

national foundations” as evidenced by legislative motions to restrict free speech (including an oppressive advertising tax), centralize authority (Hungary’s new constitution has been amended five times), and erode the independence of the judiciary. Noting that the geopolitical “wind is blowing from the East,” Orban has credited Moscow for these latest Russian-styled Hungarian “reforms.”

These illiberal trends have been accompanied by distinctly pro-Russian foreign policies in Budapest. Orban has consistently derided the EU’s sanctions against Russia, and Hungary abruptly discontinued its sale of excess gas supplies to Ukraine after a visit from the CEO of Gazprom this fall. Hungary received a 10 billion euro loan from Russia for a new nuclear power plant facility, increasing Hungary’s energy dependence on Russian technology and financial support. Negative developments in Hungary and its neighbors threaten to derail wider European efforts to restrain Russian recidivism.

Although the 21st-century East-West confrontation does not bear the ideological vestiges of the Cold War, there is a clear ideological component. This contestation is between liberal versus illiberal, transparency and good governance versus corruption and “managed democracy.” The unqualified success of Central Europe’s transformation from Communism to liberal democracies and market economies is not immutable, and we should not trick ourselves into believing it is so. ►

## Putin’s Dilemma

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**Just days before Boris Yeltsin shocked the world by retiring early from the Russian presidency on December 31, 1999**—making then-Prime Minister Vladimir Putin acting president—Putin released his *Millennial Statement* that outlined Russia’s immense challenges and a vision for its future. This vision emphasized greater predictability, prosperity, and stability for Russia after the economically and socially traumatic 1990s. The document’s other core theme was the urgent need to reconsolidate the Russian state in order to lead the recovery of the Russian nation.

For the past 15 years that Putin has served as Russia’s *de jure* and/or *de facto* national leader, the majority of Russian people have been satisfied that he has delivered what he promised and what they want. During his first two terms as president, the Russian economy grew at approximately 7 percent per year (measured in nominal dollar terms and accounting for ruble appreciation, the figure is an impressive 26 percent). Even after the global economic crisis in 2008–2009, the Russian economy regained its footing growing at a rate of more than 4 percent in 2010 and 2011.



The foundation for Vladimir Putin’s consistently high political ratings has been the Russian people’s perception that their economic prospects were constantly improving. Putin’s so-called *vertical of power*—an increasingly state-centric political economy—has been facilitated by a growing economic pie that could be carved up and distributed to Putin loyalists. This system, *patrimonial authoritarianism*, finds its historical roots traced to the princes of *Muscovy*, Russian tsars, and later Soviet general secretaries. In this sense, Vladimir Putin is a very traditional Russian leader.

But signs that not all was well in modern *Muscovy* manifested themselves in the winter of 2011–2012 when the largest political demonstrations took place in Russia in 20 years as tens of thousands of protesters took to the streets to condemn the falsified Duma elections of December 2011. Putin’s United Russia party fared poorly in those elections marking Putin’s first electoral defeat since his emergence on the national stage a decade earlier. The demonstrations also marked the first large social media-mobilized opposition Putin had ever faced. It seemed clear from private discussions with Putin and his inner circle prior to the 2011 election that Putin was taken by surprise. The demonstrations were a shock to Putin personally

as well as to the political system he oversaw for over a decade.

While the protesters were ideologically diverse, the majority were the relatively well-off middle and upper-middle classes who had benefited the most during those prosperous years of Putin’s tenure. But they viewed Moscow’s centralized, corrupt, and authoritarian political system nurtured by Putin as incapable of promoting further economic growth or answering their demands for improved governance.

When he returned to the presidency in May 2012, Putin faced a difficult choice as signs of economic stagnation were already visible: he could either co-opt the growing middle class by addressing their concerns and embark on structural economic reforms or risk undermining the political foundation of his *vertical of power*.

Putin’s dilemma is reminiscent of the Soviet Politburo in the early 1980s. Despite massive windfall revenue of petrodollars, the economy was so structurally inefficient that the Soviet growth rate was close to zero. At the high point of Soviet *zastoi* or stagnation, Brezhnev and his successors decided structural economic reform was too politically risky and attempted to muddle through. Had oil prices remained high,

muddling may have been successful and the Soviet Union would have endured. Of course, oil prices plummeted, the Soviet Union attempted reform, and collapse ensued.

Putin, like his Soviet predecessors, has avoided reform and the Russian economy has continued to stagnate (1.3 percent growth in 2013) *even before Crimea annexation and the war in Ukraine* despite historically high oil prices. It appeared that Putin had already decided to abandon economic growth and prosperity as the foundation for his political popularity and authority. This risky political strategy would require a new political narrative to justify his indefinite leadership if economic growth and prosperity were no longer the essential thread.

This new political narrative began to form in 2012–2013 with a growing emphasis on traditional Russian values captured in the 19th-century Russian policy of “official nationality” revolving around the triptych of autocracy, orthodoxy, and Russian nationality. The crisis over Ukraine offered an ideal opportunity to further consolidate this new political narrative. Previously, Putin had always been careful to avoid enflaming Russian nationalism, but his seminal speech to the Russian Assembly formally annexing Crimea on March 18, however, articulated a highly chauvinistic form of Russian nationalism that does not accept the legitimacy of post–1991 borders let alone post–World War II and even post–World War I borders.

Putin has reintroduced the Tsarist-era term of *Novorossiya*, which geographically included much of Eastern and Southern Ukraine under the administrative jurisdiction of Russia. This has become his new political narrative and a rallying cry for the insurgents in Eastern Ukraine.

Putin will manage the devastating economic consequences of his strategic choice in many different ways. The nearly 25 percent decline in oil prices has put further pressure on his

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government. The house arrest in September of leading economic magnate Vladimir Yevtushenkov sent a deep chill through the Russian business community in a similar manner as the 2003 arrest of Mikhail Khodorkovsky. The Khodorkovsky affair and the destruction of the Yukos oil company was the watershed event in the establishment of Putin’s *vertical of power*, including the redistribution of some of the core assets of the Russian economy.

As the economic pie is reduced, Putin must find ways to assure the loyalty of his core allies and the intelligence services to guarantee his leadership. All signs suggest that another redistribution of assets to his loyalists is underway. Western sanctions may actually help facilitate this process as Western financial institutions and individual investors are removed as arbiters in the Russian market that make it easier for erstwhile Putin allies to consume their own.

Putin clearly has made a Faustian bargain with Russian nationalism and oligarchic predators with unpredictable consequences for Russia’s neighbors, regional security, and the Russian people. Although government officials and experts perceive that Russia is weak, Putin has proven himself time and time again as highly adept at playing what appears to be a weak hand. Ukrainian President Peter Poroshenko has described Putin as “unpredictable, emotional, and dangerous.” How long Putin can manage this volatile situation that he has created is an open question, but we should not assume it will be brief or that whoever comes after Putin will be easier. ►