

Russia had hoped to sidestep the economic and financial crisis now sweeping the globe and remain an “island of stability.” It has failed. Late last fall, the country slipped into recession. Inflation jumped and

Sifting Through the Russian Crisis

EMPLOYMENT

By Marina Krasil'nikova

unemployment rose. Moscow faces choice: Yield to the potential for social unrest or overhaul a stagnant system

The gradual embedding of the global economic crisis has led the Russian elite to take the word “change” seriously. In a static society that until recently seemed unwilling to consider systematic social and economic progress, the downturn is being seen by some as a providential opportunity to modernize.

There are two directions in which Russia can go, and each has a distinctly different flavor.

The first would effectively extend the status quo; that is, an authoritarian regime based on a so-called “empire of raw materials” and an economy dependent on the extraction and exporting of crude oil.

The second, and far more ambitious, is the development of a state that relies more on high tech innovation and invests in human capital, educational development and encourages institutional reforms, including an independent judiciary, freedom of speech, and a return to a vibrant multiparty system.

But the Russian situation is still fraught with question marks.

Many political analysts are convinced that the crisis will, over time, create the conditions for mass public protests of the kind the country’s hasn’t seen since the end of communism. Such protests are seen as one way of buttressing Russia’s political

opposition, which is currently non-existent. Resistance could also drive a wedge into a Russian leadership that for more than a decade has exercised total control over the health and status of the national economy. Analysts who believe dissent is immanent also say that slippage in national quality of life, intrinsic to any serious long-term crisis, will also by nature inevitably erode public support for the government, opening the door to reform.

Unlike other European countries, the impact of the crisis in Russia has been erratic. Authorities have begun to behave nervously, as if stricken with a sense of loss of control and slight panic. Meanwhile, some opponents have been emboldened and begun openly showing their disdain.

In fairness, Russia has always been high on drama. Catastrophe is often mentioned even in its absence. Serious problems are inevitably portrayed as disasters requiring an immediate review of the entire system. Recurring social and economic dilemmas, even seasonal ones, receive rhetorical treatment.

This tendency is a vestige of an epic Soviet past that emphasized the perils of impending doom and frequently used militaristic rhetoric to mobilize public opinion to meet threats real and imagined. Soviet authorities considered alarmism the only way out of inertia. Before each winter, for example, local workers (led by



Corbis, S. Vladimiri/TAR TASS

a "general's staff") were "called to arms" to prepare cities for the worst, namely the winter.

Every autumn "the battle of the harvest" was joined. Even if the harvest turned out well, problems regarding crop conservation and the unscrupulousness of middle-men were immediately raised as an alarming specter that all needed to know about and reckon with, lest the country face yet another undoing.

The bureaucracy responded to these crises by creating commissions and committees and swelling them with "expert" officials. The state solved problems of lending and national resource distribution. It rescued banks and secured the future of public companies. This in turn led to endemic corruption among those entrusted with the task.

It's no surprise, therefore, that the current crisis has been a gold mine for bureaucratic hysteria, particularly regarding national resources. All of Russia's regions now have an anti-crisis "general staff" (Ulyanovsk, Lenin's birthplace and a city of 600,000 on the Volga River, has six such anti-crisis agents). In keeping with military order, there is also a high command, the "unified anti-crisis general staff."

Predictably, this kind of "disaster mentality," almost inconceivable in a free market economy, only hinders solving the problems themselves. On the one hand, this monolithic approach to problems presents them as widespread, urgent and in need of immediate resolution (an impossible goal); on the other, they create emergency conditions that cause those who have to face the

_Demonstrators rally in Vladivostok to protest growing unemployment, rising prices and utility rates during a rally staged by the local Communist Party division. The banners read: "Our children must live in a law-governed state!" and "Authorities must serve the people!".

problems to work with utmost urgency using only the tools they have at hand.

All is urgent and immediate. "Extraordinary" problems require "exceptional" measures that are almost invariably "temporary." In Soviet fashion, "heroic" work serves to patch national holes. Once they are patched, the sense of heroic self-satisfaction is so great the larger remaking plan is forgotten. Thus the problems that caused the original emergency recur.

No doubt many Russians are now convinced that the current crisis is truly systemic and requires radical reform within economic institutions that have been untouched for two decades. But the mere mention of the need for reform has been bandied around for so long that the actual problems have been pushed into the background. The issue of reform is like a theatrical set that remains unchanged notwithstanding years of touring.

Most Russians have lived the last decade in relative prosperity. They haven't needed to think about deeper problems. This makes all the more reluctant to seek solutions now. It's simply not what they've been trained to think about.

Thanks to the steady influx of oil proceeds,

real income of the population rose between seven and nine percent annually. Oil revenues also gave the country a solid reserve of financial stability, allowing the government to lavish funds on its own bureaucratic strengthening. All agreed willingly to the official definition that Russia was living through a new era of prosperity. "Stability" was the watchword and Russia itself an "island of stability." Some worriers warned that it couldn't and wouldn't last (that it would yield to what in Soviet times was referred to "Brezhnev stagnation").

Most observers generally concede that Russia's difficulties have two basic roots, a global drop in energy resource prices (which torpedoed revenues) and an earthquake in the banking sector (which has deprived the economy of foreign credit resources). Analysts and experts also agree that Russia suffers these global problems worse than most countries because of its bulky state structure.

The Russian public was much slower in coming around to the conclusion that something was amiss. Last summer, public opinion seemed to agree with the assertion that the crisis "didn't touch" them. But by late autumn, 65 percent of those polled agreed that the crisis had been maturing for years and was inextricably linked to defects within the Russian economy itself. High inflation, monopoly practices and corruption made it difficult to imagine Russia extricating itself any time soon. Once again, however, these problems aren't new; they long predated the current downturn.

In truth, both economist and Communist Party officials had placed structural reform high on the agenda as early as the Brezhnev period of the late 1970s and early 1980s. A 20-year master plan known as the "Program for Scientific and Technological Progress" (KPNTP) was developed with the intent fostering long-term domestic growth and "innovation." The idea was to move away

from central planning by establishing intermediate industrial associations and combines in various countries (which were often empowered to negotiate their own international deals). But like many Soviet attempts at reform, the effort proved short-lived.

The popular view of the current crisis — seen from a blue-collar perspective — is not surprisingly considerably different than the way it's seen by the elite. Most Russians didn't profit sufficiently from the recent 10-year boom to sense that such a boom had come to an end. Many have yet to recover from the difficulties of the now two-decade-old post-Communist transition. This accounts for deep-seated resistance to change, a recurring demand for social stability above all else, and a desire to maintain the status quo despite the deepening economic problems.

The first signs of the current crisis emerged from the financial sector. Starting mid-2008, the securities market began reeling, responding to impact of the liquidity crisis in the banking sector. But this affected only a small portion of the overall population. Despite a decade of growth and improved living conditions, most of the Russian population still lived modestly, if not poorly. When you don't possess luxuries you're not in a position to lose them. The needs of most Russians remained fairly basic and their day-to-day troubles remote from the problems of high finance.

Russia's elite 10 percent earns 16 times more than the economic rung immediately below it (independent experts say the number isn't 16 but 26). According to data from the Levada Polling Center, only a quarter of the population even possesses savings. The percentage of Russians who own securities, stocks, investment funds, mortgages (all the tools of the crisis-ridden finance industry) is also exceedingly low.

TABLE 1. HOW HAVE THE MATERIAL CIRCUMSTANCES OF YOUR FAMILY CHANGED OVER THE LAST YEAR?

	MARCH 2008	SEPTEMBER 2008	DECEMBER 2008	MARCH 2009
Hasn't improved	28	24	18	11
Hasn't changed	55	53	47	39
It's gotten worse	17	21	32	48
I don't know	1	2	2	1

(Expressed in percentages based on 1,600 interviews)

The purchasing power of 85 percent of Russian households is such that their incomes is at best sufficient only for current expenditure, including food and clothing. Expenses always rise to significant financial difficulties (Table 2).

TABLE 2. IN YOUR OPINION, TO WHAT SEGMENT OF THE POPULATION DO YOU AND YOUR FAMILY BELONG?		
	September 08	March 09
1. We have a hard time making through the end of the month. Available funds don't ever cover food costs.	9	10
2. We have enough to pay for food but buying sufficient clothing is difficult.	25	30
3. We can afford food and clothing but affording appliances and similar goods (TV, refrigerator) is difficult.	50	45
4. We can afford appliances but buying truly expensive items, a car for example, is difficult.	16	14
5. We can afford luxury items, including an apartment, a country home and similar.	1	0

(Percentage by column based on a sampling of the adult population; 1,600 interviews).

With such a low standard of living, most Russian families weren't even touched by the financial upheaval. It simply had nothing to lose.

Instead, most Russian families felt the downturn's more immediate consequences, namely inflation and unemployment. But inflation has remained a constant. Recent years have seen double-digit inflation (the only exception was in 2006, when prices rose only nine percent, according to the Russian statistical institute Rosstat). In 2008 inflation was 13 percent. What this means in simple terms is that Russians expect high inflation. It can't be included automatically as a crisis ingredient.

For example, at the end of 2007, a full three quarters of Russian population (based on polling) expected price increases to at least equal the ones they'd faced the year before (40 percent of respondents expected it to grow significantly). A year later, in November 2008, 90 percent of those polled were convinced that inflation would maintain the same pace, while half expected it to worsen.

A somewhat newer and deeper and more pervasive problem is unemployment. For five years in the early 2000s, the Russian workplace was relatively stable. Jobs were available, unemployment negligible. But when crisis-hit companies began dismissing workers, reducing their pay or failing to pay on time, a ripple effect swept through the broader Russian population as a plague of anxiety. This



OXANA ONIPKO/AFP/Getty Images

was particularly evident in the final two months of 2008. Unemployment more than doubled in a few months (Table 3).

TABLE 3. TELL US ABOUT NEXT YEAR: DO YOU THINK UNEMPLOYMENT NUMBERS (PEOPLE WHO DON'T HAVE WORK AND WANT IT) WILL GO UP, STAY THE SAME OR DROP?

	October 2008	February 2009
The figures will go up	34	76
They'll stay more or less the same	46	18
They'll drop	5	2
I don't know	16	4

Based on data from periodic polls of Russian citizens, based on percentages; 1,600 interviews.

Russians have gradually begun reducing consumption. Many have stopped long- and midterm family planning. Initially this slow-down trend was evident only in majorities with low or medium incomes. The more affluent (more or less one in six families) at first adopted a money-shedding strategy, purchasing goods to rid themselves of cash that was rapidly losing value.

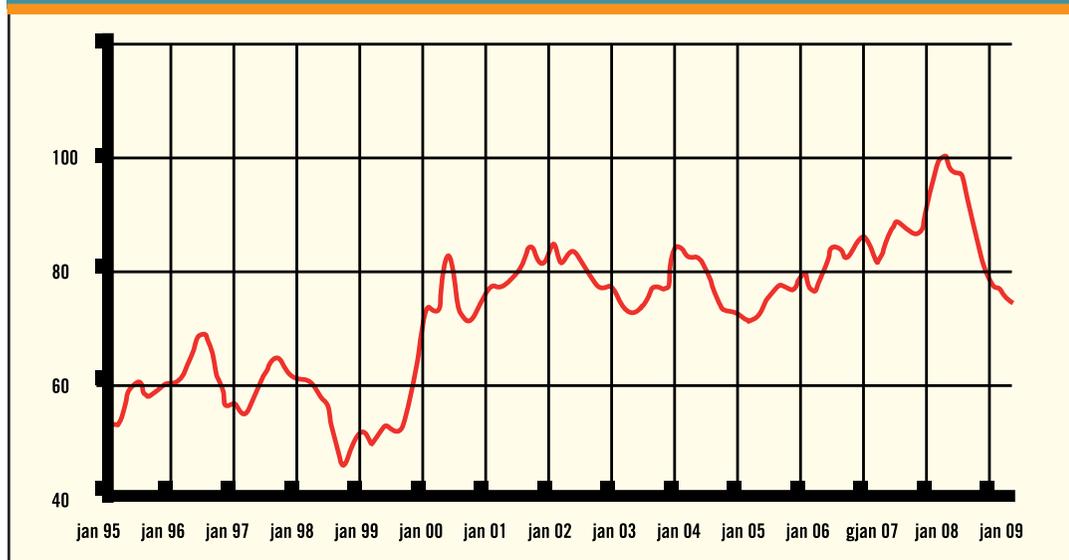
But by February 2009 even the more affluent segment began reducing expenditures (see Table 4). As a result, the consumer confidence index (Consumer Sentiment Index, CSI) dropped 40 percent in a year.

TABLE 4. THE DYNAMICS OF DEMAND AMONG CONSUMERS BELONGING TO DIFFERENT INCOME GROUPS.

	WE'LL BUY WHEN WE FEEL LIKE IT		IT'LL BE HARD TO MAKE THAT PURCHASE		WE'LL POSTPONE THE PURCHASE	
	DEC 2008	MAR 2009	DEC 2008	MAR 2009	DEC 2008	MAR 2009
AVERAGE	30	24	25	15	45	62
Of whom, depending on their material status:						
The family struggles to make ends meet monthly or has only enough income to cover food.	18	10	21	10	61	80
The family can afford food and clothing but has a difficult time imagining the purchase of an appliance, such as a TV or a refrigerator.	31	21	23	17	46	62
The family has no problem with purchases, including luxury goods.	39	43	33	16	28	42

(Percentages by column based on public opinion polls of the adult Russian population; 1,600 interviews).

SOCIAL MOOD INDEX MARCH 2008 = 100 PERCENT



Even the most general social mood indicator shows that the crisis now afflicts most of the Russian population with few seeing light at the end of the tunnel. (See Figure 1).

The decline in social mood indices is now no less marked now than it was at the start of the 1998 Russian crisis, which came on the heels of the Asian financial downturn. The crisis began with default and subsequent sharp devaluation of the ruble. From January to August of 1998 the stock market lost more than 75 percent of its value, 39 percent in the month of May alone.

Though the worst downturn in recent public mood came at the end of 2008, the figures have continued falling into early 2009, albeit more slowly. This suggests the situation will only worsen. Recent experience shows that these social mood indices have an important forecasting function. Social mood usually improves a few months before the end of a crisis and is then reflected in economic data.

A look at the data today suggests an extremely complex situation. According to early assessment, first quarter GDP fell by seven percent while the growth in consumer prices was more than five percent (slightly higher than the previous year). By the end of February 2009 real income had fallen by more than five percent (based on annual income) and some 6.4 million people were unemployed (using MOT methodology, unemployment stood at 21 percent annually). Some two million people had already visited unemployment offices in search of work (an increase of 28 percent from the previous year).

For now, the job market situation and consumer discontent is not as dramatic as the 1998 crisis. On the other hand, however, the "bottom" of the crisis yet to be felt although the pace of downturn has slowed.

In March 2009, according to Levada, a third of families with employed workers had at least one family member who hadn't been paid (30 percent) or had suffered a salary cut (35 percent). Among families of four, more than a quarter of the family members (26 percent) were involved in lawsuits against their former companies.

Deepening economic woes have also had a notable impact on the lifestyle of many

Russian families. In March, the 25 percent of respondents said that rising prices for food has led to a change for the worse in the tenor of family life. In the short-term, only 40 percent of families said they'd even be able to maintain the current standards. More or less the same number believed they'd have to surrender habits and purchases (38 percent), while one family in six (15 percent) thought its purchasing ability was likely to change significantly for the worse.

At the same time, returning to Russia's dramatic streak, it's fear to say that societal fears still outweigh the actual effects of the crisis.

But mood, while wholly subjective, can have a profound effect on the overall economic behavior of individuals. If people cut personal and family spending, the natural economic consequence is a reduction in the demand for consumer goods, which in turn hampers economic development and leads to production cuts. The downward spiral effect nurtures the crisis.



_A protest placard that reads, "No to Unemployment!"

Russia, which is highly monopolized and corrupt, also faces the very real threat of stagflation, a contemporaneous decline in output as inflation increases. Price cuts that could indeed help Russia extricate itself from the crisis are exceedingly unlikely.

Examining the effects of the downturn on Russians elicits the glass-half-full vs. glass-half-empty idiom. It depends on how you look at the question. From the “catastrophic” Russian point of view, the situation is still controllable. Those affected by the crisis are fewer in total numbers than 1998. Russian inflation in 1998 reached 84 percent and welfare costs grew considerably. Many banks were shut down.

At the same time, if you compare the current Russian situation to other nations also touched by the downturn, the Russian situation is infinitely worse than the norm. Russians are deeply worried about what comes next.

Still, the significant deterioration in living standards has yet to influence public perception toward authorities. The images of Prime Minister Vladimir Putin and President Dimitri Medvedev are largely unscathed. Nor has the crisis significantly changed public perception of the overall situation in the country. (Figure 2. The consensus index weighs the difference between positive and negative statements regarding how the state is managing current events; the final point on the right of



the graph refers to the survey data taken March 2009). Inertia, paternalism and deference towards the country’s traditional power-brokers, a mixture of hope, illusory optimism, and sheer lack of awareness of alternative act as a stabilizing factor. Taken together, they help preserve the contours of the Russian social compact.

BACKING OF POLICIES PROMOTED BY PRIME MINISTER VLADIMIR PUTIN AND PRESIDENT DIMITRI MEDVEDEV.

