The Moscow Times
30 YEARS
INDEPENDENT NEWS FROM RUSSIA

# Why Putin Should Keep His Old Team – for Now

By Martin Gilman

April 01, 2012




In many countries the post-election transition period between governments can be fraught with uncertainty, as seasoned politicians and political appointees cede the reins of power to inexperienced replacements. Fortunately, most new governments also benefit from a honeymoon period when citizens give the newly elected authorities the benefit of political goodwill.

In Russia, perhaps it is just as well that the new president and prime minister will be fully conversant with their mandates — and that many of the old government team and Kremlin staff will stay on in responsible, even if somewhat altered, positions.

Normally, so much continuity for more than a decade should be roundly condemned as a recipe for complacency if not stagnation. But the next few months may be far from normal. If so, an experienced team could make the difference in avoiding an economic meltdown. In any case, it might be a fortuitous insurance policy since any honeymoon period would be

a luxury under an adverse global economic reversal.

No doubt this ominous warning sounds unduly alarmist to many readers. I hope for all the best. In fact, right now, with the global economy seemingly in recovery mode and the Russian economy accelerating, it may be hard to argue that such insurance is warranted. Indeed, this past year has been surprisingly benign despite repeated warnings of a possible new recession in the United States, a hard landing in China and a debt default with deflation in Europe. Even rising oil prices are not viewed yet with undue concern.

Meanwhile in Russia, the economy is going from strength to strength. The private sector is booming. Private sector credit — calculated monthly as a share of gross domestic product — is all the way back to pre-crisis peaks when it was considered borderline bubbly. Automobile production and sales have more than doubled since the trough in 2009 and are back to all-time highs. The only reason that GDP growth was not higher in 2010 or last year is because there was almost no growth in real budgetary spending, and this put significant downward pressure on items like construction activity, especially when compared to the exuberant pre-crisis days.

But a positive surprise could soon occur because federal budget expenditures have jumped in the past few months and are now up nearly 30 percent over the same period in 2011, a reflection of the government's decision to increase real outlays in almost all areas of the budget. As a result, fixed-investment spending has already accelerated visibly in the first quarter, and a similar pickup in building construction can be expected. Abstracting from the external situation, short-term prospects are very positive.

There are just two problems.

One is the well-worn issue that Russia clearly needs far-reaching structural and institutional reform over the medium term. The other, more germane in the year ahead, is that the global scene may not remain so benign. There is a virulent debate as to whether or for how long this state of affairs can continue.

Christine Lagarde, the head of the International Monetary Fund, said it well on March 17: "The world economy has stepped back from the brink, and we have cause to be a little bit more optimistic. But optimism ... certainly should not lull us into a false sense of security."

In a few months we may have a better sense of whether the world has been able to manage the debt overhang of the last decade. Perhaps the optimists will be vindicated by the direction if not the speed of a global recovery.

Certainly most major equity markets, and notably in Russia, have risen dramatically in the first quarter of 2012. Many analysts suggest that the financial markets are leading indicators and will usher in a period of sustained growth.

The IMF is right to caution about a false sense of security. After all, major equity markets also peaked right before the beginning of the great recession in 2008. There are too many warning signals to be complacent. The debt problems in Europe have been postponed but not resolved. Spain and Italy face growing social unrest. The outcome of the French elections is unpredictable. Portugal could become the next Greece, and even Greece's debt write-down

may only be the first step. China's leaders are adamant to avoid a hard landing in this year of political transition, but their policies to mitigate the slowdown seem to squeeze consumption even further. Japan appears more fragile almost by the week. Improving data in the United States remain to be confirmed after the weather-induced employment spurt this winter, as production remains soft. And of course, there is the conundrum of the Middle East, Iran and oil prices that could induce fear in mature markets. Any of these risks could tip the world back into recession. If so, Russia as a major supplier of raw inputs into the global production chain would feel the impact.

As observed so often, Russia is highly dependent upon what happens in the global economy. If sales of final goods should stay flat or even fall, then the ramifications for suppliers further up the distribution chain will be amplified in a bullwhip effect. Russia should know — just look what happened between July and December 2008 when Brent oil prices fell from about $144 per barrel to $35 per barrel.

Even those who have their pulse on the global economy and perhaps have the best vantage point are keeping their fingers crossed.

A new Russian government cannot ignore these risks even if, as we hope, they do not materialize. If all goes well, then Russia will have a window of opportunity to tackle its inherent structural problems. Hopefully then we will start to see new faces with appropriate talents increasingly involved in the new government. If not, then it would be better perhaps to have those with some experience of how things have gone wrong in the past to steer the country through the storm ahead. As the late MIT economist Rudiger Dornbusch once said, "The crisis takes a much longer time coming than you think, and then it happens much faster than you would have thought."

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