

THE RUSSIAN MIDDLE CLASS IN A BESIEGED FORTRESS

ANDREI KOLESNIKOV | APRIL 6, 2015

How will the Russian middle class react to the effects of low oil prices, Western sanctions, and deep-set economic problems, a state of affairs that some economists have dubbed the “triple whammy”? Unfortunately, these problems are only part of the broader systemic crisis that plagues Russia today. Yet there is little reason to believe that the Russian middle class will react to the ongoing financial and economic crisis with protests or renewed calls for change. Instead, it seems almost certain that this dynamic segment of society will opt for strategies of survival and perseverance rather than articulating a political agenda that challenges the Russian government or its current policies.

The nature and consequences of Russia’s current crisis cannot be reduced to economic issues. Sberbank President German Gref argued in his January 14, 2015, speech at the Gaidar Forum in Moscow that it is important not to overlook the impact of critical governance shortcomings. But instability or gaps in the quality of the state’s administrative capabilities—however important—are not a root cause. Rather, they are one of the effects of a deeper institutional and values-based crisis. All other aspects of the crisis, including the current political situation, merely stem from it. And there should be no question that Russia is indeed in a political crisis, despite outward manifestations of calmness and the consolidation of society and elites around the head of state.

Unfortunately, the triple whammy is not unleashing the forces of “creative destruction” or disruption that some reformist voices had been pinning their hopes on. In many cases, crises enable states to reform political life and move forward. In this

sense, the 2008–2009 financial crisis was a lost opportunity for Russia. The crisis did not change behavior among state capitalism’s elites nor did it spur structural reform. Rather, the struggling economy was simply flooded with money from the state’s reserve funds. The state’s playbook conformed with former U.S. president Ronald Reagan’s old axiom: “Government is not the solution to our problem; government is the problem.”

THE ECONOMY AFTER CRIMEA

Russia’s economic problems are certainly significant.

Economic analysts generally agree that Russia’s gross domestic product (GDP) will decline by at least 3–7 percent in 2015 while annual inflation will soar. Inflation is forecast by the central bank to peak at 17.0–17.5 percent in the second quarter of 2015.



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Headline inflation was 15 percent in January 2015 (from January 2014 to January 2015), and increasing at a rate of 3.9 percent a month—the highest rate since February 1999. The disaggregated components of the inflation numbers also tell a powerful story. Prices for medicine and medical equipment grew 6.6 percent in January (19.4 percent year-on-year). Food prices, excluding fruit and vegetables, were up 3.7 percent in January (18.4 percent year-on-year). Fruit and vegetable prices increased by 22.1 percent in January (40.7 percent year-on-year).

Assessments of the effect of sanctions on overall GDP vary. Experts from FBK Grant Thornton, a business consultancy, suggest that the sanctions will shave off 1.2 percent of Russian GDP by mid-2015.¹ The effect of the sharp decline in oil prices on GDP is even greater. Gaidar Institute for Economic Policy experts Sergey Drobyshevsky and Andrey Polbin estimate that a decrease in oil prices to \$40 per barrel would translate into a 3.7 percent decline in GDP in constant prices.

Structural problems, for example, state intervention on behalf of favored industries and companies and the blocking of pension reform, are in part linked to the Russian economy's dependence on oil and gas. They are also tied to the lack of reform in the sectors of the economy (such as healthcare and education) that are human-capital-intensive as well as the lack of resources allocated to these sectors due to inadequate government financing.

As the labor force has shrunk, economists have begun to notice a decline in the skill level of Russian workers. The rector of the Russian Presidential Academy of National Economy and Public Administration, Vladimir Mau, has pointed out that “the unemployment rate in Russia is rather low due to the effects of demographic factors. However, a conflict is brewing: on the one hand, the army of retirees is on the rise; on the other, there are young people who are unwilling to fill the jobs being vacated.”² The low-skilled segment of the labor market is also changing. Inflation and a weak ruble have made Russia unattractive even to migrants—the most unpretentious part of the workforce; there was a 70 percent decrease in the number of migrants arriving in Russia in the beginning of 2015.

Another factor contributing to the current situation is the large percentage of workers who are employed in the shadow economy, which, according to official statistics, accounts for

12.5 percent of GDP. According to Rosstat data, in 2011, 22 million Russians—almost a third of the 71-million-person workforce—were employed in informal sectors of the economy. (This sector comprises, for example, many entrepreneurs and their employees, those providing paid services off the books, and agricultural workers.)³ The number is expected to increase as a result of the ongoing decline in real incomes, worsening labor market conditions, employee realignment and reductions at various large-scale enterprises, and other crisis-related factors. Workers in the informal economy pay no taxes and therefore will not be able to contribute to the Pension Fund. According to data from the Russian Ministry of Labor and Social Protection, 20 percent of the able-bodied population is missing from the Pension Fund databases.⁴

POLITICS AND POLICY

While oil price volatility is certainly not a by-product of current Russian economic policy, the other two components of the triple whammy—sanctions and structural problems—have a lot to do with decisions made by the government. Moreover, they are directly related to the nature and content of domestic and foreign policy decisionmaking. In a nutshell, such decisions are increasingly the province of an extremely close-knit and ever-shrinking circle of decisionmakers around Russian President Vladimir Putin, known as “Putin’s friends,” a description that has become increasingly literal.

It is telling that Russia's economic downturn worsened after the annexation of Crimea in the spring of 2014. Macroeconomic indicators looked dreadful by the end of the year. The ruble was the world's worst-performing currency against the dollar.⁵ Former finance minister Alexei Kudrin has suggested that the drop in oil prices only accounts for 25 percent of the ruble's recent depreciation. Kudrin claims that sanctions account for 25 to 40 percent of the currency's slide with the dollar's overall surge contributing an additional 5 to 10 percent. Kudrin also highlights the negative effects of “risks, expectations, and fears,” including investors' lack of confidence in the government's efforts to improve the investment climate and support economic growth.⁶

Economic policy making is increasingly held hostage by a new and unexpected set of actors. For example, any attempts by the government to mount superhuman policy changes in the economic sphere or complex diplomatic maneuvers could be blown to bits if Donetsk People's Republic leader Aleksandr

Zakharchenko were to order his troops to move on the city of Mariupol. Russia's investment climate, financial stability, and economic development depend more on the actions of separatist leaders in Donetsk and Lugansk, the chief prosecutor, and the Investigative Committee than the central bank's official monetary and interest rate policies or deputy prime ministers' declarations at the Davos World Economic Forum. Amid growing isolationism, nationalism, and anti-Western sentiments, the "Zakharchenko Factor" may not be the sole determinant of current developments, but it plays a very important role.

TAXPAYER'S DEMOCRACY: AN UNATTAINED IDEAL

Meanwhile, Russians remain quite passive about their economic situation, even as the consequences of the triple whammy gradually emerge.

Both Hegel and Marx wrote about alienation (*Entfremdung*), specifically, the mutual alienation of the people and their government. On a conceptual level, governments seek to exploit the benefits from GDP, economic rents, and tax revenues for the sake of self-preservation. This goal in turn leads to unproductive government expenditures on defense, law enforcement, and operations that significantly exceed productive government expenditures in other areas, say, education and healthcare.

In Russia, the clique of Putin-era oligarchs is not constrained by political institutions that would ordinarily help relay public opinion to the government. Of course, the Russian political system has never fully subscribed to the principle of "no taxation without representation." However, under Russia's particular brand of state capitalism and heavy dependence on oil and gas profits, closed channels of political representation have practically obliterated it.

The president's inner circle views economic rent as its personal revenue stream or private property, as evidenced by state-owned oil company Rosneft's request for substantial subsidies from the National Wealth Fund, which was created in order to accumulate oil-based revenues to compensate for a projected state-backed Pension Fund deficit. This is quite logical for a system in which having power is synonymous with owning property; this so-called power-property

relationship is also sanctified by the authority of the Russian Orthodox Church. The church is increasingly playing a role geared toward maximizing the effect of pro-government propaganda and ensuring greater conformity inside Russian society with its socially conservative goals and values. (The persecution of the band Pussy Riot is only the most well-known example of these efforts.)

However, such an arrangement contradicts the Russian constitution, which states that "land and other natural resources shall be utilized and protected in the Russian Federation as the basis of the life and activity of the peoples living on the territories concerned." Those resources were not intended to be the basis of life and activity for a handful of beneficiaries of state capitalism and their families.

Economic rent is alienated from the people, and so is the government. People believe that they have no way to advocate meaningful change in their country and thus allow the establishment to make decisions on its own. The classic Putiner-era social contract ("freedom in exchange for sausage") that emerged during the period of high oil prices gave way in 2014 to "freedom in exchange for Crimea and national pride."

The government is also alienated by virtue of the fact that elections now distort the principles of representation more than ever before. This fact triggered the street protests in 2011–2012, when some in the middle class demanded democracy and fair elections. These demands were perfectly in line with Seymour Lipset's theory that higher living standards, education, and income are the foundations for a realization by increasingly affluent members of society of the need for greater democracy.⁷

In 2011, Russia's urban middle class offered some support for Lipset's hypothesis by advancing their demands for democracy. Yet in 2014, after failing to achieve their original goal, they set aside such political interests in favor of the "Crimea is ours" (*Krym nash*) concept. In essence, they agreed that the concoction of hybrid and trade wars was better for the motherland than its presence, to put it pompously, in the family of European nations.

The year 2014 marked the degradation and militarization of state policies and mass consciousness. These policies were a striking contrast to the recent behavior of modern democratic

societies, which consider military losses unacceptable and regard appeals to an entity's sacred status as a relic of bygone theocratic eras.⁸

Along with the post-Crimean consolidation of Russian society, sociologists have found that Russians stayed true to a core belief: "We cannot have an impact on anything so therefore we do not want to impact anything." According to a Levada Center poll, about 60 percent of the population agree with the statement that they are unable to affect the situation in the country. Close to 50 percent believe that they can do nothing to influence events in their own city or town.⁹

Such views give rise to paternalistic attitudes like "let the state decide everything for me." These attitudes correlate with the relatively insignificant contribution that taxpayers make to federal and local budgets compared with the budget revenues derived from sales of oil and gas.

Kudrin has described the public's alienation from the decisionmaking process in the following terms. "In the 2000s, the country's prosperity grew largely due to the revenue from natural resources," he wrote. "But the people were not the ones benefiting from it. In terms of GDP, out of 37 percent of all collected taxes and other payments, rents constituted more than a third, while individual income tax accounted for only about 3 percent. . . . Officials easily and freely redistributed easy money—as a result, no feedback mechanisms were created."¹⁰

While the Russian citizen is alienated from the rent revenues, he knows that his livelihood depends on them. He is willing to accept them from the state, but at the same time he develops an inferiority complex about his material wealth, knowing that he did not exactly earn the money. This belief allows pro-redistribution coalitions—which divide rent among those close to the authorities' clans as well as lobbyists and pressure groups—to claim their "right" to "their" share in the redistribution of public funds. This stance seems extremely provocative in the midst of the economic crisis but clearly indicates who holds the keys to the house of Russian politics. For example, Nikolai Podguzov, the deputy minister for economic development, recently announced that "Rosneft requests a total of 1.3 trillion rubles from the National Wealth Fund (NWF) for 28 projects. . . . Rosneft proposes that the

NWF finance projects worth over 3 trillion rubles."¹¹ Not surprisingly, such a state of affairs angers the members of other pro-redistribution coalitions.

Out of this emerges a level of passivity among the public and acceptance of the consequences of the triple whammy as they gradually materialize. It appears that there never was and never will be a taxpayer democracy in the current rentier system—after all, individual contributions to the national well-being are quite small when contrasted with what is received from hydrocarbon-based rents. The public's impact on government decisions, their own political participation, and their involvement in civic life are just as insignificant. The process of spending taxpayer money does not concern the taxpayers themselves.

But when the oil-oozing, ostensibly collective pie is complemented by the mantra "Crimea is ours," it destroys both consensus-based and participatory democracy, along with any sense of civic duty or collective effort. Crimea was not a collective effort by any stretch—the Russian public stormed the peninsula while sitting in front of their televisions. Rather, Crimea was a gift from the government.

In their heart of hearts, Russians do not consider themselves creators of national wealth. That further discourages most forms of political participation, which should ideally be directed at achieving a more rational, honest, and equitable distribution of the goods and services produced by the economy.

This reality explains the public's willingness to tolerate just about everything and its unwillingness to protest. It also explains the lack of incentive for private initiative, for private investment, for innovation, and for the protection of private property. For their part, state investments further discourage private economic activity and fail to spur economic growth. Generally speaking, state-generated investment produces a pool of money that either provokes inflation or encourages capital flight to countries with more attractive investment climates. The Russian economy needs state investment as much as Soviet-era enterprises needed foreign machinery, most of which was never unpacked and rusted away in leaky warehouses.

THE CLASS PYRAMID

The triple whammy is a blow to all income levels of Russian society, but it especially affects lower- and middle-income

groups who are more sensitive to price increases. The general level of inflation that took off in early 2015 severely impacted the middle class, the major consumer of various services and durable goods. Real disposable incomes fell 7.3 percent in December 2014 compared to the same period in 2013. According to a January 2015 Public Opinion Foundation poll, 62 percent of the population describes the situation as an economic crisis and sees “dreadful inflation” as the main manifestation of the crisis.¹²

Research on the middle class by the director of the Independent Institute for Social Policy at the Russian Presidential Academy of National Economy and Public Administration, Tatyana Maleva, suggests that the social structure of Russian households has not undergone significant change in recent years. According to Maleva, about 70 percent of the population are below the middle class. Approximately 40 percent of households belonging to that group are at risk of poverty, while 30 percent could potentially join the middle and upper-middle class.

The size of the middle class can be measured in a number of ways based on different criteria. A rough estimate of the size of the middle class puts the number at around 20 percent of the population.¹³ While some other studies have come up with different numbers, an approach based on analysis of 2012 Eurobarometer data supports Tatyana Maleva’s conclusions.¹⁴

In a political sense, the group at risk of poverty makes up the regime’s social and electoral base. Not coincidentally, they are also the main recipients of public funds. Even amid the constraints imposed by the triple whammy, the government will therefore strive to ensure that this group does not end up below the poverty line. Humanitarian considerations play a fairly minor role in these efforts, which are based on cold political calculations and the regime’s desire to discourage the creation of social tensions. Social mobility from the middle to the upper-middle class, which has been long stifled by the highly monopolistic economy controlled by a small number of political-business elites, may cease altogether as a result of the current crisis.

Thus, the regime’s social goal is to preserve the class pyramid, which emerged during the oil boom and economic recovery of the 2000s and has enabled the system of power-property and crony capitalism to reproduce itself. Evaporating material gains are being replaced with spiritual appeals, which will

involve using cruder and more archaic propaganda, including indoctrination by the top brass of the Russian Orthodox Church, as well as the increasingly selective application of repressive laws.

THE ESTATE STRUCTURE OF THE RESOURCE STATE

This is only a slight correction of the regime’s principal course of action, which Higher School of Economics Professor Simon Kordonsky describes as “the suzerain takes care of his people—the amalgamation of estates—by distributing resources in a way that ensures that the privileged estates don’t get too brazen and the underprivileged ones don’t die from hunger.” Notably, this theory views modern Russian society as estate-based rather than class-based. And, as Kordonsky explains, “The distribution of resources is at the core of estate-based society, in contrast to class society, whose economy is mainly based on converting resources into capital and their broader reproduction.”¹⁵ In essence, this is status commercialization.

Status can be acquired by assuming high office (hence all the talk of regime figures buying top positions, seats in parliament, and so on). It can also be bestowed by the suzerain (look at the members of the Kremlin’s inner circle, who share similar security and intelligence backgrounds with Putin), and it can be inherited. Children of high-ranking officials and state capitalists from the redistributive coalitions take charge of high offices and even receive government decorations. Naturally, concludes Kordonsky, “Such a system does not need democracy as an institution for reconciling interests, nor does it focus on the needs of individuals who fall outside of the estate system.”¹⁶

Privatization in the 1990s was a way to utilize (and increase) resources within the market framework. The “re-privatization” of the 2000s in favor of state capitalism and figures from the president’s inner circle was a way to escape the market framework and return to a system based on estates.

Instead of encouraging middle-class growth, this type of estate structure actually slows it down. Quite often, one can only join the middle class—at least in terms of income levels—by working in a system dominated by the most privileged estates,

for example, state-run corporations and companies that live off of government contracts or tenders.

THE CONFORMIST CLASS: SURVIVAL INSTEAD OF CHANGE

How will the Russian middle class respond to the triple whammy? How will its political behavior and socioeconomic well-being be affected?

Some researchers point out that the middle class has been “the main actor of socioeconomic adaptation” in recent years.¹⁷ At the same time, it is still not large enough, strong enough, or confident enough in its future well-being to clearly formulate a political outlook or to insist on proper representation in government bodies and decisions. Other economists also talk about its “low bargaining power.”¹⁸

This bargaining power decreased even more after the failure of the 2011–2012 protests. After Dmitry Medvedev left the president’s office, both society and the loyal, liberal political elite lost incentives to construct political, lobbying, and civic coalitions in favor of modernization. Thus, modernization coalitions were replaced with redistributive, estate-based ones.

The big question is whether the middle class, which is quite adaptable, even wants such coalition-based bargaining power. In reality, its political behavior and positions are far removed from the romantic image that took shape in Moscow’s streets and squares and in the independent media during the democratic illusions of late 2011 and the first half of 2012.

In a 2014 book, Francis Fukuyama argues that the middle class has been the engine behind practically every recent protest in various countries across the world.¹⁹ What’s more, even a fairly elected but ineffective or corrupt government does not enjoy sufficient legitimacy in the eyes of the most advanced segments of the population. As Fukuyama writes, “Government actually had to deliver better results if it was to be regarded as legitimate, and needed to be more flexible and responsive to changing public demands.”²⁰

That was exactly the chief motivation behind the 2011–2012 protests. Russians were dissatisfied with the government, and its legitimacy was diminishing as a result of dishonesty and ineffectiveness.

But the political protests that grew out of the public’s stance against the regime’s corruption were mostly limited to Moscow and involved only a very small part of the educated, urban middle class (although some upper- and lower-income segments of the population joined at times). This social stratum was immediately named the “creative class,” which, in turn, led to the shorter and more derisive word, “creatives.” While this concept does have something in common with the term coined by Richard Florida, the Russian meaning of the term does not actually cover people who are engaged in creative work. It refers instead to a small segment of Russian citizens who are dissatisfied with the regime and its authoritarian rule, predominantly for political and ethical reasons. In their beliefs and goals, creatives today somewhat resemble the democratic intelligentsia of the late 1980s.

Nor is the creative class always synonymous with the middle class, especially in terms of income levels (although its behavior does correspond to that of the middle class). In addition, its opposition activities sharply contrast with the conformism exhibited by the majority of the middle class. Contrary to expectations, this conformism will only grow or remain unchanged as a result of the triple whammy. Despite some sporadic protests, the majority will more readily embrace the strategies and tactics of survival instead of protests and demands for change, at least in 2015.

Consider the 2012 Eurobarometer survey of the middle class.²¹ According to the data, against the backdrop of blatantly dishonest elections that provoked protests in 2011, the middle class actually voted for United Russia—the pro-regime party. And at higher strata of Russian society, the level of support for the regime actually increased. The motivations underlying voting behavior varied: some voters had benefited handsomely during the economic boom of the early 2000s while others became complacent with their lot. Either way, conformism became the overarching trend.

The middle class was only slightly more active in terms of participation in opposition rallies (2.3 percent versus 1.9 percent at lower-income levels). The upper-middle class seemed to be the most active (11.7 percent), but this stratum was also quite active when it came to attendance at pro-government rallies (6.7 percent versus 1.0 percent of the middle class).

The lack of participation by the middle class—either in opposition to or in support of the government—suggests that its conformism is inherently passive. It does not express passionate or unequivocal support for the government; rather, the middle class is simply not ready to struggle for change. (It seems that active support for the regime manifested itself only after the referendum in Crimea and did not diminish much, if at all, as the Ukraine crisis worsened.)

According to the Eurobarometer survey, the middle class was evenly split in its assessment of the political situation (43 and 44 percent were satisfied or dissatisfied with it, respectively). In fact, the majority of respondents wanted no change to the political situation, while 12 percent preferred radical change.

The middle class's relationship to the European Union (EU) is further proof of its conformism: 18.2 percent of the middle class and 27.8 percent of the upper-middle class wanted Russia to distance itself from the EU as much as possible. It is quite indicative of the mood in the country that the lower-middle class was the biggest supporter of EU integration, at 23.4 percent. These numbers have changed in the direction of greater "patriotism" for the time being. A January 2015 Levada Center poll, for example, demonstrated an increase in negative attitudes toward the United States and EU countries to 81 and 71 percent, respectively.

CONCLUSION

In his 1997 work "Anomalies of Economic Growth," Yegor Gaidar, the architect of Russian reform, noted that two main social groups are interested in liberal market reforms in Russia: "The middle class, which needs a level playing field, effective protection of private property, and a government that is not cumberously involved in economic affairs; and the intelligentsia—those who are connected to the science, education, healthcare, culture, and other such sectors—to whom the redistribution of resources objectively reflects the economic needs of the country." Russia's developmental perspectives depend on the combined resources of these two groups.

In the nearly two decades since Gaidar began his work, by and large, very little social change has come to Russia: those in the middle class are considered the agents of change. The creative class can be considered the new intelligentsia. Nevertheless, the coalition for modernization that began to emerge under Dmitry Medvedev was never realized. The signal from above that permitted the very existence of such a coalition was unceremoniously cut off, while the politician who had the best chance to launch perestroika 2.0 surrendered power based on his own free will.

The Russian model of change can only work if the demand for modernization expressed from below is noticed and clearly approved from above. In such a case, the notorious middle-class conformism toward official government policy could yet play a constructive role. If the higher-ups allow democracy, this brand of conformism implies that citizens will recognize that it must be supported and taken advantage of. As for the creative potential of the Russian middle class, it may very well serve as the engine of economic liberalization and political democratization, if it receives a level of representation in the government.

However, the creative forces among the agents of change can lie dormant for extremely long periods of time. After all, modernization coalitions in Venezuela and Iran have never really gained momentum, and those countries have experienced their own analogues to the triple whammy. So far, these forces have not yet fully shaken the Russian middle class.

We are now anxiously waiting for the agents of modernization, who have turned into the agents of mobilization, to finally come to their senses. But we probably will need to wait quite a bit longer. Give it a year or two.

NOTES

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