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In Brief

Russia after the Global Economic Crisis

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The economic and financial crisis that raged across the globe in 2008–09 hit the Russian economy hard. Hailed as an economic miracle until 2008, the country saw its GDP tumble by 8 percent in 2009 and the stock market plunge by 80 percent from May to October 2008. A sharp decline in the price of oil and other commodities as well as capital outflows put the economy in a tailspin. Since the global crisis hit, some of Russia's largest companies have gone bankrupt, Russia has spent $200 billion of its foreign currency reserves to stabilize the ruble, and unemployment has surged. Why did Russia suffer so badly? Was Vladimir Putin's "growth decade" of 1999–2008 an aberration? Did Russia just have bad luck, or has the global crisis revealed profound shortcomings that need be fixed? A dozen American and Russian experts explore answers to these questions in the second book from the Russia Balance Sheet project of the Peterson Institute for International Economics, Center for Strategic and International Studies, and the New Economic School in Moscow.

The growth in the precrisis decade, say Sergei Guriev and Aleh Tsyvinski, was not a fluke. The benefits of this growth have trickled down to all parts of Russian society. Russia's economic success came not only from high oil and commodities prices—at most, half of Russian growth during 1999–2008 can be attributed to oil prices—but also from economic reforms undertaken during the 1990s and Putin's first term. However, the growth decade failed to address several major problems in the Russian economy—specifically, corruption and dependence on production and exports of commodities.

Despite its deficiencies, Russia successfully responded to the global crisis, and as oil prices are rising again, it does not face any serious problems in the immediate future. But the global crisis has exposed the severe structural problems that have been plaguing the Russian economy for decades. For the country to again enjoy the growth it did before the global crisis, it urgently needs comprehensive reform. The current system is no longer suitable for the challenges ahead and is facing a dead end; it is not sustainable in the long run and must change. But, as is typical of a country suffering from a resource curse, the Russian leadership will likely delay reforms as long as oil prices stay high. Reliance on energy rents to once again fuel prosperity while ignoring fundamental reforms will only slow growth in the long run and eventually lead to bankruptcy. How long will Russian society be willing to live with low growth, which is inevitable without serious reforms? Will the government remain popular if real disposable income rises at 1 to 2 percent per year rather than 9 to 10 percent?

Russia faces a choice between Brezhnev-era stagnation and difficult economic reforms that will build the foundation for faster economic growth. The leadership's choice will ultimately depend on economic performance in the long run, which Daniel Treisman argues to a large extent has determined the president's popularity in Russia. Russia's leaders have enjoyed high approval ratings in times of prosperity and have used the popularity to enact and implement policies. But ratings have plummeted during bad economic times, rendering the leader ineffective. Although the two political leaders' popularity has declined slightly during the last one and a half years of crisis, the decrease has been remarkably small, perhaps due to the Kremlin's control over the media and extensive social transfers or because popular dissatisfaction is yet to be fully expressed in Russia. President Dmitri Medvedev praised the continuing social and thus regime stability as the biggest achievement of 2009. But if economic performance worsens, social unrest could heighten, prompting the Kremlin to make an unusual about turn and embrace reforms to prevent social and economic disorder.

STRUCTURAL PROBLEMS EXPOSED

Among the severe structural problems are low labor productivity; poor infrastructure; excessive regulations; energy inefficiency; high public spending, especially on pensions; heavy dependence on commodities, especially oil and gas; and widespread corruption and weak rule of law. Even without the global crisis, these problems would have inevitably led to an economic collapse (or at least a significant slowdown) by the end of the decade. Many economists note that a slowdown in some important sectors began well before the crisis, and the causes were purely domestic, having nothing to do with the global environment.

Corruption is by far the worst structural problem facing nearly all facets of the Russian economy. The nature of Russia's federalism itself, as Ekaterina Zhuravskaya illuminates, breeds corruption. Putin's creation of a "strong political vertical" with the appointment of governors has created major problems, including inadequate provision of public goods, because of the absence of accountability of both regional and federal officials. Without a strong opposition and free media, the federal center cannot pursue efficient policies. The alternative to the political vertical is building strong national political parties, which can exercise accountability.

Using his enterprise surveys from 2000 and 2008, Timothy Frye shows that corruption has not abated after 2000 but become somewhat worse. Big companies are given an unfair advantage over small firms, hampering the latter's development, whereas in the West, small businesses are the innovators. The share of small and medium-sized enterprises in GDP has stagnated in recent years, demonstrating the illiberal character of the Russian economy. Corruption is largely a natural consequence of lack of economic freedom and the state's excessive influence on business.

One industry that has managed to operate without excessive government regulation—due primarily to its young age, absence of legacy assets, and small size—and thus been relatively successful in the global market, is software and information technology (IT) services. But, as Keith Crane and Artur Usanov find, corruption remains the key challenge to continued growth in this sector. Bribing inspectors, tax collection agents, and the police places a substantial burden on these companies. The IT sector is one of the "five strategic vectors" that President Medvedev has identified for the economic modernization of his country. Given the pervasive corruption in tax collection and law enforcement and lack of innovation, argue Crane and Usanov, hopes of Russia's leaders that high-technology industries will be the main driver of Russia's future growth seem misplaced.

Another structural challenge to Russia's future growth is the high energy intensity of the economy—i.e., energy consumed per unit of GDP. Russia's energy intensity is two to three times higher than in any industrial country, higher than any of the other BRICs (Brazil, India, and China), and more than two times higher than the world average. Most of the existing industrial capacity was installed several decades ago and is highly inefficient. Also, energy producers waste staggering amounts of energy resources. Samuel Charap and Georgi Safonov demonstrate that Russia has an enormous potential for energy saving, a theme that President Medvedev has taken up and given new prominence in Russian policy. But it remains to be seen whether his recent statements really indicate a new beginning.

While beneficial to the economy as a whole, energy saving will reduce demand for gas, hurting the gas monopoly Gazprom, which Anders Åslund notes is already in a serious structural crisis. Because of its size and importance for the Russian economy, much of Russia's future depends on how the government handles this national champion with huge resources. The gas glut in Europe, expanded production of shale gas in the United States, and Gazprom's neglect of other markets and technologies all call for a more market-oriented and diversified gas policy.

Since its default in 1998, Russia has only become more dependent on oil and gas. When commodity prices dropped during the global economic crisis, Russia's GDP followed suit. Not only has Russia relied on energy rents for economic growth but, as Dmitri Trenin points out, it has also used its enormous reserves to champion its position as an energy power, comparing its oil and gas resources to the nuclear arsenal that once gave the Soviet Union superpower status during the Cold War. But the use of energy as a weapon proved to be a disaster, as Gazprom's gas cutoffs to Ukraine in 2006 and 2009 made clear: Its reputation as a reliable gas exporter was destroyed, and Europe finally decided it needed to find alternative energy sources.

Russia is an important international power, but it does not have sufficient resources to be a global superpower. Russia's conventional forces, even when they are eventually reformed, as Pavel Baev details, will have only a limited capacity to act beyond the country's borders. More important, the Russian defense-industrial base will have to be fundamentally restructured to support even that capacity.

CREATING A NEW RUSSIA

As the economic crisis has demonstrated, the model Russia's present leaders have chosen—growth without development, capitalism without democracy, and great power foreign policy without international appeal—can run only so far. Unless the country modernizes, Trenin cautions, Russia will further marginalize its position in global affairs. Russia's foreign policy is as much in need of a fundamental overhaul as are its economy and social and political systems. Instead of pursuing a separate course, Trenin argues, Russia should aspire to integrate into the world economy.

One way Russia can do so is by joining the World Trade Organization (WTO). Russia has a lot to gain from WTO accession, no less than 3.3 percent of its GDP annually in the medium term, calculate David G. Tarr and Natalya Volchkova. They also contradict the common view that Russia is facing excessive demands from the WTO, showing that the demands are somewhat more lenient than has otherwise been the case. Russia's attempts to form a customs union with Belarus and Kazakhstan, which Putin declared was as important to Russia as the WTO, have yielded no success since 1995 and are yet another example of Russia's fruitless collaboration with its neighboring countries.

Russia has been unable to build any new alliance with even close post-Soviet partners, which instead prefer to keep a distance from Russia's overbearing presence. In his obituary on the post-Soviet space, Åslund lists four areas where Russia has left its neighbors dissatisfied: territorial integrity (recall the Russia-Georgia war of 2008), gas policy, trade policy, and financial assistance. He argues that Russia would benefit from winding up the Commonwealth of Independent States and all its suborganizations, which increasingly are being perceived as a threat to the sovereignty of these newly independent states. Russia's relations with its neighbors would benefit from a new, constructive policy.

The bottom line for the Russia Balance Sheet project is its implications for US-Russia relations. Andrew Kuchins concludes that while US-Russia relations have undoubtedly improved in the first year of the Barack Obama administration, the relationship is constrained by an enduring mismatch in strategic outlooks in Washington and Moscow. More than 20 years after the Cold War, Russia still persists in arguing that the United States represents the greatest risk to its security. This deeply anachronistic assumption not only places significant constraints on the bilateral relationship but also leads Moscow to pursue many foreign policies that seem at odds with its stated goals of economic modernization and prevent it from addressing the security challenges it actually faces.

The Russian leadership has a great opportunity to change things for the better. On the one hand, it is evident that the current economic model cannot deliver sufficient growth in the next several years. On the other, the Russian regime does not face any apparent immediate internal or external problems. Therefore, the Russian government can launch reforms if it so desires. The president of Russia himself has expressed the enormous challenges his country faces in his September 2009 manifesto-article, *Go Russia!*—"Should a primitive economy based on raw materials and endemic corruption accompany us into the future?" he asks. Only time will tell if this stark analysis of Russia's structural challenges will prompt the leadership to pursue the much-needed reforms.

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