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Learning Modernization from Gref

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By Konstantin Sonin

There are several reasons for the relative calm regarding Russia's economy. First, the crisis looks worse on the pages of newspapers and analytical reports than on the streets of Moscow, where it doesn't appear that we are in the middle of a deep crisis.

Despite official figures showing that unemployment reached 10.2 percent in late April, there have been no mass demonstrations outside the Moscow Ring Road like there were during the turbulent 1990s.

Second, the economic downturn has finally slowed its pace.

Third, most of the signals coming from world markets are positive. If the Chinese government is not manipulating its economic data -- which is always a distinct possibility in countries without a free press -- then even the sharp drop in exports has not stopped the Chinese economy from growing at considerable speed. Meanwhile, the price of oil, which is considered an indicator of investor confidence, refuses to climb back to levels of seven or eight years ago, a time when it was widely believed that the global market economy had learned to function without a cyclical rise and fall.

But there are still many reasons to be pessimistic. First, many governments of the world have transferred the burden from future generations onto the present one by piling on huge debt, making the task of balancing their budgets extremely difficult for years to come.

Second, gross domestic product has fallen at record speeds in many countries. This played a mean joke on governments. If in the past they refused to increase the money supply for fear of spurring inflation, now this is longer off limits since prices across the board have fallen along with the economy. But it is anybody's guess as to how those governments will eventually close their budget deficits.

Russia's prospects look bleak on their own without taking into consideration the broader problems in the global economy. How will the Russian economy turn the tide by showing positive GDP growth? If the price of oil does not rise above current levels, Russia will earn enough petrodollars to cover its budgetary needs but not enough to address the problem of long-term development.

Cheap liquidity is not the solution because the price of borrowing money will only increase in the near future. As soon as the global economy picks up again, most developed economies will have to tighten monetary policy. The energy with which bankrupt Russian firms resist creditors' efforts to repossess their property makes it clear that credit will be hard to secure for years to come because political favoritism has kept so many "zombie firms" artificially alive.

Given these circumstances, it is not clear when we will ever see positive growth again. Now is the time to think seriously about modernizing Russia's economy. Perhaps President Dmitry Medvedev should dust off the strategic modernization program that German Gref developed in 1999, when he was head of the Center for Strategic Development think tank, and read it cover to cover. He might learn something new.

Konstantin Sonin, a professor at the New Economic School/CEFIR, is a columnist for Vedomosti.