

# Russia: Economic crisis fuels differences within Kremlin

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The impact of the global financial crisis on the Russian economy is fueling conflicts within the country's ruling elite over the administration of state resources. In recent weeks there have been a series of events pointing to tactical differences between competing layers of the state bureaucracy and business oligarchy grouped around President Dmitri Medvedev and Prime Minister Vladimir Putin.

Since 2008, Russia's economy has been driven into severe recession. In early November of this year, the State Statistics Service reported that Russian gross domestic product (GDP) shrank 8.9 percent in the third quarter as compared to a year earlier. Since October of last year, industrial production in the country has fallen 11.2 percent, significantly more than the 8.1 percent anticipated by experts.

While improvement is expected next year, with forecasters predicting GDP growth of between 1 and 3 percent, this is a far cry from the high levels of economic expansion experienced in the early years of the decade. At that time, growth rates averaged 7 percent per year. Russia's economy is not expected to return to its pre-crisis performance level until 2012.

The economic decline is having a destabilizing impact on Russian society. Official unemployment—which significantly underestimates real joblessness because of the large numbers of people who work outside the official economy—stood at 7.7 percent in October. Wage arrears have risen since the onset of crisis.

The falloff in industrial production has had a particularly severe impact on the country's so-called "mono-towns," urban centers in which the local economy is entirely dependent on a handful of enterprises. Over the course of the summer and into the fall, popular protests erupted in mono-towns across the country. These were inspired by the actions of residents of Pikalevo earlier in the year, when protesters blocked roads to demand an improvement in their living standards and a revival of production at local plants.

The social position of the small, but significant, middle class that developed in Russia as a result of oil wealth filtering its way through the economy has been undermined over the past year. The economic gains of this layer, which formed a significant portion of the pro-Putin constituency within the broader population, have eroded. This phenomenon has manifested itself in, for example, widespread defaults on mortgage payments.

The primary source of Russia's economic decline is the sharp falloff in world oil prices, which has come alongside a tightening of credit and capital flight.

Under these conditions, it appears that disagreements have emerged within the ruling elite over how the country's wealth should be

managed and divided up among sections of the state bureaucracy and big business. At issue, in particular, is the operation of Russia's so-called "state corporations."

On November 12, in his annual State of the State address, President Medvedev called for the "comprehensive modernization" of the country and criticized Russia's "chronic backwardness," "primitive economic structure," "humiliating dependence on raw materials," and "corruption."

"The global financial crisis has affected everyone," observed Medvedev, "but Russia has experienced an even more severe economic downturn than most countries." He added, "We should not lay the blame on the outside world alone."

In addition to arguing that the country had to develop a more diversified economy by becoming a leader in the fields of medical technology, nuclear energy and telecommunications, he also insisted that Russia's seven state corporations, which were established under Putin's initiative, had to be fundamentally transformed.

The state corporations are essentially large private enterprises set up with government finances. Despite the fact that they have unique access to state resources, receive special tax breaks, and play a major role in the Russian economy, their financial and administrative operations are extremely opaque.

They are not actually owned by the government and are not legally subject to government oversight or obligated to report back to the state about their activities. While few details are publicly available about their holdings or internal structure, it is widely known that Prime Minister Putin appointed cronies to leading positions within these enterprises during his tenure as president.

In short, the state corporations are a significant source of both political power and wealth for Putin's clan. They are a means by which large amounts of public wealth are funneled into the hands of Putin's backers.

The state corporations have been the recipients of massive government bailouts. For example, Rostekhnologii, which owns the near-bankrupt AvtoVaz carmaker in Togliatti, got a 50 billion ruble (\$1.72 billion) infusion from the government this summer. This money was squandered without any improvement in the auto plant's fortunes, after which plans were announced for the potential layoff of 27,600 people.

A few days before Medvedev gave his State of the State address, the attorney general announced the results of an investigation into the affairs of these enterprises. According to a November 11 article by *RIA-Novosti*, the government discovered an array of criminal affairs, including the "frittering away of money on bonuses."

In his address, Medvedev stated, "I think that this legal form of

enterprise has no future overall in the modern world.”

He called for the transformation of state corporations into either regular, privately owned firms—which, by implication, would be subject to laws governing such enterprises—or “joint stock companies under government control.”

He further advocated the introduction of “modern corporate governance models” in enterprises with significant state participation, as well as a system of independent auditing.

The president is expected to issue concrete proposals for the reform of Russia’s state corporations on March 1, 2010.

Medvedev’s critical attitude towards the way in which Russia’s state corporations operate has not been a secret. In September, he published an article entitled “Go Russia!” which outlined many of the points he raised in his State of the State address.

Just prior to this, two scholars with close ties to the president issued a major report entitled *Post-Pikalevo Russia*, which documented in some detail the mechanisms used by leading oligarchs, who are known to have close ties to Putin, to effect a large-scale transfer of government wealth into their own hands under the cover of bailouts for corporations hit by the economic crisis. The report linked their activities to the growth of social unrest.

News of the report, which was authored by Vladislav Inozemtsev, director of the Center for the Study of Postindustrial Society, and Nikita Krichevskii, scientific leader of the Institute of National Strategy, had been leaked to the press over the course of the summer. Its contents were widely understood to be a lurid exposure of the manipulation of the Russian economy by Russia’s powerful oligarchy, in which sections of the Kremlin bureaucracy were clearly implicated. The report suggested strongly that the health of the country’s economy and state treasury was being endangered by the fact that there are no checks on the depredations of such forces, which are closely associated with the state corporations.

Medvedev’s dissatisfaction with the way state corporations operate and the concerns among his backers over the activities of the Kremlin’s oligarchs are not rooted in any fundamental opposition to the fact that Russia is dominated by a criminal gang of bureaucrats, *siloviki* (people with ties to the security services and military), and Mafioso businessmen. Rather, this section of the ruling elite feels that it has been denied its share of the spoils allotted to the clans grouped around Putin at the federal level. It is also worried about the long-term effects of the policies and methods utilized by Putin’s clique to secure its wealth on the Russian economy and the country’s national interests.

Particularly under conditions in which the global economic crisis has exposed the weaknesses of the Russian economy—its excessive dependence on oil wealth and the lag in the country’s technological base—these layers feel that a certain adjustment needs to be made in the way the economy is governed.

The most egregious excesses of Russia’s oligarchs need to be reined in somewhat, corporations funded through state assets need to be made subject to some form of government oversight, and an effort must be made to secure transnational investment in Russia’s industrial sector so as to bring it up-to-date and make it competitive on the world market.

On November 11, Aleksandr Shokhin, president of the Russian Union of Industrialists and Entrepreneurs and a supporter of Medvedev’s critique of the state corporations, gave an interview to *Rossiskaia Gazeta*, the official state newspaper. In it, he made clear that his central concern was ensuring the health of Russian capitalism

by making certain that state corporations were also subject to the rules of the market.

He said, “Essentially, the state is encroaching on private businesses’ ‘turf’ through the state corporations. And in the process, is creating preferential conditions for itself. The competitive environment is being distorted, the business climate is deteriorating, and private initiative is being stifled.”

For the moment, it appears that Putin has agreed to some sort of reform of the state corporations, although it remains to be seen how this process will play out and how far the disagreements within the Russian ruling elite will evolve.

While constitutionally Medvedev’s position as president gives him the authority to push ahead with significant changes in government economic and political policy, Putin continues to wield enormous power. Medvedev is aware of the fact that any attempt on his part to seriously rein in the prime minister and those forces around him would likely unleash a full-scale civil war within the ruling elite that could fundamentally destabilize the Russian political system. As the killings and assassinations of critics of the Kremlin in recent years have demonstrated, politics in contemporary Russia is often resolved at the point of a gun.

Those within the halls of power are wary of any possibility that disagreements between Medvedev and Putin might develop into a full-blown crisis. The use of electoral fraud by United Russia during the regional elections held in October to secure a decisive victory—despite the fact that this party, at the head of which Putin stands, would have handily won without resorting to such measures—was bound up with an effort by a section of the ruling elite to give the appearance of overwhelming political unity within the country.

While some in the Western media have argued that the apparent disagreements between Medvedev and Putin are an expression of a real split within the “ruling tandem”—perhaps in an effort to encourage the president, who is generally viewed as more sympathetic to US interests—Medvedev’s criticisms thus far have been relatively cautious and lacking in concrete details.

Medvedev has the same social base as Putin. Furthermore, he presides over a country in which social discontent is widespread over corruption, low living standards, and the disappearance of opportunities for advancement into the middle class. A recently released report by Transparency International, for example, rated Russia 146th out of 180 countries on a corruption index, noting that bribe-taking of various forms is a \$300 billion-a-year industry and is worth almost one-fifth of the country’s economy.

While a real campaign against corruption and the unchecked power of the oligarchy and state bureaucracy would likely be supported by the broader population, in his criticisms of the state of Russian society Medvedev is careful not to make any serious appeal to such sentiments, which could easily spin out of his control.



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