Russia Readies Itself for Unrest

Forecast

- The Kremlin will allow the economies of many of the country's Soviet-era mono-cities to deteriorate.
- Protests against the Kremlin will increase as more Russians fall under the poverty line and regional and municipal debt grows.
- The Kremlin will crack down on protest movements and opposition parties to block the formation of any serious challenge to its hold on power.

Analysis

Russia's economy is in steep decline, and the financial strain on the Kremlin is beginning to spread to the country's regions, cities and people. Many of Russia's regions are already on the verge of default. As the pressure continues to build at the regional level, the country's municipal governments and citizens will find themselves increasingly strapped for cash.

With little hope of economic recovery in the near future, the Kremlin is taking steps to quash any threat of regional defiance or mass protests against its leadership. As its attention shifts inward over the next few years, the Kremlin's capacity to assert itself abroad will diminish.

Russia's Mono-Cities Are Struggling

Russia's mono-cities, or single-industry towns, are beginning to feel the weight of the heavy financial burden bearing down on regional governments. There are 319 mono-cities that together house 14 million Russians (roughly 10 percent of the country's entire population). The cities are a relic of the Soviet period, when towns relied on one industry or plant to employ the bulk of their populations, sustain their economies and provide social services. Most Russian mono-cities center on manufacturing, metallurgy, timber or fuels, which make up 30 percent of the country's industrial production. The inherent problem with the mono-city structure is that it creates an inflexible economy. Furthermore, the mono-city workforce is trained to work in a single industry, making it difficult for laborers to migrate elsewhere for better jobs or salaries.

Most of these cities require subsidies from the federal government or from Russia's oligarchs to survive. In a recent visit to the mono-city of Usolye-Sibirskoye, Russian Prime Minister Dmitri Medvedev said only 79 of the country's 319 mono-cities were economically stable, adding that the federal government would not be able to save the other 240. According to Russian Economic Development Minister Alexei Ulyukayev, 94 single-industry cities are "in the red zone," meaning they are nearing economic collapse or bankruptcy. Though the Kremlin has set aside a fund of $525 million for Russia's mono-cities, Ulyukayev has pointed out that this amount is only enough to help about 20 towns for a year.
When the mono-cities began slowing in 2009, during the recession, workers with no alternative employment options saw their salaries decline. Protests broke out across the towns, prompting then-Prime Minister Vladimir Putin to travel to the cities to launch a propaganda campaign. In the town of Pikalyovo, Putin ordered Oleg Deripaska, the oligarch who owned Basic Element, the company running the city, to pay $1.3 million of his own money to calm the city's protesters. Now the oligarchs are not as flush with cash and are less able to make up for the shortfalls in the Kremlin's funding.

Citizens Feel Financial Strain

The regional and municipal governments, already under great financial pressure, have been unable to prevent the effects of the economic crisis from trickling down to the Russian people. Inflation hit a 13-year high of 16.9 percent in the first half of 2015, reducing wage values by 14 percent from the previous year, the fastest decline seen since the 1998 ruble crisis. According to state statistics service Rosstat, the number of Russians below the national poverty line also rose by 14 percent in the first half of 2015. During the 2008 financial crisis, the Kremlin raised the minimum wage and increased social benefits to avoid a hike in poverty rates; this time, the Kremlin has taken no such measures, choosing instead to keep the cash for the federal government's use.

According to Moscow's Higher School of Economics, Russians are currently selling their foreign exchange savings to keep their households afloat. However, it estimates that most of these savings will dry up later this year, which could significantly restrict Russians' access to funds, pushing more citizens under the poverty line in 2016.

The Kremlin Prepares for Pushback

The Kremlin is becoming increasingly concerned that the financial pressures on the regional and municipal governments, as well as on the Russian people, will translate into regional defiance or mass protest against the federal government. The Kremlin is less concerned about its popularity, since it is enjoying its highest approval ratings in years. Still, its popularity has more to do with Russian nationalism amid Russia's tense standoff with the West. As the economic pressure continues to mount, the Kremlin will eventually see its popularity start to erode.

Conversation: Analyzing Russia's Economic Crisis

To guard against the threat of unrest, the Kremlin is taking steps to ensure that it retains control over the country in the years to come. The federal government has allocated $5.2 billion in federally subsidized loans at a 0.1 percent annual interest rate to regional and municipal governments. Though the loans will provide minor relief, they are only a small fraction of the funds regional governments need to stay afloat. Consequently, the regions continue to turn to riskier commercial loans to meet their needs. Russian commentators have suggested that the Kremlin will eventually come to an arrangement with state-owned lenders Sberbank and VTB, the regions' chief creditors. However, after a July 31 meeting with Putin, Sberbank chief Herman Gref said the bank's financial situation for the remainder of 2015 was "complicated" and gave no indication that Sberbank would assist the regions.
Alongside its efforts to find financial relief for the regions and cities, the Kremlin is focusing heavily on preparing political and security responses. Over the past month, the Russian Duma has introduced a series of laws expanding regional governments' ability to monitor for protests. They include encouraging direct contact between security forces and the leaders of protest movements. The Duma also increased the powers of the police force, including greater rights for using weapons against civilians.

Regional security forces have already cracked down on opposition leaders and organizations in the lead-up to September's regional and municipal elections. Opposition leaders in Novosibirsk, Kostroma, Kaluga and Magadan have been detained in recent weeks, even though elections are more than a month away. Some regions are also barring opposition parties from qualifying for the elections. Putin has kept in contact with the heads of Just Russia and the Liberal Democratic Party, two of Russia's larger official opposition parties, in the months before the elections.

The Kremlin has also begun maneuvering against potential political dissent in the more distant future. In June, the federal government moved Russia's 2016 legislative and regional elections from December to September; by setting the elections closer to the summer holidays, the Kremlin is hoping to prevent protests and political campaigns organized by the opposition. The move prompted widespread speculation among both Russian and Western media that the Kremlin expects the economic crisis to worsen next year.

Though it is possible that Russia will see some economic growth in 2016, the Kremlin will not be able to stabilize the regions or guard against public sentiment unless oil prices rebound or the federal government steps in. Federal intervention would require the Kremlin to drain much of its $541 billion in reserves, which is spread throughout its currency reserves, the National Wealth Fund and the National Reserve Fund. So far, the Kremlin has largely avoided dipping into those reserves, waiting for tougher economic times. But those tougher times are looming in the not-so-distant future, and the Kremlin may yet be forced to draw from its funds to save the regions, cities and people from further hardship. In the meantime, the Kremlin will continue to count on its popularity — and its tightening grip on political dissent — to maintain stability in the short term.

Over the next few years, the Kremlin will have to focus more of its efforts on keeping the country stable. Eventually, this may mean Russia will have to limit its moves abroad as internal issues consume the bulk of its attention. Meanwhile, the United States or other Western entities may seek to exploit public dissatisfaction in Russia, as seen in the protests in 2011 and 2012. The Kremlin, keenly aware of this possibility, will likely continue cracking down on U.S. ties in Russia.