The Covid-19 Pandemic Offers a Glimpse into Russia's Economic Future

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The disruption due to Covid-19 has forced a rethink, and the programme has now been relaunched as a more realistic 8-year programme and with adjusted priorities.

The Fiscal Rule also makes the National Projects, as well as other measures announced aimed at encouraging investment and economic diversification, more achievable. The diversion of hydrocarbon surpluses means that Russia's National Fund is worth almost $180 billion today. Total national debt is at a still-modest 18 percent of GDP, having jumped from under 13 percent at the start of the pandemic in early 2020. In other words, the government can now afford to fund this better-structured and more transparent recovery and growth programme.

Challenges certainly lie ahead. The legacy of Russia's poor behavior with investors, the most recent example of which being the Barings Vostok case, and the continuing sanctions threat means that private sector investors will be reluctant to participate too quickly. These investors will be needed in the coming years if the programme to pull the economy out of a low-growth environment is to succeed; the state will not be able to do it on its own. Three oil price shocks since 1998, pressure from Western sanctions and a slowly changing and more demanding population means that the government has no choice. It is now embarked on an irreversible course, as the consequences for social and political stability of doing otherwise are worse.

About the Author

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The Covid-19 Pandemic Offers a Glimpse into Russia's Economic Future

By Janis Kluge (German Institute for International and Security Affairs—SWP, Berlin)

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Russia's economy survived the Covid-19 crisis with a relatively mild GDP contraction of 3.1 percent. Under the exceptional circumstances of the pandemic, having a less complex and less internationally integrated economy turned out to be an advantage. A relatively short-lived Covid-19 lockdown helped as well, but with excess mortalities during the pandemic rising above 400,000 in Russia, it is becoming increasingly clear that the more vulnerable parts of Russia's population paid an immense price for keeping businesses open.

The unspectacular GDP statistic may not suggest it, but the Covid-19 pandemic has offered a glimpse into Russia's economic future. First and foremost, recent developments on international energy markets and the trajectory of climate policies around the world are spelling the definite end of the era of limitless oil and gas rents. Although Russia will continue to export hydrocarbons for many years, stagnating and eventually falling demand will result in lower long-term average prices. Heightening the pressure on margins and tax revenues, prospective new oil projects such as Rosneft's Vostok Oil in the Arctic are more expensive to develop, and stricter sustainability requirements on international capital markets make financing these projects costlier.

While some Western observers fear that the Russian economy will fall into deeper isolation as the role of hydrocarbon trading diminishes, the opposite is likely to happen. The government's ongoing attempts to achieve economic sovereignty through import substitution and trade barriers is costly. Today, Russia's economic model is based on the redistribution of oil and gas rents to uncompetitive domestic industries, both through government subsidies and cheap domestic energy prices. Once hydrocarbon revenues dry up, it will become more difficult for Russia to finance its isolationist policies. Integration into international value chains will also become more attractive and economically feasible as the symptoms of Russia's "Dutch disease" subside.

The Covid-19 pandemic has also given a boost to Russia's digital economy. The rise of sectors such as IT and communications, but also financial services, runs against the government's intentions of making the economy sanction-proof. Many of Russia's promising growth stories are deeply integrated with Western capital markets and technologies, and are even more prone to sanctions than the country's traditional industries. In 2019, the US and EU accounted for almost 80 percent of Russia's trade in telecommunications, computer and information services, while China accounted for a mere 3 percent. In November 2020, Russia's e-commerce front-runner Ozon.ru raised USD 1.2 billion at the NASDAQ stock exchange during its initial public offering. As Russia's economy transforms, its Western dependencies deepen.

Of course, the Russian leadership does not (yet) accept the reality that economic sovereignty is a dead end, and it is unclear how much damage it is willing to inflict before it changes its mind. Emboldened by apparent successes of import substitution in agriculture, and operating strictly within the mindset of the more-and-more-influential security elites, Moscow is ramping up pressure on international linkages of Russia's digital economy as well. It has delayed the introduction of the next mobile communications standard 5G until 2024 in order to give state corporation Rostec time to develop a Russian-made network solution, which experts believe will never materialize. The government also plans to force critical sectors of the economy to switch to Russian-made software by 2023 and Russian-made hardware by 2024.

Businesses, both state and private, are resisting these plans, with the exception of a small (but influential) group of beneficiaries. Gazprom CEO Alexei Miller has warned that substituting foreign IT with Russian-made alternatives would cost the company 180 billion Rubles (2 billion Euros). Russia's mobile operators have tried for years to block the introduction of stricter import substitution requirements in 5G. Of course, Russian firms are very experienced in watering down unfavorable regulations and shirking overly strict rules, even after they are imposed. However, for Russia to manage its economic transition without calamity, the government's vision of the future urgently needs to be realigned with economic realities. The Covid-19 pandemic has shown that the cost of not doing so will only rise.

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Russia's Economy: A Possible Vision for the Future

By Michael Rochlitz (University of Bremen)

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Imagine it is October 2021. Your political party has just won the recent Duma elections, and you have been appointed Minister of Economic Development of the Russian Federation. Your Prime Minister has tasked you to sketch out a vision for the future development of the economy. What are you going to propose?

The last 13 years have not been good for the Russian economy. In 2021, GDP per capita is lower than it was in 2008, a consequence of two economic crises and a prolonged period of economic stagnation. But Russia is still a rich country, with abundant natural resources, especially oil and gas. These resources will not last forever, and the world's energy mix is changing fast, but you will still have 10 to 15 years to use them. Thus, your first move is to use an annually increasing share of the oil rent for investments into future economic drivers, while setting spending on defense, prestige projects and the bloated state sector to decrease. A part of the newly available funds will be used to upgrade decrepit infrastructure in Russia's smaller cities. You launch a large-scale investment project to transform Russia into a transport hub between Europe, China and Central Asia, making use of the country's unique position as a bridge between East and West. Finally, decentralized programs will be launched in every region to encourage start-ups and small and medium enterprises by offering cheap credit for newly founded firms.

To facilitate the successful implementation of these programs, your government launches a comprehensive reform of incentives for state officials and the security services. Following the example of China, Russia's regional governors will be evaluated first and foremost with respect to the economic success of their region and their ability to attract investment. Similarly, the success of the regional security services will no longer be measured by the number of arrests, but by the economic dynamism of a region, the number of new firms that manage to stay in business, and the security of property rights.

These measures are just a first step. One of the biggest problems of Russia's economy is the high share of large, state-owned companies that are not competitive on world markets, but face practically no competition at home. As a result, they provide Russian consumers with goods and