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Russia: Can Economic Difficulties Weaken the Political System?

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Russie.Nei.Visions

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Executive Summary

Year after year, Russian liberal politicians and experts have been promising radical changes in Russia's economics and politics, which, they believed, would lead to the collapse of the Putin regime. Domestic protests, Western sanctions, oil price fluctuations and public discontent caused by a drop in living standards are only some of the causes that could lead to such a development. However, neither the Covid-19 pandemic, instability in the global energy markets nor massive street protests earlier this year managed to undermine the foundations of the Russian political system. The reasons for their failing to do so were obvious: the Russian economy is far from being the disaster that foreign observers like to portray; people are willing to survive by relying on themselves alone; and the protests in Putin's Russia are more a way to express personal opinion than a tool to achieve the goals of masses of dissatisfied citizens. The last two decades indicate that neither political liberties nor opportunities for business are primary values for Russians. Russian society does not reject the apparent tightening of the regime, it does not demand that living standards be maintained, and it does not close its ranks in response to repression of dissenters. Meanwhile, Western economic sanctions have made almost no impact on government bureaucracy, since these days it prefers to concentrate its business domestically while reducing its contacts with the outside world to a minimum.

Let's be frank: Russia is not a "slightly distorted" version of a Western nation. Its "uniqueness" is too profound for developing policy based on expectations that one day Russia becomes a "normal country". Instead, Moscow's negative impact on Western nations and their allies should be strictly limited while Russia is left to go on its own path until it reaches an economic dead end and finally realizes the need for changes—as happened to the USSR due to its economic and technological failures.

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Introduction

By the end of 2020, the Russian opposition had great expectations since several factors were seemingly contributing to the imminent destabilization of the Putin regime. Before that date, the future of the regime looked bright; the current author expected it to last until the end of the 2020s.¹ The Covid-19 pandemic, which erupted in spring 2020, worsened Russia's eternal economic problems due to reduction in global energy demand and collapsing oil prices. The Russian government was forced to emulate other nations and declare a lockdown, close its borders, and introduce restrictions on transportation and many other industries. As a result, after several years of stagnation, Russia plunged into recession.² The poisoning of popular opposition leader Aleksey Navalny in August 2020 provoked an international outcry and multiple accusations against the Kremlin for its policy of eliminating its political opponents by any means, including weapons of mass destruction. Severe international sanctions were increasingly imposed on Russia.³ The victory of Joe Biden in 2020 US presidential election fueled expectations of a restoration of transatlantic unity and a tougher stance toward Russia's foreign and domestic policy,⁴ as statements by the President-elect and his senior officials had clearly indicated.

The Kremlin promptly responded by taking a number of steps. On one hand, it introduced some social bonuses: even though it provided only for parents with underaged children, 4.7 million families received 400 billion rubles (€4.5 billion) in aggregate.⁵ On the other hand, it tightened the screws: anti-extremist laws were toughened, new rules allowed individuals to be designated as foreign

Translated from Russian by Alexei Sobchenko.

1. V. Inozemtsev, I. Joutchkova, "La Russie en 2030", *La Revue internationale et stratégique*, No. 92, Winter 2013, pp. 157-165.

2. "Padenie ekonomiki Rossii iz-za pandemii stalo maksimal'nym za 11 let" [Contraction of Russia's economy due to the pandemic was the sharpest in 11 years], *RBK*, February 1, 2021, available at: www.rbc.ru.

3. A. Blinken, "Imposing Sanctions on Russia for the Poisoning and Imprisonment of Aleksey Navalny", March 2, 2021, available at: www.state.gov.

4. J. Marks, "The Cybersecurity 202: Biden Will Get Tougher on Russia and Boost Election Security. Here's What to Expect", *The Washington Post*, November 9, 2020, available at: www.washingtonpost.com.

5. "Vladimir Putin Held a Videoconference Meeting on Social Issues", President of Russia website, January 5, 2021, available at: <http://en.kremlin.ru>.

agents,⁶ and, as regards Navalny, he was warned that he would be arrested if he returned to Russia.⁷ However, that did not dissuade the opposition leader: on January 17, Navalny went to Moscow and was immediately arrested. Later he was sentenced to 2.5 years in jail. His supporters released a documentary exposing Putin's corruption and staged massive protests on January 23 and 31, mobilizing between 110,000 and 160,000 people⁸ (fewer than in the 2017 and 2019 protests). The Kremlin responded with a massive campaign of detentions and arrests (after the January 31 protests, 5,750 people were detained—a record number in post-Communist Russia),⁹ and the protests gradually subsided. Navalny's lieutenants emigrated, his organization was declared extremist, and the State Duma endorsed a law banning anyone who was somehow associated with its activities for the last three years from running for any elected office.¹⁰ As a result, by the time of the electoral campaign to the Duma in September 2021, the political framework in Russia had been properly purged, Navalny's supporters had ceased activities at their regional headquarters,¹¹ "Open Russia" had been completely shut down,¹² and many opposition activists who had expressed their intention to run for the Duma (Dmitry Gudkov, Maxim Reznik and Ketevan Kharaidze) had either been detained or had left the country.¹³

6. "Gosduma priniala zakon o priznanii fizlits inostrannymi agentami" [The State Duma endorsed a law on the recognition of individuals as foreign agents], *RBC*, December 23, 2020, available at: www.rbc.ru.

7. "FSIN prigrozil Naval'nomu zamenoj uslovnogo sroka na real'nyj" [Federal Penitentiary Service threatened Navalny to replace his suspended sentence with a real one], *Kommersant*, December 28, 2020, available at: www.kommersant.ru.

8. "V aktsiiakh 'Svobodu Naval'nomu!' po vsej Rossii priniali uchastie minimum 110 tysiakh chelovek" [At least 110,000 people attended the "Free Navalny!" rallies throughout Russia], *MBKh-Media*, January 23, 2021, available at: <https://mbk-news.appspot.com>.

9. M. Shubin, "Vtoraia vserossijskaia aktsiia protesta 'Svobody Naval'nomu!'" [The Second All-Russian Protest "Freedom to Navalny". Results], *OVD-Info*, January 31, 2021, available at: <https://ovdinfo.org>.

10. "Federal'nyj Zakon O vnesenii izmenenij v stat'iu 4 Federal'nogo zakona 'O vyborakh deputatov Gosudarstvennoj Dumy Federal'nogo Sobraniia Rossijskoj Federatsii'" [Federal Law on Amendments to Article 4 of the Federal Law "On the Election of Deputies of the State Duma of the Federal Assembly of the Russian Federation"], The State Duma of the Russian Federation, May 18, 2021, available at: <https://sozd.duma.gov.ru>.

11. "Volkov ob"iavil o rospuske shtabov Naval'nogo" [Volkov announced the dissolution of the headquarters network of Navalny], *Kommersant*, April 29, 2021, available at: www.kommersant.ru.

12. "Otkrytaia Rossiia' zaiavila o pol'nom prekrashchennii deiatel'nosti. Eto ne zachistka, uveriaet Kreml'" [Open Russia announced the end of its operations in Russia. The Kremlin assures that this is not a mop-up], *BBC*, May 27, 2021, available at: www.bbc.com.

13. "Dmitry Gudkov pokinul Rossiiu iz-za ugolovnogo presledovaniia" [Dmitry Gudkov left Russia because of criminal prosecution], *Interfax*, June 6, 2021, available at: www.interfax.ru; "Peterburgskij deputat Reznik zaderzhan po delu o narkotikakh" [Petersburg legislator Reznik detained in drug case], *Kommersant*, June 17, 2021, available at: www.kommersant.ru; "V Moskve sotrudniki SK zaderzhali munitsipal'nogo deputata Ketevan Kharaidze" [The Investigative Committee's officers detained municipal legislator Ketevan Kharaidze in Moscow], *OVD-Info*, June 18, 2021, available at: <https://ovdinfo.org>.

Nowadays, the people of Russia are partially intimidated and overwhelmingly indifferent, and a new surge of protests is highly unlikely.

The failed expectations of the Russian opposition to secure wide public support require a thorough analysis. It should include economic factors, since many experts claimed that “stagnation” and lower living standards, continuing for the last seven years, would make daily existence unbearable, and people’s discontent would reach an extremely high level. Today one can assume that the main difference between the Russian protests of 2020-2021 and those of 2011-2012, let alone the ones of 1980s and 1990s, is that back in 2011-2012 the wave of discontent surged spontaneously while generating and raising new leaders of the protest movement. Today’s leaders have been working hard to generate a surge, but the “perfect storm” never arrived. The reasons for this failure are mostly of an economic nature, and this is what this text is about.

Economic Factors in the Protests: A General Assessment

The economic development of any nation, its living standards, and government cuts of citizens' economic rights (raising taxes, price increases for specific goods and services, changes in retirement benefits) may have a strong impact on the attitudes of voters in democratic nations. For instance, in France the most serious recent protests were caused by exactly such measures: the gasoline price rise in 2018 or the pension reform in 2019, which led to hundreds of thousands of people joining street rallies and strikes.¹⁴ However, in Russia and in other former Soviet republics the dynamics are totally different: the last nation-wide protest caused by economic factors happened in 2005 (when the government introduced the "monetization of welfare benefits"),¹⁵ while in Georgia, Moldova, Kazakhstan and Ukraine one can hardly recall any protests of this kind at all. The devaluations of the ruble, the freezing of contributions to the state pension system since 2014 and even the raising of the retirement age in 2018 made no difference in Russia¹⁶ (it would take special research to identify the reasons for this "post-Soviet economic indifference").

Experts who believed that the lowering of living standards caused by Western sanctions following the occupation of Crimea and the Russian invasion of Ukraine, as well as by the depreciation of the ruble and the flight of investors, would jolt the electorate were operating under a number of false presumptions. The main one was the premise of "exchange of freedom for economic prosperity", which, according to several political scientists, was the basis for "Putin's consensus".¹⁷ This assumed that the people would not accept the

14. J.-Y. Dormagen, G. Pion, "Gilets jaunes', combien de divisions?", *Le Monde diplomatique*, No. 2, February 2021, p. 20; and "Réforme des retraites : 806 000 manifestants en France selon le ministère de l'Intérieur, 1,5 million selon la CGT", *La Provence*, December 5, 2019, available at: www.laprovence.com.

15. A. Papp, "Protestnoe dvizhenie protiv monetizatsii l'got (II): protsess politizatsii" [Protest movement against the monetization of benefits (II): process of politicization], The SOVA Center for Information and Analysis, February 15, 2005, available at: www.sova-center.ru.

16. G. Litvintseva, "Rossiia: pensionnaia reforma vyzvala vseobshchee nedovol'stvo, no ne massovye protesty" [Russia: pension reform has caused widespread discontent, but not mass protests], *Eurasianet*, September 14, 2018, available at: <https://russian.eurasianet.org>.

17. M. Siruk, L. Shevtsova, "What Should We Expect During Putin's Third Term?", Moscow Carnegie Center, May 15, 2012, available at: <https://carnegie.ru>.

absence of both freedom and prosperity. Besides, the experts believed that Putin's attempts to tout his economic achievements by comparing them with the disastrous situation of the 1990s were implausible and could not convince a young generation of voters possessing no memories of the 1990s and assumed to be demanding a rise in living standards. The final false presumption was that any lowering of living standards would be unacceptable to a majority of people and that the rise of poverty would be tantamount to a death-knell for the Putin regime.

However, back in 2015, we considered the Putin regime's future to be secured, from an economic point of view, "at least until the early 2020s or even 2024".¹⁸ The regime's durability can now be probably extended until the second half of the 2020s. Constitutional reform and many other recent developments have reduced the chances of a change in power bringing it almost to zero.

Two factors supporting this thesis seem evident: despite "paternalistic expectations" dominating among Russians,¹⁹ the people do not rely on the government. This is why the freezing of retirement savings or the raising of the retirement age did not provoke any protests. People do not make long-term financial plans and tend to adapt quickly to changing realities, relying only on themselves. It seems that the portrayal by many politicians of the prosperity of the 2000s as resulting from a rise in oil prices helped to mitigate the pain caused by the end of the bonanza era. Another "endurance test" was the 2008-2009 crisis. Finally, the economic downturn that started in 2014 was a gradual process (2-5% annually), and it was attributed to external factors (as happened with the 2008-2009 turmoil). Even after several years of recession, living standards remain significantly higher than in the 1990s or the first half of the 2000s, consumption patterns are more up to date, and everyday life is more comfortable. Meanwhile, the leadership has successfully played the old trick of ascribing all problems to Western policies and other factors that do not depend on the Russian government.

Lately, it has become obvious that the Russian economy is much sturdier than it sometimes seems to be. Analysts who try to draw numerous parallels between present-day Russia and the Soviet Union do not realize how different the two systems are.²⁰ The market

18. I. Joutchkova, V. Inozemtsev, "La 'logique non économique' de Vladimir Poutine", *Politique étrangère*, No. 2, 2015, p. 48.

19. N. Chernota, "Paternalistskaia funktsiia gosudarstva v Rossii: istoriia i sovremennost'" [The paternalistic function of the state in Russia: History and the present], *Sigma*, May 14, 2020, available at: <https://syg.ma>.

20. V. Inozemtsev, "Russie, une société libre sous contrôle autoritaire", *Le Monde diplomatique*, No. 10, October 2010, pp. 4-5.

economy rules out any risk of shortages or crisis as in the last decade of the USSR. It is much more flexible now, and if a problem emerges it can be attributed to human error and not that of the system. In 1984, when Moscow residents had cash in their hands but the grocery stores lacked basic products, the system could be blamed. However, in 2021, when grocery stores are full of all kinds of goods but not everybody has cash to buy them, it is not the system but people “who can’t make money” who are to be blamed.²¹ Political issues such as the violation of civil rights or deficiencies in the electoral law can be easily attributed to the government, but to the Russian mind economic challenges are of a different nature; since the responsibility for them is borne by the government and the people in equal proportions, these challenges cannot become the main driver of protests (unless combined with many other factors such as destruction of trade unions and exacerbated individualism, but even then economic challenges would be secondary).

In other words, in today’s Russia economic hardships do not provoke protests; the government may disregard economic problems and should not feel responsible for economic growth. The dominant mood of the people is “we can live with it as long as it doesn’t get worse”, and nobody really expects a continuation of prosperity. It looks like the government does not intend to spend significant funds on raising living standards, and instead is going to provide “targeted” funding for law-enforcement agencies and propagandistic media, which create an environment for stricter control over citizens and suppression of pockets of resistance. The environment that the opposition believed to be highly propitious for its success in reality happened to have all the elements required for transition to the rule of terror,²² and so far there are many reasons to consider the regime quite stable.

21. V. Inozemtsev, “Individualizm i diktatura” [Individualism and dictatorship], *VTimes*, December 29, 2020, available at: www.vtimes.io. Editorial comment: The publication ceased to exist in June 2021 due to the decision of the Ministry of Justice to add it to the list of foreign agents.

22. V. Inozemtsev, “Shtrafy i arresty na sutki pokazhutsia nam tsvetochkami” [Fines and arrests for 24 hours will seem to us to be children’s play], *The Insider*, December 28, 2020, available at: <https://theins.ru>.

Foreign Pressure and Social Mobilization

Russia's economic development in the 2000s was heavily influenced by favorable trends in the external market. In 2000-2004 average annual revenues from oil exports stood \$33.5 billion above their 1999 level; in 2004-2008 the figure rose to \$223.6 billion, and in 2011-2014—to \$394 billion.²³ The global economic crisis of 2008-2009 led to a collapse of the Russian economy: GDP dropped by 7.9%. However, the government pitched in cash from the Russian Reserve Fund equivalent to 13.9% of GDP,²⁴ reducing the Reserve Fund's coffers by 3.5 times: from \$142 billion to just \$40 billion.²⁵ This drastic step prevented real incomes from falling and as a result Russia was the only G-20 nation where incomes did not fall in 2009.²⁶ However, economic recovery in 2010-2011 did not prevent the “Protests of Failed Expectations” of 2011-2012, which were caused by a striking difference between the liberal rhetoric of Dmitry Medvedev and Putin's decision to return to the Kremlin, combined with rigged parliamentary elections. The protests frightened the government, and the 2008-2011 experience convinced the Kremlin that any effort to mitigate economic impacts on living standards does not preclude manifestations of public discontent, and that economic challenges *per se* do not provoke them. This is why in recent years the Russian government doesn't pay much attention to economic issues and doesn't overestimate their role.²⁷

Western politicians with experience in using economic sanctions as a tool of political pressure do not share this point of view. In response to the large-scale Russian aggression against Ukraine and terrorist activities in Donbas involving Russian military, Western nations imposed a number of financial and sectoral sanctions aimed

23. V. Inozemtsev, “Chto sdelala neft' s Rossiej” [What oil has done to Russia], *Vedomosti*, December 16, 2014, pp. 6-7.

24. V. P. Goregliad, *Mirovoj krizis i paradigmy gosudarstvennogo finansovogo regulirovaniia* [The global crisis and paradigms of public financial regulation], Moscow, 2013, p. 206.

25. “Ob'iom sredstv Rezervnogo fonda” [Amount of the Reserve Fund], Ministry of Finance of the Russian Federation, January 16, 2018, available at: <https://minfin.gov.ru>.

26. “Real'nye dokhody naseleniya RF v 2009 godu vyrosli na 0,7-1,0% – Putin” [Putin: in 2009, real personal income in Russia increased by 0.7-1.0%], *RIA Novosti*, December 30, 2009, available at: <https://ria.ru>.

27. V. Inozemtsev, “Putin denkt überhaupt nicht über Wirtschaft nach”, *Wiener Zeitung*, November 15-16, 2014, p. 4; and V. Inozemtsev, “Putin Doesn't Care About Economic Growth”, *Project Syndicate*, June 27, 2019, available at: www.project-syndicate.org.

at specific Russian industries (mostly defense and financial ones), territories (occupied Crimea and offshore oil extraction regions), and specific projects and companies linked in one or another way to the Kremlin's activities.²⁸ Besides, more than 720 government officials, businessmen and other individuals ended up being affected by the sanctions.²⁹ These measures are believed to cost Russia 1.5%-2% of GDP annually,³⁰ which in aggregate equals \$100 billion.³¹

In Russia, however, the impact of the sanctions looks quite insignificant—for a number of reasons.

First, the sanctions did not hit Russia's crucial industries, did not cause any shutdown of critical production facilities, and did not lead to a rise in unemployment or any other serious economic consequences.

Second, a dramatic drop in the ruble's exchange rate in 2015-2016, which really hurt the people, was caused by a sharp decline in oil prices, and only to a lesser degree by sanctions. It did not cause any significant discontent in the Russian society since it was a "natural" phenomenon and did not depend on the government's activities.

Third, the sanctions did not have any notable impact on the current economic situation, and even the foodstuff "counter-sanctions" (which many Russians still believe were introduced by the West) did not provoke any significant response beyond the large cities. What the sanctions did really hurt were the long-term projects of Russian modernization, which is not a matter of immediate concern for either the government or the people. As a result, today one can deem the impact of the sanctions exhausted. Given that the sanctions policy as a political pressure tool against Russia has proved to be ineffective, what else can the West do now?

On one hand, Western options are limited. Recently, the European Parliament mentioned in a resolution the possible exclusion of Russia from the Swift payment system and an embargo on energy imports,³² while the United States does not rule out a

28. V. Inozemtsev, "Poetin is gewoon een tweede Gaddafi" [Putin is just another Gaddafi], *NRC Handelsblad*, July 21, 2014, pp. 10-11.

29. A. Eineman, "Sanctions by the Numbers. The Geographic Distribution of U.S. Sanctions", *Center for a New American Security*, June 15, 2020, available at: www.cnas.org.

30. D. Fried, A. Karatnycky, "A New Sanctions Strategy to Contain Putin's Russia", *Foreign Policy*, May 4, 2021, available at: <https://foreignpolicy.com>.

31. I. Nikolaev, "Kakova nastoiashchaia tsena sanktsij dlia Rossii?" [What is the real price that Russia pays for sanctions?], *Otkrytie Media*, June 25, 2019, available at: <https://openmedia.io>.

32. "European Parliament Resolution on Russia, the Case of Alexei Navalny, the Military Build-up on Ukraine's Border and Russian Attacks in the Czech Republic No. 2021/2642(RSP)", European Parliament, April 28, 2021, available at: www.europarl.europa.eu.

complete ban on transactions with Russian debt securities.³³ It is not the first time that we hear about such threats, but they still sound either implausible (as in the case of an embargo on oil and natural-gas purchases) or non-crucial for the Russian economy (in the case of securities transactions). European nations do not want to and cannot give up on import of Russian hydrocarbons. Germany's policy clearly indicates the strong interest of German companies in turning their country into the main gas distribution hub in Europe.³⁴ It would be possible to replace the Russian supplies of oil and natural gas. The current oil market situation allows for a dramatic increase of production in the Persian Gulf and the US, and the number of reserve regasification facilities can fully provide for the EU's demand for liquefied natural gas. However, Western economies would not welcome the resulting price increases. Besides, previous oil embargoes, such as the one slapped against Iraq, were introduced by the UN Security Council;³⁵ this would be out of the question in relation to Russia, and the chances of reaching EU consensus on forfeiting Russian hydrocarbon supplies are very low, since some Central European countries are 100% dependent on Russian imports.³⁶ Finally, all these punitive measures could be introduced in response to a Russian attack on Ukraine, which is currently highly implausible (though not everybody shares this point of view).³⁷ As far as financial sanctions are concerned, Russia's foreign debt is insignificant, and Russian banks have enough funds to buy all Eurobonds and federal loan bonds with the prospect of pledging them at the Bank of Russia. The Finance Ministry, which announced expansion of its borrowing program for 2021-2023,³⁸ can easily place new bond issues among Russian investors, because, even in the event of a dearth of their own surplus funds, banks can easily refinance through the Bank of Russia. In the end, the government would pay the interest on such bonds to itself, since 75% of the Bank of Russia revenues are transferred to the

33. A. Blinken, "Nord Stream 2 and Potential Sanctionable Activity", US Department of State, March 18, 2021, available at: www.state.gov.

34. For more information see: K. Westphal, "Nord Stream 2—Germany's Dilemma", Stiftung Wissenschaft und Politik (SWP), Comment No. 2021, p. 32, April 30, 2021, available at: www.swp-berlin.org.

35. "The UN Embargo and Oil-for-Food Program", Britannica, available at: www.britannica.com.

36. For more information see: V. Inozemtsev, "Can Europe Survive Without Russia's Natural Gas?", *Policy Brief*, Vol. 2, No. 2, The German Marshall Fund of the United States, March 2015.

37. A. Illarionov, "Putin Was Not Ready to Launch a War in the Spring", *Live Journal*, May 1, 2021, available at: <https://aillarionov.livejournal.com>.

38. A. Siluanov, "Rastratit FNB za dva goda bylo by nepravilno" [It would be wrong to squander the Russian National Wealth Fund in two years], *Vedomosti*, May 6, 2020, available at: www.vedomosti.ru.

budget at the end of each year.³⁹ However, Western investors would lose billions when forced to close positions in Russian securities in the panic environment of their sell-off. Therefore, one can assume that the West is not going to impose new financial sanctions on Russia⁴⁰ (which was confirmed by the recent Biden-Putin Geneva summit, which essentially cemented the current situation indefinitely).⁴¹ In any case, if new sanctions were imposed, they would not deal a serious blow to the Russian economy.

Whatever happens, the Russian government is preparing to mitigate the impact of possible punitive measures by building a parallel banking transaction system, increasing reserve funds, and withdrawing their assets from dollar instruments. It would take years of very severe sanctions before the Russian people would start to feel the pain, though most likely it will never happen.

On one hand, there is a lot of talk about possible sanctions against Russian oligarchs who hold Putin's slush fund and secure his financial interests. So far there have been a few attempts to impose this kind of sanction. The results were quite painful: after sanctions were imposed on Oleg Deripaska and his UC Rusal, the company's market cap fell from \$27.5 billion to just \$4.2 billion,⁴² and some enterprises belonging to Deripaska's GAZ Group faced serious financial challenges and were forced to stop production. It is not only Western politicians who come up with the idea of punishing the oligarchs: recently, Navalny's supporters sent a letter to President Biden with a similar message,⁴³ while some political emigrants' groups include many businessmen on the "Putin's List".⁴⁴

These attempts will continue. They can be counterproductive since they can hit businesspeople who for years were legitimizing their assets by building a legal system of asset ownership both in Russia and abroad and, which counts more, creating their fortunes in Putin's Russia without seeking to capitalize on political connections (out of 123 billionaires of the latest *Forbes* list only 10 to 15 people

39. "Federal Law No. 86-FZ of 07.10.2002 (version of 04.20.2021) 'On the Central Bank of the Russian Federation (Bank of Russia)", article 26, World Trade Organization, available at: www.wto.org.

40. V. Inozemtsev, "The Physics of Sanctions", *Riddle*, March 17, 2021, available at: www.ridl.io.

41. V. Inozemtsev, "Putin snova priznan rukopozhatnym" [Putin became acceptable in a decent society again], *Spektr*, June 17, 2021, available at: <https://spektr.press>.

42. Calculation based on the current capitalization of UC Rusal on the Hong Kong Stock Exchange. *Yahoo Finance*, available at: <https://finance.yahoo.com>.

43. A. Hess, "Russian Anti-Corruption Group Founded by Navalny Calls for Biden to Sanction Putin Allies in Letter", *CNBC*, January 30, 2021, available at: www.cnbc.com.

44 "The 'Putin's List' Project", *Free Russia Forum*, undated, available at: www.forumfreerussia.org.

became rich thanks to their Kremlin ties).⁴⁵ One should also keep in mind that Putin launched the “nationalization of elites” program well before his invasion of Ukraine. This program stipulated government officials and entrepreneurs with strong ties to the government should either reduce their dependence on foreign assets or abandon them altogether.⁴⁶

This policy was quite successful. Today, increasingly large amounts of the proceeds of corruption are invested domestically, and former officials acquire Russian retail chains, office buildings, industrial enterprises and restaurant chains instead of French châteaux and luxurious ocean yachts. The difference between Putin’s new elite and the old one can be illustrated by the example of two ministers of agriculture: Yelena Skrynnik, who was in charge from 2009 until 2012, was recently caught by the Swiss prosecutor’s office in possession of 60 million francs, kept in a Zurich bank account;⁴⁷ while Alexander Tkachyov, who took ministerial office in 2015 and retired in 2018, owns 650,000 hectares of arable land in his native Krasnodarski Krai, valued at \$1 billion.⁴⁸ Lately, most government officials, heads of state-owned companies and entrepreneurs who serve the interests of federal and regional political elites abandon their ties with the West. An indirect confirmation of this is the rapid increase in demand for cash rubles (in recent years the Bank of Russia has increased their volume in circulation by 5.2 trillion or 5% of GDP⁴⁹ even though people’s real income has not been growing, and the share of electronic transactions has been rapidly increasing).⁵⁰ In other words, sanctions against oligarchs would affect the part of Russian big business whose owners are most critical of the current regime and would result in an opposite effect to that desired: the value of the assets of sanctioned “oligarchs” would drop sharply, and their companies would be quickly bought out by the state or by corrupt officials who have long been in business. And if sanctions affected those who are really close to Putin (as happened to

45. “200 bogatejshikh biznesmenov Rossii-2021” [Russia’s 200 richest businessmen in 2021], *Forbes Russia*, undated, available at: www.forbes.ru.

46. N. Ivanitskaia, K. Dokukona, I. Malkova, “Natsionalizatsiia elity: kak Kreml’ zastavlial chinovnikov rodinu liubit” [Nationalization of the elites: How the Kremlin forced officials to love their country], *Forbes Russia*, April 17, 2013, available at: www.forbes.ru.

47. S. Roque, “Swiss Authorities Freeze Accounts of Ex-Russian Minister of Agriculture”, Organized Crime and Corruption Reporting Project, October 28, 2015, available at: www.occrp.org.

48. “Agrokompleks imeni Tkachiova vozglavil rejting krupnejshikh zemlevladel’tsev v Rossii” [Tkachyov Agrocomplex topped the rating of the largest landowners in Russia], *Kommersant*, June 18, 2019, available at: www.kommersant.ru.

49. “Nalichnoe denezhnoe obrashchenie” [Cash circulation], The Central Bank of the Russian Federation (Bank of Russia), undated, available at: www.cbr.ru.

50. “Dolia beznalichnykh platezhej v Rossii dostigla 70%” [The share of cashless payments in Russia has reached 70%], *Vedomosti*, February 12, 2021, available at: www.vedomosti.ru.

Arkady Rotenberg and Gennady Timchenko), they would be covered by the new Russian laws providing that the state budget should compensate them for the losses caused by foreign nations' activities.⁵¹

It should be taken into account that business has no “voice” in Putin's Russia, and big businessmen are unable to influence the Kremlin. One can understand the reasons behind the idea of sanctions, but the current author has already tried to explain with much detail⁵² why Putin would benefit rather than lose from the sanctions.

However, the main question remains the same: to what extent can foreign pressure on Russia intensify disappointment with Putin's regime and generate steady support for the opposition? For several reasons, this scenario is highly unlikely.

First, and most importantly, the tightening of sanctions would provide Putin with an excuse to blame the West for all economic problems and to remove himself and his entourage from harm's way, even though, in fact, he and his minions are responsible for the current economic difficulties (the Russian economic slowdown started prior to the Ukrainian crisis and has been driven to a much greater extent by the government's restrictive policy than by external factors).⁵³

Second, sanctions have little impact on the real economy, and only a strict energy import embargo could make Russia feel the pain, though even in this case the government has financial reserves and organizational tools that can level the impact of the embargo for two to four years, during which much can happen, including changes critical to international security.

Third, the main groups of influence have recently much weakened their dependence on Western assets, reducing their presence outside of Russia. Thus, if the sanctions are tightened they will not suffer, while the main impact would be on business people who made their fortunes in the 1990s, and whom the Kremlin considers politically unreliable. Such sanctions would not help to mobilize those in Russia who could be deemed Western allies.

51. “Federal'nyj zakon No. 58-F3 ot 3 aprelija 2017 g. ‘O vnesenii izmenenij v glavu 23 chasti vtoroj Nalogovogo kodeksa Rossijskoj Federatsii” [Federal Law No. 58-FZ of April 3, 2017, “On amendments to chapter 23 of part two of the Tax Code of the Russian Federation”], *Rossijskaia Gazeta*, April 5, 2017, available at: <https://rg.ru>; For more information see: “Geroj nashego bremeni” [The Hero of our Burden], *Kommersant*, March 14, 2017, p. 1.

52. V. Inozemtsev, “Vozmozhnaia oshibka sanktsionnoj politiki” [Possible sanctions policy mistake], *Neprikosnovennyj zapas*, 2020, No. 4.

53. I. Joutchkova, V. Inozemtsev, “La ‘logique non économique’ de Vladimir Poutine”, *op. cit.*, p. 42.

So far, sanctions against Russia have proved to be an inefficient tool for influencing Russian politics, for two reasons: they cannot reach a scale that would make a difference among the Russian elites, and they are based on the erroneous presumption that a relatively insignificant decline in living standards could trigger mass protests in Russia.

Several years ago, while addressing the German Council on Foreign Relations, the author warned the audience against this scenario and explained that Putin's Russia cannot be modified from outside; the West's only option is to "outlive" it.⁵⁴ In the 2020s the developed world is geared toward decarbonizing the economy. This trend is fraught with much greater peril for Putin's Russia than any sanctions. Russia is incapable of modernizing in a way that would free it from oil dependence. Instead of escalating confrontation, it would be much wiser for the West to proceed along the path of simply reducing its dependence on hydrocarbons. In the long term, this would be disastrous for Russia. The combination of a thaw in political relations with the sustainable economic development of the West represents a much bigger threat for Moscow than ramping up current confrontation. The experience of the 1980s fully confirms this argument: the USSR was facing the challenges of the Cold War with relative confidence, but began to fall apart with the policy of *détente*. As with the Soviet Union, one should not try to change Putin's Russia but simply outlast it.

54. V. Inozemtsev, "Russia of the 2010s: How to Live with It and How to Outlive It", German Council on Foreign Relations, June 4, 2015, available at: <https://dgap.org>.

Domestic Economic Policy and Protest Potential

An analysis of the 2020-2021 protests leads to several conclusions. The most important of these is that Navalny's main message to the Russian people since the early 2010s has produced no serious response in Russian society. That message was that the ruling "United Russia" party was, as he put it so aptly, "the party of crooks and thieves",⁵⁵ and that the fight against corruption should be the focus of social mobilization. Although Russians watched the film "He Is Not Dimon [a colloquial diminutive of the name Dmitry, referring to Russian Prime Minister Medvedev] to You" uploaded on the YouTube channel by Navalny's Anti-Corruption Foundation to great interest (more than 43 million views since 2017) and the film "Putin's Palace" (more than 116 million views since January 2021),⁵⁶ the number of people who joined pro-Navalny rallies never exceeded 120,000 to 160,000 across the country.⁵⁷ In other words, interest in Navalny's revelations of blatant corruption did not translate into rejection of the political system, nor did discontent lead to massive protests. It seems that Russians have gotten used to the idea that their country is owned by the ruling bureaucracy⁵⁸ and do not see how this can be changed. Economic problems and financial challenges might reinforce public indignation at other kinds of injustice, such as stolen elections, police violence, environmental problems, etc, but by themselves they cannot trigger mass protests. The crackdown on the Anti-Corruption Foundation means, among other things, that that the government can move the issue of corruption off the national political agenda, despite the opposition's optimistic statements.

55. "Aleksiej Naval'nyj in 'Sukhoj ostatok'", *Radio Final FM*, February 2, 2011, available at: www.youtube.com.

56. "He Is Not Dimon to You", Wikipedia, available at: <https://en.wikipedia.org>; "Putin's Palace (film)", Wikipedia, available at: <https://en.wikipedia.org>.

57. For the 2017 data see: "12 iunija na ulitsy vyshlo bol'she liudej, chem 26 marta" [On June 12, more people took to the streets than on March 26], *Meduza*, June 13, 2017, available at: <https://meduza.io>; for 2021 data: "V aktsiiakh 'Svobodu Naval'nomu!' po vsej Rossii priniali uchastie minimum 110 tisiach chelovek" [At least 110,000 people attended the "Free Navalny!" rallies across Russia], *MBKh-Mediia*, January 23, 2021, available at: <https://mbk-news.appspot.com>.

58. V. Inozemtsev, "Outliving Putin & Co", *Riddle*, May 11, 2021, available at: www.ridl.io; and V. Inozemtsev, *Kommercheskoe gosudarstvo: novaja real'nost novogo stoletija* [The commercial state: The new reality of the new century], Moscow, Alpina Publishers, 2021.

One should also pay attention to at least five issues, which were and continue to be factors preventing economic hardship from becoming the main driving force behind the protests.

First, the Russian economy looks pretty solid today. Any expectations of its dramatic collapse seem unrealistic. Unlike in developed countries, the Russian economy is dominated by basic industries, and the domestic demand for these products cannot decrease significantly (today Russians spend more than 43% of their income on food and household goods,⁵⁹ and their consumption is quite stable). At the same time, the government continues to create demand for investment goods, keeps the defense industry busy with new contracts, and generates incentives for both residential and industrial infrastructure construction. The industries that in the West would be the most susceptible to crisis—such as services, the hotel and restaurant business, transportation—constitute a relatively insignificant share of Russia’s GDP and are less developed. Therefore, they cannot precipitate any dramatic economic contraction as they could in the developed world. In many respects this is the reason why Russia survived the crises of 2015-2016 and 2020 much better than the turmoil of 2008-2009. The economy has stopped growing and is, as they say in Moscow, “gathering its strengths”: it cannot be forced to grow rapidly, although verbally the Kremlin has committed itself to this task, but it would also be quite difficult to send it into a tailspin.⁶⁰ To convince Russian society that the situation is disastrous and requires extraordinary measures, living standards would have to drop by 20-30%, and there would also have to be serious industrial and regional challenges. None of these can be expected in the near future.

The last factor is extremely important: the protest movement always emerges as a response to disappointment, to a mismatch between expectations and reality. This is what happened in the last months of the USSR, when people took to the streets to protest the attempted coup initiated by the State Committee on the State of Emergency. This is what happened in Ukraine in 2004 and 2013, when election results were rigged and the long-planned Association Agreement with the EU was abandoned. This is what happened in Russia itself when, after several years of Medvedev’s talks about democracy and modernization, Putin returned to the Kremlin and the opposition-minded politicians were not allowed to be elected to the

59. “Raskhodi rossiiian na tovary pervoj neobkhodimosti i produkty pochti ne izmenilis’ za god” [Over the years the spending of Russians on essential commodities and food has hardly changed], *Nakanune*, February 27, 2021, available at: www.nakanune.ru.

60. V. Inozemtsev, “Russian Economy in the 2020s: A Cheerless Future”, *Aspen Review Central Europe*, No. 2, 2020, pp. 82-93; and V. Inozemtsev, “The Russian Economy: No Crash, No Progress...”, The Middle East Media Research Institute, April 26, 2021, available at: www.memri.org.

State Duma. This is what happened last year in Belarus when the registration of a single independent opposition candidate raised hopes for regime change, which were later brutally crushed. Today's challenge is that people have no unrealistic economic expectations. In the crisis of 2009, the government took the right step by supporting living standards after a decade of economic growth, at a time when a 10-15% drop in real disposable income was much more painful than it would be now after almost a decade of stagnation has stripped the Russians of any positive expectations and prepared them for another decade slow decline. These days, people are used to stagnation, and the most common Russian wisdom says: "as long as it doesn't get worse". The uniqueness of the present-day Russian reality is that the government does not need to prove itself with achievements (particularly economic ones) for remaining popular. It seems that neither the Russian opposition nor Western experts take this factor into account.

Third, there is a common erroneous belief that economic problems (the fall in the ruble exchange rate, inflation, and a slowdown in economic growth) affect all segments of the population equally. However, economists and sociologists long ago proved, for example, that inflation reduces the income of the poorest segments of the population the most,⁶¹ and that society in general does not suffer nearly to the same degree. The economic protests of the 1990s and 2000s were either of a sectoral nature (as in the case of the coal miners) or territorially limited (as in the case of "monotowns" built around a single factory or areas with a high concentration of the defense industry). However, after the 2000s inequity in development should be seen through the prism of the "four Russias" theory,⁶² with the reasons for protests becoming increasingly local. The government learned not to provoke the most vulnerable groups; the retirement-age increase (in 2018) was less keenly felt than the abolition of certain benefits for retirees (in 2005) because it did not affect already retired people at all, but only a narrow tranche of those aged 55-60; for whom the retirement age was raised (though not by much). Simultaneously, the government increased child benefits for poor families (implicitly emphasizing that the problems of the poor as such do not concern the government too much, but it continues to focus on

61. A. Bogomolova, "Inflitsiia v Rossii: 'krasnaia triapka' dlia bednykh" [Inflation in Russia: a "red rag" for the poor], *Gazeta.ru*, September 30, 2018, available at: gazeta.ru.

62. N. Zubarevich, "Chetyre Rossii" [Four Russias], *Vedomosti*, December 30, 2011, pp. 6-7. According to this expert on Russian geography and economics, the "first Russia" refers to the great cities, such as Moscow and St Petersburg, which underwent a relatively rapid post-Soviet modernization. The "second Russia" refers to industrial and middle-sized towns still carrying footprints of the Soviet era. The "third Russia" is related to agriculture. The "fourth Russia", the poorest, mainly comprises the ethnic regions where Russian is not predominant.

aid to children). The government also raised (albeit symbolically) taxes on wealthy Russians. The Kremlin is perfectly aware that protests require a “consolidation point”, which it skillfully prevents from emerging.

Fourth, in contrast to the widely held view of Western experts, Russian business remains viable. A key underestimated factor is the absence of a sharp decline in the service sector while prices stopped rising and some even fell (in the hotel and restaurant businesses, in internet and mobile communication, and in taxi services). Until 2008-2011, Russia’s economy produced constantly rising production costs in goods and services,⁶³ but now the situation has changed. There has been a significant increase in competition and a rationalization/optimization of businesses. About 950,000 small and medium-sized companies folded last year,⁶⁴ though one should not forget that more than 1.5 million people have registered as self-employed due to new laws allowing small entrepreneurs to open and run their business without creating a legal entity, paying just around a half of the previous taxes.⁶⁵ It is true that the dominant trend among graduates of prestigious universities is to seek employment in a state-owned corporation or in government service, but several million people continue to be entrepreneurs. Self-employment remains an essential tool for many to overcome problems in politics and social life. In the past five years, many people have chosen to leave the country because of the increased danger of political activity, and many have been persecuted for their beliefs, but virtually no-one has closed their business, gone bankrupt, or become the target of illegal takeover. Businesses that stay away from politics operate with relative freedom—and this helps to dampen political problems rather than exacerbate them.

Fifth, the government actively seeks to maintain a relatively acceptable standard of living. Recently, the share of pensions, welfare benefits and various social payments reached 21% of the overall income of the population, the highest value in the entire post-Soviet period.⁶⁶ Despite serious economic challenges, the government has not reduced its reserves, and this year it will most likely bring the

63. V. Inozemtsev, “Izderzhavshaiasia strana” [A run-down nation], *Vedomosti*, May 31, 2010, p. 6.

64. L. Matushevskaja, “Skol’ko IP zakrylos’ v Rossii” [How many individual enterprises have been closed in Russia?], *Moneymakerfactory*, April 7, 2021, available at: <https://moneymakerfactory.ru>.

65. “Kolichestvo samozaniatykh v Rossii dostiglo 1,7 mln chelovek” [In Russia the number of self-employed people has reached 1.7 million], *Izvestiia*, February 10, 2021, available at: <https://iz.ru>.

66. A. Komrakov, “Padaiushchie dokhodi khotiat podnimat’ arifmeticheskimi priiomami” [They want to raise the falling income by arithmetic means], *Nezavisimaia Gazeta*, May 4, 2021, available at: www.ng.ru.

federal budget into surplus again, due to growing oil and gas revenues. Today the average price of oil is approaching \$70/barrel against the price of \$45.3/barrel factored into the budget,⁶⁷ while the rapid recovery of the global economy after the Covid-19 crisis promises a further short-term rise in commodity prices. In other words, the Kremlin has wide room for maneuver if the economic crisis worsens and personal income begins to decline. Moreover, and just as importantly, in the face of the pandemic the Kremlin dared to take a step that no Western government could afford: by not imposing prolonged lockdowns, the Russian authorities have allowed extremely high mortality levels from the coronavirus (from April 1, 2020 to March 31, 2021, “excess” mortality totaled more than 500,000 people, exceeding by 27.5% the mortality figures for the previous 12-month period).⁶⁸ This was a horrible price to pay for maintaining relative economic stability without losing the trust of people.

The dynamics of economic recovery in early 2021 give every reason to believe that Russia, in a relatively short time, will reach the pre-crisis economic level, though further rapid growth seems unlikely. The recent economic dynamics not only confirm our earlier thesis that large-scale economic modernization of the country is impossible,⁶⁹ but make us wonder whether it is necessary. Back at the turn of the 2000s and 2010s, we mentioned that many advocates of modernization during the Medvedev era, who claimed that “Russia’s Imodernization has no alternative,”⁷⁰ were completely mistaken. As the experience of many European, Asian and Latin American countries proved, one can start modernization at almost any stage of economic development as long as society is convinced that it is urgently required.⁷¹ Russians were not convinced of this need at the end of the 2000s, nor are they now. Actually, if it seemed to be badly needed earlier, when the nation faced a serious crisis for the first time after years of rapid growth, now, after seven years of stagnation, there is no general impression that Russia needs to be developed. A very sad conclusion is that the economic factor, which in many countries is

67. “Gosduma priniala zakon o federal’nom biudzhete na 2021-2023 godi” [State Duma approved the law on the federal budget for 2021-2023], *Interfax*, November 26, 2020, available at: www.interfax.ru.

68. I. Terentev, “Izbytochnaia smertnost’ v Rossii za vremia pandemii koronavirusa prevysila 500 000 chelovek” [In Russia excess deaths during the coronavirus pandemic exceeded 500,000], *Otkrytie Mediia*, April 28, 2021, available at: <https://openmedia.io>.

69. V. Inozemtsev, “Ist Russland Modernisierbar?”, *Transit*, No. 42, 2012, pp. 78-92; and V. Inozemtsev, “Modernizatsiia rossijskoj ekonomiki: prichiny provala” [Modernization of the Russian Economy: Causes of Failure], *Russie.Nei.Visions*, No. 96, September 2016, available at: www.ifri.org.

70. I. E. Diskin, “Modernizatsiia i grazhdanskoe obshchestvo” [Modernization and civil society], The Higher School of Economics, June 22, 2010, available at: www.hse.ru.

71. V. Inozemtsev, “Nishcheta modernizatsii. Pochemu Rossiia propuskaet odnu tekhnologicheskuiu volnu za drugoj” [The poverty of modernization. Why Russia misses one technological wave after another], *Forbes Russia*, April 11, 2017, available at: www.forbes.ru.

one of the most important triggers of public discontent, will continue to play no significant role in Russia. As a result, the entire debate about Russia's future will have only a political dimension, and the Russian opposition will become a community of dissidents, with all the consequences that this entails.

Russia in the 2020s: A Period of Authoritarian Stability

To our mind, experts and politicians have not fully appreciated the role and place of the second decade of this century in Russian history. It started in 2011, when “modernization” and “reset” were the buzzwords. Against the backdrop of the global wave of “color revolutions” and rejection of dictatorial practices, this decade generated in Russia the most powerful protest in post-Soviet history, and seemingly brought back some elements of democracy (including the development of the multiparty system, restoration of regional governors’ elections, and the success of opposition candidates in the many mayoral races). However, this mood was replaced by the euphoria caused by the annexation of Crimea, “patriotic consolidation”, and growing confrontation with the West. The government began its campaign of “nationalization of elites”, toughened electoral laws, strengthened repression of dissent, introduced the stigma of foreign agents and undesirable organizations, amended many parts of the constitution, and *de facto* banned opposition activists from running for elective offices, arguing that every one of them was at some point linked to “extremist organizations” “during the last three years”. The 2010s began with growing protests and expectations of a crisis of the Putin system, and took a clearly downward trajectory toward the possibility of a fully, not hybrid, authoritarian regime.

An important feature of this decade was that the government proved its resilience to falling living standards, and increasing external pressure from sanctions brought an end to the “Putin economic miracle”. Both trends indicate that economic factors do not play a major role in the legitimization of Putin’s regime. Hence the logic that Russians would give up “freedom for economic prosperity” turned out to be erroneous. They did not trade their civil rights for increased incomes. They simply did not consider these rights to be important and yielded them without compensation. This is the only explanation for the fact that neither a steady decrease in living standards nor the obvious inability (and even unwillingness) of the government to stimulate economic growth, nor even direct attacks on economic rights (ranging from pension reform to control over bank transfers,

the widespread system of fines, and the government's right to draw funds from citizens' accounts without a court decision) have been able to provoke social resistance. There was never any hypothetical bargaining "between economy and politics" in the 2010s. What happened instead was a consistent and simultaneous attack on both political and economic rights.

This explains why hopes for a rise in protests were baseless. The mood of apathy and disillusionment is growing in Russian society, and there is no desire to protest and fight against the government. In the 2000s there was political stagnation in Russia; in the 2010s there was economic stagnation, and by the early 2020s the government realized it could launch both economic and political offensives on a large scale. Following this logic, the Kremlin has defeated the legal opposition, and whatever is left of it has been demoted to the level of dissidents. The Kremlin blatantly abandoned serious social programs right on the eve of elections to the State Duma (many commentators called Putin's recent address to the Federal Assembly "the stingiest one" in recent years)⁷² and took a course towards a tougher regime, using methods of "terror and pure authoritarianism".⁷³ Any opportunities to reverse this trend in the medium term have been exhausted.

For many years, Western experts have treated Russia as "a normal country",⁷⁴ in which actions of the government produce generally the same responses as in Western societies. The activities of the Russian opposition that seemed to confirm this hypothesis turned out, however, to be more of a smokescreen concealing the fact that Russian society and political institutions have a completely different quality, and perhaps even a different nature. The coming decade will not be a period of decline for Putin's regime, but rather the period of its maturation, an era of authoritarian stability. Therefore, for those who think that the Russian political system is a colossus on clay feet whose time is long over, the coming years may bring much disappointment.

72. "Samoe zhadnoe poslanie v istorii" [The most stingy address ever], *Ekho Moskvy*, April 21, 2021, available at: <https://echo.msk.ru>.

73. V. Inozemtsev, "Vrem'ia terrora i chistogo avtoritarizma. Razmyshleniia o tret'ej deкаде Vladimira Putina" [Time of terror and pure authoritarianism. Reflections on Vladimir Putin's third decade], *Snob*, January 20, 2021, available at: <https://snob.ru>.

74. This point of view is most clearly stated in A. Shleifer, *A Normal Country: Russia After Communism*, Cambridge (Ma.), London: Harvard University Press, 2005; see the author's counterarguments in V. Inozemtsev, *Nesvoio vremennaia strana: Rossiia v mire XXI veka* [An out-of-date country: Russia in the world of the 21st century], Moscow, Alpina Publishers, 2018.

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