

Eyes Wide Shut: The Social Consequences of Russia's Economic Crisis

Sam Greene

It was a remarkable scene, as Russia's third president, Dmitry Medvedev, lit into the country's ruling elite during his first Address to the Federal Assembly. He said:

"...the bureaucracy still does not trust free citizens and free activity. This logic pushes it into dangerous conclusions and actions. The bureaucracy from time to time casts fear over the business world, pressuring it to keep in line and not to take what they consider wrong action, takes control of this or that media outlet, trying to stop it from saying what they consider the wrong thing, meddles in the electoral process, preventing the election of whom they consider the wrong person... The result is that the state bureaucracy is the biggest employer, most active publisher, best producer, and is its own court, its own political party, and ultimately its own people."

The best Hollywood prosecutor could not have delivered a more elegant and damning indictment of the men and women sitting in that gilded hall, many of whom represented that bureaucracy. But the real drama came when Medvedev paused: the bureaucracy applauded. Such is the fear within them now that they listened as their president, until recently just another stony face in that same hall, recounted their sins, and

then they rejoiced in the counting. It would have been almost a religious experience, except that Medvedev is no priest, and this confession brings no absolution.

The bureaucracy's fear is understandable. The stability of Russia's political system over the past nine years has been predicated on two factors, neither of which looks likely to persist much longer. The first is rapid, resource-driven economic growth, which has allowed officials, businessmen and, to a large extent, ordinary citizens to ignore many of the country's structural problems, in much the same way that a bicyclist can ignore the precipices on either side of his path: so long as the bicycle is speeding steadily forward, it will not fall to one side or another. Oil is down to \$50 a barrel, other commodities have fallen sharply as well, and a prolonged global recession — one which is looking increasingly likely to stifle even Chinese growth — does not bode well for a near-term recovery in Russia's fortunes.

The second factor of stability has been the elite's parachutes, the "cash-out" option by which bureaucrats and officials could jump off at any point and be assured of a relatively soft landing — often in Western financial capitals — thanks to the



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significant assets accumulated over the course of their service. Because of this cash-out option, it seemed, the political system would be able to withstand any number of crises, as the more risk-averse members of the elite would just leave, rather than vying to change the system they felt had become too risky. Ironically, this arrangement increased the level of risk involved in Russian politics, encouraging high-stakes games of expropriation and re-appropriation, from which all but the most unlucky stood to gain handsomely. The global financial crisis, however, has put large holes in many of those parachutes. Assets that were once liquid are now leaden.

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The losses, both in Russia and abroad, have been so catastrophic that many who might once have jumped will now be forced to sit tight. That, in turn, encourages them to take a closer look at where the bicycle is headed and at the precipices on either side of the path. It is not a pretty picture.

Another side-effect of the risky nature of Russian politics, meanwhile, is that it forces people within the system to operate with an extraordinarily short time-horizon. Because every individual bureaucrat and official, from the highest to the lowest levels, knows that his or her position of power can evaporate almost instantaneously, they have no choice but to conduct a constant calculation: jump now, or hold on just a little bit longer? The fate of those who held on too long — the Yukos leadership, for example — clearly illustrates the importance of getting the calculation right.

This constant, day-to-day reevaluation of one's personal position, however, has always been more of a gut-feeling judgment than a mathematical calculation, largely because there was very little reliable information with which to work. To help keep risks manageable, the bureaucracy worked to eliminate those potential sources of instability that it as a group could not control: thus, voters, politicians, journalists and businessmen had to be brought to heel, as Medvedev so eloquently described. Civil society and trade unions, though Medvedev didn't mention them, met much the same fate. The result is what Andrew Wilson calls "Virtual Politics", replacing institutions with simulacra and feedback mechanisms with day-dreams.¹

For a while, when there was plenty of liquidity to smooth out the bumps in the road, Russians and their rulers could be fairly easily convinced that this system was somehow effective. That doesn't mean, however, that anyone ever really believed in the façade or bought into the propaganda. Ellen Mickiewicz has demonstrated quite clearly that the majority of Russian citizens understand when they are being lied to (in the case of her study, on the television news) and have very little patience for the lie itself.² To cope with a system in which laws empower bureaucrats rather than citizens, verdicts are an invitation to begin negotiations and the truth is just the most authoritative re-telling of fiction, citizens resort to any number of "informal" practices of the kind that Medvedev called "legal nihilism". It is, in essence, a new variation on the old Soviet line that "they pretend to pay us, we pretend to work:" in today's Russia, "they pretend to govern, we pretend to obey."

This ground-level dissatisfaction began to manifest itself even when the economy was doing well. Beginning in 2005, motorists unhappy with overbearing regulations and erratic policing took to the streets re-

peatedly, frequently forcing the state to back down.³ In cities across the country, residents organize dozens of protests each week against a range of abuses by municipal authorities and real estate developers, the most high-profile of which took place in the Moscow suburb of South Butovo in the summer of 2006.⁴ And beginning with strikes at the Ford Motor Co. assembly line outside St. Petersburg in 2005, independent labor activists have staged a constant series of work stoppages at factories and mines across the country.⁵

It would be a mistake to say that these phenomena form some sort of cohesive opposition — in fact, they have very few organizational ties among them, and no real ties at all to Russia's formal political opposition. But they do reflect a combination of two very powerful sentiments that are manifestly shared by all of the protestors, regardless of their specific grievances. The first of these sentiments is a feeling that Russia's economic boom has not been accompanied by economic justice: most Russians, while enjoying somewhat more prosperous lives than during the 1990s, have been priced out of the shining new Russia they are incessantly shown on television. The second sentiment is a sense of entitlement: while few Russian citizens take their political rights very seriously, they do believe very strongly in those limited economic rights they are able to enjoy and are willing to stand up to defend them. So when officials who drive new BMWs want to raise import duties on used VWs, the reaction is visceral. When officials who live in guarded villas want to raze humble wooden homes in South Butovo, the anger is palpable. And when the ruling United Russia Party campaigns on a slogan of increased salaries, workers expect them to make good.

Russia's perfect storm

The good times, however, are gone, as the Russian economy has been hit by a perfect

storm of bad news. The global credit crunch has dried up the cheap sources of capital that fueled the aggressive expansion of Russia's construction, retail, automotive, technology and consumer goods sectors, putting the brakes on diversification at just the same time that Russia's traditional revenue sources were undermined by collapsing commodity prices. In a November 17 report, the World Bank noted a steep drop in investment (beginning, incidentally, in early 2008), a "sudden reversal" in capital flows and ever-increasing foreign debt (mostly corporate, until you consider the shareholding structure of "private" companies, such as Gazprom and Rosneft), and predicted a "prolonged economic slowdown" that would dominate most of 2009 and possibly longer.⁶ Two days later, despite prime minister Vladimir Putin's continued assertions that Russia faces difficulties, but not a crisis, minister of economic development Elvira Nabiullina told the State Duma that "the global economic crisis, which has only just begun, has demonstrated the exhaustion of the model of Russian economic growth that has been in place in the previous years." Nabiullina, together with finance minister Alexei Kudrin and Central Bank chairman Sergei Ignatiev, told the parliament that "we have very serious problems."⁷ Banks have stopped lending to homebuyers and consumers and some have stopped operating altogether. Government agencies, financial institutions and even oil companies have lined up to get help from the state. The World Bank estimates the total fiscal, quasi-fiscal and monetary cost of the bailout to date at 5.64 trillion rubles, or about \$205 billion. Relative to the size of Russia's economy, that's about twice as much as the \$700 billion the United States is planning to spend under the Paulson plan.

If that still doesn't look like a crisis from the top down, from the bottom up the situation is clearer. Almost all Russians have

seen their home values and spending power drop. An increasing number of Russians, meanwhile, are losing their jobs. A new website has popped up to chronicle the carnage, and since it began counting on September 30, it has noted some 78,000 job losses, including dismissals and unpaid layoffs, across the country through November 20 (when this Briefing was drafted).⁸ That figure, meanwhile, does not include companies that only reported percentage cuts rather than nominal job losses; when those are taken into account, job losses between September 30 and November 20 are likely to have totaled more than 100,000. Again, adjusting for the relative size of the population, that's roughly equivalent to job losses in the U.S. in the same period. According to the latest Russian official statistics, some 1.5 million workers had been laid off by the end of November. Lay-offs are happening throughout the economy: in manufacturing (25,000 at GAZ, for example), metals (10,000 at Evraz, 3,000 at Magnitogorsk), finance (nearly 2,000 at Renaissance Capital, 20% of the staff at Troika Dialog and Uralsib, 70% at Antanta-PIOGlobal), transportation (100% of the staff at Krasair, 3,000 jobs at Dalavia, 50% of the employees of the Kaliningrad Seaport), the media (500 at the Ostankino television studios, 30-50% at the Afisha Publishing House, 50% at Rambler), and so on. Even the government is not immune: 15% of the employees of Rostekhnadzor will be dismissed, as will 100 city officials in Nizhny Novgorod and 7% of the staff of the governor of the Perm Region, just to pick three examples.

The worst may be yet to come, however. Business leaders say privately that the peak of the so-called "margin calls" — essentially a situation in which Russian companies' foreign lenders, fearing a default, can call in all outstanding loans, rather than simply those scheduled for repayment — beginning in December will lead to significantly more

layoffs than have been seen so far. The Russian Union of Industrialists and Entrepreneurs is negotiating with the state-backed Federation of Independent Labor Unions (FNPR) to allow modifications to collective bargaining agreements and, presumably, to keep the peace. The United Russia Party has even gone out of its way to sign an agreement with the FNPR's main rival, the oppositional Sotsprof grouping of unions, whose members have been responsible for all of the high-profile strikes in recent years. The terms of the agreement, announced November 13, are unclear, but Sotsprof has recently backed away from some of its more militant rhetoric.

A large portion of the next round of layoffs, meanwhile, will affect white-collar workers, mostly young mid- and low-level managers who have become accustomed to large salaries and conspicuous consumption but who have, for the most part, neglected to save for a rainy day. Their current but soon-to-be-former employers worry not only that these individuals will have a difficult time adjusting to what may be a lengthy period of unemployment, but that they will take out their frustrations on their old companies, making good use of all of the potentially damaging insider information accumulated over the years.

What worries business leaders most, however, is that these and other unpleasant surprises will hit an unsuspecting population as an unwelcome New Year's present. They are frustrated that the government is not preparing its citizens for what is coming, sticking instead to rhetoric about "islands of stability" and the idea that this is the West's crisis, but not Russia's. The television news failed to notice Nabiullina, Kudrin and Ignatiev's "we have very serious problems" speech to the Duma. Government-friendly newspapers do little better: Izvestia has reported on bank layoffs in the U.S. and Europe, but failed to mention that they were

happening in Russia, too. Kommersant and Vedomosti provide comprehensive coverage of the economic fallout, but they have a limited circulation and are read primarily by those who already know that the crisis is at hand. Workers who have been convinced that everything is fine may soon learn that they are unemployed and are likely to blame their employers. Business is concerned that the politicians may be inclined to point the finger in that same direction.

Fingers are pointing in plenty of other directions, too. Construction companies — notably absent from the layoff lists mentioned above — have halted most major projects less than 80% completed and, as a result, are releasing large numbers of workers. Those workers, though, are unlikely to show up in the unemployment figures, because relatively few of them are Russian citizens. Unfortunately, they are likely to show up in police reports. Some 114 non-ethnic Russians, mostly migrant workers, have been killed in presumably racially motivated attacks in Russia since the beginning of the year.⁹ The Young Guard youth wing of United Russia has proposed deporting all migrant workers from the country, ostensibly both to promote public safety and to increase employment opportunities for Russian citizens.

Confusion reigns

Alongside businessmen and foreigners, though, Russian citizens are likely to assign at least some of the blame for the crisis to their government, particularly if the crisis drags on. So far that doesn't seem to be happening. According to the Public Opinion Foundation's surveys, Medvedev's approval ratings have been stable, reaching an all-time high of 57% on November 8-9. Putin, despite formal responsibility for the economy, is even more popular, although his approval ratings have fallen ever so slightly from 73% in September to 71% on November 8-9.

When it comes to the economy, the numbers are a bit more nuanced. In the most recent survey by the Public Opinion Foundation on November 13, only 6% of respondents said that their personal welfare had improved over the past two to three months; 37% reported worsening personal finances, while 55% noted no change. Looking ahead, the same survey found that 29% of Russians believe the economy is set to get worse, 43% say it will stay the same and 12% are optimistic about improvements. The numbers get more interesting, however, when broken down by social groups. Thus, unsurprisingly, the elderly, poor and poorly educated were most likely to say that their personal welfare had worsened in recent months. But these same groups — those without higher education, with income under 7,000 rubles per month and older than 55 years of age — were also the most optimistic about the economic outlook for the near future. Conversely, those who had done relatively well in recent months, largely because high incomes absorbed consumer price increases, were disproportionately likely to believe that the economy was headed for the doldrums (although, even of those groups, only a minority were pessimistic).

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There is clearly a disconnect between perception and reality. In the November 8-9 survey, 68% of respondents answered that their firms had experienced difficulties, ranging from delayed and decreased salaries

to layoffs, but on November 13 only 37% reported that they had been adversely affected by the economy in recent months, and only 29% said they thought the economy was worsening. This may be due, in

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part, to the media environment, as well as to survey respondents' tendency to give answers that reflect the media's dominant message, rather than their own perception. Without more study, it is impossible to know. Russians withdrew 80 billion rubles from their deposits at Sberbank — widely regarded as Russia's safest bank — in October, the biggest outflow the bank had seen since 1998. Russians abandoned the ruble as well, helping to drive it down from approximately 25 to the dollar in the beginning of October to nearly 27.5 to the dollar in mid-November. Russians, then, may be outwardly supportive of their leaders, but that doesn't mean that they have much confidence in their leaders' ability to manage the economic crisis.

Among the new principles should be a promise that management and workers will share the burden, that safety and quality control will not be compromised, and that companies will open their books to the public, so that workers and others can share in the evaluation of effectiveness.

The real problem is that their leaders may not have much confidence in their own ability to manage the crisis, either. The bailout

measures analyzed by the World Bank were drafted and announced in a seemingly ad-hoc process over a protracted period beginning September 17 and ending October 14, frequently revisiting and revising earlier measures along the way. Promises of support to various sectors appeared to be made as and when those sectors came to the government looking for help, rather than as part of a carefully considered stimulus package. Early signals from the finance and economic development ministries were that there would be no significant support to the oil and gas companies, only for the prime minister to announce otherwise. Likewise, Putin and Medvedev both declared there would be no devaluation of the ruble, only for Ignatiev to announce that the Central Bank would temporarily stop propping up the currency.

By creating a \$50-billion fund to help key companies restructure their foreign debt and thus prevent large and perhaps controlling stakes from shifting overseas, the government is sending a message to the elite that it will do its utmost to keep the system together. But by allowing the currency to go into freefall and by failing to provide any clear explanation to the population about why tens of thousands of Russians are losing their jobs — and why hundreds of thousands more may do so in the near future — the government is only creating more nervousness and uncertainty among both the elite and the population. Ordinary Russians, starved for information and guidance, may begin to panic, causing bank runs and even, possibly, civil unrest. That, in turn, will have to factor into those daily risk-reward calculations of the country's ruling and bureaucratic elite. More and more of them will probably be looking to test out their parachutes, even if they are a bit less reliable than they once were. The result would be a cycle of panic in the political system similar to the dynamic that drives stock market crashes: a

general loss of confidence becomes a self-fulfilling prophecy, and everyone suffers.

The road ahead

There are ways out of this situation. Various players, both inside and outside Russia, can do a lot to increase the time horizons of at least some of those within the system, giving time for cooler heads to prevail. This could be accomplished by creating new domestic and international partnerships.

Domestically, if the state at the highest levels persists in denying the depth of the crisis, it would behoove the Russian Union of Industrialists and Entrepreneurs and other business associations to come together with FNPR and Sotsprof to draft a statement of principles — including very clear red lines regarding treatment of workers and respect for contracts — that would go a long way towards building trust between employees and employers. Among these principles should be a promise that management and workers will share the burden, that safety and quality control will not be compromised, and that companies will open their books to the public, so that workers and others can share in the evaluation of effectiveness. If the state will not cooperate, this will fall short of a true tripartite arrangement, but it may suffice to keep the peace in the near to medium term.

Internationally, the global financial institutions and government and private donors should encourage and assist Russian research and analytical organizations, NGOs, journalists, business groups and labor unions to engage in the global debates on policy solutions to the economic crisis. Given the lack of an open public debate on how to deal with the crisis in Russia, helping Russian stakeholders to latch onto policy discussions and initiatives internationally will empower them at home to create new, content-rich platforms for debate, as well as to be ready with solutions when and if the state

determines its own policymaking to be at an impasse. In addition, helping Russians to see their own economic crisis in a global context may go some way towards rationalizing the public debate in Russia.

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Nobody is interested in seeing an economic, social and political implosion in Russia: not the politicians or the bureaucracy, not the workers or the employers. Managing these sorts of crises, however, is a significant challenge even for the most open societies with the most mature democratic institutions. Success requires a rare combination of leadership, cooperation and patience. None of those qualities, unfortunately, have been encouraged by the political and economic developments of the last decade or so in Russia. If Russia's political, economic, labor and civic leaders are able to develop a working relationship and an open and honest dialogue with each other and the public, such that perception and reality throughout society and the state can be brought into alignment, Russia will emerge stronger than ever from this crisis. There is, incidentally, no other option.

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Notes

- ¹ Wilson, A. *Virtual Politics. Faking Democracy in the Post-Soviet World*. New Haven: Yale University Press, 2005.
- ² Mickiewicz, E. *Television, Power, and the Public in Russia*. Cambridge: Cambridge University Press, 2008.
- ³ Greene, S. "Gosudarstvo i obshchestvennyi suverenitet" in *Pro et Contra*, No. 1, 2006.
- ⁴ For more on these, see <http://www.ikd.ru/taxonomy/term/13>
- ⁵ Greene, S. and Robertson, G. "Novoye rabocheye dvizheniye v Rossii" in *Pro et Contra*, No. 2, 2008.
- ⁶ World Bank, Russian Economic Report No. 17.
- ⁷ «Zanachki Kudrina khvatit na sem' let», <http://gazeta.ru/financial/2008/11/19/2888546.shtml>
- ⁸ See <http://www.sokratili.ru/>
- ⁹ <http://www.moscowtimes.ru/articles/detail.php?ID=372509>

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