The Washington Times
www.washingtontimes.com

# Putin and the reformers

By Richard W. Rahn
Published April 14, 2004

MOSCOW. -- There was a remarkable event last Friday evening in Moscow. Several of the world's most prominent free-market reformers spent more than four hours in a spirited dialogue about economic reform with Russian President Putin.

The participants included Ed Crane, president of the Washington-based libertarian Cato Institute; Jose Pinera who, as a Chilean government minister, began the world's first privatized social security system a quarter-century ago; and Ruth Richardson, who, as finance minister, was instrumental in New Zealand's highly successful free market reforms.

They were in Moscow to participate in an important Cato Institute conference on economic reform co-sponsored by the Russian Institute for Economic Analysis and the Russian Union of Industrialists and Entrepreneurs last Thursday and Friday, followed by another conference in St. Petersburg Monday.

President Putin has received mixed reviews in the West. On one hand, he has been reforming Russia's economy while retrenching on some press freedoms and democratic reforms. He has a very able team of market-oriented economists. His chief economic adviser, Andrei Illarionov, is highly regarded by many Western economists who have known or worked with him over the last decade. One of Mr. Illarionov's favorite themes, presented at the Cato conference, is the optimal size of government. He has compiled an impressive amount of evidence that most governments, including Russia's, are too large to maximize economic growth and popular well-being.

The Putin administration has the clear goal of greatly increasing Russia's economic growth, from the respectable 5 percent to 6 percent range of the last several years, to 7 percent or more. Despite Russia's recent economic successes, it is a laggard to its higher growth neighbors on the east and south, particularly China and India. Russia has, in part, been succeeding because of high oil, gas and metals prices, all of which it produces and exports in prodigious quantities. But these also make it very vulnerable to the next cyclical commodity price downturn. To achieve its goal of higher economic growth, Russia must create modern manufacturing and service sectors that it sorely lacks.

Economic Adviser Illarionov and President Putin well understand part of Russia's problem is the excessive and stifling government bureaucracy. For instance, the Russian Central Bank has 82,000 employees, 3 times as many as the U.S. Federal Reserve, even though we have twice the population and 20 times the gross domestic product (GDP) of Russia. New Zealand's Ruth Richardson told Mr. Putin she believed he needs to act more quickly in cutting back the size and powers of the bureaucracy, and Elena Leontjeva of the Lithuanian Free Market Institute added that he should do so by slashing budgets rather than by rearranging the deck chairs.

Russia has made progress in tax reform by instituting a highly successful 13 percent flat rate income tax. However, the total tax burden is still way too high to make Russia truly competitive. A Russian businessman explained to me that before he pays his employees each week, he first deducts from wages the 13 percent flat tax, then a 35.6 percent "social tax" (for the state pension program) that is now slated to be reduced to 26 percent. In addition, he has to pay a 35 percent tax on business profits and a 17 percent value added tax on his purchases. In his comment to Mr. Putin, Jose Pinera, whose privatized social security programs have been adopted by 17 countries, stressed the need to simplify and speed Russia's proposed move to a partially privatized social security system.

In his dialogue with Mr. Putin, Ed Crane of the Cato Institute emphasized the importance of privatizing all the press and not restricting press freedoms, and noted that a truly strong leader makes his people freer. President Putin was highly engaged in the meeting and clearly understood the observations and recommendations being made to him.

If one goes to downtown Moscow, it is clearly vibrant, and the renovations of recent years make it look not much different from a normal European city. The problem is that central Moscow is not yet typical of all Moscow, let alone much of the rest of Russia, where real poverty and hardship are the plight of the typical family. As one who has been to Russia many times and was involved with the early reform efforts, I am heartened to see the progress but also discouraged by the continuing corruption and missed opportunities. Mr. Putin and his economic advisers clearly know what they should do, but the open question is whether Mr. Putin will use his current high political standing to act quickly and boldly enough to make his country a real economic "tiger" or will continue only incremental steps.

Mr. Putin may go down in history as just another Russian ruler who squandered the opportunity or he as Russia's greatest statesman, who elevated his country to prosperity and freedom. The choice is his, and the jury is still out.

*Richard W. Rahn is a senior fellow of the Discovery Institute and an adjunct scholar of the Cato Institute*