

Analysis No. 234, February 2014

WHAT THE ECONOMY CAN TELL US ABOUT POLITICS IN RUSSIA?

Serena Giusti

This analysis reveals that Russia is marked by a bubbling social climate. Although opposition is still fragmented and discontent has not yet been channeled through an alternative political project, the dissatisfaction with the current leadership is mounting. Negative assessment of Putin, does not for the moment translate into a wider movement of protest. However, a prolonged modest economic growth can undermine political stability in Russia as social policies are less affordable than in the past. President Putin is not inclined to lead a profound transformation of his country because he is well aware that structural economic reforms entail more political efficiency and good governance, in other words more democracy. Putin's presidency has temporarily benefitted from some successes in foreign and he might – depending on terrorism – distract its public opinion with Winter Sochi games. Nevertheless these events cannot help overcoming the real problems of the country. Economy and politics are so intertwined that the greatest challenge to the establishment in Russia is not coming from the streets but from the market.

Serena Giusti is Senior Associate Research Fellow for the Russia and EU Eastern Neighbours Programme at ISPI and, assistant Professor at the Scuola Superiore Sant'Anna di Pisa. She is also lecturer of Russian Foreign Policy at the Catholic University in Milan.

Mounting discontent

The Briefs composing this study have taken into consideration new actors crossing the Russia's political landscape. There are clear signs that Russian society is less homogenous than in the past and that there are many groups asking for more political representation. As one Brief points out, the use of the web has reinforced the group of the unsatisfied. The accessibility of information has contributed to the formation of a more opinionated public opinion while the virtual interconnection, at least among the urban and educated youth, has cemented a variety of people not only resident in Moscow. Through internet a new generation of Russians has the chance to develop independent views, to debate a broad spectrum of issues and, eventually to take concrete steps towards a deeper involvement in politics. As we know, this is not a sufficient condition for renovating the system of power in Russia. We do believe that this, however, is a fruitful humus in a long term perspective. This analysis is showing that, given the bubbling social climate, a further effective incentive for change can be offered by the country's poor economic performing.

Although opposition is still fragmented and discontent has not yet been channeled through an alternative political project, the dissatisfaction with the current leadership is mounting. According to a Levada Center survey, public support for Putin has declined: about 5% of respondents said that they had a sympathetic opinion of him compared to April 2008's record-breaking 80%. Only 35% believe that he is an "ideal head of state" (46% disagree with that statement). As many as 55% of Russians want the president who will be elected in 2018 to be someone completely different, and only 22% would choose Putin for another term. Likewise, support for the President's party, United Russia, has also dramatically deteriorated (in May only 24% of respondents said they would vote for it). Negative assessment of Putin does not for the moment translate into a wider movement of protest. Those who in the past have taken the streets still represent only a little portion of society. While dissatisfaction is diffusing, the risk of unexpected uprising is extremely low.

At the time of mass protests, people were mostly disappointed with Putin returning to the presidency, swapping jobs with Dmitry Medvedev (as Hanson explains "This manoeuvre was not necessarily unwelcome or unexpected, but the leaders made the mistake of presenting it as a fait accompli, about which no prior public consultation was deemed appropriate").¹ Currently, people are mostly embittered because of the stagnation of the economy and of the overall state organization. Part of

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¹ P. HANSON, "Russia in the Global Economy in the Next Few Years", *The International Spectator: Italian Journal of International Affairs*, 2 October 2013.

society also believes that Putin primarily represents the interests of the bureaucracy and oligarchs while the most innovative parts of society are not adequately encouraged.

The first two Putin's mandates coincided with the peak of the country's economic growth since the establishment of the Russia Federation. This contributed to the strengthening of Putin's legitimacy. As the economic growth contracted, people were less enthusiastic about their leadership. It is yet unclear how the central power will react to this consensus plummeting: cosmetic changes (e.g. the replacement of key ministers or even the prime minister) do not seem adequate to dissolve a gloomy atmosphere. We believe that only a strategic and comprehensive plan of reforming would help limiting the loss of consensus while preventing risky turbulences.

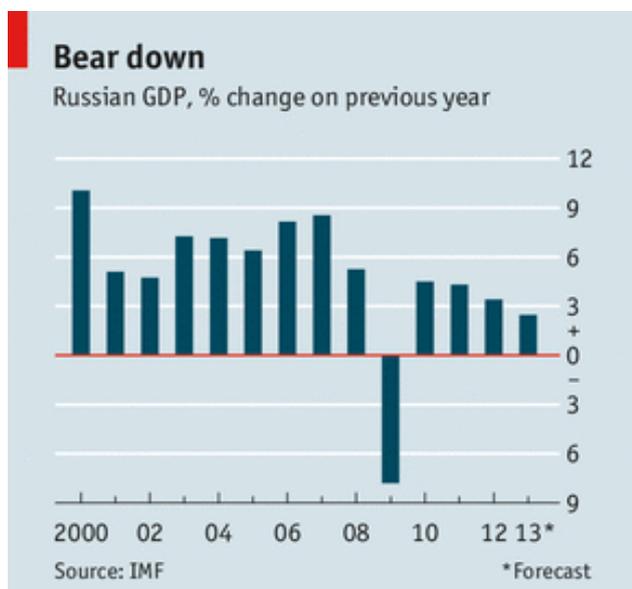
According to the president's vision, modernization was to cover all spheres of the country's life, bringing about the diversification of Russia's economy from dependence on natural resources to an economy based on innovation. Medvedev called on external actors to help out with the country's mission and affirmed that the effectiveness of foreign policy would be measured by its contribution to the improvement of living standards in the country.

Gloomy Economic Perspectives

Although Russia's economy was hit hard by the global crisis of 2008 and 2009 – between those two years, its GDP fell by 7.8 per cent – it nevertheless grew by 3.6 per cent in 2012. In the first quarter of 2013 it rose at a slim annual rate of 1.6 per cent, the slowest since 2009. This month Russian government slashed its economic forecasts for the next two decades, amid weak investment, low demand for its commodities exports and capital outflow that could hit \$70billion this year². According to Economy Ministry growth is expected at an annual rate of 2.5 per cent to 2030, down from the forecast in April of 4.3 per cent, below the global average. Actually Russian growth would lag behind the global average for the next 16 years.

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² In 2011, the net capital outflow was 4.5 per cent of GDP, and in 2012 it was almost 3 per cent – or \$54bn. In the first quarter of 2013 alone, the net capital outflow was \$26bn – more than 1 per cent of annual GDP.



When inaugurating his third presidential mandate, Putin promised a 5 per cent growth but the above mentioned forecasts show that the target is not reachable. Manufacturing is slowing while private consumption is declining. The economic model based on oil and gas revenues (it is calculated that the oil price at which Russia can finance budgeted spending without borrowing has increased from just \$34 a barrel in 2007 to above \$100 for the years ahead)³ is not working anymore and future growth will need investment in new technology and improvement regarding efficiency and labour productivity. State-driven investment is diminishing while private investment has stayed low because of high inflation that is causing an increment of costs while a strong ruble has further damaged competitiveness. The banking and financial system is still weak. Relatively high wages and a low quality of products are not making the country very attractive⁴.

In early 2012, Putin ordered the government to improve the business climate with a view to pushing Russia to 50th position in the Doing Business (*The Doing Business report* by World Bank measures the efficiency and strength of laws, regulations and institutions relevant to domestic small and medium-sized companies throughout their life cycle to rank the world's best places to run a business) rankings by 2015 and 20th in 2018. The government has so far adopted nine road maps encompassing a total of 520 measures to that end. Four more road maps are expected for completion by the end of this year. As for the 2014 edition, World Bank experts praised Russia in particular for achievements in five areas – ease

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³ "Russia's Economy, The S word", *The Economist*, November 9, 2013, p. 32.

⁴ *Ibidem*.

of opening of new businesses, simplified application process for construction projects, simplified registration of property rights, prompt connectivity to the electricity grid and improvement in global trade procedures. These improvements will hardly ameliorate the business climate without radical and structural state reforms.

Social and Political Implications

In consideration of a low growth, the Economy Minister Ulyukayev said that it would be difficult to maintain high the social expenditure and as a result salaries and pensions will rise more slowly. This might have serious political consequences in a country with 20m state-sectors workers and 40m pensioners. Putin's consensus at least until mid-2011 has been strengthened thanks to the economic benefits guaranteed to Russian people on the basis of the energy exports revenues. As Inozemtsev of the Centre for Post-Industrial Studies noted, «growth income is more important than growth in economy itself»⁵. The gap between citizens' expectations and government's delivery is due to rapidly increase eroding further consensus for the ruling elite. Furthermore, a prolonged period of a modest economic growth could negatively impact the political support in the regions, which have so far remained relatively loyal to Putin despite last years' protests by middle class in Moscow⁶.

In this context, it seems that slight institutional changes will not be determinant for fortifying the leadership. Frequently, the idea that President Putin might replace Dmitry Medvedev as prime Minister, has been floated. Many analysts, however, believe that any reshuffle, especially in the economic group, will not happen before the Winter Olympics in Sochi in February 2014⁷. After that, if the economy will continue to deteriorate, Putin might finally engage in a process of structural reforms that many advisers are advocating but that some of his entourage are opposing for the fear of losing their privileges. Once again, Russian intelligentsia is divided on the country's path towards modernization (that is intended in a minimalist way: diversification of Russia's economy from dependence on natural resources to an economy based on innovation).

Consequently, so far the signs of a reforming are very timid while the president seems unwilling to come to terms with those who are criticizing his operate. Putin is embracing a hard-line and adopting repressive

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⁵«The Russian economy», *The Economist*, 22 June 2013.

⁶ K. HILLE, «Russia slashes long-term growth forecast», *Financial Times*, 7 November 2013.

⁷ Putin has been particularly critical against three ministers involved in the public sphere: Labour Minister Maxim Topilin, Health Minister Veronica Skvortsova, and Education Minister Dmitry Livanov.

measures including controversial laws on treason, protests, foreign-funded non-governmental organizations and censorship⁸.

In order to alleviate the bad economic situation, the government has approved a stimulus programme designed to accelerate economic growth. The programme consists of infrastructure investments and breaks for small and medium-sized enterprises (SMEs). In June Putin announced that the government would invest Rb450bn from its national wealth fund into three major transport projects: a new high-speed railway from Moscow to Kazan, improvements to the trans-Siberian line and a new ring road around Moscow. Russia could spend up to half of its US\$87bn reserve fund on infrastructure investment.

Instead of accelerating privatization (privatization revenue targets have been lowered as asked by some of the Putin's inner circle but also because there is a weak demand for Russian stocks) and further economic liberalization, the state on the contrary is strengthening its control over the economy (the state currently controls about 50 per cent of the economy; in the oil sector, government control has grown from 10 per cent in 1998-99 to 40-45 per cent). Not only as a result of the state intervention for saving strategic assets which suffered from global crisis but also because in 2008-2012 private sector lost 300,000 jobs. The state added 1.1m, pushing its numbers to 18m (around 25 per cent of the workforce). Private firms not only lose business to state-owned ones, but also compete with them for labour.

The number of people interested in opening their own business is still very low, people are more inclined to become part of the system rather than to create their own. According to a survey by Babson College and the London Business School, only 3.8 per cent of Russian entrepreneurs intended to open a business in the near future. The corresponding collective average

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⁸ In July 2012, president Putin signed a law *Introducing Amendments to Certain Legislative Acts of the Russian Federation Regarding the Regulation of Activities of Non-commercial Organizations Performing the Function of Foreign Agents*. The law requires all NCOs to register in the registry of NCOs, which is maintained by the Ministry of Justice, prior to receipt of funding from any foreign sources if they intend to conduct political activities. Such NCOs are called "NCOs carrying functions of a foreign agent". In June 2012, 150-fold and 300-fold increases to existing fines for violating rules on the participation in and organization of public protests for individuals and organizations, respectively, were enacted. In July 2012, defamation was reintroduced as a criminal offence in Russia, which mandates fines on media outlets of up to two million rubles (approximately \$61,000) for producing "defamatory" public statements. Also in July 2012, changes introduced to the Law on "Information, Information Technologies and Information Protection" increased Internet censorship and curbed the freedom of expression. On October 23, 2012, the law on amendments to the criminal code was adopted, which expands the definition of treason, making it so vague that it allows the government to brand any inconvenient figure as a traitor.

in Brazil, India, China and South Africa, the other BRIC countries, was 21 per cent. Russian university graduates also overwhelmingly favor working for state companies rather than in private enterprise, though interest in major international companies is on the rise⁹.

The private sector is also struggling with a high rate of corruption and lack of property rights. In the occasion of Navalny condemnation, former Finance Minister, Alexei Kudrin, affirmed that the verdict was «an attempt to isolate him (Navalny) from society and the electoral process» and that the verdict would hurt business activity and the investment climate in Russia¹⁰. In July the Russian Duma approved an amnesty for entrepreneurs (later it reduced the number of criminal code provisions subject to the amnesty from 53 to 27, in part to exclude people like Khodorkovsky and Navalny) seeking to stop the legal offensive against the Russian business community. More than 100,000 Russian businesspeople are either in prison or have been subject to criminal proceedings, and the majority of them are presumably innocent. Law enforcement authorities use criminal law statutes, many still based on Soviet law, for criminalizing regular business activity, otherwise permitted under Russian civil law. So Russian criminal investigators, tax inspectors, prosecutors and other monitoring bodies – often connected to criminal groups – tend to use legal instruments to intimidate, and steal from Russia's small business community.

Conclusions

A prolonged modest economic growth can undermine political and social stability in Russia. Discontent among people is on the rise (from the major cities to the regions) although mass protests are very rare in comparison to the previous two years. Social policies are less sustainable than in the past and so the consensus around the leadership is plummeting. President Putin is not inclined to lead a profound transformation of his country. He is well aware that structural economic reforms entail more political efficiency and good governance, in other words more democracy. There are some not revolutionary improvements which can be enacted to boost the economy and attract more foreign direct investments. However their beneficial effects are ephemeral if not accompanied by a campaign against, what previous president Medvedev called, legal nihilism (in particular, protection of property rights and rule of law) and a long term plan for modernization. Putin's presidency has temporarily benefitted

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⁹ The survey is quoted by Reuters, *How Russia puts business behind bars*, 5 July 2013.

¹⁰ http://www.demdigest.net/blog/2013/07/a-new-russian-mandela-us-deeply-disappointed-by-navalny-conviction/?utm_source=feedburner&utm_medium=email&utm_campaign=Feed%3A+DemocracyDigest+%28Democracy+Digest%29#sthash.raU88IpN.dpuf

from some successes in foreign policy (e.g. the chemical weapons plan for Syria that prevented a military intervention by the US, and the agreement reached with Iran for curbing some of its nuclear activities) and has the chance to distract its public opinion with Winter Sochi games. Nevertheless these events cannot help overcoming the real problems of the country. Economy and politics are so intertwined that the greatest challenge to the establishment in Russia is not coming from the streets but from the market.