

Russia: The Duma Election Result – And Beyond

Russia has now completed its Duma elections held on Sunday, December 7, the fourth Duma elections in a decade, as well as 11 regional governor elections. In this note we offer an early analysis of the outcome, an assessment of market implications and medium-term political consequences, as well as look ahead to the March 2004 presidential elections, the re-formation of the government, and the policy agenda for the next four years.

- **The main outcome of the Duma elections, as was much expected, is that the pro-Putin United Russia is strengthening further its already dominating position. Riding high on President Putin's popularity, United Russia surged to assure the Kremlin and the government of possibly a majority. If taking into account the full impact of single-mandate districts, United Russia appears to reach, or at least come very close to, a direct parliamentary majority of its own, i.e. over 225 seats. The pro-Putin share of the Duma is even larger when taking into account various support factions, as well as considering that the third largest party, Zhirinovsky's Liberal Democratic party, has essentially been a support party to the pro-Putin bloc.**
- **The other main development, also as was much expected, is that the Communists have dropped dramatically, and for the first time since the 1993 elections the Communists are not the largest party at the election.** The significantly weakened Communists come in at second place, just ahead of Zhirinovsky.
- **A third development, very disappointingly but not fully unexpected, is that the recently created nationalist-populist-leftist party Rodina surged from almost nothing over the last weeks to a fourth place in the Duma elections. This is perhaps the main negative aspect of the Duma election outcome, and it is a development of medium-term concern for Russia.** As such, Rodina could be seen together with the Communists as what remains of a left-wing opposition in the Duma (the Communists polled some 12.7% on the party-list ballot, Rodina 9.1%). While one should expect Rodina to be a rather "vocal" part of the new Duma, raising the profile of various populist measures and in general contributing to a deterioration of the political debate, we would at this point expect its influence on actual government policy to be limited. For example, concerns over the fate of Anatoly Chubais as CEO of UES, or concerns over energy sector reforms because of Rodina's Duma entry, appear well overdone.
- **A fourth development, also very disappointingly but for one of them not unexpected, is that none of the two main liberal parties, the Union of Rightwing Forces and Yabloko, appears to have managed to cross the 5%-threshold to enter the Duma on party-lists. It means that the two liberal parties can only rely on a few single-mandate district seats. While the reform agenda of the government and the Kremlin is assured of a continued Duma majority through the United Russia party, the loss of the liberals is a substantial blow to the process of working with and formulating reforms in the Duma.**
- **In terms of market implications, there are four points to make. These points suggest that market implications of the Duma elections, which as we stress certainly involves some disappointing aspects, may in the end not be too negative or substantial. Ultimately, market reactions will be decided by President Putin's likely re-election in March, whether the composition of a re-formed government remains reform- and market-friendly (which current indications suggest is likely), and whether the policy agenda for the next four years remains focused on reforms (which current indications suggest is likely). The four points are:**

1. **Despite the loss of the liberals, the election outcome will essentially deliver a continuity in terms of Duma majority support for the government's and the Kremlin's economic and structural reforms;** paradoxically, the executive branch may have even greater ease in pushing through a certain reform agenda than before, given the result of United Russia. Note that some leading liberal policy-makers in the government have today made this point, and President Putin emphasized this aspect as well in his first comments on the result. Notably, Putin specifically stressed today that all the ideas and potential policy-makers from political forces that lost the elections will be taken into account and that continued contribution from these forces will be welcomed, in what appeared as a clear reference to the liberal parties. Amidst a continued solid macroeconomic situation, the main change *in this regard* coming from the Duma elections is that the pro-Putin Duma bloc is even more dominating than before, in this sense the elections have not produced a *completely* new balance of power as de facto the pro-Putin bloc was already the largest one in the previous Duma – rather, the elections have tilted the “balance” even further in one direction.
2. **Nevertheless, the loss of the liberals, notably the Union of Rightwing Forces, is a substantial hit to the process of working with economic issues in the Duma and in terms of policy formulation;** a lot of this influence will now have to take place (as it did also in the previous Duma) informally and via policy-makers, in line with Putin's comments referred to above. The loss of the liberals, even if they were not exactly a major part of the previous Duma (although they were a very effective part), has upset the balance of the Duma composition, and this is not a positive.
3. **The entry of the nationalist-populists of Rodina will bring with it a deterioration of the economic policy debate in the Duma** (but not necessarily a significant impact in practice); Rodina is likely to focus on a number of populist ideas, including taxation, redistribution, currency controls and a general “anti-oligarch” message (it should though be noted that higher taxation of the oil sector is an issue supported by most political forces, including the liberals and liberal policy-makers, with the question being how and by how much).
4. **In the end, what matters most for Russia's policy agenda is not Duma elections per se, but the March presidential elections, the composition of the re-formed government, and that government's program** – and this is especially so in the current situation given that United Russia, which is an instrument of the executive branch, sits on such a commanding position in the Duma. Note that today leading ministers have emphasized the continuity of reform priorities over coming years, such as continued reforms to diversify the economy, natural monopoly reforms, administrative reforms, health system reforms, army reforms and other key areas of structural changes.
 - **With the high probability of President Putin winning directly in a first-round vote on March 14, indications remain that liberal economic policy-makers either will retain key positions or get promoted, and that the underlying economic program will continue to be run by them.** Overall, the composition and profile of a re-formed government following presidential elections will most likely be similar in strategic terms to the current government. On the policy side, the most likely is that continuity will be a central feature for the next four years: the Russian executive branch will continue to implement the many structural reform priorities it has already identified and begun work on, such as energy sector reforms, gas sector reforms, further tax reforms (raising oil sector taxation somewhat and closing loopholes, while cutting the tax burden significantly in other areas, notably for domestic sectors), army reforms, administrative reforms, WTO-related reforms, financial system reforms and financial market reforms. In addition, President Putin's likely 2004-2008 term will focus on health system reforms, education reforms, housing reforms, and municipal services reforms.
 - **While the economic policy and market implications of the Duma elections may not be substantial, the election result does raise a number of medium-term political issues.** Most of these issues pertain to the next electoral cycle, the 2007-08 cycle. First, given the failure of the two main liberal parties to enter, one could perhaps now finally expect a consolidation on the liberal political forces, a “merger” of some kind between Yabloko and the Union of Rightwing Forces. Second, the emergence of the nationalists-populists of Rodina, as well as the performance of Zhirinovskiy, may suggest that by 2007-8 the main political divide will no longer be between reformers, modernizers and centrists on the one hand and Communists on the other, but between reformers, modernizers and centrists on the one hand and nationalists-populists on the other. Third, the voter turnout was low, much lower than in 1995 and 1999, and only somewhat higher than in 1993, and the against-all-category on the ballot appears to have almost recorded 5%. This suggests a continued problem of deepening and broadening the political process, a challenge that will remain for many years to come.

1. The Duma elections, December 7, 2003: the outcome

With parliamentary elections now completed, it could be said to again have showed that Duma elections are important for the evolution of Russia's political dynamics. The consolidation of a reasonable Duma majority in 1999 was one of the key factors behind the legislative success over the last four years; certainly the 1999-2003 Duma has been Russia's hitherto most productive parliament in this sense. At the same time, it should be noted how recent this situation is. Up until the 1999 elections, the Kremlin and Russian governments constantly struggled to work with the Duma, and never had anything resembling a workable parliamentary majority or consistent support. Also, it is worth remembering that this is only Russia's fourth Duma following the fall of the Soviet Union, and only the eight Duma in 97 years. The four Duma elections we have now seen in a decade have all had their "key themes". In 1993, the main theme was the emergence of the Zhirinovskiy phenomenon, in 1995 it was the whole fight against the Communists (linked to the 1996 presidential elections), and in 1999 it was the surge of the Union of Rightwing Forces, as well as the emergence of a large pro-Putin bloc (called Unity at the time). This election, the December 2003 elections, has mainly been about the "Kremlin majority" – *kremlyevskoe bolshinstvo* - or "Putin majority" – *putinskoe bolshinstvo* - in the shape of United Russia.

The main outcome of the Duma elections, as was much expected, is that the pro-Putin United Russia is strengthening further its already dominating position (see table below)¹. Riding high on President Putin's popularity, United Russia surged to assure the Kremlin and the government of an even stronger Duma position. If taking into account the full impact of single-mandate districts, United Russia appears to reach, or at least to come very close to, a direct parliamentary majority of its own, i.e. over 225 seats (at the time of writing this, some indications are that United Russia has around 222 seats secured, through the party-list and single-mandate districts, more on that below). If confirmed, this would be the first time in post-Soviet politics that the Russian executive branch has a direct, or near-direct, parliamentary majority through one party so obviously the party of the Kremlin. Furthermore, the pro-Putin share of the Duma is even larger when taking into account various support factions, as well as considering that the third largest party, Zhirinovskiy's Liberal Democratic party, has essentially been a support party to the pro-Putin bloc. For Zhirinovskiy the elections turned out to be almost a "re-birth", after seemingly fading away in the previous couple of elections, his party bounced back on Sunday into third place. Taken together, the United Russia party, with support factions and support parties, may in selected questions reach what is called a constitutional majority of at least 301 votes.

Duma Elections, December 7, 2003 (97.87% of votes counted): Parties Over The 5%-Threshold

	Party list (% of votes)	Total Duma seats (party list+ single mandate) as per preliminary estimate by Merkator group at the Academy of Sciences
United Russia, or <i>Edinaya Rossiya</i> (Gryzlov, Shoigu, Luzhkov, Shaimiev)	37.1%	222
The Communist Party (Zyuganov, Kondratenko, Kharitonov)	12.7%	53
Liberal Democratic Party (Zhirinovskiy)	11.6%	38
Motherland, or <i>Rodina</i> (Glazyev, Rogozin, Varennikov)	9.1%	37
Against all	4.8%	
Independents, other factions		100

Note: Turnout 55-56%. Note the first column of the table is with regards to the party-list ballot, and does not include single-mandate district seats. The official results of the single-mandate districts, and thus the full Duma elections, are due later, by December 17-18. The second column is an estimate of the total likely size of the Duma parties, combining party-list seats and single-mandate districts, from the group Merkator (head: D. Oreshkin) at the Russian Academy of Sciences, the Institute of Geography. The Merkator group estimates the single-mandate district vote outcomes, and adds to this the party-list ballot outcome.

The other main development, also as was much expected, is that the Communists have dropped

¹ For a perceptive comment see also *Kontrolny paket dumy – y Prezidenta*, Otdel politiki, Izvestia, December 8, 2003, as well as A. Makarkin, *Dumskie vybory: vyigravshie i proigravshie*, December 8, 2003. ¹ See also our pre-Duma election report, *Russia: The New Duma – A Constructive Majority For Economic Reforms To Remain Amidst A Larger "Kremlin Majority"*, EC475, December 1, 2003.

dramatically, and for the first time since the 1993 elections the Communists are not the largest party at the election. Still, they remain the second party.

A third development, very disappointingly but not fully unexpected, is that the recently created nationalist-populist-leftist party Rodina surged from almost nothing over the last weeks to a fourth place in the Duma elections. The performance of both Rodina and Zhirinovskiy (as well as a relatively high against-all vote) suggest a continued strong role of the protest electorate. This is perhaps the main negative aspect of the Duma election outcome, and it is a development of medium-term concern for Russia (more on this below). As such, Rodina could be seen together with the Communists as what is left of a left-wing opposition in the Duma. While one should expect Rodina to be a rather vocal part of the new Duma, we would at this point expect its influence on actual government policy to be limited.

However, it is already clear that Rodina, while winning less than 10% of the party-list votes, will contribute to a deterioration in the general economic policy (and other) debate in the Duma. Rodina is led by a former reformer but by now long-time leftist populist Glazyev and the nationalist Rogozin. It also includes the former Central Bank Governor Geraschenko. This combination of economic populism and nationalism proved to be quite effective in the final weeks of Duma campaigning, as evidenced by Rodina's result, but these ideas are highly unlikely to be of much objective relevance for Russia's modernization challenges. On the economic side, Rodina will draw attention to various populist ideas in the areas of taxation, redistribution and currency controls, cloaked in an overall rhetoric of being "anti-oligarch". As stressed, while likely to attract attention and be quite vocal, the actual policy influence of Rodina is likely to be limited because of the obvious populism of their ideas, and certainly given the likelihood that the key economic posts in the re-formed government following presidential elections will be run by liberal policy-makers. On the foreign policy side, Rodina may be more influential, through Rogozin, who was Chairman of the international affairs committee in the previous Duma. Rogozin has already called for a special Europe committee in the Duma to be set up, to focus on how to manage Russia's European policy, and he has called for stronger attention to Russians living in neighbouring countries.

A fourth development, also very disappointingly but for one of them not unexpected, is that none of the two main liberal parties, the Union of Rightwing Forces and Yabloko, appears to have managed to cross the 5%-threshold to enter the Duma on party-lists. It means that the two liberal parties can only rely on a few single-mandate district seats, most likely no more than 2-4 seats each. Neither the leader of Yabloko, Yavlinsky, nor Nemtsov and Chubais from the Union of Rightwing Forces will be Duma deputies in this new Duma, as neither of them stood in a single-mandate district (they were on their respective party lists). While the reform agenda of the government and the Kremlin is assured of a continued Duma majority through the United Russia party, the loss of the liberals is a substantial blow to the process of working with and formulating reforms in the Duma (more on this below)

Thus, Russia's fourth Duma in a decade will (most likely) see a parliamentary majority commanded by the pro-Putin United Russia, with only three other parties entering on the party list; the significantly weakened Communists, a resurgent Zhirinovskiy (mainly a support party to United Russia in practice), and the emergence of the nationalist-populists of Rodina. To get the final, relative size of these four parties in the new Duma one will have add, to the above party-list results, the outcome from the single-mandate districts (and over time there will be movements from the so-called independents to some of these parties, and movements between parties and factions possibly). Earlier today, the Central Electoral Commission estimated that on the party-list ballot alone (i.e. not adding single-mandate seats), United Russia may get 117 seats, the Communists 41 seats, Zhirinovskiy 38 seats and Rodina 29. As we noted above, if adding single-mandate seats to United Russia's party-list seats, it could well be that United Russia gets very close to, or even gets, a direct parliamentary majority of at least 226 seats. According to some indications from a research group at the Russian Academy of Sciences, United Russia may have at least 105 single-mandate seats, which would suggest at least a total of 222 seats. The Communists appear to only be able to add about 12 single-mandate seats to their party-list ballot, and Rodina about 8. Zhirinovskiy appears not to have won one single-mandate seat at all. Other Duma factions with single-mandate seats will likely be Narodnaya partiya, maybe with about 19 seats (a support faction to United Russia), while so-called independents may number about 65 on the single-mandate seats. Yabloko and the Union of Rightwing Forces appear to get about 2-4 single-mandate seats each.

Finally, note that Russia also held 11 regional governor elections on Sunday, where in most cases the

incumbent won overwhelmingly, including e.g. in the elections for the Mayor of Moscow (i.e. Luzhkov won, for a third term).

2. Market implications over the near-term and coming four years

The key *for financial markets* is the legislative efficiency of the Duma in the areas of economic and structural reforms, i.e. given a certain reform agenda of the executive branch (the Kremlin, the government) what is its position in the Duma. Despite the loss of the liberals, especially of the Union of Rightwing Forces, the Duma outcome will essentially deliver a continuity in terms of Duma majority support for the government's and the Kremlin's economic and structural reforms. Paradoxically, in some sense the executive branch will have even greater ease in pushing through a certain reform agenda than before, given the result of United Russia (hence the importance of the policy agenda of the Kremlin and the government).

Already today, one of the leading liberal reform ministers in the government, First Deputy Minister for Economic Development and Trade Sharonov, has made this point. While certainly saying it is a pity the two liberal parties have not entered the Duma, Sharonov went on to say that the relationship between the government and the Duma may be even further facilitated now, that pushing through reforms may be even easier, and he expressed hope for a continued focus on reforms. Notably, President Putin emphasized similar aspects in his first comments on the Duma result, calling on the government to work constructively with the new Duma. Notably, Putin specifically stressed today that *all the ideas and potential policy-makers from political forces that lost the elections will be taken into account and that continued contribution from these forces will be welcomed*, in what appears as a clear reference to the liberal parties. It should be noted that it is this part of the Duma, the large pro-Putin bloc and the liberals that has provided the main parliamentary support for economic and structural reforms over the previous four years. Also, Deputy Prime Minister Khristenko has today outlined how the policy priorities of the government for the next couple of years will include continued reforms to diversify the economy, natural monopoly reforms, administrative reforms, health system reforms and army reforms (more on the policy priorities for the next four years further below).

Thus, while the loss of the liberals, notably the Union of Rightwing Forces, perhaps may not be exaggerated from this perspective, it is, as we have stressed, *an undeniable and substantial hit* to the process of working with economic issues in the Duma, and the overall formulation of an effective policy agenda. This party was very important because it was the most constructive force in setting a productive agenda in economic and structural reforms, and it is with this party that the government has had the most productive cooperation in these areas. The loss of the liberals means that a lot of this policy influence will have to take place informally (as it did previously also) and through government ministers and policy-makers, in line with Putin's comments today referred to above.

Apart from the loss of the liberals, another worry is the entry of the nationalist-populists of Rodina. As we have discussed above, this party will push for various populist ideas in the areas of taxation, redistribution and currency controls, as well as driving an overall rhetoric of being "anti-oligarch". However, the actual policy influence of Rodina on the economic side is likely to be limited, given that the next government most likely will have liberal policy-makers continuing to run the economic posts, given that the reform program for the next four years is more or less known (see more below) and given that objectively much of Rodina's ideas in the economic sphere are much too populist to be objectively in accordance with the economic modernization strategy that Putin has been pursuing for the last four years. This is not to say that Rodina's emergence is not a negative, but it is to say that rather than in area of market implications, the main consequences are in the area of medium-term political developments (see below).

This leads us to perhaps the key point when assessing the impact of these elections on the economic and structural reform agenda. To a large extent, it is the approaching presidential elections, the composition of the re-formed government, and the President's/the government's policy agenda that have a key impact on this agenda, rather than the Duma elections. This is because it is the executive branch, the Kremlin and the government, that overwhelmingly sets the reform agenda in these areas, and as over the last four years, the pro-Putin bloc becomes an instrument of implementing this agenda.

With the high probability of President Putin winning directly in a first-round vote on March 14, indications are that liberal economic policy maker either will retain key positions or get promoted, and

that the underlying economic program will continue to be run by them. Thus, overall, the composition and profile of a re-formed government following presidential elections will most likely be similar in strategic terms to the current government. On the policy side, the most likely is that policy continuity will be a central feature for the next four years: the Russian executive branch will continue to implement the many structural reform priorities it has already identified and begun work on (for a fuller analysis, see further below).

In summary, in terms of market implications, there are four points to make. These points suggest that beyond the nearest term, market implications of the Duma elections, while as we have stressed certainly involving some disappointing aspects, may not be too negative or substantial, and that a key focus will rest on the next government and its policy agenda.

- Despite the loss of the liberals, the election outcome will essentially deliver a continuity in terms of Duma majority support for the government's and the Kremlin's economic and structural reforms; paradoxically, the executive branch may have even greater ease in pushing through a certain reform agenda than before, given the result of United Russia. As noted, some liberal policy-makers in the government have already made this point today. Amidst a continued solid macroeconomic situation, the main change *in this regard* coming from the Duma elections is that the pro-Putin Duma bloc is even more dominating than before, in this sense the elections have not produced a *completely* new balance of power as de facto the pro-Putin bloc was already the largest one in the previous Duma.
- Nevertheless, the loss of the liberals, notably the Union of Rightwing Forces, is a substantial hit to the process of working with economic issues in the Duma and in terms of policy formulation; a lot of this influence will now have to take place (as it did also in the previous Duma) informally and via policy-makers, in line with Putin's comments today referred to above.
- The entry of the nationalist-populists of Rodina will bring with it a deterioration of the economic policy *debate* in the Duma (but not necessarily in practice to a great extent); Rodina is likely to focus on a number of populist ideas, including taxation, redistribution, currency controls and a general "anti-oligarch" message (it should though be noted that higher taxation of the oil sector is an issue supported by most political forces, including the liberals and liberal policy-makers, with the question being how and by how much).
- In the end, what matters most for Russia's policy agenda is not Duma elections per se, but the March presidential elections, the composition of the re-formed government, and that government's program – and this is especially so in the current situation given that United Russia, which is an instrument of the executive branch, sits on such a commanding position in the Duma.

3. Medium-term political consequences

With both of the liberal parties in the end not entering the Duma, and the fact that the nationalist-populists of Rodina entered the Duma, suggest that over the next four years we may finally see a consolidation of the liberal political forces. While a major challenge (efforts at consolidating the liberals have been attempted for about a decade now), this now appears like an important strategic development ahead of the December 2007 Duma elections. Anatoly Chubais, of the Union of Rightwing Forces, declared immediately on election night that talks with Yabloko on merging will be re-started today. The galvanizing issue could be the surge of nationalists-populists, which now need to be countered through a consolidation of liberal political forces. At the same time, both the liberal parties will now have to go through some self-evaluation process, because the performance was indeed particularly poor, note e.g. that the "against all-category" appears to have gotten more votes than both the Union of Rightwing Forces and Yabloko. Indeed, Chubais has today stated that the Union of Rightwing Forces will have to also evaluate themselves to find the reasons for the poor result, to evaluate the election and campaign strategy and other issues.

The sudden emergence and surge of the nationalist-populist-leftist Rodina is a matter of medium-term concern. This party was only very recently created, allegedly designed/supported by some elements of the political elite and allegedly even supported by some oligarchs. The Rodina story is yet another example of Russia's designer-politics, i.e. how one can almost from nothing in a very short time period create a

political force. As we have stressed throughout this report, for the political process and for the quality of the debate on economic policy this party is bad news for Russia. This is because they are openly populist-leftist as well as nationalist. The problem now with this development is that a genie may have been let out of the bottle and it may be difficult to put it back. Such an impression is backed up by the fact that Rodina did well in both Moscow and St.Petersburg, essentially being the second party in these two cities. In some sense, the Rodina party may have partly been created to drain votes from the Communists, but it appears to have perhaps ended up a larger project than perhaps it was intended. The basic conclusion that can be drawn is that the main political divide four years from today, for the December 2007 Duma elections and the 2008 presidential elections may stand between reformers, modernizers and centrists on the one hand, and nationalists-populists on the other.

Finally, the voter turnout was low, much lower than in 1995 and 1999, and only somewhat higher than in 1993. Also, importantly, the “against all”-category on the ballot appears to have almost recorded 5% on the nation-wide party ballot, and even higher in Moscow voting. For example, in the elections for the mayor of Moscow, the against all-category got over 7%, and in four single-mandate districts (of Russia’s total 225 single-mandate districts), the against all-category even won the election (which means in these districts there will be a repeat ballot)! This pattern of low turnout and high against-all voting confirm a continued problem of deepening and broadening the political process, a challenge that will remain for many years to come

4. The 2003-07 Duma: what agenda on the economic side?

The legislative agenda of the 2003-07 Duma will most likely, as it has over the last four years, mainly be driven by the policy and reform agenda of the government and the Kremlin². Thus, the main focus following the Sunday Duma election now turn towards the March presidential elections, whose outcome is fairly certain, and then on to the re-formation of the government and the policy agenda for the next four years. As we discuss in the section below, the most likely is that policy continuity will be a central feature for the next four years: the Russian executive branch will continue to implement the many structural reform priorities it has already identified and begun work on, such as energy sector reforms, gas sector reforms, further tax reforms, army reforms, administrative reforms, WTO-related reforms, financial system reforms and financial market reforms. In addition, President Putin's likely 2004-2008 term will focus on health system reforms, education reforms, housing reforms, and municipal services reforms.

Thus, much of the Duma’s work over the coming four years will be in these above areas. As has been the case over the previous four years, a lot of Duma effort is likely to go into further tax reforms. The main emphasis in this next phase of tax reform is likely to be two-pronged. On the one hand, the new Duma will focus on adjusting oil sector taxation upwards, possibly by USD 2-4 bn per year in total, as well as closing any remaining tax loopholes. On the other hand, work will continue on significantly lower the tax burden in other areas, and in particular for domestic sectors, e.g. social taxation reform is likely to be a main feature.

One good indication of what the new Duma might focus on in terms of economic issues is the expectations of Alexander Zhukov, the well-respected Chairman of the Duma Budget Committee (in the outgoing Duma), and a United Russia deputy (Zhukov was overwhelmingly re-elected to the new Duma). A couple of days before the Sunday Duma elections, Zhukov outlined the following three points as key areas of interest looking ahead: 1) the possibility that inflation in 2004 goes into single-digit territory, that if falls below 10% (from around 12% this year), 2) continued work in attracting increasing inflows of investments, 3) further budget and tax reforms, including the increase in oil sector taxation and lowering the tax burden elsewhere. (For more on Zhukov’s outlook for the coming years, see further below.)

5. The March 2004 presidential elections, a re-formed government and the next policy agenda

As mentioned, focus now shifts to the March 14 presidential elections and the subsequent re-formation of the government. The outcome of the presidential elections is not in doubt; Putin will be re-elected to a second four-year term. The President’s overall approval ratings are in the high-70s, while presidential

² Note that this section and the next section we contains much of what we already analyzed and outlined in our pre-Duma election report, *Russia: The New Duma – A Constructive Majority For Economic Reforms To Remain Amidst A Larger “Kremlin Majority”*, EC475, December 1, 2003.

election opinion polls indicate Putin would win over 50% of the votes direct in a first-round vote. Indeed, the latest presidential election opinion poll by the ROMIR agency, outlined in the table below, is telling. The poll reports on a number of two-way races; for each combination Putin gets well above 70%. (Note also the Putin-Khodorkovsky two-way race, at 78% for Putin versus 3% for Khodorkovsky.)

Presidential Elections Opinion Poll: Two-Way Races (ROMIR poll, November 27-28)

Putin-Zyuganov	79% vs. 3%
Putin-Yavlinsky	75% vs. 7%
Putin-Glazhev	74% vs. 6%
Putin-Tuleyev	78% vs. 3%
Putin-Rogozin	79% vs. 2%
<i>Putin-Khodorkovsky</i>	78% vs. 3%

Note: Poll by ROMIR.

In line with Russian constitutional affairs, the government will be re-formed following the March presidential elections (the President nominates his choice of Prime Minister, to be approved by the Duma, the Kremlin and the Prime Minister proceeds to appoint the rest of the government). Overall, the composition and profile of a re-formed government will most likely be similar in strategic terms to the current government. It is important to note that most likely, at least these are the indications, the neutral-liberal lawyer Dmitry Kozak, the First Deputy Head of the Presidential Administration, will be in charge of Putin's election staff. This is an important signal (see more on Kozak, and Medvedev, below).

A supporting dimension is that President Putin's overall economic and structural reform agenda remains the same, more on this below. Thus, indications are that liberal economic policy maker either will retain key positions or get promoted, and that the underlying economic program will continue to be run by them. The ministerial changes that may be made could reflect that the President has lately started to move into somewhat of a new phase appointment-wise, in terms of gradually becoming more and more his own, building his own team. The recent promotions of the liberals Medvedev as Head of the Presidential Administration and Kozak as First Deputy Head are two examples. Indeed, at the time of these appointments, the current Deputy Prime Minister/Minister of Finance Kudrin explicitly linked the exit of Voloshin, the previous Head of the Presidential Administration, with the end of Yeltsin-era politics.

Indeed, in this vein, indications are that Russia's next Prime Minister, if the re-formation of the cabinet will include a new name on this post, could well be a very established name from the liberal camp, currently in a key post in the government, or a technocrat. Also, officials involved in drafting key areas of the future policy agenda (see below) could also do well in a government re-formation, as was the case in 2000. At the same time, leading current liberal policy-makers, e.g. someone like German Gref, the Minister for Economic Development and Trade, should continue to do well. Overall then, signs are both suggesting that market-positive, liberal policy-makers will retain key positions and/or be promoted, and that President Putin's whole program for the 2004-08 term will remain that of a comprehensive economic modernization and liberal economic reforms. This has recently been strongly emphasized by e.g. the current Deputy Prime Minister and Minister of Finance Kudrin³.

There are essentially three dimensions to the preparation of the policy agenda over the next four years. The first is that the bulk of economic and structural policies will focus on implementing many of the reforms already identified and approved and analyzed in many government strategy documents over recent years, e.g. focus here will be on financial system reforms, currency liberalization, further tax reforms (cutting taxes on domestic sectors, raising it somewhat on natural resource sectors), energy sector reforms, gas sector reforms, administrative reforms, WTO-related reforms. As noted, many, if not most, of the liberal policy-makers in charge of drafting and pushing for these reforms over recent years will remain in key positions, and the emphasis in many of these areas will be on implementation.

Backing up this point of policy continuity, in a meeting of key ministers chaired by Prime Minister Kasyanov recently, it was decided that a 2004 reform and legislative plan will be discussed by the full government in the second half of December. Already in the last week of November relevant ministries

³ See *O finansakh c ministrom finansov*, Itogi, nr.48, 2003.

submitted to the government administration the relevant draft initiatives (they have already been worked on). Even though the government is likely to be re-formed, as would be normal, following the March presidential elections, policy continuity is very much a feature and one should expect a re-formed government after the presidential elections to pursue the very same structural reform agenda which is already identified and to which additions are being worked on at the moment, partly to function as parts of Putin's electoral program. This point of policy continuity, of continuing to work on implementing already identified and prioritized reforms has also been emphasized recently by the (in the previous Duma) Chairman of the influential Duma Budget Committee, Alexander Zhukov, particularly in the areas of tax reforms. According to Zhukov, the new Duma will continue the work on tax reforms that has proceeded for much of the 1999-2003 period. This further work will include lowering quite significantly social taxation (from 35.6% to 30%, and yet lower for certain income brackets). Zhukov also would like to continue lowering VAT, recall from next year VAT is decreased from 20% to 18%, and there should be a new tax regime for excises, as well as reforms to property taxation. Also, as already mentioned, a lot of the further tax reform work will focus on oil sector taxation, by how much and exactly how to increase taxation in this sector. Finally, Zhukov has stressed the new Duma will work closely with the government to reform the vast municipal services sector, a significant area of budget expenditure reforms, as well as to reform the housing sector.

A second dimension is that there is a special government, intra-ministerial, committee focusing specifically on how to reform the bureaucracy, how to proceed with administrative reforms. This work has lately been chaired by current Deputy Prime Minister Alyeshin, essentially a neutral technocrat. This is an area that will take a prominent part in the next policy agenda. The third, and significant, dimension is that the Deputy Head of the Presidential Administration responsible for economic issues, the young Igor Shuvalov, is in charge of a special working group drafting reform measures in a number of key areas, a work that essentially will provide the bulk of Putin's electoral program as well as a large part of the reform agenda for the next four years. The main priorities of this group, the so-called Shuvalov group, are army reforms, health system reforms, education system reforms, housing reforms, and the development of Kaliningrad⁴. Many of these areas involve policy aspects from other areas, e.g. liberalization, de-bureaucratization, marketization, budget expenditure reforms and so on. As with the first economic modernization and reform strategy under Putin, from 2000, the Shuvalov group is working out this program based mainly in the Centre for Strategic Studies, the think-tank structure that German Gref led in the run-up to Putin's first election in the spring of 2000. Several of leading Russian liberal policy-makers are part of the Shuvalov group, and it also includes entrepreneurs, Duma and Federation Council people.

⁴ As with so much of Russia's reform agenda, it should here be noted that Professor Egor Gaidar was the first one to present a substantive, systematic and comprehensive approach to these issues, in the context of Russia's key long-term challenges. See e.g. Gaidar's speech to SPS council in December 2002; and studies by Gaidar like *Sovremenny ekonomicheskii rost I strategicheskie perspektivy sotsialno-ekonomicheskova razvitiya Rossii*, delivered as a speech in February 2003, and the associated *Perspektivy ekonomicheskovo razvitiya Rossii*, *Izvestia*, February 25, 2003. In terms of Russian policy and other challenges beyond the next four years, see also the speech by Anatoly Chubais; *Missiya Rossii*, given in St.Petersburg on September 25, 2003.

Disclosure Appendix

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I, Niclas Sundstrom, hereby certify that all of the views expressed in this research report accurately reflect my personal views about any and all of the subject issuer(s) or securities. I also certify that no part of my compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or views in this report.

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