sup>th</sup>, at the session of the Public Chamber dedicated to the Russian public healthcare problems, ***Dmitry Medvedev indiscreetly supported the Minister of Health and Social Development, saying that this far Michael Zurabov is coping with his functions.***

The first Vice Prime Minister of the government, who considers the implementation of projects to be satisfactory, recently carried out a whole series of

actions devoted to this theme, which led to some increase of his rating. Dmitry Medvedev considered that the main problem of implementation of projects lies in the bureaucracy; he threatened careless officials with dismissal and intervention of the General Prosecutor's Office in the structure of which with Yury Chayka's coming the respective «profile» division was created for supervision of observance of the due course of law in the area of projects' implementation. Moreover, one should expect that in future not only he will act as the «generous donor» of social benefits, but will play the role of a strict judge for those who hampers implementation of national projects.

On October 5<sup>th</sup>, in Moscow the enlarged session of the Council for Implementation of Priority National Projects was held. The project Affordable Habitation, the most actual and painful of the four existing projects was the first to be discussed, followed by the one of not the less importance, concerning public health service, and during the last session of the National Projects Council Vladimir Putin dedicated his report to problems of agriculture. Summarizing the first results of implementation of the housing project has already brought about some administrative replacements – the Assistant to President Igor Shuvalov was appointed the head of special commission under the National Projects Council which will deal with issues of housing construction and interaction with regions on this issue, thus depriving Vladimir Yakovlev and the Ministry of regional development headed by him of the part of their functions, which for a long time has been criticized for its inability to resolve issues connected with housing.

***The national project of Affordable Habitation is the most actual and the most problematic one at that, and in this situation Igor Shuvalov should help Dmitry Medvedev*** who, in the opinion of some experts, if not started to lose his positions in the second half of 2006, at least paused in his political growth. This happens largely because of the situation around national projects, implementation of which goes with great difficulty. Such state of affairs is also favourable for Dmitry Medvedev because in case of the unsuccessful development of the situation in the area of housing construction (which is more than probable) he can disclaim all the responsibility, putting it up to Igor Shuvalov.

The «liberal» orientation of the assistant to Vladimir Putin, as well as the fact that Igor Shuvalov is the man of President of Russia, gives rise to no doubt; so one may assume that his actions have been directly initiated by the head of the state which, proceeding with building the system of checks and balances, has sensed the activization of representatives of the «power» grouping, first of all of Igor Sechin, and certain weakening of Dmitry Medvedev's positions.



On October 22<sup>nd</sup>, the first Vice Prime Minister took part in the TV show «Sunday night» with Vladimir Solovyov on the NTV channel. *The speech of Medvedev, who became the main and the only hero of the program, has been estimated by expert community as the program speech which triggered off the presidential electoral campaign of 2008.* Each time during his infrequent public speeches Dmitry Medvedev was getting certain handicap as the more «fresh» candidate than the Minister of Defense, and found himself in somewhat advantageous position. He was getting the opportunity to transform his speeches into program speeches as it happened in the above mentioned public appearance in St.-Petersburg.

The national projects' «rehabilitation», the detailed discussion of which started in September when they were one year old and continues till now, is one of his main tasks. Dmitry Medvedev tried to let everybody know in the kind form, that the projects are long-term ones and cannot quickly resolve social problems which have accumulated in the country.

However, this far the projects called to improve the life of population do not pay their way in full, and the main reason of their so far unsuccessful implementation at the federal level is that they are insufficiently elaborated and calculated. At the local level there is a lack of officials' understanding of what needs to be done, and sometimes even open obstruction can be met. At that, each project is based on the selectivity principle, which does not promote popularization of the idea of national projects on the whole. And the degree of awareness of the population about them is not too high, as it was revealed by interviews in 2006. Thus, Dmitry Medvedev found himself to be the hostage in his sphere of competence for which he will have to continue to be responsible in future, at that it is not known how the implementation will go on. Apparently, at that the situation develops in such a way that the first Vice Prime Minister has no other significant resources, if not to count the support of Gazprom, the problems and successes of which are of much less interest for Russian population than the affordability of habitation.

In 2006 Medvedev has visited several regions in connection with implementation of Priority National Projects. So, for instance, in August the first Vice Prime Minister visited Bashkortostan where, among other things, he was also engaged in the affairs connected with the activity of Gazprom. Implementation of the Affordable Habitation national project, which attracts the increased attention now, became the main topic of Dmitry Medvedev's visit. It is enough to recall the General Prosecutor's Office request to the Federal Antimonopoly Service to check the reasons of the unprecedented rise in the real estate prices in Moscow.

During his summer holiday which proved to be rather relative, Dmitry Medvedev did not miss the chance to check how Priority National Projects are implemented in the Far East.

In September he visited China where he met with the administration of the State Council of the People's Republic of China and took part in several non-political actions under the aegis of the year of Russia in China. Most likely, his meeting with the President of the Chinese National Oil and Gas Corporation was one of the main objectives of his visit; this event took place even before the beginning of the official visit of the first Vice Prime Minister and remained to be almost unnoticed by the Russian mass media. China, being an important strategic partner of Russia, lately attracts the enhanced attention both of the power grouping representatives (Rosneft), traditionally focused on the East, and the liberal grouping (Gazprom), whose interests are represented by Dmitry Medvedev.

The trip to Kazakhstan during the same month, the purpose of which was to prepare for Vladimir Putin's visit, allowed the first Vice Prime Minister to get acquainted with the experience of the southern neighbours in implementation of social programs similar to Russian National Projects. Upon his return to Russia Dmitry Medvedev held the meeting with members of the government and big business representatives, the main subject of which was the discussion of the opportunity to change the tax system in the sphere of real estate which, according to his plan, should lead to reduction of prices for habitation. The next year's national defense expenditures in the federal budget are planned in greater amount than the expenditures for articles concerning social sphere and national projects, but Dmitry Medvedev may count on the success in lobbying subsidies for the regions, his visits to which will be certainly continued in 2007.

On November 15<sup>th</sup>, 2006, the Deputy Chairman of the Board of Directors of Gazprom and the General Manager of Gazpromneft Alexander Ryazanov, who represented the interests of the «power» elite grouping, was dismissed; the personnel replacements which were favourable, in the first place, for the company's Chairman of the Board of Directors Dmitry Medvedev have occurred in Gazprom, because the top positions became occupied by relatively «neutral» figures. Valery Golubev, who will become the deputy to Alexey Miller, is the former colleague of Vladimir Putin by the work in the city hall of St.-Petersburg and the former employee of the state security bodies, which allows drawing a parallel with appointments of new executives at the Ministry of Internal Affairs which took place simultaneously. Both Oleg Safonov and Evgeny Shkolov have had the school of service at KGB and are personally familiar with President of the country.



One more factor also is common for the situations with appointments in Gazprom and at the Ministry of Internal Affairs – the interest of Victor Ivanov, assistant to President of the Russian Federation supervising personnel issues in the Presidential Administration. On the one hand, appointment of relatively neutral figures to the team of Rashid Nurgaliyev, who is the ally of Nikolay Patrushev, became a positive moment for Victor Ivanov as the representative of one of competing «power» subgroups. On the other hand, resignation of the former head of Gazpromneft Alexander Ryazanov who represented Ivanov's interests in the gas monopoly, too, is the strategic defeat both for the «personnel» team, and for the «power» grouping in general.

Gazprom resources are Dmitry Medvedev's basic resources, and any weakening of «siloviks» within the limits of gas monopoly is beneficial to the first Vice Prime Minister. Gazprombank, which also owns Gazprom-media with the company's media assets concentrated in it, is the basic element of the «power» grouping in Gazprom.

The results of the political year for Dmitry Medvedev are ambiguous. On the one hand, he has consolidated his positions as of the first Vice Prime Minister in the result of appointment of the «liberal» grouping adherents to important positions, made a series of successful program statements and increased his international popularity. On the other hand, his rating remained to be fluctuating around 10%, not very much (within the statistical error limits) differing from his main competitor's rating.

All this speaks, in the first place, of the dependence of the first Vice Prime Minister on how his activity is covered in mass media, and second, of his popularity growth rates being far from expected. The main explanation of this lies in the uncertainty which appeared in the course of implementation of Priority National Projects, probably including a rather poor administrative experience of the first Vice Prime Minister. One more reason which does not allow Dmitry Medvedev to win the hearts of the potential voters is his insufficiently pronounced (or, perhaps, poorly displayed) leader qualities or, in other words, the absence of charisma. And Medvedev looks too young on the background of «respectable» Sergey Ivanov.

Successor №2, Vice Prime Minister Sergey Ivanov, has lost some of his positions last year. The reason for this is the factor which, at the first sight, provides him an advantage – an earlier start compared to Dmitry Medvedev. Despite the fact that both main candidates to the successors got their positions of Vice Prime Ministers practically simultaneously – in November, 2005, – Sergey Ivanov had already been the Minister of Defense almost during four years. This

excluded for him the opportunity, unlike Dmitry Medvedev, to position himself as an administrator called by President to clear away the «Augean stables» from the very start. The situation in the area of defense, especially from the point of view of «human» dimension, is tense enough in Russia. Abuse in the army and during call-up for the service and other drawbacks make the official, who is responsible for this area of activity, a convenient target for criticism.

Sergey Ivanov's position was seen as more perspective during the first half of the year. Not having the burden of quite risky national projects, unlike Dmitry Medvedev, he knew exactly which way to go. Ivanov chose two main directions of his activities within the limits of the competition of successors.

The first and foremost was to redistribute powers and resource control functions by means of reforming the control system of the Armed Forces, in particular, the system of the government's defense order. The necessity to fight with the unauthorized use of assets by the participants of the defense order implementation process, which is in line with the «anticorruption» general political conjuncture in Russia, is named as one of the main motives for creation of the agency dealing with ordering arms, military and special equipment.

The second direction includes measures for improvement of the image of the Minister of Defense which means creation of various newsbreaks or the positive coverage. So, publications on development and supply of new kinds of arms to the army appeared in the press regularly. At the same time, the information that air defense units have not registered launching of seven North-Korean missiles was hastily denied by Yury Baluevsky, the Chief of General Staff of the Armed Forces; he explained that these launches did not threaten the country's safety. Shortly afterwards the Minister of Defense declared that Russia was going to acquire 58 up-to-date Su-34 bombers.

At the same time the Minister of Defense tried to «gain his points», demonstrating his professional efficiency. So, he declared that the spring draft was implemented by 100%, which had not happened until recently. Approximately at the same time Sergey Ivanov announced about reduction of the number of military commissariats and rotation of the officer personnel at the military enlistment offices, which should also contribute to the decrease in the corruption level in the Armed Forces' system. The public's opinion about his initiatives to create «public councils» at military units for eradication of «hazing in the military» and corruption was rather positive.

By the middle of the year 2006 President Vladimir Putin who is not interested in the continuous consolidation of any of the candidates to the «successors», took

a series of steps aimed at the «slowdown» of Sergey Ivanov's influence growth rate. On June 20<sup>th</sup>, 2006, at the session of the Security Council of the Russian Federation, Vladimir Putin criticized heavily the situation in the sphere of the country's safety, for which, unlike Medvedev in case with demography, Ivanov had been responsible for a long time already, and the head of the state could make more serious claims against him. So, for instance, President of the Russian Federation noted that reformation of separate branches of the military industrial complex is going too slowly. It is remarkable that during this session Medvedev's activity was not exposed to criticism at all.

It became clear that Sergey Ivanov's seemingly advantageous position in comparison with that of the first Vice Prime Minister, who has no extra responsibilities apart from his position, is actually far from this. Being also the Minister of Defense, he becomes responsible for the department headed by him and for the problems it has. These problems – both strategic and routine and repeating ones – are many, and everybody is aware of them: drafts, hazing in the military, low officers' salaries, retirees' problems, worn-out material resources, etc.

Approximately at the same time the Minister of Defense became the next after Dmitry Medvedev object of criticism by Sergey Stepashin, the head of the Audit Chamber. Although Ivanov's name was not mentioned, the information that the military department is inefficiently using large amounts of the budget means may be regarded as a stone cast at him. Despite the fact that, judging by the policy Sergey Ivanov carries out in relation to the Ministry of Defense (e.g., the situation connected with implementation of the government's defense order), his positions at the Ministry are not as strong as it may seem from outside; and in the consciousness of the population any army problems are related with the name of the «power» Vice Prime Minister.

So, in the summer of 2006 the situation with Sergey Ivanov's image changed to the worse. The speeches of his «competitor №1» at the international economic forum in St.-Petersburg and at the Security Council's session were more convincing than the analogous program speeches of the Minister of Defense. Unlike the first Vice Prime Minister, Ivanov's speech contained the report on the well-known directions of work of the Ministry of Defense, connected with the military industrial complex in general and the Armed Forces in particular; and practically no specific proposals for «optimization» of the situation were suggested. In general, this speech at the forum was quite standard and rather looked as a speech of an official supervising the military industrial complex, rather than that of Vladimir Putin's successor.

By and large, the activity of the Ministry of Defense in 2006 did not look successful, and, on the one hand, the implemented reforms confirmed this fact, while on the other hand they suggested that Sergey Ivanov would not specially weaken the structure subordinated to him if he had the full control of the situation. The matter is that during the change of the system of formation and implementation of the government's defense order, the Military Industrial Commission will be engaged into its formation. Since January 1<sup>st</sup>, 2007, the Ministry of Defense will lose its functions concerning conclusion of contracts for the purchase of arms and material support of the Armed Forces, – these functions will be delegated to the specially created Federal Agency for the supply of arms, military and special equipment with its direct subordination to the Government of the Russian Federation. On the other hand, to whom this new structure can be subordinated in the Government if not to the Vice Prime Minister Sergey Ivanov who is supervising this block?

Sergey Ivanov, despite his belonging to the «power» nomenclature political group, cannot be considered as its full-fledged candidate, partially due to his complex relations with Igor Sechin and other leaders of the nomenclature political group. In the autumn of 2006 the Minister of Defense started to play his own game, trying to emphasize his independence and seriously conflicting, for instance, with Sergey Chemezov, concerning the defense order issues. Before appointment of Chayka and replacement of Savenkov by Fridinsky, he conflicted with Chief Military Prosecutor and, respectively, with Ustinov, but he was rather «defending» himself against «attacks» from the ex-General Prosecutor. Ivanov is even better known abroad than Medvedev, owing to his ministerial post. The responsibility for the army is rather bringing to Ivanov minuses than pluses so far; an indicator here is «Sychev's case» which was instigated with Ustinov's efforts and which could be softened only after his resignation.

The case of bullying Andrey Sychev, private of the support battalion of Chelyabinsk tank institute became the most notorious «military» incident of the last years. The events of the new year's eve of 2006 cost the young man his physical invalidity, and for a certain number of military bosses resulted in the loss of their positions and career. This case reflected the peculiarities of the Russian Army on the whole and of the military justice in particular. Sychev's case influenced the political position of minister Sergey Ivanov in the most direct way. Officers and generals of the Ministry of Defense made an «ill service» to their head, trying to pressurize prosecution witnesses and to shift the responsibility onto Military Prosecutor's investigators, who allegedly took illegal actions. This

activity became the public domain, which was also beneficial to Sergey Ivanov's opponents.

On September 26<sup>th</sup>, 2006, the main accused on Sychev's case, junior sergeant Alexander Sivyakov was sentenced by the Chelyabinsk garrison court to 4 years of imprisonment. Both prosecution and defense declared that they will insist on revision of the court's decision. From the formal point of view the process is not finished yet, but already now it is possible to summarize it.

The Chelyabinsk court's decision seems to be the trade-off variant. Sychev's case, which lasts for nine months already, has gone through several stages. Being a reflection of the processes happening in the modern Russian Army, it has seriously undermined the image of the Minister of Defense Sergey Ivanov. Wide coverage of the process in the federal mass media prompted that the interested parties tried to transform Sychev's case into a show case.

Development of this process became the reflection of the clash of interests between the Minister of Defense, on the one hand, and ex-General Prosecutor Vladimir Ustinov and the former Chief Military Prosecutor Alexander Savenkov, on the other hand. At that time, on the background of antagonism in the «power» environment, the confrontation outlined between Sergey Ivanov and Igor Sechin, whose interests were expressed by Vladimir Ustinov. This is why the former General Prosecutor, using the available resources and powers, did the maximum possible to enhance the resonance of Sychev's case. In his turn, Sergey Ivanov even declared about his intention to create special lawyers' service at the Ministry of Defense for protection of interests of soldiers and officers.

The situation has changed radically after Vladimir Ustinov's resignation and appointment to the position of General Prosecutor of Yury Chayka who, most likely, was instructed to neutralize the negative attitude towards the Ministry of Defense and Sergey Ivanov personally. Alexander Savenkov was one of the first to be dismissed, and other assistant to General Prosecutor Sergey Fridinsky was appointed to his position. After that relations between the Ministry of Defense and Chief Military Prosecutor became warmer and started to improve. As the result, Sychev's case started to collapse, and the main accused got a relatively short term of imprisonment, although General Prosecutor demanded a more severe punishment for him.

The trade-off decision was adopted, which became the result of the unwillingness of political elites to aggravate the situation. By and large, the heat was taken off Sergey Ivanov, and the sentence of acquittal would look too defiant. However, if one considers Sychev's case more globally, one must recognize that it has extremely negatively affected the image of the Minister of Defense.

Thus, in the autumn of 2006, the «power» grouping headed by Igor Sechin actually found itself without its candidate for «successors». The Minister of Defense, who was considered to be the one, started to play his independent game, trying to assume maximum of powers and opportunities connected with the military industrial complex, at that, openly affecting the interests of Sergey Chemezov, the head of Rosoboronexport, playing an important role in the «power» grouping. In the resulting circumstances this strategy seems to be the correct one, because Vladimir Putin can prefer in the end a formally independent candidature to a representative of the interests of any of opposing forces, keeping in mind preservation of the relative balance of forces with the purpose to prevent aggravation of the political situation on the eve and during the electoral campaign of 2007-2008.

The degree of Sergey Ivanov's presence in the media field in 2006 was pretty high. At that, one way or another, he is the representative of the power structures which gained their political points during the first half of 2006 on liquidation of Shamil Basaev and successful «preventive» measures against radical oppositionists on the eve of the G-8 summit. Nevertheless, Dmitry Medvedev more often outscored Sergey Ivanov in confidence rating during the year.

However, the Minister of Defense remained in 2006 to be one of the main newsmakers in the Russian political space, but not always he found himself in the advantageous position. So, within the limits of discussion of the federal budget for 2007, Vladimir Putin called the Minister of Finance Alexey Kudrin to resolve the problem with monetary compensations to the retired servicemen for the food ration, with the result that Sergey Ivanov, who was supporting cancellation of these compensations, again showed himself at a disadvantage.

Having met his American colleague Donald Ramsfeld on August 28<sup>th</sup> in Alaska, Sergey Ivanov returned to Russia where within the short period of time he managed to create several important newsbreaks. First, he assured the public that reduction of the active service period from two years to one year, expected starting with 2008, will not result in the increase of the service age, and transition to the contract army will be carried out at a high pace. Second, he informed of the planned increase of the budget expenditures both for the military industrial complex on the whole, and for the government's defense order in particular. At that, it is expected to spend more money than before for re-equipment of the Armed Forces, instead of their upkeep. This should lead to the increase of the role of the Military Industrial Commission headed by Sergey Ivanov. This sort of statements speaking of gradual normalization of the situation in the Russian Army



should contribute to the increase of the rating of confidence to the minister who has to be responsible for everything what happens in the areas subordinated to him. Simultaneously with this the work on improvement of Sergey Ivanov's image was performed by other directions, too.

Upon expiration of a little over one week after Medvedev's statement on the NTV, Sergey Ivanov has made a statement of the same sort, informing that so far he does not plan to participate in presidential elections. Everything what is happening looks rather as the proof of the intrigue on the background of Vladimir Putin's statements that he has firmly decided to leave in 2008, but at that he has not determined his «successor» yet. It looks that, with all the sincerity of the Minister of Defense, he distanced himself from the possible presidential perspective only because there was no corresponding «instruction» from the top, and Sergey Ivanov, one of the most reliable pillars of the vertical of power, will obligatorily think of this should such order be given.

It is indicative that Sergey Ivanov started in 2006 to use Dmitry Medvedev's tactics to some extent, making visits to Russian regions. Having spent his vacation in Kamchatka region, he then visited Magadan, Primorski Krai and Chukotka. However, Dmitry Medvedev was ahead of Sergey Ivanov, for instance, having visited Vladivostok several days earlier.

Upon returning to Moscow the Minister of Defense was appointed by Prime Minister Michael Fradkov to be responsible for the safety of flights of civil and military aircraft. This decision by its scale and uncertainty can be compared to assigning to Dmitry Medvedev the task of supervising the demographic situation in the country. Most likely, Sergey Ivanov's actions connected with solution of problems of civil aircraft and his opposition at this front to the Minister of Transport Igor Levitin were the attempt of the Minister of Defense to attract additional organizational and financial resources.

At the end of the year Sergey Ivanov made a series of quite important statements of populist character. At the traditional meeting of the key personnel of the Armed Forces in November, 2006, the Minister of Defense announced about creation of the public council at the Ministry of Defense, introduction of the civil control by parents of the compulsory-duty servicemen, as well as the 40% increase of the money allowance to officers and contract soldiers by the end of 2008. These statements were especially important in connection with the recently closed Sychev's case which has certainly left a negative «deposit» in the public consciousness, as well as new legal claims, where the military department is the respondent, including the claim initiated by the relatives of the

submariners who died on board of nuclear submarine K-159 of the Northern fleet on August 30<sup>th</sup>, 2003.

As already mentioned above, Sergey Ivanov is not «silovik» in its true sense of word – in many ways he should be considered as some compromise figure who, when needed, could find the common language with «liberals» (unlike the «radical siloviks» represented by Sechin).

The rating of confidence of population to main candidates to the successors has been growing from November, 2005, when they got the vice prime minister positions, by lower rates, than it was planned. This conclusion can be made if one analyses the sociological research (performed by the All-Russian Public Opinion Research Center) from beginning of 2006. The rating of Sergey Ivanov, already quite known politician at that moment, first revealed a certain growth tendency, then it was fluctuating within the limits of 4 – 10%. Dmitry Medvedev, who had not been a public figure before his administrative promotion, although he started with the 2%, which is within the error limits, also reached the level of 15% by the end of the year. Dmitry Medvedev's low rating appears to be especially noticeable on the background of his publicity rating which owing to Priority National Projects has grown very essentially since November, 2005. Apparently, the same national projects do not allow the first Vice Prime Minister to count on the trust of the population. The increased attention which the authorities and mass media pay to him, are combined with the absence of specific results at the local level and with their criticism, which sounds often enough, including the criticism by top officials.

All this creates the sensation among the population of the country that «the state is cheating once again». Dmitry Medvedev is to some extent the «hostage» of these projects – in the same way as Sergey Ivanov has been till now and, despite the numerous statements, still continues to be the «hostage» of the situation existing in the Armed Forces.

On November 14<sup>th</sup>, Chairman of the Council of Federation Sergey Mironov in his interview to Independent Newspaper stated that both probable successors of Vladimir Putin, Dmitry Medvedev and Sergey Ivanov may take leading positions in the state.

Mironov, who during the whole year 2006 continued his vigorous activity in the political and media space of the country, gave several long interviews to the biggest Russian mass media, touching, in particular, on the subject of Vladimir Putin's power continuity. Among other variants the scheme was suggested under which both of the probable successors – Dmitry Medvedev and Sergey Ivanov – would become the first state officials, who may get the positions of President and



the Prime Minister of the country. It is indicative that a little earlier the same assumption during his visit to the USA was made by the Chairman of the Board of Directors of the RJSC EES of Russia, the «informal» Russian «negotiator» Alexander Voloshin.

This sort of statement for the first time is sounded by a government official of the level of Sergey Mironov who usually prefers evasive answers to questions on the probable successor of Vladimir Putin. Mironov has chosen the compromise variant, having named both candidates, but, not specifying who of them will take the post of President and who will become the head of the Government. Such variant of preservation of friendly neutralism with Sergey Ivanov and Dmitry Medvedev is at present the most beneficial for Chairman of the Council of Federation, who is «equally distanced» from both, especially in view of the fact that President of Russia Vladimir Putin yet does not give his preference to any of the candidates, providing them both with equal opportunities to reveal themselves.

Different experts name up to 15 candidatures from among the so-called «informal» successors. With equal degree of probability one may assume that President will make his choice on one of them. With the same degree of probability one may admit that the successor will be chosen from beyond this list.

The majority of experts during 2006 named Vladimir Yakunin, the head of one of the most powerful natural monopolies in the country – OJSC Russian Railways – as number one from among the «informal» successors. In June some mass media spread the unverified information on the change of the government's structure, on the appointment of German Gref as another Vice Prime Minister. It was also supposed that for the sake of the balance of forces between «siloviks» and «liberals», apart from Gref, one more Vice Prime Minister can be appointed from the «power» environment; otherwise the overbalance of «liberals» among Vice Prime Ministers would become overwhelming. The issue whether Gref will continue to be the minister, like Sergey Ivanov, remained to be open. If not, then even the transfer of the weakened Ministry of Economical Development to anyone from the power grouping representatives will not be a serious loss. But appointment in compensation of someone from «siloviks» to the post of Vice Prime Minister, without combining this post with other position, may, among other, entail the loss of control over some other strategically important direction. By some last summer's estimations, Vladimir Yakunin, the head of OJSC Russian Railways, could also happen to be this person.

He was one of those whose name was referred to as the potential buyer of Kommersant publishing house, eventually acquired by the Director General of Gazprominvestholding and the co-owner of Metalloinvest Alisher Usmanov, who belongs to the «lawyers'» environment.

Nevertheless, Yakunin did not or would not declare loudly enough of his presidential ambitions during the year. Besides, he is not the person from Vladimir Putin's inner circle, and in case of election he may start to implement too independent policy. However, at that his refusal from the high position at United Russia in December, 2006, looks «suspicious» and it gives grounds to assume that Yakunin aims at the higher-priority «non-party» administrative position. By the inside dope, Vladimir Putin gave Yakunin his personal «advice» to abstain from membership in United Russia.

A series of events which have occurred already in the beginning of 2007 testifies in favour of consolidation of Yakunin's positions. In particular, the data appeared on the possible purchase by the structures close to the head of Russian Railroads of Komsomolskaya Pravda publishing house which «has appointed» its associated ESN group – the formal buyer of the publishing house – for management of its media assets. Media-Partner Holding (the affiliated structure of ESN) has been formed specially for media assets management in January, 2006; and its only asset (apart from Komsomolskaya Pravda) is Publishing House RZhD-Partner which, apart from the magazine with the same name, includes the advertising agency Reklamotiv and magazine Sackvoyage-SV. Despite the change of the owner (Russian Railroads), RZhD-Partner magazine continues to be strategically oriented at the monopoly. Most likely, ESN carries out the role of the «trustee manager» of Russian Railroads, which is done with the purpose to position these editions as independent from the monopoly. On the eve of elections Russian Railroads creates the media assets consolidation center, in the management of which ESN is engaged.

Possibly, Vladimir Yakunin, apart from the assets controlled by Russian Railroads, will be able use the assets of the new influential elite group, conditionally named Russians, as the resources. This group includes Russia bank, Surgutneftegaz, Severstal and the oil trader Gunvor which exports at least a quarter of the Russian oil. The group also supervises REN-TV and the Broadcasting Company Petersburg. The owner of Gunvor and one of shareholders of Russia bank Gennady Timchenko (the former colleague of Vladimir Putin) and the shareholder of Russia Yury Kovalchuk are named among the group's leaders.

Russian Railroads and Russians (Timchenko in the first place) are connected by their closely interlaced interests. First of all, both Gunvor, and Russian Railroads have close partner relations with Severstal Trans Company – one of the largest commercial carriers. Earlier Vladimir Yakunin used to be the member of the Board of Directors of Russia. The fact that the connections between Timchenko and Yakunin have been retained is proved by appointment in July, 2006, of Igor Romashov, who earlier used to be Director General of Transoil and Link Oil SPb companies, connected with Timchenko, to the position of the head of the Federal Agency of Railway Transportation.

Most likely, appearance of this alliance and its consolidation was supported by President Vladimir Putin. Two main elite groups («siloviks» and «liberals») have been considerably fragmented during the last year and the resulting subgroups started to fight with each other. This has decreased their controllability by President and caused the necessity of appearance of the new elite group. One of the necessary conditions of its existence, apart from its orientation directly at President, is its leaders' closely interlaced interests, which essentially reduces the probability of appearance of the intragroup conflicts. At that, the group represented by Yakunin can obtain a relatively known (even though «unpromoted») leader, because the leaders of Russians Timchenko and Kovalchuk are extremely closed figures and evade contacts with press. At the same time Vladimir Yakunin is relatively known and is not responsible for such socially unsuccessful management segments as medicine, habitation, agriculture (Dmitry Medvedev) or the army (Sergey Ivanov).

Two «regionals» are named among other successors – the Governor of St.-Petersburg Valentina Matvienko and Head of Presidential Administration, the former Tyumen governor (2001-2005) Sergey Sobyenin. Valentina Matvienko is self-confidently governing in St.-Petersburg and, most likely, enjoys the full confidence of President, which was once again proved during on December 6<sup>th</sup>, 2006, when she addressed about the early termination of her powers as of the governor of St.-Petersburg and raised the question of confidence. V.Matvienko explained such her decision by the complexity of the forthcoming year, as the elections to the legislative assembly of St.-Petersburg and the parliamentary elections were expected, and it was necessary to keep the stable authority in the city. President did not refuse his credence. V.Matvienko, possessing a large work experience at the top positions in the Government of the Russian Federation and management of the Northern capital, certainly, may be the «successor» of the second turn.

Sergey Sobyenin was appointed the head of the Presidential Administration in November, 2005, – immediately after the transfer of the former head Dmitry Medvedev from this position to the position of the first Vice Prime Minister. Originally his candidature was considered as «technical» because Sobyenin was a representative of the regional elite and until recently had no significant personnel and other resources in the capital, despite his six-years' stay in the position of the head of the Constitutional Legislation Committee of the Council of Federation. His attempts to transfer part of his team to Moscow have met the fierce resistance from the «veterans» of the administration's management.

However, in the beginning of 2007, there appeared the information on activization of Sergey Sobyenin's administrative activity. First, he was ascribed the organization of anti-Semigin «revolt» in the Duma People's will fraction. Earlier, with the effort of political technologists of the Presidential Administration, Sergey Baburin was moved to the honourable but actually representative position of the vice-speaker from the fraction, and his place was occupied by the leader of the Patriots of Russia Gennady Semigin who is known as the organizer and main sponsor of the split of the Communist Party of the Russian Federation. Initially Sergey Baburin's attempts to reconsider this casting unprofitable for him did not bring results. However, later on he united his efforts with the leader of the Socialist United Party of Russia, Vladimir Putin's personal judo coach Vasily Shestakov, which put Semigin's leadership into question. Presumably, Sergey Sobyenin is the shadow organizer of this demarche.

Most likely, this demarche is an element of the combination conceived by Sobyenin for formation of fraction controlled by him in the State Duma; the last week there was the information that Semigin was ready to join the Shestakov-Baburin alliance. At that, the candidatures of Sergey Glazyev and Alexander Lebedev are considered among potential participants of the new fraction. In case of successful implementation of the project the new fraction will have the number and the influence comparable to the Communist Party of the Russian Federation. Its function will consist in implementation of ideas of the «official nationalism», taking over the initiative from the Congress of Russian communities and partially from the Communist Party of the Russian Federation. The fact that, according to some sources, the final revocation of the bill on banning meetings during pre-election period happened right after Boris Gryzlov's conversation with Sergey Sobyenin, also offers that positions of the head of the Presidential Administration in the State Duma are strengthening.

It is remarkable that the original initiative on creation of the new fraction belonged to President's representative in the State Duma Alexander Kosopkin

who is said to be closely connected with Sechin. His support of Prime Minister Michael Fradkov, who is also connected with Sechin's people, also speaks in favour of the administrative union of Sobyenin and Sechin's supporters. Some analysts speak about Sobyenin's support of Fradkov's candidature as the successor; however this variant seems to be extremely improbable. From Sergey Sobyenin's last administration achievements one may name the appointment of the official who is close to him – the former General Prosecutor of Tyumen region Ernest Valeev – to the position of the Assistant to the General Prosecutor of the Russian Federation.

Up to the mid-summer 2006, then General Prosecutor Vladimir Ustinov was mentioned as the candidate for successor from «siloviks» headed by Igor Sechin, but his resignation from the high position and his transfer by diagonal to the chair of the Minister of Justice with deprivation of significant powers hints that the stake will not be made on him.

Ustinov's resignation has led to appearance of different rumors around the further development of his political career. The three versions dominated among them – the start of preparation for the presidential elections of Russia, his appointment as the assistant to President and replacement of Dmitry Kozak with him in the position of the plenipotentiary in the Southern Federal District. On the eve of proposing the candidature of Yury Chayka to the Council of Federation, Vladimir Putin assured that Ustinov will continue working at the state service, and in the position equivalent to the one he occupied earlier. However, at this moment, the position of the Minister of Justice in the administrative hierarchy is far from being adequate to the position of General Prosecutor, considering the fact that more or less significant directions of work of the Ministry of Justice include control over the activities of political parties and public organizations, penitentiary system and the institute of court enforcement officers. Thus, Vladimir Ustinov's opportunities to influence the occurring processes have considerably decreased.

Sergey Stepashin became noticeably more active in 2006. One of the «candidates of the second turn», he concentrated his main efforts on the fight with corruption. In the beginning of June the round table discussion was held at the Audit Chamber concerning the issues of fight with this social malady during which Stepashin announced about detention by the Federal Security Service of one of employees of his department for bribery. In the result of special operation, the assistant to one of the auditors of the Audit Chamber was arrested on the fact of acceptance of a bribe in exchange for exclusion of «adverse» data from the materials of the audit by the Auditing Chamber of Transaero Company. Later

Stepashin, having discharged three more of his employees, achieved the dismissal of auditor Vladimir Panskov «of his own free will».

At the same time Stepashin addressed the State Duma and the Council of Federation with the request to be more attentive to appointment of auditors of the Audit Chamber, and suggested to perform in the department the anticorruption examination of the bills considered by the State Duma.

Apart from the fight against dishonest officials, Stepashin was consolidating positions of his own department. In the middle of the year Vladimir Putin held a meeting with him after which the decree of the government was promulgated, obliging all the structures receiving budgetary financing, in the first turn, largest budget means recipients – federal ministries and departments, – to submit to the Audit Chamber on the monthly basis financial reporting for spending budgetary funds by the forms approved by the above mentioned Cabinet of Ministers' decision.

In July the official criticized several significant Russian political figures at once. Roman Abramovich became the first one openly accused by the head of the Audit Chamber of the «incorrect use» of the budgetary funds at the expense of using the internal offshore zones.

Stepashin also placed in doubt the success of implementation of Priority National Projects including the Affordable Habitation which, by assessment of the head of the Audit Chamber, exists only on paper, at that «doubtful» schemes are already appearing around it.

From the point of view of political engagement Sergey Stepashin is the inconsistent enough figure if one recollects his political career history. On the one hand, by definition he should belong to the «power grouping» as the former head of the Federal Security Service, ex-Minister of Justice and ex-Minister of Internal Affairs. On the other hand, his «democratic past» during the period of the verge of 1980-1990-ies and his participation in fraction Yabloko (Apple) when he was the deputy of the State Duma allow referring him to the category of politicians liberal by their belief. Despite the aforesaid, at present it is possible to call the head of the Audit Chamber a relatively neutral figure, who is not affiliated closely with any of the opposed groupings.

Stepashin who has not been involved in loud scandals has established his reputation of the man of principle, and in 2006 (especially in summer) also of the fighter with corruption, including his own department. And this activity, as known, is one of priorities of Vladimir Putin's internal policy without the support of which Stepashin would hardly be able to keep the position of the Chairman of the Audit Chamber already during over six years. In general, several experts state that



Stepashin, with the corresponding PR support, may become a quite good candidature for the position of Vladimir Putin's successor – should there be the current President's desire for that. Stepashin's candidature is the most convenient for Vladimir Putin from among the «second turn» figures also because Sergey Stepashin has got the reputation of the responsible and initiative executive focused on the top power and incapable of playing his large-scale independent game. President with such psychological characteristics would quite satisfy Vladimir Putin who is going to retain the essential influence on processes which will take place in the country after his resignation.

The speaker of the Council of Federation and the leader of the new Fair Russia party Sergey Mironov has certainly got the presidential ambitions, but very latent. He is too dependent on Vladimir Putin to somehow reveal these ambitions. This far, he is satisfied with the position of the leader of the party claiming to become the second «ruling party» after United Russia.

In 2006 Mironov time and again stood up for protection of the Constitution, rejecting the possibility of the third term, and after the Kondopoga events he made the statement about the necessity to change the national policy – generally speaking, he was among the first roles in the information realm. However, the main event of 2006 for Mironov certainly was the creation of the really competitive United Russia party after the merger of the Russian Party of Life, Rodina (Motherland) party and the Russian Party of Pensioners. Such association is certainly beneficial to Sergey Mironov. If his career as of an independent politician is developing quite successfully, the Russian Party of Life headed by him until recently cannot boast with any significant success. The experience of the majority of regional elections demonstrates that ideas of the party attracting significant sponsors' assets for performance of electoral campaigns are not too close to the Russian electorate, which prefers political forces with more definite ideological orientation. Even the consistent orientation on President's policy on which the Russian Party of Life made the stress during the spring campaigns, did not allow it to achieve big success.

Sergey Mironov hardly expects to become Vladimir Putin's successor, but he will not refuse from having a «spare ruling party», which can be differently used depending on the development of the political conjuncture. The variant is possible that the new association will work in the long term for someone from the potential President's successors.

In 2006 the political comments also involved the speaker of the upper chamber Boris Gryzlov as a candidate for successors. Probably, he should also be

considered as a transitional figure for the period 2008-2012, but not more than that. Dmitry Kozak, President's plenipotentiary in the Southern Federal District, was also sometimes mentioned in the same quality. There was the information on D.Kozak's candidature as the candidate for replacement of Ustinov at the General Prosecutor's position with the further promotion up to the position of President. Kozak's belonging to Vladimir Putin's inner circle is his big advantage; his current remoteness from the federal Center must be marked as his disadvantage; this is the consequence of this politician's tendency to be independent and firm.

The name of Sergey Chemezov, Director General of Rosoboronexport, often appeared in mass media in 2006, mainly in the context of opposition to Sergey Ivanov after the control not only over the defense export, but also over the defense order. Chemezov's positions have become considerably stronger at the end of the year: his organization obtained the control over export of the largest domestic arms manufacturing companies, and on December 2<sup>nd</sup>, 2006, at the VII congress of United Russia in Ekaterinburg Chemezov was unanimously elected to the party's Supreme Council. His personal meeting with President Vladimir Putin (with whom he has been in friendly relations since the times of their joint service in the German Democratic Republic) may be considered as the growth of influence of the head of Rosoboronexport. However, so far this person should not be considered seriously as the potential successor, because of his low publicity in the country.

One should not exclude that one of the governors who proved his business qualities and loyalty can become the transitional figure. The Krasnodar governor Alexander Tkachev has been named in such quality more often than others.

## **2.2. Changes in the Structure of Executive Power and Staff**

Last year «siloviks» have considerably consolidated their administrative and personnel positions, traditionally preferring the administrative resource to the media one. This became both the consequence of the change in the executive power structure, and, in the first turn, personnel replacements, the peak of which matched November. Such consolidation can be considered as compensation for the absolute domination of «liberals'» representatives in the information realm (apart from Sergey Ivanov's activity). And «siloviks» in this struggle acted not as one consolidated group, but by separate «fractions», and frequently consolidation of one of them was accompanied by weakening of the other.



Signing by President of the Russian Federation of the decree On Counteraction to Terrorism can be named as the most significant administrative «novel». Pursuant to this document the National Antiterrorist Committee (NAC) will be formed, headed by Nikolay Patrushev, director of the Federal Security Service of Russia (FSB). Thus, one can speak about the significant growth of «siloviks'» political resources. Since decisions of the Federal Operative Headquarters are obligatory for all state bodies, representatives of which are included into its structure and into the structure of the operative headquarters of the constituent entities of the Russian Federation, it means that in the certain situation «siloviks» can get practically unlimited authorities.

The presidential decree provides for introduction of the principle of one-man management during elimination of consequences of an implemented act of terrorism and fighting terrorists. Now implementation of the first priority measures in such circumstances is delegated to the head of the corresponding regional structure of the Federal Security Service. He carries out management and coordination of all other «siloviks» and the state authority bodies until beginning of work of the local operative headquarters which reports directly to the federal headquarters. Such increased attention to «antiterrorist» activity is caused by the consideration that unsuccessful actions of the authorities on liquidation of the consequences of terrorists' attack shortly before elections can entail rather serious consequences and endanger implementation of the «Successor» project.

First «testing» of the National Antiterrorist Committee was performed in the middle of January, 2007, when the state of emergency was introduced practically for the four days all over the country (in fact, without its legal registration). Information from the unnamed «foreign colleagues» who (presumably) informed on the group of terrorists which were going to implement an act of terrorism served as a pretext for these actions. The actions taken by the governmental bodies after they received the information from the National Antiterrorist Committee became the biggest ones during the existence of the post Soviet Russia. Practically all constituent entities of the Russian Federation have been covered by them; antiterrorist actions have involved 100% of objects in the sphere of railway and aviation transportation. The measures on protection of the structures of OJSC RAO EES of Russia have been also enhanced without the prior notification receipt. In the Moscow underground the mobile communication was disconnected for 24 hours on January, 17<sup>th</sup>, because, as the previous experience has shown, activation of explosive devices and coordination of activity of terrorists in most cases happen with the use of cellular communication means. It is necessary to note, that, by the

messages from public sources, cellular operators complied with the oral request of the representatives of law enforcement bodies and received the written instruction from them only post factum. On Friday, January 19<sup>th</sup>, by the order of Nikolay Patrushev, the head of the National Antiterrorist Committee, from 06:00 all law enforcement bodies' divisions were transferred to the regular mode of performance of duty.

One should note that last year a certain erosion of the notions «liberals» and, especially, «siloviks» happened, which was the result of the apparent internal fragmentation of these elite groups. The resources' redistribution process is in full swing here. During the five years' time the power grouping has elaborated an effective administrative warfare toolkit. Now they are using their «achievements» against each other. There are influential players in the «power» group who would like to raise their administrative status. For example, the head of Rosoboronexport Sergey Chemezov has been aspiring for a long time to get connected to the main projects of the grouping, the more so that not only the financial streams of the military industrial complex are concentrated in his hands, but also those of the car assembling industry, which will allow him to diversify the projects' financing forms.

Sharp activation of resources' redistribution inside the «power» grouping has happened after creation of the Military Industrial Commission. Vladimir Putin has signed the decree by which he has delegated the activity coordination functions of all military industry structures to this permanent commission headed by the Vice Prime Minister of Defense Sergey Ivanov.

This induced the latter to start his fight for the control over the defense order. However, here Ivanov has met the hard resistance from the main players in the military-industrial complex. He needed several months to find the forms of intervention into the defense order planning and distribution. By now Ivanov has managed to gain over several heads of defense enterprises, which became part of the commission, having abandoned their former positions. It is Alexander Goev, Director General of Krasnogorsk factory named after Zverev; Vladimir Pospelov, Vice-President of the State Nuclear Shipbuilding Center (Severodvinsk), the former head of Rossudostroenie, and Alexander Bobryshev, Director General of the Novosibirsk Aircraft Building Association named after Chkalov. With their support Sergey Ivanov is hoping to find common language with other heads of defense enterprises. The events of recent time offer that Sergey Ivanov and Sergey Chemezov's interests started to discord. The Minister of Defense ceased to be under control of the «silovik» grouping and is trying to play his own game, having a certain basis for this.

Such change of the intralite layouts induced Sergey Chemezov to take the response actions. In the middle of the year he suffered the administrative defeat when he did not manage to lobby through the candidature of his assistant Vladimir Pahomov for the position of the head of Rosoboronzakaz. Sergey Maev who is working in the direction set by Sergey Ivanov has been appointed to this position. However, this balance can change together with the change of the structure of Gosoboronzakaz. During 2006 the Center for orders and supply of arms, military and special technical equipment and material resources has been created. In 2007 on its basis the Federal agency for orders and supply of arms, military and special technical equipment and material resources must be created (initially it was supposed, that it would be created by the end of 2006). The scope of its authority will exceed the possibilities of Rosoboronzakaz, as the new structure will perform supplies to all power departments, which will considerably increase the administrative weight of its head (the agency will report directly to the government). In the second half of last year the struggle for the position of the head of the new structure started already. In particular, the PR-campaign started, which was called to prove the inadmissibility of appointment to the top positions in the agency of retired military men which is beneficial to Sergey Chemezov, who is the head of the formally «civil» department.

Resignation of General Prosecutor Vladimir Ustinov became a serious stage in the struggle of the opposed groupings. The changes in the administration of the General Prosecutor's Office and the Ministry of Justice which happened after this in the middle of June, 2006, in the end turned out to be a castling. Nobody expected such development of events not only in the expert community, but also in the «corridors of power». Among the reasons of resignation they name the unsuccessful administrative move of Ustinov who, wishing to strengthen his status of the fighter with corruption has brought to President the materials compromising his nearest environment. The prepared by the General Prosecutor's Office large-scale audit of the activity of company LUKoil, which had to grow into the «YUKOS case» N° 2, might serve as another reason of the resignation. Supposedly, the final purpose would be actual absorption of LUKoil by Rosneft, which would considerably strengthen the resource base of Sechin's company. President, who does not wish that big enhancement of any of the parties, and also apprehending the negative reaction of international investors, was forced to resort to extreme measures.

Suggestion by Vladimir Putin of Yury Chayka's candidature for the position of General Prosecutor became an unexpected move for the majority of observers.

The struggle for General Prosecutor's position was considered in the light of opposition between the «liberal» and «power» groupings. For this reason such neutral figure as Yury Chayka was not considered as the possible claimant; the candidates promoted by elite non-party groupings, plenipotentiaries Dmitry Kozak and Alexander Konovalov, as well as acting General Prosecutor Yury Biryukov appeared to be the most realistic candidates.

Judging by the fact that more than two weeks passed from the moment of Vladimir Ustinov's resignation until the candidature of Yury Chayka was suggested, President of the Russian Federation, most likely, did not have an unambiguous solution, which was caused by the complexity of the administrative situation. Yury Biryukov is «Ustinov's man»; therefore his appointment would mean restoration of the same balance of forces which existed before the resignation, i.e., Igor Sechin's influence on the General Prosecutor's Office would practically remain the same. The appointment of Dmitry Kozak to this position would become even bigger weakening of the «power» grouping; and, most likely, it was for this reason that Vladimir Putin, generally inclined to preserve the system of checks and balances, did not take this measure. Otherwise Kozak, known for his determination, would unleash a heavy «clean-up» of his political opponents. At the same time, Alexander Konovalov's insufficient administrative «weight» did not allow him to actually count on such sudden «promotion» and the immediate entrance to the top spheres of «the big policy».

Yury Chayka became the compromise figure not belonging to any of the opposed sides, which generally suited everybody: «liberals» were happy with the departure of their old hard opponent and «siloviks» – with that their opponents did not manage «to impose their will» on the General Prosecutor's Office. Respectively, this appointment has been positively commented practically by all outstanding public politicians. Yury Chayka, who used to work earlier in the General Prosecutor's Office, is not involved in any scandals and intrigues or in lobbying anyone's interests. Exactly this sort of person, by the idea of Vladimir Putin, should be at the head of the General Prosecutor's Office. Having won the confidence of President of the Russian Federation, he will be oriented in his activity mainly at the head of the state and will execute his political will.

Right before proposing the candidature of Chayka to the Council of Federation Vladimir Putin assured that Vladimir Ustinov will continue to work in the state service in the position, equivalent to the one he occupied earlier. However, at this moment the position of the Minister of Justice in the administrative hierarchy is far from being adequate to the position of General

Prosecutor, considering the fact that more or less significant directions of work of the Ministry of Justice include the control over activities of political parties and public organizations, penitentiary system and the institute of court enforcement officers. Thus, Vladimir Ustinov's opportunity to influence the occurring processes has considerably decreased. Vladimir Ustinov's appointment can be regarded only as a partial compensation to the «power» grouping for the loss of the General Prosecutor's Office.

If one estimates the results of the casting Ustinov – Chayka, one can say that on the whole it has weakened the positions of «siloviks», which lost the control over the General Prosecutor's Office and did not get the compensation adequate to this loss. «Siloviks» can add to their assets the only circumstance that a relatively politically neutral person became General Prosecutor (although recently Chayka more often has been working in «tandem» with Dmitry Medvedev). Appointment of Dmitry Kozak would be a much worse variant for them. Kozak, who in these circumstances was expected to get promoted, still remains to be the plenipotentiary in the Southern Federal District, and this far he is an «exception to the rules» as the person from Vladimir Putin's inner circle not having a worthy position near President.

The first assistant to General Prosecutor, to the position of which Yury Buksman, the former head of the Department of the Federal Registration Service in Moscow was appointed, from now on will not supervise the investigation block as before, but will concentrate on the general supervision issues.

The international legal department got the status of the main department and it will be dealing with issues of extradition of Boris Berezovsky, Julia Dubova, Ahmed Zakaev and other Russian emigration figures residing in the Great Britain. It seems that this task is going to become the top priority for the General Prosecutor's Office. Yury Chayka's first statement in his new position was dedicated to this subject; he promised to send the interdepartmental delegation to London to clarify details of the case. By the way, Vladimir Ustinov's inability to achieve extradition of Berezovsky and of other «political emigrants» was referred to as the possible reason of his resignation.

The federal legislation observance supervision department got the status of the central board, and the analytical structure was created within its framework, which will be engaged in the assistance to implementation of Priority National Projects, including analysis of the normative and legal acts at the local level, where, in the opinion of Yury Chayka, implementation of these projects is sabotaged.

In the same board, for the first time in the General Prosecutor's Office the department will be created for supervision of observance of the legislation on the state and municipal service, which main function will be countermeasures to corruption. Large-scale checks of several federal executive power bodies and of the structures subordinated to them took place at the end of the year, which, in particular, resulted in the arrest of executives of the Obligatory Medical Insurance Fund.

The loud «furniture case» also got its continuation. Its renewal was a blow on Yury Biryukov, «Ustinov's man», whose appointment to the position of General Prosecutor would be the best variant for the power grouping. Biryukov, unlike Vladimir Ustinov, could not stop renewal of the case. Possibly, Vladimir Putin intervened here too, as it already happened in 2002.

The Ministry of Internal Affairs became the department in which the largest personnel replacements have taken place in 2006. The first appointment was that of Vladimir Putin's «schoolmate» by the Leningrad state university, who used to work in the system of the Leningrad Prosecutor's Office as the head of Investigating Committee at the Ministry of Internal Affairs. This may lead to destabilization of this structure's activity. The matter is that in the Ministry of Internal Affairs they are not happy with those who come from the Prosecutor's Office because of the old «departmental opposition». As the result, ignoring by the investigators' body of the new administration can end up with reduction of Anichin's influence to the minimum.

On November 15<sup>th</sup>, 2006, Vladimir Putin made several replacements among the top officials of the Ministry of Internal Affairs of Russia. Resignation of general-colonel Andrey Novikov, who supervised the criminal militia service of the Ministry of Internal Affairs, from the post of the Deputy Minister of Internal Affairs became the main one. His place was occupied by Oleg Safonov, one of auditors of the Audit Chamber, who started his career working at the state security bodies; after that he worked together with Vladimir Putin at the External Relations Committee of the city hall of St.-Petersburg. Apart from that, Evgeny Shkolov, who until recently held the post of the Vice-President of JSC Transneft, was appointed to the position of the head of the economic safety department of the Ministry of Internal Affairs. During Soviet time Evgeny Shkolov also worked at the state security bodies, where he got acquainted with the current President of the country. He took the place of general-lieutenant Sergey Meshcheryakov who, in his turn, became the head of the Department on Fighting Organized Crime and Terrorism, which for a long time remained without its permanent head. Besides,



the Minister of Internal Affairs Rashid Nurgaliev, who on the day of staff replacements was reporting to the State Duma on the issues of fighting extremism and corruption, got a new assistant – Michael Vanichkin, the former head of the Municipal Department of the Internal Affairs of St.-Petersburg and Leningrad region, whose place was occupied by one of his assistants.

The expert community did not have an unambiguous opinion on the reasons of the performed replacements. Different versions included continuation of the campaign on fighting corruption, «technical» personnel substitutions and the beginning of the gradual and carefully planned campaign on the structural and personnel reorganization of the system of the Ministry of Internal Affairs.

From the formal point of view, Deputy Minister Andrey Novikov who was dismissed without indication of his next position was the only one who lost in the result of these replacements, but, according to certain information, the reason of the dismissal was neither Andrey Novikov's professional impropriety, nor any facts pointing to his involvement in any corruption scandals. Andrey Novikov has achieved considerable successes in the crime solving rate, and, probably, his resignation will lead to his promotion. Positions of the Minister of Internal Affairs and of the President's plenipotentiary in the North West Federal District are named as options.

Nevertheless, these serious replacements demonstrate that the state of things in the system of the Ministry of Internal Affairs is not quite good, and President has made an attempt to solve the problem by the personnel replacements which may also have the character of a shake-up. Both Oleg Safonov and Evgeny Shkolov, being the people from the presidential reserve, who have gained their experience working at KGB, at the same time are not the permanent staff of the Ministry of Internal Affairs, i.e., professionals in this area; this, by the way, cannot but cause negative reaction of the department employees. Thus, it is possible to say that the purpose of the appointments was to perform assessment of the existing situation in the system by people who are quite good managers from the point of view of President of the country who takes decisions on personnel.

Also during the whole second half of the year there were the persistent rumors about creation of the power «superdepartment» – the Federal Service of Investigation subordinated directly to President. It was supposed to be created on the basis of the Investigating Committee and to include the investigatory branches of the Federal Security Service and of the Prosecutor's Office. However, the rumors did not prove to be true. They may have been groundless, but one also should not exclude that Vladimir Putin simply did not want to end up with another



significant reinforcement of the administrative positions of any grouping of the «power» wing.

Among «liberals», German Gref, the Minister for Economic Development and Trade, became the party which suffered most from the structural and personnel changes. In May, 2006, by the order of President Vladimir Putin, the Federal Customs Service earlier subordinated to the Ministry of Economical Development, was resubordinated directly to the government, i.e., to Prime Minister Michael Fradkov. At the same time the head of the Federal Customs Service Alexander Zherikhov retired «at his own free will», and the former head of Rosoboronzakaz Andrey Belyaninov was appointed to his place. This personnel castling is said to have been connected with Vladimir Putin's discontent with practically full corruption of the customs service (earlier President spoke about it practically in plain language). The disfavour character of this resignation is also supported by the fact, that Zherikhov did not get any significant appointment in the executive power system. Andrey Belyaninov after his coming to the Federal Customs Service performed a large-scale clean-up. In particular, on May 15<sup>th</sup>, deputy heads of the Federal Customs Service Yury Azarov and Leonid Lozbenko were dismissed. On June 15<sup>th</sup>, Nikolay Volobuyev, Deputy Head of the Federal Customs Service, was dismissed. Also deprived of their positions became the Chief State Customs Inspector of the Customs Value Control Department of the Central Federal Customs Revenues Department Maria Arkhipova, the Head of the Customs Value Control Department Irina Sukhareva, the Chief State Customs Inspector of the Department of Coordination and Application of the Risk Control System of the Customs Control Organization Head Office of the Federal Customs Service Zulfia Rakhmatullina, the Head of the Department of Interaction with Taxation and Supervisory Bodies of the Customs Inspection of the Federal Customs Service Maxim Baranovsky, as well as several heads of regional customs. In December Belyaninov dismissed Evgeny Rybakov, the Head of the Central Power Customs. The Central Power Customs occupies the strategic position in the Federal Customs Service, as it processes the energy carriers' supplies.

On September 11<sup>th</sup>, 2006, Yury Zhdanov, the Head of the Federal Agency for the Management of Special Economic Zones, was dismissed. Resignation of Zhdanov from his post looked somewhat unexpected and mysterious. It was only obvious that the reason of dismissal of the general-lieutenant of the Ministry of Internal Affairs was not connected with his professional qualities. Within the short time he managed to launch the complicated project providing creation of special economic zones. One may say that special economic zones were the brainchild of

Zhdanov, who started to deal with this subject when he was the Deputy Minister of Economic Development; later he became one of the main developers of the law On Special Economic Zones. After this he headed the federal agency specially created within the Ministry of Economical Development and Trade.

Yury Zhdanov had the reputation of the talented organizer capable «to promote» a most difficult project quickly and with good quality, he has never been involved in scandals or dark stories, and the information on the connection of his resignation with the Three whales' case was disproved – Yury Zhdanov had been working at the State Customs Committee only for a few months, and he was not engaged in the customs and furniture issues when working at other departments. The only thing which can be supposed is that people like this always have ill-wishers, and, probably, Yury Zhdanov's success caused someone's envy.

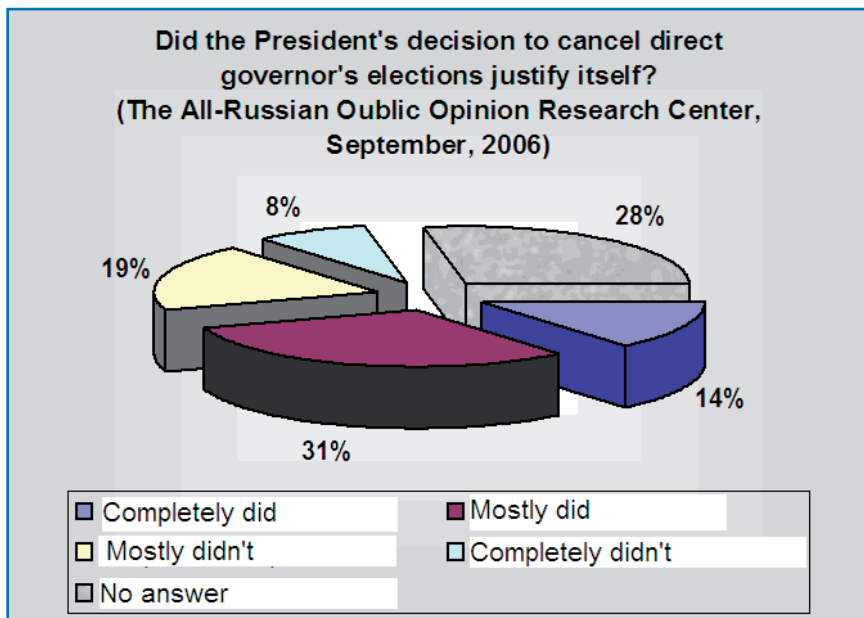
The fact that German Gref has nothing to do with Yury Zhdanov's resignation is beyond any doubt. The Minister for Economic Development and Trade, as well as in the case with the Federal customs service, was presented with a *fait accompli* and learned about Michael Fradkov's decision already after signing the corresponding decree. By all appearances, Yury Zhdanov fully suited German Gref, which is proved by the unwillingness of the latter to let his subordinate go to work at the General Prosecutor's Office, where Yury Chayka invited the head of the Federal Agency for Management of Special Economic Zones last summer. German Gref considered special economic zones as «the most important tool of the innovative breakthrough», which also allowed to be in charge of significant budgetary funds, and, consequently, prompt creation of smoothly operating mechanism, to the extent possible in the Russian conditions, was favourable for him. By the way, Yury Zhdanov more than once showed his discontent with the volumes of financing of projects connected with Special Economic Zones.

In this situation «liberal» German Gref was satisfied with his subordinate who might be referred to the category of «power businessmen» and which to some extent was a compromise figure. In the end of December the head of Rosnedvizhimost (the Federal Real Estate Cadastre Agency) Michael Mishustin who may be called the «man of Gref» was appointed as the new Head of the Federal Agency for Management of Special Economic Zones. Thus, the Head of the Ministry of Economical Development, having missed one administration blow in the middle of the year, managed to block the second one. Time will show whether he will 'clinch' the victory, – in 2007 all subordinated structures may be removed from the authority of the Ministry of Economical Development, including the Federal Agency for Management of Special Economic Zones.

### 2.3. Staff Policy in the Russian Regions

*President's aspiration to keep the inraelite balance of forces in the regions whenever possible* remains to be the characteristic feature of the personnel policy in the regions during the time which passed from the moment of introduction of the new «authorization» procedure. Rotation in the governor's corps in favour of new candidates promoted by President could become the natural consequence of refusal from direct elections of governors. However, this did not happen: the increase of loyalty in exchange for prolongation of powers became the key task of President concerning regional elites.

Application of the new mechanism of formation of executive power has involved 53 constituent entities of the federation; however, the composition of the greater part of the governor's corps has remained the same. At that, the preschedule reappointment became the characteristic tendency – 29 regional leaders have prolonged their powers, raising the question of «confidence» before President. This is connected both with the especially urgent problem of «personnel deficiency» in certain cases, and with the fact that, *despite numerous contradictions, the representatives of the main elite groupings are interested, first of all, in predictability and controllability of regional political processes.*



**REGIONAL HEADS, WHO HAVE BEEN GRANTED THE PRESIDENTIAL  
«CONFIDENCE» (As of January 1<sup>st</sup>, 2007)**

<b>Region</b>	<b>Governor</b>	<b>Approval date</b>
Primorski Krai	Sergey Darkin	February 4, 2005
Tyumen region	Sergey Sobyenin	February 17, 2005
Kursk region	Alexander Mikhailov	February 18, 2005
Amur region	Leonid Korotkov	February 22, 2005
Evenki Autonomous Area	Boris Zolotarev	March 3, 2005
Republic of Tatarstan	Mintimer Shaimiev	March 25, 2005
Chelyabinsk region	Pyotr Sumin	April 18, 2005
Kemerovo region	Aman Tuleev	April 20, 2005
Kostroma region	Victor Shershunov	April 21, 2005
Orel region	Yegor Stroev	April 23, 2005
Samara region	Konstantin Titov	April 26, 2005
Penza region	Vasily Bochkarev	May 14, 2005
Lipetsk region	Oleg Korolev	May 28, 2005
Rostov region	Vladimir Chub	June 14, 2005
Orenburg region	Alexey Chernyshev	June 15, 2005
Republic of Ingushetia	Murat Zyazikov	June 15, 2005
Smolensk region	Victor Maslov	June 24, 2005
Tambov region	Oleg Betin	July 13, 2005
Kaluga region	Anatoly Artamonov	July 26, 2005
Chuvash Republic	Nikolay Fedorov	August 29, 2005
Republic of Kalmykia	Kirsan Ilyumzhinov	October 24, 2005
Stavropolye region	Alexander Chernogorov	October 31, 2005
Republic of Mordovia	Nikolay Merkuskin	November 10, 2005
Sverdlovsk region	Eduard Rossel	November 21, 2005
Ulyanovsk region	Sergey Morozov	March 29, 2006
Republic of Bashkortostan	Murtaza Rakhimov	October 10, 2006
Yaroslavl region	Anatoly Lisitsin	October 31, 2006
Republic of Yakutia	Vyacheslav Shtyrov	December 7, 2006
Republic of Adygea	Aslan Thakushinov	December 13, 2006
Saint-Petersburg	Valentina Matvienko	December 20, 2006

During the last year the problem of solving the «personnel issue» concerning national republics acquired the high priority importance from the point of view of federal interests. The key tendency of the regional policy in this area can be formulated as follows: ***On the eve of 2007-2008 the Center seeks to settle conflicts with regional elites in the process of «negotiation» with the observance of the principle «loyalty in exchange for preservation of the status», instead of taking «radical» decisions on the change of management of constituent entities of the federation.***

This logic is proved both by the forced rotation of authority which took place in 2006 in the republics of Dagestan and Adygea, and the prolongation of authority of administration heads in Bashkortostan and Yakutia in exchange for assistance in the solution of the top priority tasks of the federal center.

***Renewal of the executive staff in Dagestan*** became possible after the former head of the republic Magomedali Magomedov who had been holding top executive positions since 1984, left his position ahead of time, having announced his resignation for health reason. This step looked quite natural because potential chances of prolongation of Magomedov's authority, which term expired in the end of June, 2006, at the moment of resignation could be estimated as extremely insignificant. Infringement of the traditional for polyethnic Dagestan society principle of proportional representation of largest ethnic groups in the power structures in favour of the Dargin clan connate to Magomedov resulted in the drastic aggravation of intraelite antagonisms, the decrease in the administrative efficiency and the sharp activation of extremist groupings.

The decision on the «personnel» issue taken at the federal level became the traditional compromise: the candidature proposed to the position of the head of Dagestan was that of Mukhu Aliev, who has been working for a long time in the system of power relations created under Magomedov. He is neither a strong political leader, nor a representative of interests of any influential group. Thus, ***the formal rotation of elites by the ethnic principle*** (Dargin – Magomedov was replaced by Avar – Aliev) ***was carried out with actual preservation of the former clan authority system.*** At the same time, the post of the speaker of the legislative assembly of Dagestan left by Aliev was occupied by Magomedov's son – Magomedsalam. It should not be excluded that the transfer of rather significant in the republic's authority system post to the son became the main condition of the consent of the former head of Dagestan for his voluntary abdication. Thus in the conditions of aggravation of contradictions between different groupings of elites on the issue of distribution of the authority and control over resources (in the first

turn – distribution of federal subsidies) he has provided certain guarantees of preservation of positions for representatives of his clan. In its turn, from point of view of the top priority task for the federal center on maintenance of the minimum stability in the region, it turned out to be the most acceptable «price» of Magomedov's resignation.

***Resignation of Khazret Sovmen, whose term of office expires in the beginning of 2007, from the position of the head of republic of Adygea, was actually predetermined.*** The threat of the new ethnopolitical conflict in April of the last year caused by the drastic activization of the national Adyg organizations informally supported by Sovmen's administration in connection with the discussion of the prospects of the merger of the republic with Krasnodar region in this case has played the key role. ***The federal Center managed to let the steam off only by means of the compromise:*** in the result of informal agreements achieved at the Presidential Administration this «consolidation» project was taken off the official «agenda», and the head of Adygea assumed the obligations for maintenance of stability till the end of his term of office during the next change of power. Thus, ***only a serious threat of destabilization of interethnic relations made prolongation of the authorities of Sovmen inexpedient from the point of view of federal interests.*** In case of maintenance of the relatively steady balance of political forces of Adygea a scenario more favourable for existing administration could be implemented.

***Aslancheri Thakushinov***, the rector of Maikop Technological University and politician known in the region, became the successor of Sovmen at the post of the head of Adygea. Apart from Dmitry Kozak, President's plenipotentiary in the Southern Federal District, who actively lobbied this appointment, the regional branch of United Russia has rendered its official support to him. As well as the existing President of republic at the moment of his election, Thakushinov also acts as the figure loyal to the Center, however, the peculiarities of his biography add importance to this: much of the successful development of the career of the rector of Maikop University is owed to Dmitry Kozak, President's plenipotentiary in the Southern Federal District, and United Russia's regional branch administration. Besides, Thakushinov had the opportunity to directly demonstrate his loyalty to Vladimir Putin: in 2000 he was actively working in his campaign headquarters in Adygea (one should take into account that voters of the region traditionally expressed their support to the «left» political wing).

Promotion of the «compromise» candidate allowed United Russia's regional branch administration to minimize the intra-party contradictions with participation



of federal officials: the candidature of Thakushinov was supported during voting by 50 deputies out of 53, only one voted in the negative. This creates a certain «margin of strength» in interaction of the executive and legislative authorities in the near term, which, theoretically, should promote the increase of the administrative efficiency. It is also indicative that part of the recent supporters of Khazret Sovmen from among the leaders of «Adyg public» has already supported cooperation with the «federal» candidate. In this case both *the high social status of Khazret Sovmen's successor, and the fact of promotion of the representative of regional elite to the post of the head of republic* have played an important role, instead of a «varangian» from the administration body of Krasnodar region or a federal official.

Many representatives of ethnic national associations of Adygea (as well as their supporters in the republican authority bodies) are ready to support Aslancheri Thakushinov in hope that with the coming of the new leader the «rules of the game» will not change considerably. At the same time *it is too early to speak about final stabilization of the situation in the republic*. Adygea is characterized by significant «split» of elites, and there are serious contradictions between the interest groups. In this connection the personnel policy issues connected with the necessity of more efficient consideration of interests of the Russian-speaking majority during distribution of administrative posts, as well as the problem of fighting corruption which is penetrating regional authority institutes organized by the clan principle, acquire the exclusive importance. The Center is also interested in their solution – otherwise the intraelite conflicts will only aggravate, and the relative stability in the region may be endangered again.

If the situation in Dagestan and Adygea may be considered as the forced (from the point of view of federal center) rotation of authority in the national entities, then *the prolongation of powers of Presidents of republics Bashkortostan and Yakutia Murtaza Rakhimov and Vyacheslav Shtyrov serves as an example of the federal personnel solutions by the principle «loyalty in exchange for preservation of the status»*. To a large degree this is preconditioned by the strategic importance of maintaining stability of the situation in «highly subsidized» regions before the electoral campaigns of 2007-2008.

So, the increasing rumors about the «disfavour» and the soon resignation of Rakhimov in the conditions of unstable «balance of elites» and in the absence of the counter elite formed in the region, (and, hence, of the real alternative to the current President of the Republic of Bashkortostan) threatened to become the catalyst for the destabilization process, which does not match the key priorities of



the federal policy. The consequences of Rakhimov's reappointment touch both upon the political and economic planes. First, the Center obtains certain loyalty guarantees from the administration of the Republic of Bashkortostan during the forthcoming electoral campaigns in exchange for preservation of the power resources for representatives of the dominating interest group («Rakhimov's clan»). Second, after Rakhimov's appointment the prospects of establishment of the federal control over the key assets of the Bashkir fuel and energy complex become much more favourable.

The most «attractive» assets of the Bashkir oil branch were privatized in 2003, after which the controlling shares of Bashneft, Bashkirnefteprodukt and the four oil refineries were introduced into the authorized capital of Bashkir capital OJSC, the main co-owner of which is Ural Rakhimov, son of the head of the Republic of Bashkortostan. At that, on the eve of the presidential elections in the Republic of Bashkortostan in 2003, the informal agreements had been achieved at the federal level, which presupposed the transfer of main enterprises of the republic's fuel and energy complex under the control of the Center in exchange for the political support of Murtaza Rakhimov. However, later on the regional administration consistently ignored its implementation of the economic conditions of the «deal». In this connection *the «back side» of the recent decision on Rakhimov's reappointment became the transition of the federal center to the strategy of direct «power» pressure on Bashkir elites with the purpose to return the largest economic assets to the state property*: Already for several months the General Prosecutor's Office has been auditing the activity of largest enterprises of the Republic of Bashkortostan. At the same time the struggle of the largest financial industrial groups – Gazprom and Rosneft – for the increase of participation in «appropriation» of Bashkir assets became more active. The «power» holding urgently needs oil refining capacities; in this connection the opportunity of sale to Rosneft of the shares of Bashkir capital belonging to Joint-Stock Financial Corporation Sistema looks rather probable. Gazprom's management is planning a large-scale expansion to the petrochemical and oil refining areas, and there are grounds to believe that refusal of the elite groups «affiliated» with local administration from resistance to this process became the key aspect of the «negotiation» on the issue of the possible change of power in the region.

During resolution of the personnel issue in Yakutia the situation was developing in the similar way: *the decrease of economic requirements of the national elites due to acceptance of the «compromise» variant of property redistribution during the transfer of control over the diamond monopoly -*

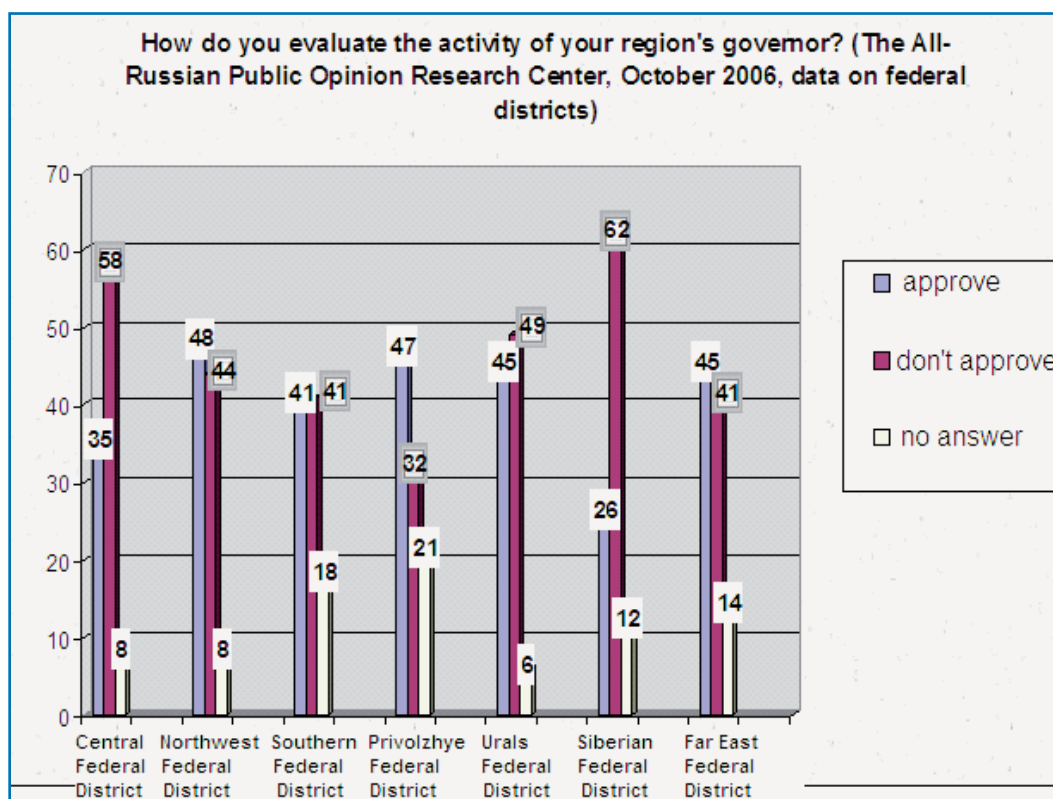
ALROSA JSC - *to the Center became the «price» of prolongation of Vyacheslav Shtyrov's powers*. Vladimir Putin set this task before the Ministry of Finance in 2001, however its solution was hampered by the fact that *the process of redistribution of the «diamond» financial streams is touching upon the interests of very many influential political players of federal scale*. In this case both the representatives of the «liberal» grouping of elites, for which ALROSA assets constitute the main resource base, and «siloviks», potentially interested in the expansion to the sphere of their competitors' traditional influence, are implied.

The fight for ALROSA continued for several years at the regional level, but only in November of the last year the administration of the Ministry of Finance headed by Alexey Kudrin managed to make the administration of the Republic of Saha (Yakutia) sign the protocol fixing the main stages of federalization of the Joint Stock Company. At that, having formally agreed to the conditions of division of the property suggested by the federal center, President of Yakutia for a long time has been evading from taking active steps in this area, preferring the policy of «maneuvering» with the purpose to avoid an open conflict with main federal interest groups and oriented at the support of local elites and the republic's population.

Simultaneously the negotiation process was carried out on the issue of compensation of the inevitable budget losses of Yakutia. The transfer of the property of the production and scientific association Yakutalmaz, on the facilities of which in the early 1990-ies the company was created (the parties must introduce these assets to the authorized capital of ALROSA as the payment for the federal and republican shares), to the property of Joint-Stock Company ALROSA entails the decrease of the republic's income by 10 billion (according to the administration) or 9 billion (according to the Ministry of Finance) rubles a year. The originally declared demands of the republic's administration in this connection totaled to the unprecedented amount – 500 million dollars from the federal budget.

However, *accomplishment of the process of transfer of diamond monopoly under control of the federal Center before the end of the current year was of strategic importance, - in the first turn, for the administration of the Ministry of Finance*, therefore, to achieve the set goal, Alexey Kudrin was ready to agree to a series of concessions to regional elites. One of them, in the long run, became the prolongation of Vyacheslav Shtyrov's powers. *The economic aspect of the achieved agreements* looks as follows.

Deputies of Il Tumen (the State Assembly) have approved the variant of the amicable agreement pursuant to which the main share of the property of Yakutalmaz will be transferred to the state with its subsequent introduction into the authorized capital of ALROSA JSC. In its turn, the new procedure of distribution of the Mineral Extraction Tax is called to satisfy the economic requirements of Yakut elites: in accordance with the recently adopted law, all receipts of the diamonds extraction tax are transferred to regional budgets (earlier their share constituted 60%). Yakutia will get practically all losses of the federal center (2,6 billion rubles a year), with the exception of 18 million rubles in favour of the budget of Arkhangelsk region (extraction of diamonds by Severalmaz JSC) and 0,4 million rubles to Perm Krai (Uralalmaz mine). The transfer of several social objects and infrastructure from the balance of Yakutia to the balance of the Russian Federation will become the second source of compensation. These assets in the amount of 2 billion rubles are included into the state budget of 2007. Deductions of ALROSA for implementation of local social, economic and ecological programs – 2% of the cost of crude diamonds sold by ALROSA – will also remain in the republic's budget. Besides, representatives of Gazprom OJSC have already declared that of the 2,4 trillion rubles planned for implementation of the general scheme of gas supply and gasification of the Far East, over 500 billion rubles will be used in the republic. At last, Rosimushchestvo (the Federal Property Management Agency) took the principle decision on recognition of the legitimacy of the recent incorporation of the company Yakutugol (Coal of Yakutia): the government of Yakutia (75% minus 1 share) and Mechel group (25% plus one share) became the shareowners. Thus, the main stage of returning the diamond monopoly to the state property should be accomplished before the end of the year. ***Strengthening of the administrative positions of Alexey Kudrin, the head of the Ministry of Finance and one of the leaders of «liberal» grouping,*** who has implemented Vladimir Putin's strategically important order, will be the most significant political consequence of the final redistribution of assets. Gazprom management, increasing its influence in the region which is perspective from the point of view of the resource potential, will have to solve the problem of minimization of possible «costs» of interaction with national elites in future.



*The two expected, but never adopted personnel decisions of the Center deserve a special mentioning* – on the resignation of the most wealthy citizen of the Russian Federation (by the version of Forbes) Roman Abramovich from the post of the governor of the Chukotka autonomous district and on appointment of the head of the Chechen Republic's government Ramzan Kadyrov to the post of the President of the republic in connection with achievement by him of the 30 years' age.

The perspective of the political career's termination of one of the most «systematic» Russian «oligarchs» has been discussed in mass media in the genre of rumors during the whole last year, and on December 20<sup>th</sup>, after the closed meeting with Vladimir Putin, Roman Abramovich for the first time publicly declared that he addressed President with a request to dismiss him from the duties of the regional head. The official substantiation of his decision is quite logical: the main goal of the administrative «team» of Abramovich after his forced promotion to the governor's position (in 2000) was to find the ways to take one of the most «depressive» regions from the economic crisis. This purpose has been achieved by

the present moment, which is proved by the budgetary parameters (thus, the total Gross Regional Product of the Chukotka Autonomous District in 2001 constituted 7,9 billion rubles, in 2004 – 15,1 billion rubles and in 2006 the Gross Regional Product is expected to reach 21 billion rubles). The public character of the address of Abramovich to President gives grounds to assume that this time the probability of acceptance of the positive decision at the federal level is high. Nevertheless, ***one cannot call the change of leadership at Chukotka to be the accomplished fact*** – as President's press-service informed, Vladimir Putin made a note of the achieved successes and expressed his belief that Abramovich will continue to work to the benefit of the district. In his turn, the governor declared that he will continue «implementation of the number of economic projects aimed at the further increase of the living standard» in the region.

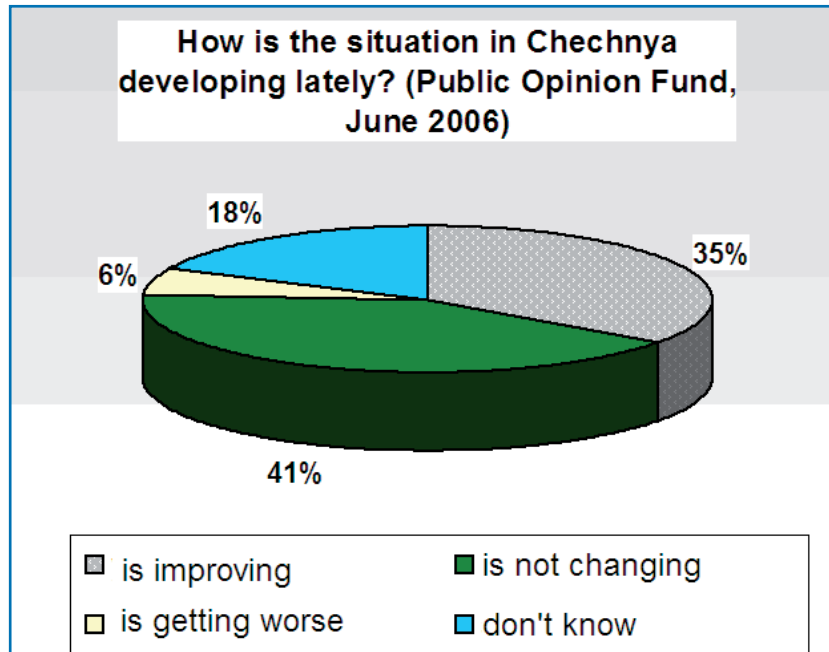
Prevention of the decrease of the fiscal capacity level and, as a consequence, of the living standard of the population after re-registration of the main taxpayer of the district – petroleum oil company Sibneft (later renamed to Gazpromneft) – in St.-Petersburg is of the key importance from the point of view of the perspectives of the regional development. As it follows from the statements of members of Chukotka administration, the «anti-crisis» system of financing has been already developed. According to the performed calculations, app. \$500 million (app. \$2000 per year per inhabitant) for the five years' perspective shall be required to not allow the drastic decrease of the living standard in the region, and Roman Abramovich has already used his administrative connections to leverage allocation by the Ministry of Finance of the subsidy in the amount of 6 billion rubles to compensate for the budgetary losses. As confirmed by Anton Siluanov, the Deputy Minister of Finance, 3 billion rubles have been already compensated by the ministry, and 3,2 billion more are stipulated for this purpose in the state budget for 2007. Apart from that, Abramovich promised to continue paying to the budget of the Chukotka Autonomous District his income tax as a physical person (1 billion rubles a year).

Nonetheless, ***acceptance of the voluntary retirement of the «oligarch» can be postponed till consideration by the government of the program «The strategy of economic development of Chukotka Autonomous District till 2020» presented by the administration of Abramovich***, (planned for March, 2007) and decision of the principle issue on the sources of its financing. This is also indirectly confirmed by the information from the press-service of the head of the state that Vladimir Putin has instructed the governor of Chukotka «to continue performance of his duties for the indefinite term».

***The second expected personnel decision of the Center touched upon the rotation of authority in the Chechen Republic.*** The intraelite situation in the region is characterized by the permanent political opposition between the supporters of Ramzan Kadyrov who has actually concentrated in his hands the main levers of power, and the formal head of the republic Alu Alkhanov who is retaining the asset of the influence based on the legitimacy of his presidential status. Periodic outbursts of the conflict to the public sphere point to the tension in relations between the Prime Minister and President; at that both the adversaries appeal to President of the Russian Federation as to the federal «arbitrator». One of the most indicative facts became the «conciliatory» meeting held by Vladimir Putin with Alkhanov and Kadyrov on May 5<sup>th</sup>, which took place soon after the armed clash between the representatives of security services of President of Chechnya and those of the head of the government.

It should be noted that ***the last year was marked for the head of the Chechen government with the essential increase in his political «capital».*** The successes achieved in the area of social and economic development of the republic (based on the unprecedented increase of the federal financial support), as well as the firm public position of Kadyrov concerning differentiation of powers with the federal center, became the key factors of the growth of his popularity among the population of Chechen Republic. In this case there is the obvious tendency of growing economic demands of Chechen elites: more than once the region's leadership expressed its intention to obtain unprecedented privileges including the free economic zone status all over the territory of the republic, the control over natural resources, and tax exemption for physical persons and legal entities (for 10-15 years). Besides, the issue on the transfer of the local fuel and energy complex enterprises (the federal state unitary enterprise Chechenneftekhimprom) to the regional property and granting of the mining license remains to be the matter of principle. The measures supported by Kadyrov's government are aimed at the change of the existing mechanism of distributing the profit from oil extracted in the territory of the Chechen Republic. This is the issue on the transfer of the controlling interest of the branch of the petroleum and oil company Rosneft –Grozneftegas OJSC to the Chechen Republic's government (for this purpose 2% of shares must be added to the package which is in the regional property) and renewal of the license for the right of development and subsoil use in the territory of the Chechen Republic. However, the center is not ready for such concessions, which is quite natural: ***the major part of economic requirements of the Chechen government is outside the federal constitutional space.***





It is important to emphasize that *the conflict between Alkhanov and Kadyrov is of the systematic character and fully reflects contradictions of the political regime formed in the Chechen Republic*. It is a question of the status of Alu Alkhanov as of the head of the republic, which was formal from the beginning, and redistribution (with the silent approval of the Center) of the real powers in favour of the prime minister based on the logic of preservation of continuity by the principle of clan relationship. At the same time, the interests of potential opponents of Kadyrov are extremely diverse and frequently contradict each other, therefore *the traditional federal «stake» on the prime minister as the dominating figure in the Chechen political system will, probably, remain to be the priority in the coming year*. Ramzan Kadyrov's appointment to the post of the President of the Chechen Republic in 2007 would hardly meet the priorities of the Center, meaning maintenance of stability and the maximum possible predictability of development of political processes in the potentially «explosive» North Caucasian region.

Analysis of the «personnel» aspect of the regional policy also actualizes the issue of the perspective of the regional elite's rotation. This is a question both *of possible candidates for federal «promotion»*, and *for demotion from the regional leaders after expiry of the term of powers*. So far there are few instances of



recruitment of regional leaders to federal posts, and the last year has not brought any changes to this picture. Appointment of the former governor of Tyumen region Sergey Sobyanin to the post of the head of the Presidential Administration (November, 2005) is only the second (after the Perm leader Yury Trutnev) case of transfer of the governor to a position in Moscow with obvious promotion (it is difficult to call other cases, concerning heads of St.-Petersburg and Primorski Krai Vladimir Yakovlev and Evgeny Nazdratenko, as career development).

In the absence of the developed formal performance efficiency criteria to evaluate heads of constituent entities, *it is possible to speak about the most general political image formation parameters of the governor's corps representatives at the federal level*. These include the degree of loyalty of this or that regional head in relation to the federal center reflected by the local administration's activity in the area of implementation of federal initiatives, the ability to provide political stability in the «subordinated» territory, as well as the administrative efficiency, the indicator of which more frequently is the investment climate and general level of regional social and economic development. Respectively, *heads of Krasnoyarsk and Krasnodar regions Alexander Khloponin and Alexander Tkachev can be named among the «efficient» regional leaders potentially claiming for «promotion»*.

The Krasnoyarsk governor traditionally maintains close relations with the federal administration, and the region subordinated to him has been granted «the most favoured region treatment» mode. This was caused by the fact that Khloponin regularly proves his loyalty to the federal center and works actively enough at the implementation of presidential initiatives. So, the project of the merger of Krasnoyarsk region, Evenki and Taymyr autonomous regions has been successfully accomplished. *Positioning himself as the main pretender for the post of the head of the consolidated constituent entity, Khloponin continues to implement the strategy of PR-support of his positive political image at the federal level suggesting numerous initiatives in the sphere of regional policy*. In July of the last year he proposed creation of the new power structure – strategic planning commission, the primary goal of which would be elaboration of programs for development of the constituent entities of federation. Thus, once again the Krasnoyarsk leader demonstrated his aspirations to raise his status – could be due to redistribution to his advantage of the authorities of the «profile» Ministry of regional development, where the administrative position of leadership becomes more and more unstable. However, so far the rumors about resignation of Yakovlev are not confirmed. Therefore *it is too early to speak about the possible*

*«promotion» of Khloponin*, especially taken that the programs of development of the consolidated constituent entity initiated by him are still far from accomplishment.

*The head of Krasnodar Krai Alexander Tkachev can be also named as the perspective candidate for the federal «promotion»*: rumors about his work transfer to Moscow were discussed in mass media almost during the whole last year. Regular personal meetings of the Kuban leader with Vladimir Putin contributed to it considerably. Although, with consideration of the described efficiency definition algorithm, it is possible to state that the «federal» positions of governor Tkachev, heading the strategically important region with the developed economy, are steady enough even without that. *Active attraction of foreign investments to Krasnodar economy is quite deservedly considered to be the main factor of the administrative efficiency of Krasnodar administration*. Last year the investments volume amounted to almost 77 billion rubles.

A large-scale PR-campaign performed by the regional administration and connected with preparation for implementation in the region of XXII Winter Olympic Games deserves special attention. Implementation of the idea «Sochi-2014» in the first place can bring potential political dividends to the regional governor who will obtain the opportunity to position himself as an effective politician of the federal scale. Adoption by the government of the special federal program «Development of Sochi as the Mountain Climate Resort (2006-2014)», which provides for additional financing in the amount of 122,9 billion rubles, independent of whether Sochi will get the status of the Olympic capital, has significantly enhanced his administrative positions.

The information *on the possible renewal of the political career of the governor of St.-Petersburg Valentina Matvienko at the federal level* also appeared in mass media on numerous occasions during the last year. The successes of the head of administration of «the Northern capital» in implementation of strategic tasks served as a basis for such rumors. The key task consisted in expansion of the resource potential of the administration of St.-Petersburg at the expense of re-registration of the whole series of large companies (Vneshtorgbank, Gazpromneft, SIBUR Holding, Transnefteprodukt, Transaero, Rostelecom, etc.), the tax revenues from the activity of which have allowed to formulate the surplus budget of the city for the first time for many years. The decision was also taken on creation in the northern capital of the first Russian oil exchange. So far in Russia there are no conditions for free oil sale, which implies creation of the exchange; however, the political aspect of this process, demonstrating the steady tendency of

governor Matvienko's influence expansion at the federal level of power, is more important.

Nevertheless, ***the probability of promotion of Valentina Matvienko to the post of the head of the state in 2008 is low***. First of all, it is necessary to take into account that implementation of the large-scale program of development of the city infrastructure declared by Matvienko and approved by Vladimir Putin can form a good basis for the governor's PR-campaign; however it is still very far from its accomplishment. Besides, the head of the St.-Petersburg administration, which has been traditionally showing adequate understanding of the political conjuncture, many times publicly emphasized her interest in preservation of her status. The preschedule initiation of the question on «confidence» before President (Matvienko's term of powers expires in October, 2008) and quite predicted reconfirmation of her appointment which took place on December 20<sup>th</sup> became the actual acknowledgement of these intentions. Thus, Valentina Matvienko preferred to take care of strengthening her positions in advance, before the elections to the city legislative assembly. Taking into account Matvienko's strained relations with the leader of Fair Russia Sergey Mironov, who is actively participating in the campaign, prolongation of her powers by the existing absolutely loyal St.-Petersburg's parliament seems to be the optimal decision – the number of the deputies in the next legislative assembly who are «devoted» to the city administration will inevitably decrease.

In this context it is important to stress that discussion of the perspectives of recruiting the governor's corps representatives to the posts at the top echelons of power is of exclusively hypothetical character, irrespective of the personalities considered. ***The role of regional elites in implementation of the «Successor» project is mainly limited to the maintenance of stability and prevention of «explosive» situations*** connected with escalation of social intensity or aggravation of interethnic relations. In these conditions ***the probability of appearance among existing heads of constituent entities of the candidate for the presidential post is not too high***. The present head of the Presidential Administration Sergey Sobyenin can be considered as exclusion; development of his political career allows adding him to regional elite representatives. Skilled and rather ambitious politician, he is reputed as the firm leader and efficient manager, and at the same time he is one of the most «closed» figures at the federal level of the authority which does not belong to any of the competing elite groups.

During one year of his being in the position of the head of the Presidential Administration Sobyenin has given only three interviews – immediately after his

appointment he answered the questions of journalists of state TV companies; during his trip to the Great Britain this May he met with the correspondent of The Times. The ex-governor of Tyumen region time and again confirmed his loyalty to the head of the state. In the year 2000 he participated in the initiative group on recommendation of Putin to President, later he promoted the initiative of prolongation of the term of presidential powers up to seven years and became one of the first governors who joined United Russia. Being the head of Tyumen region, he concluded the cooperation agreement with President's native city, under which the Tyumen business-group performed financing of the restoration of architectural monuments in St.-Petersburg. Many elements of reforms carried out in the region, for instance, «single-channel» financing of medical institutions or the «money behind the pupil» principle, were subsequently used during development of the national projects, and replacement of direct elections of the mayor of the regional center by his election by the deputies of the municipal дума has found its reflection in the amendments to the law on local self-government. Vladimir Putin before announcement of his annual Message to the Federal Assembly has specially emphasized the leading part of the head of the Presidential Administration during preparation of the document. At last, Sobyenin's administrative influence has also increased due to his appointment to the status post of the Chairman of the Board of Directors at Tvel corporation (earlier this post was occupied by the Assistant to President Sergey Prihodko), which is in charge of controlling state blocks of shares of enterprises extracting and processing nuclear fuel.

Thus, the head of the Presidential Administration actually became the facilitator of the last large-scale reform – transformations in the nuclear branch – implementation of which is scheduled before the presidential elections. However, ***Sergey Sobyenin's «independent» political influence does not yet quite match his position in the informal hierarchy of federal power structures***, therefore it would be premature to speak about his preeminent chances for getting promoted as Vladimir Putin's successor. It is only important to consider that in the conditions of general stand-off of regional elites from the process of rotation of the federal authority, this scenario has the right for existence.

Analysis of development of regional political processes for the last year allows naming several figures that run the biggest risk of losing their status of the regional leader. So, ***Presidents of republics Tyva and Buryatiya Sherig-ool Oorzhak and Leonid Potapov may hardly count on obtaining the presidential «confidence»*** (their powers expire in March and June, 2007, respectively). In the first case there are more than enough formal reasons for acceptance of this

decision. First, the low result of United Russia at the elections on October 8<sup>th</sup> (the party list led by Sherig-ool Oorzhak won only 46,3% instead of the expected 70%) became a serious fiasco of Tyva administration. Second, one should consider high antirating of the head of the republic and extremely low level of social and economic development of the region. Third, the unstable political situation connected with lawsuits by claims of activists from the local branch of the Russian Party of Life, who challenge the results of the autumn elections on the five one-candidate constituencies of Kyzyl, and «demarche» of the part of newly elected deputies of United Russia, who demonstratively abandoned the parliament and thus blocked the work of the regional legislative power continues to play extremely negative influence on the image of leadership.

Thus, the prospect of rotation of authority in Tyva is quite realistic, and in this connection *it is possible to predict the aggravation of contradictions between three main influence groups* which have formed around President Sherig-ool Oorzhak, secretary of the regional branch of United Russia Sholban Kara-Ool, having the resource of support from the head of the Ministry of Emergency Situations Sergey Shoygu, and speaker of the legislative chamber of Hural Vasily Oyun who discredited himself by active involvement in the parliamentary conflict. From point of view of interests of the Center, the search of «personnel» solution becomes complicated because Tyva is a vivid example of «monoethnic» entity; therefore appointment of a «varangian» of the «non-title» nationality in this case is politically inexpedient. However, in the republic there is no «compromise» candidate who could be supported by all groupings opposed to the current administration. It should be noted that such federal level player as OJSC Severstal is also interested in development of the resource potential of the region, and it is possible that the company's management will lobby promotion of its candidate to the post of Oorzhak's successor.

The situation in Buryatiya looks less definite because in the region there are no obvious intraelite conflicts, which at the federal level is considered to be indicator of political stability. The republic's administration headed by its self-perpetuating President Leonid Potapov has been demonstrating its loyalty to the federal center for a long time, actively supporting all presidential initiatives – including the project of «integration» of regions (the Buryat leader even proposed to expand the frameworks of this process and to create the new subject – Transbaikalian Krai – including Irkutsk region, Ust-Ordynsk Buryat Autonomous District, the Republic of Buryatiya, Chita region and Aginsk Buryat Autonomous District). However, during the last year this tendency has undergone certain

changes. There are reasons to believe that it was the informal (including financial) support of Buryat national organizations from Potapov's administration which contributed to the increase of the protest moods during preparation of the referendum on the merger of Irkutsk region and Ust-Ordynsk Buryat Autonomous District, which eventually forced the federal Center to take unprecedented measures for prevention of the unsatisfactory voting result. Nevertheless, *the threat of destabilization of the situation in autonomous regions – places of compact residence of Buryat ethnos representatives which is the largest in Siberia – remains to be urgent*, which with consideration of priorities of the federal policy during the pre-election period may well become the determining factor for the beginning of the regional authority change process.

At last, *the governor of Kamchatka region Michael Mashkovtsev can be named as another potential candidate for «abandoning» the governor's corps*. The «scheduled» liquidation of the territory «subordinated» to him as an independent constituent entity of the federation – already on July 1<sup>st</sup> the new region (Kamchatka Krai) will appear in structure of the Russian Federation, formed as the result of the merger of Kamchatka region and Koryak Autonomous District – is the formal basis for this. This «integration» project was launched largely owing to the initiative of Mashkovtsev, who was actively politicking on the background of disruption of the heating season admitted by the former administration of Koryak Autonomous District in the winter of 2005. By this he obtained the opportunity to demonstrate his loyalty to the federal center and to be the first «to offer» his candidature for the post of the head of the integrated entity. However, the probability of appointment of the «old formation» governor, known for his sympathies with the Communist Party of the Russian Federation and rather complex relations with the federal Center was extremely low from the beginning. Besides, a series of «loud» legal proceedings added to the deterioration of the image of the head of Kamchatka at the federal level (in 2003-2004 the regional head and several members of his administration were charged with exceeding their duties and unauthorized use of money in the amount of 140 million rubles). And during the last year mass media repeatedly published the information on the expected appointment of the large entrepreneur, the co-owner of the group of companies Renova Victor Vekselberg to the governor's post at the new region, although the «personnel issue» has not been decided yet at the federal level.

In these conditions almost the unique chance of Michael Mashkovtsev to retain his positions was his transfer to cooperation with the alternative «ruling party»: in the beginning of January he declared that he would support Fair Russia



during elections to the legislative assembly of the consolidated region. This may provide to the main opponent of United Russia a noticeable growth of the electoral support in the constituent entity with traditionally high share of protest voting, especially with consideration of the fragmented character of the regional elite community which at present has no strong personalities, capable to make a real competition to Mashkovtsev. However, the issue on how much the response support of the «actual left» will contribute to preservation of powers after the head of Kamchatka remains to be open.

### **2.3. Political Parties**

The party life became more active as «the big race» of 2007 is approaching; the two legs of power – United Russia and Fair Russia – became its two main actors. The final stage of preparation for the forthcoming electoral cycle has started on the party field of Russia. Elections 2007-2008 will be of the strategic importance for the country. Many a time Vladimir Putin declared that he was going to leave the post of the head of the state upon termination of his second term, therefore it is possible to say that the transfer of power should take place at the future presidential elections in the country. In these conditions the parliamentary campaign preceding this is important from several points of view at once.

First, Putin's «successor» will have to work with the parliament elected in 2007 at least during his first presidential term. Second, the parliamentary elections should become some kind of a big «rehearsal» before the presidential elections. Besides, the State Duma in its new composition will directly participate in legitimation of the results of the fight for the post of the head of the state.

By the beginning of pre-election struggle between the potential «successors», each of them should have a certain pre-election strategy. The efficiency of using these or other ideological schemes and political technologies can be assessed by the level of their efficiency during election of the new deputy's body of the State Duma. Therefore, the parliamentary race will have the same fierce character as the presidential one.

The role of the State Duma of the fifth convocation during the first years of the new President's ruling will be extremely high. Members of parliament will have to legally «consolidate» the new regime. It is the deputy's body that will consider the bills introduced by the new head of the state, adjusting the political system to his interests. The recently adopted legislation opens wide horizons for



«self-actualization» of separate units at the party field. Pursuant to the new rules, only separate parties will participate in the federal parliamentary elections, their consolidation into blocks will be impossible now. At that, the rules of party structures' registration have been essentially toughened. Thus, the situation is created when the party system of the Russian Federation must approach the more predictable and «adequate» variant with the «a few parties».

United Russia has spent the year steadily enough, and, being a little bit pressed in March and October at the regional elections, on the whole has retained its undoubtedly leading positions at the political field of the country. 2006 has been the year of the VII party congress, which took place in Ekaterinburg and was held, as many observers noted, in the conditions vividly reminding the Soviet era. The congress did not accept the anticipated party program, limiting itself to the policy statement which became the work product of five independent analytical groups. This, in the opinion of some analysts, can be a reflection of ideological struggle among the leadership of the party, the representatives of which during the year made statements of both the right liberal and social-democratic character. The new doctrine of United Russia is based on the three first priority tasks: development of the economy of innovative type, fight against corruption and «taking care of people». United Russia adherents intend to go out of the demographic crisis which has struck Russia within 10 years also due to the increase of the average level of wages up to 25 thousand rubles within three years. By and large, the program statement of United Russia is filled both with conceptual and detailed policy lines – which, according to its authors' plan, should confirm its status of the «party of real actions». Nevertheless, despite the external ideological abundance, many congress delegates have been critical enough when evaluating the party's ideology status.

In the organizational plane, the bureau of the Supreme party council was enhanced by governors Victor Ishaev, Alexander Tkachev and Aman Tuleev, as well as the head of Rosoboronexport Sergey Chemezov. Despite the announcements, Vladimir Yakunin, the head of OJSC Russian Railroads, avoided entering the party, which can point to his big ambitions.

One may state that the main problem of the ruling party has not been resolved in 2006 – till now its main elective resource is based on the high rating of President who is projecting his own popularity onto it. In some sense United Russia continues to remain an electoral block. And no matter how much the party ideologists declare that today United Russia is associated with the course of President rather than his person, United Russia's adherents will have difficulties

without Vladimir Putin's support, especially on the background of Fair Russia, which suddenly emerged and boomed at the end of the year. The struggle between these parties may become the main intrigue of the party year 2007 and the basis of the political script at the elections of deputies to the State Duma.

The metamorphose of Rodina (Motherland) party became one of the main party intrigues of 2006. This structure was one of the main newsmakers at the Russian party field after the elections of deputies to the State Duma of the fourth convocation: constant personnel replacements among the top party leadership, expulsion of Sergey Baburin from the party with the subsequent split of the fraction and its resulting merger with the Russian Party of Life have been in the focus of attention of «general public».

The «Rodina project» conceived by the political strategists of the Presidential Administration has been initially aimed at «dispersion» of the left patriotic electorate, first of all, of the Communist Party of the Russian Federation. However, gradually Dmitry Rogozin's structure started to go out of control of the authorities and gain political influence, including regions, and in such a way, that in the first half of 2006 it could be referred to the opposition. This forced the party field supervisors from the Presidential Administration to take a series of strict measures against Dmitry Rogozin and his colleagues. At that, counteraction of the current authorities to Rodina (Motherland) party became of rather consistent and systematic character, and the arsenal of means and methods used by the representatives of «old Moscow» grouping against this party became quite diverse. The following methods have been successfully applied against Dmitry Rogozin's party:

- Informational blockade in mass media;
- Association with the party's activity of certain illegal actions of persons who have nothing to do with the party (the Moscow synagogue case);
- «Enticement» of deputies of Rodina fraction at the State Duma;
- The countrywide removal of its «voting lists» during regional electoral campaigns.

The work with the party leadership was simultaneously conducted – instead of independent Sergey Glazyev and Dmitry Rogozin, who has become an odious figure, Rodina was headed at last by Alexander Babakov, loyal to the current authority, under whose leadership the project has practically returned to its initial status.

The merger of Rodina with the Russian Party of Life has communicated absolutely different direction to this process. Rodina has actually changed its political orientation, having become the «propresidential» project. Sergey

Mironov, the speaker of the Council of Federation, «the third person in the state», has direct access to Vladimir Putin, being «the man of President». The merger initiative belongs to him; therefore Fair Russia may be also named as the personal project of Mironov, who can afford supervising large-scale political organizations.

This merger was certainly beneficial for Sergey Mironov. If his career as of independent politician is developing quite successfully, the Russian Party of Life, headed by him, could not boast with any significant success. In the result, on July 26<sup>th</sup>, 2006, the leaders of the Russian Party of Life and Rodina have announced about the anticipated merger of the two structures. Soon after his meeting with President, the pensioners' leader Igor Zotov also joined them. However, according to certain information, the union with the Russian Party of Pensioners was imposed to Mironov by the political strategists of the Presidential Administration, which would like to have at least «blocking share» in the new structure, if not the controlling interest. Apart from that, during the attempt of Fair Russia to go out of control, the Russian Party of Pensioners could play the role of the «Trojan horse» in its way. Subsequent Zotov's statements only confirm these considerations: he tried to firmly defend the indicative word «pensioners» in the new party's name, as well as the leading post for himself. Besides, his party tried to actively oppose their «allies», so far acting independently, quite often playing on their field and using hard electoral technologies against them during the last regional elections in October, 2006.

In the meantime United Russia, looking for the ways of counteraction to the populist actions of Fair Russia, in the autumn of 2006 took an unprecedented step, having offered its cooperation to the Communist Party of the Russian Federation, so far only at the level of one region (Vladimir region). This offer can mean not only looking for allies on the left flank, but also the tendency of United Russia to «turn left», which could be seen even during the recent development and acceptance of the party program. Besides, one should not exclude, that under the secret understanding with United Russia, the Communist Party of the Russian Federation later will enjoy the «most favoured party treatment» for the game on the «left populist» field, which was planned «to be processed» by Sergey Mironov's supporters.

Immediately after Sergey Mironov and Alexander Babakov's announcement about the soon appearance of the «actual left» and attachment of Igor Zotov's Russian Party of Pensioners, the decision of United Russia followed about acceptance of the Russian United Industrial Party which was recently documented in the form of the concluded official agreement. Attachment of the Industrial Party

to certain degree is «symbolic»; – the increased attention is paid to the new industrial policy both in the activity of the Government of the country, and in United Russia's program. Last week, as the answer from the other side, the information was submitted on the possibility of future consolidation of the «even more actual left» – «social democrats» whose basis will be comprised of People's Party and Patriots of Russia. And if for them «consolidation» is their last chance to stay in the «big politics», then the appearance of the «actual left» project is much more in line with the «unification» course proclaimed by Vladimir Putin.

If in the first half of the year the government was the main object of criticism of United Russia adherents, by the end of 2006 a much more dangerous competitor appeared, and at the seventh congress in Ekaterinburg the leaders of United Russia sharply criticized Fair Russia as a whole and its leader in particular, the criticism being of somewhat «hysterical» character. It shows that the «ruling party», as United Russia used to consider itself to be for the five years of its existence, started to have a real competitor, which was able to complicate its serene existence on the «cleared» party field.

One should add that United Russia adherents noticed their competitor even earlier – after the October elections in the regions. Then United Russia concentrated its efforts on the struggle with Sergey Mironov personally. At first, deputies of United Russia fraction prepared the collective enquiry to the Prosecutor General of the Russian Federation Yury Chayka with the request to check Sergey Mironov's actions who, in their opinion, used to put pressure upon the electoral commissions of Sverdlovsk region. Then, Vice-Speaker of the State Duma Oleg Morozov with the acridity characteristic of him made a series of statements, the sense of which is that United Russia, supervising the Legislative Assembly of St.-Petersburg, may not allow Mironov to stay the Chairman of the Council of Federation for another four years, not having prolonged his senatorial powers. A little bit earlier something similar, but in a more kind form, was also sounded by another outstanding United Russia's functionary Andrey Isaev. It is possible to understand the leaders of the main «ruling party» – Sergey Mironov's actions and statements in the second half of the year made the «bears» to be nervous. Probably, he understood this himself, and meaningfully provoked United Russia to such sharp statements, automatically obtaining the opportunity for the reply and PR-promotion.

The case with the cousin of President of Russia Igor Putin, who demonstratively left United Russia and declared about his joining the Russian Party of Life, looked provocative. Sergey Mironov became the winner anyway, more

and more establishing himself in the status of the main oppositionist in relation to Boris Gryzlov's structure. As for Mironov's prospects as the Chairman of the Council of Federation, here the decision will be adopted by President of the country, not by United Russia.

Constant and rather hard opposition of the leader of the Russian Party of Life to United Russia can suggest that Sergey Mironov, among other, is acting (even though indirectly) in the interests of the «power» grouping which would benefit from weakening of United Russia and the political strategists of the Presidential Administration standing behind it which started to think over the response actions. It is in this light that one might consider the sounded idea about creation of the «social democratic» alternative to the «actual left» which is not only beneficial to its participants, but also capable to draw a certain part of votes from Mironov's party, when necessary. This is the second attempt – after introduction of the «Trojan horse» in the form of the Russian Party of Pensioners – to react to the unauthorized, or rather, incompletely authorized initiative of the speaker of the Council of Federation. Nevertheless, the results of the last regional elections have shown that, despite the quite successful performance the Russian Party of Life and the Russian Party of Pensioners, United Russia also has made a step forward compared with the spring electoral campaign.

United Russia is seriously concerned with the developing political conjuncture on the threshold of regional elections on March 11th, 2007, and elections of deputies to the State Duma in December of the same year. Creation of Fair Russia and strengthening of positions of Sergey Mironov as the public political figure is the main reason of this. Regional elections which were held in October of this year have demonstrated that United Russia has made correct conclusions from the spring electoral campaign, - this time the set task has been implemented practically in all constituent entities of the Russian Federation, and the final figures turned out to be higher than the March ones.

But at that the Russian Party of Pensioners and the Russian Party of Life, which were not united at the moment, achieved considerable success, especially on the background of their previous campaigns. If «pensioners» just continued their series of successful performances, consolidation of positions Sergey Mironov's Russian Party of Life in many respects was connected with other circumstances. First, the head of the Council of Federation managed to competently use his opportunity to access Vladimir Putin, obtained his support in the party building business and managed to get certain support of the administrative resource at the local level. Second, the «actual left», which before joining Fair Russia had been

associated mainly with the Russian Party of Life and Sergey Mironov, in the opinion of the part of voters became something like fresh and worthy alternative to United Russia, the alternative which, unlike other system opposition parties, enjoys public and private support of President.

United Russia turned out to be not quite ready to the current situation connected with creation of Fair Russia and rather sharp consolidation of Sergey Mironov's positions, who feels more and more on the firm ground. At that, the «ruling party» still has time to draw conclusions and to try to regain control of the situation, which in many respects becomes complicated by the relative independence of Chairman of the Council of Federation due to his personal contacts with President of Russia. In this connection one may forecast a certain weakening of United Russia's positions, which, nevertheless, will allow it to win the elections to Duma with significant breakaway from its competitors, but, most likely, to get not more than 40% of votes. The public policy expectations, which have been fairly forgotten for the last few years, are growing, too. The public policy may become the result of the discussions between heads of the two chambers of the Russian parliament, belonging to antagonistic political parties.

On October 28th, 2006, congresses of the Russian Party of Life, the Russian Party of Pensioners and Rodina and the consolidating congress of the «new left» took place.

So, Sergey Mironov managed to create a new structure – Fair Russia - Rodina. Pensioners. Life. Practically all conditions of the merger had been approved even before the consolidating congress. The main initiator of the new association – Chairman of the Council of Federation Sergey Mironov – became its leader; Alexander Babakov took the post of the head of presidium of the party, and Igor Zotov, who declared during negotiations that he agreed to the merger only in exchange for the post of the co-chairman, will head the Central Council of the new structure.

The Russian Party of Pensioners performed on the whole more successfully than both Rodina and the Russian Party of Life at the regional elections in the beginning of month; still, this did not prevent Sergey Mironov from approval of his leadership with other participants. From the expected protesting actions of the ones dissatisfied with the merger, one may note only the statements of Andrey Savelyev who promulgated his position already a long time ago.

In the result, the Russian Party of Life and the Russian Party of Pensioners were transformed into public movements (the Russian Party of Life became the «Charter of Life», where Sergey Mironov remained to be the chairman, and the



Russian Party of Pensioners became the Pensioners of Russia) with the purpose to join Rodina, renamed into Fair Russia. Not randomly Rodina was chosen as the base party— first, it is the most numerous structure of all the three; second, it has its fraction in the State Duma which will represent from now on the new association in the parliament of the country.

The last unresolved issue was giving naming to the new association. Shortly before the congresses, in mass media there appeared the information that the new name will resemble United Russia – there will also be the word Russia in it, but with another adjective. Variants included «our», «favourite» or «indivisible». In a few days before the merger Sergey Mironov announced the new name of the party according to which Russia became «fair». Simultaneously, Chairman of the Council of Federation declared that Alexey Podberezkin's Social Justice Party, which ideology and name fit well into the alliance of the «new left», may join the new alliance after its re-registration by the Federal registration service. By that Sergey Mironov once again opposed himself to United Russia and the political strategists of Presidential administration – recently in mass media there appeared the information on future association of the «social democrats», where the Social Justice Party can become one of participants whose task will be to act on the electoral field of the «new left».

Red and yellow have been selected as the main colours of the new alliance (as it was with Rodina), flag color – also red. Thus, the new party, positioning itself as the left centrist party, intends to claim a certain share of communist and left patriotic electorate. At the same time, October regional elections have demonstrated that positions of the Communist Party of the Russian Federation remain steady enough, and Rodina has lost a significant part of its voters.

It is necessary – especially after the hot discussion on the «sovereign democracy» – to take care of the recognized ideological material. The leader already made hints to possible approaches to solution of this issue. So, Sergey Mironov on September 25<sup>th</sup>, 2006, at the first autumn session of the Council of Federation declared that the existing national policy is «hopelessly obsolete» and needs to be replaced by a new one, and called senators to perfection of the legislation and preparation of the corresponding report.

Thus, the speaker of the Council of Federation let everybody know, that it is the «actual left» who are going to make initiation and solution of the issues anyhow connected with the national and migration problems part of their current and pre-election activity. However, Rogozin's sad experience suggests that it needs to be done rather moderately and delicately, but «cautious steps» in this



direction also give the chance to retain the former voters of Rodina. The electorate of LDPR (the Liberal Democratic Party of Russia) is stable and will hardly undergo any considerable reduction or increase, and United Russia tries to not touch upon the national subject, limiting itself to acceptance of amendments to the migration legislation. At that, now Sergey Mironov has got the opportunity to carry out his policy simultaneously both through the Council of Federation and through the State Duma using Rodina fraction. And the new party, with the successful course of the merger, will become the second party in the country by the numerical strength. By developing the national subject, Sergey Mironov is trying to resolve the problem of retaining the electorate of Rodina to which «dim» ideas of the Russian Party of Life and of the Party of Pensioners are not very close.

Despite the impressive aggregate numerical strength of the three parties (about 350 thousand members and second in Russia), the overall support of Fair Russia by the electorate of the Russian Party of Life, Rodina and the Russian Party of Pensioners still is not guaranteed, as their «personal» voters are too «diverse».

The liberal wing parties actually turned out to be atomized. Yabloko (Apple) and Union of Right Forces (SPS) which repeatedly declared their intention to unite, have not found a consensus on division of leader powers. Apparently, political strategists from the Presidential Administration managed to find common language with leaders of both parties, having promised passing of their parties to the State Duma in December, 2007 (and non-passing of their liberal «colleagues») in exchange for refusal from criticism of President and of the policy performed by him. Returning of the liberals' top persons to TV screens became the result of acceptance of these conditions (criticism of actions of the government was not included into the «package» agreements).

Nevertheless, political strategists of the Presidential Administration, judging by the series of their actions, do not intend to allow any considerable consolidation of «old liberals» on the electoral field. For this purpose they are going to enhance the split in the right wing even more. In the beginning of December it became known about reformation of the administrative bodies of Free Russia Party. The supreme council should appear in the party structure which will include well-known people sympathizing with the party, who are not its members. In particular, these include Michael Barshchevsky (according to some mass media, the post of the head of the supreme council will be offered to him), Vladimir Pozner, Vladimir Solovyov and other popular people in the liberal environment.

Thus, the Kremlin project has been launched on dispersion of votes of the right wing electorate during «the big campaign» of 2007-2008. Free Russia is

practically unknown to the average voter. It was created in 2002 by the Ekaterinburg businessman Alexander Ryavkin as the Russian Network Party for Support of Small and Medium Business. It has won at the elections only once – in October 2006, having collected 11% by party lists during elections to the Novgorod regional duma. Most likely, Konstantin Babkin, the head of Rosselmash who headed the list at the elections, provided for the party such electoral «breakthrough». Most probably, the Kremlin project supervisors before the beginning of the «big race» decided to improve the party's recognizability at the expense of well-known persons, which does not require big material inputs. Chances are that during the forthcoming elections the party should take a part of votes from Union of Right Forces – a unique right wing party which possesses both the well-known brand, and certain financial and organizational resources.

The party's affiliation with the Presidential Administration causes few doubts. First, during elections to the Moscow City Council last year Free Russia acted as the classical «spoiler», called to take the maximum of votes from Yabloko (Apple). The scandal which took place last week can serve as the proof of close connections between Free Russia and the Presidential Administration. At the press conference which took place on December 7<sup>th</sup>, heads of the near Moscow branches of Union of Right Forces, Yabloko (Apple), Democratic Russia and Free Russia have declared that on situated they will go to the near Moscow elections in March, 2007, as one list. However, later representatives of the central structures of Free Russia and Yabloko (Apple) disavowed their regional leaders' statements and declared that they will go to the elections in separate columns.

It looks that each party has its own reason for refusal. So, by the unconfirmed information, the authority has reached certain agreements with Grigory Yavlinsky according to which Yabloko (Apple) will return to TV screens and, probably, will get several seats by the results of regional elections in exchange for abstaining from criticism of President Vladimir Putin. If this assumption is true, it will not be beneficial for Yavlinsky to enter any pre-election alliances, acting as «locomotive» for other right wing parties. Free Russia, not having such guarantees, most likely has followed the advice of the supervisors from the Presidential Administration whose primary goal at the forthcoming elections is not to allow association of oppositionist or potentially oppositionist forces.

Apparently, the use of «spoiler» parties will be one of the hits of the Kremlin political strategists at the pending elections. However, this tactics is a component of the wider strategy, apparently, approved by Vladimir Putin personally. One of its main elements, apart from «twin» parties, will be the encouragement of real

competition between political forces. This version is supported by the fact that Fair Russia actually has been given freedom and is supported by President from time to time. Such strategy will create an illusion of competition at the elections to the Russian parliament in 2007, which will allow to minimize the criticism of the current authority from the West concerning authoritarian tendencies in the country.

The pro forma list of «twin» parties became known in the beginning of December, when Vladimir Putin met with heads of ten parties. And, if four of them «deserved» the attention of the chief state executive by their political weight and potential (United Russia, Fair Russia, the Communist Party of the Russian Federation, the Liberal Democratic Party of Russia) the others can hardly be considered as the basis of parliamentary fractions in the future State Duma. First of all, People's Will, the Agrarian Party, People's Party, SEPR (the Socialist United Party of Russia) refer to these parties. The first one may be considered as the «spoiler» of the nationalist party on the basis of KRO (the Congress of Russian Communities), the last one – as the «spoiler» of the Communist Party of the Russian Federation or even of Fair Russia. However, the full list of «real» parties and «spoiler» parties will be finalized by the spring elections.

In the middle of December formation of one more «spoiler» started, this time on the nationalist wing. On December 15<sup>th</sup>, Gennady Semigin, the leader of the party Patriots of Russia was elected as the head of Rodina fraction (People's Will – the Socialist United Party of Russia) in the State Duma of the Russian Federation. The «dwarfish» fraction, consisting of only several deputies, who split off in its time from the «big» Rogozin's (nowadays – Babakov's) Rodina, has been significantly enlarged. Independent deputies Gennady Semigin (the leader of the party Patriots of Russia), Gennady Seleznev (the leader of the party Revival of Russia) and the former Rodina deputy Yury Savelyev and some less known deputies have been delegated for the enhancement.

It seems that supervisors from the Presidential Administration responsible for the party projects, have finally defined who at the forthcoming elections will represent the third, «ensuring» leg of the Kremlin. According to the statement of Gennady Semigin, the leader of the newly formed fraction (who will enter the office on January 9<sup>th</sup>), there was no discussion of the merger of parties at the session of the fraction which took place on December 15<sup>th</sup>. However, the assumption that the «fraction» reform is the first step to the merger seems to be logical. Otherwise, the merger will lose its sense – deputies, being «independent», would have much more space for maneuvering. At the same time representation in the Duma as a fraction gives the future party the advantage in

the form of the platform for promulgation of various initiatives during the electoral campaign.

Now Gennady Semigin's inconsistent behaviour in November, 2006, became clear; first he signed the document and then he denied his participation in such project. In the beginning of November the four leaders of the «dwarfish» left wing parties (Gennady Gudkov (People's Party), Gennady Seleznev (the Party of Revival of Russia), Gennady Semigin (the party Patriots of Russia) and Alexey Podberezkin (the Social Justice Party) signed the agreement on creation of the coordination council. In several days the Social-Democratic Party led by Vladimir Kishenin joined them. However, later Gennady Semigin denied his participation in the coalition, thus having puzzled the analysts.

In view of the last information it becomes clear: the November agreement was the false start of creation of the «third» leg. Probably, this was the individual initiative of his main lobbyist – Gennady Gudkov, the leader of the People's Party. After Gennady Semigin realized this, he immediately distanced himself from the project. Gennady Semigin's refusal to sell his media assets (newspapers the Patriot of Russia and the Native Newspaper, Political Magazine and the National News Agency), which was offered to him by Sergey Mironov's representatives, also speaks in favour of the assumption on his serious political ambitions.

The attention should be paid to one detail. Although analysts name the created coalition (as well as its failed predecessor) the «small left», the presence of the figures popular in the systematic nationalist party is eye-catching. Sergey Baburin, whose meeting on November 4<sup>th</sup> became a cover for DPNI (Movement against Illegal Immigration), and former Rodina participant Yury Savelyev may be named among them. The information was also promulgated that Nikolay Kuryanovich known for his support of DPNI can join the fraction. It is natural that such personnel solutions were not spontaneous and were taken with the approval of the Kremlin supervisors. Therefore, the assumption appears that the party will be carrying out the spoiler functions not only on left wing (the Communist Party of the Russian Federation), but also on the right wing, which actually puts it to the place of today's Liberal Democratic Party of Russia. One should to note that the rumors that the Kremlin is closing the project of the Liberal Democratic Party of Russia have appeared in mass media this autumn. However, finally the favourite of the authorities on the social-national field will be defined closer to the autumn elections.

Thus, one may draw a conclusion that the party being formed has been conceived as the classical spoiler, called to split both the left and right electorate.

However, the necessity to play on the two ideological fields at a time may seriously complicate achievement of the tasks set by supervisors.

### 2.3. Civil Society Becoming More Active

The pre-election year will be a special period, including the activation of political forces, large financial investments into political and social processes and sharp perception of events. So far the current authorities underestimate the mass factor, thinking that all decisions should be taken at the top, without consideration of the public opinion, believing the latter to be fiction to certain extent and the means to attempt manipulation of this opinion and substantiation of decisions which cause disapproval of part of the society.

The authorities have serious grounds for such point of view. Undeveloped party system, almost full absence of independent mass media, low level of public consciousness and self-organization provide the chance to manipulate the public opinion, mainly by means of TV, in a rather wide range. At the same time, absence of the adequate system of monitoring and reaction to really serious problems in the society can play a low-down trick with the authorities which believe in the omnipotence of the state TV and, in the emergency, the «power resource». Some last year's episodes have convincingly demonstrated this: the horrifying facts of «hazing» in the Chelyabinsk tank school, the fire in Vladivostok, Kondopoga, et al. Not always the existing authority managed to operatively and adequately react to them. Besides, in many regions the tariffs for the housing and public services have grown sharply. At that, the society is tired of the infinite promises of social and economic welfare in the country, as the result the protest moods are growing in the country.

In 2006 people were not «silent», but tried to act actively enough on several occasions. They can be divided conditionally into socially significant, situational and national. And if on the first occasion the most socially unprotected layers of population traditionally acted, on the occasions of situational character the «middle class» representatives more actively joined the opposition to the authority. Both these and those acted jointly on the ethnic issue.

The problems existing in the country last year attracted the attention of the increasing number of citizens, first of all, of those referred by the official statistics to the «poor» category. As revealed by the polls in 2006, *the society is tired of political and social and economic promises, which is accompanied by the*

***increasing mistrust of the population practically to all state institutes (except for President of the Russian Federation).*** As the result of the spreading of largely welfare mentality, citizens expect from the state actions which would lead to improvement of their well-being, they want the results of the country's economic growth to directly reflect in their material welfare. However, this does not happen.

The government's economic and social policy leads to the increase of the protest activity. From the beginning of 2005, when the reform was launched on replacement of privileges with monetary compensation, the mass protest actions became a usual phenomenon in the country. The more so that the government made concessions to those who showed their discontent with the monetization process, and thus has created a precedent. This fact deserves special attention, whereas earlier the authorities tried to not give in to pressure protesting and to not carry out their requirements, because such «productivity» of blackmail would allow to turn mass actions into the real lever for pressurizing the country's leadership; however the «monetization process» has shown that the authorities are ready to carry out the requirements of those protesting.

The protest movement against monetization became so massive and dangerous to the authorities, that Vladimir Putin in 2005 gave direct instructions for implementation of the requirements of the dissatisfied population. This local success has demonstrated the strength of the organized broad masses and gave them the grounds to believe that it is possible to continue with pressurizing of the «Kremlin».

Since this moment the dangerous process of spontaneous spread of the protest moods and organization of the mass actions has been launched, which continued in 2006, too. Appearance «from below» of organizations which directly represent interests of the population has created a serious danger to the authorities. When representatives of political structures are in the head of the protest movement, it is possible to agree with them, to reach a mutually advantageous compromise, and then the course of mass actions may be supervised and directed to the channel beneficial to the authorities. But the work with self-organizing movements is difficult because they are mobile and they put forward quite certain requirements. Usually this is not very big list of claims which, however, the authority should carry out to terminate the protest actions. At present, political technologists of the Presidential Administration, who should deal with issues of fighting with the protest activity, do not have ready recipes for channeling of discontent to the safe channel. Therefore, the stake was made on the already existing «constructive» facilities: this may be proved by active promotion in mass media in 2006 of the



topic of «oppositionism» of the Communist Party of the Russian Federation and its leader Gennady Zyuganov.

The Presidential Administration took not very successful attempts to partially reanimate the former popularity of the «systematic» Communist Party, with the purpose to de facto put the protest of the population of the country under its control. The protest activity can result in the more radical and non-system forms; moreover, in the process of its growth, the economic requirements will be complemented by the political ones, which can provide ground almost for revolutionary moods. Therefore, the attempts were made to impose the role of the «social protest motive force» on the Communist Party of the Russian Federation and create the impression among the population that it was «Zyuganov's party» that should protect their interests at the federal level. In their turn, communists readily agreed to their «leadership» in the protest actions. For instance, in February, 2006, at the Izmaylovsky hotel complex, through the intermediary of the Communist Party of the Russian Federation the All-Russia meeting of officers was carried out. Representatives of military pensioners from 65 regions have passed a no-confidence motion against the Supreme Commander-in-Chief Vladimir Putin and demanded resignation of the Minister of Defense Sergey Ivanov; this created the «protest» effect for the Communist Party.

This and other facts support the version that «Zyuganov's men» have taken the obligations to participate in the Presidential Administration's projects, privately becoming the allies of the authority. However, not always and not everywhere during this year the population went to the streets to inform «the top» of their problems in an organized way and under the red flags.

In 2006 in the regions regularly appeared spontaneous and uncontrollable sites of discontent with the social policy of the authorities. So, starting with January 1<sup>st</sup>, 2006, the prices for municipal services have grown. And in several regions the increase in the cost of housing and public services constituted about 30% instead of the planned 20%. The population turned out to be practically unaware of the forthcoming increase of the tariffs. As the result, spontaneous and rather numerous protest actions against the economic policy of the government of the Russian Federation have started in many regions. The most part of the population of the Russian Federation refers to «paternalists», for which it is important to feel the care from the authorities. Therefore, the increase of tariffs for housing and public services on the background information that there is overabundance of oil dollars in the country is only enhancing discontent in the society. One should note that the authorities responded to these protest moods,



having decreased by 2 times the rate of growth of tariffs since January 1<sup>st</sup>, 2007.

Priority National Projects, which have been positively apprehended by the population, also run the risk of «falling into disrepute». According to the statements made by the first Vice Prime Minister of the Government of the Russian Federation Dmitry Medvedev in his recent interview, the immediate implementation of main national projects, in particular, connected with the solution of the problem of habitation accessibility, will actually begin only in 2007-2008. This is quite logical, in connection with the terms of the next presidential and parliamentary elections.

Self-organization of the population in the absence of official structures and channels which could resolve this or that urgent issue «in accordance with the established procedure» became an acute problem for the authorities in 2006. At that, the qualitative change of the protest actions' participants happened. More and more often medium-income people, who are not suffering from heavy material problems, went to the streets, not just representatives of socially unprotected layers of population.

The main characteristic of self-organizing structures is their «survivability» and possession of the very high mobilization resource. At that, there are a series of problems which are urgent both for separate regions, and for the whole country. For instance, actions of the owners of motor vehicles with the right-hand steering wheel have been carried out in the Far East during the whole year 2006. They opposed the specific decisions which concerned their region. However, at the same time, owners of the «right-handed» vehicles all over the country have performed several solidary actions against the import ban and operation of the corresponding vehicles in Russia.

Protests of automobilists gradually become rather unpleasant for the authorities. The mass character of participants of the protest actions, as well as their mobility and possibility to implement unauthorized actions allow them to demonstrate their high activity all over the country. For instance, in Moscow the dissatisfied motorists have adopted the following tactics: at a certain time a large number of cars with flashing emergency lights go to the Garden Ring Road or other important highway of Moscow and move with low speed. At that, drivers who earlier did not know about the action quickly join the «activists». Formally car owners do not break the ban on implementation of unauthorized mass actions, because they are not standing still, but moving. The authorities cannot limit the right of movement of cars with flashing emergency lights. Although law

enforcement officers during such actions try to detain a couple dozens of cars «with preventive purposes», nevertheless, they have to let drivers go, as they do not formally break any bans. In the number of regions actions of motorists have been carried out in connection with the increased cost of the compulsory civil liability motor-vehicle insurance policies.

Social intensity sites emerged repeatedly in 2006 around the country in connection with protests of the deceived participants of the share construction of habitation. The difficulty of settlement of these conflicts for the authorities consists in collision of significant material interests of builders and investors (as a rule, «middle class» representatives), ambiguity of legal interpretations and time-consuming legal proceedings.

The fire on January 16<sup>th</sup>, 2006, in the 9-storey office building of the Far East Institute of Industrial Design in Vladivostok was another tragical event which shocked the country's population. 9 people died, all women, mainly young, who jumped out of windows of the three top floors enveloped with fire. The information that the fire team was rescuing the bank's management from the wing of the building which was not endangered by the fire spread quickly. Similar publications, as well as the evidence of witnesses of the fire have caused a wide public resonance. In a number of cities, including Moscow and St.-Petersburg, meetings were held where people demanded to punish the culprits, several sites were created on the Internet which represented «independent» information on the fire, and the emotional discussion of tragical events during the fire continued in regional press for a long time. The opinion was formed on the social «insensibility» of authorities and their unwillingness to provide safety of the population. Despite rather resolute actions of law enforcement bodies on detection and punishment of persons guilty of what had happened, the interest of the public to such events does not abate.

The Army problems were also in the focus of the public attention in 2006. After the tragical incident with Andrey Sychev during the whole year practically all federal channels and large printed publications informed about new incidents in the Russian Army, the number of which is only growing. Despite the fact that this information campaign was meant, in the first place, against the Minister of Defense Sergey Ivanov, however, it has caused serious damage to the authorities on the whole.

Discontent with the conditions in the «invincible and legendary» [Army], where the considerable part of the population still has to send their children without any guarantee of their safety, can provoke in 2007 much more serious discussions in the society.

Instances of injustice admitted by the existing authorities in relation to ordinary citizens also cause the anger of the population. The «double standards» during legal estimation of actions of ordinary citizens and of high-ranking officials provoke deep indignation. The public reaction to the results of the legal proceedings on the case of death of the governor of Altay Krai Michael Evdokimov in the road accident became a vivid example of such discontent. The court has sentenced driver Oleg Shcherbinsky, whose car was hit by the governor's Mercedes, to four years of imprisonment with serving his sentence in the colony-settlement. In a couple dozens of Russian cities drivers have carried out protest actions against this severe sentence. The largest action took place in Moscow – over a thousand cars with posters and flashing emergency lights blocked movement on Rublevskoe and Aminyevskoe highways and Michurin Avenue. One should note that automobile owners, i.e. people who are not poor, are participating in these actions, as well as in the «right-handed» protest.

On the night of August 29<sup>th</sup>, 2006, in the town of Kondopoga of the Republic of Karelia there happened a mass fight between natives of the North-Caucasian region and inhabitants of the local nationalities, in the result of which two «aboriginals» of Kondopoga died from the received wounds.

The General Prosecutor's Office of the republic declared that it «has no information that any interethnic relations, national, religious and other motives similar to them could be the basis of the conflict», which is certainly the truth. The died and the survived young men could hardly go to restaurant Chayka (Seagull), which became known to all the country and which belonged to the natives of the Northern Caucasus, with the purpose to organize the conflict on the national basis, risking their lives. If this action had been planned in advance, there would be more victims on both sides, and the scale of actions would be larger. As the result, a grassroots quarrel received its development and has led to the events, which provided the reason to speak about the national theme. The attempt of the General Prosecutor's Office of the republic to present the subsequent chain of events as the planned action has been dictated only by the desire to justify its lack of activity during the time before the incident.

According to the General Prosecutor's Office of Karelia, the appeals to the town dwellers to take part in the unauthorized meeting started to be spread through the Internet since August 30<sup>th</sup>, i.e., one day before its beginning. It seems to be a difficult task to gather within 24 hours and take to the meeting one fifth part of the town's population, especially if one considers the fact that the computer network users are not so many in Kondopoga. The statements of the General Prosecutor's

Office of the republic concerning involvement of activists of the Movement against Illegal Immigration in organization of the well planned action also looked as an attempt to reload the responsibility for the event on the «external» forces. This is also confirmed by the recognition that there were no grounds for detention of activists of DPNI (Movement Against Illegal Immigration), although organization of unauthorized meeting is already a basis for detention and trial. One of leaders of DPNI Alexander Belov was noticed on the site of events; he, having spent one day in Karelia (the day of meeting), did not take any illegal actions and was released.

Even if one admits participation of «destabilizing forces» in the Karelian events in any form, it will be necessary to consider it as a concurrent factor and recognize that «there is no smoke without fire». Moreover, the situation which has developed in Kondopoga, in this or that form is characteristic for many cities of Russia. Thus, the events in Karelia provided a reason to pay attention to serious social and political problems which led to them.

Corruption of employees of the Ministry of Internal Affairs at different levels, which is not a secret for everybody, became the direct reason of the current situation. Low official salaries of employees of the law enforcement bodies lead to conclusion of the union with representatives of the criminal world and natives of the Northern Caucasus. According to inhabitants of Kondopoga, the majority of the town's places of entertainment belong to «newcomers», and visitors of restaurant Chayka had no alternative. The fact that at the moment of the incident near the restaurant there were officers of the law enforcement bodies who did not interfere into the course of events, confirms all the aforesaid.

Another reason is the lack of activity of regional and local authorities which shut their eyes to the current situation, and do not wish to make the emerging conflicts public. Not having the opportunity to legislatively influence the migratory situation, regional authorities can only change it by means of administrative methods which they usually neglect for the reasons specified above.

At that, during the first half of 2006 the authorities practically did not pay any attention to internal migration issues. Guest workers from the Ukraine, Belarus, Moldova and Central Asian republics disturb less the population of the country, which on the whole does not approve of appearance of a big number of visitors, than the «internal migrants». While the first occupy the workplaces of «indigenous» inhabitants, who are not happy with the offered wages' level, the second, promoting themselves in prestigious areas with the «assistance» of the authority representatives, contribute to creation of situations similar to the one

observed in Kondopoga. Small Northern town is not an exception and it can serve as a sample of other settlements of various sizes with similar situations, which have been concealed and ignored for the time being. The example of Kondopoga has also shown that sooner or later there comes an end to the patience of the people, and their mass appearance in the streets is a realistic thing.

Serious personnel conclusions from the Karelian events, large decisions on the migratory processes became the answer of the authorities to the unauthorized interethnic activity. Meanwhile the events around the «Russian march» on November 4<sup>th</sup>, 2006, have shown, on the one hand, a large potential of the groups of the population with nationalist moods, and on the other hand – the ability of authorities, with adequate instruction, to soften and neutralize the consequences of splashes of xenophobia moods in the society.

The «Russian march», discussion of preparation to which became a much bigger public event than the march itself, took place in the form of the meeting approved by the authorities of the capital, and has been carried out the way it was supposed to, so that all the involved parties would be happy. Several hundreds of people arrested rather for the preventive purpose, the absence of any serious collisions, detention of the deputy of the State Duma Nikolay Kuryanovich and the administrative protocol drawn up on the deputy of the State Duma Sergey Baburin because of the number of people which gathered for the meeting exceeded the preliminary application. The meeting, the contents of which did not bear and could not bear anything substantially new, for some semi-forgotten political figures became an occasion for their self-advertising, and for some – the end of the old and the beginning of the new stage of their political career.

The fate of the «Russian march» was predetermined on the eve of its planned performance, when Dmitry Rogozin addressed the management and members of the Movement Against Illegal Immigration, the initiator and organizer of the «Russian march», with the request to refuse from the planned action in the Moscow underground and to be limited to meeting, the sanction for implementation of which had been received by one of DPNI's ally organizations. The «semi-action» of the nationalistically oriented political forces has convincingly demonstrated that actions of the radical character, in the first place, will be stopped in future by the authorities of all levels, second, under certain circumstances, may enjoy a significant support of the population.

A new institute to Russia – the Public Chamber – started to function in 2006. Formation of the Public Chamber happened in three stages in the autumn/winter of 2005. At the first stage President Vladimir Putin «by the results of his

consultations with public organizations» has appointed 42 candidatures which then elected 42 more members from all-Russia public organizations. At the final stage 84 members elected 42 more members from regional and inter-regional public associations. This helped to observe both territorial and «ideological» representation. However, still there was the «gravitation» towards the figures loyal to the authorities – from the «elects» who are absolute power supporters (the author of the book «Putin and his ideology» Alexey Chadaev) up to figures which are neutral or rather benevolent to the top authorities (for instance, Yaroslav Kuzminov, the rector of the Higher School of Economics).

Proceeding from the analysis of statements and actions of the Public Chamber members during the last year, it is possible to assume that on the whole they were limited by one informal restriction, just as all public figures who have the access to mass media: in their statements they must not «go down» to the criticism of the chief state executive of the state and his environment, which has been observed.

Among the loudest events which took place with participation of members of the Public Chamber one may separate «private Sychev's case», «Butovo conflict» connected with the forcible eviction of residents by Moscow authorities, protest actions of the deceived co-investors, the case of driver Shcherbinsky, accused of the death of the Altay governor Evdokimov, and creation of the coordination council of the nonprofit organization on public control in December of the last year.

The majority of events in which members of the Public Chamber participated, were of the resonant and conflict character. At that, these scandals damaged certain representatives of the elite groups. For example, «Sychev's case» has seriously damaged the reputation of the candidate to the «successor», Vice Prime Minister Sergey Ivanov; Butovo conflict affected adversely the authorities of Moscow, actions of the deceived co-investors damaged the first Vice Prime Minister Dmitry Medvedev responsible for the national project of Affordable Habitation. This wide spread of objects of «attack» allows to speak about the relative neutrality observed by the Public Chamber during the fight between leading elite groups. The activity demonstrated by «public activists» pursued two goals – to justify their existence in the eyes of the society and to «test strength»; it demonstrated that the presence in the media streams and the skill of the majority to behave in public, which is the result of their wide experience of public activity, is the only but rather effective weapon of members of the Public Chamber. As for the administrative levers, the results of the first year have revealed their practically full absence. Despite the presence in the legislation of provisions on the obligatory registration of the results



of the parliament's examination of the Public Chamber, this provision during the last year was actually ignored (e.g., the results of examination of the Water and Forest Codes practically have not been considered).

Practically immediately the Public Chamber was shown its place by other «representatives of society», first of all, by the State Duma. This happened during discussion of the possibility for members of the Public Chamber to be present at sessions of the lower chamber of parliament. Representatives of the Public Chamber insisted on the unimpeded entry of its members to the parliament building and to the meeting room, as well as on their participation in discussions concerning legislative drafts. However, the committee on the rules of procedure of the State Duma took a rather strong stand, having limited the number of representatives of the Public Chamber at the committees' sessions by five members and actually excluding any opportunity of free participation of the Public Chamber members in debates at the plenary sessions.

Thus, an obvious signal was sent to the Public Chamber that will not be admitted to solution of the issues concerning redistribution of any specific resources (financial, administrative, etc.). President did not interfere into the conflict, thus indirectly supporting members of parliament. At that, the possibility of active participation of members of the Public Chamber in the «steam release» procedures – parliamentary hearings – has been fixed institutionally.

Proceeding from the analysis of the results of the Public Chamber's activity for the last year, one may separate several real tasks for solution of which the Public Chamber has been created. First, this is channeling of protest moods. Recently the activity of the civil society, which is outside of control of the state institutes, has increased considerably, and an institute became necessary, which would be capable of enclosing these moods into the constructive channel. For instance, it was after the meeting with members of the Public Chamber that the deceived co-investors have stopped their hunger strike and carried their fights over to the Ministry of Regional Development. Its second function is creation of the appearance of support by the society of the authorities' actions in the eyes of the western community. The Public Chamber coped with this task, too; this was especially obvious during the G8 summit in July, when the Public Chamber took a grave view of the activity of the Other Russia congress. At last, some analysts consider that the existence of the Public Chamber may have one more function – that of the spare variant of «employment» of Vladimir Putin after the end of his presidential term. Of course, for this purpose it is necessary to reconsider cardinally the status of the Public Chamber regarding its endowment with serious



administrative and financial levers of influence. However, the likelihood of these hypotheses will become more clear closer to the end of the first term of powers of the Public Chamber – January, 2008.

So, the political situation in Russia in 2006 can be characterized as follows. During the whole year there was the race between «official successors» – Dmitry Medvedev and Sergey Ivanov. President Vladimir Putin took the position of the ultimate arbitrator with «egalitarian» policy, setting down the leader and helping the one who lags behind. At that, by the end of the year it became finally clear that the current President does not agree to stay over for the third term under no excuse, which added special acuteness to the «race». At that, the figures of other «successors» started to acquire definite political and resource outlines, the third «prize-winning» place in the list of which belongs to Vladimir Yakunin, the head of OJSC Russian Railroads.

During the whole year 2006 the active fragmentation of elites was happening, accompanied by the redistribution of resources which predetermined the structural and personnel changes in the executive power system. In 2006 division of the Russian elite into two groups – «liberals» and «siloviks» – gradually becomes less actual. It seems to be more appropriate to speak about more and more amorphous «liberal» and «power» wings which include separate, quite often conflicting groups – Kudrin and Gref (liberals), Sechin, Sergey Ivanov, Victor Ivanov, Chemezov, Zolotov, Patrushev (siloviks). In parallel to this, another large elite group is emerging, which is not connected with the two above mentioned «wings» – Russia bank; Gennady Timchenko, the former colleague of Vladimir Putin, can be named its leader.

«Liberals» represented by German Gref have suffered in the result of the administrative and personnel replacements most of all. However, in the result of these transformations, one may not call the «power wing» an unambiguous winner, because the nomenclature assets lost by Gref will become the «apple of discord» in the «power wing», which will enhance its fragmentation even more.

The protest activity of the population has increased on the background of the incessant conflict of elites and party construction. At that, the existing systematic parties, by virtue of the objective restrictions, cannot satisfy the electoral demand of many groups of population; anti-system movements, mainly of nationalistic nature, are making use of this. If the signal sent to elites in 2006 is not heard by the Russian society, the «Successor» operation may proceed according to the script which is far from the current one.

Chapter 3.

## **MACROECONOMIC SITUATION**

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The macroeconomic situation in 2006 was conditioned by the standoff of the major interest groups in the “economic block” of the Russian Government. As a matter of fact it was different approaches to state governance that predetermined the annual indicators of the Russian Federation.

Until recently, the monetary policy of the Russian Federation was reduced to manageable (“gradual”) strengthening of the ruble. This policy was promoted primarily by the Ministry of Finance and the Central Bank. Sergei Ignatiev’s agency would buy up liquid dollar assets and, on a planned basis, lower the mandatory reserve requirements. Thus, since March 2004 the requirements for most types of borrowing were lowered from 10% to 3.5%. In parallel, Alexei Kudrin’s Ministry would “cut off” dollar cash from oil exports to the Stabilization Fund. Yet, “black gold” prices grew by leaps and bounds and huge volumes of petrodollars still made their way into the market of the Russian Federation. In its turn, it spurred inflation which devalued both government expenditure and the investment appeal of the ruble.

However after the failure of the inflation plans for 2005, the financial policy of the Central Bank changed. “Total” (“strict”) strengthening of the ruble became a strategic priority. It was prompted, among other things, by the spring address of the President where the slowing down of the devaluation of the national currency was declared a pivotal goal. The Central Bank all but ceased its currency interventions with respect to the dollar which resulted in a significant strengthening of the ruble. Besides, the reserve requirements were substantially reduced.

In this connection, on August 22 at his Bocharov Ruchei Residence, Russian President Vladimir Putin received Minister of Finance Alexei Kurdin. Initially it was planned to discuss the finalizing of the 2007 Draft Budget. However the main subject became the policy for preventing a considerable strengthening of the ruble.

It was noted that the strong ruble could undermine the competitiveness of the national economy. It applies first of all to major exporters, whose products are denominated in the US currency. First and foremost, these are raw material companies. Moreover, the higher is the added value of a product the higher are costs incurred by the manufacturer. Hence companies with the highest margin become the most vulnerable. In the national economy such are primary, secondary and tertiary processing structures. Thus the highest losses are sustained by large metallurgical companies (ferrous and non-ferrous metallurgy with high added-value): Severstal, EvrazGroup (rolled steel); Rusal, Sual (aluminum); Norilsk Nickel (nickel and copper); UGMK (zink); VSMPO-Avisma (titan and magnesium).

Their direct competitors in world markets receive significant preferences due to weak national currencies. It is due to the difference in exchange rates. Thus their production costs will be markedly reduced, whereas our national companies will be losing profit.

However the greatest damage was done to the residents competing with foreign manufacturers also in the domestic market. What is more, non-residents are ousting Russian companies from the national market. Imports are on the rise. In 2003 imports were up by 25%, in 2004 – by 28%, in 2005 – by 29%. This year their growth will be 27%.

In its turn it also hits the budget receipts of the Russian Federation, for foreigners pay the major taxes at the place of their registration.

Heavy engineering companies should be singled out among national residents that have suffered substantial damage from the strengthening of the national currency. A landmark example here is Vladimir Potanin's Silovye Mashiny. Let us remind you that this Russian company more than others suffered from foreign manufacturers, particularly after a reduction in the customs duties on imported machinery.

Thus, at the end of the 1<sup>st</sup> quarter the profit received by the company was 2.4m rub. In other words, for the first six months of the current year the loss of Silovye Mashiny totals 136.7m rub. compared to the net profit of 301.5m rub. for the same period of last year. The company's RAS revenues in 2005 went up to 16.21bn rub. from 15.75bn rub. Net profit totaled 194m rub., sales profit – 1.614bn rub. IFRS net loss of Silovye Mashiny in 2005 totaled \$40.5m against the profit of \$10.2m the year before.

Among others, the Head of Interros actively championed the idea of a gradual (“manageable”) weakening of the ruble. Note that Potanin had long warned about the dangers of strengthening the national currency, however until recently his words remained unheeded. He is thought to be among the major businessmen who managed to lobby through today's monetary policy of the Kremlin.

In principal, there are just three efficient measures for reducing the rate of ruble strengthening in the Russian Federation. And all of them are pursued by individual interest groups within the Russian Government.

The first – is customs regulations. This measure allows one to keep in check dollar money supply by increasing duties. Thus in the event of high custom charges, quotas, the presence of importers in the national market declines. Hence, the “washing out” of rubles from the market is reduced. This mechanism worked successfully in the agricultural sector. To be more precise, in the poultry meat

market. This project was actively lobbied by Minister of Agriculture Alexei Gordeev. At his recent meeting with Vladimir Putin he spoke for maintaining quotas on poultry meat imports from the US. Until 2003 this customs regulation was one of the most efficient measures. Its major drawback was a limited area of application: in the case of domestic market protection it can help, but when it comes to exports it is less efficient. This mechanism is implemented by the Federal Customs Service of the Russian Federation which is closer to the “siloviki” interest group.

The second – is the monetary policy of the Central Bank. It has already been mentioned. It is mostly currency interventions (dollar purchase) and increasing the reserve requirements. The said mechanism is supervised by the Central Bank headed by Ignatiev. Moreover, since 2004 it was the most important tool in the Russian financial policy. However the positions of the Bank of Russia were markedly weakened after the introduction to the State Duma of a draft law on full ruble convertibility which provides for canceling the reserve requirements (crucial levers of influence on the financial policy of the Russian Federation).

The third – is sterilization of the greater part of export revenues at the Stabilization Fund. This strategy is implemented and actively lobbied by the Ministry of Finance headed by Alexei Kudrin. Actually, the Minister’s initiatives which he expressed at his meeting with the President are designed to significantly strengthen his administrative positions. Thus, according to Kudrin, 80% of the ruble rate control mechanism will be at the disposal of the Minister of Finance and only 20% - of the Central Bank. As a matter of experiment, 16 Federal Agencies will change over to result-oriented budgeting (ROB).

Thereby, the introduction of ROB targets two goals. The first - is to strengthen Kurdin’s positions of control over the financial policy of the Russian Federation. The second - is to create levers of influence on outside agencies at the Government.

The Central Bank’s symmetrical response to the Minister’s proposals was increasing the reserve requirements for obligations to foreign banks. It should be reminded that Ignatiev’s agency intends to raise the requirements from October 1, 2006 from 2% to 3.5%.

On top of that, Head of the Ministry of Economic Development and Trade (MERT) actively stepped into the fray. His Ministry prepared a national export support agency project with the financing in the amount of 2% of budget expenditure. It is proposed to transfer the main exporter support functions to Gref’s Agency. It is planned to take away the granting of state guarantees from the Ministry of Finance and the subsidizing of export credit interest rates – from the Ministry of Industry and Energy.

Thus, the main struggle for the levers of control over the economic policy of the Russian Federation went on among four agencies: MERT, Ministry of Finance, Central Bank and Ministry of Agriculture.

The standoff along the Gref-Kudrin line assumed the greatest significance. Both Ministers substantially modernized their projects which considerably furthered their implementation potential.

The ROB was complemented with a non-oil and gas fund project whose major provisions were formulated in the document: “Methodology for the Formation of the Non-Oil and Gas Budget Balance of Russia”.

Essentially the proposals of the Ministry of Finance boil down to using “separate accounting for oil and gas (raw material) and non-oil and gas revenues”. Alexei Kudrin proposes to manage these revenues in a special mode: withdraw them from the economy to a separate Fund with a special expenditure administering procedure or, at least, account for them separately.

Alexei Kudrin includes in oil and gas revenues the “corporate profit tax payable to the federal budget as revenues from the sale of oil and gas products”. Under this category will also fall excise taxes on gasoline, diesel fuel and motor oils. To separate out gas export revenues, viewed by the Ministry of Finance in the same way as oil revenues, it is proposed to restore also the excise tax on natural gas which was cancelled in 2004. It is suggested to include in oil and gas revenues the part of the mineral production tax (MPT) on oil, natural gas and gas condensate payable to the Federal budget. Export duties on gas and on oil products are also supposed to be included here.

Apart from that, it is suggested to consider “revenues from different forms of interest in capital, dividends on shares owned by the Russian Federation, revenues received from enterprises engaged in hydrocarbon extraction and production of oil products, and revenues from the operation of JV Vietsovpetro” as oil and gas revenues.

The Head of MERT also substantially modernized his national export support agency project. It was re-worked into a comprehensive plan for industry and technology development for 2006-2007 which was introduced to the Government on October 24. As a matter of fact, the above document incorporated all principal economic initiatives of MERT for the last year.

The plan lays a special emphasis on tax regulation mechanisms. Thus, the greater part of measures envisaged in the plan are related to changes in none other than tax legislation.

Actually, the key provision of the document is the support of Russian industrial exporters. It is suggested to stimulate them through accelerating the

VAT refund while simultaneously stepping up control over the refund process as well as through improving the mechanism for subsidizing export credit interest rates and the mechanism for granting state guarantees, including to small and medium-sized business enterprises.

On top of that, it is proposed to improve the depreciation policy mechanisms. This part is based on a draft Resolution of the Government on Amending the Classification of Fixed Assets included in depreciation groups. Among other things, it is suggested to afford taxpayers an opportunity to revalue fixed production assets. It is supposed to considerably increase companies' depreciation reimbursement. Besides, it is suggested to significantly raise depreciation bonuses from 10 to 20-30% in the event of purchasing high-tech equipment. The legislative framework for the above measures is expected to come out roughly at the end of 2007.

It is also intended to exempt from VAT patenting and leasing operations related to industrial properties as well as research and development operations.

Moreover, active introduction of investment agreements is separated into an individual clause. Currently they are actively used in the Russian motor industry and give significant preferences to foreign companies with highly localized production. It is worth reminding that this type of relations does not sit well with WTO representatives who look upon it as a violation of free trade rules. Supposedly, investment agreements will be introduced in key production sectors of the economy, For example, in the aircraft industry.

It should be noted that the standoff between MERT and the Ministry of Finance is related both to the opposing interests of the Ministers and also different areas of their competence.

MERT, for example, responsible for GDP growth and domestic export support, is interested first of all in slowing down the ruble strengthening rate. Therefore considerable state spending plays into German Gref's hands, for they may reduce the pressure on the national currency.

This, however, will result in inflation growth, direct responsibility for which is held by the Ministry of Finance and the Central Bank. In principle, market strengthening of the ruble is in Alexei Kudrin's interests. The point is that in this case the "damaged parties" will be MERT and the Central Bank. The former will get a significant decline in industrial exports, the latter will be accused of domestic currency appreciation, whereas the Minister of Finance will get additional arguments in support of the "budget control" project.



Chapter 4.

## **STATE FINANCES**

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## **4.1. Budget**

In 2006 the struggle for budget control went on between the major interest groups in the political elite, with the key role being traditionally played by Head of the Ministry of Finance Alexei Kudrin.

Thus, on August 28, the Ministry of Finance of the Russian Federation introduced to the Government a methodology for the formation of the non-oil and gas budget balance of Russia and the basic operating principles of the Future Generations Fund. Alexei Kudrin asked in it to instruct the Ministry of Finance and the Ministry of Economic Development and Trade with the participation of the Bank of Russia to consider the proposed methodology and make coordinated proposals for its potential application in budget planning practice.

The major players in the struggle for budget resources are the Bank of Russia (CB), the Ministry of Economic Development and Trade (MERT), the Federal Customs Service (FCS), each pressing ahead with its own project of addressing the export [issues] and strengthening the ruble. Thus the CB proposes to raise the reserve requirements for non-residents and step up interventions. MERT insists on establishing a national export support agency, to which should be transferred the state guarantees and interest rate subsidy functions. The FCS favors a considerable increase in import duties and reduction in export ones.

Yet the key role in the above standoff is played by Minister of Finance Alexei Kudrin. His people are actually developing two key projects. The first – is result-oriented budgeting (ROB) which was made public at the meeting with Vladimir Putin on August 22 this year. The purpose of this project is to intercept control over the main agencies of the Government. Thus, ROB will apply to 16 agencies not subordinate to the Ministry of Finance.

The second (and crucial) project will become the so-called “non-oil and gas budget”. It is its promotion that came to be one of the landmark events of 2006. The concept of the “non-oil and gas budget” made its debut in the well-known article by Alexei Kudrin in the February edition of the “Voprosy Ekonomiki” magazine. In essence it boils down to this: a so-called “oil and gas Fund” is set up on the basis of the Stabilization Fund. It is intended to accumulate in it all revenues of the Russian Federation from energy transactions. Thus, it will accumulate the tax on the profit of oil and gas companies, excise taxes on gasoline, diesel oil and motor oils. Besides, it is proposed to introduce an excise tax on natural gas canceled in 2004. The new fund will also receive the federal part of the mineral production tax (MPT) on oil, natural gas and gas condensate. It will also retain

export duties on gas and on oil products. Moreover, another source of replenishment will become dividends on the shares owned by the Russian Federation, received from enterprises engaged in hydrocarbon extraction and production of oil products, as well as revenues from the operation of JP Vietsovpetro.

Consequently, the new budget will consolidate up to 52.2% of all federal budget revenues which will substantially reinforce Kudrin's positions on the eve of 2006.

As calculated by the Ministry, in 2006 oil and gas revenues of the federal budget will be 3.199 trillion rub. (52.2% of all revenues), in 2007 – 3.195 trillion rub. (45.7%), in 2008 – 2.7 trillion rub. (39.9%), while in 2009 – 2.46 trillion rub. (33.2%). The non-oil and gas budget deficit in 2006 will reach 5.2% of GDP, in 2007 – 5.4% of GDP, in 2008 - 5.3% of GDP, while in 2009 – 4.2% of GDP. According to the Government's long-term financial plan, the extended budget surplus is down from 6.8% of GDP in 2006 to 2.2% of GDP in 2009. The oil and gas deficit of the extended Government in 2006-2008 will be generated at the level of 6.1-6.5% of GDP with a subsequent decrease to 5.1% of GDP in 2009. The major non-oil and gas deficit is generated at the federal level, whereas for the consolidated budgets of the constituent entities of the Russian Federation and state extra-budgetary funds of the constituent entities such oil and gas deficit will not exceed 1% of GDP. Of the total amount of oil and gas revenues of the consolidated budget of the Russian Federation in 2006 the federal budget is estimated to account for 91 percent.

The fund itself will be divided into two parts. The first – is the future generations fund. It will assume the function of the Stabilization Fund for maintaining the market-determined energy revenues. The second is a reserve one. It is from the latter that transfers will be made to the federal budget which, after withdrawal of its major revenue items, will turn into a deficit one. The transfer will be 4% of GDP which is supposed to cover the deficit.

The “non-oil and gas” budget project was proposed as a measure for supporting exporters and weakening the ruble. Thus, its justification (the document is officially titled: “Methodology for the Formation of the Non-Oil and Gas Budget Balance of Russia”) says that the establishment of the fund will encourage dollar sterilization (withdrawal of the US currency), which should reduce the pressure on the ruble. The Russian currency by losing ground to the dollar will ensure a significant competitive advantage primarily to domestic exporters in foreign markets.

Thus the project is announced within the framework of the new economic policy which substantially strengthens Kudrin's positions for its promotion.

The Prime Minister responded to the activization of Kudrin's group in late August. Properly speaking, the standoff between the Head of the Government and the Minister of Finance over budget funds has a long history. Thus, the "Methodology for the Formation of the Non-Oil and Gas Budget Balance of Russia" had been proposed to the Government as an efficient measure yet at the annual Board meeting of the Ministry of Finance. However Fradkov characterized it as a purely analytical evaluation tool pointing to the impossibility of its implementation.

Nevertheless, Kudrin still managed to push the "Methodology..." through to the Government along with the 2007 budget. In response the Prime Minister came up with a project of a government commission for Russian industry support. As a matter of fact, this project combines those of Gref ("national export support agency") and Kudrin ("non-oil and gas budget"). Thus the Government structure will, on the one hand, provide export support and, on the other, develop anti-corruption measures to remove the barriers preventing industrial growth. Furthermore, the commission will have jurisdiction over the depreciation policy and departmental target programs. Thereby, the Prime-Minister, by borrowing elements from the competing projects, deprive his major rivals of their principal arguments.

The preliminary discussion of Fradkov's project took place on August 28 at the meeting planned as preparation for the Council on Competition and Entrepreneurship. It is at this Council actually that the official presentation of said commission will be held. And on August 30, at the meeting of Vladimir Putin and Prime Minister at the Kremlin, the project was agreed with the President.

On top of that, the Ministry of Fuel and Energy has entered the fray for control over the budgetary funds. It is related to the fast-tracking of Victor Khristenko's two key projects which are supposed to considerably strengthen the Minister's positions in the struggle for the 2007-2008 budget flows.

It should be noted that in the period of inter-agency standoff over the sources of financing for the next two years Khristenko was not an active participant. The main struggle unfolded in the "siloviki" and "economic" blocks of the Government. Thus the non-oil and gas budget program was announced by the Ministry of Finance, the establishment of a single Russian export support body was announced by Gref, import limitation measures were presented by the FCS, finally, the plan for "the financial weakening of the ruble" was proposed by the CB.

And yet, despite a considerable delay in the struggle for state investments, it is the initiatives proposed by the Head of the Ministry of Industry and Energy that have the most favorable prospects. It is related both to the use of some foreign policy factors and also fairly strong political support of these projects.

Khristenko's first project has been under implementation with varying success over several recent years. It is the so-called "Caspian Project" associated with the reinforcement of Russia's positions in the Caspian Pipeline Consortium (CPC).

It is worth reminding that the Caspian Pipeline Consortium – is the owner of the only private oil pipeline in Russia connecting Kazakhstan's fields with Novorossiisk. The major government shareholders are: Russia (24%), Kazakhstan (19%) and Oman (7%), non-government shareholders – Chevron (15%), Joint Venture of LUKOIL and BP (12.5%), Joint Venture of Rosneft and Shell (7.5%).

Here two major groups of interests are represented. On the one part, it is the interests of the Russian Federation, and on the other, of non-government shareholders. The latter's interests are actively lobbied at the CPC by Chevron of the US.

The non-government shareholders of the Consortium are also the principal pipeline users. They are not interested in a marked rate increase, however are actively lobbying an increase in the CPC capacity. First of all, it is true for the already-mentioned Chevron which is the operator of Tengizchevroil – the largest exporter of Kazakh gas. Thus, non-residents propose a one-time increase in the pipeline rates from \$27.38 for the transportation of one ton of oil from Kazakhstan to Novorosiisk by \$2.5, immediate approval by Russia of the CPC capacity extension project from 34 to 67m tones a year, introduction of amendments to the CPC Charter boosting the role of production companies at the CPC, reduction in annual interest rates on credits of CPC private shareholders to the Consortium down to 10, 5%, restructuring of the CPC's debts with maturity in 2014. It is suggested to adopt these changes in a single package.

The opposite position is held by the Russian Federation. The Federal Center is lobbying a significant rate increase but is not interested in a serious extension of the CPC. The point is that unlike the foreign shareholders, the Russian Federation and Kazakhstan contributed to the share capital not financial assets but the transportation infrastructure (pipelines, pump stations, land). In exchange they were issued bills for the appropriate amount. It is assumed full repayment of these bills should start in 2009. However in the event of extension it may be delayed by another several years.

The active standoff between the Russian Federation and Chevron resulted in a range of high-profile projects for reducing the influence of foreign private

companies. Thus, in May 2006 the CPC was accused by the Federal Tax Service (FTS) of using “tax schemes”, of having the operating principles that were disadvantageous to Russia. The FTS began the recovery of 4.7bn rub. of the unpaid profit tax from the CPC.

The role of the Head of the Ministry of Fuel and Energy is to actively promote the interests of the Russian Federation at the governmental level. Thus, it is Khristenko’s agency that was first to announce the possibility of the project going bankrupt in favor of Russia.

It should be reminded that over the period from 1998 to the 3<sup>rd</sup> quarter of 2004 the CPC transferred to Russia’s budgets of all levels 525 million dollars as taxes, duties, charges, and charitable aid. Apart from that, tax payments from the wages of the CPC employees and payment for the services of Russian contractors (and, accordingly, their taxes) should also be taken into account. The Russian assets transferred to the CPC in 1997 had been idle by that time. The value of these assets was converted to a loan of the Russian Federation to the Consortium. 85 percent of all funds spent by the CPC in Russia are received by Russian suppliers and the Government of Russia (around 90 million US dollars annually). Calculations allowing for the multiplier effect show that every dollar spent by the CPC on orders to the Russian party gives an additional 2 dollar growth of the GDP, i.e. the full effect is three times higher than the direct one. In November 2004 the CPC started receiving Russian oil at the Kropotkin Pump Station in the Krasnodar Krai. The volume of Russian oil supplies in 2005 will grow up to 6 million tones a year. Thereby Russia will get an additional route for its oil exports and the related taxes and export duties to the government budget.

The second project that has surfaced targets the domestic market and is implemented in the interest of Gazprom. Thus the following week the President is presumed to have held a meeting on the issue of energy security of the Russian Federation. There was presented a report of the Ministry of Industry and Energy, according to which energy consumption growth in Russia will average 5-6%. As a result, by 2011 it is required to invest around \$600bn in gas production and transportation.

Half of this amount will have to be provided by Gazprom. Presumably, apart from direct state investments, a range of measures will be implemented with the result of evening out the gas prices in the domestic and foreign markets. Thus it is proposed from January 1, 2007 to introduce a system of long-term gas contracts with the price linked to the price of export contracts, to raise the gas price for industry and Hydro Power Plants up to \$80, while keeping the prices for the public,



housing and utilities complex and Thermal Power Plants unchanged in 2007. At the same time it is suggested to increase up to 30% the share of unregulated electric energy trade and review the rates taking into consideration the share of liberalization and the size of the gap between regulated and unregulated prices.

On top of that, the Ministry of Communications headed by Leonid Reiman entered the struggle for budgetary funds. The Minister's move was prompted by Vladimir Putin's visit to Zelenograd on October 17. The President took a close look at the products of the Micron Plant - the parent enterprise of OJSC Sitronics as well as held a meeting dedicated to the development of information technologies. Head of the State was shown the whole range of high-tech products manufactured at the Sitronics plants, including TV-sets, mobile phones and DVD-players. "In Russia we acquire, first of all, not technologies but machinery and equipment which accounts for 60% of costs. As a rule, we purchase morally obsolete equipment, outdated machinery. While on new technologies, licenses and patents we spend less than 2% of funds", - remarked the President.

Actually there are three major development projects for high-tech sectors that are represented at the Government structures.

The first is to create special innovative development areas, the so-called technology parks (technoparks). As a matter of fact, the latter were designed yet in the 80s of last century. The technoparks were supposed to be based on the science cities of the Soviet type. Today this project at the Government is promoted by a group of officials from the Ministry of Communications (hereinafter – "communications officials") led by Leonid Reiman. Currently budgets of different levels provide for 26.3bn rubles in funds for the technoparks development.

The major agency rival of the "communications officials" is the agency headed by Gref, himself belonging to the so-called "legal experts". He is actively promoting the special economic (SEZ) zones project, which were initially positioned by the group as an alternative to technoparks. It is worth reminding that the fundamental difference between them lies in different investment stimulation patterns. Thus, the technopark provides significant preferences through collective space lease and joint use of the infrastructure. Whereas the SEZ presupposes, first and foremost, tax concessions. Moreover, neither "communications officials" nor "legal experts" have any intention of giving away their leverage tools in Research & Development to their rivals. Quite instructive is the situation when Prime Minister suggested introducing tax benefits at the technoparks but was rebuffed by Reiman, since in this case they would pass to the jurisdiction of MERT.

Apart from SEZ the “legal experts” are actively lobbying the establishment of state venture funds to which private companies could later be attracted. Thus, Vice-Premier of the Russian Federation Alexander Zhukov stated that in the next 2-3 years in Russia it was planned to establish, from the funds of the Russian Venture Company, 10-15 venture funds with a total capital of around 30bn rubles. He announced it when speaking at the Congress of the Russian United Industrial Party (ROPP). Over 2006-2007 15bn rubles will be allocated to these ends. According to MERT’s program, the Russian Venture Company will be established with 49% of its investments financed by the state and the remaining 51% formed through private investments. Within two years the volume of investments is expected to be around \$1.05.

There is also a third project represented in the Russian Federation designed to consolidate the financial resources allocated towards the R&D development in the Russian Federation. It is the so-called “high-tech cluster” model. Let us remind you that the cluster development theory was actively advanced by M.Porter and the Stockholm School of Economics. According to Porter, the cluster – is a network of suppliers, manufacturers, consumers, elements of industrial infrastructure, research institutes, interrelated in the course of creating the added value. As a matter of fact, organizationally, the cluster is closest to the technopark. This project is primarily promoted by AFK Sistema helmed by its former major shareholder Vladimir Evtushenkov. The company intends to create a new high-tech cluster on the basis of Sitronics - its subsidiary.

AFK Sistema is the largest service market-oriented company in the private sector of Russia and the CIS providing services to over 60 million consumers. Established in 1993, the Company holds leading positions in the telecommunications, technology, insurance, real estate, banking, retail trade, and mass media sectors. The Company’s earnings for 2005 totaled \$7.6bn, while for the 1<sup>st</sup> quarter of 2006 - \$2.0bn. The total assets as of December 31, 2005 were \$14.9bn. AFK Sisma’s shares were listed on the London Stock Exchange under the symbol: SSA, on the RTS Stock Exchange under the symbol: AFKS, and on the Moscow Stock Exchange under the symbol: SIST.

Actually, the budget adopted by the Federation Council in late 2006 came as a result of the struggle of the above agencies. On December 8, the Upper Chamber of the Russian Parliament approved the budget of the Russian Federation for the next year by a landslide vote: 138 senators voted “Yes”, two abstained and one voted “No”.

The total revenue volume of the budget system of the Russian Federation will be 11713.9bn rubles, or 37.52% of GDP. Russia’s consolidated budget revenues

for 2007 are projected at 10523.6bn rubles or at the level of 33.71% of GDP, including net of the Unified Social Tax funds payable to the Federal Budget and allocations to the Stabilization Fund of the Russian Federation - at 8464.1bn rubles (27.11% of GDP). Federal budget revenues in 2007 will be 6965.3bn rubles (22.31% of GDP), including net of the Unified Social Tax funds payable to the Federal Budget and deductions to the Stabilization Fund of the Russian Federation – 4905.9bn rubles (15.71% of GDP).

The revenue pattern of the federal budget provides for: tax revenues in the amount of 4253.0bn rubles (13.59% of GDP), including net of the Unified Social Tax funds payable to the Federal Budget and allocations to the Stabilization Fund of the Russian Federation – in the amount of 3245.1bn rubles (10.39% of GDP); non-tax federal budget revenues – 2721.9bn rubles (8.72% of GDP), including net of the Unified Social Tax funds payable to the Federal Budget and allocations to the Stabilization Fund of the Russian Federation – 1660.3bn rubles (5.32% of GDP), target deductions from national state lotteries - 0.5bn rubles. Compared to the expected execution of the 2006 federal budget, the projected revenues will increase in 2007 by 806.2bn rubles. Having said that, as a result of the declining exchange rate of the US dollar to the Russian ruble, federal budget revenues will be down by 84.2bn rubles. Changes in the tax and budget legislation, by and large, will lead to a reduction in federal budget revenues in 2007 relative to the expected budget execution in 2006 by 169.7bn rubles. Due to the effect of other factors, federal budget revenues will increase by 113.7bn rubles. The share of federal budget revenues in the Gross Domestic Product in 2007 will be 22.31%, and compared to 2006, will be down by 0.32 percentage points, including due to changes in the tax and budget legislation – by 0.54% of GDP. At the same time, changes in the macroeconomic performance and the effect of other factors will result in a budget revenue growth by 0.22% of GDP.

According to the document, federal budget revenues will be 6 trillion 965.3 billion rubles, expenditure – 5 trillion 463.5 billion rubles. The Gross Domestic Product is projected to grow next year by 6%. Inflation is projected within the range of 6.5-8 percent. The 2007 Budget is based on the annual average price of Urals oil of 61 dollars per barrel with the ruble to dollar exchange rate of 26.5. The Law on the Budget sets forth the upper limit for Russia's internal debt as of January 1, 2008 in the amount of 1 trillion 363bn rubles, for external debt – 46.7bn.

According to the official figures, state expenditure under the “Education” section is up roughly by 37% on 2006, expenditure under the “Health Care and Sport” column has increased likewise. It is planned to spend nearly 278bn rubles

on the financing of education. 206bn rubles will be spent on health care and sport issues.

Expenditure under the “National Issues” section will be 808bn rubles. As regards the defense, the volume of budget appropriations, embedded in the “National Defense” section, is up by 23% on 2006 and stands at 822bn rubles, expenses within the “National Security and Law Enforcement” section will be 662.86bn rubles – an annual growth of 22%.

The “National Economy” section will be financed in the amount of 497bn rubles – a 47-percent growth, expenditure for purposes of the “Housing and Utilities Infrastructure” section will stand at 53.03bn rubles – a 39-percent growth. For purposes of the “Environmental Protection” section is appropriated 8bn rubles – a 30% increase on the year before.

Expenditure under the “Culture, Cinematography and the Mass Media” will be financed in the amount of 68bn rubles – by 35% more than the year before. 215bn rubles is reserved for the “Social Policy” section - a 7% increase.

As a matter of fact, there is a fierce inter-agency fighting going on for the expenditure items of the country’s primary financial document, first of all, between Ministries of the Government and United Russia.

Ultimately, the parliamentary majority managed to edge through its version of the budget. Even though it was substantially amended, the battle for the key financial indicators was won by UR. The fundamental thing here was an increase in the social component of the budget which is of no small importance on the eve of 2008. The lion’s share of expenditure is related to the major directions of the national projects. In its turn, it will substantially strengthen the positions of the “legal experts” interest group.

Besides, defense and security expenditure has been markedly increased. It will enable Head of the Ministry of Defense Sergei Ivanov to maintain the resource base. This is important in the context of the Minister’s problems with assets under his control, the most liquid of which is Aeroflot. It should also be noted that a considerable part of the funds appropriated to the defense will be utilized by Sergei Chemezov’s Rosoboronexport, which will further reinforce the already strong administrative positions of the Head of the Federal State Unitary Enterprise.

The price of large-scale state investments in the social sphere and defense – cutting back the projected budgets of the Ministries. Thus Igor Levitin, German Gref, Alexander Sokolov, and others, had to curb their appetite. Furthermore, considerable losses were sustained by the Ministry of Finance, which had to appropriate additional funding.

Nonetheless, both Gref and Kudrin intend to “take revenge” at the expense of long-term projects.

Thus, according to the plans of the Ministry of Finance, in February work will begin on a three-year budget draft for 2008-2010. The document is expected to be introduced to the State Duma as early as April. According to Kudrin, the three-year budget can be adjusted annually, however around 90-95% of the expenditure side will remain unchanged. It is within this document that the Minister intends to pass through the idea of the “non-oil and gas budget” which was never realized in the 2007 Budget.

Gref also counts on strengthening his positions in the mid-term. His main instruments will become - the Venture Fund and the Investment Fund, the build up of which is actively lobbied by the Head of MERT.

For example, within the framework of the Venture Fund project the Minister has already presented the Board of Directors of the Russian Venture Company (RVC). It includes independent directors: former Prime-Minister of Finland Esko Aho, Chairman of the Israel Venture Association Yigal Erlich and owner of the *Nezavisimaya Gazeta* newspaper Konstantin Remchukov. Also on the Board are: German Gref himself as a representative of the Government, Head of the Federal Antimonopoly Service Igor Artemiev and Deputy Head of the Ministry of Education and Science Dmitry Livanov. According to the Head of MERT, the RVC will deal with investments in long-term high-tech projects. The company’s share capital will be 15 billion rubles.

The Investment Fund is calculated by the Minister for three years ahead. In his words, the total planned volume of the Fund in 2006-2009 will be in excess of 377.9 billion rubles. It is worth reminding that this year already several regions have won the right to be funded in part from the resources of the Investment Fund. Primarily these are infrastructure projects, the bulk of which will be implemented in the European part of Russia. But the main priority in the future, according to German Gref, is development plans for the Far East and Siberia

It should be noted that in the new year the standoff over budgetary funds continued when Alexei Kudrin tried to take away control over state investments from German Gref.

On January 22 at the meeting held by Prime-Minister Mikhail Fradkov the Budget Code reform was agreed, whose key provisions had been a bone of contention between the Ministry of Finance and MERT for the last several years. As a matter of fact, another active stage of the standoff over state investments between Kudrin and Gref began yet in the last autumn, when both agencies came

up with measures for supporting domestic exporters in foreign markets. In the end, the project of the Head of the Ministry of Finance for the formation of the “non-oil and gas” budget envisaging sterilization of excessive money supply was actually declined, the Head of MERT claiming the victory. Yet, the Finance Minister prepared another project for intercepting control over the key state investment channels, namely: Kurdin’s three-year budget plan, the transition to which is planned already in 2008.

Under the adopted long-term financial plan of the Russian Federation for 2007-2009, federal budget revenues in 2008 will be up by 2%, in 2009 - by 11% compared to the current year’s figures. At the same time, expenditure will grow by 11% and 22% respectively, reaching the amount of 6716.23bn rubles in 2009. The overall volume of inter-budgetary transfers will increase by 16% next year and by 26% in 2009. However transfers to budgets of other levels will grow on average by 1% a year. At the same time, the funding of government extra-budgetary Funds in 2008 will increase by 25.7%, and in 2009 – by 42.3%. The greater part of this funding will be allocated to the Pension Fund of the Russian Federation, whose budget will nevertheless be in deficit in 2009. The total amount of the federal budget surplus in the next year will be down by 33% compared to this year’s figures. Its slight increase is planned only for 2009, however even then it will not exceed the 72% surplus amount provided for 2007.

It should be reminded that now state investments are annually distributed by MERT. The Ministry of Finance proposed to unite all programs, subject to approval during the preparation of the three-year budget, into long-term target programs for a six-year period. As a result, German Gref would lose his main administrative resource - annual distribution of budgetary funds. The Ministry of Finance intended to reduce also the list of investment tools by replacing federal target programs, target investment program (FTIP) and agency target programs (ATP) with long-term target programs.

Realizing that it was impossible to directly “torpedo” the project (it was agreed directly with the President of the Russian Federation), Gref still managed to significantly compound its implementation.

First of all, the Head of MERT managed to delay the enactment date of the Finance Ministry’s proposals. Thus, it was resolved to add to the Draft Law “On the Introduction of Amendments to the Budget Code...” articles on the FTIP and ATP. Now the document envisages “transitional provisions” for these programs up to 2009. Consequently, for another two years MERT will form the investment programs the way it was done before – every year practically anew. But already



during the preparation of the 2010-2013 budget, the FTIP will disappear, the major administrators of budgetary funds (Ministries and Agencies) are granted the right at their own discretion to allocate funds for facilities with a budgeted cost of under 600m rubles.

Another concession to German Gref – the article on the financial balance sheet was added to the Budget Code. This document “characterizing the volume and utilization of the economy’s financial resources and sectors of the economy” will be developed by MERT during the preparation of the three-year budget. Thus Mr.Gref’s remark that the Ministry of Finance was suspending MERT from the budget work was taken into account. Moreover, the Code will for the first time include an article describing the Investment Fund - currently it is also distributed by MERT. Under this article it is allowed to carry over its balance to the next year. Previously Alexei Kudrin could dispose of the unused amount of the Investment Fund the same way as of other account balances - allocate it to the Stabilization Fund. It should be noted that the Investment Fund is the crucial leverage tool of German Gref. Thus, the Fund’s volume in 2006 will be 69.7bn rub. The long-term financial plan for 2007-2009 provides for the following appropriations to the Investment Fund: 110.6bn rub., 104.3bn rub., and 93.3bn rub for each year respectively.

The compromise will help Head of MERT German Gref retain his influence on budget formation. Furthermore, after 2008 the composition of the Government of the Russian Federation can change substantially and the implementation of Kurdin’s program be adjusted.

## **4.2. Taxes**

The formation of Russia’s tax system is also largely determined by the standoff of the key interest groups. First of all, these are the Ministry of Finance and MERT.

Thus, in 2006 the Ministry of Finance passed through the Government amendments to the Tax Code (TC). The formal reason for the Finance Ministry’s initiatives was the demand by the Russian President to suppress transfer pricing. It was voiced by Vladimir Putin within this year’s Budget Address. Later, on its basis, Mikhail Fradkov prepared instructions for the Government. The document obligated the Ministry of Justice, the Ministry of Finance and MERT to present measures for changing the legal framework until November 30, 2006.



As a matter of fact, the transfer pricing problem surfaced long time ago. Its essence lies in expenditure “optimization” (reduction) by way of over- or understating internal corporate prices. First of all, it applies to related structures along the “parent – subsidiary” line. For the first time this tax “optimization” scheme came to light in the NKYUKOS case. It is worth reminding that NK’s affiliates would purchase raw materials from subsidiary structures and resell them to YUKOS, which significantly decreased tax revenues. Telling is the case of NK’s Financial Director Bruce Misamor. He was charged with misappropriation by the Company of 31bn rubles worth of funds in 2001 using a Mordovian trader, Fargoil. The investigators believe that the trader would purchase oil from YUKOS’ subsidiaries at transfer price and on the same day resell to the same YUKOS or oil refineries at a much higher price. This being the case, oil never left the metering stations of production companies but the trader would save on regional tax benefits. Thereby, with the help of such transfer “optimization” the oil company in 2003 managed to lower the tax burden from 24% to 7%.

Later a number of measures were adopted aimed at making the application of this mechanism more difficult. First and foremost among them are changes in the tax legislation. Liquidation of domestic offshore zones came to be the first step. Besides, the system of oil production tax calculation was changed. Previously this tax was calculated in percentage, now – in rubles per ton. It was actually within this policy that two years ago the Ministry of Finance prepared a draft law of December 28, 2004 “On Introduction of Amendments to Articles 20 and 40 of Part One of the Tax Code”. Yet the draft was never adopted. The decision to put it on hold was made by Vladimir Putin.

As a matter of fact, the document prepared by the Ministry of Finance copies the 2004 draft law. Let us remind you that within this draft it was proposed to introduce a mechanism for proving the market nature of prices by the taxpayer. It worked as follows: a company was required to substantiate to the Federal Tax Service (FTS) compliance of its prices with market conditions. What is more, this requirement applied not only to subsidiaries and parents but also to sister (with one “parent”) and “grandchild” (linked indirectly through a third company) structures. If the FTS considered the transfer prices between counter parties to be non-market ones, it could assess back taxes on such companies. It was proposed to use market prices between “bona fide and independent” agents as the standard.

This draft is prepared largely in the interest of none other than the “siloviki” interest group, which traditionally controls the FTS. The draft law makes it possible to substantially strengthen the group’s role in regulating the activities of

major business structures, particularly raw material companies. The point is that transfer prices are typical of large vertically-integrated companies. While fairly blurred formulations enable the FTS to use this measure against any company. For example, it is not clearly set out in the draft, who are these “bona fide and independent” agents in the market and in what way the “fair” market price can be determined. For, most raw material markets in the Russian Federation are rather highly concentrated or monopolistic. Thus, for example, for such companies as Gazprom, Transneft, RAO UES of Russia it is impossible to determine “fair” transfer prices for Russia.

It will give the FTS a most powerful lever of influence over crucial raw material assets of the major interest groups which will be of no small importance on the eve of 2008.

Apart from that, another project in favor of the “siloviki” group will become the introduction of VAT payers’ mandatory registration system. It is contemplated that as early as 2007 a new law will be adopted introducing the system from 2008. In 2009 the VAT share in budget revenues is supposed to grow from today’s 24.9% to 40.5%, and in nominal terms – to become twice as high – from 1534.5bn to 3019.4bn rubles. For this projection to come true, VAT revenues must grow by 17.9% annually. But so far the VAT collection growth is strongly behind its refund rates. For January – July, according to the FTS, tax refund increased by 60% compared to the last year’s level (up to 426.1bn rub.), while revenues – by 3% (up to 542.5bn rub.).

It is worth reminding that the registration demand for VAT payers appeared in the Tax Code in 2001. Yet, several months later it was rescinded, since the system was practically not operational. The thing is that registration was not mandatory. Besides, it gave residents no considerable preferences. Later, in 2003-2006, registered companies were granted an opportunity to get excise tax refunds. However, most companies refused to pay the excise tax as such, which led to a decline in excise tax payers.

The current draft provides for making it binding on large companies to register in the VAT payer system, whereas middle-sized and small companies will be able to enter it on a voluntary basis. Moreover, only members of this system will be entitled to VAT deductions, while those not admitted to the system will not have this right. It is assumed control over the system will be exercised again by the FTS.

Thus, this measure will significantly strengthen the position of the “siloviki” group concerning control over major exporters. The point is that it is first of all

among exporters that the VAT refund mechanism is operational. Importantly, a virtual exclusion of middle-sized and small businesses from this system will enable the concentration of resources solely in the hands of large companies. It should also be noted that the “legal experts” are actively playing against this draft law. Thus, this group recently has been actively promoting the idea of VAT replacement with a 10% sales tax. This idea was voiced, in particular, by Head of the Expert Department of the Presidential Administration Arkady Dvorkovich.

Properly speaking, the intensification of Kudrin’s activity in the interest of the “siloviki” interest group indicates that the Head of the Finance Ministry is looking for potential allies in 2007-2008. The Minister needs political cover for the pre-election year. Furthermore, co-sponsors will be required to lobby through the Duma and the Government draft laws important for Kudrin.

The standoff of the economic Ministries continued in late September. Then a letter of Deputy Minister of Economic Development and Trade Kyrill Androsov was published heralding changes in the depreciation rules. The letter was addressed to Vice-Premier Alexander Zhukov. The essence of the Deputy Minister’s proposals lies in a revision of the very system of depreciation deductions. Let us remind you that under the existing normative base, depreciation is calculated based on the historical cost of an asset. However, since the market value of fixed production assets grows, companies lose the difference between the par value (historical cost) and real (current market) value of a product.

Now MERT proposes to use a new mechanism. It provides for periodic revaluation of fixed production assets. As a result the value of equipment will rise considerably and, hence, the profit tax from which depreciation is deducted will be reduced. Gref’s agency justifies its decision by the wish to release additional funds for domestic investments and replacement of fixed assets. Thus MERT considers the key problem to be lack of funds for the purchase of new equipment, inasmuch as reimbursement was based on the outdated price of products.

According to MERT’s calculations, if companies are allowed to account for revaluation already in 2007, they will save 276bn rub. on profit tax. Another 333bn rub. will remain at their disposal in 2008 and 421bn rub. – in 2009. By allocating all this money to equipment replacement, business will accelerate GDP growth by 0.3-0.6 percentage points over three years, hopes the Ministry of Economic Development and Trade.

MERT’s major allies in profit tax reduction are business structures and organizations representing their interests. Thus, its support for the new initiative of Gref’s agency was proclaimed by the Russian Union of Industrialists and

Entrepreneurs (RSPP). Actually the latter has long been lobbying the possibility of changing the depreciation deduction system. Thus the organization prepared a study according to which the budget of the Russian Federation [could] receive a considerable part of indirect revenues. For example, when the value of assets grows, so do property tax collections. Furthermore, domestic investments and re-equipment will allow profit growth for enterprises, which will also affect tax revenues on the plus side. In other words, according to RSPP's calculations, in 2007 the federal budget will lose 174bn rub. instead of 276bn.

As a matter of fact, it is not the first attempt to change the depreciation deduction system. It should be reminded that formally such a possibility had existed until 2002. Then companies could make revaluation of their assets based on their market value. As a result, most Russian business structures increased the value of their production assets.

However as a result of purposeful activities by the "siloviki" interest group, the possibility of revaluation was abolished: The State Duma passed amendments to the Tax Code limiting the application of this procedure. The main argument of "siloviki" represented by the FTS was a significant reduction in budget revenues. As calculated by the FTS, losses could be as high as 200bn rub. a year.

Now MERT's plans are fiercely opposed by the Ministry of Finance. Kudrin's group is not interested in losing control over 500 bn rubles. Thus, the Ministry of Finance focuses attention on the lack of legitimate mechanisms for ensuring the investment of saved funds in production modernization. The Agency claims that free financial flows will be removed from business structures as dividends. Moreover, it is accentuated that the new system will be used primarily to export monetary funds and to minimize the profit tax.

Kudrin's main ally is the "siloviki" interest group, in whose interest the Finance Minister is already implementing a number of promising projects. The "siloviki" are interested in making the FTS, traditionally controlled by them, stronger. It should be especially noted that the group has strong positions in the relevant Committees of the State Duma. We are talking, first of all, the Budget and Taxation Committee of the State Duma and the Expert Council of the State Duma on Taxation. Thus Chairman of the latter has already slammed MERT's new initiative.

Chapter 5

## **NATIONAL PROJECTS**

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## **5.1. National Projects as Political Ideology**

At the official level the existence of national projects was made public on September 2005, when President of the Russian Federation Putin V.V. spoke at the meeting with the leadership of the Government, Federal Council and Members of the State Council. The main directions of the national projects and their general provisions were outlined to them for the first time.

However it should be noted that said projects are very different both in the level of detail and target objectives which necessitates a comprehensive analysis of each of them.

The concept of national projects as a comprehensive state policy takes roots from the practice of Soviet state planning (five-year plans). Nevertheless as the early 90s came, in the new political reality, the state planning experience was viewed by economists rather negatively (inefficiency of the Soviet economy was largely blamed on the cumbersome and underdeveloped projects and five-year plans of the USSR).

In the information space interest in the national projects emerged in early XXI century, or more precisely – in 1999. It was due to a number of factors, of which among the key ones are:

- Positive foreign economic environment (energy prices);
- New economic policies of the Government;
- Strengthening of conservative positions in the political elite; and others.

It should be noted that initially projects were of a somewhat local (territorial) nature and related to the development of individual regions. They were promoted by politicians, such as Dugin, Krupnov, and others, to name just a few. Being geopoliticians, politically, they represented the Eurasian position.

However, the national projects hit the agenda in all seriousness after actors, close to the party structures of United Russia and the Presidential Administration, got involved in their development. Here two types can be distinguished:

- Organizations and associations;
- Individual actors (primarily Heads of Constituent Entities).

Properly speaking, the key role here was played by two associations: the Institute for Social Planning and the Efficient Policy Foundation.

As is known, the first is headed by Fadeev Valery Alexandrovich, who also has a second job as Chief Editor of the Expert Magazine and is a Co-Chairman of Delovaya Rossiya [Business Russia] (middle-sized business). He is committed to

national capitalism, i.e. being a fervent supporter of market economy, champions an active role of the state in the economic and political areas. It is the national projects, in Fadeev's opinion, that are supposed to become a catalyst to the country's economic activity. Considering the above doctrine, his harsh criticism of the Government (particularly of its economic block) becomes understandable. For it is the Government, as the expert believes, that is holding back economic growth by way of giving up on state investments and increasing the Stabilization Fund. Speaking of the political position, Fadeev himself defines it as conservative liberalism (liberal system with a significant role of the state).

The Efficient Policy Foundation is helmed by Gleb Pavlovsky. In terms of positioning, he is very close to Fadeev. However, he is to a greater extent incorporated (included) in the political elite.

These two organizations often cross their paths in different projects and can be said to represent a project network of a kind. As, for example, within the Mediokratia project. Besides, the national projects were developed within the framework of the Seraphim Club.

Apart from organizations and associations, a considerable contribution to the development and formulation of national projects was made by the Heads of Russia's constituent entities. Among them: Luzhkov (Moscow has developed practices nearly in all the four areas of the national projects), Shaimiev (Obsolete Housing Replacement Projects), Tkachev (Development of the Tourist Industry of the Krasnodar Krai).

Crucial, however, as analysts believe, became the preparation of United Russia's program which was to be announced at the party's Congress in Krasnoyarsk scheduled for late November. Development of this program began yet in the summer.

Two key events should be pointed out here. First, conclusion of a framework agreement between United Russia and Delovyya Rossiya, within which the Institute for Social Planning was engaged to develop the program for United Russia. It was this Institute that had developed the party's economic program which also included a number of national projects. However this program was never approved. Yet, a number of its provisions were included in the national projects.

The second event – the “Lower Angara Region Development Project” was prepared by Alexander Khloponin, Governor of the Krasnyarsk Krai. Unlike the previous territorial projects it was thoroughly calculated and economically feasible. Moreover, Khloponin is known to represent the interests of Interros and



Norilsk Nickel, i.e. he is a spokesman of large business represented by individual Financial and Industrial Groups. This is precisely why his program was supported by United Russia's General Council in November.

Summing up we would like to note that the national projects as political ideology were developed by none other than representatives of large and middle-sized business. However the explicit social orientation of the national projects is rather a compromise between the socially oriented policy of the state and business development projects.

## **5.2. Goals of the National Projects**

### **Economic Sphere**

The first goal – is to reduce inflation and to raise GDP. A budget surplus presupposes certain inflation growth (in 2006 – roughly 10.5%-10.8%), whereas GDP (amount of goods in monetary terms) is disproportionate to money supply. If there is a lot of money (money supply) in the market – inflation is high, if there are a lot of goods (GDP) – inflation is low.

Actually, in order to reduce inflation, on the one hand, and raise GDP, on the other, money supply should be invested in production (goods) on the understanding that this money is invested with maximum efficiency. In other words, one ruble of money must give more than one ruble of goods so that the ratio of GDP to money supply changes in favor of goods, and inflation (their ratio) does not pick up pace.

The second goal – is to stimulate domestic demand. When wages increase, so does the purchasing capacity of the population, hence demand is growing which affects the prosperity of companies, which in its turn enhances the competitiveness of domestic companies. Furthermore, tax revenues go up as well.

Here numerous goals could be named, however those above – are the major ones.

### **Political Sphere**

The first goal – is to ensure the political base for the implementation of the “successor 2008” project. It is known that Vice-Premier Medvedev will be directly responsible for the implementation of the national projects. Thus, he gets, on the

one hand, an immense administrative tool (in his new position he can actually influence operations of the entire Government Office and a number of Ministries), and on the other - a potential electoral base at the 2008 elections. And if the social orientation of the projects (doctors, teachers, students, the military) is considered, then the most numerous (and vulnerable) electoral groups will sympathize with Medvedev. On top of that, his positioning as a champion of key national priorities and “a man of action” (who implements specific and quite tangible projects) makes him stand out from his potential competitors.

Admittedly, though, there are a number of problems here. The first is that the Vice-Premier has no experience in public politics which is actually why he is permanently present in the country’s information space.

The second – is tough administrative struggle. It is common knowledge that Medvedev as a representative of “Petersburg’s legal experts” competes with the “siloviki” group whose key player is Sechin. Moreover, some analysts believe that the only way for the latter to increase his electoral base is by exacerbating the situation, for the “siloviki’s” main resource is concentrated at the security bodies (Ministry of Internal Affairs, Federal Security Service, Main Intelligence Directorate, and others).

Apart from that, Mikhail Fradkov himself does not agree with the role of a “technical premier” and is not prepared to give away the whole amount of political power at the Government. It is precisely what accounts for the diffusion of the key functions between Head of the Russian Government Office Naryshkin S.E. (Fradkov’s creature) and the first Vice-Premier, which enabled Fradkov to maintain control over the Government Office.

The second goal – is to try and deprive the radical opposition of its electoral base. Thus, the revolutions in the countries of the CIS and Eastern Europe, where youth organizations acted as the crucial player (Tako (It’s Time) - Ukraine, Kmara (That’s Enough) - Georgia, Otpor (Rebuff) – Yugoslavia), were determined by the mass activity of the most economically vulnerable sections of the population. It is important here to single out three groups: students, the military, other public sector employees. It is the activity of the first, the inaction of the second and the disunity of the third that ensured the success of the revolution project.

Besides, as a landmark phenomenon looks the popularity of the ideas of the “orange revolution” among the youth that was accumulated by the Rodina Party at the Moscow Elections. On the other hand, there is a new socialist project with the CPRF trying to make use of its resource through merger with the Red Youth Vanguard (AKM) and other youth organizations.

Another factor giving a boost to protest sentiments in these social groups will be the change-over to one hundred percent payment for utilities (in some regions it will be + 30%) and high inflation. As a matter of fact, providing for these social groups is exactly what the national projects are aimed at.

The third goal is to build a long-term state policy. Indeed it can be noted that after the 1998 crisis, the policy has become short-term within one financial year. Whereas the absence of long-term programs created uncertainty, both political and social. Moreover, one may consider the emergence of a long-term state policy in the context of parties' strengthening. For, it is the ideological and program platform of a strong national party rather than situational (short-term) decisions of the President that are becoming a dominant of political development.

### **Cultural Sphere**

The cultural sphere should include the building of a new common national identity. Particular relevant in modern political reality. In many ways, unification of the regional policy and development of a long-term state policy will form Russia's positioning which will be predicated on the target objectives of the national projects rather than on the local (territorial and ethnical) dominant.

### **5.3. Essence of the National Projects**

At the official level the existence of national projects was made public on September 2005, when President of the Russian Federation Putin V.V. spoke at the meeting with the leadership of the Government, Federal Council and members of the State Council. The main directions of the national projects and their general provisions were outlined to them for the first time.

However it should be noted that said projects are very different both in the level of detail and target objectives which necessitates a comprehensive analysis of each of them.

#### **'Health'**

Initially the project's budget for 2006 was estimated at 62.6bn rubles. Whereas the total value of state investments for 2006 – 2007 was 145bn rubles. However later the expenditure within the project for 2006 was revised upwards several times which resulted in its increase up to 88.4bn rubles.

The primary components of the project are as follows:

- Furnishing over 10 thou. municipal, first of all, rural polyclinics, as well as regional hospitals and paramedic stations with new diagnostic equipment;
- Ensuring a salary increase for primary care physicians, pediatricians, and general practitioners in early 2006 by 10 thou. rub. a month, of nurses - by at least 5 thou. rub;
- Preparation of over 10 thou. primary care physicians and general practitioners;
- Replacement of the ambulance fleet, including the purchase of emergency care vehicles, medical equipment and modern communications systems;
- At least four-times growth in the number of citizens who will receive medical assistance at the expense of the federal budget;
- Construction of new high-tech medical centers in the Russian regions, including Siberia and the Far East.

This project has three key directions: support of primary care medical staff, development of high-tech medicine and medical re-equipment.

Thus primary care medical staff have fewer opportunities to earn money in contrast to specialist doctors within medical institutions. As a result of the salary increase, the issue of evening out staff shortage in the health care system of the Russian Federation was addressed.

High-tech medicine – is a sphere of development with great potential. Today Russians' needs in this sphere are met just by 10%-20%. Besides, this area acts as a development catalyst with respect to other “related” areas (instrument making, genetics, education, pharmaceutical industry, etc.).

The third direction – re-equipment of the entire sector (from emergency care vehicles to modern communications systems) is the most problematic for the regional health care system.

The major co-sponsors and customers of the project are constituent entities of the Russian Federation and large companies operating in the health care market. Thus, within the project considerable budgetary appropriations were utilized by the GAZ Motor Plant owned by Oleg Deripaska's Russkiye Mashiny. Furthermore, it is believed that the main initiator of the ‘Health’ project was Head of the Ministry of Social Development Mikhail Zurabov. Supposedly in this project the Minister lobbied the interests of business structures close to him. Thus, the greatest part – one fifth – of all contracts for medical equipment supplies was awarded to ZAO Medstor,

which, according to the Accounts Chamber, is affiliated with the Minister's spouse – Yulia Zurabova. Moreover, until very recently she was also at the helm of her own established firm Octopus which, too, participated in the national project.

It should be noted that the national project 'Health' is for the most part differentiated into a range of various projects and individual measures and does not have a complete prototype represented by a Federal Target Program. Initially this national project was the most socially-oriented and one of the least expense-consuming. However, gradually its budget grew. It was related to a number of implementation problems. First of all, Dmitry Medvedev found himself up against a rather complex system of financing the regional health care systems. Besides, hefty amounts were spent on the salary increase program for primary care staff which took place in 2006.

Among the main risk factors of the project should be mentioned: absence of a staff performance evaluation system. Accordingly, a problem arises with medical staff motivation.

Tough competition among the Federal constituent entities for appropriation of this project's resources should also be mentioned. Thus, a long struggle is going on for the state financing of high-tech centers.

Nevertheless, as of now 'Health' is the most important project for the Vice-Premier. It is the most "instructive" and ensures a substantial image effect.

### **'Education'**

It is rather difficult to determine the total cost of the project. Initially the 2006 budget was planned to be 30.8bn rubles. However, later it was considerably extended. Its federal part alone totaled 40bn rubles.

The main components of the project are as follows:

- Purchase of laboratory equipment, software for several dozen higher education institutions and a thousand schools, modernization of classrooms, and teacher training.
- Provision of Internet access to at least 20 thou. schools.
- Opportunity for army conscripts to receive primary professional education, and for contract soldiers – to prepare for applying to higher educational institutions.
- Opening of new universities in the Southern and Siberian Federal Districts and business schools for management staff training in the Moscow Region and Saint-Petersburg.

- Establishment of at least 5 thousand individual grants for school children, students, young specialists.
- Ensuring a monthly salary increase for qualified research officers of up to 30 thou. rub. on average.
- Transition to normative financing of the educational process, when budgetary funds “follow” students.
- Additionally monthly remuneration for the position of a form master.

‘Education’ is the most eclectic national project, consists of several Federal Programs and has substantial regional peculiarities.

As the most interesting directions should be named the establishment of large federal higher education institutions in the Southern and Siberian Federal Districts, for here we have a rather fierce struggle for financing. Candidate recipients of funds in Siberia are Krasnoyarsk, Tomsk, Novosibirsk, Irkutsk, in the South – Krasnodar, Stavropol, Rostov-na-Donu, and Taganrog.

Apart from this, of interest is the contest of innovative educational programs among higher education institutions (HEIs), for which certain political confrontation is already underway.

However the most promising aspect of the project is the organization of two business schools in Moscow and Saint-Petersburg. And if there was not much uncertainty about the Northern Capital (the business school must be based on the Saint-Petersburg State University (SPGU)), in Moscow the right to receive state financing was contested by the major economic universities (State University of the Higher School of Economy (GU VShE), Plekhanov Academy, Financial Academy, and others). Yet, the victory was claimed by the ‘Skolkovo’ project supervised by Chairman of the Board of Directors of the Troika Dialog Group Ruben Vardanyan. Later he was joined by Roman Abramovich, Alexander Abramov (Evraz), Leonid Mikhelson (NOVOTEK), Andrei Rappoport (RAO UES), and Valentin Zavadnikov (Member of the Federation Council).

Among the main project initiators should be pointed out large HEIs (Moscow State University, SPGU, Moscow State Technical University, GU VShE, etc.). The above-mentioned entrepreneurs have also benefited in some way from this project implementation. Thus, the tender for bus supplies for secondary education institutions in the rural area held within the national project in mid October 2006 was won by three bus makers – PAZ, KAvZ (part of the GAZ Group), and UAZ (owned by Severstal’s boss Alexei Mordashov).

The main problem of ‘Education’ is lack of coordination of the key measures within the project. Thus the advancement of the project in different regions is still

not synchronized. Besides, no concrete phased implementation plan in the mid term has been presented yet. Therefore, the most interesting sphere for the Vice-Premier remains the most well-developed and instructive directions of the project: provision of Internet access to HEIs, salary increase for education employees and rise in scholarship for students of the Russian Federation.

### **‘Affordable and Comfortable Housing – to Citizens of Russia’**

Initially the project was called ‘Affordable Housing’ and its budget in 2006 stood at 21.9bn rubles, while for 2006-2007 was planned to be 48.5bn rubles. However later it was increased more than fivefold. Now the spending in the next two years will total 212.9bn rubles, of which direct expenditure – 122.9bn rubles and state guarantees – 90bn rubles.

The project provides for the following:

- Increase in housing construction by 2007 by at least one third. Appropriation of funds from budgets of all levels for the engineering infrastructure of housing construction sites.
- Development of a mortgage loan subsidy mechanism and a considerable increase in the share capital of the Housing Mortgage Lending Agency.
- Full-scale functioning of the savings mortgage system for the military.
- Growth in federal budget expenditure on support to young families.
- Assistance to young specialists in rural areas in solving the housing problem.

The implementation of this national project is the most problematic. The thing is that it has the largest regional component, both financially and administratively, with federal budget appropriations of 86.1bn rubles of direct expenditure and 60bn rubles of state guarantees. Regional and local budget appropriations – 36.8bn rubles of direct expenditure and 30bn rubles of state guarantees. Besides, in most regions the construction market is controlled by companies affiliated with local Administrations, which makes the project implementation significantly more difficult.

Deputy Head of the Presidential Administration Igor Shuvalov can be considered the main developer and lobbyist of this project. Under his supervision and in partnership with the Center for Strategic Developments an expert group on housing legislation improvement was established. It developed a so-called



“housing package” – 27 draft laws, most of which were passed by the State Duma yet at the end of 2004. Among the most important ones should be noted the Housing and City Building Codes, the Law “On Participation in Shared Construction”, several amendments to the mortgage legislation.

The next stage in the development of this project became the ‘Zhilische’ (‘Housing’) Federal Target Program developed by the State Committee for Construction and Architecture (Gosstroy) two years ago. There are conflicting assessments of its efficiency. However most analysts view it rather skeptically. Yet, it was this program that lay the foundation for the related national project.

It was submitted for consideration to the Government by the Ministry of Regional Development. The latter is thought to have been behind its finalization which provided for the program’s budget increase and change in the very method of financing. Now instead of actual housing it was planned to provide state subsidies (apartment allowance) and state mortgage guarantees. To this end, state guarantees to the Housing Mortgage Lending Agency (AIZhK) were significantly increased. Besides, a sub-program: “Provision of Utilities Infrastructure for Land Plots” coupled with the Program of Citizens’ Relocation from Dangerous and Dilapidated Housing was separated out. Actually speaking, most new provisions of the Federal Target Program were included in the national project.

Nevertheless, the implementation of the project right from the start ran into a number of difficulties. Thus, it can be pointed out that this program does not provide for required investment or tax preferences for the construction industry. While it is due to the increased costs of the latter that housing market prices have gone up. In this connection, worthy of note is the conflict between the Federal Antimonopoly Service (FAS) and Eurocement. The latter was accused of violating the Law “On Competition” which resulted in a considerable housing price increase in Moscow. Apart from that, another problem of the project is lack of a well-developed legislative framework. It is precisely the insufficiently developed shared construction and mortgage legislation that led to a crisis in the real estate market (numerous swindled investors). The implementation was further seriously compounded by a inter-agency conflict. The above-mentioned Ministry of Regional Development lobbied an overall budget increase for this project. This idea was actively promoted by Vladimir Yakovlev who was fighting hard for financial resources with Head of the Finance Ministry Alexei Kurdin.

### **‘Development of the Agro-Industrial Complex’**

Initially the project’s budget was: in 2006 - 19bn rubles, in 2006-2007 it was intended to be around 30bn rubles. However, gradually the amount of financing was changed. But if in 2006 expenditure was down to 16.2bn rubles, in 2006-2007, on the contrary, it rose to 34.9bn rubles.

The national project for the development of the agro-industrial complex provides for the following:

- Ensuring real access of agricultural enterprises to credit resources.
- To this end, appropriation of additional funds from the federal budget for interest rate subsidies.
- Creation in 2006-2007 of a land mortgage lending system for a long term and on acceptable interest on security of land plots.
- Providing for additional funds in the federal budget for subsidizing interest rates for up to eight-year loans on the construction and modernization of animal production units.
- Appropriation of considerable resources for the development of agricultural leasing.

Cancellation of import duties on animal production process equipment having no domestic analogs. Resolving the issue of reducing, and in individual cases – of canceling the import duties on such equipment for other industries as well.

As is evident from the project there stand out two major directions in agriculture, investment in which will be maximally efficient and which hold real prospects for “rearing” a competitive domestic producer. These are animal production development and stimulation of small business types. In the first case there are real growth prospects (potential for meat demand may be as high as 80% for individual categories). In the second – it is stimulation of small businesses development – currently the main producer of agricultural products in the market. Thus around 50% of all meat, 80% of vegetables, 90% of potatoes are produced by such entities, which, by the way, also include personal household plots whose major problem is the sale of products.

The Ministry of Agriculture believes that the key instrument for supporting these directions is interest rate subsidies which will enable production re-equipment, allow one to start purchasing pedigree livestock, to mechanize and automate businesses, increase the contribution to applied research.

Apart from the two main directions, numerous related measures can be singled out, such as the support of innovative programs, housing construction for young families engaged in agriculture, etc.

The national project 'Development of the Agro-Industrial Complex' is the most well-developed and coherent. The economic effect is precisely calculated and the action schedule is fully developed. For a long period this project was lobbied by the Ministry of Agriculture and personally its head – Alexei Gordeev. Besides, the project received the support not only of small and middle-sized business, but also of the agricultural lobby (large agro-holdings). Thus, several major Russian and foreign companies at once announced the construction of modern commercial pig units in Russia. Among them: Rusagro, Agriko, Cargill, Sucden, Cherkizovsky. And even though, according to some reports, this project serves, among other things, to launder funds, nevertheless the development of domestic animal production is currently on the rise.

Having said that, the national project 'Development of the Agro-Industrial Complex' has also a number of drawbacks. First of all, it should be taken into account that it is a long-term project and no quick results from its implementation should be expected, which significantly reduces the value of the 'Development of the Agro-Industrial Complex' for Dmitry Medvedev on the eve of the election cycle. The point is that the national projects are viewed by the "legal experts" interest group as an "electoral ticket" of the year 2008 and the absence of significant results is unacceptable for Dmitry Medvedev.

Another risk factor is the very specificity of the project's implementation. Thus, the Head of MERT in the autumn of 2006 signed the WTO Accession Agreement with the USA. However one of German Gref's most painful concessions to the Americans was a reduction of subsidies for domestic agricultural producers. The above measure received a chilly welcome at the Ministry of Agriculture. It threatens to turn into another administrative standoff which will not accelerate the project's advancement either.

#### **5.4. Sources of Financing**

The implementation of the political projects of the major interest groups requires significant state financing. As a matter of fact, it is for control over it that a fierce struggle is underway in the federal elite with the key players here being Head of MERT German Gref and Head of the Ministry of Finance Alexei Kudrin.

The major resource base of the Finance Minister is traditionally the Stabilization Fund of the Russian Federation which as of December 2006 totaled \$83.21bn.

Moreover, Alexei Kudrin is pressing ahead with a number of projects aimed at increasing it.

The first – is result-oriented budgeting (ROB), voiced at the meeting with Vladimir Putin on August 22 this year. The objective of this project is control over spending at the key federal agencies. This, apart from an overall budget reduction, will allow the Head of the Finance Ministry to strengthen his influence at the major Ministries of the Government. Thus ROB will apply to 16 agencies not subordinate to the Finance Ministry.

The second (and crucial) project will become the so-called “non-oil and gas budget”. It is its promotion that came to be one of the landmark events of 2006. The concept of the “non-oil and gas budget” made its debut in the well-known article by Alexei Kudrin in the February edition of the “Voprosy Ekonomiki” magazine. In essence it boils down to this: a so-called “oil and gas fund” is set up on the basis of the Stabilization Fund. It is intended to accumulate in it all revenues of the Russian Federation from energy transactions. Thus, it will receive the tax on the profit of oil and gas companies, excise taxes on gasoline, diesel oil and motor oils. Besides, it is proposed to introduce an excise tax on natural gas canceled in 2004. The new fund will also receive the federal part of the mineral production tax (MPT) on oil, natural gas and gas condensate. It will also retain export duties on gas and on oil products. Moreover, another source of replenishment will become dividends on the shares owned by the Russian Federation, received from enterprises engaged in hydrocarbon extraction and production of oil products, as well as revenues from the operation of JP Vietsovetpetro. Consequently, the new budget will consolidate up to 52.2% of all federal budget revenues which will substantially reinforce Kudrin’s positions on the eve of 2006.

The major rival of the Head of the Finance Ministry in the struggle for state financing is German Gref. His main instruments will be – the Venture Fund and the Investment Fund, the build-up of which is actively lobbied by the Head of MERT. Thus, within the Venture Fund project the Minister has already presented the Board of Directors of the Russian Venture Company (RVC). Its share capital will be 15 billion rubles. The Investment Fund has been calculated by the Minister of Economic Development for three years ahead. According to him, the total planned volume of the Fund in 2006-2009 will exceed 377.9 billion rubles. It is worth reminding that in 2006 a number of regions already won the right to be financed in part from the resources of the Investment Fund. Primarily these are infrastructure projects, the bulk of which will be implemented in the European part of Russia. But the main priority in the future, according to German Gref, is development plans for the Far East and Siberia

Gref's another crucial project is the establishment of the national export support agency. Its financing must total 2% of budget spending. According to the initiatives of the Head of MERT, it is proposed to transfer to his Ministry exporter support functions. Thus, it is planned to take away state guarantees from the Ministry of Finance and export credit interest rate subsidies from the Ministry of Industry and Energy.

Hence, the success in the implementation of the political projects will in many ways come as the result of cooperation of the major interest groups and Ministries controlling the distribution of state financing in 2007-2008. The general configuration of future alliances is outlined already now. Thus, the Head of MERT has of late been actively advocating at the federal level the interests of Dmitry Medvedev's group. The Finance Minister, on the contrary, gravitates more towards the Sechin-Bogdanchikov group. Thus, in 2006 at least two projects came to light that were implemented by the Ministry of Finance in favor of the "siloviki". The first – is the second preparation of the draft law "On Introduction of Amendments to Articles 20 and 40 of Part One of the Tax Code". This document confers on the FTS significant levers of influence over large national companies. The second – is the introduction of the VAT payers' mandatory registration system which will allow the tax authorities to control major exporters of the Russian Federation.

Chapter 6.

## **FOREIGN POLICY OF RUSSIA**

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2006 was marked by the Russian authorities' consistently building the status of the Russian Federation as a world energy power. This being the case, Moscow's foreign policy was largely determined by the previous year, and so it is possible to speak of a strategy for targeted promotion of Russia's national interests abroad.

The event of the year came to be the G-8 Summit in Saint-Petersburg heralding a new stage in the formation of the Russian foreign policy. As President of the forum, Moscow defined the agenda. And that was energy security which can also be considered a priority strategy chosen by Russia for the near future. Most events of the Russian foreign policy "season" of the first half of 2006 were aimed at the preparation for the G-8 Summit. Thereby Russia declared at the official level that it had enough resources to ensure this security and that energy cooperation was a priority in international politics. The Summit had been preceded by a number of no less important meetings at different levels, one way or other dealing with the subject of energy security. Among this year's most important events defining Russia's foreign policy priorities came was its participation in the meeting of the G-8 Ministers of Energy, as well as organization of the meeting of the Foreign Ministers of this informal alliance in Moscow.

The national foreign policy throughout the year demonstrated a multi-vector nature. At the same time, over the recent period nearly all international events concerning Russia's interests dealt with the subject of energy security. By giving up on the image of his country as a "raw material appendage" to the West, Vladimir Putin is betting on the "revival" of Russia and its return to the world stage as a strong and independent player. The Russian Federation does not relinquish its multi-vector course which is fully manifested in its relations both with post Soviet states and the BRIC countries, which include China, India and Brazil. Furthermore, the end of the year was marked by warming of the Russian – American relations which prompted the parties to soften their positions on the most important aspects of international activity. A concession on the part of the US was its consent to Russia's accession to the WTO, while on the part of Russia – toughening of the requirements for the Iranian "nuclear dossier" and partial consent to the imposition of sanctions against the IRI. Diversification of the foreign policy course is aimed not only at the implementation of the chosen strategy but also at reducing potential risks from potential protests on the part of world leading players, such as the EU and the US, as well as China, gaining weight in world politics.

The primary task of Vladimir Putin under the existing conditions - is to follow the chosen geopolitical strategy, playing on the differences among major world



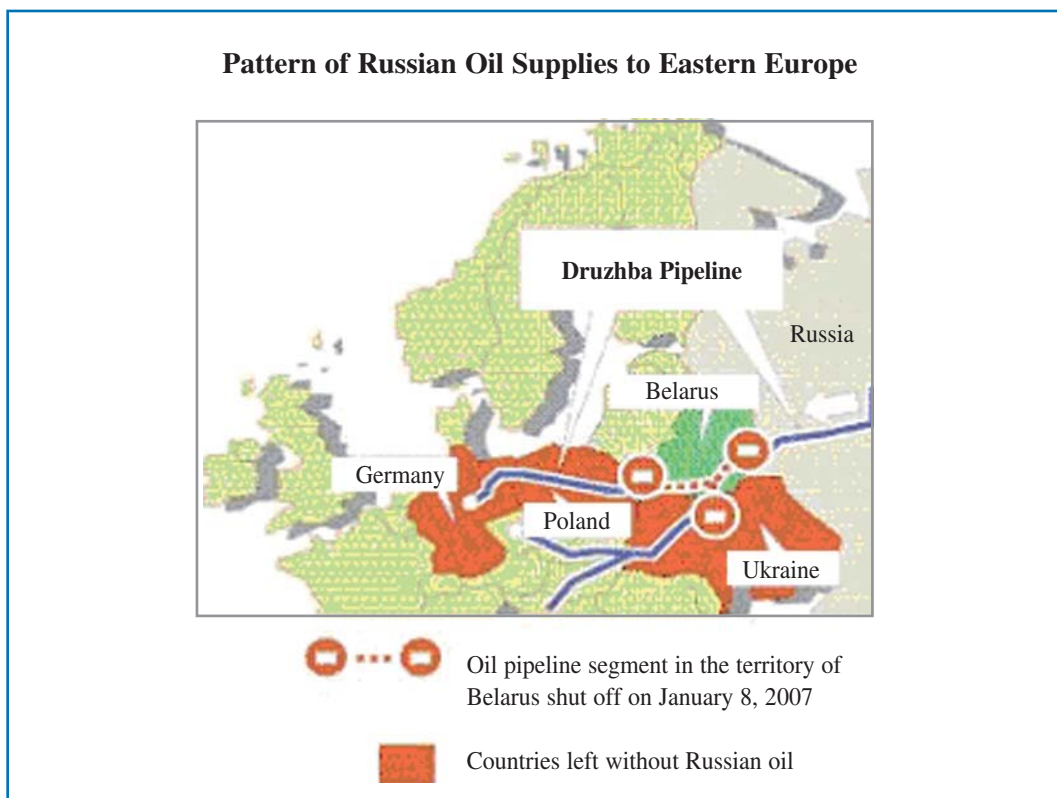
powerhouses and deriving political and economic benefits from it. Putin manages to maneuver between the two major geopolitical players – the EU and the US. The parties are ideologically close, however recently an increasing number of issues have appeared, on which it is hard to reach a compromise. Among such are the US policy in Iraq, and as a resonance, accusations against Washington of selective democracy and dual approach to the human rights issue, the NATO prospects as an integrational military organization and advisability of the Alliance's expansion. Recently the subject of energy security and behavior of leading geopolitical players based on their own understanding of this concept has increasingly become the focus of attention. The task of Vladimir Putin – for purposes of implementing the strategy for transforming Russia into an energy super power is to build the image of our country with the Western community as a serious and influential actor prepared to play by the established rules, but at the same time in no way willing to make unilateral concessions.

### **6.1. Russia's Relations with Western Countries**

In 2006 Russia at last determined the priority direction of its foreign policy, made public during the meeting of Vladimir Putin and German Chancellor Angela Merkel. It is the strengthening of partnership relations with “Old Europe” and entry of leading domestic companies into the European market. Apart from this, here the emphasis was laid on energy cooperation between Russia and Germany.

The importance of the German market for the Russian Federation is also evidenced by Moscow's desire to establish a distribution center of Russian energy resources in Germany so as to minimize the risks related to fuel supplies in the period of a potential interstate conflict. The final accord of 2006 came to be another “energy war” involving, along with Russia, the previously brotherly Republic of Belarus as the central character. Under these conditions, the creation of a distribution center is one of the links in the chain of measures of the Russian leadership for saving the image of its companies in the West. The gas sphere in our relations with European countries had dominated over oil issues until the supplies of Russian “black gold” to the countries of Eastern Europe and Germany were halted. The symbol of the Russian-European gas union is the North European Gas Pipeline (NEGP) project designed to supply gas to Russia's priority partner – Germany, and in the long-term – also to other European countries bypassing the transit territories of the Baltic States.

At the same time the pipeline construction project does not sit well with its potential participants themselves. Sweden throughout the second half of 2006 maintained that its Government could possibly impose a ban on the construction of system segments in close proximity to the country's sea borders. The NEGP is not that much an economic as an image-building project which has already been called one of Gazprom's most ambitious designs. Putin could not but foresee that its construction would set off a wave of resentment among European officials whose main official argument – fears of an ecological disaster. In reality most countries not involved in the project see the pipeline construction as a threat to their independence and thereby demonstrate that such large-scale Russian presence in the region is unwelcome.



Throughout the year European and American readers more than once were given the opportunity to take a closer look at the new concept of Russian authorities. Vladimir Putin published articles in the influential Western press presenting to the Western public his vision of Russia in the world. Among such

articles is “Three World Problems”, in which Putin justifies the selection of the energy security concept as the priority subject during the summit of the G-8 leaders. If the purpose of this article was to prepare the West for the forthcoming “forum of the year” – the G-8 Summit, the article: “Europe need not fear Russia’s ambitions” is rather of an exculpatory nature, given the adverse situation of late 2006 on the foreign policy front for the Russian President. Publishing articles in the foreign press, Putin thereby emphasizes the paramount importance of international aspects for building his own status as a figure of world significance.

At the same time Russia does not seek to conduct a dialogue with Europe as a single whole. It is largely due to the lack of consolidation in the European Union itself. The reasons for it are differences in the objectives and foreign policy priorities of the Member states of the “European Family”. If the “Old European” countries led by Germany - the integration powerhouse, are by and large disposed towards a constructive dialogue with Moscow, being aware of their still continuing energy dependence, a number of “neophyte” states can be considered the lobbyists of anti-Russian policies in the EU. These are primarily former participants of the Warsaw Treaty Organization which over the short period of membership in the “European Family” have never managed to give up their historical and geopolitical “complexes”. Besides they are trying to find their own niche within the EU as a “shield” against “Russian imperial expansion”. These differences exacerbated most clearly on the eve of the Russia – EU Summit as well as the North-Atlantic Alliance Summit in Riga. The growing anti-Russian rhetoric on their part gradually turned into personal criticism of Vladimir Putin himself. Such a case scenario, particularly if the information and propaganda “attack” on the country’s national leadership should be joined by the EU powerhouses, is fraught with grave foreign and domestic policy repercussions. However so far such a hostile attitude is mostly demonstrated by the Western mass media and Governments of “small states” (like Estonia). Nevertheless, a range of high-profile murders on the eve of the Summits (Anna Politkovskaya, Alexander Litvinenko) are the subject of intense discussions by the European public and have already provoked a serious chill in relations between Moscow and Brussels.

German Chancellor Angela Merkel said that she sees a consolidation of the “European Family” members as one of the priority tasks of her EU Presidency which must be reflected in the adoption of a common European Constitution. Poland is openly advocating its interests to the detriment of supranational ones, while Estonia, by its anti-Soviet laws, is putting European officials in a tight corner. On the one hand, unorthodox legislative acts of the Estonian parliament

prescribing the dismantling of Soviet monuments are supposed to receive an adequate reaction from Brussels. However, this would mean acknowledgement of the fact of violating informal norms in its own “domain”. On the other hand, the European Union does not have the moral right to support Tallinn either. Otherwise, its relations with Moscow will be finally ruined. Brussels opts for the most acceptable variant for itself – to step aside letting the conflicting parties to settle it on their own (President of the PACE Rene van der Linden called the situation in Estonia an internal affair of the state). A new hotbed of tension has emerged in Europe having every capability to trigger another trade war. Russian parliamentarians have already pledged to consider the issue of possibly imposing economic sanctions against Estonia. This measure will hardly be realized in practice, since it will give another reason for European leaders to accuse Russia of an attempt to resolve a political problem by economic means. After the recent Russian-Belarusian showdown it is the last thing Moscow wants.

Italy can be considered Russia’s ally in Europe which, despite the departure from the political scene of Silvio Berlusconi who was building the dialogue with the Russian Federation on the basis of his friendly relations with Vladimir Putin, is still prepared to ensure support for the Russian interests. It is largely accounted for by the economic interest of the state in close cooperation with Russian business. The autumn of 2006 was marked by the signing of a large agreement between Gazprom and Italian ENI. Under the agreement, the parties plan to cooperate on a long-term basis (the contract expires in 2035). Importantly, Gazprom is gets an opportunity to supply Russian gas directly to the Italian market - the third largest in Europe after Great Britain and Germany. The volume of direct supplies will grow in stages up to 3bn cubic meters by 2010. Italy has thereby safeguarded itself against the risks related to the halting of gas transit from Russia which has been the subject of discussions of European officials for several years already. The Italian market is the third largest in Europe after Great Britain and Germany. The main natural gas suppliers are Algeria and Russia. A diversification of supplies in order to reduce energy dependence on Moscow is discussed also in other European countries. And it is true not only for gas, but after the Russian-Belarusian crisis, for oil supplies as well. However none of the potential sources as of now represents a more reliable system than Russia. Furthermore, the organization of alternative supplies will prove rather cost-intensive, and under the conditions of growing energy consumption it may have a marked effect on the economy of fuel importing countries.

The European Commission has already announced its intent to closely consider the prospects of supply diversification, with the Middle East, the Caspian

Region and Central Asia viewed as the target alternative routes. But none of these regions is more stable than Russia. The Middle East will soon face both a standoff of intra-national groups caused by the execution of Saddam Hussein and the intervention of external actors, primarily the US, and possibly, NATO troops. Besides, Iran lays claim to the Iraqi oil province of Basra demanding withdrawal of the British troops. The Persian Gulf oil exporters (first of all, Saudi Arabia, Kuwait) may find themselves one way or other drawn into the potential conflict between Iran and the US, therefore an exacerbation of the situation in the Middle East will be unable to guarantee Europe the stability of oil and gas supplies.

**Comparative Data on Oil Production in the Russian Federation  
and Leading Oil-Exporting Countries: (thou. barrels/day)**

2006			
	October	September	August
Russia	9593	9293	9689
OPEC Countries: total	29447	29611	29773
of which :			
Iraq	1958	2048	2065
Saudi Arabia	9031	9056	9183

*Source:* Federal State Statistics Service of the Russian Federation, 2006.

Intensification is possible in the Caspian direction. Here the most promising, from the point of view of European consumers, are considered oil supplies via the Baku-Tbilisi-Ceyhan pipeline, development of the Kazakh deposit Kashgan with the participation of Italy's ENI which plans to invest up to \$29bn in the project. However the deposit development has not started yet, even though the project was supposed to have been in development as early as 2005. Furthermore, Caspian oil is also supplied to Europe in transit through Iran, and in the event of a military showdown the EU will have no guarantees of stable supplies.

As far as Central Asia is concerned, the EU could first of all be oriented towards Turkmenistan. However with the change of the internal political situation in the country guarantees of uninterrupted supplies will hardly be provided. Kazakhstan could come out as an alternative supplier. However the EU

demonstrated its unwillingness to look upon this Central Asian republic as an equal geopolitical player by denying Astana the OSCE Presidency in 2009. As a result, despite the European officials seeking to diversify supplies, it will hardly happen in the near future due to the tensions in the Middle East. The institutional framework by which the EU is trying to limit the influence of Russian oil companies remains futile. The Energy Charter, whose ratification is pushed by the Europeans, including Germany, will deprive Russia of its monopoly right to energy supplies to the EU countries. Moscow does not make a secret of it, and therefore all attempts of the EU countries to put pressure on Moscow through the Energy Charter remain fruitless.

Another unresolved issue in relations between Russia and the European Union is the determination of Kosovo's Autonomy status. The most optimal variant for Russia – is to maintain the current status quo, when Moscow has a serious tool for blackmailing the European Union. However in the EU they preferred to wait for the parliamentary elections in Serbia where they count on the clout and political will of the relatively pro-Western Democratic Party of Serbian President Boris Tadic. Whereas for Russia Kosovo still remains an effective instrument of pressure on the European community in the issue of determination of the status of unrecognized republics in the post-Soviet space, first and foremost, in Georgia and Moldova. It is appeals to the “Kosovo scenario” that are crucial for the position of the Russian leadership regarding the fate of the self-proclaimed republic. Vladimir Putin stated that in the event of granting independence to Kosovo, the unrecognized state entities in the CIS territory would be able to claim independence as well. However the West insists on the Kosovo situation being unique, refusing to see a precedent in the positive outcome of the problem. The issue of national sovereignty is still unresolved in international law. On the one hand, the UN Charter declares the right of nations to self-determination, but on the other – the principle of territorial integrity, according to which the territory of one state may not become the object of acquisition by another.

It is also in Moscow's interests to have a de-facto undetermined status of Kosovo because, first, the long-running negotiations can be used as an instrument of pressure on the EU for purposes of getting preferences, in particular, responsiveness of European officials on energy issues. Second, in the event of making the positive decision by the international community, Moscow will be expected to realize its threats and put into practice the promised acceleration of the process of granting independence to the rebel pro-Russian regions, which is fraught not only with image damage but also with violations of international legal



norms. Another reason why Moscow is unlikely to go for it is that on the whole the rebel territories are of no serious interest to it. Europe has increasingly fewer legal grounds for granting independence to the Province. On October 30 a referendum on the Constitution was held in Serbia, based on the results of which Kosovo was declared an integral part of Serbia with broad autonomy rights. It is this fact that will become the main argument of those opposing the separation of Kosovo, including Serbian Prime-Minister Vojislav Kostunica and Serbian radical Vojislav Seselj, currently kept in a Hague Jail.

The end of the year was characterized by a warming of the Russian – American relations which prompted the parties to soften their positions on the most important aspects of international activity. A concession on the part of the USA was its consent to Russia’s accession to the WTO, while on the part of Russia – toughening of the requirements for the Iranian “nuclear dossier” and partial consent to the imposition of sanctions against the IRI. Diversification of the foreign policy course is aimed not only at the implementation of the chosen strategy but also at reducing potential risks from potential protests on the part of world leading players, such as the EU and the US, as well as China, gaining weight in world politics.

The primary task of Vladimir Putin under the existing conditions - is to follow the chosen geopolitical strategy, playing on the differences among major world powerhouses and deriving political and economic benefits from it. Putin manages to maneuver between the two major geopolitical players – the EU and the US. The parties are ideologically close, however recently an increasing number of issues have appeared, on which it is hard to reach a compromise. Among such are the US policy in Iraq, and as a resonance, accusations against Washington of selective democracy and dual approach to the human rights issue, the NATO prospects as an integrational military organization and advisability of the Alliance’s expansion.

Seeking to acquire the status of the leader of a leading world power in the eyes of the foreign elite, Putin is actually fighting a war on two fronts. On the one hand, – EU countries which are geographically and politically closer to Russia than the US, and hence more dependent on energy supplies from Russia. On the other hand, – the eternal geopolitical rival represented by official Washington, with which Moscow, in the grand scheme of things, has not managed to establish strong positive relations since the end of the “cold war”. Having said that, for purposes of promoting his concept Putin views the US not only as a permanent opponent on the international arena, but also as a potential ally on the way of implementation of his “megaplans”. Apart from that, the American authorities themselves are



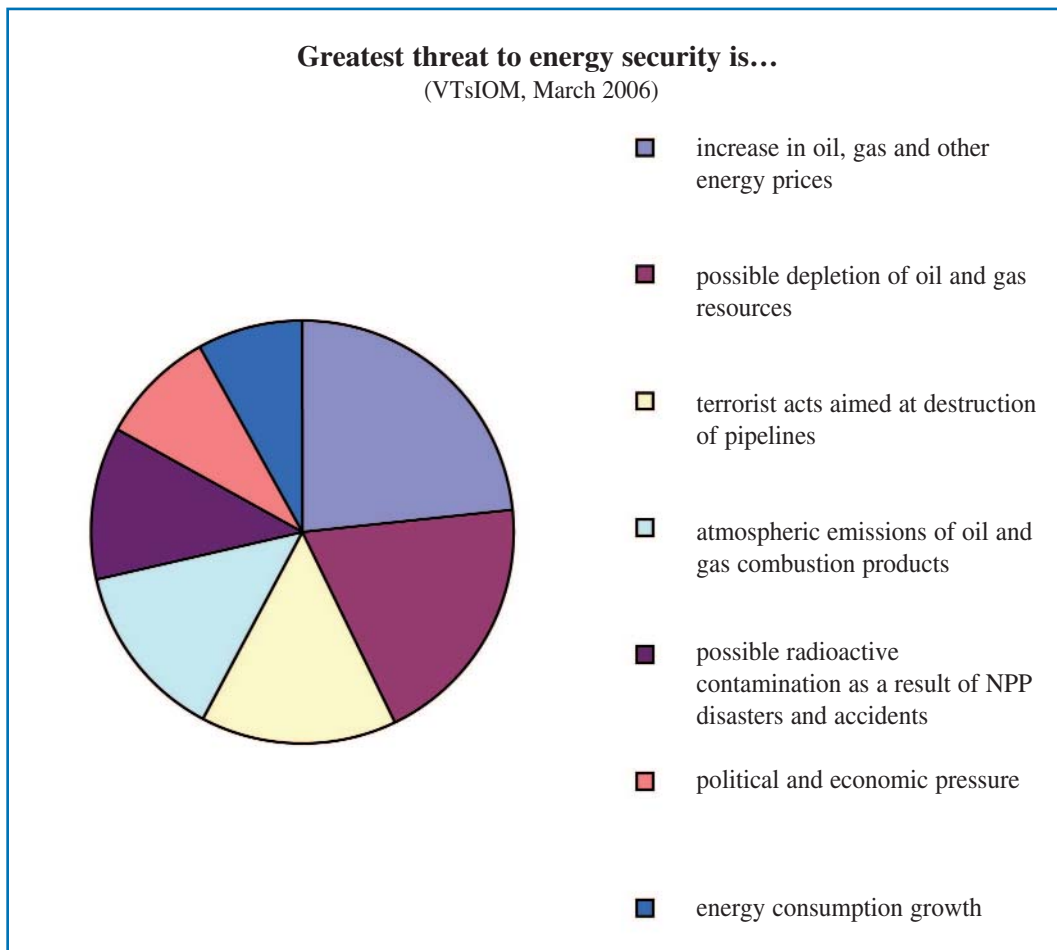
prepared for rapprochement with Russia. It was particularly evident in the autumn, after the elections for the US Congress, where the incumbent Republican Party was beaten by its Democratic opponents and thereby lost the opportunity to have the same scope of influence on America's foreign policy activities.

Characteristically, the warming of relations with the US was marked by a parallel deterioration of the Russian-European dialogue. There may be several reasons for it. First, an objective split inside the Euro-Atlantic Alliance and the difference in approaches of the US and EU to international activity. Russia's increased attention to one party is naturally accompanied by discontent of the other, and vice versa. While for Moscow such a status quo is quite welcome and allows it to obtain from its partners political and economic preferences. Putin's behavior in the Euro-Atlantic direction is based on pragmatism which was atypical of Russia just a few years ago. Putin is proving as best he can that now Russia has resources, the possession of which enables it to dictate its terms. It allows him to keep his head high in relations with major geopolitical players, which are currently the EU, US, and China. Putin demonstrated the secondary role of cooperation with the US by the example of the Shtokman field by announcing the re-direction of its resources to Europe instead of North America. However, the Russian leader is not going to build any other relations than those predicated on a rational approach with the EU either. It is evidenced by the tough stance taken by the Russian leadership with respect to the Energy Charter. Recognition of the document would mean Russia losing its monopoly to gas development in its own territory, and accordingly, would become a serious obstacle to the implementation of the energy superpower strategy.

## **6.2. Russia's Relations with CIS Countries**

The positions of Russia in the post-Soviet space are currently determined by energy capabilities of the former socialist republics. Being, on the one hand, fuel producers and, on the other, - transit areas, these countries lay claim to the role of large geopolitical players in their region. To a greater extent it is demonstrated by the republics of Central Asia which by virtue of possessing considerable mineral resources as well as having well-established stable political regimes are seeking to strengthen their positions not only in relations with Russia but also with Asian countries. Their course for mutual cooperation as well as growing gravitation towards diversification of fuel supplies enable these countries to pursue their own

energy policy. It is too early to say that Russia has lost its positions in the CIS territory, but a trend towards their weakening can be seen. It is manifested in the inability to influence the political situation in these republics in any way but through economy. And in the event that such republics have their own resource base, such pressure proves to be practically unfeasible.



The Russian leadership use a cautiously pragmatic approach with respect to the post-Soviet countries that are themselves energy exporters. It is true for our relations with countries of the Central-Asian Region (Turkmenia, Kazakhstan), where Russia no longer has the same political clout as before, but nevertheless is viewed by the leadership of these republics as a beneficial economic partner, since Asian fuel is supplied to Europe through the Russian territory. Equally interested

in the development of the Central Asian Region is China. Hence, the Russian Federation has to make certain concessions in the negotiation process with Central Asian exporting countries in order to maintain its presence in the strategically [important] region. Russia's complaisance is also due to the still remaining strong political positions of these countries' power elites.

Vladimir Putin, by counting on Russia's maintaining its influence in the post-Soviet space, acts as a supporter of integration processes. The Russian Federation is taking active part in "unification" events involving the post-Soviet space. Among them: CIS Summit, the Summit of the Heads of Governments of the Commonwealth Member States, meetings within the military block of the Collective Security Treaty Organization. For Vladimir Putin the CIS is rather a confirmation of Russia's leadership, if formal, in its former domain, since at the moment cooperation with former Soviet states is much more successful on a bilateral basis. The last CIS Summit in November 2006 defined Vladimir Putin's allies, among which are representatives of the "old", predominantly still "Soviet", elites - of Kazakhstan, Uzbekistan, Armenia, and in part Moldova. Actually Russia, notwithstanding its "stick" policy manages to retain at least one ally in each strategically important region. It keeps one from speaking of the final exit of Moscow from the post-Soviet space and its losing ground. In the meanwhile, the influence in the region is contested, apart from Russia, by another two key players with which the Russian leadership seek to maintain constructive relations – the US and China. Being a promising sales market for energy resources from Kazakhstan and Turkmenistan, is for the most part China that is setting sights on the Central Asian region. Having wealthy natural gas reserves, Central Asian countries are also eyeing close cooperation with Washington. But in this case the prospects of close interaction look rather vague. The US foreign policy recently has been oriented towards fighting the "world evil", which, despite the claims of the White House to the contrary, is quite certainly of Muslim denomination. Since, formally, the population of the Central Asian countries follows Islam, the likelihood of a confidential dialogue between them and the US considerably wanes.

Of all Central Asian countries Kazakhstan remains the most loyal to Russia, notwithstanding that Nursultan Nazarbaev's foreign policy course, just as that pursued by the leaders of other republics in the region, is a multi-vector one. The beginning of 2006 was marked by a political rapprochement of the Russian and Kazakh Governments, which was no less important than that in the oil and gas area. Vladimir Putin and Nursultan Nazarbaev signed a package of documents on the establishment of the Eurasian Bank. This structure is designed to finance the

integration processes within the Eurasian Economic Community (EurAsEC). The financial unity of the two countries is politically motivated. It is not ruled out that the establishment of such an investment organization purports to monopolize the CIS financial market and to push aside such world giants as the IMF and EBRD.

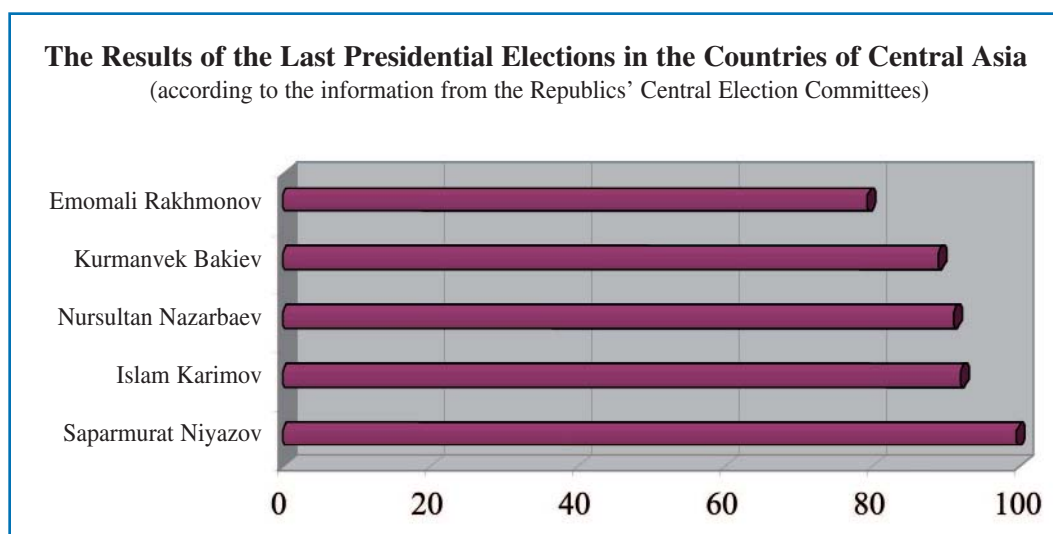
At the same time, Kazakhstan is attractive to Russia, first of all, in terms of its energy reserves. In October 2006 the parties signed an agreement for establishment of a joint venture for the gas transportation and processing of gas from the Karachagansk oil and gas field in Western Kazakhstan at the Orenburg Gas Processing Plant. The consortium developing the project (British Gas and ENI - 32.5% each, ChevronTexaco - 20%, LUKOIL - 15%) will sell [gas] to Kazrosgaz existing since 2001, owned by Gazprom and Kazmunaigaz (50% each). Kazrosgaz will supply gas to the established joint venture for further processing. Under the terms of the agreement, from 2012 the plant will process at least 15bn cubic meters of gas annually. Gas processed at the JV will be purchased by Gazexport. It will go to Ukraine and belorus, and further to Western Europe. The joint project of Gazprom and Kazmunaigaz is designed to further establish the positions of Russian business in the Kazakh energy market.

The behavior of major geopolitical players in Central Asia will be seriously affected by the situation in Turkmenistan. Saparmurat Niyazov's decease was, on the one hand, a predictable, and on the other, unexpected fact, considering the international balance of forces in the Central Asian region. It is the results of internal struggle that will directly affect the international orientation of the republic and, accordingly, will indicate the vector of development of the Russian-Turkmen relations.

China, cooperation with which was recently a top priority for Niyazov, too, will be directly involved in the division of spheres of influence in Turkmenistan. Diversification of gas supplies in the Chinese as well as Indian directions would allow Turkmenbashi to manipulate gas prices even more, particularly considering the undetermined volume of "blue fuel" in the territory of the Republic. Ashgabat's contacts with Beijing intensified yet in mid 2005, when Chinese CNPC was offered to perform exploration on the right bank of the Amu-Dariya. In April 2006 the course for energy partnership was established by signing a general agreement, under which China would be able to receive Turkmen gas in the amount of 30bn cubic meters a year, admittedly, though, to make it happen a pipeline should be constructed first. The launch date of this project was scheduled for 2009. However, under the existing conditions the prospects of this project's implementation become uncertain.

Given that all international contacts of Ashgabat were based on Niyazov's personal participation, after his death there is high uncertainty about further cooperation not only with the Russian but the Chinese company. The Chinese-Turkmen gas cooperation worried Russia and Ukraine in terms of the already agreed supplies. In spite of the claims that the agreement with China would not damage other Turkmen gas buyers, and that the PRC would receive gas supplies from new fields which are currently under exploration, the general agreement contained a clause under which, if required, extra volumes of gas could be supplied from other fields as well. Given that Turkmenbashi not infrequently reneged on agreements already reached, the likelihood of filling the Chinese pipe with gas intended for the Russian Federation was quite probable, whereas Moscow, as usual, would not have been able to do anything about such a move by the Turkmen leader.

On the gas issue Niyazov's negotiating positions proved to be stronger than Russia's. Russia agreed to purchase "blue fuel" from Turkmenistan at \$100 per thousand cubic meters which happened to be 2.5 times higher than the expected price. Thereby Niyazov managed to demonstrate not only to Russia but to buyers – countries of Central and Western Europe – room for maneuver. Niyazov built his foreign policy based on possibilities of cooperation in the energy sphere, the negotiation process was his sole prerogative. After the death of the chief negotiator the future of the concluded contracts becomes vague. Russia's interest is to prevent changes in the existing price agreements and ensure the guarantees of gas supplies at their previous level.



Equally pressing remains for Russia the South-Caucasian issue. Currently we witness the republics of this region gradually give up on cooperation with Russia as a priority direction of their foreign political and foreign economic activities. For example, Azerbaijan, just as Georgia, has long not made a secret of its pro-Western orientation. In the light of Russia's positioning as an energy power and its attempts to put pressure on some post-Soviet republics, Azerbaijan is ever more actively assuming the role of an alternative fuel supplier to Europe. Telling in this sense is the Memorandum on Energy Cooperation signed recently by President of Azerbaijan Ilham Aliev and Head of the European Commission Jose Manuel Barroso. This agreement became just a legal formalization of the parties' mutual desire to get rid of the fuel and energy hegemony of the Russian Federation. According to the document, the participants will seek to reduce their dependence on Moscow through energy supplies from deposits in the Caspian Sea. In September Britain's BP announced it would engage in gas production on the Shah Deniz Caspian field which is supposed to improve the energy security of the European Union. Shah Deniz is developed jointly by BP, Norwegian Statoil and Azerbaijan SOCAR. Fuel from the field will be supplied via the South-Caucasian pipeline running through Azerbaijan and Georgia to Turkey, whence it will be redirected to Italy and Greece. Russia is not happy about such "redistribution" of the sphere of energy influence. The creation of the alternative Georgia-Azerbaijan alliance runs counter to Moscow's plans for "neutralization" of the Saakashvili regime. With respect to the adamant Transcaucasian republic Russia used the "punitive" mechanism of pressure which once again proved its efficiency. Considering that from the New Year Russia enters a different stage of its political development, it is important for Putin to maintain the already built line of relations with Tbilisi. Otherwise softening of Russia's positions on the "Georgian issue" will mean if not a collapse but considerable weakening of all politics of the Russian Federation in the region.

For the US Azerbaijan is, first and foremost, of strategic importance. It is related to Baku's ambition to become a NATO member which is in the best interests of Washington. First, Azerbaijan will have to join the sanctions against Iran. Second, a NATO military contingent will be deployed in the territory of the republic, which will significantly strengthen the US positions in the oil-bearing region while putting the only South-Caucasian state still loyal to Russia – Armenia – into quite an unpleasant predicament of being "the odd man out" surrounded by Western satellites. Third, under the conditions of the ongoing "struggle against international terrorism", whose image is quite well-defined, it is quite important



for the United States to secure the support of as many Muslims as possible. In the event of exacerbation of its relations with Baku, Moscow may use the frozen Nagorny Karabakh conflict as a bargaining chip in the course of political bargaining with Azerbaijan and openly declare its support of Armenia. Moreover, the example of Georgia has demonstrated that veiled support of the West still does not guarantee assistance in issues relating to the resolution of ethnical conflicts.

Russia's increasing gas prices for Armenia naturally caused discontent in the local political circles. The tone did not soften even after the October visit of the Armenian President to Moscow. The leaders of the two countries had to admit that the predominance of European investments in the Transcaucasian republic becomes a regularity, and Russia, in this respect, was no longer the priority direction. Besides, the course towards European integration was later voiced by Prime-Minister of Armenia Andranik Margaryan. Thus, the political elites of Armenia acknowledge officially that the previously dominant constructive relations between Moscow and Erevan are no longer as constructive as before. While cooperation has a pragmatic nature.

Indicative of such a trend is Gazprom's desire to purchase the Iran-Armenia pipeline. Gazprom's representatives justify it by the need for optimal control over gas supplies to the republic due to its unauthorized siphoning in the Georgian territory. While in fact Gazprom expressed its desire to obtain control over Armenia's pipeline system in order to deprive it of alternative gas fuel sources and thereby to become the monopolist in the Armenian energy market. The need for deepening economic ties with the West is also the keynote of the statements of Armenian opposition. A Deputy of the Armenian National Assembly for the Spravedlivost (Justice) opposition bloc spoke with unconcealed sympathy of the course chosen by Georgia and Azerbaijan, resolving their domestic problems at the expense of the superpowers' interests in the Transcaucasian region, hinting at Georgia's possible accession to NATO.

No less telling along the line of toughening the Russian policy with respect to the post-Soviet republics is the situation around RUSAL in Tajikistan. The Russian aluminum giant is accused of failure to perform its obligations for the construction of the Rogun HPP to the Republic's Government. The Republican authorities announced also their refusal to admit the Company to the construction of the Tajik Aluminum Plant. The conflict over the situation with the Russian company reached the state level, since the HPP is a heritage of the USSR, and accordingly is partly owned by Russia. Accusing RUSAL of inaction, Tajikistan thereby demonstrates it is not at all intimidated by Russian business. Such behavior of the



Tajik Government attests to a change in the balance of forces not only in the Transcaucasian, but also in the entire Asian region, and gradual reorientation of the authorities of the previously loyal republics towards the West.

Russia's energy pressure applies not only to the clearly pro-Western republics. A striking example of this is Belarus, in relation to which Russia, as a matter of fact drew the line by launching a duty, and later, also a trade war. Minsk is already developing new economic areas, such as, Azerbaijan, first of all. Minsk explains its orientation towards cooperation with this South-Caucasian republic by mutual interests. Being a transit area, Belarus is ready for cooperation with Azerbaijan in the area of oil and gas supplies. Tellingly, it was none other than pro-Western Azerbaijan that was chosen by Alexander Lukashenko as an alternative partner. This move serves to demonstrate Russia that he is independent and that the Belarusian authorities have room for maneuver. Although it is doubtful that the announced cooperation prospects will transform into serious projects. Azerbaijan, oriented in its foreign policy towards the West, will hardly agree to enter into serious economic relations with Minsk.

The end of the year was marked by a sharp deterioration of the Russian-Belarusian relations. Russia has taken the course for making good on its promises with respect to Belarus and in this direction is demonstrating the consistency characteristic of the recent months. Belarus has long remained Russia's ally in the post-Soviet space. Whereas Moscow, apart from economic stimulation, have turned a blind eye to the domestic political regime of Alexander Lukashenko. The relations reached their peak during Boris Yeltsin's period in office, when both Presidents were united by friendly and not business ties. Unlike his predecessor, Vladimir Putin does not look upon Lukashenko as the Head of the "brotherly" Republic, and therefore is not averse to use tough methods of pressure, tested already on the "orange" leaders. Russia is actually pushing Minsk into an economic deadlock, however, realization of this fact coupled with similar sanctions against Ukraine does little to soften the Russian position. By canceling the preferential treatment for Russian oil exports to the neighboring republic, Russia is again practicing economic methods of political pressure for purposes of building, in the eyes of the Western public, the image of a country that is impartial and unbiased in its foreign policy. It is not ruled out that Putin also seeks to demonstrate to the West toughness of his positions with regarding the authoritarian regime of Lukashenko, intensely criticized by American and European human rights activists, in order to correct the "mistakes" of his predecessor.

Even though the energy issue between Moscow and Minsk is by and large settled, the tensions between the states do not ease. When imposing an export duty

the Russian leadership thereby intended to even out the structure of economic cooperation with Belarus. Lukashenko's reaction was unorthodox but nevertheless predictable. In contrast to Ukraine and Georgia, guided by the opinion of the West, the Belarusian President does not need to act bearing the reaction of developed countries in mind. This artificially created advantage expands the room for political maneuvering, allowing Lukashenko to intensify cooperation with such outsiders of world politics as Chaves and Ahmadinejad.

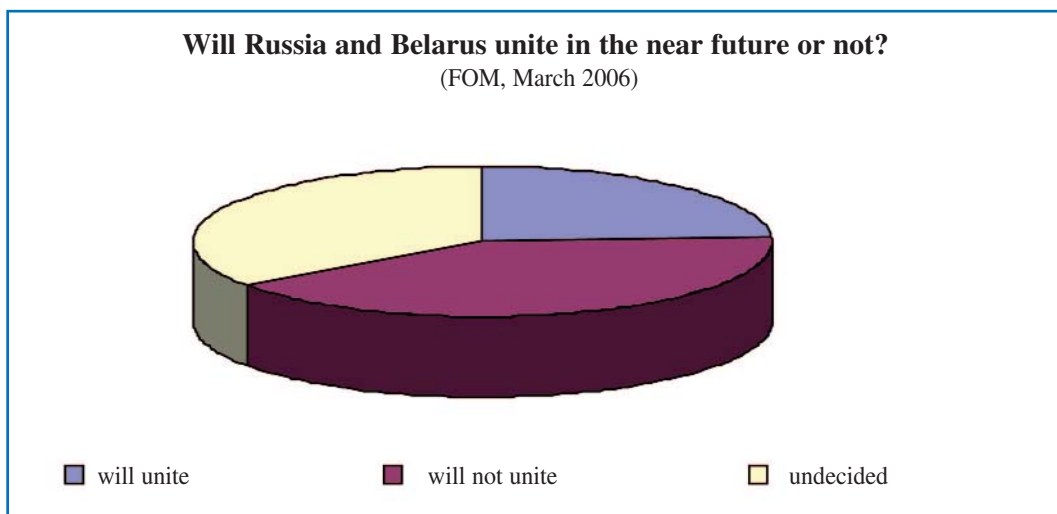
The reasons why Russia was consistently increasing pressure on Belarus were both economic and political. Over the recent time the bone of contention in Russian-Belarusian relations has been the prospects for creating a Union State. Currently this "semi-mythical" alliance is an image-building project rather than a concept that can be realized in practice. The stumbling-block to the unification is the difference in the Parties' approaches. Russia insists on the economic nature of such unification which must be based on the Russian currency with a single emission center in Moscow. Lukashenko cannot be happy with this approach, since in the case of introduction of the Russian ruble in the territory of the Republic of Belarus it will, as a matter of fact, violate the Republic's economic sovereignty. The process of creating the State of Russia-Belarus has dragged on for more than 10 years already. And if it was not created under Boris Yeltsin, who was on a much friendlier footing with Lukashenko, under Putin the unification prospects become even slimmer.

In 2001 Belarus unilaterally withdrew from the Customs Treaty thereby putting Russia into the position of an indirect sponsor of the Belarusian economy, which, according to Russian officials, cost Russia annually up to \$4bn. Under the Treaty 85% of export duties collected on Russian oil products was to be transferred to Russia and 15% to remain in the Belarusian budget. However, Lukashenko's Government neglected this provision, thus violating bilateral agreements and putting into question its ambitions to press ahead with the creation of the Union State. Under Lukashenko the creation of the Union State the way it is presented by Moscow is not feasible.

Despite the fact that a number of institutions continue to function within the Treaty, among which is the universal pattern of crossing the Russian-Belarusian border, the State as a political union has never been established. It can be assumed that by exerting pressure on Lukashenko over the oil issue, Moscow intends to get him to complete the Union State project prior to the Presidential Elections in the Russian Federation. However it is doubtful that the Russian authorities are seriously counting on Lukashenko's responsiveness on this issue. The sanctions of

Moscow against official Minsk have already proved inefficient, and Russia is gradually losing levers of influence on the intractable President. Moreover Russia's energy pressure gave grounds to Lukashenko to start making advances to the West, in particular, to European countries. Yet during the CIS Summit in November Lukashenko called upon Kiev to unite in order to stand up to Russia's growing oil hegemony. The provocations with halting of Russian oil supplies triggered harsh criticism in Eastern European countries against the Russian foreign policy, even though Lukashenko himself is persona non grata in the European community. The Russian-Belarusian conflict gave an excellent reason for countries importing Russian fuel to once again accuse Moscow of unreliability and "the political nature" of its economy and to remind it of the need to ratify the Energy Charter.

At the same time, Moscow made it clear that while protecting its own economic interests it was not ready to walk out on Belarus. It was evidenced by the gas talks on the New-Year eve during which Belarusian officials managed to lower the required price from \$105 to \$100. Notwithstanding that gas supplies to the Republic happened to be in jeopardy, Moscow preferred not to repeat the Ukrainian scenario of the 2006 winter but opted for a compromise variant. However, Moscow's blow dealt to the Belarusian economy in the form of an oil export duty did not go unnoticed. It is doubtful that the resolution signed by Fradkov will be performed in full, however the toughening of the Russian stance gave a perfect reason for the Belarusian authorities to enter into political games with Moscow by imposing an artificially created duty on Russian oil transit to Europe.



It could be presumed that Russia's attacks on the Belarusian economy were aimed at discrediting even the otherwise unpopular Lukashenko regime. At the same time this version hardly has a leg to stand on too. Lukashenko paints the Russian-Belarusian conflict as Russia's ambition to bring the Republic under heel, which is designed to hide the weakness of the Belarusian economy behind populist slogans. If Moscow indeed wanted to oust Lukashenko from power this process would have been initiated yet prior to the March elections of 2006, as it was the case with Ukraine. However, unlike Kiev, Lukashenko has at his disposal a powerful blackmail tool – the Union State project whose collapse would mean serious image-related problems for the Russian leadership and personally for Putin. In spite of the fact that the implementation of this project under Lukashenko is all but unfeasible, Moscow nevertheless is not inclined to publicly give up on the idea of unification. Furthermore, as of now in Belarus there is no figure similar to Yanukovich. Milinkevich, the leader of the Belarusian opposition, has never been a supporter of close integration with Russia. His interests lie mostly in the area of building ties with the West. Besides, Milinkevich does not have the powers of government that are actively made use of by Yanukovich, even though there are no serious political and economic preferences on the part of Ukraine. It is not in Moscow's interests to deal with the Belarusian domestic policy due to the forthcoming electoral process in the Russian Federation itself.

Under these conditions the economic version of the "fuel war" looks the most constructive. Russia has long sought to buy out Belarusian enterprise Beltransgaz. According to the Agreement signed on the New Year eve, Belarus is to pay \$70 in monetary terms, and 30 dollars – in shares of Beltransgaz. Supposing that the ultimate goal of Putin's foreign policy – the transformation of Russia into an energy superpower having oil enterprises not only within Russia but also in the territory of "transit" states, the issue of coming into possession of the former Soviet republics' property would make sense indeed. The Russian leadership would like to acquire ownership also of the oil processing industry of the Republic of Belarus, whose flagship is the Belarusian State Oil and Chemistry Concern (Belneftekhim). If in the gas sphere Moscow and Minsk have agreed on this issue in legal terms, in the oil sphere there are many unresolved issues left between the parties, particularly after the imposition by Russia of the export oil duty, following which the leadership of Belneftekhim announced the termination of the contracts with Russian oil companies.

As long as Lukashenko is in power in Belarus, Russia can be said to have lost its western neighbor, politically and economically. Lukashenko has already

demonstrated that Moscow has quite weak levers of influence on his regime, while all attempts by Russia to put some pressure on the unwelcome politician are perceived in the West first of all as Russia's ambition to build up its energy might. Hence, no one will deal with the Belarusian domestic policy until the Presidential Elections.

The fundamental differences in approach to the establishment of the Union State will also have a negative effect on the future of the Russian – Belarusian integration. This issue too will become an object of close scrutiny by Putin's successor. One should not expect a significant warming of relations between the two countries, however the tone of bilateral talks will still change for the better. Russia, despite adopting a rather tough stance towards Minsk, will take into account the importance of the transit component of the Belarusian economy not so much for commercial benefits, but for the implementation of the "energy superpower" concept.

In parallel to the deterioration of our relations with Belarus, signs of warming have appeared in the Russian-Ukrainian dialogue. It is due to the domestic balance of forces in Ukraine itself. On becoming the Prime-Minister, Victor Yanukovich throughout the entire year demonstrated a negative attitude to the course pursued by President Victor Yuschenko. Even though Moscow has not received any significant preferences from such "castling", the anti-Russian rhetoric of official Kiev has markedly subsided. Apart from that, the Russian Federation has managed to agree with Ukraine on the gas price which became one of the lowest among all the countries in the post-Soviet space. However still unresolved is the issue of the deployment of the Russian Black Sea Fleet Base in Sevastopol. Extension of the lease term is a big question as of now. Indicative of this are both the uncertainty in the Russian-Ukrainian negotiations, during which the Ukrainian party calls the presence of the Russian base unconstitutional; and the large-scale construction of a base in Novorossiisk; as well as the ruling of the Sevastopol Economic Court of Appeals to obligate the Russian party to return a range of navigation and hydrographic facilities of the city into Ukrainian ownership.

### **6.3. Russia's Relations with Developing Countries**

At the same time Putin shows his ambition not to confine his influence only to the energy dependent countries. For a more efficient advancement of the "energy power" concept it is important to secure the support of as many countries as possible. Especial foreign policy activity of the Russian President can be noted

in the African direction, since the “Black Continent” is viewed as a potential launching pad for promoting Russian political and business interests.

Thus for instance during the Moscow visit of President of Angola Jose Eduardo dos Santos over 10 cooperation agreements were signed between the two countries. No less noteworthy in this respect is also Vladimir Putin’s visit to the South African Republic and Morocco this summer, which culminated in numerous lucrative contracts. The African market is beneficial for Russia not only economically but also strategically. Strengthening of its positions on the “Black Continent” means the regaining of its influence in this region by the Russian Federation, lost after the breakup of the Soviet Union.

Russia is seeking to reap maximum benefits from the cooperation with African companies. The participation in projects of Russian leaders in their industries – Gazprom and ALROSA – bears witness to a favorable investment climate of the region and to the readiness of business to invest in long-term projects. JSC ALROSA has signed agreements with national companies of the Republic of Angola ENDIAMA AND SONANGOL. Pursuant to the Protocol ENDIAMA will use ALROSA’s exploration, mining and beneficiation technologies. Besides, the Yakutian company will ensure the appropriate training of Angolan specialists engaged in diamond projects and commercial companies with its interest. JSC ALROSA, OJSC Zarubezhneft and Dark Oil Company have signed with SONANGOL (National Oil Company of the Republic of Angola) a Memorandum of Cooperation in the area of joint prospecting, exploration and production of hydrocarbons. Gazprom also strives to get a firm footing in the promising market. A Memorandum of Cooperation was signed between the Russian gas monopolist and African company Sonangol, according to which the parties will produce natural gas in the territory of Angola. It evidences Russia’s ambition to reinforce its positions in the new market in the country’s priority direction. Systematic work to strengthen its positions is underway also in banking. On the basis of Vneshtorbank a branch of this organization has been established in Angola - VTB-Africa which will deal with the issues of financial support for the activities of Russian entrepreneurs in this country.

Dissemination of Russian influence is going on also in the Algerian direction. Early this year Russia wrote off this North-African country’s government debt (around \$4.5bn) in exchange for the purchase of Russian weapons. Apart from that, Algeria’s energy capabilities make this country quite attractive for the expansion of Russian business. Algeria is a large supplier of gas to Southern Europe (12%), whereas the Eastern European region is controlled by Russia (over



25%). Gazprom has already indicated its wish to exchange assets with Algerian gas giant Sonatrach in order to get access to the markets of South Europe (Spain, Portugal, Italy). In such a way Russia's energy influence will cover the greater part of the Eurasian space, and this will even further strengthen Moscow's positions in the energy dialogue with the European Union, but will result in new criticism of the Russian "imperial" authorities.

As for Egypt, Putin attaches quite a lot of importance to cooperation with this republic. He declared it during the Moscow visit of ARE President Hosni Mubarak. Egypt is indeed of serious interest to Russia and may act as a principal partner of Putin's policy in the Arab world. Notwithstanding that territorially Egypt belongs to the African continent, its primary interests are concentrated in the Middle East, whose countries are among those Russia is also interested in maintaining close ties with. Currently the most promising avenue of cooperation is development work in the area of nuclear energy. Joint activities in this area have been underway since as early as the 1950s, however it is precisely at this moment that Egypt is about to face the prospect of a fuel shortage. In consequence of this, Russia, the US and China are ready to provide assistance necessary for the development of this branch of the energy industry. By intensifying cooperation with Egypt all the three major players pursue their own goals. If for the PRC it is important to further its expansion in the African region (as it is doing so in Central and South America), and the US seek to take under their control the nuclear construction process, Russia, bearing in mind the extent of Cairo's clout in the Arab world and the similarity of the countries' positions on Iran, is actively trying to recover its former Soviet might in the region.

And nonetheless, despite the importance of the above meetings, Putin preferred to start the active development of the African continent from the RSA. For Russia it is quite a promising economic market. The Russian Federation is establishing cooperation in the area of diamond mining, where the Russian party is represented by the ALROSA Holding. Manganese is mined by Renova. Development of cosmic space has also been recognized as one of the key elements of cooperation. And as long as the RAS market is currently less developed for Russia than those of Angola and Egypt, this South African Republic may act as guarantor of the Russian presence in the South of Africa.

Striving to secure the backing of as many developing countries as possible, Moscow has more than once spoken for the participation in the G-8 Summit of such growing economic powers as China, India and Brazil as part of the BRIC. The leaders of Russia and China have emphasized time and again that bilateral



cooperation, particularly in the energy sphere is a priority direction. Apart from that, close economic ties could deprive the US of mechanisms of influence in this region. Thus, according to Vladimir Putin, Russia intends to supply to China 60-80bn cubic meters of gas a year through the construction of a new gas main in the western segment of the Russian-Chinese border.

However China, too, being a major world player, at the same time poses competition to Russia in the region. In consequence of this, Putin, when taking part in the geopolitical game, resorts to the methods realized with respect to the US and EU. The stumbling block so far has been the Kovykta gas condensate field. China has announced it is prepared to purchase Russian gas at market prices, however, Russia has never started supplying fuel to the PRC in view of the conflict between Gazprom, supported by the authorities, and TNK-BP, the operator of the field development project. There is a controversial situation developing over the Eastern Siberia- Pacific Ocean pipeline, which is planned to branch off to China. The design customer is Russian company OJSC AK Transneft. In mid November President of the company Semen Vainshtok confirmed the information that the branch pipe to China would be constructed, adding, however, that this information was unofficial. Russia is delaying the implementation of economic projects with China even though this direction is one of the most promising and strategically beneficial for the country. Russia may soon feel growing competition on the part of China in the Central Asian region, therefore the energy bargaining that can be seen going on between Moscow and Beijing is designed to get certain concessions from China in exchange for cooperation in the energy area.

In parallel to China, Russia is actively expanding into India, where at the core of cooperation lies the military-industrial complex. India, just as the PRC, on the one part, is within the sphere of interest of the US, and on the other – is increasingly building up its own economic potential and becoming a large regional player. That Moscow in Delhi will have to compete with Washington is evidenced by the latter's wish to become Delhi's major partner in the area of nuclear energy. In late 2006 George Bush signed a law on cooperation with India in this sphere. However this cooperation will not be charitable. The condition for it must become delimitation by the country of its nuclear facilities into military and civil ones, as well as access for the IAEA to the latter. Russia is also interested in extending its economic presence in the area of nuclear energy on Indian soil. Russia has set its sights on NPP Kudam Kulan.

Contacts with Brazil are not so intense because of its geographical remoteness. However this South American state has not gone unnoticed by the

Russian leadership either. In April 2006 Mikhail Fradkov visited Brazil, noting that the commodity turnover between the two countries required serious adjustments upwards. Moreover, Russia is planning to participate in the construction of a transcontinental pipeline in the territory of Latin America, where the market is all but untapped by our country.

#### **6.4. Russia in the Middle East**

The Middle East, in spite of there being several pockets of tension, is still of prime interest for Russia. The leading role in the region is played by the US. But throughout the past year Moscow was actively trying to win the positions of a major regional player by choosing the role of a mediator. Russia does not rule out its indirect involvement in the Middle East conflict, considering the developing pre-war situation there. Later in the year Vladimir Putin hosted President of Syria Bashar Assad, while not long before it an official visit to Moscow was paid by a representative of the opposite party to the conflict – Prime-Minister of Lebanon Fuad Saniora. The fact that the conflicting parties intend to engage Russia in the resolution of the decades-long Syrian-Israeli feud is evidence that the country has certain negotiating resources it can make use of.

However at the informal level Moscow's positions are not unambiguously neutral. As a military co-sponsor of Syria, the Russian Federation has to indirectly support Damask in its confrontation with Israel. During Tel-Aviv's summer military campaign in Beirut, Moscow adopted a uncertain stance which happened to go unheard in the Middle East. The only reason to remember Russia's role in the conflict came to be the fact that Hezbollah militants were found to have weapons allegedly of Russian make, which made it into Lebanon from Syria. Official Moscow neither denied nor confirmed this information, preferring to maintain its previous positions and not to provoke either Israel or Lebanon against itself.

However the fact that Moscow is nevertheless inclined to be on the same side with the West in the Syrian-Lebanese-Israeli negotiating process is evidenced by its joining the UN Resolution which condemns the murder of pro-Western Ex-Premier of Lebanon Rafik Hariri and provides for the establishment of an international tribunal to investigate the murder. The underplot of the tribunal is its explicit anti-Syrian orientation, even though Prime Minister of Lebanon Saniora claims that the future commission will be unbiased and politically neutral. Whereas Russia, although having consented to the establishment of the tribunal, at

the same time did not want to give up on its contacts with Syria. Multimillion deals (antitank missile systems Kornet-E) (worth 65m dollars) and Metis-M (worth 73m dollars) prevented both Moscow and Damask from resigning to the international situation and sever the trade relations in the area of weapons supplies that had been taking shape for years.

The threat of a civil war in Lebanon with the immediate participation of external forces, such as Syria and Israel, may entail unofficial confrontation of larger geopolitical players - the US and Russia as well. Notwithstanding that Moscow almost throughout the conflict kept out of the fray, participating in it only at the declarative level. Whereas now Moscow intends to assert itself as a real force prepared to unlock the Lebanon crisis.

Now that the situation in the region has exacerbated which is due not only to the growing confrontation of the Hezbollah Shiites and supporters of the pro-Israeli Government of Saniora, but also to the Government crisis in Palestine and uncertain political future of Iraq and Iran, the “game” may go beyond the regional limits. And in this sense, it is important for Russia not to pass up the chance and take such a stance that would allow it, on the one hand, to demonstrate that it has levers of political influence in the region, and on the other, not to harm its relations with its partners in the West and at the same time retain the loyalty of Arab Syria and Iran. Furthermore, Moscow cannot write off the interests of the oil empires of the Persian Gulf (Saudi Arabia, Kuwait, Bahrain, Qatar) being the major exporters of the “black gold” to the US and also for the most part negatively disposed towards Damask and Teheran. Vladimir Putin, playing host first to Saniora and then to Assad, thereby seeks to enhance Russia’s role as a negotiator in the Middle East problem where up until now its political weight has not been that significant.

Russia, without officially taking sides in the conflict, is still more inclined to support the countries that have been traditionally criticized by the US. And the visit of the Syrian President in this case is quite telling. However it is not only about the economic cooperation between the two countries. Moscow, by making political advances to Damask, thereby seeks to occupy the still vacant niche, behind which there are no other international forces, as it is the case with Israel acting with the direct support of Washington. Even though the existing Syrian leadership headed by Bashar Assad does not have authority in the Arab world and is included by the US in the so-called “axis of evil”, Damask is still a major regional player. For Moscow it is important to enhance its status in the Middle East, and Syria, in this sense, could be of significant support, for it is a member of the League of Arab States.

There is instability also in the Persian Gulf which particularly aggravated after the execution in late December of 2006 of Ex-President of Iraq Saddam Hussein and uncertainty over the “Iranian nuclear dossier”. It compelled the George Bush Administration to intensify their activity in the region. Hussein’s execution, which has already been recognized as a symbol of the collapse of American democracy, the heaviest casualties of the US troops for the entire Iraqi campaign as well as the growing instability in the region related to the intensification of Iran and Syria, provoke George Bush into more radical moves towards their eternal enemies. Iran, included by American officials in the so-called “axis of evil”, has also intensified its foreign policy activities in search for allies.

At the same time, the United States are worried about Iran’s growing influence not only in Latin America, where Iranian leader Mahmoud Ahmadinejad went for help and which Washington has all but lost, turning its all its attention to the resolution of Middle East problems. Russia also gave cause for concern confirming the fact of Russian weapons supplies to the IRI. The fact of selling anti-aircraft missile system Tor-M1 to Iran makes both the US and Israel does not sit well with either the US or Israel. These countries have accused Russia of arming a potential enemy, even though the existence of large military contracts between the Russian Federation and the IRI has never been a secret to Washington and Jerusalem. The White House spoke of its discontent over the Russian-Iranian military contracts yet in 2005 after the information about signing the Russian-Iranian Contract for the sale by Moscow of Tor-M1 had been made public. Actively developing the Iranian market Russia becomes a strong player in the region which worries the White House. The attempts of Washington to exert influence on the intensification of the Russian-Iranian cooperation have materialized in the sanctions against three Russian companies – Rosoboronexport, Tula KB Priborostroeniya (Tula Instrument-Making Design Bureau), Kolomna KB Mashinostroeniya (Kolomna Engineering Design Bureau).

Domestic political reasons played an important part as well. The US public are not happy with the way the Iraqi campaign is going which was further aggravated by the disgraceful sentence to the Ex-President of Iraq. Democrats made good use of the anti-republican sentiments in society managing to secure a majority in the Congress during the November elections of 2006. If for Bush the pull-out of troops from Iraq would mean a collapse of his foreign policy course, for the Democratic opposition it would become a serious political victory and actually guarantee the presidential office to a representative of their party in 2008. The campaign in Iran (as of now only an air operation is considered), if crowned

with success, could become a “small victorious war” for Bush on the eve of the presidential race.

Moscow’s ambition to enhance its role in the Middle East settlement fits into the “superpower” concept implemented by Vladimir Putin throughout his second term in office. For Moscow it is important to demonstrate its presence in any region of the planet. The Middle East, in this sense, is the most attractive because of the clash of interests of a maximum number of countries. The US, while playing one of the key roles in the region, has so far failed to establish a peaceful co-existence of the historic enemies thereby failing to fulfill its mission of saving the world from the terrorist threat. Quite probably, Moscow is prepared to take on a similar mission. Mediation in the Middle East would become a serious image acquisition of the Russian President.

The foreign policy direction of Vladimir Putin’s activity can be called the priority one, whereas increasingly less attention has lately been paid to the regional aspect. Putin is focusing on international developments. The objective of his foreign policy – is the implementation of the strategy for transforming Russia into an energy superpower and ensuring that Western countries gradually stop looking upon the Russian Federation as a “raw material appendage”. For Putin it is important to build a positive image in the eyes of the world community not only of Russia itself but also of himself as a strong leader of a strong country. For purposes of implementing the strategy one has proposed the concept of energy security as the cornerstone of international relations in 2006 - the year of Russia’s G-8 Presidency. Membership in this elite club affords the Russian president an opportunity to speak not only about the growing influence of his country in the world but also about confidence in it on the part of its former ideological enemies. Throughout the year Russia sought to take part in as many major world forums as possible, where Vladimir Putin would be able to present already a stronger and more influential country.

2006 was marked by another major event of international proportions - Russia’s accession to the WTO. Notwithstanding that Moscow will definitely suffer economic losses, accession to this elite institution quite aptly fits into the strategy for enhancing Russia’s image on the international arena. Apart from that, the WTO accession signified a warming of relations with the US, which, however, came as a consequence of rather subjective reasons – changes in the domestic political situation in America and weakening of George Bush’s positions.

Along with the normalization of relations with Washington came harsh criticism of the Russian foreign policy at the hands of Brussels. In the EU they are

inclined to view Moscow's energy projects as an intent to carry out a full-scale expansion into the region. Such considerations are typical rather of the relatively recently accepted members of the European Union, whereas the powerhouses of the European integration, first of all Germany, are still oriented towards cooperation with Russia. The Russian Federation is disposed towards rather unflinching promotion of its interests, giving up on building its relations with neighbors on the principles of friendship. Vladimir Putin increasingly more often resorts to economic methods of political pressure not only with respect to the opposition regimes, above all Georgia, Ukraine and Moldova, but to previously loyal Belarus as well.

Chapter 7.

## **EDUCATION, SCIENCE AND CULTURE**

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## 7.1. Education and Training

*Currently education is an area of social life which the state controls the least.* This situation is facilitated on one hand by the “spirit of freedom” traditionally dominating the higher education institutions, and on the other hand by the lack of desire of the ruling elite to exacerbate its relationships with the rector community and the students on the brink of the 2007-2008 electoral cycle. *Nevertheless, the unification process is gradually drawing in the higher education institutions as well.*

First of all it is necessary to mention the fact of gradual implementation of one of the priority national projects in the area of education. On one hand, after the radical market reforms of the first half of the 1990's the national education has been left in the back lines for a long time, from the stand point of the state priorities, because it was unable to provide a quick commercial return and represented an area of loss. However, as the Russian state identity was strengthening and the country gained a budget excess, this area also started to receive financing. Moreover, in the autumn of 2005 education became one of the corner-stone targets of the priority national projects currently supervised by Dmitriy Medvedev, the First Vice-Premier. On the other hand, additional financing and state support are accompanied by an increased state controlled in the area of education, implementation of strict rules of the game in the liaisons between the bureaucracy and university community, unification and implementation of standards in teaching.

In 2006 investments in education amounted to more than 200 billion RUR, out of this amount more than 25 billion was routed to the priority national project “Education”. This project covered seven target goals in the most problematic areas of education. During the previous year a certain progress has been achieved. For example, salaries paid to teachers have been raised (including additional payments for grade supervision), Internet connection is available in more and more schools, equipment and training materials were purchased, the state supported tenders for supporting innovative higher education facilities (although selection of the latter was often accompanied by conflicts in their lobbying potential). Also rural schools are being equipped with buses fully complying with the national standards applicable to transportation of children. At the beginning of 2006 there was organized a competition between teachers from all over Russia. 10,000 best teachers received cash awards in the amount of 100,000 RUR. Another competitive direction of the National Education Project is support provided to

talented youth. Talented university and high school students can receive two types of awards in the amount of 60 and 30 thousand RUR. The first prize is awarded to winners and runner-ups of international Olympic games and other competitive programs. The second type of award is granted to winners of national competitions.

It is budgeted that in 2007 the volume of financing for the National Education Project will be increased by 1.5 times, which means that financing of the main target areas of the project will also grow. Although for the most part this will be conditioned by electoral reasons. On one hand this generosity is effective in terms of demonstrating achievements of the current government, on the other hand, high school and university teachers are considered to be potential agitators and propagandists, while the students are a rather socially active population group.

*Thus in 2006 the State Duma adopted amendments to the law that actually cancelled the electivity of rectors, as well as introduced a new position, a University President.* All of this caused protests from the management of higher educational institutions. Supposedly all rector candidates at first will have to go through an attestation committee that will by one half consist of executive power representative. Thus rectors will have to prove their loyalty to the ministry supervisors before taking up a high position.

The institute of university presidents also infringes upon the rectors' rights. Andrey Fursenko stated that this position of intended for the former university teachers that have to retire due to the age censure. One would think that the initiative of the Ministry of Education looks very attractive for the rectors, because they can retain their positions even after their VIP status has expired. However, in reality Fursenko needed the position of university president in order to eliminate opposition of the most influential rectors that he wanted to send to honorable exile in the presidential chair.

In order to match the Russian and European educational systems, the state continued to introduce the Bologna Process elements in the area of education. Andrey Fursenko, the RF Minister of Education and Science, acts as the main lobbyist of the reform. Despite the fact that a part of the educational community supports these initiatives, a vast majority of the Russian faculty are extremely negative about them. Sadovnichy, Rector of the Moscow State University, acts as the opposition leader, he is trying to arrest or at least to sabotage the transformations. As for the students, they are also rather skeptical about the Bologna Reforms. To a large extent this skepticism is caused by the vagueness of

the reform concept, lack of confidence in its efficiency, as well as the influence of conservative professors over the student audience.

Supporters of the Bologna Reform use the following positions as positive arguments:

1. Convertibility of diplomas. It is well known that so far only a few European countries accept Russian university diplomas. Therefore this problem will be resolved as soon as Russia ratifies the Agreement. In the end it would be easier for young specialists to find jobs in European countries and adapt to living abroad.

2. Mobility. Liberalization of educational space will lead to intensification of student exchange and establishment of pluralism in teaching and scientific activities. Therefore the Bologna System framework removes all barriers and obstacles in the way of free travel of students, teachers, researchers and the management apparatus.

3. Another argument in favor of upgrading the national education system according to the Bologna standards is based on the assumption that the new system will make the Russian high school or university student more independent, responsible for his or her intellectual choice, provide the student with more opportunities to work with his or her schedule and labor input. Specifically, the Bologna system supporters assert that currently the educational model both in high school and on the university level limits the students' initiative. The rigid mandatory classes system prevents the students from freely choosing an optimal package of study courses. Specifically, while in US and Europe up to 70% of classes are elective, in our education model the share of extracurricular classes is no more than 30%, i.e. the ratio is directly the opposite. Therefore, according to the opinion of the reformers, if Russia is seriously planning to plug into the Bologna process, it will have to cardinally break down the current system of subject-object relationships in the area of education. Under the new system, the student will become a very responsible figure with the right of choosing the vector of his or her education, as well as with the right to make a mistake, i.e. a person responsible for all his or her initiatives, both positive and negative. In the words of one of the supporters of the Bologna system reforms, "plugging into the Bologna process will allow us to move forward in the very educational culture from the traditions of the nineteenth century to the twenty first century, I hope, where every person has the right to manage himself and his own time, and carry the responsibility for it".

4. A number of supporters of the "Bologna system" also point out that under the new system the very supply and demand structure and the system of relationships in education will change. From now on (when the freedom of choice

enjoyed by students in professional training) the teachers will not have the right to force the students to select this particular class, but will have to fight for the student under tough competition, first of all relying on the quality of material and his or her teaching skills.

5. Finally, most of the reformers suppose that the reform will facilitate the process of integrating Russia into the European house and overcoming the heritage of the Soviet repressive educational model. In particular, signing of the Bologna declaration will become a strong argument for accepting Russia into the WTO, because according to the rules the educational system of new member countries must comply with the EU standards.

At the same time, opponents of Russia's joining the Bologna process have counterarguments as well.

A majority of them point out that this reform will not be superficial and will lead to a cardinal review of the basics of educational policies and training process in the Russian Federation. They think that adaptation of European educational principles will conflict with traditions of the Russian higher education of the Soviet and pre-revolutionary periods. In particular, the Bologna process opponents object against the narrow specialization of students foreseen by the European standards, which implies dropping most of the basic fundamental courses and replacing them with a system of specialized courses. In their opinion, in this case the Russian higher schooling system would lose its traditional depth and universality of education, while the graduates' knowledge will become fragmented and incidental.

Other opponents of the Bologna process think that realization of its principles in Russia is rather premature due to different reasons. They are asserting that the 6-year education system (4 years of Bachelor's and 2 years of Master's) is not yet sufficiently supported in the Labor legislation. For example, in the labor market a Bachelor's diploma is valued at two positions below a specialist diploma, and there is no way to convince the employer that they are quite compatible. At the same time, a Master's degree is not treated equally with a "Candidate's" degree, which makes it useless to spend a year working on a Master thesis (as opposed to a specialist program).

The desire of the Bologna reform supporters to break down the mandatory class system in one stroke also causes serious doubts. Strong dominance of elective courses (under the modernized model their share is supposed to reach 70%) may lead only to chaos in the educational system and to a substantially deteriorated level of quality of knowledge (especially considering the paternalistic mentality of students in this country). This becomes an especially strong argument considering

that this reform is to become a radical severance from the traditions of both the Soviet and pre-revolutionary periods, where mandatory lecture classes had priority importance.

Finally, there are objections against the so called module system of teaching introduced by the Bologna Conventions. Revolutionary innovations under this system modify or sometimes even completely eliminate the former traditional subject-based educational system. The module consists of a combination of educational targets resolved through different types of works or through learning several related by different subjects. Therefore, module education is rigidly aimed at narrow specialization and applicative nature of knowledge, which actually means breaking all ends with both Russian and European traditions of fundamental education.

Nevertheless, it looks like the top state authorities have made the cardinal decision regarding application of educational reform, and in 2006 the university community started to yield. Most of Russian universities, including the most conservative ones (such as the Financial Academy and MGIMO), started to develop new curriculums inspired by the Bologna requirements.

The reform efforts were complemented by careful but insistent actions aimed at pushing independent and ambitious university leaders out of the system. For example, in 2006 the state officials cancelled the position of the Russian State Humanitarian University President, therefore Yury Afanasyev, the former charismatic leader of the university and the first wave democrat, left this institution. The staff changes at the RF Government Financial Academy were less cardinal but also significant. For example, there was introduced a position of the Financial Academy president, and Alla Gryaznova, who has been the Academy Rector for twenty years, occupied this new position, while Michael Eskindarov, the First Pro-rector, became her successor. Although the latter is also a product of the Academy (he even used to be a Young Communists Secretary there), from the standpoint of the authorities he is a more predicable part of the system.

Other influential representatives of the rector community are under the fire of legal authorities. In particular, in September 2006 the state initiated a tough audit of commercial activities at the Saint Petersburg State University, which resulted in several criminal court cases against members of the circle close to Lyudmila Verbitskaya, the head of SPSU. Considering her loyalty personally to Vladimir Putin and to the official government overall, we can hardly view this action as a measure to scare the SPSU management. However, in view of the fact that the university became the cradle of the “Saint Petersburg team”, especially the legal

part of the Russian elite, we can assume that the attack against Verbitskaya was undertaken by the national security for the purposes of indirectly pressuring Dmitry Medvedev's team.

By the way, it is necessary to mention another tendency in the area of education. It looks like the authorities do not want to rely too much on the propagandistic potential of the traditional university faculty, which for the most part is thinking either along the communist lines, or is too liberal, and are trying to establish specifically engaged universities that will be aimed at training the youth in the spirit of loyalty to "sovereign democracy". The political strategists at the Presidential Administration are especially active in this area, they substantially participated in setting up a semi-official Higher School of Management oriented at training activists for pro-Kremlin youth movements (Nashi (Ours), Molodaya Gvardiya (Young Guard), Mestnye (Locals) etc). At the same time the Higher School of Management is summoned to become a staff filter for selecting the most promising young people for further service promotions. Moreover, there is a possibility that in the future under the auspices of this structure will be set up a chain of Higher Party Schools for the Yedinaya Rossia (United Russia) Party, following the example of the Soviet Higher Party Schools.

## **7.2. Science**

In 2006 in the area of science two tendencies have been observed:

- A splash of activity in scientific efforts, including fundamental research, as well as increased state financing.
- Government attempts to minimize independency of the scientific community and integrate it into the state policy of sovereign democracy.

Reforms at the Russian Academy of Sciences are geared towards mobilizing the scientific community and involve changes in the structure and operations at the Academy. On September 12, 2006 the RF Government approved amendments to the Law on Science and State Science and Technology Politics, which actually changes the current status of the Russian Academy of Sciences.

The long awaited and discussed reform of the Russian Academy of Sciences was finally launched. One of the drafts was suggested by the Ministry of Science and Education and involved actually stripping the Academy of any independency whatsoever, depriving it of the right to dispose of its property, turning the Academy into a sort of a science club. This idea was flatly rejected by the



Academy members, and finally the reformers found a compromise solution, and the Russian government launched its implementation in cooperation with the Academy leaders.

Legislative amendments approved by the Cabinet and submitted to the State Duma for review anticipate substantially limiting independence of the Russian Academy of Sciences. Now the President elected by the Academy will have to be approved personally by the RF President (he used to do it de-facto), the Academy Charter will be approved by the government, and the Russian Academy of Sciences itself will not be at liberty to independently allocate the budget funds. The annual budget of the Academy amounts to approximately 20 billion RUR plus other income, for example, rental income from the premises owned by the Academy. Disposing of its property is the only thing that the RAS management might be able to retain. An agreement on cooperation between the Academy and Vneshtorgbank signed right after the government made these decisions became a partial compensation for the losses.

Compliance of the RAS management with these changes can be attributed to several reasons. First of all, it is not safe and does not make any sense to resist decisions made on the government level. Secondly, the suggested system looks rather acceptable, compared to the Fursenko Project, which in the end failed to establish control over RAS. Third, there seem to be personal aspects present in this situation. Yury Osipov has been in his position since 1991 and he is not planning to part with his chair. In this situation he decided not to fight against the suggested changes in exchange for extending his powers for an unlimited period of time.

The existing age limit would not have allowed Yury Osipov to participate in the presidential elections at the Academy scheduled for December 2006. Therefore, the Academy Presidium decided to suspend all actions involved in preliminary works and voting itself until the State Duma adopts the relevant amendments and a new Charter is developed, subject to governmental approval. In the new version of the Charter there may be a new article on canceling the age limit. This issue is being actively raised by interested parties, but so far its discussion has been postponed. It is most likely that the current situation became possible exactly because of Yuri Osipov's special interest.

It is very typical that such an event as a major reform at the main scientific institution of the country did not draw proper attention of the media and the population. Nobody cared much for the opinion of the Academy members as well, Alexander Nekipelov, the Vice President of the Academy, was only present at the final government session. The Russian Academy of Sciences itself is not the last



party to blame for it, because lately it has been pushing science in the second plan and caring more and more for apparatus games, financial interests and other issues not involved in direct duties of the Academy. All of this led to exacerbation of the prolonged crisis of the Russian science overall and at the Russian Academy of Sciences in particular, and now the only way to solve this crisis is to apply administrative methods.

As to the achievements of the Russian science in 2006, it had been expected that they will have mostly to do with activities of the Special Economic Zones, especially the technical application group, that were supposed to become an analogue of the Silicone Valley in the US. However it turned out that instead of stimulating innovative research the Special Economic Zones prefer developing operational and commercial projects, for example, ports or tourism and recreation zones that can bring payback in the nearest future. Moreover, instead of building Special Economic Zones in the form of green field, as it had been planned previously, they were established on the basis of already existing enterprises and often become a hidden form of subsidizing them.

At the same time the main innovative developments have been traditionally associated with the Military Industrial Complex. After the collapse of the 1990's, the companies operating in the Military Industrial Complex are currently gradually recovering from the crisis. For example, the total volume of production in the defense industry from 2001 to 2005 was growing at an average rate of 6-7% per year, which exceeds the production growth dynamics in the industry overall (4.3% – 4.5%). Furthermore, the share of defense industry amounts to more than 70% of the entire science products manufactured in the country, and more than 50% of all scientists are working in the defense industry branches.

As to the most significant achievements of the Russian scientists in 2006, in this area the leader is certainly Grigory Perelman, a mathematician who solved the Puankare hypothesis that waited for him for more than 100 years. The problem, or as it is sometimes called, the Puankare hypothesis, was developed in 1904 by Henry Puankare, a French mathematician. It is considered to be the central problem in topology, a science of geometrical qualities of objects that cannot be changed by stretching, twisting or compressing. The Puankare hypothesis is one of the seven most important mathematical problems of the millennium, and for its solution the Clay Institute of Mathematics (USA) announced an award in the amount of one million US Dollars. Nevertheless, the Puankare Hypothesis was solved four years ago by Grigory Perelman, a Candidate of Physical and Math Sciences and a Leading Researcher of the Mathematical Physics Equations

Laboratory at the V.A.Steklov Mathematical Institute in Saint Petersburg. After a thorough international verification of the proof, which lasted about 4 years, international scientific community concluded that the solution provided by Perelman is impeccable. Respectively, in August of 2006 he was presented with the Fields Medal For Input in Geometry and Revolutionary Achievements, which is the highest award in the world of mathematics ranked equally with the Nobel Prize. However, the Russian scientist maintained his non-standard stance in this matter as well, he refused to receive the award explaining that he “abandoned math because it disappointed him”.

### **7.3. Art and Culture**

In 2006 situation at the Ministry of Culture somewhat stabilized. An old conflict between Alexander Sokolov, the Minister of Culture, and Michael Shvydkoy, Head of the Federal Agency for Culture and Cinematography formally supervised by Sokolov, is no longer a subject of public discussion, and it seems like the officials have reached an agreement on their spheres of influence.

By the way, especially obnoxious scandals have not been observed also in the artistic environment, and even the traditionally controversial communities of writers, composers etc. were dominated by relative peace and order. To a great extent this can be attributed to the fact that lately the cultural sphere has been receiving much more extensive financing, as well as to productive cooperation of the art elite and the authorities.

It is also necessary to mention a serious difference of opinion between the cultural preferences of the elite and the rest of the population. The popular culture demonstrates primitive priorities, trust to kitsch and undemanding tastes. Elite culture is geared more towards the post-modernist values, glamour and non-standard phenomena. At the same time both groups are substantially contrasting with the basic values of the Russian cultural traditions of the pre-revolutionary and even the Soviet Russia.

According to data obtained by the All-Russian Public Opinion Survey Center, more than one half of the surveyed consider a TV figure skating project Stars on Ice the main cultural event of 2006. Yevgeny Petrosyan’s stand-up comedy program *Krivoye Zerkalo* (Distorting Mirror) full of doubtful jokes and banal reprises is also very popular with the TV audience. Personalities popular with the masses are also very peculiar. For example, the best writer of 2006 was named

Darya Dontsova who authored numerous pocket-book police novels, and the best singer – Dima Bilan, a pop-singer who took the 2<sup>nd</sup> prize at Eurovision.

As for the Ministry of Culture, its opinion is different from the popular opinion. During Alexander Sokolov's press conference, the main profile initiatives of the year 2006 was called the First Forum of Art and Science Intellectuals from CIS Member Countries, the Ceremony of Transfer of Remains of Empress Dowager Maria Fedorovna, the spouse of Emperor Alexander III, from Kingdom of Denmark, and Burial of them at the Pyotr and Paul Cathedral in Saint Petersburg, as well as a number of other major interagency projects.

#### **7.4. Spiritual Life**

The clergy of the traditional Russian religions (Orthodox, Islam and Judaism) is trying to take control over the world outlook and spiritual positions of the Russian population at the time when the secular authorities are losing their influence over the minds.

“Orthodoxy, sovereignty, national character” – this is the triune set of values in the formula of existence of the pre-revolutionary Russia. In our days the Russian state is formally secular and the church is legally separated from the government.

On the outside the relationship between the two parties are strictly polite and discreet, and the position of mutual non-interference is widely promoted. At the same time the Orthodox Church is gaining a more and more important role in the internal politics implemented by the state authorities. Considering obvious circumstances, almost all elite groups have to take into account the position of the Russian Orthodox Church, because despite the wide variety of confessions in the multinational Russia, members of the Orthodox Church are traditionally in the majority among the faithful.

Despite the formal distribution of functions, the state and the Russian Orthodox Church have reached a certain mutual understanding. Unofficial interests of the state authorities and the Orthodox Church have been well and wide known for a long time. The state government is well aware of the influence that the Russian Orthodox Church has over the population, and on the brink of the 2007-2008 elections it wants to secure its support in order to deliver certain ideas to the electorate. That is exactly why it is in the interests of the secular power to expand the influence of Orthodox Church, and the government does not try to object to it and even facilitates this influence.

In response the Church is counting on additional preferential treatment for expanding its proselyte and commercial activities. It is not a secret that the Russian Orthodox Church is a serious business structure which is involved not only in profile business activities but also has its interests in the alcohol and tobacco trade, and enjoys a number of substantial benefits.

Furthermore, in several regions in Russia the school curriculum includes Basics of Orthodox Culture, and the Russian Orthodox Church is actively routing for including this subject in the school curriculum nation-wide, which causes many arguments. The public opinion on this matter is far from being unanimous, and it is very arguable that this step will be positively accepted by the popular masses. Nevertheless, the direction has been set and in the future the state government might initiate legislative approval for this initiative of the Moscow Patriarchate.

However, the Russian Orthodox Church is not a solid and unanimous structure in itself. At this time the hierarchs of the Russian Orthodox Church are unofficially split into at least four movements:

- Supporters of Aleksey II, the current Patriarch, whose status in the framework of the Russian Orthodox Church is similar to the Old Muscovites in the society. They are ready for constructive cooperation with the authorities, but still try to maintain a certain distance. Their main goal is to overcome the schism in the Russian Orthodox religion between the Russian Orthodox Church and the Russian Orthodox Church Abroad, which occurred back in the 1920's.

- the group of Metropolitan Cyril (Gundyaev), which holds a more pragmatic stance about cooperation with the authorities and to a greater extent demonstrates its desire to perform the government's chores, has substantial control over the financial flows related to the commercial activities of the Russian Orthodox Church. Moreover, supporters of Metropolitan Cyril are advocating rapprochement with the Catholic Church for the purpose of joining the forces against atheism spreading in the society and expansion of radical Islam in Europe. The idea of Orthodox-Catholic cooperation has been especially actively promoted since the death of Joan Paul II, an anti-Russian Pope supporting renewal tendencies, and the traditionalist Benedict XVI taking his place. During the last few months Metropolitan Cyril has been actively working on strengthening the positions of this clan. He initiated consecration of an Orthodox cathedral in Rome and negotiations between representatives of the Russian Orthodox Church and the Catholic Church.

- in-house church liberals oriented on the RF of the beginning of the 1990's, which do not completely agree (and sometimes radically disagree) with the

sovereign patriotic pathos of the current Russian government and with the ideas of sovereign democracy. Their informal leader is Vladimir, the Metropolitan of Saint-Petersburg and Ladoga.

– the group of “radicals”, rigidly oriented to national-patriotic values, strongly influenced by the Russian Black-Hundred movement of the beginning of the 20<sup>th</sup> century with its negative attitude towards the foreigners. After the decease of their mentor, Metropolitan Joann of Saint-Petersburg and Ladoga, in November of 1995, they still have not been able to find a replacement for him, and currently this group does not have a strong leader. Representatives of this movement (for example, Archbishop of Vladivostok and Primorye Benjamin) are actively cooperating with para-church national patriotic organizations (such as the Union of Orthodox Gonfalon Carriers, the Christian Renaissance Union etc), and participate in spiritual fertilizing of their religious and political demarches.

Furthermore, besides the Church hierarchs we can assign to the elite of the Russian Orthodox Church Orthodox newsmakers that every once in a while make statements on behalf of the Church and inform the population of the Church’s opinion on various issues. This group includes Father Andrey Kuraev (the group of Patriarch Aleksey II), as well as Archpriest Vsevolod Chaplin, Deputy Chairman of the All-Russian Supreme Church Council (the group of Metropolitan Cyrill).

Among the Russian Muslim clergy the internal elite conflict also has several vectors. First of all, there is competition between Ravil Gaynutdinov, Chairman of the Russian Mufti Council, Chairman of the European Russia Religious Directorate of Muslims, representing the system wing of Russian Islam closely affiliated with the Federal authorities, and Talgat Tadjudin, the Supreme Mufti of Russia, who is known for his more radical views and statements. Furthermore, in a number of Russian regions (especially in the Northern Caucasus) the official Islam clergy is substantially less popular than the Wahhabite ideologists and other religious authorities (for example, in Dagestan Sheikh Said-Afandi Chirkeyski has many supporters).

At this time the Russian Judaism is generally under control of the state. It happened after Adolf Shayevich, a westernized Talmudist who was in close contact with the disgraced oligarch Vladimir Gusinsky, was replaced as the head Rabi of Russia by Berl Lazar, a traditional Hasid, who was a better fit with Vladimir Putin’s conservative course.

Therefore, it is important to mention that a constructive union of the clergy and the temporal power has been almost finalized. In exchange of loyalty granted

by the main confessions, the state government offers them substantial preferential treatment and compensations (financial and property privileges, assistance in combating sects and “non-traditional” religions, support in sustaining the religious and moral values etc). In this aspect a representative precedent was set in a court case of the Russian faithful versus the Rodionov Publishing house, settled in January 2007. The publishing house was fined for placing a photo of a seminude model on the cover of Moulin Rouge magazine, and the prosecutor was supporting his legal arguments by excessive quoting of Bible and Koran.

Chapter 8.

**THE ARMED FORCES  
AND THE MILITARY INDUSTRY**

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## **8.1. The Army in the Mass Media Mirror**

The increase of the budget costs allowed the Minister of Defense to make in 2006 confident statements in mass media about the forthcoming upgrade of the technical base of the Armed Forces and development of enterprises of the military industrial complex. Besides, Sergey Ivanov worked rather successfully at improvement of his image, which is directly connected with perception by the population of the Russian Army on the whole. It touches upon the Star TV channel, and improvement of relations with the General Military Prosecutor, and reduction of the term of compulsory military service, and statements on the soon transition of all servicemen on the «contract» service.

The visit of the Minister of Defense on August 16<sup>th</sup>, 2006, to Kamchatka for his vacation «coincided» with the beginning of the large-scale maneuvers of the armed forces in the Northeast Russia in which all military groupings were involved, and the Minister's departure was expected to coincide with their termination. These maneuvers are unique for the reason that for the first time they are not «antiterrorist», as they used to be during the last several years, but strategic (i.e., the armed forces of other states play the role of the maneuver enemy) and must demonstrate the military power of Russia.

However, the Minister of Defense Sergey Ivanov, who has been fruitfully working during the whole summer including his vacation, in the beginning of September has received several sensible blows on his reputation. So, on September 7<sup>th</sup>, 2006, the intercontinental ballistic missile Bulava-30, which was at the stage of testing, fell into the sea, and on September 11<sup>th</sup>, in the vicinity of Vladikavkaz the helicopter Mi-8 of the Ministry of Defense got into an accident, in the result of which 11 people died.

The accident with the helicopter of the Ministry of Defense has resulted not only in the death of people among which there were senior and general officers of the military department. After this summer's air accidents Sergey Ivanov was appointed responsible for the safety of flights of military and civil aircraft, therefore the events near Vladikavkaz have directly affected him.

The unsuccessful tests of the ballistic missile Bulava could have more serious consequences for the Vice Prime Minister. Nuclear submarines of new generation must be equipped with Bulava, and commissioning of these missiles is the key moment in the process of upgrade of the nuclear force of Russia. As it has been revealed, Bulava was developed in the conditions of tight time and budget, therefore the decision was taken to refuse from implementation of the necessary



amount of tests. Besides, some experts cast some doubt on the change of the developer of missile systems for the submarine fleet, which is the Moscow Institute of Heat Engineering at the moment.

Russian nuclear submarines' reequipment process is accelerated by the expiry of the operating life of both the existing missiles, and of the nuclear submarines. Phasing-in of Bulava was planned to be carried out by the end of the next year, but the events of recent time show that it will be difficult to fit in this schedule. Meanwhile, the Ministry of Defense and Sergey Ivanov put their main hopes on Bulava.

The acute need of upgrading of the Armed Forces' technical base leads to acceleration of the events which result in the incidents like the ones noted above. Meanwhile, the volumes of the budget means allocated for the costs on articles connected with the national defense imply putting of the Armed Forces into order in short terms and with good quality, of which Vladimir Putin has reminded to the minister at the Security Council and repeated his request during the subsequent meeting with the Minister of Defense.

## 8.2. Attempts to Introduce Public Control Institutes

The case of bullying Andrey Sychev, private of the support battalion of Chelyabinsk tank institute became the most notorious «military» incident of the last years. The events of the new year's eve of 2006 cost the young man his

physical invalidity, and for the certain number of military bosses resulted in the loss of their positions and career. This case reflected the peculiarities of the Russian Army on the whole and of the military justice in particular. Sychev's case influenced the political position of minister Sergey Ivanov in the most direct way. Officers and generals of the Ministry of Defense made an «ill service» to their head, trying to pressurize prosecution witnesses and to shift the responsibility onto Military Prosecutor's investigators, who allegedly took illegal actions. This activity became the public domain, which was also beneficial to Sergey Ivanov's opponents.

On September 26<sup>th</sup>, 2006, the main accused on Sychev's case, junior sergeant Alexander Sivyakov was sentenced by the Chelyabinsk garrison court to 4 years of imprisonment. Both prosecution and defense declared that they will insist on revision of the court's decision. From the formal point of view the process is not finished yet, but already now it is possible to summarize it.

The Chelyabinsk court's decision seems to be the trade-off variant. Sychev's case, which lasts for nine months already, has gone through several stages. Being a reflection of the processes happening in the modern Russian Army, it has seriously undermined the image of the Minister of Defense Sergey Ivanov. Wide coverage of the process in the federal mass media prompted that the interested parties tried to transform Sychev's case into a show case.

Development of this process became the reflection of the clash of interests between the Minister of Defense, on the one hand, and ex-General Prosecutor Vladimir Ustinov and the former Chief Military Prosecutor Alexander Savenkov, on the other hand. At that time, on the background of antagonism in the «power» environment, the confrontation outlined between Sergey Ivanov and Igor Sechin, whose interests were expressed by Vladimir Ustinov. This is why the former General Prosecutor, using the available resources and powers, did the maximum possible to enhance the resonance of Sychev's case. In his turn, Sergey Ivanov even declared about his intention to create special lawyers' service at the Ministry of Defense for protection of interests of soldiers and officers.

The situation has changed radically after Vladimir Ustinov's resignation and appointment to the position of General Prosecutor of Yury Chayka who, most likely, was instructed to neutralize the negative attitude towards the Ministry of Defense and Sergey Ivanov personally. Alexander Savenkov was one of the first to be dismissed, and other assistant to General Prosecutor Sergey Fridinsky was appointed to his position. After that relations between the Ministry of Defense and Chief Military Prosecutor became warmer and started to improve. As the result,

Sychev's case started to collapse, and the main accused got a relatively short term of imprisonment, although General Prosecutor demanded a more severe punishment for him.

The trade-off decision was adopted, which became the result of the unwillingness of political elites to aggravate the situation. By and large, the heat was taken off Sergey Ivanov, and the sentence of acquittal would look too defiant. However, if one considers Sychev's case more globally, one must recognize that it has extremely negatively affected the image of the Minister of Defense.

Sergey Ivanov's response consisted in creation of parents' committees at the military enlistment offices, as well as the Public Council at the Ministry of Defense, about the necessity of creation of which President Vladimir Putin has repeatedly declared earlier. However, these measures contain mainly a PR component, and may hardly lead to appearance of an institute of civil control over the Army.

In particular, the Ministry of Defense at first categorically denied that it planned to create operative commands and abolish military districts during the forthcoming years. The information appeared later that during implementation of the three strategic experimental maneuvers, carried out on basis of three military districts (it is remarkable, that the Minister of Defense Sergey Ivanov was present at one of them – in the Privolzhye-Ural military district, which is the largest), the practicability of structural changes was evaluated. However, in 2006 the Russian Army management structure remained to be unchanged: the General Staff – Military Districts – Armies – Corps – Divisions – Battalions. Based on the informal data, the planned changes have collided with hard resistance of the generalship. The data on the beginning of development of new military doctrine of Russia instead of the existing one, which is already outdated on many positions, were resolutely denied. However in January, 2007, this problem was discussed at the conference of the Academy of Military Sciences. The fact that three colonels have been dismissed for disclosing the information on the unsuccessful launching of the new missile Bulava also speaks of preservation of the former information closedness of the Ministry of Defense.

In 2006 an active PR campaign was launched, the basic key message of which was the accelerated reequipment of the Army. This in no small measure was connected with that Sergey Ivanov, as a matter of fact, became an individual supervisor of domestic military-industrial complex. Within a year he has visited practically all «defense» regions, some of them – more than once; he has launched a series of «perspective projects», as, for instance, construction of a couple dozens

of new fighters Su-34. Although, by and large, the unprofitable for Russia upgrading of old fighting equipment both for land arms, and for aircraft was mainly going on. As for the fleet, submarines of the fourth generation Yury Dolgoruky and Alexander Nevsky, which were planned to be commissioned in 2003-2004, have not been commissioned another time.

### **8.3. Reequipment**

A series of visits of the Minister of Defense to the military industrial regions, apart from his «study of the state of affairs at the local level», were also supposed to demonstrate that the Russian Army, after many years of stagnation, started at last its active re-equipment. On June 2<sup>nd</sup>, the Military Industrial Commission of the Government of Russia headed by Sergey Ivanov adopted the State Program of Development of Arms for 2007-2015 (GPRV-2015). However, the military industrial complex experts believe that this program presupposes not the perspective development, but the backlog in several main military and technical areas. In particular, representatives of the Ministry of Defense declare that while the previous program, approved in 2001 and intended till 2010, did not provide for serial purchases, now the main costs (over 63%) will be the costs of equipment of the Army with new types of arms. But at that it is silenced that GPRV-2005 (approved in 1996) and GPRV-2010 actually have been a failure in this respect: the level of their implementation by various positions did not exceed 10-15%.

At the same time the Federal program on the technical rearmament and development of the defense and industrial complex was adopted. This event was also accompanied by the powerful PR campaign in which chief state executives took part. This is quite relevant, since the domestic military industrial complex is characterized with the strongly pronounced export orientation.

It seems relevant to compare the volume of arms supplied by the domestic military and industrial complex abroad and to the Russian Army. For instance, in 2004, 300 tanks were exported to India, while the Russian Army received only 30 machines. The aircraft industry of the Russian Federation is serving mainly foreign customers. For the last five years the amount of aircraft purchased for the Air Force of the Russian Federation is 28 times less than the amount sold abroad; and from 1994 to 2003 new aircraft and helicopters have not been supplied to aviation units at all. For the whole year 2006, as well as for the whole post-Soviet period there has not appeared any new type of military air equipment. The advertised flying

laboratory of the prototype of the aircraft of the fifth generation Su-37 has not been presented officially till now, but this is another upgrade of Su-27, introduced in the beginning of the 80-ies. Many other «modern» developments also refer to this period. At that, the volume of R&D is quite big: annually about 100 R&D works were accomplished under the programs of 2001-2005 (of their total amount 3500) and at the same time 200-300 new ones were launched.

In Miass (Chelyabinsk region) during more than 15 years the sea-based strategic missile Bark had been developed. The relevant guideline documents prescribe implementation of not less than seven test launches of the newly constructed missile. The first three launches of Bark turned out to be unsuccessful. After that by the government's decision, under the pretext of «unification of missile systems» the project was terminated and handed over to the Moscow Institute of Heat Engineering. At the Moscow Institute of Heat Engineering, development of the new sea-based missile complex Bulava was started. However, development of Bulava still is not accomplished; because of this the Russian Navy did not receive new strategic submarine cruisers till now.

In this connection Russian experts of late frequently cite as an example the model of arms purchases in India, which has the military budget approximately equal to that of the Russian Federation. During 1999-2004 Delhi spent about 12 billion dollars for the purchase of products of the military industrial complex from Russia. During these five years 124 tanks T-90 have been purchased and 186 more tanks Indians produced themselves by the Russian license, the Indian Air Force received 250 latest aircrafts (and 150 more have been modernized) and 80 helicopters (including 48 Russian-made). The Navy of India has been enhanced with 1 aircraft carrier, 4 ships, 3 submarines (plus 5 submarines, which have been upgraded). These figures do not include the arms ordered by India in other countries – in Great Britain, Israel, and France. In Russia it was planned to spend in 2006 about 10,5 billion dollars for the purchase of arms and military equipment. The Armed Forces of the Russian Federation have received for this money: 6 intercontinental missiles, 6 space vehicles, 12 carrier vehicles, 31 tanks, 125 armored personnel carriers, 3770 motor vehicles, 9 aircraft (one Tu-160). 139 tanks, 125 cannons, 104 aircraft, 52 helicopters have been upgraded.

Arithmetic calculation shows that with such reequipment (and upgrade) rate – one tank battalion and one combat aircraft squadron per year – reequipment of the Armed Forces of the Russian Federation will last for many decades. For instance, it will take 64 years for replacement of 6 thousand tanks T-72 and 5 thousand tanks T-80 currently available in the Russian Army, and almost 100 years for



replacement of 1,8 thousand combat aircraft of the Air Forces and the Air Defense Forces (transition to the upgraded aircraft may take 16 years).

Not everything is so simple with the advertised missile complex Topol-M with which 5 battalions of the Strategic Missile Forces are equipped at the moment. From 1988 to 1994 the Armed Forces received Topol the operative life of which is 17 years. Only 4 silo-deployed missiles Topol-M of the newest modification have been supplied in 2005, in 2006 – 6. From here it is obvious that at such a rate it will be possible to replace the out-of-date missile complexes almost in 90 years' time.

Experts of the State Duma Committee for Defense consider that a significant increase in the annual supplies of arms and military equipment is necessary for the adequate reequipment of the army and fleet – in the volume up to 5% of the amount corresponding to the effective combat strength of the Armed Forces. It is not less than 140-150 aircraft, 40-60 helicopters, 200 tanks, 250 artillery pieces per year. These parameters exceed the ones stipulated by the State arms program by 2-5 times. But even if the domestic military industrial complex reaches such radical volumes of the purchase of arms and military equipment, it will provide for rearmament of the Army not earlier than in 20-25 years' time, that is, by the year 2030. At present, by estimation of the State Duma Committee for Defense, the share of modern arms in the total amount of arms in the Army does not exceed 21%, while in armies of the leading world countries this parameter constitutes over 60%.

#### **8.4. International Cooperation**

The Ministry of Defense has achieved certain success in international military and technical cooperation. Uzbekistan has returned to the Organization of the Collective Safety Agreement (ODBK). A series of joint bilateral antiterrorist maneuvers carried out in 2005 and in 2006, at which the head of the Russian military department was present in person, as well as his different from Washington and Europe view at the tragical events in Andizhan, have largely promoted the decision of Tashkent to expel the American air base from the country and «to reinforce» ODBK, which, certainly, resulted in consolidation of Moscow's influence onto the geopolitical space of the post-Soviet Central Asia. Besides, the Russian Army groupings have been enhanced in the territory of Armenia and Kirghizia (with simultaneous termination of all military and technical relations with Georgia), certain arrangements with Azerbaijan and Ukraine have been achieved.



Connections with the important regional neighbour – Turkey – have become stronger. After the negotiations on September 15<sup>th</sup> in Moscow between Sergey Ivanov and the Minister of National Defense of the Turkish Republic Vecdi Gonul it has been announced that the Russian Navy will participate in the Black Sea Guarantee-2006 operation, carried out by the Navy of the Russian Federation's southern neighbour. Ivanov has made the following statement: «The two leading countries – Russia and Turkey – should be responsible for the safety in the Black Sea». Soon after there came the appeals from Kiev that one should not make a thing around the Russian Black Sea fleet based in Crimea, and President of Ukraine Victor Yushchenko spoke about it, too.

At the same time in 2006 the obvious deterioration of relations was observed within the Russia-NATO Council. The summit of the alliance carried out in the end of November in Riga vividly demonstrated that NATO members do not consider Moscow to be their ally and partner. And they cooperate with it as far as it is necessary now for the block, including solution of their problems in Afghanistan, Iraq, Iran and North Korea. Even a brief analysis of NATO's activity shows that the alliance does not cope with specific threats of the present time, especially so in the troubled areas of the world. All this allows to make a conclusion that one should not expect any prospects in the development of relations within the Russia-NATO Council in 2007.

### **8.5. The Level of Discipline**

A rather resonant «private Sychev's case» has come to its end quite silently: the main culprit of the «Chelyabinsk tragedy» sergeant Alexander Sivyakov has been convicted not for a long prison term as asked by the prosecution, but «only» for 4 years. Thus, the Ministry of Defense has achieved what it wanted: the «information» processing of the public opinion in favour of that nothing abnormal has happened in Chelyabinsk on the new year's eve has been accomplished successively. Sergey Ivanov, creating parents' committees and the Public Council in the Army «under his control», has never mentioned «Sychev's case». That is, as a matter of fact, the military department officially has not given any guarantees that something similar will not happen again.

The vigorous activity «on eradication of hazing in the Army» following Sychev's case has resulted in the next campaign, which only created the visibility of the uncompromising struggle with this army evil. In 2006 the majority of mass

media contained the information on how the next captain, colonel or general, who forced soldiers to work at his summer residence, was brought to responsibility. However, with «Sychev's case» leaving the information realm, the Ministry of Defense practically immediately stopped spreading the information on the negative phenomena in Army. Considering that very little was said about the positive examples from the practical work of officers in the Army (except for the general information), it becomes clear that the negative image of the officer corps was again created in the expiring year, mostly by the hands of the Ministry of Defense, which did not happen from the beginning of 1990-ies. The discipline among officers in 2006, according to the Chief Military Prosecutor, continued to deteriorate.

At present, in the opinion of experts, the generalship of the Ministry of Defense is still paying its main attention not to eradication of hazing in the Army, but to taking measures on «the increase of the executives' responsibility for concealing the information on hazing and other infringements». At that, the principle issues, decision of which would help to reduce the number of instances of hazing to certain degree, practically have not been considered. The society has never learned what legislative initiatives the Ministry of Defense has suggested (or would like to suggest) for manning of the Army not only with recruits and contractor servicemen, but also with sergeants and officers. The question at what expense the responsibility of the latter for the state of things in the barracks should be increased also remains to be without any answer.

As for suggestions on the perfection of the military service, the expert community comes up with the following ones: in view of transition to the new term of active service, the new laws must provide for the increase in the draft age up to 21 years for students; to restore the segment of professional sergeants in the Army and in the Navy by means of organization of three-year or two-year educational institutions (sergeant's departments at military schools and military academies); to introduce the profession of sergeant into the list of professions of the Russian Federation with the corresponding recommendations of the Ministry of Labor; to develop financial normatives for sergeants with the approximate correspondence of their salaries on the fifth year of their service to the salaries of officers of the company level; to provide for exclusively sergeant's contract positions for tank commanders, gun-commanders, gun-crew commanders, radio station commanders. However, the Ministry of Defense during 2006 has not announced its official position on any of these issues.

As the result, by the end of 2006 it remained to be absolutely vague, in which way the civil control over the Army had to be carried out. The activity of the

parents' committees and of the Public Council is defined rather vaguely, therefore one may not speak about coming of any effective civil control to the military units in 2007, too.

## **8.6. The Attempts to Resolve Social Issues**

In the social sphere the Ministry of Defense practically did not manage to resolve any significant problems in expiring year. As of the beginning of the year, according to Victor Zavarzin, the Chairman of the State Duma Defense Committee, the power departments needed 450 thousand apartments for their officers. As it is known, since the year 2005 the accumulative and hypothecary system (NIS) started to exist for young officers, to which the top military authorities assign the super task in the solution of the housing problem of servicemen. Meanwhile, if in 2005 the amount of the accumulative payment per one serviceman constituted 37 thousand rubles, at present it has increased to 40,6 thousand rubles. With such accumulation rates and the apartments' price rise (now the average price in Moscow suburbs is 39 thousand rubles per 1 square meter), after 25 years of service a military man will not be able to buy more than 10 – 15 square meters of habitation. Those who have concluded their contract with the Ministry of Defense before 1998, were promised to be provided with habitation by 2010. The Ministry of Defense says nothing about this concerning the draft of 1999-2005.

Still there is a significant gap between salaries of the servicemen of the central body of the Ministry of Defense and officers and warrant officers of provincial garrisons. The list of medicines distributed in the military hospitals became shortened, expensive and import medicines have been «wiped out», the term of stay of retirees in the military health resorts shrunk from 21 to 12 days.

At last, payment to the military pensioners of the monetary compensation for rations which at the moment constitutes 20 rubles per day was not increased. The acts of the Constitutional and other courts which passed unequivocal judgments in favour of veterans of the Army and the Navy (to pay them over three times more), have been actually ignored by the Ministry of Defense and the Ministry of Finance. Moreover, the Ministry of Defense in 2006 has unilaterally written off its debts for payment of the rations in the amount of approximately 60 thousand rubles per pensioner.

### **8.7. A «New Year's Gift» to the Generalship**

On December 30<sup>th</sup>, President of the Russian Federation Vladimir Putin has extended the term of office of the Head of the General Staff of the Ministry of Defense of the Russian Federation Yury Baluevsky for another 3 years. Pursuant to the law On the Active Duty Service Commitment and Military Service, the general officers upon achievement of the age of 60 must leave active military service and retire. However, as an exception, the Supreme Commander-in-Chief, President Vladimir Putin, may prolong this term, which he did in respect of the head of the General Staff Yury Baluevsky who was 60 on January 9<sup>th</sup>.

At first sight, Yury Baluevsky is the typical professional serviceman who for 15 years has been methodically making his career at the General Staff. In 2001, after resignation of Marshal Igor Sergeev, a «civil» minister Sergey Ivanov was appointed to the post of the head of the Ministry of Defense, which has caused resentment of part of the senior generalship. The then head of the General Staff charismatic Anatoly Kvashnin, who frequently publicly contradicted Sergey Ivanov, headed the generals' «opposition». However, the latter managed to lobby through the resignation of the head of the General Staff by summer of 2004, after which the «brain center» of the Army was headed by the professional general Yury Baluevsky. Apparently, his thin administrative intuition prompted him that Yeltsin's epoch of outstanding personalities was passing (Kvashnin was its representative), and the technocratic style of management was in vogue, which allowed him to consolidate his new position (as an example from other sphere, it is possible to refer to Gerashchenko's replacement by Ignatyev at the post of the head of the Central Bank).

Appointment of Baluevsky allowed to avoid the aggravation of the conflict with the generalship (his post has occupied by a «friendly» person). On the other hand, Baluevsky enjoys Sergey Ivanov's full confidence. Some administrative transaction was concluded at the very beginning of his career as of the head of the General Staff. On the one hand, the General Staff became the structural division of the Ministry of Defense and lost its special administrative status which in the days of Kvashnin was provoking the separatist moods. On the other hand – its volume of powers has been essentially extended: now the General Staff is organizing preparation of maneuvers and mimic warfare, it has expanded its functions on the control of the Army, etc.

Reappointment of Baluevsky became a distinct signal to the military elite concerned with the Army reform (for instance, transition to one year's term of

active service), on that there will be no «change of the course». In its turn, the authority can count on the neutrality and even on the loyalty of generals in case of aggravation of the situation in connection with the «Successor» project.

## **8.8. General Situation in the Military Industry**

In 2006 prices for the products of the military industrial complex had been constantly growing due to the downtimes of the production equipment and of workers. The losses are referred to the cost of orders, which results in the product price increase by 2-3 times. According to Vice Prime Minister – the Minister of Defense Sergey Ivanov, the state of things in the war industry are not so bad. The total production volumes at the enterprises of the military industrial complex have increased by 7% for the last five years, while this figure does not exceed 4,5% for the country.

Since the enterprises of the military industrial complex are loaded with the state order only by 20-50%, Sergey Ivanov calls to the transfer to production of hi-tech civil products. This far, its share, according to the head of the military department, constitutes 46% versus the required 70% in the total production volume of the military industrial complex. Achievement of these figures will allow the enterprises to support not only themselves, but also the unloaded military production – the mobilization capacities.

However, statistical data demonstrate that production of civil goods in the industry of conventional arms has reduced in 2006 more than by 5%. In the first place, production of motor and railway vehicles has shrunk, including freight cars, technological equipment for light industry, mining equipment, ore mining and power generating equipment. This has been caused by the absence at the enterprises of the means for development of hi-tech civil production, creation of new production lines and training of personnel. 97% of the means received for the products is spent on covering the production costs. At that, the costs are growing, since the obsolete equipment stock is leading to reduction of the work productivity.

The problems of enterprises of the military industrial complex remained to be the same in 2006: the absence of working assets and venture capital, low level of management, ageing workers, worn out capital assets, social sphere as the additional cost center, low capital/labour ratio, high energy costs, fines and penalties of fiscal services due to delays in payments from the customer. This must be completed by purposeful incitements of bankruptcy and seizures by raiders.

The situation in the ammunition production industry remains to be critical. Many enterprises have considerable debts, while their products are not demanded. The attempts to work for export run the risk of making contracts with foreign customers unprofitable because of the growing prices for raw material, first of all, for nonferrous metals. Large-scale protest actions of workers took place at the number of factories during the year. At the session of the Military Industrial Commission on November 2<sup>nd</sup>, the Vice Prime Minister Sergey Ivanov declared that in the sphere of production of ammunition «the state of things is not excellent». «This leads to scientific, technical and technological backlog of the domestic «war» industry on several main directions of the ammunition branch. The scientific and technical reserve which has been created earlier, unfortunately, is not capable to provide in the parity with the advanced foreign developments on all directions», - stated the Vice Prime Minister. «The special concern is caused by the fact that, due to the increasing crisis phenomena, this sector of industry is not capable of producing the full line of ammunition any more». Sergey Ivanov declared about the necessity in the strategy of development of the branch, but so far there was no mentioning of specific actions, which allows to make the assumption that the tendency of actual «dying» of the branch continues.

### **Shipbuilding**

The Russian shipbuilding suffers from the shortage of orders. 94,4% of the total tonnage of civil vessels built for the last 10 years by the orders of Russian ship-owners, have been built abroad. Only 5,6% – in Russia. At that, civil goods' production is decreasing. For the period January – October the reduction constitutes 3,2%. The peculiarity of the situation is that production for export has increased by 19,7% and for the domestic customer it has decreased by 15,1%. During the first 10 months of the year 20 vessels of different purpose have been constructed, 141 vessels are under construction.

Bank's interest rates for credits are too high in Russia, and foreign banks do not finance construction of vessels in Russia. Therefore, it is more favourable to build tankers and dry-cargo ships abroad. Besides, in Russia taxes and duties are high, which increases the cost of a vessel by 20-25%, and the conditions for the investments inflow are absent, too. Hence, one may not expect development of the branch at the expense of civil orders.

The Russian shipyards have traditionally specialized on war ships construction, and civil ships have been built abroad. As the result, in Russia production costs are



high, the production cycle is long, mechanization is low, labour intensity is high. As the result, 44% of vessels are built against the state defense order, and 33% more are accounted for by the military ships' export.

In 2006 the corvette Steregushchy (the Guard), the mine sweeper of the fifth generation and the diesel-electric submarine of class Varshavyanka, made to export, the artillery ship Astrakhan for the Caspian Fleet have been set afloat. Only in the summer of the last year the Amur Shipbuilding Factory set afloat the submarine K-152 Nerpa under the project 971 Shchuka-B, building of which was started in 1988. Construction of many ships is delayed not by years, but by decades because of insufficient financing. The war ship Murena-E was produced by the Khabarovsk Shipbuilding Factory for the Republic of Korea. The cost of the order is 100 million dollars. There has been no problem with financing as usually is the case during the work with the foreign customer.

At present, there are many new ships under construction at shipyards. And the volume of financing required for their construction is much more than the state defense order can provide. Nevertheless, it does not prevent from development of the state strategies and of the programs of development of the Navy, development of the shelf sea, construction of high-speed vessels, etc. At that, the state-of-the-art ships equipped with effective arms are built for foreign customers, and the Russian Navy, because of long period of construction, gets, as a rule, the ships which are 15-20 years old.

### **Aircraft Industry**

Creation of the United Aircraft Building Corporation (OAK) headed by the Vice Prime Minister – the Minister of Defense Sergey Ivanov became the main event of the year in the aircraft industry. The authorized capital of the United Aircraft Building Corporation is comprised of 100% of the shares of the Aircraft Holding Company Sukhoy, 15% of shares of the Foreign Economic Association Aviaexport, 38% of Ilyushin Finance Co. OJSC, 25,5% of Komsomolsk-on-Amur Aircraft Production Association named after Yu.A.Gagarin OJSC, 86% of Interstate Aircraft Building Corporation Ilyushin, 38% of Nizhniy Novgorod Aircraft Building Plant Sokol, of 25,5% of Novosibirsk Aircraft Building Association named after Chkalov, of 90,8% Tupolev OJSC, 58% of Financial Leasing Company OJSC, 50,09% of Scientific Production Corporation Irkut OJSC. Before April 1<sup>st</sup>, 2007, Russian Aircraft Corporation MIG and Kazan Aircraft Production Association are expected to join the United Aircraft Building Corporation (OAK).



According to Deloitte Company, the value of assets of corporation with consideration of recommendations of Rosimushchestvo (the Federal Property Management Agency) – is 4,5 billion dollars. At that, the share of Sukhoy Holding constitutes 2–2,2 billion, the share of Irkut – 940 million dollars. The founders of the United Aircraft Building Corporation estimate the volume of assets as 96,7 billion rubles. At that, the share of the state constitutes 90%, but will be gradually decreased to 75%.

It appears that enterprises, first of all, design offices which did not join the United Aircraft Building Corporation, may not count on serious financing and are doomed to financial problems with their subsequent liquidation. Inside the United Aircraft Building Corporation there are also «the first among equal», for instance, the Aircraft Holding Company Sukhoy, which will claim for the bigger share of allocated funds (since aircraft building is a rather capital-intensive industry, investments into it will be considerable). By the statement of the Chairman of Board of Directors of the United Aircraft Building Corporation Sergey Ivanov, the corporation is ready to build 1100-1800 new aircraft of various classes for Russian airlines by 2015. It is only necessary to allocate 12 billion dollars of the state guarantees from the budget.

The foundation conference of the Helicopter Production Association (AVI) took place in December in Moscow. The Helicopter Production Association is the public organization, called to unite the efforts of all Russian companies – helicopter manufacturers and users. AVI is going to be engaged in the marketing analysis and economic forecasting at domestic and foreign markets of building and operation of helicopter equipment. It has been noted at the conference that Russian manufacturers account only for 5-6% of the global helicopter market, at that, during recent years, Soviet machines of brands Mil and Kamov constituted up to 30% of the world's helicopter market.

Six Mi-28N Night Hunter helicopters have been purchased for the Ministry of Defense in 2006, the order for Ka-50 Black Shark has been placed. So far the question is to accomplish building of 4 helicopters which have been standing on the assembling jigs of the Arsenyev Aircraft Building Plant since 1998, when financing this program was suspended. By the end of December Novosibirsk Aircraft Production Association (NAPO) named after Chkalov handed over two first multipurpose fighter-bombers Su-34 to the Air Forces of the Russian Federation. According to Commander-in-Chief of the Air Force, General Vladimir Mikhaylov, these are absolutely new fighters which the Russian Air Force will receive for the first time since 1992. The total cost of two machines is 1,8 billion rubles (the supply of six Su-34 has been ordered for 2007).

The upgrade of the aircraft fleet of Russian Air Force is going on. The first supply of 6 upgraded fighters Su-25SM has been handed over to the Air Force by the aircraft-repair plant 121 of the Ministry of Defense in Kubinka which is the main contractor by the program of upgrading Su-25 of the Air Force of Russia. The choice of the contractor has been caused by the strategic orientation of the Ministry of Defense – to try to not give the money allocated for performance of work on improvement of arms and military equipment to the Military industrial complex, but spend it directly in the department. In 2006 the decision was taken not to finance the development and production of unmanned aerial vehicles. At that, even countries which do not possess the developed aircraft industry, e.g., Taiwan and the United Arab Emirates now are engaged into development of unmanned aerial vehicles.

### **Armored Vehicles**

In 2006 the Ministry of Defense planned to purchase 31 tanks T-90, 125 armored personnel carriers, 3770 motor vehicles (it was planned to upgrade 139 tanks and 125 pieces of artillery). The Ministry of Defense prefers not so much to purchase new armored vehicles, but rather «upgrade» the existing ones, and exclusively at its dedicated tank repair plants. At that, upgrading of tanks by export orders is entrusted to tank plants which are not part of the Ministry of Defense, because foreign accepting inspectors put forward more strict demands to the quality and level of upgrade.

So, the Ministry of Defense of the Russian Federation intends to place the order for upgrading of T-80 tanks in the interests of foreign customers in the amount of up to 450 machines per year with the Federal State Unitary Enterprise Omsktransmash, which, apart from the state intermediary, the Federal State Unitary Enterprise Rosoboronexport, also has the right for export. In this connection it is planned to take the enterprise from the bankruptcy procedure which has been carried out since 1998. At present, the company's debts constitute 1,5 billion rubles and its total property is evaluated as 2 billion rubles. Possibly, Omsk tank builders will join the export production of T-90S tank; operation of this machine by the Armed Forces of India has demonstrated its high efficiency. Contracts for the purchase of T-90S by Algeria, Libya and Morocco may be signed in the nearest future. India has refused from its plans to upgrade old equipment and intends to pass over to rearmament with T-90S.

## **8.8. Program Activity**

In 2006 the Federal Target Program Reformation and Development of the Military Industrial Complex (2002-2006), approved in October, 2001, has been accomplished. It was supposed to create within five years' time 70 integrated structures – holdings and concerns in the Military industrial complex, to finally overcome the systematic crisis in the industry and «to implement the military construction tasks». However, enterprises were not in a hurry with their integration, because they apprehended the attempt to subordinate them to their managing companies as the way to withdraw their income. Therefore, it was possible to form only 6 holdings, and they tried not to mention the Federal Target Program. Nonetheless, the state has not refused from its intention to unite enterprises of the military industrial complex into the vertically integrated structures. This has been proved by creation of the United Aircraft Building Corporation (OAK) which should be finally registered by April 1<sup>st</sup>, 2007.

In accordance with the existing plans it is supposed to create 40-45 holdings by 2010, which will unite 46% of enterprises of the military industry. The summary register counts with the total of 1265 registered enterprises and institutions of the military industrial complex – plants, scientific research institutes, design offices. Holdings will include a limited number of structures which are developing and producing final products under the state arms program. In other words – those provided with the guaranteed money of the state military order and export contracts.

In March the Military Industrial Commission (VPK) has been created for management of the military industrial complex under the government of the Russian Federation under the guidance of the Vice Prime Minister – the Minister of Defense Sergey Ivanov. Its management included several directors of big enterprises, which thus obtained the opportunity to lobby through participation of their structures in the state military order, which has considerably reduced their degree of opposition to the suggested measures on integration.

The main tasks of the military industrial complex include development and implementation of concepts, programs and plans in the military and technical area. As well as the «development of the military industrial complex, science and technologies in the interests of ensuring defense of the country, law-enforcement activity and the state security». This allowed a number of experts to speak about the revival of the Ministry of the defense industry and the consolidated management of the Russian Military industrial complex. Some predicted even

Sergey Ivanov's leaving his position of the Minister of Defense, because it is impossible to supervise two such «super departments» at once.

However, the further succession of events has shown that the Military Industrial Commission turned out to be only a commission interested, first of all, in concepts and plans. Thinking logically, this governmental structure should supervise decisions and activity of the power structures and of the Ministry of Industry and Energy of the Russian Federation regarding the military industrial complex, but since Sergey Ivanov is already supervising the Ministry of Defense and, as the Vice Prime Minister, all the defense industry, these functions disappeared as they were not necessary. Thus, the predicted revival of the Ministry of defense industry did not happen.

In these conditions the activity of the Russian Machine Building Union, headed by Director of the Federal State Unitary Enterprise Rosoboronexport Sergey Chemezov, became more active. The Union has grown from 16 enterprises to 66. Such giants as VAZ, KamAZ, the North Shipyard, Sevmashpredpriyatie, Sukhoy, Uralvagonzavod have joined the Union. The main goal of the expansion is the fight for money of oil-extracting companies which prefer to order equipment abroad and lobbying of the interests of the domestic industry.

### **8.9. Rosoboronexport as the Locomotive of the Russian Arms Export**

According to expectations, the state intermediary company, by the results of 2006, will sell abroad arms and military equipment for the value of more than 5 billion dollars. And the total amount of supplies abroad may exceed 6 billion dollars, which is approximately equal to the sales volume of 2005. The potential of domestic arms business outside the country has been practically exhausted, and the technological stagnation of the military industrial complex of the Russian Federation threatens with the loss of foreign markets in several years. Following these tendencies, the management of Rosoboronexport started implementation of its own industrial policy, the «prelude» to which became the expansion of the company in the Russian military industrial complex. The affiliated company Oboronprom acquired the controlling interest in over a dozen defense enterprises and actually took hold of the whole helicopter production in Russia.

Corporation VSMMPO Avisma Corporation, the unique manufacturer of titanium and products made of it is under control of Rosoboronexport. Another

asset of the state intermediary is AutoVAZ JSC which together with Magna Company will build a new car assembling factory with the production capacity 440-480 thousand cars a year. The powerful market structure is being created in the area of mechanical engineering under control of the state-owned company which is concentrating private enterprises. And this system is more efficient than the forcibly created holdings, as this is a question of production expansion and development of new technologies, instead of financial flows' redistribution.

On December 7<sup>th</sup> President of the Russian Federation has signed the decree according to which the exclusive right for export of final product of military purpose is granted only to the Federal State Unitary Enterprise Rosoboronexport. All other enterprises starting with March 1<sup>st</sup>, 2007, may independently export only spare parts and services. One may state that in the Russian industry the structure has appeared which is not just supervising export, but implementing its own policy in this area. The peculiarity is that it is focused on the foreign buyer, instead of serving the manufacturer. In other words, it is interested in the hi-tech production of new products of mechanical engineering. This is its radical difference from the Military Industrial Commission and other state structures connected with distribution of budget funds. In 2006 Russia consolidated its positions in the Latin American market, where it came a year ago with the Venezuelan contract on the supplies of Kalashnikov automatic guns earlier. In total, export agreements for the sum exceeding 3 billion dollars have been signed with Venezuela for the last one and a half years. They include the supply of 24 warcraft and 53 helicopters. In addition, servicing of the equipment sold and experts' training is provided. In March, 2006, the large-scale contract has been concluded with Algeria on arms delivery in exchange for the write-off of the national debt of this country to Russia. The contract value exceeds 7 billion dollars. There have appeared the prospects of increasing the sales of the military industrial complex products to Syria, Iran, Vietnam, Indonesia, Brazil and some other countries.

Thus, the essential diversification of the sales markets happened in 2006. If some time ago India and China accounted for 80% of export, now their share starts to decrease. However, India still remains to be the largest buyer of the Russian arms. On December 15<sup>th</sup>, the Baltic Ship-building Plant Yantar signed the memorandum on construction of three frigates for the Navy of India. In the autumn of 2006 the Ministry of Defense of India took the decision to build 1000 tanks T-90S under the license and buy in Russia 300 more of these combat vehicles in 2007-2008. The contract value is 950 million dollars, but, according to the existing data, only 860 million is due to Russia, because the fire control system is the

product of the Belarus company Beltechexport, and part of other electronic equipment is manufactured by Israeli company Tales. However, one more negative tendency for the Russian military industrial complex outlined in the expiring year: more and more often Russia supplies only «hardware», and the electronic components of aircraft, helicopters, combat ships and tanks are imported.

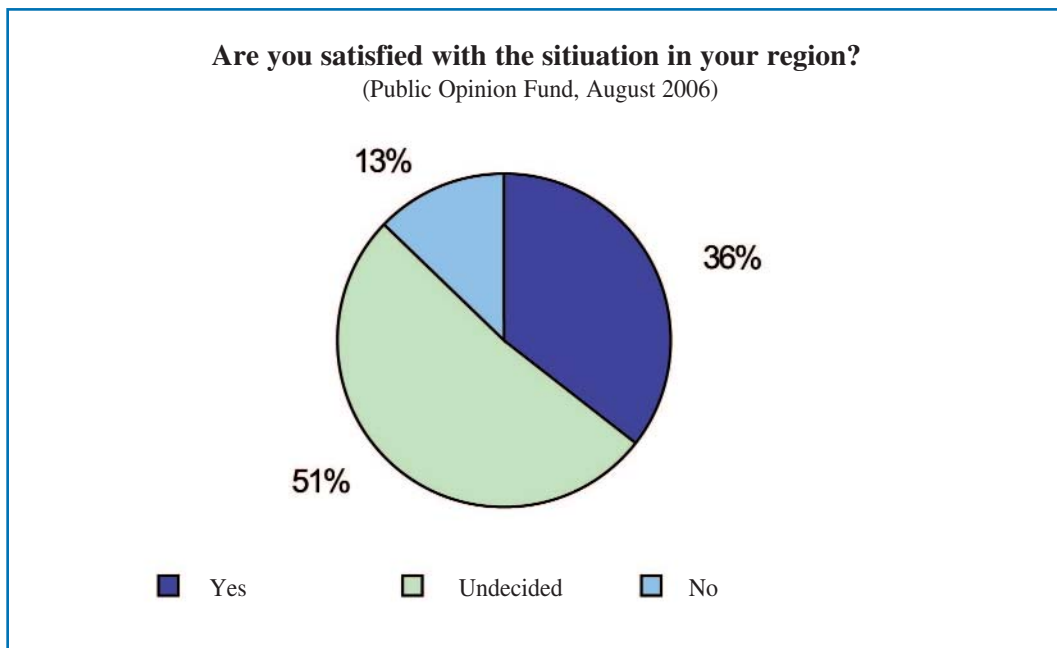
Chapter 9.

**REGIONAL DEVELOPMENT IN RUSSIA  
IN THE YEAR 2006**

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On the threshold of federal election campaigns of 2007-2008 the political situation in the RF regions was left out of the main focus of attention of the most influential players, including the presidential administration. *The level of activity of the federal elite groups at this stage is determined by their desire to assure the maximum satisfaction of their interests in the process of electing a successor for the current head of state, while the regional elites are not very much involved in this process.* In this context it is rather logical that *the main development tendency of the Center's regional policies in 2006 was improvement of control mechanisms supervising activities of the heads of regional administrations.* This theme is becoming especially salient in the context of promoting the priority national projects implementation of which is substantially financed from the federal budget. These investments seriously expand the resource base of regional elites while the federal center is actually incapable to follow up on allocation of additional financial resources in the Federation's subjects.



The issue of auditing operations of executive powers in the Russian regions has been discussed in the expert community for the last one and a half year. Back in June 2005 the RF Presidential Administration announced a tender for establishing “an automated system for monitoring the social, economic and

political situation in the RF subjects”. The winner was supposed not only to write a computer **program**, but actually to design the actual methodology of **auditing** in the form of a set of analytical reporting forms. The tender was won by two companies, ZAO Prognoz from Perm, which had won a similar tender back in 2003, and the Center for Fiscal Policies. According to the media, these organizations have submitted the results of their works to the presidential administration back in December of last year. However, these projects were not in anyway covered in the press. Representatives of the developing companies and of the state refused to submit any comments, referring to the commercial secret.

Last year there were several initiatives suggested on the federal level and aimed at improving the management effectiveness of regional administrations. First of all, we are talking about the work of a special task force at the State Council, chaired by Vladimir Yakushev, the Tyumen Oblast Governor. This task force developed a set of criteria for formatting the procedure of evaluating the operational effectiveness of governors and their administrations. On September 13, 2006, during an ordinary meeting of the State Council Presidium, the task force submitted a report containing 127 indices in all areas of operations of the local executive powers, from the living standards of the local population, economic growth, operations of housing and communal services, and the quality of education and training, to the volume of funds spent on “cultural and spiritual development of the local residents”. In order to determine the level of effectiveness under one parameter the evaluator has to find answers to numerous additional questions, each part of the report dedicated to a certain criterion consists of 21 chapters. The analysis of regional situation is based on statistical data, and an arithmetical mean obtained from summing up the data from all federation subjects will become sort of a reference point (or a general criteria). Server Sarychev, Tyumen Oblast Deputy Governor and one of the minds behind the project, told the media that if the charts demonstrate that one of the regions is substantially behind on one of the criteria (for example, in the area of wage levels), it will be compared with a region with similar economic and geographic indicators). “If it turns out that in two regions that are otherwise absolutely alike under all criteria the level of GNP is substantially different, experts from Moscow will be dispatched to the region that is lagging behind. They will analyze the situation and single out the guilty party”, - explained the Vice-Governor. He also announced that results of the monitoring will be transparent and any RF citizen will have access to the materials.

All indicators in the report are divided into three types: results, resource use effectiveness, and process management. Formally they all have equal importance,

however, they are substantially different in contents, which reduces objectivity of the evaluation. For example, the approach of Yakushev's work group suggests evaluating economic policies of regional administrations according to such indicators as volumes and dynamics of gross regional product and investments in equity. However, this methodology fails to account for the fundamental differences between objective conditions of economic growth (for example, availability of mineral resources and carbohydrates in the region). In other words, in an oil-rich region economic growth will substantially outpace that of a region void of oil, even if administration in the former is not actively working on creating favorable investment climate, while in the latter case even more limited growth rates may well be the result of hard work undertaken by the regional administration. Thus in order to evaluate economic policies implemented by regional authorities, it seems to be a more correct method to use indicators describing specifically the economic (investment) policies rather than economic growth rates or attracting investments.

In general the idea of setting up a single system of evaluating effectiveness of operations of executive power for all regions (both for donors and for recipients) looks quite timely and fully complies with the official federal policy aimed at improving the quality of life for Russian citizens. However, Yakushev's project contains a number of positions that obviously do not fit into the actual political and economic situation, therefore it should be viewed only as a preliminary plan that requires further fine-tuning. The situation with evaluating the quality of housing and communal services provided to the population makes this fact very obvious. Specifically, members of the State Council task force decided that all housing and communal service companies in the country must be incorporated and operate under the conditions of market competition. At this time the market of communal services operates under the terms of state monopoly, which is an important factor delaying the industry reform. The "average" approach described above is also a subject of criticism, because it does not take into consideration the regional specifics while applying a tremendous number of criteria complicating the evaluation procedure. According to the project designers, the average indicators are supposed to stimulate the administrations of subsidized territories for more effective work, however, they do not point out a source for financing this anticipated breakthrough. Furthermore, it is difficult to forecast to what extent the consolidated statistical data will reflect the actual situation, not to mention the fact that the quality of work demonstrated by local officials often poses a substantial question mark with respect to validity of "official" data.

The second project in the area of evaluating operations of administrations in federal subjects became a program of financial control developed by the Ministry of Finance officials led by Alexey Kudrin. The Minister of Finance did not agree to allocate additional sources of income to the regions, however, he suggested improving the inter-budget relationships by other means, such as improving the quality of management in regional finances (i.e. implementing new budget planning methods) and stimulate regions for raising their own income. For this purpose it is anticipated that changes will be made in the methodology of providing federal financial aid. "The existing system facilitates dependency", - explained Anton Siluanov, Deputy Minister of Finance, in an interview. At the same time, economic success does not imply complete dissociation from federal transfers. If the region has achieved growth rates that exceed the average figures, the amount of federal assistance will only be somewhat decreased.

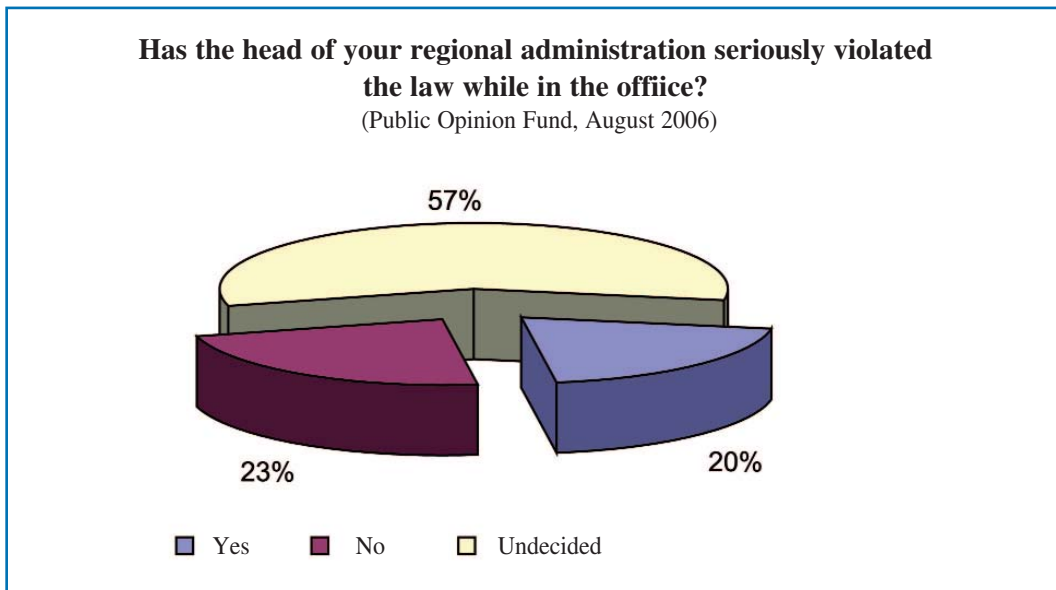
According to the plans developed by the Ministry of Finance, the degree of regional financial autonomy will be directly linked to the level of their own budget sustainability. Subjects subsidized in the amount of less than 20% from their own income will be allowed everything "that is not prohibited by the Budget Code". Regions where the federal aid share in their budget amounts to 20-60% (which is the majority of the regions) will be limited in their expenditures allocated to setting up power structures, as well as in determining the amount of salaries for state employees. Finally, subjects subsidized in the amount exceeding 60% of their own income will operate practically under the supervision of the Ministry of Finance. The local administrations will have to sign agreements with the Ministry specifying all limitations established for them, including all benefits that they provide. Furthermore, the RF Audit Chamber will have the right to audit the budgets in such regions. The Ministry of Finance does not support suggestions submitted in the middle of 2005 by Dmitry Kozak, Presidential Ambassador in the Southern Federal District, regarding implementation of external financial management in the most subsidized regions, because provisionary administration may carry out only audit functions but cannot facilitate growth of the income base. However, unlike the methods submitted by the State Council Work Group, this program of the Ministry of finance has not yet been accepted for implementation on the federal level.

Another sign of the Center's strive for tightening control over the regional authorities was submission for review by the State Duma senators (September 26) of a state legislative bill aimed at substantially simplifying the procedure of premature termination of gubernatorial power. Pursuant to amendments to a

number of Criminal Code and Criminal Procedure Code articles submitted by the Ministry of Justice, the president may be granted the right to remove governors from the office right after charges have been indicted under any article, regardless of how heavy is the incrimination. Moreover, in the event if the amendments are approved, the situation of a regional leader suspected in violating the law will become much more severe, especially in the case if his activities are viewed in the plane of “aiding and abetting terrorism”. Such measures logically fit into fortifying the vertical of power, in the framework of which two years ago were cancelled popular vote gubernatorial elections, and comply with the main priorities of the federal regional policy, the most important of which is maintaining a high level of political process manageability in the federation subjects, on the threshold of the parliamentary and presidential election campaigns in the following electoral cycle.

The submitted amendments to Article 114 of the RF Criminal Procedure Code grant Vladimir Putin the right to temporarily remove governors from the office for committed legal offences pursuant to relevant reports submitted by the State Prosecutor. At this time this procedure may be implemented even if the Prosecutor’s office is investigating the activities of a regional leader involves capital and heavy crimes. In the note accompanying the legislative bill, the need to such tightening is explained as follows: “The suggested measure will facilitate fortifying of the power vertical here in the RF, as well as secure an additional disciplinary impact on the specified category of state officials”.

Most of the suggested amendments to the Criminal Code also directly involve responsibility of regional leaders for committed managerial mistakes. For example, the new amendments include more severe punishments under the articles of embezzlement and negligence. In the first case the imposed fine amounts to 100-500 RUR, and possible term of incarceration is up to 4 years. Pursuant to current legislation an official was risking not more than a 80 thousand RUR fine for intended distortion of truth or false information. The law also foresees up to two years of prison, but only if the court proves that the crime was committed for the purposes of “financial benefit or out of personal interests”. The amendments eliminate the requirement of such proof, it would be enough to state that the actions of the accused “caused substantial violation of the rights and legitimate interests of other people”. The same formula is applied to the article on negligence, however, the punitive measures in this case remained the same.



According to the text of the accompanying note, the reason for introducing the aforementioned changes to the legislation was the need to design new measures for combating terrorism, which is “posing a serious threat to the national security in Russia”. In the opinion of the Ministry of Justice officials, the ineffective work of government officials in regional administrations is specifically that very factor that facilitates commitment of terrorist acts and hinders implementation of preventive measures. A firm belief of the authors of this legislative bill is that unscrupulous attitude of the officials to their duties leads to “open propaganda” of extremist and nationalistic ideas, causes distrust towards government authorities among the population, spurs the “feeling of impunity” in terrorists and allows for “unchecked recruiting of new members into terrorist organizations, including state officials with certain authority”.

By applying “local” administrative measures to regional elites under the terms of official completion of an anti-terrorist operation the government can expect at least two different political effects. On one hand, increasing responsibility for white-collar crimes along with the explanation provided provides an opportunity to minimize the possible Fronde reactions from the governor core representatives, because they become more dependent from the staff decisions center represented by the Administration of the RF President. On the other hand, this provides an opportunity to delegate a great deal of responsibility for the situation with ensuring safety of the population from the federal power structures to the regional executive

branch management, at least within the public space. This in its turn makes easier the inevitable search for a guilty party in the event of a new aggravation of extremist activity, which is supposed to help in containing possible image losses for the federal authorities in the event of losing control over the course of events on the threshold of the 2007-2008 election campaign.

## **9.1. Federal Reforms on Regional Level**

### **9.1.1. Regional Consolidation**

Regional consolidation became one of the main vectors of federal initiative on the regional level in 2006. The official grounds for the need in such projects is the idea of establishing subjects with an efficient administrative management system and strong economics, based on utilization of strategic advantages of the territories within the region. The solution of this problem involves reducing the number of unprofitable federation subjects, and including smaller and economically non-viable regions dependent on the federal budget funds into larger and wealthier regions (Permskiy and Krasnoyarskiy Kray are a good example of such union). The argument of the federal authorities regarding the need to consolidate the so-called Matryoshka (nesting doll) federation subjects in order to improve management efficiency, also looks reasonable. At the same time, from the stand point of the Center, one of the main results of consolidating initiatives must be streamlining of control over the use of resource potential in the territories. Federation subjects consolidation processes logically fit into the course on reducing direct federal subsidizing of the financially lagging territories. The regions that used to be subsidized directly by the center in 2006 started to receive subsidies from the budgets of oblasts and krays into which they had been included.

Last year the key factor determining the course of the consolidation process became the need for sustaining stability in the wake of the 2007-2008 election cycle. Practice showed that only the first consolidation projects went through rather peacefully, while further projects caused a splash of activity among non-profit organizations rooting against losing autonomy (this relates first of all to autonomous districts). We have to mention that autonomous districts were selected for consolidation due to two main reasons: scarce population and, in more than one half of them, an extremely low level of economic development. However, in the course of consistent implementation of the presidential initiative, the federal



<b>REGIONAL CONSOLIDATION: PROJECTS AND RESULTS</b>		
<b>Date</b>	<b>Federation subjects</b>	<b>Plans/Results of Referendum</b>
07.12.2003	Perm Oblast and Komi-Permyatskiy Autonomous District	For consolidation voted 84% of the participating voters in the Oblast, and 89.7% - in the Autonomous District. Starting from January 2007 RF has a new subject – Permskiy Kray.
17.04.2005	Krasnoyarskiy Kray, Evenkiyskiy and Taymirskiy (Dolgano-Nenetskiy Autonomous District)	For consolidation voted 92.45% in Krasnoyarskiy Kray, 69.95% on Taymyr, 79.87% in Evenkiya. Officially consolidated Krasnoyarskiy Kray was established on January 1, 2007
23.10.2005	Kamchatskaya Oblast and Koryakskiy Autonomous District	For consolidation voted 84.99 % in the Oblast and 89.04% in the AD. Officially Kamchatskiy Kray will be established on July 1, 2007
16.04.2006	Irkutskaya Oblast and Ust-Ordinskiy Buryatskiy Autonomous District	For consolidation voted 89.77% of the Oblast residents and 97.74% of the District residents. The new subject will appear on the RF map on January 1, 2008
	Altayskiy Region and Republic of Altai	Voting on consolidation is schedule for December 2007
	Chitinskaya Oblast and Aginskiy Buryatskiy Autonomous District	Voting on consolidation is scheduled for Spring 2007

government seemed to have overlooked such an important aspect as the ethnic factor, which is just as strong in autonomous districts as it is in national republics. According to comparative analysis, in two autonomous districts the indigenous population is in the majority, in five AD it amounts to almost a quarter of total population, and in all districts except the Komi-Permyatskiy, its share demonstrates a strong growth tendency, due to a higher birth-rate and migration outflow of Russians.

**Share of indigenous ethnic groups in population of autonomous districts**

Autonomous District	Share of title ethnic groups in population, %	
	2002	1989
Aginskiy-Buryatskiy	62.5	54.9
Komi-Permyatski	59.0	60.2
Ust-Ordynskiy	39.6	36.3
Koryakskiy	26.7	16.5
Chukotskiy	23.5	7.3
Evenkiyskiy	21.5	14.0
Taymirskiy (Dolgano-Nenetskiy)	21.5	13.2
Nenetskiy	18.7	11.9
Yamalo-Nenetskiy	5.2	4.2
Khanti-Mansiyskiy	1.9	1.4

Source: "Independent Newspaper"

The issue of the indigenous people's interests is especially salient with respect to Buryats, the largest ethnos in Siberia Consolidation of Buryat autonomous districts with the oblasts provokes a significant growth in social tension. This tendency first of all has to do with the historical specifics of Buryats' ethnic and cultural development. The problem is that this is the second forced changing of the established habitat of this ethnos after the remaking of state borders in 1937. We also should consider the fact that Buryats are the only ethnic community in Russia representatives of which are divided by borders of three federation subjects (Buryatia Republic, UOBAO and Aginskiy Buryatskiy Administrative District). This status has been maintained for a long time and traditionally has been stimulating growth of ethnic self-consciousness.

An additional complicating factor is that due to long-term processes of marginalization of the social structures and aging of the population in the rural areas of "Russian" regions, the social situation is much more complicated than in the Buryat districts that represent an example of rather sustainable rural ethnic community. Consolidation of such territories usually only speeds up the process of decay of the traditional social organization forms, and since urban culture in the

Zabaikalye area is very poorly developed, there are hardly any positive ways of modernizing the life style of the mostly rural population in the areas to be consolidated. Therefore it seems like political plausibility of consolidation must be accompanied by considerations of the ethnic and political risks involved in this process. However, analysis of the federal center policies in this area demonstrates that these factors are most likely being overlooked.

Preparations for a referendum on the issue of consolidating Irkutskaya Oblast and UOBAO represent a vivid example of such contradictions. In the course of these preparations opponents of consolidation initiated a movement in Buryatia led by activists of a regional union of young scientists, rooting for restoring of “historical justice” and preventing discrimination of the Buryat people. We have to note that while in the autonomous district the most important obstacle for an effective voting was the growth of protest reactions stimulated by the activities of Buryat national organizations, in the Oblast the most impeding factor was the lack of interest among the population, and the promotional campaign initiated by Alexander Tishanin’s administration with participation of all main political parties was obviously not sufficient to stimulate this interest. Failures of the Irkutsk administration in the area of implementing the federal consolidation task can be attributed to obvious limitations of administrative methods that were supposed to stimulate electoral activity levels (establishing massive social organizations supporting consolidation etc), as well as to Governor Tishanin’s political weakness. He failed to demonstrate administrative efficiency or ensure constructive cooperation with representatives of the main business groups. In this context it seems very logical that the President strongly criticized the work of Irkutsk administration during his meeting with regional leaders in Moscow. In Vladimir Putin’s opinion, “the social situation in Irkutsk was and remains unfavorable”, the living standards are below the federal level, while the crime rate is much higher etc.

From the stand point of contents Tishanin’s campaign (especially during the final stage of preparing for the referendum) was built around one main theme – a protest against construction of the first stage of the East Siberia – Pacific Ocean pipeline in the environmental zone of the Lake Baikal. The Governor himself actively participated in the mass protests. In the brink of the referendum, Alexander Tishanin preferred to appeal directly to the public opinion because he did not have a chance to expect any serious support from the regional financial and industrial groups. This was a very good excuse for boosting up the governor’s popularity. Irkutsk became the site of a series of very crowded protest actions

under the slogan “Say ‘No’ to Transneft”, supported by the local scientific, student and environmental organizations, as well as political parties from NBP to Yedinaya Rossia. For example, management of the main operating company under the ESPO project was accused of manipulating the results of geological survey and environmental audit as well as of failure to comply with the applicable legislative norms. Consequently, according to representatives of the Governor’s team, objective analysis of environmental risks was substituted with “lobbying for the desired decision by using all available tools of administrative pressure”. Tishanin reminded everyone about the alternative options for the pipeline route, for example along the Lena River (Ust-Kut – Kirensk – Lensk), i.e. by-passing the Baikal Ridge along the Siberian Platform territory. Nevertheless we have to stress that in this case the question of pros and cons in selecting a certain route option was not of primary importance. The main aim of the Irkutsk administration was to switch the public attention from discussing the future status of Buryat ethnos to the struggle to save Baikal as “one quarter of world fresh water resources”.

Insufficiently effective use of administrative resource in preparing for the referendum combined with negative effect from using rhetoric appealing to feelings of representatives of ethnic minorities caused a clear and present danger of coming up with negative results of voting on establishing a consolidated Irkutsk Oblast. In these conditions the federal government had to directly interfere in the consolidation processes: on April 1 the meeting with Governors Alexander Tishanin and Valeriy Maleyev was conducted by Vladislav Surkov, Deputy Head of Presidential Administration, and on April 5 was held the aforementioned meeting with Vladimir Putin. He did not express any direct assessments of the work accomplished by the heads of Oblast and UOBAO administrations and reminded them about the great responsibility for the voting results. He said: “I am afraid to think of the fate of the officials that will mess up the campaign”. In his turn, during a meeting with the officials responsible for consolidation, Vladimir Putin made an unprecedented step in order to stimulate the level of electoral activity. The President announced his intention to sign a decree on additional support measures for the newly established consolidated federation subject. These measures include establishment of social infrastructure, development of the energy sector, first of all the electric energy branch, as well as additional financing in other branches where “the Federation must and can provide support”. Furthermore, during the meeting the state officials made a decision to donate to the Oblast two hydrolyze plants where 51% of shares were owned by the federal government. Finally, during the meeting with the President the parties came to an agreement on

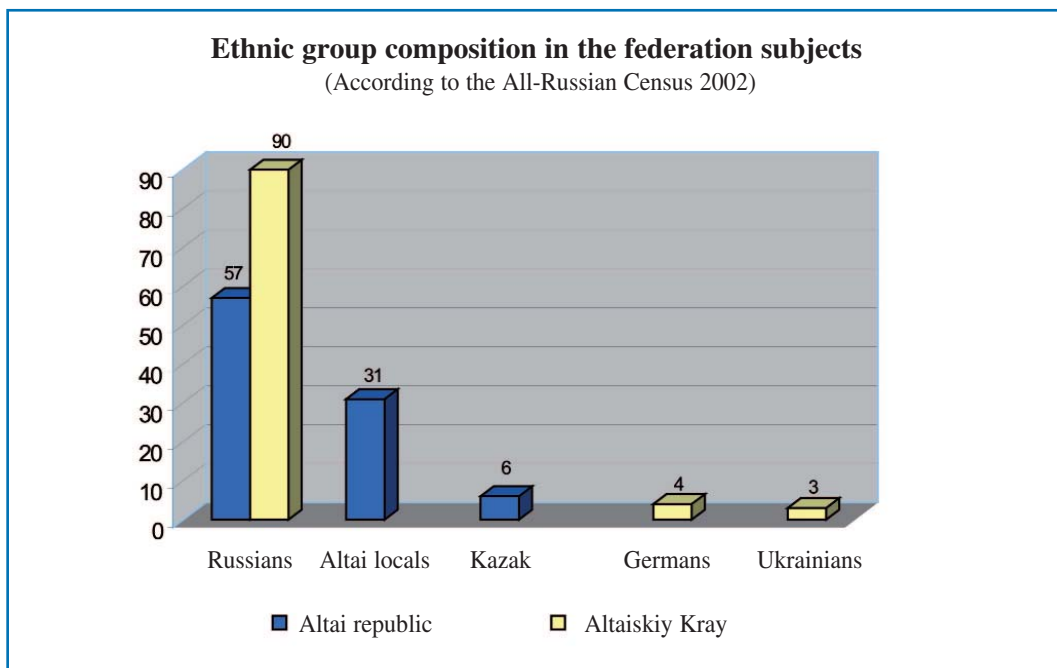
the issues involved in constructing a bypass highway around Irkutsk and completing construction a bridge across Angara. Thus the Center actually agreed to satisfy all requests that the Irkutsk administration submitted back when Boris Govorin was the local Governor as necessary requirements for the consolidation process.

Therefore the success of the Irkutsk referendum to a great extent resulted from federal interference on an unprecedented scale. However, the ethnic factor related to the level of activity of the national elites in the area of protecting their own interests is still salient. For this reason future prospects for implementation of other consolidation projects in the pre-election year of 2007 are still unclear.

This brought back to the agenda the issue of possible consolidation of the Altaiskiy Kray and the Republic of Altai (RA). The rationale behind implementation of this project is the fact that prior to 1991 Altaiskiy Kray and RA used to be a single territorial unit. The key factor here is the desire of the Federal Center to optimize expenditures on development of depressed territories, typical for the federal regional policy in general. According to the Center for Fiscal Policies, the volume of gross regional product per capita in both subjects is several times lower than the general rates across Russia, and most of the expenses both regions are financing out of transfers from the federal budget, therefore in this case we cannot count on implementing the “growth locomotive” policy. Moreover, because the local budgets are highly subsidized implementation of already existing regional development projects is hardly possible without additional financing from the federal government. Geographical factor also carries tremendous importance, because the Republic of Altai is located at the crossing of borders of Russia, Kazakhstan, China and Mongolia, and consolidation of subjects is to a certain extent motivated by strategic goals.

However, the federal initiative for consolidation of Altai has still not been accepted by representatives of the regional elite community. First of all this involves the Republic of Adigey, where 31% of the total population belongs to the indigenous people. On October 31 consolidation was protested by Kurultay of Altai People (a social organization representing the interests of the indigenous population in the Republic), For the Republic movement, announcing its main goal “protection constitutional status of RA”, as well as the deputy core of Gornyi Altai Parliament (State Assembly). Vice Speaker Nikolay Taytakov voiced the general position of the local lawmakers. He stated that the process of eliminating the Republic is being implemented “without consideration for national and historical traditions and socio-economic rationale”, and “further progress in this direction is

threatening stability and Russia and facilitating social tension”. After the State Assembly had approved a document on firm maintenance of Gornyi Altai’s status as a Russian Federation Subject, the capital of the Republic hosted a meeting against consolidation with about five thousand participants, which became the largest political affair since the beginning of the 1990’s. At the same time representatives of another non-profit organization Ene Til (Mother Land) prepared an address to international human rights organizations in order to draw attention of international community to the process of forced consolidation of the two regions.



Analysis of this situation demonstrates that this level of activity on the part of organizations protecting the interests of the indigenous population was a direct cause of support provided by RA elite community to operations of numerous non-governmental organizations and movements protesting consolidation. In this case the key role is played by economic interests of the ethnic minority representatives. According to data provided by the Gornyi Altai administration, this region is developing much more dynamically compared to the neighboring Kray. Therefore, the resource potential of RA is rated much higher, and the local elites are quite predictable in their protests against probable redistribution of financial flows

involved in consolidation of the territories. The ethnic factor is a traditionally effective mechanism of mobilizing population in support of ideas complying with interests of the local political establishment.

In this context the problem of effectiveness of governors appointed by the Federal Center is especially salient. In a situation where the national elites have a dominant influence on key decisions on the regional level, a governor-outsider (for example, Alexander Berdnikov, a former federal inspector) is actually deprived of any chance to put pressure on the key players. He is forced to seek compromise with the largest interested parties. This is the main reason of wavering in the position of RA Governor regarding the need for consolidation. In the summer of last year Berdnikov stated that he does not see any reasons for consolidation with *Altaiskiy Kray* because both regions are highly subsidized. According to his words, he expressed this point of view in a letter addressed to Vladimir Putin. At the same time the Governor admitted that at the Presidential Embassy in Siberian Federal County the issue of consolidation is still being discussed, while the Altai elite circles are very hostile towards administration of the country represented by Anatoliy Kvashnin. Berdnikov hinted that he will implement the RF President's orders on consolidation of the regions in the event if there are such orders.

Therefore assuring positive results of Altai referendum is consuming a tremendous amount of resources, and the price of failing such a large-scale federal initiative in the wake of elections will inevitably become extremely high. The federal government's standing might also suffer quite substantial losses, including the President, because it is exactly the head of state who initiated consolidation of territories as one of the main vectors in the Federal Center's regional policies. In the light of this factor further course of preparing for consolidation will depend on success of efforts to be undertaken by the RA Governor and representatives of Presidential Administration in the issue of reaching a compromise with Gorniy Altay's elite groups. Under favorable circumstances the term of preparations for the voting may be extended (initially it was scheduled for December 2007 at the same time with the State Duma elections). In the opposite case implementation of the project may be postponed for an indefinite period in order to prevent further escalation of protests.

The situation with the project of establishing a *Zabaikalskiy Kray* by consolidating *Chitinskaya Oblast* and *Aginskiy Buryatskiy Autonomous District (ABAD)* is much more favorable. As in other cases involving consolidation projects, this decision is motivated in public space by desire of the regional leaders "to improve well-being of the Oblast and District residents". At the same



time, regional development dynamics analysis demonstrates that establishment of Zabaikalskiy Krai is not a typical version of potential consolidation. In this case, unlike the Perm or Irkutsk oblast, or such a financially successful subject as Krasnoyarskiy Krai, the mother subject has traditionally been a depressed territory. Moreover, in the last few years the regional development rates in Chitinskaya Oblast have been much lower than these figures for the AD. In the area of industrial production development rates in ABAD substantially exceed those in the Oblast, which to a great extent has been achieved due to a consistent course implemented by Bair Zhamsuev's administration aimed at reducing the share of subsidies in the regional budget by attracting large business in the real economy sector.

Consolidation of these regions did not look very efficient also from the stand point of utilizing the resource potential, because Chitinskaya Oblast is rich in potential natural resources. Therefore it is logical that during the last several years the head of ABAD administration has been an active opponent of the consolidation idea, motivating his position by the need to maintain national autonomies and convincing economic arguments. However, after consulting with the RF President's Administration, ABAD administration had to admit that "the situation in the country has changed", and "show voluntary initiative". Consequently, the state should not expect organized resistance of the local elites in the event of consolidation between ABAO and Chitinskaya Oblast, while the local residents will almost certainly support the federal initiative. The only factor that was not taken into account and is hard to forecast at this time is the position of Buryatia's administration headed by Leonid Potapov, who has not yet received the presidential approval (his term expires in 2007). It is quite possible that the federal government will make a decision to replace the current leader, and in this situation Potapov would gain relative freedom for a political maneuver using the nationalistic factor for protecting the interests of the largest in the region Buryat ethnos. Non-profit organizations in Buryatia have already announced their intention to set up a tent camp during the referendum campaign in order to accomplish a series of protest meetings. Responsive actions of the federal center will be traditionally undertaken only for stabilization purposes.

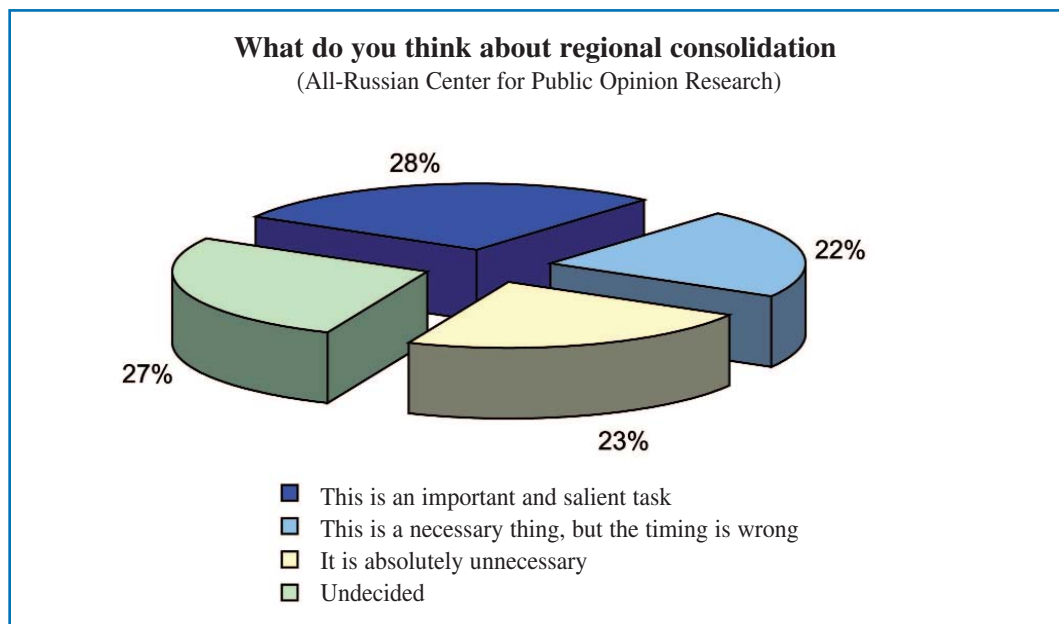
Finally, another project of consolidation between Arkhangelskaya Oblast and Nenetskiy Autonomous District discussed on the federal level can be considered to have been postponed for a period after 2008, considering the federal government priorities in the wake of the upcoming election campaigns. The elite community of resource-consuming NAD is rather consolidated and traditionally stands against

changing the District's autonomous status. Furthermore, last year the conflict between the regional administrations related to poorly regulated inter-budget relationships, has permeated the federal level as well. During the process of preparing for signing the agreement on delimitation of authority between subjects for 2007 the negotiations have been resumed several times resulting in new addresses to the President, Prime-minister and the State Duma. This way administration of each of the regions tried to demonstrate their firm stand based on their own economic interests. For the Arkhangelskaya Oblast administration headed by Nikolay Kiselev the priority task is recovering from the budget deficit, which in 2006 amounted to approximately 2 billion RUR. Considering the lack of additional sources of financing, the only available solution for expanding the resource base is a new delimitation of power. In addition too the symbolic status upgrade, this expansion of competency is expected to bring in additional resources for implementation of new duties, which the Oblast would be able to obtain directly from the budget of NAD. The strong negative reaction of lawmakers from the donor region looks quite reasonable, because redistribution of tax income and federal subsidies brings about a threat of failure to implement social programs scheduled by the District administration.

These contradictions have a long history, however, at the end of last year Kiselev's administration suddenly boosted its efforts to assure positive decision. It is very likely that the key factor became the change in situation within the local elite in NAD after Aleksey Barinov, former Governor and a strong supporter of maintaining the local autonomy, had been removed from the office. In May 2006 he was charged under Article 159, Part 2 of the RF CC (fraud), later the charges were changed to Article 160, Part 3 (embezzlement of property), and the episodes reviewed by the prosecutor occurred during the period when the former governor was the head of OAO Arkhangelskgeoldobycha (1999-2000). The choice of Natalie Popenko, a former chief federal inspector for NAO Valery Potapenko as Barinov's successor became a vivid example of promoting a governor-outsider. On the federal level one of his main political trumps would be an absolute loyalty to the Center. This logic in making staff decisions was especially important in the case with NAD because the regional elite community craves for independence and demonstrates a high level of corporate cohesion.

The Agreement on delimitation of powers and inter-budget relationships signed on November 20 resulted from a political compromise. This year NAD will contribute to the Oblast budget 1.65 billion RUR, a matching amount will be allocated from the federal budget. In 2007 the District's budget will have 6.7

billion RUR. Under the condition of outperforming the financial plan Arkhangelskaya Oblast will receive 70% of the District's additional income, while NAD keeps 30%. The District's administration retains more than 20 state powers in its territory. We have to mention that signing this agreement did not become the final decision. This agreement stipulates signing of a protocol in 2007 in order to specify certain financial parameters. Furthermore, there is a tendency to gradually cut down financial resources of the NAD administration. At first site the amount of 1.65 billion RUR is not so important for the District's budget, but compared to contributions made by NAD to the Oblast budget in 2005 (500 million RUR) this figure increased by more than three times (without the 70% of additional income that under the new agreement the District is supposed to submit to the Oblast budget in the event of outperforming the financial plan). Therefore there is a possibility that economic autonomy of NAD will be actually eliminated without any referendums and other procedures necessary for official consolidation of the regions. Considering that the elite groups in NAD have traditionally been very strongly opposed to the existing regional consolidation project, it is plausible that the federal government will decide to start consolidation de-facto, while formally maintaining the status of an autonomous district, at least in the short-term perspective. From the stand point of federal interests, the priority is to resolve political and economic problems present in the region, therefore it would be reasonable to start establishing this new federation subject after 2008.



In the end we should touch upon the possible changes in legislation regulating the regional consolidation process. At the beginning of October Sergey Mironov, the Speaker, set up a task force at the Federation Council (FC), the priority task of which is to improve these norms. We have to remind that previously senators representing at the FC the regions that are preparing for consolidation have often voiced their initiatives on making changes to the Law on Accepting to the RF and Establishing Within its Structure a New RF Subject, in order to simplify the consolidation procedure and settle the issues involved in budget financing of the consolidated subjects. On October 12 Rafgat Altynbayev, Federation and Regional Policies Committee Chairman heading the task force at the FC, submitted an unprecedented suggestion to cancel referendums on consolidation issues. This measure is aimed at substantially decreasing the duration of the consolidation process, however, it is even more important that this amendment would allow the regional leaders responsible for implementation of the projects important from the stand point of federal regional policies to substantially reduce the possibility that circumstances outside of the system might bring about irreparable losses to their political image and career development.

The amendment submitted by Senator Altynbayev suggests replacing the referendum procedure by voting in the legislative assemblies of the subjects to be consolidated. This way there will no longer be the need to take into consideration the opinion of the local population in order to implement a federal initiative. According to the Senator Altynbayev's plan, in the new decision-making mechanism there still will be maintained the necessary "element of democracy", because everything still "will depend on the representatives chosen by the people at the elections".

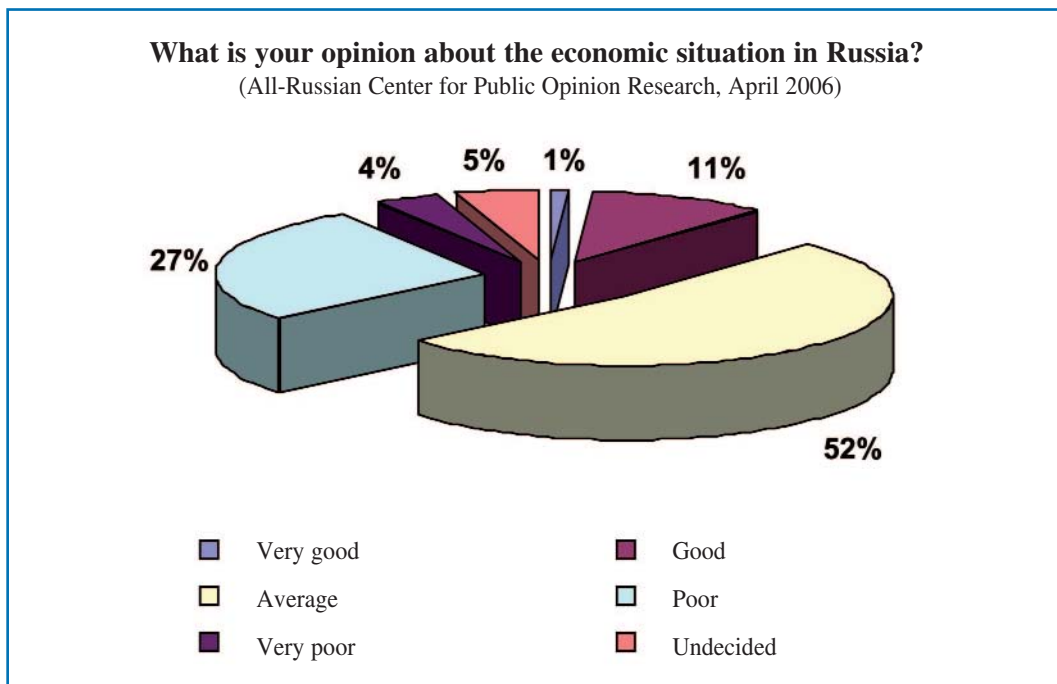
According to the official comments, this suggestion submitted by the leader of the new FC task force is only his "personal initiative". At the same time according to our source at the Presidential Administration, the possibility of canceling consolidation referendums is already being discussed at the highest government levels for a long time. In this case Sergey Mironov's task force is playing the role of a conductor for the decisions aimed at preventing negative effects of the consolidation process similar to the ones that have already happened in political practice previously. This statement is indirectly confirmed by the fact that previously the federal government has already made attempts to optimize the legislation on consolidation. In the autumn of 2005 Vladimir Putin submitted amendments to the aforementioned law. We would like to remind that in the original version of the law stipulated that formally the consolidation initiative was

supposed to be launched by activist groups of residents in the respective subjects, and only after that the issue of consolidation was to be reviewed in the regional legislative assemblies, and then legislative representatives were supposed to consult at the Presidential Administration and set a date for voting. The amendments made by the RF President delegated the right to submit the consolidation initiatives to the local governors. Governors were also granted an opportunity to promote consolidation, which allows them to substantially improve the effect from the campaigns by using the administrative resource). At the same time putting together an initiative group is possible only after the president approves the consolidation project. This means that in the medium-term future there is a certain probability that the amendments canceling the mandatory referendum on consolidation will be approved. The actual process of regional consolidation is quite an expensive project, starting with preparing and conducting a referendum and ending with establishing new power agencies. There is a danger of tremendous political losses involved in prevention of possible complications in the process of preparing public opinion for the voting. The new consolidation mechanism would have allowed the government to get rid of a substantial part of these problems, because right now there is an almost zero chance that a constitutional majority in any of the regional parliaments will coherently vote against a federal initiative.

### **9.1.2. Special Economic Zones**

Last year an important vector of implementing the federal scale projects became setting of special economic zones (SEZ). The federal law On Special Economic Zones in the RF stipulates creating two types of zones, industrial (with an area not exceeding 10 square km) and technical and implementation zones (area up to 2 thousand square km) was signed by the President on July 23, 2005. On November 28 were announced the results of the first regional applications tender. The Ministry of Economic Development and Trade recommended for approval the technical and implementation SEZ projects in Zelenograd (microelectronic research), Dubna in the Moscow Region (nuclear physics), Saint-Petersburg (information technologies and analytical instrument engineering), and Tomsk (nuclear nanotechnologies). According to the tender results, industry and production zones will be located in Tatarstan (the town of Yelabuga – production of bus components with participation of a number of foreign companies, as well as petrochemical products), and in Lipetskaya Oblast (production of household

electronics in cooperation with Merloni (Italy), and furniture). Therefore, the competitive choice of territories for Special Economic Zones does not comply with the original understanding of SEZ as a mechanism of stimulating economic growth by developing non-natural resource branches. Implementation of these projects last year did not bring any obvious results. According to the most optimistic forecasts, the main part of the infrastructure of regional applications accepted for implementation will be set up no earlier than at the end of 2007. As for potential investors, there is a great number of Russian and foreign companies that announced their desire to work in the special zones (including Boeing, Motorola, General Motors, Siemens, Alcatel), however, there are not that many registered residents in the Special Economic Zones. All of this demonstrates that from the stand point of regional economic development positive effects from SEZ projects may be achieved only in long-term future.





### 9.1.2.1 Tourism Infrastructure Development Projects

It is important to mention *that during the previous year there were made legislative amendments providing for an opportunity to set up tourism and recreation SEZ*. These zones may include development of healing mineral water springs, peloids, as well as other mineral resources included in the category of medicinal and used for treatment and prevention of diseases. Residents of tourism and recreational SEZ are considered individual entrepreneurs or commercial organizations (except for unitary companies), registered in the territory of municipal formation within the borders of which the SEZ is located, that signed an agreement on tourism and recreational activities with the SEZ administration.

*Establishment of tourism and recreational zones in the medium-range future must become the main vector of further development of SEZ projects in the regions*. At the beginning of December an interagency commission headed by MEDT reviewed the results of regional application tender and named seven winning projects submitted by administrations of Altai, Buryatia, Irkutskaya Oblast, Krasnodarskiy and Stavropolskiy Kray, as well as Kaliningradskaya Oblast. However, this decision was not final. The 2007 budget allocates for the tourism zone infrastructure only 1.1 billion RUR, therefore originally the plan had been to approve only three projects. “This is a very hard choice, we cannot turn down any of these projects”, - said about the commission’s decision German Gref, head of the Ministry of Economic Development and Trade. As an alternative there was discussed a possibility of merging the applications in clusters, however, according to a source at the commission, this idea hardly can be implemented.

*The issue of financing of promising projects became the main stumbling block in the course of discussion*. Before the year 2026 the federal budget will allocate 44.5 billion RUR for setting up tourism-oriented SEZ. These funds will be mostly used for construction and reconstruction of roads, airports, electric power lines, gas and water supply systems. Private investments are supposed to amount to 273 billion RUR. The idea is that every “special” zone must have its specialization. For example, Irkutsk will promote business tourism, Buryatia – mountain skiing and water sports, Krasnodarskiy Kray – beach tourism. Within the first two or three months of the year the MEDT is supposed to submit to the state government draft regulations for every zone, and during the year the interested regional administrations and municipalities are supposed to submit concepts and master plans for establishing SEZ. This drafting process will be financed out of the federal budget.



*Krasnodarskiy Kray Administration headed by Alexander Tkachev as well as Alexander Tishanin, Irkutskaya Oblast Governor from the very beginning were the main lobbyists of establishing tourism and recreation SEZ in Russia.* According to certain data, Yuriy Zhdanov, the former head of RosO EZ, viewed applications from these regions proposing development of rest and recreation zone in Sochi and a tourist facility near the lake Baikal as the most promising ones. His failed in the apparatus struggle with Alexey Kou drin, the Minister of Finance, for control over the financial flows involved in establishing SEZ, therefore ***the number of officially scheduled winners of the tender was reduced.*** For example, the Ministry of Economic Development has stated on numerous occasions that the actual chance to win will be granted only to three or four projects, or maybe even less, because the quality of applications developed by regional administrations often was very poor. ***In this case economic argumentation does not raise any doubts:*** the 1.1 billion RUR allocated in the budget may not be enough for implementation even of several major projects, considering that development of infrastructure for each tourism zone will require an investment of no less than 5 billion RUR during the first 3-5 years.

***Implementation of tourism and recreation zone projects involves a whole number of serious problems.*** The costs involved in these projects are very high (considering the need to develop a full-fledged tourism infrastructure, which is not present even in the most economically developed federation subjects), while investment attractiveness is much less compared with other special zones. We have to mention that because there are no area limitations, for the tourism and recreational zones the lawmakers decided to give up the idea of free trade mode present in production and innovation zones. As compensation it is planned to include the residents of tourism SEZ in the special tax mechanism applied to the production and technical SEZ. We are talking about the 14% rate of Unified Social Tax (with tax base of up to 280 thousand RUR for every physical entity), application of a special coefficient to the main amortization norm when calculating the profit tax, lifting the 30% limit on tax loss carry forwards, as well as 5-year exemption from land and property taxes. However, these ***tax benefits do not cover the costs of implementing the applications submitted by the regions, and there are no short-term plans for substantial increases in the volume of financing of these projects from the federal budget.***

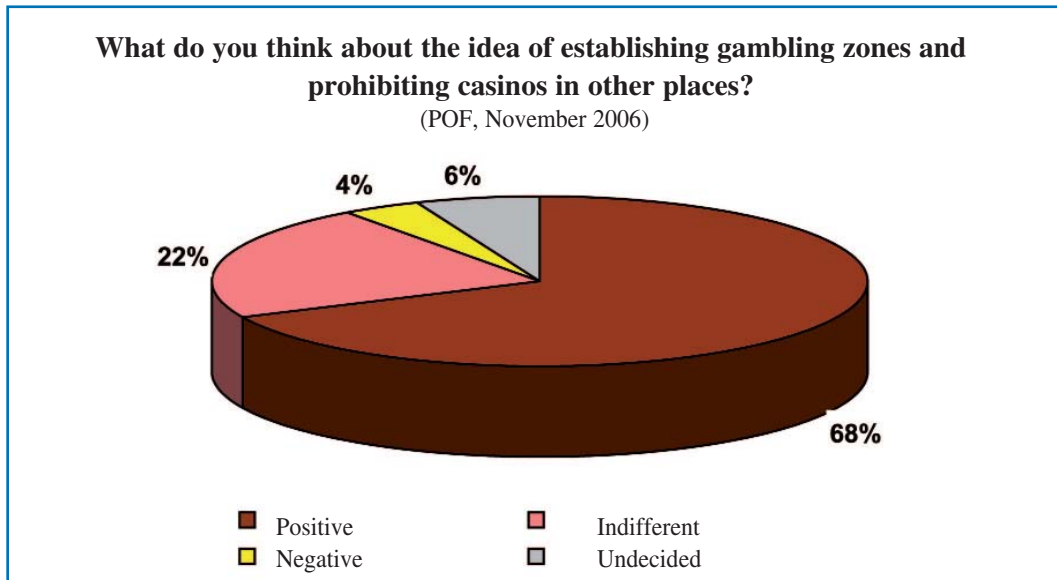
It is very much likely that regional tourism projects will be regularly underfinanced considering the active lobbying activities of Igor Levitin, the Minister of Transportation. With support of RosO EZ he is promoting the most

resource-consuming aspect of the SEZ project – dock zones. In this area Alexey Koudrin traditionally has been Levitin’s main opponent. The Ministry of Finance refuses to coordinate the relevant legislative bill due to absence of a feasibility study, thus preventing implementation of the next regional application tender. Furthermore, *the search for compromises in the course of potential consolidation of regional applications for establishing tourism SEZ is substantially complicated by political contradictions*. The RF subject administrations are trying to gain control over massive investment flows and are reluctant to reduce their resource potential by sharing with their neighbors. As for the general potential for implementation of the project, we have to take into consideration that there is still no clear definition of control mechanisms over economic process in the SEZ territories. It is only known that the new “special” zones will be set up with mandatory participation of federal structures. Therefore, there is a potential danger of establishing a ‘mutually beneficial’ cooperation between the center and the regions for more effective lobbying of interests of the most influential players and turning the tourism SEZ into ‘regional off-shores’. In this situation the main role may be played by the desire of regional elites to compensate a part of political influence lost during the process of building the system of distributing authority, in the wake of the 2007-2008 federal elections.

#### **9.1.2.2. A Verdict for the Gambling Business**

We should take a special look at the process of implementation of Vladimir Putin’s initiative involving *relocation of gambling facilities to the “territories free of residential premises”*. This idea was expressed by the head of state at the beginning of October of last year based on results of inspection undertaken by the law-enforcement authorities at several major Moscow casinos. During the inspection the law enforcement agencies discovered a number of serious violations in the operations of entertainment facilities. On December 20 State Duma representatives accepted the final reading of the Law on State Regulating of Gaming Organization and Operating. By 2007 it is expected to set up special gaming zones in Kaliningradskaya Oblast, Primorskiy Kray, Azovskoye Sea and Altaiskiy Kray, and from 2009 it is expected that operations of gaming facilities will be prohibited everywhere except these zones that will be established in the open field. During this period it is expected to develop land use and construction projects, make the necessary architectural and construction works, build the necessary facilities, commission them and obtain all the necessary permits. There

are a total of 6300 gambling licenses issued in Russia. In 2005 the turnover in this industry amounted to 5-6 billion USD. The leaders in this area are Ritzio Entertainment Group (the Vulkan chain), Storm International (managing the Super Slots chain and several casinos in Moscow and Saint Petersburg), and Jackpot. According to comments provided by the market participants, in reality this process will take not less than six or seven years, and ***it is not possible to implement the legislative bill in the original form.*** According to a source in the State Duma Economic Policies Committee, the amendment on placing the zones outside of residential areas was initiated by the Moscow government because “gaming salons in the city promote social problems”.



***Implementation of gaming industry reform includes two stages.*** On July 1, 2007 limitations aimed at facilitating concentration of gaming business will come into power. Net assets of the company running a gaming facility are supposed to be not less than 600 million RUR, minimum area of a casino must be 800 square meters, gaming machines salon no less than 100 square meters, the operator must own the gaming equipment, minimum number of gaming tables – 10, slot machines – 50, and the technically programmed percentage of winning must be no less than 90%. Age limit for patrons and staff must be no less than 18 years. Gaming facilities that fail to comply with these requirements will be closed. The term of all licenses for any types of gambling activities expires in 2009, because

since on December 31, 2004 the right of licensing was withdrawn from the competence of Rosspport, licensing has been practically suspended, and the maximum term of any gambling license is 5 years. In the future licenses will be issued by a federal authority that has not yet been specified. Zone borders and management procedures will be supervised on the level of Federation subjects. ***Until July 1, 2007 the regional authorities have the right to make a decision of prohibiting gambling on their territories*** (outside of gaming zones), which can create ***additional opportunities for corruption***. Finally, all gambling in the Internet and over cellular communications is prohibited.

Before July 1, 2009 all gaming facilities in Russia must be concentrated in four zones: Kaliningradskaya Oblast, Altaiskiy and Primorskiy Krays, as well as on the border between Rostovskaya Oblast and Krasnodarskiy Kray. According to Vladimir Medinski, deputy chairman of the State Duma Economic Policies Commission, ***the main criteria in selecting the regions became ‘the desire of the local authorities’***. The lawmakers also considered ***the geographic location, investment perspectives, proximity to the border, presence of airports, and tourism attractiveness***. An opportunity to attract foreign players is also an important factor. This approach opened to the regional leaders wide opportunities for lobbying their interests, that’s why it is not surprising that even though the number of gaming zones was originally limited, administrations of 12 subjects submitted applications for participation in the federal tender. It is interesting to note that the list originally did not include Krasnodarskiy Kray, which finally ended up among the winners.

***A strict limitation of the number of zones was greatly related to the need to implement adequate measures in response to actions of a number of regional administrations that tried to maximize their own profit from gambling in the absence of federal legislation regulating gaming activities.*** A good example is the politics implemented by the government of the Republic of Tatarstan, which found a place for gaming reservations on the territory of the region, thus redistributing financial flows and causing numerous court claims. Most of the regional budgets are showing deficit because of the limited tax base and systematically insufficient financing of responsibilities formally delegated to the regional and municipal levels. In this context it is not surprising that a whole number of governors announced their decision to have a gaming club or a casino in their territory. Due to gaming taxes this would allow them to allocate additional funds on implementation of priority national projects and thus demonstrate their effectiveness on the federal level.

**Federation subjects that announced their intention to establish  
and host gaming zones**

Region	Average monthly wage (RUR)	Economic situation in the region
Altai Region	5800	Subsidized
Ivanovskaya Oblast	6150	Subsidized
Irkutskaya Oblast	10450	Subsidized
Kaliningradskaya Oblast	8600	Subsidized
Kalmykiya Republic	5200	Subsidized
Kamchatskaya Oblast	18150	Subsidized
Leningradskaya Oblast	10100	Donor
Moskovskaya Oblast	11050	Donor
Nizhegorodskaya Oblast	7700	Subsidized
Primorskiy Kray	10380	Subsidized
Rostovskaya Oblast	7000	Donor
Samarskaya Oblast	9000	Donor

Source: "Independent Newspaper"

However, *the choice of the federal commission* which included representatives of the Ministry of Economic Development, Ministry of finance, MEDT, as well as, according to certain sources, power agencies, *to a great extent turned out to be unexpected*. The only project that does not cause surprise is the gaming business zone project *on the border of Krasnodarskiy Kray and Rostovskaya Oblast*. Alexander Tkachev's administration traditionally actively participates in implementation of federal economic projects because the head of the Kray has established government liaisons for promoting his interests. Economic potential of this project looks most promising because of the geographical advantages of the future zone and high investment attractiveness of the resort region. On the opposite, *organization of gaming business in Kaliningradskaya Oblast* may become unprofitable because for the Russian tourists the exclave is hard to access, while the neighboring Poland and Germany are not sufficiently interested in visiting the new entertainment territory. Furthermore, *the geographic factor hardly will promote development of gambling in Primorskiy Kray*. Proximity to the Asian-Pacific region can hardly compensate for the problems related to insufficiently developed infrastructure.

Considering the substantial budget deficit of the Kray, establishing of the necessary infrastructure will take a long time. Furthermore, according to the official statistics of the presidential embassy at the Far East Federal Okrug, Primorye stands out from all other subjects of the Okrug with the highest crime rate and extreme non-transparency of the local economics. Finally, *the Altaiskiy Kray territory looks much more promising for setting up a tourism and recreation SEZ in the region* (a relevant decision has already been made pursuant to the tender of respective regional applications): the attractiveness of this area for foreign gamblers is reduced by the territorial remoteness, while the Russians traditionally view Altai as the environmental tourism zone.

In general concentration of gambling business in special zones by 2009 looks hardly plausible, first of all due to practical difficulties involved in implementation of this idea. The time for obtaining a new license, project development, obtaining the necessary permits and construction approvals, the construction itself and setting up the infrastructure may take from 5 to 10 years, according to the experts. Furthermore, this project requires substantial investments, however, the law does not stipulate the technical or financial aspects of the zoning process. Therefore there will be a “transition period” for finalizing the legislative bill on the state government level, and the terms of the project are likely to be extended. It is also possible that in the future the legislative bill will be sent in for review, which would actually imply sustaining of the existing ‘rules of the game’. In the event if the scheduled changes are still initiated, we can expect that a number of the gambling market participants will slide to the area of shadow economy, while the industry leaders will prefer a strategy of risk diversification, investing a substantial part of their assets in development of other vectors of their business. Thus, Oleg Boyko, a co-owner of Ritzio Entertainment Group, has already announced that he is planning to withdraw about 2 billion Dollars out of his gambling business and invest them in a chain of food stores in 2007.

### **9.1.3. Economic Development Program for the North Caucasus Regions**

The official completion of counter-terrorism operations in the territory of Chechen Republic gave start to a new, economic vector of federal politics in the North Caucasus regions. On September 28 in Sochi Vladimir Putin chaired a round table on the issues of economic development of the Russian South, organized by the presidential embassy in the Southern Federal District. In the course of discussion *the most influential representatives of the Russian business elite were*



***faced with the task to ensure facilitation of industrial growth in the SFD regions, and particularly of the Republics with the lowest level of social and economic development.*** The RF President suggested that such major businessmen, as Vagit Alekperov (LUKoil), Vladimir Bogdanov (Surgutneftgaz), Sergey Bogdanchikov (Rosneft), Viktor Vekselberg (Sual-Holding), Oleg Deripaska (Rusal), Vladimir Dmitriyev (Vneshekonombank), Vladimir Yevtushenkov (AFK System), Andrey Kostin (Vneshtorgbank), Vladimir Lisin (Novolipetsk Metallurgical Plant), Dmintri Pumpyanskiy (Piping Metallurgical Company), select investment projects out of the list generated according to suggestions of regional administrations.

***The Round Table in Sochi became the federal answer to the investment proposals of the business community, submitted by the Russian Union of Industrialists and Entrepreneurs*** back in the Fall of 2004, at the time when demonstration of social responsibility of the major companies was not only a necessary component of positive image of its owners in the public space, but also a guarantee of maintaining the status positions by the company. At that time it was decided that in order to reduce the level of unemployment in certain regions reaching 60-70% even according to official data and eliminating the existing social base for development of religious extremism, it is necessary to ensure annual growth of regional economics by 6-7% during the next 15 years. Among the most promising projects, representatives of the RUIE named completion of Zaramagskaya hydro-electric power station in Northern Osetia-Alanya and Irganayskaya hydro-electric power station in Dagestan, the program of tourism industry development in Adygeya, Kabardino-Balkarya and Karachaevo-Cherkesia, as well as a network of marine and river trade docks. The business community suggested implementing a state-private partnership mechanism based on the principle of the state assuring safety and infrastructure for investments, while the business component is attracting funds and manages the projects, as the main mechanism for implementing these projects. Now the largest corporations have to start with massive investments. According to the calculations made by the Presidential Embassy, the total amount of investments must be approximately 14 billion RUR (524 million USD).



**PROGRAM FOR FACILITATING INDUSTRIAL DEVELOPMENT  
IN THE NORTH CAUCUSIS REPUBLICS**

Region	Largest Project	Cost of Implementation (mln RUR)	Total Number of Projects	Total Cost (mln RUR)
Adygeya	Glass Factory Construction	914	4	1,881
Dagestan	Meat Processing Plant Construction	950	3	2,482
Ingushetia	Oil Refinery Construction	1, 134	3	1,364
Kabardino-Balkaria	Recovering production capacity at Tyrnyauzskiy Ore-Dressing Plant	1,850	7	5,015
Karachaevo-Cherkesia	Maara Tourism and Recreation Facility Construction	388	2	526
North Osetia	Glass Factory Construction	845	6	2,350
Chechen Republic	Building WiMAX wide-band wireless networks	380	1	380

Source: "Vedomosti"

In addition to the high corruption potential of the government agencies organized according to the clan principles, *lack of necessary infrastructure is one of the most obvious obstacles for development of large-scale investment projects in the North Caucasus Republics*. At this time the mechanism for overcoming this problem is known neither to the potential investors nor to regional administrations, as well to the representatives of the Center in the name of the presidential embassy. The federal government thinks that effects of other negative factors are overestimated. During his meeting with the businessmen Vladimir Putin stated that in the North Caucasus regions "the social and political situation is improving", and the local authorities are represented by "more and more modern thinking people". Furthermore, Dmitry Kozak stressed the fact that the crime rate in SFO subjects is by 40.8% lower than the average figure across Russia. This statistics is not always confirmed in reality, however, the established format of relationships between business and power in this case demonstrates an example of operations of the administrative vertical similar to the federation subjects, therefore there is actually no need for additional arguments in favor of attracting investments. "Everyone knows that investments in North Caucasus are not good business, most of the

projects either have a too long period of return, or are unprofitable”, - said to the media one of the meeting participants, who does not want to disclose his name. “However, if the president said that we must invest, we will have to do it”.

***For the federal Center the program of stimulating economic development of the North Caucasus Republics initiated by the President has a key meaning.*** In the conditions when the counter-terrorism operation has been completed, it would be a very ineffective strategy to rely on power methods for maintaining stability in the region. Growing activity of extremist groups in certain areas such as Ingushetia and Dagestan demonstrates presence of a social base for spreading of radical ideas of Islamist nature. In its turn this explains the instability of the balance of powers established in the North Caucasus, which creates an additional threat of destabilizing the political system in the wake of the parliamentary and presidential elections in 2007-2008. Implementation of economic measures that will be positively accepted by the electorate is aimed at minimizing the possibility of implementation of this scenario, as well as sustaining a favorable image of the federal administration in the eyes of the local public opinion.

Furthermore, the state has planned for a symbolic compensation for the players that have persuasively demonstrated their social responsibility. ***In exchange for participation in the process of facilitating development of the North Caucasus subjects, the Federal Center will grant the businessmen preferential treatment in the relevant regions*** - controlling blocks of shares in companies or tax benefits, as well as “guarantees that the investors will not be subjected to additional “duties” in the area”, according to a source in the Presidential Embassy. However, in certain areas there are present obvious obstacles for implementing this cooperation mechanism, for example, the Chechen Republic still lacks a mechanism regulating privatization, therefore the local authorities can offer the investors assistance only on the zero cycle stage and regional tax benefits. Under these conditions ***federal business groups would probably prefer to concentrate on establishing production capacities while trying to limit the volume of financial flows routed to the region***, and it hardly would be possible too control these financial flows. On the other hand, the regional administrations are counting both on the investments and on the inflow of highly qualified managers, because the problem of staff shortage in the region is just as salient as the lack of financial resources for industrial development.

Implementation of the federal program of both voluntary and forced attraction of investments in the North Caucasus republics probably will start in the nearest future. The government can hardly expect any organized resistance from

representatives of the business community obligated to demonstrate their social responsibility first of all for self-protection purposes. However, *it is still too early to talk about a “breakthrough” in development of “depressed” regions*. We must remember that the chronic budget deficit in North Caucasus republics to a great extent is attributed to non-target expenditures and actual lack of effective mechanisms for federal control over regional economic processes. Operations of the local business structures often affiliated with administrations are almost completely closed for the federal supervisory authorities, and there are serious doubts about the possibility of changing this situation with the assistance of the recently set up Kozak Committee. Therefore in a short-term perspective a massive investment program may bring mostly political dividends, first of all to Vladimir Putin. One of his main achievements in the presidential office is considered to be the pacification of Chechnya and general stabilization of the situation in the North Caucasus.

#### 9.1.4. Local Self-rule Reform

According to the Ministry of Regional Development, *since the beginning of 2006 the law on local self-rule has been enforced in 46 federation subjects (out of 88)*. By that time heads of most of the regions have announced their readiness for large-scale municipal changes, however, it was explained more likely by the motives of the current political situation, the governors were in a hurry to demonstrate their loyalty to the Center one more time, making reports on promoting federal initiatives. The only visible achievement of the regional powers became the administrative demarcation of territories and municipal elections resulting in establishment of almost 25.5 municipal units, rural and urban communities, municipal okrugs and rural districts (except for the territories of Ingushetia and Chechnya that have no borders between them). We have to mention that a typical feature of this process became *the emergence of territorial arguments about the new borders of the municipal okrugs*. According to data obtained from the Moscow Center for Legal Support of Local Self Rule, to the Supreme Court of the Russian Federation have been submitted about 300 such claims from representatives of Tulsкая, Voronezhskaya, Lipetskaya, Bryanskaya, Irkutskaya Oblast, Stavropolskiy Kray, Kabardino-Balkaria and Tatarstan. In most of the cases the problem was with the territories with production, tourism and other income-generating objects. Pursuant to the new municipal demarcation, undertaken in accordance with the legislation of the RF subject, they will either be

delegated to the region, or become a part of other municipal territories less fortunate from the financial point of view, and where the administration is usually more dependent on the regional powers than heads of rather rich cities and towns.

At the same time, ***actual implementation of the reform implies performance of all responsibilities legislatively delegated to the municipal units, and this task looks practically impossible under the current conditions.***

We have to remind you that pursuant to the amendments made in the fall of 2005, enactment of the Federal Law No. 131 On General Principles of Organizing Local Self-Rule in the RF was postponed from January 1, 2006 to January 1, 2009. The state also decided to postpone enforcement of the inter-budget articles of the Budget and Tax Codes. Furthermore, division of property between different authorities was extended until 2008, and during the transition period the federal, regional and municipal agencies are allowed using this property free of charge. .

Analysis of the contents of the legislatively stipulated changes demonstrates that ***the concept of the local self-rule reforms requires additional review, and its implementation in the regions leads to a whole number of serious problems.*** First of all we mean that the regions are lacking the necessary normative base in the form of bylaws establishing the criteria for division of responsibilities and property to be delegated to authorities on different levels. Consequently the majority of the regions that decided to go through with the reform (42 out of 46) introduced limitations on the local self-rule bodies during the transition period (from one to three years), and in Yaroslavskaia Oblast the new municipal bodies did not get any responsibilities or their own budgets, they still fully depend on the Oblast authorities.

However, this situation remains to be typical: ***formally from the beginning of the reform the local self-rule was granted substantial powers, however, the taxable base for their realization is obviously insufficient.*** For example, the local self-rule administrations will supervise operations of communal services, transportation and communications, as well as a number of health protection facilities, preschool and high school education etc. The municipal formations are supposed to allocate funds for these functions out of their own budgets, using the tax income that must be tied to the local self-rule authorities. At this time they include personal income tax, land and agricultural tax, funds from rental of municipal property and creating unitary companies for commercial operations. Considering that the cadastre land evaluation has not been completed and there is no stable practice of charging the land tax, it is understandable that the collection levels last year were much lower than the scheduled figures. The budgeting norm

introduced by an amendment to the law on organizing local self-rule bodies stipulating budgeting on the basis of actual income and expenses rather than the local taxes also does not solve this problem. If we look at the list of expenditure rights of the local self-rule bodies, it becomes obvious that most of the municipalities will not be able to handle them without financial support of the federation subjects.

Summarizing the results of meetings of the coordinating council of the Union of representative local self-rule bodies, we can say that ***the start of the local self-rule reform in the regions fulfilled all of the most dissatisfying forecasts.*** In most cases municipal income along with subsidies from the federation subject budgets do not cover even the minimum necessary expenses. Representatives of the municipalities regularly submit requests to review the regional laws on inter-budget relationships, specifying the deadlines for depositing subsidies, as well as for transferring property and financial resources to the municipal level and change the taxation system. Specifically, Vladimir Mokriy, head of the State Duma Committee on local self-rule bodies, has confirmed on numerous occasions that all issues on increasing the municipal share of income tax to 40%, as well as the amendment on transferring of the transportation tax to the local budgets, have been posed to the RF Government. The Union of Representative local self-rule bodies initiated an address to the federal powers with an offer to increase the tax base of the local self-rule and allocate for its needs a part of the Stabilization Fund. However, these efforts failed, the main argument of Alexey Koudrin, the Minister of Finance, opposing allocation of the Stabilization fund, is that we still need to control inflation and the fact that this topic is still salient on the federal level prevents us from even looking into a potential possibility of using this source of financing for municipal needs.

***Considering the difficulties involved in changing the local self-rule system, prior to the beginning of the reform management of Yedinaya Rossia announced its intention to take under party control implementation of the reform.*** For this purpose members of the YR announced their initiative to create their own social organization that would represent the local self-rule organs on the federal level instead of the independent Congress of Municipal Units. (CMU). We have to remind you that pursuant to the Law on General Principles of Organization of Local Self-Rule in the RF, all local authorities on the federal level must be represented by a single national organization. Until the middle of 2006 this function had been performed by the CMU uniting more than a thousand of municipal associations. On May 31 in Moscow about a thousand delegates from

80 regions and more than 300 guests attended the congress of Yedinaya Rossia Party and established an All-Russian Council of Local Self-Rule (ACLS). Its founders headed by Valeri Galchenko, a member of the Duma YR fraction, expressed their hope that the Council will be able to protect the interests of the municipal units and “build them into the process of important government decision-making processes”. Extension of the federal vertical of power down to the level of the local self-rule bodies by setting up an ACLS resulted from an evolution of the idea to set up a Yedinaya Rossia system of local self-rule bodies, which ***the largest political party in the country is striving to gain additional political capital at the federal elections of the third electoral cycle.***

The interest of Yedinaya Rossia in setting up its own municipal union is quite understandable. Considering the strategic tasks faced by the party (a 45-50% result in the regional elections and majority in the State Duma in the next assembly) there is no doubt that the party needs to fortify its positions in the regions. With the assistance of the association, which was supposed to include members of the local YR branches), the Yedinaya Rossia was planning to expand the influence of YR on the level of local authorities and establish a channel of promoting new national leaders. However, the process of vacating the independent municipal unions was delayed and consequently the concept changed, the YR General Council Presidium decided that the along with the deputies the Council will include representatives of executive powers and ordinary citizens that are willing to join an organization set up according to a strict party principle. This idea gained support at the Presidential Administration as well, and according to the mass media the federal administration of Yedinaya Rossia has already delivered to the regions instructions obligating the municipal representatives that are members of the YR Party to join the ACLS. The Yedinaya Rossia leaders are hoping to unite the municipal officials around such strategic issues as settling of inter-budget relationships, expansion of the income base of municipalities and state support to the housing and community complex.

Therefore, YR managed to take the initiative away from the CMU, as the newly formed council will actually perform the functions of the All-Russian Association of Municipal Unions, which is supposed to be set up under the new Law on General Principles of Organizing the Local Self-rule. However, enforcement of this law has been delayed until January 2009, and establishment of the association has also been postponed until 2009. Until that time ACLS will be the only authority representing the interests of all municipalities on the federal level, which means that Yedinaya Rossia will have an opportunity to substantially expand the space for party affairs.



*Such a strategy (in the event if it is successfully implemented) can turn out to be quite effective as applied to solution of the main task – improving the electoral popularity of YR.* Agencies of the municipal level of power in most of the federation subjects are strongly dependent on regional administrations in terms of financing, therefore with serious support of the federal administrative support this initiative may facilitate strengthening YR's positions in their struggle with the opposition on the local level. This is especially salient in big cities where Yedinaya Rossia traditionally has been experiencing difficulties in the course of election campaigns on different levels. An additional argument in favor of implementing the ruling party's projects in the field of local self-rule is that the reforms implemented in the federation subjects in the framework of the municipal reform the number of officers employed at the local self-rule agencies has substantially increased and will continue to grow, which inevitably reduces the degree of predictability of the regional political processes.

*At the same time with development of the party direction in implementation of the municipal reforms, last year was the YR representatives initiated resumption of the discussion on the prospects for changing the status of municipalities and elimination of mayor elections.* The start was given on March 31, when the State Duma received *a legislative bill stipulating delegation of a substantial share of mayoral authority to the heads of regional executive authorities.*

According to a suggestion made by members of Yedinaya Rossia fraction at the State Duma Vladimir Mokry, Chairman of the State Duma Local Self-Rule Committee, Vladimir Zhidkikh and Alexei Ogonkov, the heads of local administrations may be stripped of such important responsibilities delegated to them during the local self-rule reform as organization of heat, gas, electricity and water supply, removal and disposal of household waste, construction and maintenance of bridges and highways, transportation services, establishing the land use and development rules and control over the use of land. Officially this initiative was based on the need to get the regional state authorities involved in "solution of the most salient problems that we face in big cities", in order to make sure that if the quality of services provided to the population deteriorates the regional administrations carry the same responsibility as the local self-rule. Representatives of the Governor Core were for the most part supportive about the reforms: *for the heads of regional authorities expansion of responsibilities on account of the local self-rule authorities would have been somewhat of a compensation for a substantial deterioration in status and the degree of political*



***autonomy after establishment of the system of granting authority.*** As to the idea of canceling the institute of mayoral elections, governors of Sverdlovskaya, Chelyabinskaya, Pskovskaya and Volgogradskaya Oblast Governors, as well as the governors of Republic of Karelia (Edward Rossel, Peter Sumin, Michael Kuznetsov, Nikolay Maksyuta and Sergey Katanandov) have stated their support of this idea on numerous occasions. This phenomenon can be easily explained by the historical tension between the named governors and the heads of regional capitals.

At the same time from the normative point of view it is quite possible to redistribute the responsibilities in favor of heads of the federation subject administrations. Currently Article 75 of the Federal Law On Local Self-Rule stipulates the following reasons that may lead to establishment of temporary state rule at a municipality, such as a natural disaster, a delinquent debt exceeding 30% of the municipal income, and non-target spending of the state subventions. We also must remember that in 1998 Russia signed the European Charter on Local Self-Rule, according to which integrating the local self-rule authorities in the general vertical of power is considered unreasonable. However, the first expression of their political will by the YR members because the language of the Charter lacks a clear description of responsibility distribution between the different layers of power.

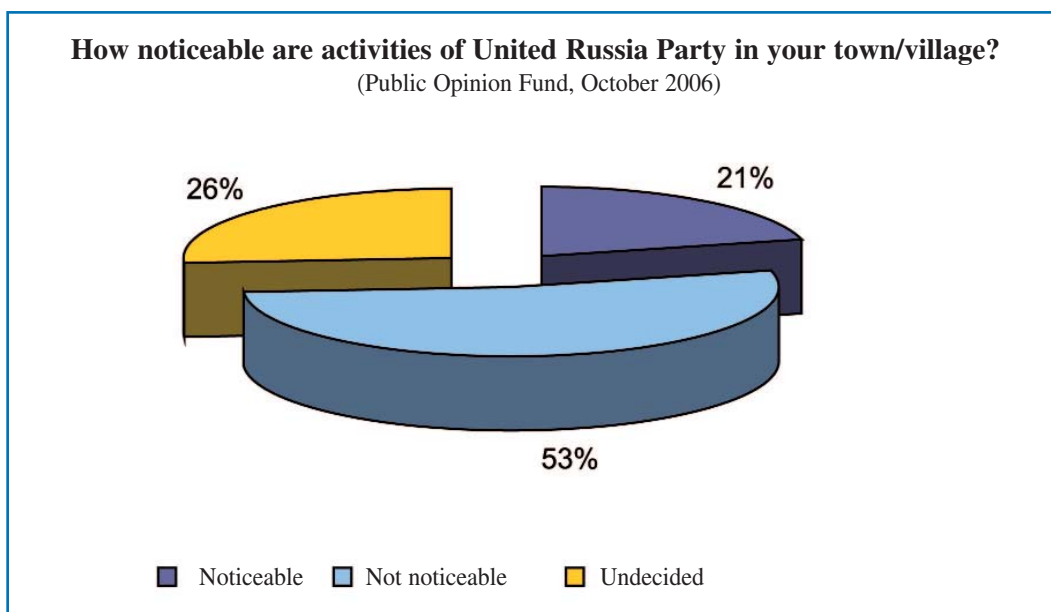
This initiative in the area of redistribution of authorities between the municipal and regional executive authorities was continued in the form of ***new amendments to the Law on General Principles of Organizing the Local Self-rule in the RF, stipulating a possibility of actual liquidation of the self-rule agencies on the level of federation subject capitals pursuant to an appropriate decision of their administrations,*** submitted by the aforementioned YR deputies to the State Duma on October 20. This time the Mokry-Zhidkikh-Ogonkov project was centered on the idea that starting from 2007 the municipal management responsibilities may be delegated from the mayor's office to the in-city territories, into which would be divided each similar municipal union, and the issue of responsibility distribution will be in the competency of the regional executive power. In the event if this amendment is approved, the head of each district still will remain an elected office, however, mayors will be appointed by the governors. Therefore, according to the authors of the legislative bill, the right to elected local self-rule will not be violated, but "it will be exercised on a different level". This procedure is already in place in the cities of federal importance. In Moscow and Saint-Petersburg the mayors are appointed at the recommendation of the President, just as other governors, and the city residents may only elect administrations to the

district boards. Therefore in Moscow the municipal power hardly has any serious responsibilities, while in Saint-Petersburg it is almost inactive whatsoever.

However, according to the text of a resolution adopted at the end of the Congress of Local and Regional Authorities at the European Council that was held in Moscow on November 13-15, the position of the ruling party regarding the possible cancellation of electivity of mayors went through predictable changes. For example, *the State Duma YR fraction does not support the amendments stipulating the possibility of actual elimination of local self-rule on the level of regional capitals* at the decision of the federation subject administration. This is not surprising if we consider that for the Federal Center the issue of political loyalty of the mayors gains importance only during election campaigns. Furthermore, the procedure of canceling electivity of the heads of city administrations does not comply with the active legislation and with the European Charter pronouncing electivity to be one of the main principles of municipal operations. Finally, a certain role was played by the wide public reaction caused by discussing the amendments. Heads of 50 Siberian and Far Eastern cities seriously criticized the idea of canceling the mayoral elections in regional capitals, and the respective address to the State Duma Deputies and members of the Federation Council approved at the All-Russia inter-municipal Forum in Novosibirsk, became the first collective action of the municipal authorities representatives.

In his opening speech during a meeting of Yedinaya Rossia leadership and federal authorities with mayors of regional capitals, Boris Gryzlov, Speaker of the State Duma and leader of the party, stated that “the process of mayoral elections must remain in place” and criticized the idea of dividing the structure of oblast center management into in-city territories. Moreover, *by the end of the previous year the subject of protecting the interests of the local self-rule agencies became an important component of Yedinaya Rossia’s election campaign*. Considering the experience of the latest elections demonstrating that administrative and ideological resources are not sufficient, YR management is planning to use financial stimuli more actively in order to attract important allies. We are talking about actually buying loyalty of mayors in regional capitals by allocating additional federal subsidies. In the framework of the third reading of the 2007 budget to be held on November 10, will be included target financing for development of transport infrastructure of the 13 cities-millionaires (administration of each of them is supposed to receive one billion RUR), and other cities will receive support in 2008. Furthermore, the nearest plans include

calculation of municipal expenses, introducing a minimal social standard, expanding the tax base in order to make sure that the “municipal unions become self-sufficient”. In particular, for this purpose the state is planning to channel to the municipalities the tax income from small and medium businesses and transportation taxes, as well as raise the private income tax rate share to be allocated to the municipal unions (right now the municipalities receive only the land tax and about 30% of income tax). Finally, the YR leaders announced their intention to establish a regular dialogue between the municipalities, regions, and the federal center. They are planning to set up a section of heads of municipal units in the framework of the All-Russian Council of Local Self-rule (ACLS) and a commission for cooperation with the municipal community. This way the *ruling power may provide the municipalities with a foundation to lobby its interests and at the same time include the local self-rule agencies in the party vertical, in the future expanding its own regional positions.*



In conclusion we have to mention that *maintaining of legislative norms confirming the principle of mayor elections does not contradict with the tendency to reduce significant powers of the local self-management authorities in the framework of the process of subordinating the municipal administrations*

*to the regional agencies of executive branch.* Therefore it is still possible that the second part of the Yedinaya Rossia's legislative bill submitted in October and delegating to the regional administrations the right to determine the limits of power and financing for the municipal authorities, may be approved by the Lower House after review. We can also forecast that the ruling party will continue its course on developing the system of "municipal labor unions" in the framework of All-Russian Council of Local Self-Rule, which suggest complete integration of the local self-rule agencies in the format of "power vertical" using the means that comply with the formal democratic standards. This would facilitate increased political dependence on the local self-rule bodies from the local branches of Yedinaya Russia. Prospects of changes in their economic status are rather pessimistic, last year there have not been reached any substantial successes in the area of improving the level of budget support for municipal powers. Therefore, *it is too early to speak about true reforms in the area of local self-rule.* Moreover, implementation of reforms in the way stipulated in the current legislation is not possible without changing the existing system of inter-budget relationships, therefore it is quite possible that in the future the concept of local self-rule reform will be reviewed and its deadlines substantially extended.

## 9.2. Electoral Processes in the Regions

*From the point of view of federal elite groups concentrated on problems of satisfying their interests in the process of implementing the Successor project, the electoral processes act as some of the most significant aspects of regional policy.* In this area last year Yedinaya Rossia fraction initiated a legislative innovation that established two single voting days for electing deputies to the legislative assemblies in the federation subjects. The first one happened on March 12, and the second one – October 8. Furthermore, on December 3 were conducted elections to the parliament of the new consolidated Federation Subject – Permskiy Kray.

The key tendency became *domination of Yedinaya Rossia, the ruling party, in all regional legislative assemblies elected in 2006.* At the same time according to the results of the spring campaign, the potential of traditional for Yedinaya Rossia strategy of recruiting locomotives is far from being exhausted. At the same time, neither the expectations of the federal government (Yedinaya Rossia's informal task was to get no less than 50% of votes in every region), nor the

substantial funds invested in the election campaign brought around the expected return. The only exception, the voting results in Khanti-Mansiyskiy Autonomous District, only proves the rule, because in this case the high results achieved by the ruling party came about due to the strategy of elites in the resource consuming region aimed at confirming their loyalty to the federal center than due to effectiveness of election campaigns of the ruling party.

### SPRING PARLIAMENTARY CAMPAIGN RESULTS

(ACCORDING TO CENTRAL ELECTION COMMITTEE DATA AS OF MARCH 14, 2006)

Region	Barrage	Parties elected to the Legislative Assembly	Against all	Turnout
Adygeya Republic	7%	Yedinaya Rossia (33.7%), CPRF (15%), ROPP (13%), APR (11%)	6.55%	45%
Altai Republic	5%	YR (27.2%), Rodina (10.52%), APR (10.41%), CPRF (8.96%), RPL (8.83%), LDPR (8.26%)	6.13%	50%
Kaliningradskaya Oblast	7%	YR (34.5%), CPRF (14.99%), RPP (8.98%), LDPR (7.49%), PR (7.12%)	16.78%	36.8%
Kirovskaya Oblast	6%	YR (28.54%), CPRF (15.11%), LDPR (14.58%), RPP (12.44%), APR (7.75%)	8.02%	43.9%
Kurskaya Oblast	7%	YR (37.36%), CPRF (11.28%), RPL (7.26%)	9.98%	43.3%
Nizhegorodskaya Oblast	5%	YR (43.91%), CPRF (17.81%), RPP (17.19%), LDPR (5.83%)	7.34%	32.7%
Orenburgskaya Oblast	5%	YR (40.35%), CPRF (16.74%), LDPR (8.27%), APR (6.41%), PR (5.65%)	8.65%	38.5%
Khanty-Mansiyskiy Autonomous District	5%	YR (54.83%), LDPR (10.53%), CPRF (9.24%), RPP (9.07%)	11.78%	43%

Note: RUIP – Russian united industrial party, RPR – Russian Party of Retirees, Russian Party for Life – RPL, and PR – Russian Patriots.

Therefore, *the results of the March elections demonstrated lack of efficiency of the administrative resource as the main instrument of Yedinaya Rossia for winning the voters' sympathy.* The ruling party managed to substantially improve

its positions with respect to the 2003 federal parliament campaign only in 4 out of 8 subjects – Kurskaya (37.36% against 30.1%), Nizhegorodskaya (43.91% against 32%), Orenburgskaya (40.35% against 27.6%) Oblasts and in Khanti-Mansiyskiy Autonomous District (54.83% against 41,3%). In two other regions (Republic of Altai and Kaliningradskaya Oblast) Yedinaya Rossia in general regained the same percentage of support, while in Adygeya Republic and in Kirovskaya Oblast Yedinaya Rossia's position has substantially deteriorated (33.7% against 51.3% and 28.54% against 32.9% respectively).

**Results of the spring campaign demonstrated by the second echelon parties were rather illustrative.** In the framework of the current disposition of political powers they represent a system opposition. For example, CPRF entered into the parliaments of all of the eight regions, in most cases occupying the second line and thus confirming its relatively high status. The election strategy of the party was determined mostly by their desire to secure a certain segment of electoral space, and was mostly aimed at *maintaining their opposition status rather than on electoral success* (this is a traditional position of the communists which once again became obvious during preparations for the 8 October elections). The same motives predetermined the more modest results demonstrated by the Russian Party of Retirees (RPR), which after management changes corrected its course at the regional elections towards moderate critic of certain federal initiatives. Similar to RPR, Gennady Semigin's Patriots of Russia managed to enter both of the legislative assemblies, due to a substantial financial support of the propaganda campaign. It is quite possible that this lowered the result of LDPR, the traditional satellite of Yedinaya Rossia granting active support to the ruling party initiatives at the regional legislative assemblies.

Rodina headed by Alexander Babakov was in the most difficult situation during the March campaign because they were very actively pushed out from the electoral segment of the left-patriotic opposition by the efforts of the old Moscow part of the Presidential Administration. However, the results demonstrated by the party in the Altai Republic, the only region where it managed to enter the elections, allow us to talk about *political rationale of maintaining a popular party brand while changing unmanageable leadership* (the results reached by Rodina on March 12 in RA has substantially improved since the federal elections in 2003 – 10.5% against 4%). Further on this factor was considered during development of a new left project led by Sergey Mironov, Chairman of the Federation Council.

Therefore it is quite reasonable that *if the main feature of the spring campaign was the court investigation of Rodina, during the fall campaign this*



***trend lost its significance.*** Prior to the elections on October 8 there was not a single refusal in registration of the party lists. The most widely publicized were the conflicts involved in withdrawal of the Russian Party for Life (RPL) in Sverdlovskaya Oblast, Republic of Tyva and JAD, and in all cases RPL headed by Sergey Mironov, the Federation Council Speaker, managed to appeal the decisions of registration cancellation and restore their right to participation in the election process. These events were widely covered in the regional and federal mass media and became very effective PR methods for RPL, which helped the party to boost its recognition rating.

***One of the main features of the fall election campaign became participation of two administrative parties – Yedinaya Rossia, traditionally relying on the resource potential of the regional administrations, and the RPL striving for leadership in the framework of the active left project.*** At the very beginning of the campaign, Sergey Mironov presented a new course for his party, striving to expand the segment of his potential voters out of the number of socially oriented electorate that usually give their votes to the CPRF. In the framework of this political strategy change there appeared an idea to participate in the regional and further on in the federal elections as the second ruling party, which also can be regarded as an innovation compared to preparations for the first single voting day. As Sergey Mironov and leaders of the local RPL branches have stated on numerous occasions, this image of the project was approved by President Putin. At the same time, ***the federal project of active left originally did not foresee any competition between YR and RPL.*** During a meeting between Vladimir Sourkov, Deputy Head of the Presidential Administration, with the leadership of YR, they only discussed the idea that Mironov's party could get support from all voters that would not give support to the government in broad sense of the word (i.e. mostly the pro-communist electorate). In that case RPL would have gained space for political maneuvers without playing in the YR's field.

Another pre-election innovation became ***the attempt to reroute Yedinaya Rossia from using presidential support as the main meaningful component of the election campaign to demonstrating actual achievements*** of the local executive power, whose leaders traditionally head the Yedinaya Rossia lists as the locomotives (with the exception of Jewish Autonomous Oblast). Pursuant to this strategy, leaders of the Yedinaya Rossia were actively exploiting the topic of implementing national projects, for example, in Novgorod success of the local administration that purchased 39 new ambulances in the framework of a national Health project was positioned as a YR achievement. In Karelia the local party



branch developed a republican development plan until 2011, promising to facilitate setting up a market of affordable housing and a “territory of protected motherhood”. However, considering that population of most of the regions has not yet benefited from specific results of implementation of priority projects, and many of them are not sufficiently informed about these federal initiatives, effectiveness of this agitation method is still at an obvious disadvantage compared with the traditional administrative mobilization of electorate. In general ***the wide use of social ideas by almost all political powers*** became another typical characteristic of the autumn campaign. For example, RPR initiated a March Against Poverty in the regions under the slogan “For grandchildren, for children, for ourselves”, while Lipetsk branch of LDPR called for reducing tariffs and canceling debts of rural population.

***As for the results of the 8 October elections, analysis of the party list results allows us to confirm, first of all, success of Yedinaya Rossia:*** their average support vote amounted to 46%, exceeding the same indicator of the spring regional campaign by 9%. Therefore, it is quite possible that if this tendency continues at the same level the party will be able to resolve the strategic task of obtaining constitutional majority at the State Duma, requiring stable results remaining at the level of 45-50%. As to the quantitative rates set by the federal management of YR as benchmarks for specific regional ranches, they also look quite positive. In Chuvashia, Jewish Autonomous Oblast (JAO) and in Primorskiy Kray the ruling party managed to exceed the planned rates, and the campaign results in Astrakhanskaya, Lipetskaya and Novgorodskaya Oblasts also turned out close to the expected rates.

However, against the ***background of general positive picture there are some notable and obvious failures***. First of all this includes Sverdlovskaya Oblast, one of the key regions in terms of political and economic resource consumption. The main factors reducing the YR results in this region became the low voter turnout, active propaganda from the non-system players (a “retirement strike” organized by Anton Bakov, one of the opposition leaders and a State Duma deputy), and insufficient effectiveness of the campaign conducted by the management of the local YR branch headed by Alexey Vorobyev, head of the Oblast government. The low turnout can be attributed to a strategic mistake of the Sverdlov authorities, because they did not find it necessary to stimulate the voters by implementing an active informational campaign expecting that the fewer voters come to the polls, the more votes will receive the ruling party. There is also a possibility that a certain role was played by the formally settled but in fact still salient political disagreements between Governor Edward Rossel and Arkady Chernetskiy, the Mayor of Yekaterinburg.

**Autumn parliamentary campaign results**

(According to the central election committee data as of October 10, 2006)

Region	Parties participating in the elections	Parties in the legislative assembly (barrage 7%)	YR Forecast	Turnout
Karelia Republic	YR, CPRF, LDPR, RPL, RPR, PR, Narodnaya Volya	YR (38.9%), RPL (16.1%), CPRF (12.77%), RPR (12.06%), LDPR (8.8%)	45%	33%
Tyva Republic	R, CPRF, LDPR, RPL, PR, Rodina	YYR (46.3%), RPL (32.5%)	70%	52.7%
Chuvashia Republic	YR, CPRF, LDPR, PR, Rodina	YR (51.4%), CPRF (19.6%), LDPR (9%),	44%	43.7%
Primorskiy Kray	YR, CPRF, LDPR, RPL, RPR, PR, Rodina, Yabloko, Narodnaya Volya, Svoboda i Narodovlastie	YR (48.2%), CPRF (12.16%), RPR (9.14%), «Свобода и народовластие» (8,65%)	37%	39.5%
Astrakhanskaya Oblast	YR, CPRF, RPR, LDPR, PR, Rodina, Narodnaya Volya, People's Party, Republican Party, Democratic Party.	YR (38.6%), «Родина» (16.1%), CPRF (13.6%), RPR (9.4%)	40%	43.7%
Lipetskaya Oblast	YR, CPRF, RPR, RPL, LDPR, PR, Narodnaya Volya, Democratic Party	YR (50.6%), RPL (11.7%), RPR (11.1%), CPRF (10.65%)	50%	45%
Novgorodskaya Oblast	YR, CPRF, RPL, LDPR, PR, Narodnaya Volya, Svobodnaya Rossia	YR (43.7%), CPRF (14.6%), «Свободная Россия» (11%), LDPR (7.03%)	45%	31%
Sverdlovskaya Oblast	YR, CPRF, RPR, RPL, LDPR, PR, Narodnaya Volya, Rodina, Yabloko	YR (40.5%), RPR (18.7%), RPL (11.5%), CPRF (7.2%)	45%	27.9%
Jewish Autonomous Region	YR, CPRF, LDPR, RPL, RPR, Rodina	YR (55.3%), CPRF (18.5%), RPR (9.9%)	50%	43.5%

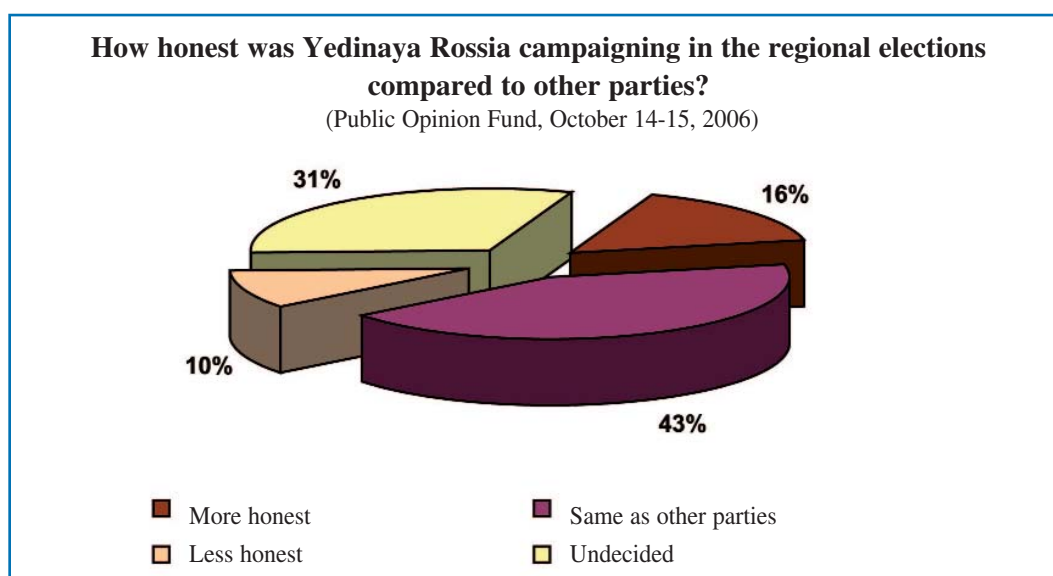
Note: RPR – Russian Party of Retirees, RPL – Russian Party of Life, PR – Patriots of Russia

***Republic of Karelia became another problematic region for Yedinaya Rossia.***

In this case the party results were reduced by the following factors. First of all, the ethnic conflicts in Kondopog that occurred at the end of August – beginning of September. They negatively impacted the political image of the acting administration and improved the opposition's chances for success. Furthermore,

the conflict of interests between Sergey Katanandov, the head of the Republic, and Viktor Maslyakov, the Mayor of Petrozavodsk (he was successfully reelected on October 8). And finally the third factor – the changes in the balance of powers that occurred after the Yabloko party list registration had been cancelled, as Yabloko has a rather strong local organization and a stable electoral base in the region. Having been withdrawn from the election process, Vasiliy Popov, leader of Yabloko, urged his supporters to support the RPL, thus pulling down the Yedinaya Rossia's results.

*The most apparent failure of the federal ruling party were the results of voting in Tyva (46.3% against the expected 70%).* This result can be reasonably attributed to a complicated situation inside the local elite which include three main influence groups gathered around the President Sherig-Ool-Oorjak, Secretary of the Regional Yedinaya Rossia Branch Sholban Kara-Ool and Vasiliy Oyun, speaker of the legislative chamber at the Great Hural. The latter has always been a principal opponent of the head of the region. After he failed to force his resignation by inner-party struggle, he joined the RPL right after the start of the election campaign and headed the party list. This provided the Life Party with an opportunity to use Oyun's substantial influence, as well as to attract an unprecedented amount of resources for financing the campaign. Considering the factor of a serious polarization in the regional elite and the rather high anti-rating of Oorjak heading the YR list, it is quite logical that the ruling party failed to get even close to the scheduled high results in Tyva.



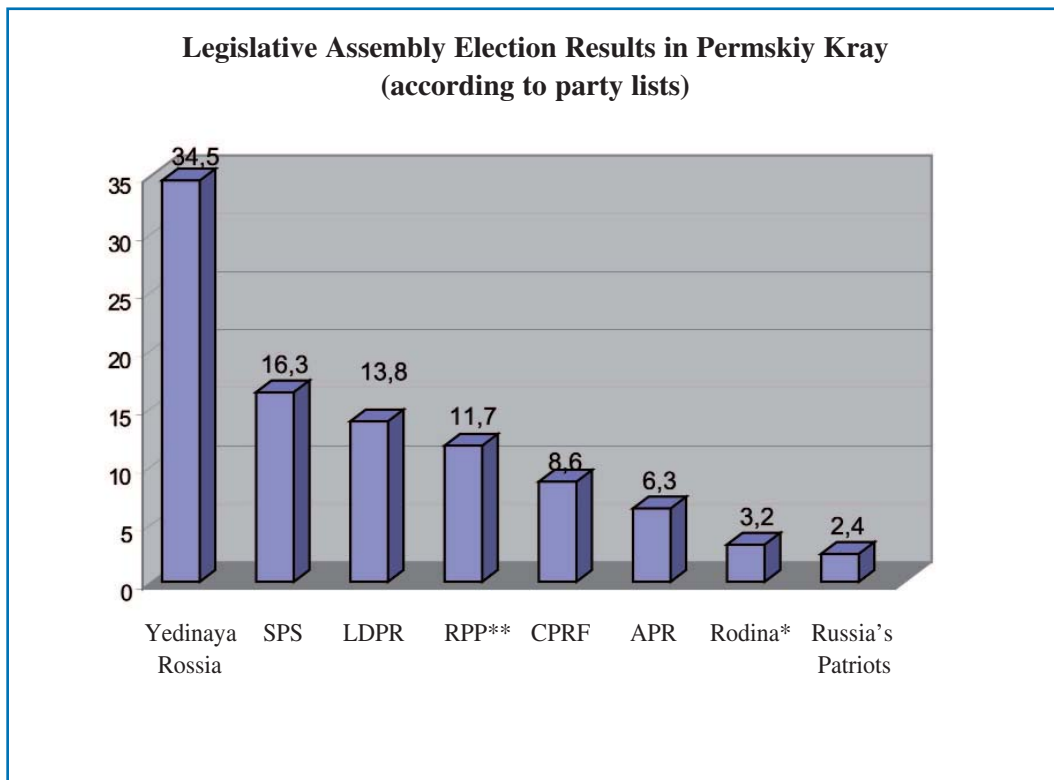
*The general regional results of the RPL campaign look rather successful but do not look adequate compared with the resources invested in the propaganda campaign*, both administrative and financial. The high status of the party leader in the federal government allowed the party to attract such an important intangible capital as open support of the RF President (a special effect had the official permission of the RF President to use his portraits and positive statements about the party in Lipetskaya Oblast, where the RPL list was headed by Sergey Mironov). Popularity rating of the party was raised also by numerous scandals involved in banning the party from the elections with further reinstatement in rights pursuant to the Supreme Court decision. However, if we compare the results of the Russian Party for Life with the Russian Party of Retirees possessing much more modest administrative capabilities, it looks like the electoral potential of the latter is much higher.

In all regions where the RPL participated in the election, the party overcame the 7% barrier, demonstrating an average result of 11.7%. The Lipetskaya Oblast campaign is a very vivid example, where the strong administrative resource of Mironov's party supported by the loyal attitude of the Oblast administration sacrificing its traditional informal support of the communists, still failed to secure a convincing victory for LPL over the potential competitors in the popular left project. Despite all of the aforementioned propaganda advantages, the Party for Life received 11.7% of votes, while the RPR lagged just a little bit behind with 11.1%. *The main factors of RPR success became the voter-demanded and well promoted brand as well as the growing importance of the socially oriented theme* in the light of approaching 2007-2008 elections, as well as the *wide network of regional branches* that demonstrated their ability to work effectively.

Results of the 8 October elections for other political powers can be expressed as follows. First of all, it is important to mention that *CPRF maintained its positions (in general)*, despite the fact that the average result of the party dropped a little bit compared with the spring campaign results (12.6% against 13.5%). The party reached the best results in the regions with traditionally high share of communist electorate, such as Republic of Chuvashia or JAD. At the same time, in Lipetskaya and Astrakhanskaya Oblast CPRF failed its expectations. In the first case the decisive role was played by the administrative support provided by Governor Korolov to the supporters of FC Speaker Mironov, and in the second case the reason was the predictable success of Rodina, the list of which was headed by Oleg Shein, a State Duma senator with a substantial influence rating and well-established contacts at the Oblast administration (we have to note that this is the

only achievement of the party in terms of results of the autumn campaign). Therefore we can talk about a tendency of gradually pushing the communists to the periphery of the left-patriotic political wing by the “new lefts”. Results of the next regional elections in March 2007 will demonstrate how successful they are in this matter. ***In the autumn campaign LDPR demonstrated rather poor results***, mostly because of the party’s failure in Primorskiy Kray, traditionally known for its high share of protest electorate. Nevertheless, it is still too early to make final conclusions about the political prospects of Vladimir Zhirinovskiy’s supporters. ***The failure of right powers represented by Yabloko*** was a rather predictable result of the autumn campaign: the only realistic chance to enter the regional legislative assembly the party had in Republic of Karelia, where it was forced to withdraw from the race by the efforts of Sergey Katanandov’s administration supporting the Yedinaya Rossia Party.

***At the December 3 elections in the consolidated Permskiy Kray the leading positions were once again occupied by Yedinaya Rossia***, even though the result of the federal ruling party (34.5%) turned out to be the lowest compared with the results of the autumn voting.



**Governor Oleg Chirkunov's multi-vector strategy** became an indirect reason of poor results demonstrated by the ruling party in Permskiy Kray. Although the regional leader headed the pre-election list of Yedinaya Rossia, in the course of the pre-election campaign he tried to diversify the political risks providing informal support to the part of the new administrative party of Sergey Mironov represented by RPR. The top three on the RPR list included Ilya Shulkin, vice-mayor of Perm, while his direct supervisor, Mayor Igor Shubin, was in the second position in the list of Yedinaya Rossia. Furthermore, this partial scattering of the administrative resource resulted from a conflict of interest between a part of Perm administration and leadership of the regional YR branch. Nevertheless, **the strategic task of Yedinaya Rossia aimed at occupying the majority of vacancies at the Perm legislative assembly was almost accomplished.** The net result demonstrated by the party was 29 out of 60 mandates, where 12 deputies were elected out of the party list and 17 won in one-mandate districts. Therefore the Yedinaya Rossia party will be able to establish a majority fraction after attracting supporters out of the 12 of the independent candidates that were elected to the Perm Parliament. Experience tells us that this is not a hard task.

**The main sensation of the legislative assembly elections in Permskiy Kray became the suddenly high results demonstrated by the right wing:** Union of Right Forces received 16.3% of votes and gained an opportunity to set up a second largest fraction (6 deputies). A number of experts explained this first of all by the “traditional popularity of liberal ideas” among the local residents, as well as by the resource of Nikita Belov, a popular leader of the rights and former Vice-Governor of Permskaya Oblast. However, **the main reason of URF's success was the resource-consuming promotional campaign that actively exploited the social theme set by RPL, with an extremely populist nature** (a good example was their promise to increase retirement wages by 2.5 times). Also worth mentioning is the wide use of black PR technologies developed by the election headquarters of the Union headed by the scandalously popular State Duma Senator Anton Bakov. It is quite possible that the leadership of the right forces managed to reach informal agreements with the Kray administration and thus managed to avoid losses related to resistance of the administrative resource. It is very interesting that not a single spoiler project participated in the elections with respect to URF. Therefore, **growing support of the right wing during the Perm elections can be attributed to a successful local PR campaign that will not have a substantial impact on URF's prospects for the next year's election campaigns.**

As for other political forces, it is important to mention that CPRF **managed to maintain its positions** once again confirming its status as the system-based



opposition and standing on the nuclear electorate that has been built over the years, as well as the *successful performance demonstrated by LDPR*, logically resulting from the active participation of Vladimir Zhirinovskiy who headed the list. *The RPR results were reduced due to an aggressive campaign by URF*. If not for the unfortunate circumstances, the electoral potential of the Perm RPR allowed them to expect the second place after Yedinaya Rossia, which was confirmed by social survey data. Furthermore, the Perm branch of Rodina also actively campaigned against RPR. Rodina was headed by State Duma Senator Valentina Savostyanova, who announced that the party does not want to join RPL in the framework of the Fair Russia project. The federal administration of the active left attempted to tighten the party discipline and ensure that Savostyanova withdraws Rodina's list from the elections, but failed in these attempts, and the party financing was substantially reduced, which negatively impacted the final results of the party, which failed to get through the 7% barrier.

In the end it is important to mention *the prospects for development of the regional electoral processes*. During this stage the priority task for the main players in the party field is *preparation for the 2007-2008 election campaigns*. The leadership of Yedinaya Rossia officially admitted competitiveness of the new party of the active left (Fair Russia), which brought about *corrections in the election strategy*. Along with traditional technologies of using locomotives the party leadership decided to review their human resources structure. According to Vyacheslav Volodin, Secretary of the Party General Council Presidium, the party is planning to make decisions about its lists on the basis of social survey results after consulting with the local elites.

During the legislative assembly elections that will be held in 14 federation subjects on March 11, 2007 (Saint Petersburg, Vologodskaya, Leningradskaya, Moskovskaya, Pskovskaya, Orlovskaya, Omskaya, Samarskaya, Tomskaya and Tyumenskaya Oblasts, Dagestan and Komi Republics, Stavropolskiy Kray), the lists of Yedinaya Rossia candidates will be once again headed by the local governors. The only exception is Saint Petersburg, where instead of Valentina Matvienko the list will be headed by Vadim Tyulpanov, the Legislative Assembly Chairman, and Pskovskaya Oblast, where Governor Mikhail Kuznetsov is in the second place on the list, and the first place is occupied by Michael Khoronen, Mayor of Pskov. In Tyumenskaya Oblast the acting executive branch will be represented by the entire threesome, Vladimir Yakushev, Governor of the Oblast, Alexander Philippenko, Governor of Khanti-Mansiysk Autonomous District, and Yuri Neelov, head of Yamalo-Nenetskiy Autonomous District. Other impressive



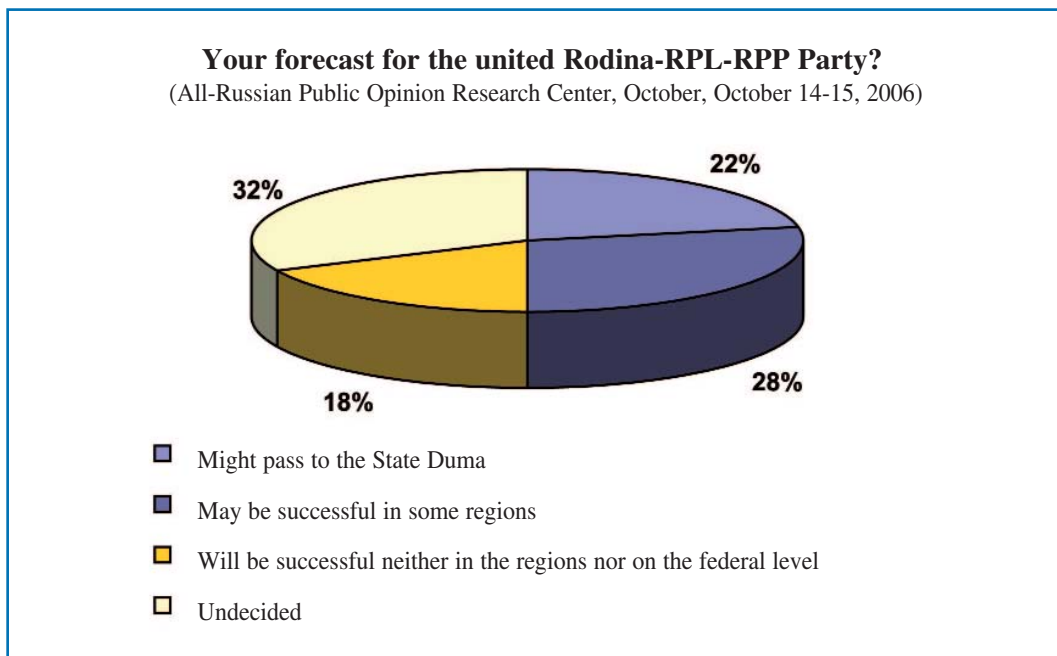
groups widely presented in the YR lists will include famous athletes and municipal leaders, including skiers Raisa Smetanina (Komi) and Larisa Lazutina (Moskovskaya Oblast), skate runner Svetlana Zhurova (Leningradskaya Oblast), figure skater Anton Sikharulidze (St. Petersburg), mayors Mikhail Savchenko (Murmansk), Petr Pimashkov (Krasnoyarsk), Mikhail Khoronen (Pskov), and Lidiya Golubeva (Velikiye Luki).

There is no clear answer as to the prospects for Sergey Mironov's political structure. For him the 11 March elections will become a durability test. The party is in general following the example of Yedinaya Rossia, attracting to their lists municipal leaders (Viktor Tarkhov, Mayor of Samara, Mikhail Kuzmin, Mayor of Stavropol, Alexander Lukichev, Chairman of the Vologda City Duma), famous athletes (figure skaters Yevgeni Plyushenko, Yelena Berezhnaya), business representatives and active senators. The search for allies among representatives of the regional executive power brought the first results. Mikhail Mashkovtsev, the head of Kamchatskaya Oblast, became the first Governor that publicly announced his decision to support Fair Russia at the Kamchatski Kray Legislative Assembly elections in December 2007. It is quite possible that in the future Mashkovtsev's example might be followed by some other regional leaders that failed to establish positive relationships with the local YR branches, for example, Nikolay Maksyuta and Viktor Shershunov, the heads of Volgogradskaya and Kostromskaya Oblasts respectively, which may facilitate local strengthening of the active left wing's positions. However, majority of the governors will remain with the YR. However, this does not guarantee the maximally efficient use of administrative resource.

Furthermore, *the success of Spravedlivaya Rossia (Fair Russia) in attracting dŭw influential supporters may be facilitated* both by the socially oriented rhetoric popular with the voters, and by the fact that this is an emerging new political force that may become quite an adequate alternative for YR for those representatives of the regional business community that do not cooperate with the ruling party due to numerous conflicts of interest. This factor is very substantial, because the influence of economic actors on the regional political processes is often not formally structured, which narrows the possibilities of evaluating this influence, but does not mean that it does not exist. Fair Russia may expect that that the number of its supporters will grow in major cities as well, especially in the regions with keen conflicts between the governors and mayors of regional capitals leading a hidden political struggle. However, *the followers of FR will be able to receive dividends from deepening of the conflicts of interest on the regional level only in case if they are able to handle their own internal problems.* The problem is that in 17

federation subjects (as at the beginning of the year) activists of the local RPR branches refused to join the consolidated party, explaining their position by Mironov supporters' attempts to infringe their interests (this was the case in Tatarstan, Kaliningradskaya, Pskovskaya, Voronezhskaya Oblast etc.). In Saint-Petersburg the majority of the local Rodina branch members refused to join the new party.

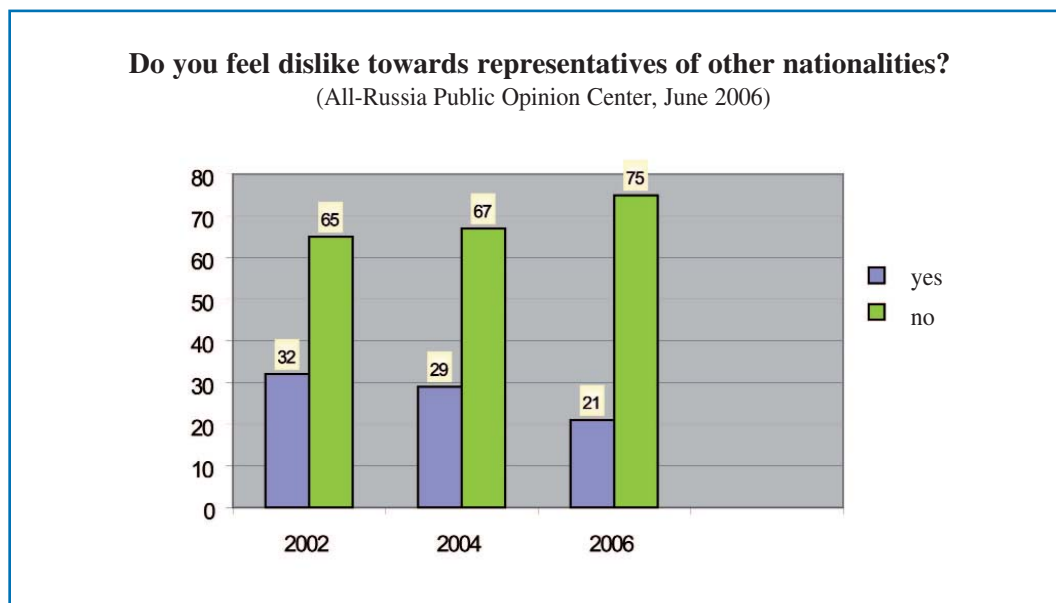
***The level of potential electoral support of the consolidated left powers will be far from comparable with the arithmetic sum of the votes submitted separately for each of the project participants during the autumn 2006 elections.*** To a great extent the numbers will depend on how effective is the cooperation inside the party and on the level of regional elites. At the same time, the numerous scandals related to the non-system behavior of the RPR activists and accompanying establishment of regional branches of Mironov's party, sharply increase the transaction expenses of the new party and substantially damage the image of the left wing, which can hardly facilitate attraction of strategic partners. Moreover, deepening of the existing contradictions may lead to plummeting of electoral results of Fair Russia. A part of players unhappy with the principles of building the new structure might play the role of its spoiler during the spring regional parliamentary campaign.



### 9.3. Relationships between nations in Russia

*Unfolding of the regional political processes in the framework of relationships between ethnic groups in 2006 was shaped by several key events.* First of all, we are talking about the mass riots in the town of Kondopoga (Republic of Karelia) that were widely covered in the media and brought about a general understanding on the federal level of the need to improve the effectiveness of migration policies. Furthermore, liquidation of ‘Terrorist Number One’ Shamil Basayev became a significant achievement in the struggle with extremist organizations in the North Caucasus. This event allowed the Center to announce that the situation in Chechnya has finally stabilized and withdraw the Chechen issue from the agenda.

Riots in Kondopoga started from a fist fight in a local Chaika Café on the night of August 30, resulting from a conflict between the café clients and a barman who summoned for help his townsmen from North Caucasus. During the fight two local residents were killed, and on the next day the town was swiped with spontaneous meetings, massacres in shops owned by North Caucasus nationals and conflicts with the local police. *This conflict grew out of an ordinary quarrel received unprecedented media coverage and signaled for a start of a wide discussion about the tendency of blowing up ethnic conflicts on the scale of the entire country.* However, this explanation is not quite justified, because the conflict in Kondopoga actually was of a local nature. In this contest it is important



to stress that *the threat of destabilization in the regions is posed not so much by the conflicts of interests between the local residents and ethnic minorities, but more by the opportunity to use ethnicity for political purposes.*

*The events in Karelia should be viewed as a multidimensional phenomenon* that became possible due to a combination of a whole number of factors. First of all, we should consider the quite plausible conflict of economic interests between several business players including representatives of the Caucasus community. This reason of the conflict was confirmed on the basis on the comments of regional law enforcement agencies. According to Dmitri Mikhailov, Minister of Internal Affairs of Karelia, “the true reason of the incident is an argument over the municipal property issues”. There is also the political factor to consider: in the wake of the autumn elections to the regional legislative assembly, the public riots could become the reason for the next demonstration of the national card on the part of the political power trying to boost their popularity. The ethnic component of such a conflict of interest in Karelia had appeared before the Kondopoga riots. On April 20 of this year in one of the buildings of the Petrozavodsk central market was observed a major conflict between Caucasian groups and local residents. In this fight a knife stab killed a Karelia native dressed in a T-shirt with the word Skinhead written over it. In this case the reasons for the conflict also were both political and economic. The events occurred at a farmer market but on Adolph Hitler’s birthday (it is well-known that this data is very special for representatives of extremely radical organizations). In this case the principal point is the position of the republican authorities that should comply with the need to resist development of the process of turning ethnic conflicts into politics. The fact that ethnic identity has the utmost importance compared for example to the social identity, appealing to the arguments based on nationalistic characteristics often have more effect than neutral slogans, and, as a consequence, they are often used for political purposes. The situation in Kondopoga is not an exception. According to Peter Klemeshev, Assistant Public Prosecutor, the mass riots in the town were well-organized and their instigators “wanted to work on this scenario for other Regions of Russia”. According to the investigation results, the special technologies applied in Karelia include distribution of information in the Internet (mostly among the young audience), selecting the time and place for spontaneous meetings and direct provocations – calls for violent actions. According to Peter Klemeshev, the meetings in Kondopoga followed by the massacres directly involve the activists from the Movement against Illegal Immigration, which is not officially registered at the Ministry of Justice. However, not a single representative of the

movement was arrested, because the investigative authorities found insufficient the evidence that they are facilitating ethnic conflicts.

Charges for mass riots and arson were brought against eight residents of Kondopoga (Article 212 and Article 167, Part 2 of the RF CC). Furthermore, the prosecutor's office brought charges against the Kondopoga City Department of Internal Affairs officers under Part 3, Article 293 CC RF (negligence) for the fact of failure to take measures on prevention of crimes and violations near Chaika Restaurant. This is quite logical, *ineffective work of the local police played an important role in stimulating the public opinion* resulting in meetings and addresses to the government requesting to kick out the Caucasus nationals. According to numerous witness statements, officers of Karelia law enforcement agencies were in direct proximity from the site of the incident and failed to properly react to the situation and prevent blood shedding.

*Official position of the regional management in general was of a compromising and neutral nature.* In the opinion of Sergey Katanandov, the head of Karelian government, even though the main reason of the riots became the fact that "right in front of us a group of representatives of another people behaved disrespectfully and obnoxiously, ignoring the mentality of our people", still the guilty party should be determined by the law enforcement authorities, and the local population should not fall for provocations of certain activists with nationalistic agenda. We have to note that the social and psychological situation development factor bears a special importance here, if we consider the unfavorable economic status and poor living conditions of the native residents of Kondopoga. In this situation social tension has a great chance of turning into xenophobia towards the representatives of national minorities residing in the region, and any crime is seen not as an action of one or several persons, but as a consequence of typical characteristics attributed to the entire ethnic group. This is the main reason why representatives of the Movement against Illegal Immigration managed to gather in Kondopoga a rather crowded meeting, thus giving its actions partial legitimacy.

In this context *the statement of Ramzan Kadirov, the head of Chechen Republic government (CR), became an example of poor use of a vivid informational cause in order to improve his own political image.* He harshly criticized the regional powers that in his opinion followed the lead of the law-breakers. Kadirov promised that "if the Karelia authorities cannot find forms and methods for settling the situation, we will be able to find methods that would carry the situation to the law enforcement grounds". This statement was positively accepted by representatives of the Chechen community in Karelia and by the

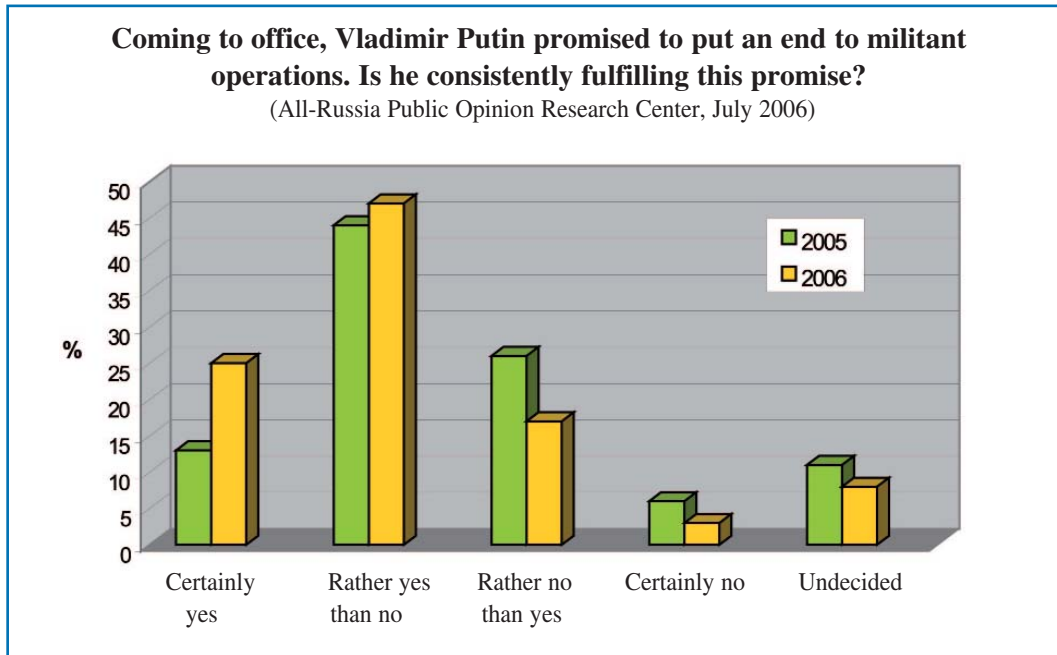
residents of Chechnya, where their prime minister is lately becoming more and more popular. At the same time, these actions do not facilitate establishment of social consensus in Kondopoga, because they suggest an actual intervention of the Chechen management in competency of the executive power of another federation subject, and therefore would bring about new political controversies. In this respect behavior of Alu Alkhanov, President of CR, sets a good example. He sent to Kondopoga a delegation headed by Movsur Ibragimov, Minister for National Policies, Press and Information, Alkhanov left Kadirov's initiative without any comments, however, he noted the correct actions of the Karelian government that "did not allow an ordinary conflict to gain ethnic grounds".

Thus *there are no sufficient grounds to view the mass riots in a Karelian town of Kondopoga as an indicator of a tendency towards escalation of ethnic conflicts across Russia*. In this context the reaction of the federal Center looks rather predictable, tough staff measures did not involve the republican administration, dealing only with the management of the regional power structures. For example, Vladimir Putin ordered resignation of Dmitry Mikhaylov, head of Karelian Ministry of Internal Affairs, and Alexei Dorofeev, head of the republican Federal Security Service Administration, while the Prosecutor General Yuri Chaika fired Vladimir Panasenko, the Prosecutor General of Karelia.

*Actions of the federal forces against operations of extremist units in the North Caucasus* also played a very important role in the area of development of ethnic relationships in 2006. The spring-summer season traditionally brought about a peak of militant activity committing a number of notorious crimes, such as the murders of Jabrail Kostoev, deputy head of Ingushetian Ministry of Internal Affairs and the family of Musa Nalgiev, commander of the republican special forces unit, or the abduction of Magomet Chakhkiyev, deputy of the Popular Assembly and father in law of the Ingushetia President Murat Zyazikov. There is *a clear tendency towards changing the nature of terrorist acts being committed*. Instead of actions against the federal forces in general the militants are using the tactics of no-address terrorism in combination with internally focused actions aimed at the officers of administrative and law enforcement facilities. We have to mention that *the general statistics in the area of maintaining security demonstrates rather unfavorable trends*: according to the data at the Ministry of Internal Affairs, positive dynamics is seen only in Chechnya, in the last two years the number of registered terrorism acts in the region reduced by more than two times. In all other subjects of North Caucasus the situation is often directly the opposite. Ingushetia and Dagestan Republics are a good example, according to



official data during the year 2006 in their borders the number of terrorism-related crimes increased by more than three times.



Against this background, *liquidation of Shamil Basayev, Terrorist Number One, became the most important factor of situation development in the region.* According to official data, this success is a result of a special operation accomplished by the RF FSB on July 10 in Nazranovskiy District of Ingushetia. It is important to consider that elimination of the extremist considered to be the main source of inspiration for the Chechen Wahhabites was positioned in the regional public space as a matter of honor for Ramzan Kadirov, the current head of the CR government. Back in May 2004 Basayev took the responsibility for the murder of his father, the first President of Chechnya, and later this version was confirmed by the Prosecutor General representatives, and the Chechnya President has stated on numerous occasions that Basayev is not only “the enemy of Chechen people”, but also his “personal blood enemy”. Ramzan Kadirov made a very logical comment regarding the special operation undertaken by the federal power structures: the head of the CR government expressed his satisfaction with its results, however, he stated, that he is deeply regretting the fact that he could not directly participate in liquidating the terrorist. In addition to the quite understandable emotional reaction, *the image component of the problem* also plays a very important role. An

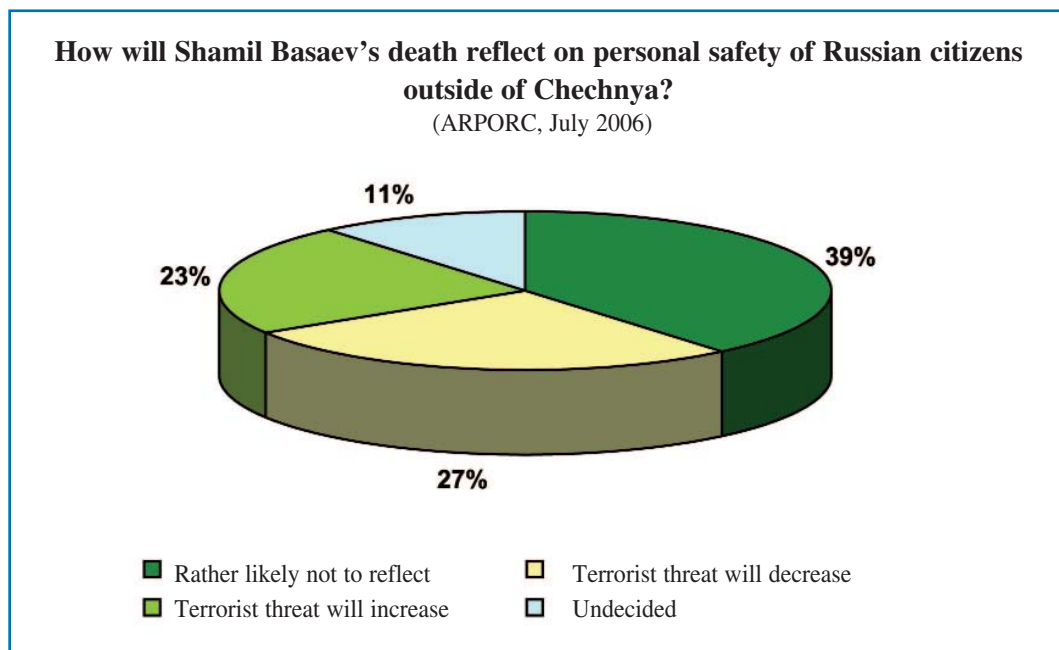


opportunity to write to his assets the liquidation of a widely known extremist leader responsible for a whole number of large-scale terrorist acts would allow Kadirov to once again reinstate himself in the role of the most effective politician in the region and improve his rating on the federal level. In this case his presidential ambitions also could be satisfied.

***Liquidation of Shamil Basayev substantially influenced the balance of powers in the region:*** a successful special operation not only partially restored the image of the Russian Special Forces that suffered after the Beslan events, but also provided the feds with a certain freedom of maneuver in the Chechen territories. However, ***the political effect of liquidating Terrorist Number One on the federal scale*** had even more importance. Despite the comments of the FSB sources explaining that most of the recent operations of the militants on the territory of Chechnya, as well as such actions as the attack on Nalchick were planned by the so-called President of Ichkeria Doku Umarov, the personal role of Basayev was great, considering his authority with the extremists. Moreover, the international fame of the terrorist allowed the groups under his control to attract substantial financial resources from radical Islamist organizations acting in a number of Middle East countries, and upon his death the volume of such investments started to shrink.

***This special operation carried great importance for the political image of Vladimir Putin as well.*** His record-high electoral rating was originally related to the successful resistance of the federal powers to Basayev's unit in Dagestan. Later on, as other well-known terrorists were being liquidated (such as Zelimkhan Yandarbiev or Aslan Maskhadov), the official rhetoric of the heads of state announced completion of the counter-terrorist operation, while supporters of Basayev symbolized "remaining pieces of armed gangs", and their liquidation was presented as a matter of a few days. In this respect Vladimir Putin's reaction to an inconvenient question of Western journalists looks quite typical. During an expanded pres-conference held in December of 2005, Putin was faced with a rhetorical "Why the Russian power agencies have failed to find Basayev so far?", the President replied: "And why ben Ladin has not yet been found?". Therefore in the public space Shamil Basayev was placed in one line with the head of the famous terrorist organization Al-Kaide, ***and the actions of the federal powers aimed at fighting terrorism in the North Caucasus acquired additional international legitimacy, while the fight against the global terrorist threat became one of the themes that bring Russia closer to its key Western partners.*** It is quite explainable that unlike the death of Aslan Maskhadov, who many

politicians and experts in Europe and USA considered as a rather moderate leader, articles in the Western media about Basayev's death were quite positive, which can be viewed as an additional positive factor strengthening the positions of the Russian government just before the G8 Summit. For the Russian internal politics, *revenge for the Beslan children became a marker of the final resolution of the Chechnya problem, accomplished by the efforts of federal special forces, which is an extremely important point, and their successful actions traditionally demonstrate effectiveness of the head of state.*



*Amnesties for the persons that committed crimes during the period of counter-terrorism operations* in the territory of the subjects of South Federal District became an important consequence of Shamil Basayev's liquidation. This initiative was submitted on July 15 by Nikolay Patrushev, the Head of the National Antiterrorism Committee), and *a presidential decree signed on August 9, pursuant to which in 2007-2008 all units of the Ministry of Defense and Ministry of Internal Affairs temporarily deployed in the region must be withdrawn.*

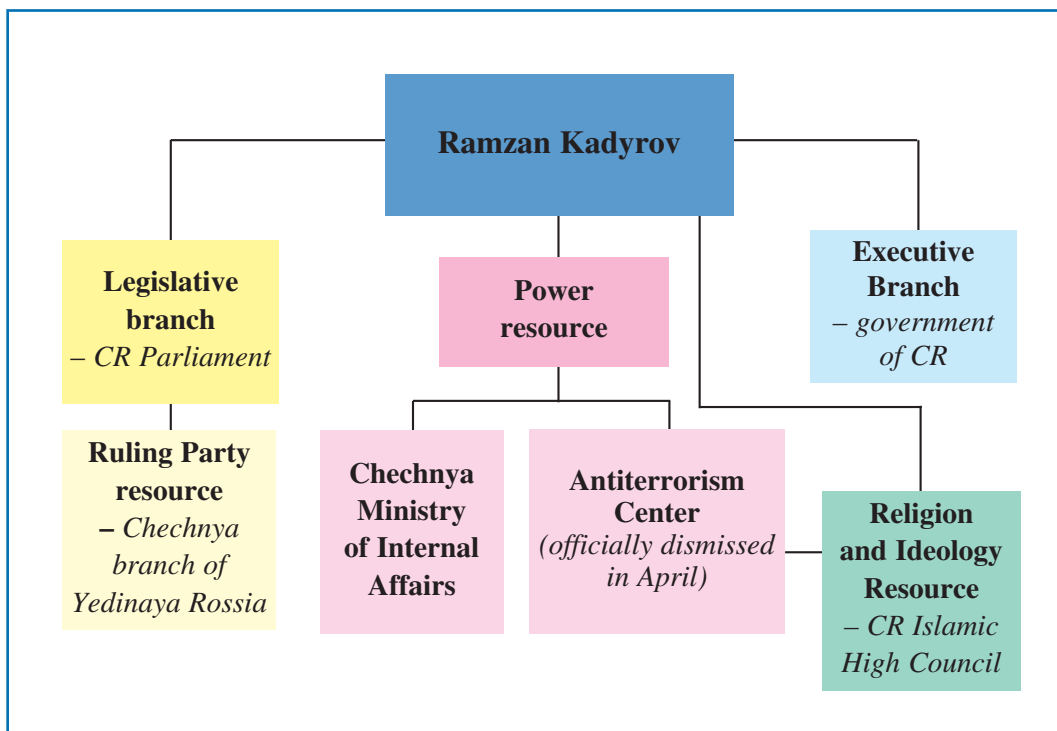
The six-month amnesty (the decree is valid until January 15) covers members of illegal armed troops as well as members of the federal armed forces that

committed various violations during the second Chechnya campaign. However, it did not cover the persons involved in especially grave and heavy offences (terrorism, banditry, mutiny, murders, abductions etc), military staff accused of supplying firearms and ammunition to the militants, as well as foreigners and persons without citizenship. Therefore, preferential treatment in court was granted only to such light CC articles as 208 (participation in illegal armed units) and 222 (illegal firearm trade) – according to a source in Chechen’s prosecutor’s office, in these cases “persons that voluntarily submitted their firearms to the authorities at any time may be exempt from criminal charges”. However, this process has been started long before the authorities called for laying down the arms and will continue after expiration of the State Duma’s decree. *The amnesty former initiated by the President most has a symbolic meaning, this step was supposed to complete the antiterrorist campaign and facilitate further fortification of Vladimir Putin’s political image*, because from the moment when he stepped into the office active struggle against terrorism has been an important component of his image.

The amnesty was accompanied by *tough competition for the right to increase their own political capital by appropriating successes reached in the area of establishing peaceful life*, between the FSB management headed by Nikolay Patrushev and the team of Ramzan Kadyrov, the head of Chechnya Government. For example, on August 31 Sergey Bogomolov, the head of the republican antiterrorist commission in Grozny and acting director of UFSB RF in the Republic accused representatives of the Chechnya law enforcement supervised by Kadirov, in using force for improving the figures on militant surrender statistics, both in the republic and beyond it. Head of UFSB underlined that “it is necessary to put an end to improper actions of officials on different levels of government agencies, management and law enforcement authorities that are trying to use the voluntary surrenders of militants for their own personal gain”. This critical remark was first of all addressed to the head of the Chechen government that traditionally positions his successes in the area of stabilizing the situation in the republic as one of his personal political achievements, which plays an important rule in the relationships between the center and the region. We must note that on the part of Ramzan Kadyrov the amnesty was not only an opportunity to directly stimulate the militants coming from under the ground, but also a way of legalization of the status of the former extremists that have already been cooperating with his supporters on the grounds of retaining the former social networks. In this respect it is notable that *the vast majority of the militants turning in their arms agreed*

*on this step only under the condition of personal guarantees granted by the Chechen Prime-minister.* In its turn this boosted Kadyrov's influence on the activities of the republican power agencies, as well as facilitated further growth of his popularity among the local population. Non-traditional measures of the Federal Special Forces used to draw attention to the initiative suggested by Patrushev (sending SMS messages to the mobile phones of the local residents urging them to turn in their arms, including this request in the mufti's sermon, distributing appropriate propaganda materials among the faithful), did not bring about the effect similar to the method with personal guarantees.

#### Resources of Ramzan Kadyrov's influence in Chechnya



*The general result of amnesty compared to data from similar campaigns in the previous years looks quite modest:* according to the data provided by the Provisionary Commission on Analysis of Situation in the North Caucasus headed by Alexander Torshin, Vice-Speaker of the Federation Council, during the period

from July to January 493 militants have turned themselves in (in 1997 in 6 months 5 thousand persons were amnestied, and in 1999 in the same period this figure amounted to 2.5 thousand persons). Analysis for the prospects for further development of the situation in terms of ensuring security in the region demonstrates that ***the fact that there is no massive surrender in the context of elimination of the most widely known militant leaders can be viewed as confirmation of presence of a rather stable and intricately structured social base of regional extremism.*** In the future its effects will mostly become obvious not in Chechnya but in the neighboring Ingushetia, Dagestan and Kabardino-Balkaria.

***Signing of the Presidential Decree on 2007-2008 withdrawal from Chechnya of the Ministry of Defense and Ministry of Internal Affairs units temporarily deployed in the region*** became an extension of the amnesty also symbolizing the final stabilization in one of the hottest spots in the Caucasus. It is notable that the Decree was published right after completion of Vladimir Putin's meeting with Ramzan Kadyrov, who has previously on several occasions expressed his opinion on the need to reduce the numbers of federal forces in the Republic, because the local police "are capable of securing safety without any assistance". In this context the decision for withdrawal of a part of the armed forces will strengthen Kadyrov's reputation as a strong political leader, which is important first of all for the situation within the region. At the same time this image success has its own political price: it looks like in the short-term perspective presidential ambitions of the Chechen Prime-Minister will not be realized.

From the management stand point ***a full-fledged implementation of the decree means a change in the "balance of powers"***: the power structures remaining in the Republic will be for the most part supervised by the current head of the Chechen government, which in general strengthens his authority. The number of permanently deployed units (the ones that for now are not subject to withdrawal) includes 46<sup>th</sup> Internal Troops Brigade (7 thousand men) and 42<sup>nd</sup> Infantry Division (15 thousand men), as well as the Itum-Kalinskiy Border Guard Detachment with approximately 15 thousand men. Thus by the end of 2008 federal troops stationed in Chechnya are supposed to be reduced from 50 thousand men to almost one half of it. At the same time, the most battle-worthy units of the republican power structures, i.e. the Ministry of Internal Affairs and South and North, the two internal troop battalions staffed with former officers of the CR President's security service, have about 20,000 men. Functions of the units withdrawn from the territory of the Chechen Republic also will be delegated to the Ministry of Internal Affairs, according to a statement made to the media by Vasili

Panchenko, head of press-service at the Internal Troops Command. We have to note that data about the numbers in the federal troops in the region obtained after signing the decree were often quite inconsistent, which probably can be attributed to the limited scope of this particular decree, because the plans of reducing the number of military troops so far involve only Chechnya.

Therefore on the federal scale the official version is the idea that the counterterrorist operation was aborted due to completion of the given tasks. In the meanwhile, *analysis of the regional situation allows us to distinguish several key factors in development of extremism as a systematic phenomenon* that must be taken into consideration, otherwise it would be extremely difficult to ensure long-term political stability.

Thus it is necessary to consider *evolution of the ideological component in terrorist activity in the North Caucasus*. At the beginning of the 1990's the main explanation for actions of extremist organizations was ethnic nationalism suggesting a possibility of territorial identity formation, however, currently Islamist radicals are becoming more and more active. North Caucasus turned out to be a very favorable soil for spreading of the so-called renewing Islam promoted by Wahhabites. Considering the political ethnos of the population this tendency is rather understandable. However, the official Islam institutes represented by the Religious Boards of Muslims turned out to be incapable of resisting the ideologists of returning to the "true Islam" by fighting against the "unfaithful".

*Religious extremists find grounds first all in the most complicated set of social and economic problems present in the region* – very low living standards, "shadow" economics and actual absence of the infrastructure, an unprecedented level of corruption and unemployment. These problems cannot be resolved by power methods (for example by ordering to liquidate all "unofficial" mosques), and it is still too early to evaluate the effectiveness of the economic measures suggested by the federal center (industrial development program for the North Caucasus republics). Creating an image of Wahhabite as the main enemy of regional stability may only worsen the situation, provoking new ethnical conflicts. Here it is important to mention the *need to support the influence of the leaders of Sufi Islam popular in the region* (by limiting their involvement in politics) and improving a number of norms in the regional legislation, which often includes in the abstract term of terrorism activities of any religious organizations that refuse to directly cooperate with the local executive power.

## TABLE OF CONTENTS

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<b>FOREWORD</b> .....	4
Chapter 1.	
<b>“RUSSIA - 2006. REPORT ON TRANSFORMATION” – MAIN THESIS</b> .....	5
Chapter 2.	
<b>POLITICAL SITUATION</b> .....	16
2.1. The Problem of Power Continuity as a Key Issue of Russian Politics .....	17
2.2. Changes in the Structure of Executive Power and Staff .....	40
2.3. Staff Policy in the Russian Regions .....	50
2.3. Political Parties .....	68
2.3. Civil Society Becoming More Active .....	80
Chapter 3.	
<b>MACROECONOMIC SITUATION</b> .....	91
Chapter 4.	
<b>STATE FINANCES</b> .....	97
4.1. Budget .....	98
4.2. Taxes .....	109
Chapter 5	
<b>NATIONAL PROJECTS</b> .....	114
5.1. National Projects as Political Ideology .....	115
5.2. Goals of the National Projects .....	117
5.3. Essence of the National Projects .....	119
5.4. Sources of Financing .....	126
Chapter 6.	
<b>FOREIGN POLICY OF RUSSIA</b> .....	129
6.1. Russia’s Relations with Western Countries .....	131
6.2. Russia’s Relations with CIS Countries .....	138
6.3. Russia’s Relations with Developing Countries .....	149
6.4. Russia in the Middle East .....	153



Chapter 7.

<b>EDUCATION, SCIENCE AND CULTURE</b> .....	158
7.1. Education and Training .....	159
7.2. Science .....	164
7.3. Art and Culture .....	167
7.4. Spiritual Life .....	168

Chapter 8.

<b>THE ARMED FORCES AND THE MILITARY INDUSTRY</b> .....	172
8.1. The Army in the Mass Media Mirror .....	173
8.2. Attempts to Introduce Public Control Institutes .....	174
8.3. Reequipment .....	177
8.4. International Cooperation .....	179
8.5. The Level of Discipline .....	180
8.6. The Attempts to Resolve Social Issues .....	182
8.7. A «New Year's Gift» to the Generalship .....	183
8.8. General Situation in the Military Industry .....	184
8.8. Program Activity .....	189
8.9. Rosoboronexport as the Locomotive of the Russian Arms Export .....	190

Chapter 9.

<b>REGIONAL DEVELOPMENT IN RUSSIA IN THE YEAR 2006</b> .....	193
9.1. Federal Reforms on Regional Level .....	200
9.2. Electoral Processes in the Regions .....	232
9.3. Relationships between nations in Russia .....	245