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24

AN EMPTY SCOREBOARD?

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Summary

- The global financial crisis has had both an economic and a political impact on Russia. Inasmuch as Russia's political system is infused with business interests and economic considerations, the crisis presents an external and unexpected challenge to the system in terms of rocking the balance between the elite groups. In effect, the crisis calls into question the assumption that the economic and social stability of the Putin years has been successfully sustained during Medvedev's presidency.

- The Kremlin's response to the rapidly changing situation has been essentially conservative and geared towards strengthening the regime rather than addressing the challenges stemming from the crisis. The anti-crisis measures that are being taken reveal that the government is relying on its finance reserves as the ultimate means to solve the problem rather than reforming state institutions.

- The president, the government and the key business groups have yet to define the terms of their relationship in the new situation. The plans to increase state control over companies as a means of tackling the crisis are problematic and likely to lead to an intensification of the struggle between the elites. At the same time, as the state takes on even more responsibility, the question of its efficiency becomes more pertinent in the crisis conditions.

- The return of Vladimir Putin as president remains uncertain despite the constitutional change initiated by Medvedev. His return becomes more probable if the crisis lingers and the overall situation worsens, thus prompting the return of the "national leader" to the driver's seat.

- The crisis alone cannot lead to major political or social turmoil or a regime change, but it nonetheless presents a major challenge for Russia in the short-term perspective. Ultimately, the outcome of the crisis will depend on how well the incumbent leadership is able to maintain a balance between tackling the crisis and protecting its own interests and legitimacy.

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Rafael Matsunaga

Effects: obvious and hidden

The impact of the global financial meltdown on Russia's economy has been discussed in numerous media and expert reports. Yet, given the hybrid nature of Russia's political system, where economic concerns are intertwined with power interests, it would be misleading to assume that the crisis is having no political impact on the country.

The effects of the crisis on Russia's politics are hidden from view. While the implications for Russia's economy are relatively easy to assess by comparing economic indicators and the government's policies, the political effects are not so obvious. Yet it can be argued that the political significance of the crisis is that it puts the current power regime to the test in three respects.

Firstly, the crisis has hit the elite sector of Russia's highly fragmented society, including the high-ranking bureaucracy, the oligarchs and the upper middle class who benefited most from the recent decade of economic growth. According to a recent survey, thirty per cent of companies in Russia are planning to reduce their personnel costs. Although this is a relatively small faction of the population, the cohort of well-paid professionals and executives working in Russia's major corporations has constituted the power base of the present regime. Furthermore, if the crisis remains, its toll on the industrial sectors of the economy will increase, particularly with regard to those industries that depend on export demands, such as the metal and steel industries. If the crisis extends into other sectors, it will hamper the state's ability to deliver on its social guarantees to the population at large.

Secondly, the crisis raises the question of whether the government is capable of fulfilling the objectives for Russia's development that were envisaged by Vladimir Putin at the end of his presidency in the Strategy for Russia's development towards 2020, commonly known as "Putin's Plan". This strategy has formed the basis of President Medvedev's model of the "Four I's" – institutions, investment, infrastructure and innovations. It is likely that the government will find it hard to reconcile the visions and strategies made prior to the crisis with the changing priorities and resources.

Thirdly, the crisis might serve as the catalyst for a new round of the inter-elite struggle if the government goes ahead with the plan to expand state control over selected companies and banks. While the economic implications of such measures are unclear, they may well lead to a misbalancing of the tandem of president and prime minister, as both will be expected to take a position on every instance of possible state takeover.

All in all, the crisis calls into question the assumption that the economic and social stability of the Putin years has been successfully sustained during Medvedev's presidency. The crisis alone cannot lead to major political or social turmoil or a regime change, but it certainly presents an unexpected external challenge to the system. Ultimately, the outcome of the crisis for Russia will depend on how well the incumbent leadership can maintain a balance between handling the crisis and protecting its own interests and legitimacy.

Reactions and responses

As far as the Kremlin and the government are concerned, the initial reaction to the crisis has been rather subdued. According to media reports throughout most of the autumn of 2008, both president and prime minister chose to downplay the significance of the crisis, or dismiss its direct effect on Russia altogether by saying its economic effects were confined to the US and Europe. This apparent reluctance to discuss the crisis with the right degree of seriousness indicated that the leadership had underestimated the significance of the global financial crisis for Russia. It also prompted the question of whether Moscow actually had a strategy with which to tackle the crisis at all.

Perhaps the most notable example of such an omission was the scant reference to the crisis in President's Medvedev's state of the nation address, delivered on November 6th 2008. Medvedev had little to say on the subject and only reiterated his previous argument that the crisis had originated in the US, and that Russia would succeed in overcoming it and would emerge as an even stronger country once it was over. Medvedev did not elaborate on how the crisis would be tackled. However, he vowed that the state would deliver on its social responsibilities to the people, an implicit reference to the significantly improved standard of living to which Russians had become accustomed in the later years of Putin's presidency.

The leadership's response became more substantive after Prime Minister Putin addressed the crisis in his speech at the congress of the United Russia party in Moscow on November 20th 2008. Putin compared the crisis to a natural disaster and subsequently proposed a series of measures to stimulate the economy, including tax cuts. In Putin's view, Russia could even make use of the crisis as a "tool" to strengthen and enhance the country and its economy. Notwithstanding this optimistic and somewhat populist rhetoric, Putin's speech did contain an important substantive message linking it not only to the crisis but also to the key feature of Russia's political system – the interplay of state and business. As Putin articulated, the state would be the major credit-giving institution and as such would increase its control over selected banks and companies under state control through state bailouts of their debts and a massive injection of state funds into the crisis-stricken corporate sector.

While it would be premature to assess the outcome of these measures, it is fair to say that it does redefine the terms of the relations between the state – president, prime minister and a handful of key ministers and officials – and the major business groups. This relationship will in all likelihood be a stormy one, but it will to a great extent determine how Russia will fare during and after the crisis.

Nationalization or redistribution?

The prospect of "re-nationalization", a term that the Russian authorities try to avoid even though a senior member of the cabinet was reported to have used it, reflects the controversy surrounding the actual success of Russia's key business players. In recent years, state companies such as Gazprom, Rosneft, as well as private corporations, have accumulated enormous external debts. This fact went largely unnoticed due to the focus on Russia's steady economic growth and the declarations of Russia's tycoons to compete globally. Now the crisis is serving to expose the problems that exist behind the flashy façade.

One notable example is Oleg Deripaska's aluminum empire, Basic Element. In recent years, the company has been proud to demonstrate its growth and rapid global expansion as far afield as Africa, India, the US, and Canada. During the crisis, Deripaska, one of the richest men in Russia with a personal fortune estimated at USD 14 billion, was forced to divest his 20 per cent stake in the Canadian car parts manufacturer, Magna International, to creditors. Deripaska's main asset, the RUSAL aluminum company, has recently reported an external debt of USD 14 billion. It is unclear what will happen to Deripaska's business during the crisis, but it is certainly not the only indicator that Russia's oligarchic economy is extremely vulnerable to external shocks. Other major players such as oil, metal, and steel companies have also accumulated

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significant credit debts and have applied for chunks of the state "rescue money".

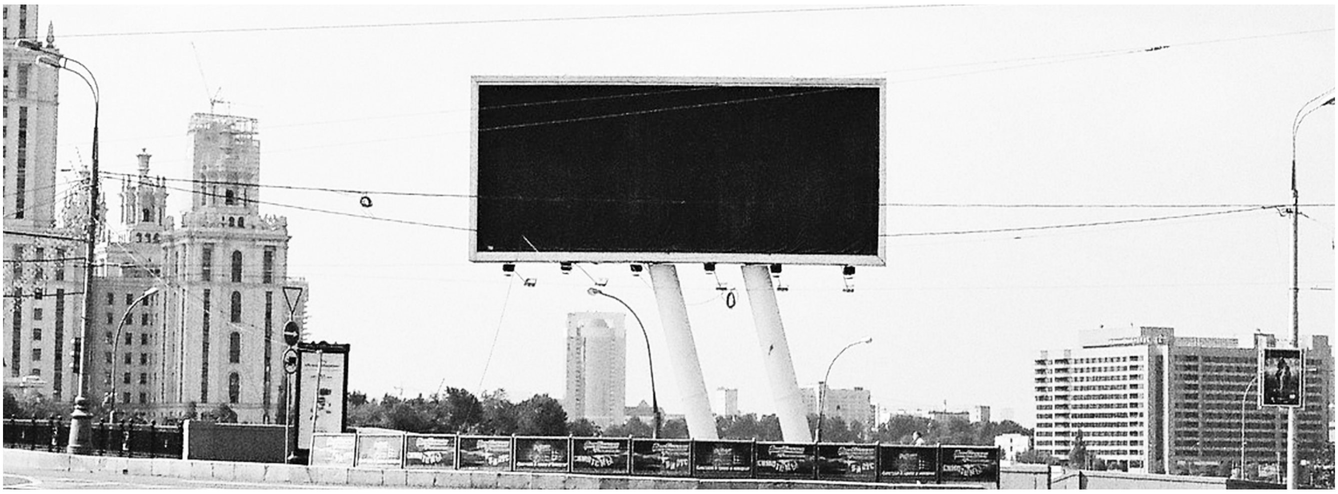
The state evidently has the resources to implement rescue measures for the sectors of the economy most severely hit by the crisis – banking, energy companies and the big investment holding companies. To date, about USD 182 billion has been allocated to support the failing banking sector. However, it is worth pointing out that these funds are also affected by the crisis as their actual value depends on the fluctuations of crude oil prices, the inflation rate and other factors. More importantly, it is unclear how the rescue measures will be implemented and what will happen after the companies that were rescued from the credit crisis are put under state control. If the state is to intervene, it will have to service the external debts of the companies and, more importantly, improve their overall management and strategy. This is a formidable task given the level of corruption, and the lack of transparency and efficiency in Russia's state institutions.

Some observers have speculated that the prospective "nationalization" will, in fact, turn out to be a redistribution of assets and property between the elite groups, similar to the situation which arose in the early 2000s following the economic crisis of 1998 and the first years of Putin's presidency. Regardless of whether and to what degree such speculation is plausible, it is certain that in the event of a crisis, the struggle amongst the elite groups will increase. It is also worth pointing out that the previous round of redistribution, which culminated in the sale of the assets of the YUKOS oil company in 2004, took place amidst growing energy prices, a favourable economic climate at home, and strong presidential leadership. The present situation is quite different with the presence of two de facto leaders with overlapping authority, and the uncertainty surrounding oil prices and the overall economic stability.

In all, both the "nationalization" and "redistribution" scenarios appear to be problematic solutions, while being in fact two sides of the same coin. On the one hand, "re-nationalization" might fail because of the fusion of state and private interests, and corruption; on the other hand, the redistribution of wealth might lead to an intense struggle and aggression between the elites. Related to that is the massive outflow of capital from the country which took place in the autumn months of 2008. According to Russia's Central Bank, the country experienced net capital inflows of USD 23.2 billion and USD 40.7 billion in the first half of 2008, but the trend was reversed in the second half of the year, with a net outflow of USD 16.7 billion in July–September.

Reforms or regime strengthening?

In light of the shifting priorities during this time of economic crisis and the continuing power struggle in the Kremlin, what are the prospects for the social reforms and other ambitious plans for Russia's development as envisaged in several strategic documents? On the one hand, the crisis has served to shed light on the fact that Russia's social sphere and infrastructure are in dire need of modernization. On the other hand, even before the crisis, the prospect



Katri Pynnöniemi

of serious structural reform seemed uncertain. It has to be pointed out that the social programmes – the "national projects" initiated by Putin and inherited by Medvedev – are not quite reforms as such. Rather, they are state-funded credit schemes and financial instruments designed to address the most pressing needs of the population, such as housing or health care, without reforming the relevant sectors of the state. It is unclear how these instruments will function in the current economic crisis. For example, Russia's Sberbank, the major credit bank for most of Russia's population, has announced that it has curbed its investment activities and has strengthened its credit policy for both companies and individual clients. Furthermore, the diversion of financial resources into "rescue operations" puts additional constraints on the state to realize the policies of modernization.

In the meantime, the Kremlin has opted for institutional and constitutional reform in order to strengthen the regime in the face of the economic crisis. The president's proposal to extend the presidential term from four to six years and the terms of the State Duma (the lower house of parliament) from four years to five reflects the underlying concern of the leadership with maintaining power. Medvedev also made proposals which would amount to increasing the role of the ruling party, United Russia, and centralizing the country further by decreasing the number of subjects of the federation.

While the proposal to extend the presidential term has been under discussion for a couple of years, and is commonly held to imply the return of Putin as president, it is not clear what will happen once the proposal is endorsed by Parliament. Putin's return as president has been regarded as likely ever since he stepped down in March 2008. It is pure conjecture whether the crisis will make this return more probable. If the economic situation deteriorates dramatically, it will prompt Putin to return to the Kremlin in order to maintain his popularity, although in his current position he enjoys almost the same degree of power as he did during his time in the Kremlin. The crisis presents a difficult dilemma for Putin personally. If his return to the president's position becomes required because of the worsening economic situation, he needs to demonstrate that he tackles the crisis successfully as prime minister. However, in order to do so he might need to stake his popularity on anti-crisis policies.

Regardless of who remains as president in the future, Medvedev's proposal can be regarded as a technical measure to strengthen the current regime in anticipation of difficult times ahead. Effectively, it limits the possibility for policy change, unless directed from the very top, which makes Russia even less adaptable to external shocks and consequently less oriented towards reforms and modernization.

What next?

Russia's response to the global economic crisis is essentially reactive and conservative in nature. The crisis is perceived as an external challenge – a tsunami of sorts – and therefore Moscow's response to it is geared towards protecting the current leadership and maintaining its position of power. The tendency to increase the paternalistic rule of the state becomes reinforced as the focus shifts towards extending the presidential term and expanding state control over the economy. However, while the framework of the system gets buttressed, the quality of its economic and social foundations gets put to the test.

In light of the aforementioned problem of "rescuing" the indebted oligarchic capital and the possible redistribution of assets in the country, the measures to strengthen the regime seem to correspond with the general logic of the current political system. However, they might not be sufficient to lead the country out of the economic crisis, should it continue. In order to address the crisis in earnest, the government would need to implement more than the proposed tax cuts. Furthermore, it will need to bolster the optimism and appearance of stability which existed before the crisis with real deliverables in order to reassure the population that the state is able to deliver on its guarantees. In this context, the mix of conservative and populist measures that the government is prepared to take will be insufficient.

In the short run, Russia's paternalistic, self-centered political regime is not likely to respond to the challenges of the crisis effectively. However, it is possible that it will withstand a brief or medium-term economic crisis given the financial resources it has accumulated in previous years. Nevertheless, if the crisis continues, it will fuel the internal dissension in the regime, namely the conflict of interests among the state-business elite, and will pose challenges to the system from within.

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