

## Analysis

# Russian Political System Faces Significant Challenges Dealing with Economic Crisis

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## Abstract

The recent drop in oil prices and the global financial crisis present difficult problems for Russia's political system. The concentration of power makes it possible for Russia's leaders to respond quickly. However, without input from a wide range of social groups, it is not clear that the leaders will choose the most appropriate policies or be able to implement them efficiently.

## Global Economic Environment Threatens Russia

The Russian political system will be deeply tested by the current global economic crisis. The legitimacy of the current leadership is based on performance. Prime Minister Vladimir Putin and President Dmitry Medvedev depend on steadily improving living standards among the population to maintain the stability of the political system that Putin has put in place. Russia's leaders have basically made a social compact with the population that they will improve living conditions in exchange for unlimited power and wealth for a small circle of elites. Now the situation will change as the global financial crisis takes hold, slowing or halting economic growth and threatening the stability and gradual progress Russians have come to expect. It is an open question whether the current leaders will be able to maintain their legitimacy if economic conditions start to deteriorate. Of course, short of street protests, ordinary Russians have no real way of directly influencing the political system.

Despite the rhetoric of Russia's leaders that the crisis will not affect Russia the way it has other countries, the global downturn is having a two-fold impact on Russia. The first and most obvious impact for Russia is the rapid drop in the price of oil, from almost \$150 a barrel in July to less than \$65 on October 24. Russia cannot affect oil prices in the international market on its own and is greatly influenced by the ups and downs of the global market. Unlike most countries in the West, Russia is an energy exporter and relies heavily on income from oil and natural gas sales. Sales of energy accounted for nearly 65 percent of Russia's total exports in 2006 and represented 37 percent of federal budget revenues in 2005. In recent years, Russia has used its oil income to finance a dramatic increase in imports from Europe. Russia exported 143.5 billion euros worth of energy and raw materials to the European Union (EU) in 2007, while the EU shipped 89 billion euros worth of manu-

factured goods (machinery, transportation, equipment), food and live animals to Russia that year.

The current Russian budget is based on expectations that oil will sell at \$70 a barrel. Prolonged prices below that level mean that the budget and trade balance will drop into deficit. Additionally, there is enormous pressure on the ruble, whose rise against the dollar has been touted as a sign of Russia's strengthened position against the US. While Russia has more than \$500 billion in cash reserves to address these problems, it is burning through this money quickly.

The second problem is that the international credit crisis is having a major impact on Russia since many of its banks and natural resource businesses are heavily in debt. As credit dries up, businesses are no longer able to operate, suggesting future losses of jobs and lower salaries, a prospect that is haunting the entire international community. In Russia, companies working in construction, real estate and retail trade are already in trouble.

## Inefficient Political Centralization

Since coming to power, Putin has put in place a system of state capitalism. He has sought to reduce as much as possible the power of Russia's most powerful businessmen. After he drove two of the dominant Yeltsin-era oligarchs into exile and imprisoned a third, the rest of the economic elite fell into line. At the same time, Putin has brought key parts of the economy back under state control after its privatization during the 1990s, particularly the oil sector and key manufacturing units, such as automobile production. The global financial crisis will make it possible to extend state control over the economy even further. To a much greater extent than elsewhere, Russia's economy is concentrated in the hands of a few key individuals. Many of the most prominent businessmen need state bailouts now and will have to give up even more control over their assets to the state to secure them. Several of the

oligarchs have lost more than 60 percent of their net worth and are hoping to gain access to some of the \$200 billion in government support Putin plans to hand out through Vnesheconombank, where he chairs the supervisory council.

The ever increasing state dominance of the economy threatens to further reduce the efficiency with which Russian companies operate. The inability of state companies to operate effectively was already apparent among oil companies as the state began to play a greater role in this sector. In fact, investment capital was starting to flee Russia many months before the extent of the crisis became apparent in the Fall, largely because of concerns that Russia would not be able maintain current levels of energy production. The Russian stock market has been steadily declining since May.

The growing state dominance of the economy creates fertile grounds for increasing corruption. In its 2008 Corruption Perceptions Index, Transparency International ranked Russia 147 out of the 180 countries that it examined. The inability to address the problem of endemic corruption was a key legacy that President Putin passed to his successor. Upon taking office, Medvedev promised to deal with the issue as well as the “legal nihilism” that went with it.

Putin has not just sought to exert control over the economy. He has spread his favored system of top-down control throughout all aspects of Russian life. He has closed off pluralism in Russian elections, sharply curtailed free speech in the media, reduced the possibility for action in civil society and made it extremely unlikely that any campaign against corruption will be effective. The main result of these policies has been to significantly reduce the possibility of any bottom-up solutions to the problems that Russia now faces. If Russia is to address the current crisis, its leaders will have to do so drawing on the political and intellectual resources at the top of the system.

### **Manipulated Electoral Processes**

Russia has not created a system for transferring power from one set of leaders to the next. The December 2007 parliamentary elections and the March 2008 presidential elections were largely stage-managed affairs with pre-determined results. Fearing another negative report, Russia set conditions that made it impossible for the OSCE to monitor them effectively. The electoral process is not serving the function it would in a healthy democracy by bringing new leaders and ideas to the fore.

Control over elections extends down to the regional level. Putin cancelled direct governors' elections in

2004, creating a situation in which governors now seek to serve the Kremlin rather than their constituents. The situation in St. Petersburg is a case in point. There Governor Valentina Matvienko has been in office for more than five years. Since the Yabloko party was disqualified from the city's 2007 Legislative Assembly elections on a technicality, there has been little public criticism of the governor's policies. Now public life in the city is characterized by a lack of free speech and political homogeneity.

The situation is no different in regional legislative elections. Russia held its latest round of regional elections on October 12 and parties that did not have representation in the State Duma effectively were not allowed to compete at the regional level. United Russia dominated the elections. The Kremlin is essentially purging the field of alternative parties. Regional legislatures filled with party loyalists will be able to do little more than pass along instructions handed down from Moscow. Such obsequiousness will not be very useful in times of economic crisis, as the Moscow Carnegie Center's Nikolai Petrov pointed out in a recent analysis. With weak ties to the local community, these representatives will not be able to advocate for the ideas and interests of the local population.

### **Stunted Civil Society**

Putin's centralization of political power has made civil society increasingly irrelevant. What could be an incubator of new policy ideas has largely been suffocated or co-opted. The extensive Kremlin control over elections means that political parties independent of the Kremlin have an increasingly smaller role to play in society. Opposition has essentially become meaningless.

The most recent example is the disappearance of the Union of Right Forces (SPS). On October 2, the SPS political council voted to disband the party in its current form, give up its oppositional character, and merge with other smaller parties into a pro-Kremlin “liberal” party. By the middle of October, there were 14 registered parties in Russia, down from 35 two years ago. New SPS chairman Leonid Gozman told Ekho Moskvyy that “it is impossible to create a party without cooperating with the authorities under the existing totalitarian regime.” SPS no longer has any independent sources of financing, forcing former leader Nikita Belykh to quit. The party has had little popular support in recent years and was no longer represented in parliament. Russia now essentially has a 1.5 party system, focused mainly on Putin's United Russia and a handful of smaller pro-Kremlin parties.

At the same time, some of the most interesting opposition groups that have appeared in Russian society in recent years have since been co-opted by the government, as Floriana Fossato and colleagues argue in the recent publication *The Web that Failed*. A prime example is Svoboda vybora (Free Choice), an association of automobile enthusiasts which was created as a reaction to the proposed government ban on right-hand drive vehicles. The group evolved into a broad-based social movement that challenged the legitimacy of government policy making. The height of the movement's activity was a nation-wide protest on May 19, 2005, against the proposed ban. The organization subsequently set up a website (19may.ru) that brought together automobilists all over the country. The organization peaked as a grassroots protest movement in 2005 and 2006 and since then Vyacheslav Lysakov, the group's leader, has shifted to working with the government from the inside. The organization now provides advice to the government on car safety issues, but no longer functions as an organized grassroots opposition movement.

### Constrained Media

The situation is no better with the media. Reporters without Borders ranked Russia 141 out of 173 countries in the 2008 Press Freedom Index, citing continued violence and harassment of journalists. The global economic crisis shows that the state will continue to use its control over television to promote short-term political goals at the cost of free-flowing information and informed discussion about the challenges that the crisis poses to Russian society.

The state-controlled and affiliated media cover the financial crisis in the rest of the world in detail, including describing the measures that foreign governments are taking to address the problems. However, they often skip coverage of the most severe impacts on Russia. The media has avoided using phrases such as "crisis" and "collapse" when discussing the situation inside the country. For example, state television did not cover the 19 percent drop in the Russian stock market on October 6. Internet forums pointed out that Russia's officials were happy to discuss other countries' problems, but not their own. Under such conditions, people lose faith in their leaders.

In some ways, Internet usage has helped to compensate for the crackdown on the media since it frequently hosts a free-flowing discussion of important policy issues. Russia has 2.6 percent of international blogs, but these blogs account for 11 percent of blog entries, meaning that the Russian users write more than others

do. The Russian bloggers also tend to have more friends than bloggers in the US and Europe, with many having more than 1,000 such links. For many Russians, on-line engagement is their primary form of community since they are not likely to be involved in clubs off-line.

While politicians frequently call for greater controls over the web, such extensive oversight has not yet been implemented. In April Medvedev blocked a bill that would have closed down media outlets on libel grounds. But controls do exist: a government decree requires all telecom companies and Internet service providers to install equipment at their own expense which allows the Federal Security Service unrestricted monitoring of all communications, phone calls, text messages, and e-mail, without the service provider or user knowing about it. Under these conditions, agencies can trace specific individuals if they want, but they cannot control the entire Internet.

Unfortunately, the Internet has yet to live up to the high expectations of those who thought that its on-line forums and discussions would translate into off-line policy solutions and political action. The Internet brings together those who are already disposed to work together. Most sites do not reach out to the uncommitted. Moreover, often rather than serving as a grassroots mobilizer, the Internet has become an effective tool in the state arsenal to consolidate power and spread messages of stability among the people who use the web. State propagandists also pay bloggers and others to disrupt discussion in opposition forums using abusive language and obstructions or acting in concert to prevent some issues from reaching important audiences. This reasonably sophisticated form of manipulation avoids the overt censorship of the Chinese model, making it possible for the Russians to claim to outside observers that they respect the freedom of expression. The government pays a lot of attention to the blogosphere, spending millions of dollars a year to exert control over it. Such attention suggests that the government takes it seriously.

### Pervasive Corruption

Upon coming to office, Medvedev announced that one of his priorities would be combating corruption. New legislation that the government has introduced for discussion in the State Duma includes definitions of corruption and conflict of interest, a step forward for Russian law. The main innovation of the law is that public officials and their families have to publish their incomes, and they cannot work for companies that they did business with as public officials for two years.

Nevertheless, in current Russian conditions, critics like Indem's Georgy Satarov argue that the current campaign against corruption is no different from previous ones: it is simply a way for one group to grab money from another. The laws stiffen penalties for those offering a bribe, not those willing to accept them. Moreover, the law does not mention classified budgets. Usually, the more classified a budget, the more susceptible it is to corruption.

A real battle against corruption will not be possible in Russia before citizens have much better access to information about what the state bodies are doing, as a recent report from the St. Petersburg-based Institute for Information Freedom Development makes clear. It argues that despite the active development of legislation in the area of freedom of information, current laws do not provide legal means and mechanisms for interested citizens to gain access to information about the activities of official agencies. As a result, interested individuals experience difficulty in realizing and defending their

right to gain access to such information. Today they are not privy to a satisfactory amount of information. Without access to this information, the battle against corruption will be nothing but empty words.

### Conclusion

With its current state system, Russia has the potential to react quickly to the global financial economic crisis. Power is concentrated and there are few opportunities for those opposed to obstruct the leadership's policies.

The question, however, remains if the leadership will be able to select and implement an effective set of solutions. By concentrating power and shutting off discussion of the topic, Russia's rulers have deprived themselves of a free-flowing debate about all the issues that incorporates broad social input. Given the low efficiency of past state interventions into the economy, there are plenty of reasons to be skeptical that the current leadership will be able to respond in a manner that will both address the problems and serve society's interests.

### *About the author*

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### *Suggested Reading*

- Institut Razvitiya Svobody Informatsii, Fond Svobody Informatsii, *Natsional'nyi doklad o dostupe k informatsii o deyatel'nosti organov vlasti v Rossiiskoi Federatsii*, September 2008, <http://www.svobodainfo.org/info/page?tid=633200206>.
- Floriana Fossato and John Lloyd with Alexander Verkhovsky, *The Web that Failed: How opposition politics and independent initiatives are failing on the internet in Russia*, Oxford: Reuters Institute for the Study of Journalism, 2008, <http://reutersinstitute.politics.ox.ac.uk/publications/the-web-that-failed.html>.