The Long-Run Challenges to Economic Growth and Social Stability in Russia

Crowley, Stephen

ANALYSIS

The Long-Run Challenges to Economic Growth and Social Stability in Russia

Stephen Crowley (Oberlin College)

DOI: 10.3929/ethz-b-000643679

Abstract
With the war and sanctions, Russia must tread an increasingly narrow path to avoid prolonged stagnation. The decision to invade Ukraine in February 2022 followed a decade or more of declining living standards. While war-time spending on weapons and social benefits has lifted the economy for now, such spending is unsustainable in the long run. Stagnation and resulting hardship will make maintaining social—and, ultimately, political—stability more problematic.

Tough Times Before the War

Sanctions alone have not, and almost certainly will not, bring about the end of the war. But even before the war, Russia's economy was already suffering from sizable challenges. The causes of these were well known: an over-reliance on commodity exports and a dependence on imported technologies; a labor market hampered by low wages, low productivity, a declining population, and low levels of human capital; and high state control of the economy, with a view more to oligarchic enrichment and social stability than to greater efficiency (Volkov and Kolesnikov 2021). All this and more produced prolonged economic stagnation.

True, none of these challenges prevented the Kremlin from launching the war. In fact, somewhat perversely, declining living standards might have provided a key impetus for the invasion. And indeed, Russia's economy has remained relatively buoyant so far. The war exposed Russia's dependence not only on imported computer chips, but also on precision machine tools and even ball bearings from abroad (Bergmann et al. 2023). Yet parallel imports have helped fill the void, even if they have come with a mark-up in price. The country's auto industry—once dominated by Western brands—was largely gutted, but Chinese vehicles have now crowded the market. Most importantly, high levels of state spending on the war economy and social benefits have kept the economy afloat.

Labor Shortage: A Seemingly Small Problem with Huge Implications

A year and a half into the war, however, the bills are now coming due. Three inter-related problems—a labor shortage, inflation, and unsustainable spending—point to a longer-term challenge. The labor shortage itself is worth exploring, since it is a seemingly small problem with outsized implications. While the Kremlin boasts of record low levels of unemployment, Russia's Central Bank reported that roughly half of all businesses complained of staff shortages in 2022, with skilled workers especially in short supply (Fontanka.ru 2023; Bank Rossii 2023).

According to conservative estimates, war mobilization and related emigration have cost the workforce around 600,000 working-age males. Workers under 30 years old now make up the lowest share of the labor market since the early 1990s (*TASS* 2023). The skilled workers that have left the workforce will not easily be replaced: as labor economist Vladimir Gimpelson (2022) notes, you can't simply turn a sales clerk into an IT worker or a car mechanic. Meanwhile, labor migrants are deterred by a devalued ruble as well as the fear of being mobilized themselves (Khashimov 2023). As a result, the Kremlin has sought to remove restrictions on child labor from the age of 14, and some are proposing to allow 16 year-olds (down from age 18) to work in dangerous occupations (*The Insider* 2023; Antonov, 2023).

Why does this matter? The Central Bank concedes that the growing labor shortage will further slow the economy. Chris Weafer, CEO of strategic consulting firm Macro Advisory, put it more strongly: the lack of sufficient labor and skills will be "as damaging for Russia's future economic growth prospects as the sanctions ban on technology" (Cole 2023). The labor shortage fuels inflation, which in turn devalues the ruble, making imports even more expensive, further fueling inflation. And indeed, Levada Center (2023*a*) polling finds that inflation is now the leading area of concern for the Russian public.

The labor shortage is compounded by another chronic problem of the Russian economy: productivity. Raising productivity—output per worker—is crucial to a country's ability to improve its standard of living (Krugman 1990). Yet Russia has suffered from low levels of productivity since long before the war. In 2020, Russian productivity levels (GDP per hour worked) ranked 37th out of 39 OECD comparator countries, below Chile and above only Costa Rica and South Africa (OECD 2023). Moreover, Russia has been on a downward trajectory: whereas productivity in OECD countries increased by five percent per year between 2011 and 2021, in Russia it decreased on average by one percent annually (Vashalomidze and Dudin 2022). Rosstat reports a further productivity decrease of 3.6% in 2022 (Kostenko 2023). The only way to raise levels of production is by adding more workers or more labor-saving technology, and Russia now suffers from a deficit of both.

From Social Stability to Social Volatility

Well before the war, reform efforts to boost economic growth in Russia created their own challenges. For example, the current labor shortage is not due solely to mobilization, emigration, and the country's serious demographic challenges. Back in the 1990s, given fears that mass layoffs would lead to a "social explosion," Russian firms responded to the crisis with deep cuts in wages (including wage arrears) rather than by sacking workers. While wages rebounded during the oil-fueled years of growth in the 2000s, firms continued to respond to changing economic conditions with extremely flexible wages rather than redundancies and rehiring. This "Russian labor market model" has resulted in a high-employment, low-wage (and low-productivity) economy (Gimpelson, Kapeliushnikov, and Roshchin 2017). Given the emphasis on "stability" for much of the Putin era, potentially painful restructuring of the old Soviet industrial infrastructure was avoided, both in good times and bad. In the wake of the 2011–12 protests "For Fair Elections," the Kremlin redoubled its efforts to maintain the support of Russia's industrial heartland. Partly as a result, nearly ten percent of Russians continue to live in single-industry monotowns, where factory closures would be especially fraught (*Esli byt' tochnym* 2023).

To date, the social impact of the war has been moderated by high levels of government spending. But such expenditures on both guns and butter are unsustainable; otherwise, higher inflation and greater economic instability will ensue. While available public opinion polling sends mixed signals, with signs that many Russians are adapting to the present conditions, since 2022 Levada Center (2023*b*) surveys have found a significant increase (to roughly 30 percent) in the share of respondents agreeing that "it's not possible to endure our plight [*bedstvennoe polozhenie*]."

Though difficult to measure in terms of both extent and frequency, local protests have sprung up in response to cuts to the supply of water and electricity, reductions in trams and bus routes, and increases in gas prices. All else being equal, labor shortages—combined with inflation—have the potential to embolden workers, who have less to fear from layoffs. Yet with the possible exception of gas prices, grievances over such local issues, including the plight of a struggling monotown factory, are likely to remain local protests, particularly with trade unions and other elements of civil society sidelined or suppressed (Meyer-Olimpieva 2023).

Broader social and economic protests in Russia have almost always been in reaction to government attempts to enact seemingly minor reforms, typically either to raise taxes or to reduce benefits. Examples include the 2005 attempt to monetize benefits, the 2009 tax on used-car imports (intended to preserve domestic autoworker jobs), the 2015 tax on long-haul trucks, and the 2018 raising of the pension age. These protests were sudden and spontaneous, with little to no reliance on civil society or opposition movements. In most cases, they pushed the Kremlin to back away from its reform goals. The exception—the pension age increase—was telling: on the one hand, the reform was aimed not only at reducing pension costs, but also at alleviating the looming labor shortage; on the other, it was widely unpopular and led to a significant drop in Putin's popularity ratings (Sharafutdinova 2020; Petersson 2021).

War expenditures now deepen the reform challenge. The government has presented a budget for 2024 that is viewed by many observers as unrealistic: it must find an additional 7 trillion rubles compared to 2023 spending levels. Some observers estimate the Kremlin can marshal sufficient funds through 2025 (Prokopenko 2023). Much depends on the amount of income Russia receives from oil and gas sales, and prices could well increase due to the conflict in the Middle East. Yet at some point the wide gap between revenue and expenditures will be difficult to close without raising taxes, cutting benefits, or both. Doing so could raise political challenges as well as social tensions.

Social Tensions and Political Legitimacy

The decision to invade Ukraine in February 2022 was puzzling to many. Yet the 2014 seizure of Crimea had been, in Petersson's (2021, 62) words, a "miracle cure" for Putin's previously sagging legitimacy. If he dreamed of a repeat performance, that dream has evaporated; Putin now finds himself fully in charge of a country that has endured a decade or more of declining social and economic conditions that will almost certainly worsen.

True, other authoritarian regimes have proven their ability to endure severe hardship, sometimes for decades. Yet Cuba, Iran, and North Korea—the countries typically invoked for their ability to withstand harsh sanctions—are all revolutionary regimes, with a clear ruling ideology and a large body of cadres to support the political system (Levitsky and Way 2022). Russia, on the other hand, is a truly personalistic regime with a single individual at the helm. The evidence suggests personalistic rulers are more vulnerable to popular uprisings, in large part because when conditions become intolerable, it's clear who is to blame (Goemans 2010).

Thus, economic hardship complicates another serious challenge facing personalistic regimes: succession. Putin is now an aging personalistic ruler with no clear plan for succession. Recent mass uprisings in neighboring states—likewise facing worsening economic conditions—highlight the succession predicament. In Belarus in 2020, Lukashenko claimed a reelection victory one too many times. In Kazakhstan in January 2022, an increase in gas prices sparked substantial unrest that pointed to the problem of a long-term authoritarian handing power to a less charismatic successor. The leaders of Belarus and Kazakhstan remained in power, but arguably due only to Russian backing (and, in the case of Kazakhstan, direct Russian military intervention). Recall that Russia's 2014 seizure of Crimea was sparked by Ukraine's "Euromaidan revolution." President Yanukovych fled the country and sought safe haven in Russia; his ill-gotten gains were turned into Ukraine's Museum of Corruption. Should a similar uprising occur in Russia, who will prop up Putin? Where would he flee?

There is every indication that the Kremlin is keenly aware of such dangers and will use every tool at its disposal—both stick and carrot—to prevent such an outcome. Yet doing so will make any return to economic growth, and the reforms that would likely entail, still more difficult.

In the summer of 2022 (before the mobilization), researchers from the Institute for Social Policy at the Higher School of Economics (2023) surveyed 25 academic, business, and other experts about their long-term prognoses for the Russian economy. The experts were asked about four possible scenarios, from the most optimistic ("new engagement") to the most pessimistic ("a turbulent lost decade"). In every scenario, the respondents envisioned that Russia's middle class would dwindle as their incomes declined, while inequality would increase as more wealth was captured at the top—all of which would lead to an increase in social tensions. The resulting report noted that while the cumulative impact of deteriorating conditions might be felt only over time, even in the most optimistic scenario notable improvement would not occur for many years.

More recent assessments suggest that the negative impact of the war might be felt sooner. There is a flip side to the high spending on war production, military manpower, and social benefits that has buoyed the economy so far. When the war eventually comes to an end, the reduction of these unsustainable spending levels could well lead to a recession. Rebalancing the economy, including redistributing the investment and workforce from military industries to productive use elsewhere, will present a massive challenge.

All of this might suggest that there are significant incentives for the Kremlin to prolong the war. Yet doing so will not only delay the reckoning, but also allow the problems—the labor shortage, inflation, and the deficit—to grow. Thus, Russia's leaders must contend with the possibility that the ever-narrower path to economic growth might end in a cul-de-sac.

About the Author
Stephen Crowley is Professor of Politics at Oberlin College. His recent book is *Putin's Labor Dilemma: Russian Politics between Stability and Stagnation* (Cornell University Press).

Further Reading

- Antonov, Kirill. 2023. "Trudovomu kodeksu predlozheno pomolodet'." Kommersant. October 19, 2023. https://www.kommersant.ru/doc/6282837.
- Bank Rossii. 2023. "Regional'naia ekonomika: Kommentarii GU." February 1. https://www.cbr.ru/Collection/Collection/File/43707/report_01022023.pdf.
- Bergmann, Max, et al. 2023. "Out of Stock? Assessing the Impact of Sanctions on Russia's Defense Industry." Center for Strategic and International Studies, April 14. https://www.csis.org/analysis/out-stock-assessing-impact-sanctions-russias-defense-industry.
- Cole, Brendan. 2023. "Russia Suffering Worst Labor Shortage in 25 Years." *Newsweek*, April 25. https://www.newsweek.com/russia-economy-unemployment-jobs-putin-shortage-1796602.
- *Esli byt' tochnym*. 2023. "Milliony rossiian zhivut v depressivnykh monogorodakh, kotorye poiavilis' eshche vo vremena SSSR." August 11. https://tochno.st/materials/milliony-rossiyan-zhivut-v-depressivnykh-monogorodakh-kotorye-poyavilis-eshche-vo-vremena-sssr-ikh-pytayutsya-ozhivit-no-poka-poluchaetsya-ne-ochen-sovmestnoe-issledovanie-esli-byt-tochnym-i-resh.
- Fontanka.ru. 2023. "Putin: v Rossii zarplaty vyrosli na 10,5%, a bezrabotitsa okazalas' na rekordno nizkom urovne." September 21. https://www.fontanka.ru/2023/09/21/72732446/.
- Gimpelson, Vladimir, Rostislav Kapeliushnikov, and S. Iu. Roshchin, eds. 2017. *Rossiiskii rynok truda: tendentsii, instituty, strukturnye izmeneniia*. Moscow: Tsentra trudovykh issledovaniĭ NIU VShE. https://publications.hse.ru/books/204342588.

- Gimpelson, Vladimir. 2022. "Spetsoperatsiia i rynok truda." *VPost media*, November 11. https://vpost-media.ru/opinions/specoperaciya-i-rynok-truda.
- Goemans, H.E. "Putin's Peers." In *The Policy World Meets Academia: Designing U.S. Policy toward Russia*, edited by Timothy Colton, Timothy Frye, and Robert Legvold. Cambridge, MA: American Academy of Arts and Sciences, 2010. https://www.amacad.org/publication/policy-world-meets-academia-designing-us-policy-toward-russia.
- Institute for Social Policy at the Higher School of Economics. 2023. "Budushchee Pod Sanktsiiami." March 21. https://iq.hse.ru/news/821709241.html.
- Khashimov, Sher. 2023. "Naturalized and Mobilized Russia's Covert Effort to Conscript Its New Citizens Sends a Chill through Migrant Communities." *Meduza*, September 22. https://meduza.io/en/feature/2023/09/22/naturalized-and-mobilized.
- Kostenko, Yaroslava. 2023. "Pochemu v Rossii sokratilas' proizvoditel'nost' truda." Vedomosti. October 9, 2023. https://www.vedomosti.ru/economics/articles/2023/10/09/999464-pochemu-v-rossii-sokratilas-proizvoditelnost-truda.
- Krugman, Paul R. 1990. *The Age of Diminished Expectations: U.S. Economic Policy in the 1990s*. Cambridge, MA: MIT Press.
- Levada Center. 2023*a*. "Predstavleniia o problemakh rossiiskogo obshchestva: avgust 2023 goda." September 7. https://www.levada.ru/2023/09/07/predstavleniya-o-problemah-rossijskogo-obshhestva-avgust-2023-goda/.
- Levada Center. 2023*b*. "Tseny i Potrebitel'skaia Adaptatsiia." September 21. https://www.levada.ru/cp/wp-content/uploads/2023/09/gr3.png.
- Levitsky, Steven, and Lucan Way. 2022. *Revolution and Dictatorship: The Violent Origins of Durable Authoritarianism*. Princeton, NJ: Princeton University Press, 2022.
- Matveev, Ilya. "The Crisis at the Door: Social Decline in Russia after 24 February 2022." Friedrich-Ebert-Stiftung *The Russian Crisis* #3 (February 2023). https://library.fes.de/pdf-files/international/20153.pdf.
- Meyer-Olimpieva, Irina. 2023. "Manipulating Public Discontent in Russia: The Role of Trade Unions in the Protests against Pension Reform." In *Varieties of Russian Activism: State-Society Contestation in Everyday Life*, edited by Jeremy Morris, Andrei Semenov, and Regina Smyth. Bloomington, IN: Indiana University Press.
- OECD. n.d. "Level of GDP per Capita and Productivity." Accessed October 2, 2023. https://stats.oecd.org/index.aspx?DataSetCode=PDB_LV.
- Petersson, Bo. 2021. *The Putin Predicament: Problems of Legitimacy and Succession in Russia*. Stuttgart: ibidem.
- Prokopenko, Alexandra. "Will the West Tap Russia's Frozen Assets?" *The Bell* (blog), September 22. https://en.thebell.io/will-the-west-tap-russias-frozen-assets/.
- *TASS*. 2023. "V Rossii dolia molodykh rabotnikov dostigla minimuma s nachala 1990-kh godov." April 11. https://tass.ru/ekonomika/17494487.
- *The Insider*. 2023. "Putin poruchil ispol'zovat' trud detei ot 14 let." August 26, 2023. https://theins.info/news/264581.
- Vashalomidze, Elena V., and Mikhail N. Dudin. 2022. "Proizvoditel'nost' Truda, Uroven' i Kachestvo Zhizni Naseleniia Rossii." *Sotsial'no-Trudovye Issledovaniia* 4 (49): 49–60.
- Volkov, Denis, and Andrei Kolesnikov. 2021. "The Coming Deluge: Russia's Looming Lost Decade of Unpaid Bills and Economic Stagnation." Carnegie Moscow Center, November 24. https://carnegiemoscow.org/2021/11/24/coming-deluge-russia-s-looming-lost-decade-of-unpaid-bills-and-economic-stagnation-pub-85852.