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Russia's Gref On Reforms: Current Situation, Next Steps

This winter it will be three years ago since the then soon-to-be President Putin created the special economic reform institute Centre for Strategic Studies – Tsentr strategicheskikh razrabotok - and appointed the young German Gref as its head, tasked with working out a comprehensive macroeconomic, structural and institutional reform program. Gref went on to become essentially the main symbolic standard bearer of the latest “generation” of Russian liberal reformers, and in his capacity as Minister for Economic Development and Trade oversees a large part of Russia's reform agenda.

Together with the fact that the next election period (basically 2003-Q1 2004, with “pre-election” politics already starting now) is approaching, this has provided a timely background for the long, in-depth interview German Gref has given in one of Russia's leading business newspapers today¹.

The Gref interview gives a useful and insightful assessment of the current state of play and Russian reform achievements, the next steps and main frustrations. This note brings together key issues as highlighted by Gref in today's interview.

- Reforms of the civil service/bureaucracy are seen as one of the most important, but also more complicated, reform challenges. If cumbersome bureaucracy proves to slow down changes, the government reformers will be ready to push them through nevertheless – and if necessary ultimately seek the required direct political support from President Putin.
- Despite the approaching election period and the associated gradual “closing” of the political window for pursuing certain reforms, Gref expects the UES/energy sector legal reform package to be approved by the Duma this autumn. Gas sector/Gazprom reforms are of a much less far-reaching nature, and Gref expects as planned that a gas sector reform concept should be concluded by the end of this year.

1. Government-Duma co-operation

Co-operation and interaction on economic reforms with the Duma is seen as continuing to be constructive. Most of the lengthy Duma discussions surrounding some specific reform initiatives are judged to be basically positive, part of the rules of democracy, and Gref in general views this process as good training for the Russian political process.

The main problem, when it appears, is rather seen as lack of full intra-government co-ordination. Some reforms (e.g. de-bureaucratization) tends to attract internal dissent (not surprisingly, as the bureaucracy is part of the target for such reforms), or at least lack of timely co-operation from parts of the government bureaucracy, and this can slow things down.

¹ “German Gref: Politicheskaya elita ustala ot stabilnosti”, *Vedomosti*, August 21, 2002.

In areas such as civil service and municipal services reforms, certain federal ministries, sometimes even with the support of government bureaucracy, are proving unable to push reforms to full implementation – not because individual ministers and officials are necessarily against these reforms, but because the incentives in the government bureaucracy are tilted in such a way. This is why a major focus is on civil service/bureaucracy reforms (more below).

Because of the need nevertheless to press ahead with reforms, Gref envisages there will be instances of reforms more forcefully being pushed through by the Ministry for Economic Development and Trade, without necessarily seeking full consensus from every corner of the cumbersome Russian bureaucracy. If needed, Gref also acknowledges that in the interest of pushing reforms forward, he is regularly ready to go to Putin for the ultimate political support.

2. Civil service/bureaucracy reforms

This is seen as one of the more complex, but also one of the more important, structural-institutional reforms. *He specifically underlines that the challenge to create new incentives, a new civil service system, is of importance for the overall Russian reform effort, and that to be successful, serious political and intellectual resources are necessary*².

Gref re-confirms the reform concept in this area will be focused on creating new and better incentives for the bureaucracy. He repeatedly emphasizes the crucial importance of reforming the state apparatus itself, and draws attention to the fact that the state has a larger involvement in the economy as a whole than what can be judged from official statistics, due to indirect influence and affiliated companies and entities to companies with large state stakes.

Typically, Gref stresses that just as corporate governance among companies has to be reformed, as is happening, so the government itself has to change its “governance” – also the Russian state institutions need to modernize, become transparent and more efficient. According to Gref, the present “government governance” system is 40 years behind today’s realities. As part of the civil service/bureaucracy reforms, Gref is also strongly in favour of moving towards a modern civil service concept where the state is seen as providing services to the population. He says that exactly this view is being tested in the areas of education reforms, and he is proposing to use the same approach in reforming municipal services.

3. Natural monopoly reforms

Answering to some criticism of the slow pace of reforming natural monopolies like UES, the Railways Ministry and Gazprom, Gref (rightly) points out the international experience is that these types of reforms are very time-consuming, as they typically involve not only major economic changes, but also political. It is also correct, as Gref does,

² The government, as well as the Kremlin, is prioritising civil service reforms as a key focus this autumn. As a political signal that President Putin specifically prioritizes such reforms, Putin on August 12 signed a presidential decree on the main principles of government service, setting out some parameters of reforms. These reform efforts are being prepared along a number of different lines. President Putin has made both Prime Minister Kasyanov and First Deputy Chief of the Presidential Administration Medvedev in charge of working out a civil service/bureaucracy reform concept. The inter-departmental working group chaired by Medvedev is getting ready to submit to the Duma this autumn an underlying, framework law for these reforms, a new Law On The System of Government Service, which essentially would be like a “Code of Civil Service Governance”. From Gref’s Ministry, First Deputy Minister for Economic Development and Trade Dmitriev (also in charge of pension reforms) is a strong advocate of liberal, transparent and modern civil service reforms. Separately, Kasyanov’s Chief of Staff (the government’s Chief of Staff) Shuvalov has been tasked by Kasyanov to also work on a reform concept for the government bureaucracy. Furthermore, Deputy Chief of the Presidential Administration Kozak is working on reforming and clarifying federal-regional political jurisdiction and responsibilities, and chairs a commission for this purpose (“the Kozak commission”).

to stress that there is no real international comparison with the Russian reform challenges in this field when it comes to the sheer *scale* of the inherited reform challenge and the depth of the required reforms.

Regarding UES, Gref says that the process of negotiating and amending the energy sector legal reform package underway during this summer is of a technical, and not political nature³. Gref estimates that in the autumn, when the energy sector legal reform package is supposed to be heard in Duma readings, the political process could be difficult, as the election period is approaching. Indeed, Gref mentions that today already, a “pre-election situation” is evident.

With these questions in mind, Gref goes into some details regarding the question of economic reforms and the approaching election period. While he clearly admits that the political window for certain structural economic reforms is closing to some extent, he also estimates that in the end, chances of the energy sector reform package being approved are quite high.

As for Gazprom, the process is very different. Here, work is still underway with regards to reform *concepts*, reform *programs*. According to Gref, Gazprom reforms issues are more “delicate”, and in general the reform program will here not at all be as far-reaching as those for UES and the Railways Ministry. By the end of this year, Gref still expects to have concluded a specific gas sector/Gazprom reform concept. Gref sees gas sector structural reforms basically limited to the following areas: a real separation of gas transportation, the initiation of exchange-based gas trading, reforms of gas prices for final consumers and equal access for all to the pipeline system.

4. WTO membership

A key current focus for the Ministry of Economic Development and Trade is WTO membership⁴. In general, while there are internal Russian debates regarding the exact modalities of negotiation positions, the fundamental political decision on whether to join or not has been taken – in favour of joining. This has more than once been explained by President Putin himself, where WTO membership is seen as not inherently good or bad, but as ultimately an instrument for integrating Russia further in the global economy and to push domestic economic reforms.

Lately, some specific corporate interests – most notably O. Deripaska, a leading “younger generation oligarch” – have come out and quite strongly criticised the government in general and Gref in particular for their policy in joining the WTO. This type of criticism has been rather crude, and in obvious connection with wishes to preserve protection for certain areas. However, other corporate interests – notably M. Khodorkovsky (Yukos) – have lately defended the government’s WTO policy, and strongly emphasized the advantages to Russia of membership.

According to Gref, the Russian WTO debate has thus entered a phase where some Russian corporate interests think it will be more difficult for them if large Western competitors emerge on their markets. Thus, Gref adds, these companies believe it is advantageous for them to seek yet further periods of instability, to pursue further re-distribution of property. The other corporate interests, those which recognize WTO membership is ultimately a positive step, according to Gref understands the benefits of stable rules of the game, of a normally-functioning legal system, of a normal and transparent

³ Deputy Minister for Economic Development and Trade Sharonov is the key government official involved in these ongoing consultations.

⁴ Russia’s negotiations are generally run by Deputy Minister for Economic Development and Trade Medvedkov.

institutional framework, the progress towards WTO membership is likely to promote. Gref specifically rejects any notion of the government succumbing to calls of awarding special subsidies or preferences to selected corporate interests, and says their main policy is to construct normal and equal rules of competition for all.

This does not mean the government is not active in some industrial areas. Gref says that in special sectors where the state has a large role – e.g. aviation, natural monopolies, the military-industrial complex – the government has to appear as the agent of change, consolidation where necessary and promote reforms. When it comes to the natural resource sector, Gref sees the government playing an important role in promoting and upholding “liberal, stable and transparent” rules of the game⁵.

5. Special Economic Zones

At the same time, Gref is one of the strongest advocates in the government of introducing so-called *special economic zones*. Such zones would specifically seek to encourage innovation and entrepreneurial corporate activity through a highly efficient and predictable institutional framework – almost like “micro”-areas of the attractive investment climate they are aiming to spread all over Russia. Others in the government (e.g. the Ministry of Finance) are more sceptical towards this idea, fearing it will become budget burdens, with companies in the zones asking for all kinds of exemptions. However, Gref is particularly careful to stress that these zones would be different, exemptions would not be the main attraction of these zones, rather the key aspect would be the above-mentioned institutional framework.

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⁵ A clear reference to the noises surrounding the recent “scandal” of a potential amendment to natural resource legislation, which would have done exactly the opposite. This amendment was supposed to have originated in the so-called Kozak commission, but the whole episode was quickly buried.