in January 2012 (following the 2009 Customs Union). However, there are only modest efficiency gains for Russia from integrating with those two much smaller economies, and the prospects for significant new members such as Ukraine joining the project appear to be slim.

One dramatic development which showed the perils of international integration Russian-style was the financial crisis which erupted in Cyprus, a member of the Euro-zone, in March 2013. As a condition for a $10 billion bailout, the European Union forced Cyprus to freeze €5.8 billion in accounts larger than €100,000 in selected banks. Half of those accounts were thought to belong to Russian companies and individuals, who have longed used Cyprus to hide their earnings from prying tax authorities. The Russian government was furious, but decided not to intervene (by offering its own rescue package to the Cyprus government, for example). Putin described the EU plan as "unfair, unprofessional and dangerous."[23]

Russian government leaders are all too aware of these structural problems: Putin published an article in *Vedomosti* on 30 January 2012 titled "We need a new economy."[24] The problem is that Putin has been calling for a new economy year in and year out since 1999—but he does not explain the lack of progress after his 13 years in power. A combination of bureaucratic resistance and political caution in the face of potential social unrest means that Putin is unable to translate his rhetorical commitment to economic modernization into policies that actually change the situation on the ground. He is relying on an old Soviet style mobilization campaign, transmitted through the ministerial apparatus, to improve state performance while somehow trying to encourage the oligarch-run economy to invest in Russia's long-term development.

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23 Ilya Arkhipov, "Putin says Cyprus bank-deposit levy is dangerous," Bloomberg, 18 March 2013.
24 http://archive.premier.gov.ru/eng/events/news/17888/

ANALYSIS

Economic Growth and Strategies for Economic Development in Russia

Richard Connolly, Birmingham

Abstract
Recent evidence indicates that economic growth in Russia has begun to slow. While some of this slowdown may be attributed to exogenous factors, it is also possible that Russia may be entering a period of slower growth due to domestic constraints on growth that may be structural in nature, or caused by defects in economic policy. This article considers recent forecasts for Russian growth rates, the potential for faster growth in Russia, and the role that longer term strategic plans for economic development might have in promoting faster growth in the future.

The Economy Begins to Slow…
A near decade-long period of economic expansion between 1999 and 2008 in which the annual growth rate averaged around 7 per cent was rudely interrupted by a severe contraction of nearly 8 per cent of GDP in 2009, the most severe recession of any G20 country during that period. Nevertheless, although post-crisis growth rates failed to reach pre-crisis highs, annual growth rates of 4.3 per cent in 2010 and 2011 were considerably faster than in Russia's richer European neighbours, and higher than many other middle-income countries, such as Brazil and Turkey, during the same period. Even as global growth slowed from 4.3 per cent in 2011 to 3.2 per cent in 2012, growth in Russia slowed to a still respectable 3.5 per cent in 2012. However, economic growth in Russia has slowed significantly in recent months. With an annualized growth rate of just 1.6 per cent in the first quarter of this year, fears are rising that Russia is in the midst of a more serious and possibly protracted slowdown. Projections for economic growth in 2013

have been quickly revised downwards: the Ministry of Economic Development has cut its growth forecast for 2013 from 3.6 per cent to 2.4 per cent, with the International Monetary Fund revising its forecasts down from 3.4 per cent to 2.5 per cent. The most extreme revision has come from the European Bank for Reconstruction and Development (EBRD), which revised its forecast down from 3.5 per cent to 1.8 per cent.

…But Why?

Accounting for this slowdown in Russian growth is not easy, if only because of the sheer number of competing explanations, which range from assigning responsibility to exogenous factors beyond the control of Russian policy makers, to laying the blame at the feet of a Russian leadership that is now paying the price for its reluctance to undertake much-needed structural reforms over the past decade.

Looking at external factors, it is clear that Russia's largest trading partner, the EU, is languishing in a state of economic stagnation as it struggles to solve its fiscal and banking crises. According to Commission estimates, the EU average growth rate declined from an anaemic 1.5 per cent in 2011 to a recessionary -0.3 per cent in 2012. It should therefore be no surprise that Russia has suffered some ill effects. Just how much the EU's malaise is responsible for Russia's slowdown, however, depends on which forecast is referred to. For instance, the IMF revision is consistent in magnitude with the revisions made to forecasts for many of Russia's other neighbours, suggesting that a common explanation, such as the weakness of the Eurozone, might lie behind a wider slowdown. However, the EBRD's downward revision for Russia is considerably more pronounced than for its neighbours, suggesting that internal problems are aggravating the effects of an external slowdown.

If the EBRD is correct in its forecast of a sharper slowdown in Russia than its neighbours, then several contributing factors stand out. First, Russian growth statistics are suffering from the 'base effect' after public spending was ramped up in advance of the 2012 presidential election. Consequently, year-on-year figures exaggerate the extent of the slowdown in Russia. Second, the size of the indigenous labour force has been shrinking since 2010. As a result, supply-side bottlenecks are becoming more evident as employment and capacity utilisation in manufacturing remain at record high levels. Third, revenues from energy extraction and exports, while still historically high, are growing much more slowly as the global prices of oil and other commodities have slowed or declined. The volume of energy extraction is also at a post-Soviet high, ruling out the potential for any sudden increase in growth rates in the near future. Fourth, the rapid expansion of consumer credit, which, along with growth in real incomes, has supported robust consumer spending in recent years, has moderated. Fifth, Russia's business environment—which has reached levels of notoriety that are perhaps unwarranted—continues to be viewed by many as a serious impediment to economic activity. Finally, these factors have coincided with, and in some ways contributed to, a deceleration of investment growth, with Central Bank data indicating that investment has contracted over the past twelve months. Given that investment already accounts for a relatively low share of Russian GDP, this tendency is perhaps the most worrying of all.[1]

Without a sustained increase in investment, it is difficult to see how the Russian economy might experience the sort of sustained increase in productivity that is required to relieve pressure on the level of industrial capacity utilization, enable a smaller and older population to generate higher levels of output, and allow the government to meet its growing list of spending obligations. If we take generating robust and sustained investment growth as the most important task confronting Russian policy makers, two immediate questions emerge. First, how fast should the Russian economy be growing? Second, what is the most appropriate path to achieving that rate of growth?

How Fast Should Russia Be Growing?

There are several methods available to identify what might constitute an appropriate rate of economic growth for Russia. The first way would be to start with the basic components of Russian GDP and examine what rates of growth would be achievable for each component given the supply side and policy constraints that currently exist. Thus, given the government's stated desire to avoid any substantial fiscal deficits, and in light of both the diminishing indigenous labour force and narrowing trade surplus, there is limited room for a growth model based on either public spending, consumer spending or net exports. Consequently, investment would be required to do the heavy lifting as far as an increase in growth is concerned. Under such parameters, if consumption growth were to moderate, public spending to grow modestly (i.e., around 1 per cent annually), and the trade balance to continue to narrow, investment growth of around 10 per cent per year would likely result in annual GDP growth of around 4 per cent in the short run. Such an annual increase would not be unreasonably high; investment grew at a faster rate in every year

1 Russia's level of investment is just over 20 per cent of GDP. This compares to around 45 per cent in China, around 30 per cent in India, and around 20 per cent in Brazil.

between 2002 and 2008. Moreover, if investment were to grow at anything close to the pre-crisis highs of over 20 per cent then GDP growth might be expected to rise to closer to 6 per cent.

Another way to identify what might approximate a reasonable rate of growth for Russia is to examine the historical evidence from cross-country studies on episodes of growth accelerations and decelerations. A recent study by Eichengreen et al (2013) examines the incidence and correlates of growth slowdowns in fast-growing middle-income countries. Such a slowdown is labelled the 'middle-income trap'. They argue that while there is considerable dispersion in the per capita income at which slowdowns occur, the mean GDP per capita is around $16,000 in 2005 constant U.S. dollars at purchasing power parity. At this point the growth of per capita income slows on average from 5.6 to 2.1 per cent per annum. By comparison, Russia's per capita GDP was just under $15,000 in 2011, suggesting that Russia is now at the point where it might hit the middle-income trap. The authors argue that slowdowns are more likely in countries where high-technology products account for a relatively low share of exports, an area where Russia performs comparatively badly. This means that if Russia were to follow the path of the average fast growing middle-income country of the past, growth would likely slow to somewhere around 2 – 2.5 per cent per annum. If, however, growth rates were higher—say, at around 4 per cent—then Russia could be considered to have performed relatively well.

What does all this mean for Russia's potential growth rate in the immediate future? First, achieving a rate of around 4 per cent is feasible even within the parameters of supply- and demand- side constraints currently present in Russia. This will only be possible, though, as long as investment grows at a rate of 10 per cent or more for a sustained period of time. Second, achieving an average annual growth rate of around 4 per cent—which would equate to an even faster increase in per capita terms due to Russia's dwindling population—would, if sustained over a decade or so, represent an excellent achievement, especially as many countries at Russia's income level have tended to experience growth slowdowns in the past. Third, and in light of the above two observations, calls for growth of over 5 per cent per year might be somewhat optimistic. Indeed, given the structural constraints outlined above, it is likely that a faster rate of growth would be only be possible through an imprudent expansion of credit, perhaps allocated through direct state intervention. Under these circumstances, the short-run benefits of faster growth would likely be outweighed by the long-run costs of a higher debt-GDP ratio and negative distortions caused by the large-scale misallocation of resources.

Government Strategies for Economic Development

If a growth rate of around 4 per cent is taken as a desirable goal, how might policy makers help make this possible? Examining the full range of policy options available to decision makers in Russia is beyond the scope of this short article. Instead, the remainder of the article will address the role of several prominent government strategies for economic development developed in recent years.

From Concept…

In autumn 2008, just as the global economic crisis was entering it most tumultuous stage, the Concept of Long-Term Socio-Economic Development of Russia to 2020, formulated by the Ministry of Economic Development (Minekon), was approved by the government. The objective of the Concept was to lay out a strategy for transforming Russia into one of the world's leading states by 2020. The authors of the Concept outlined three scenarios of economic development: one based on an increase in the role of energy and raw material exports; a second based on 'inertia', or simply maintaining the current course; and a third scenario based on innovative development. In particular, the innovative scenario aimed to show what would be required to overhaul the structure of the Russian economy away from energy and commodity exports and towards the production of innovative, knowledge-based goods and services. Such a transformation would, its authors hoped, make Russia the best place in the world to live and a leading geopolitical actor for years to come. To achieve this goal, the Concept stated that the average annual rate of economic growth between 2008 and 2020 would need to be 6.5 per cent, with faster growth in the earlier years and a slight moderation towards 2020. This scenario envisaged an increase in the share of GDP devoted to education (to 6.5 – 7 per cent, from 4.9 in 2007), health (to 6.7 – 7 per cent, from 4.2 in 2007) and research and development (R&D; to 3 per cent, from 1 in 2007). The Concept also acknowledged the importance of well-functioning institutions, such as courts and the state administration, for creating a more favourable business environment in which investment and innovation could increase.

…to Strategy

The global financial-economic crisis meant that the formulation and implementation of programmes to support the goals of the 2020 Concept were stopped before they had even begun. Instead, the Russian government reverted to 'manual control' (i.e., day-to-day management of the economy in response to problems that arose rather than behaving according to any plan or strategy). Only after economic growth returned to respectable rates over 2010 and 2011 did the government, then under the leadership of Vladimir Putin in his position as Prime Minister, revisit the formulation of an updated strategy for Russia's long-term economic development. This time the strategy was drafted by an expert group under the leadership of Vladimir Mau, Rector of the Russian Academy of the National Economy and State Service (RANKh i GS), and Yaroslav Kuz'minov, Rector of the National Research University Higher School of Economics (NIU HSE).

The final version of what was now known as 'Strategy-2020' was published in March 2012. As with the 2008 Concept, three scenarios for development were presented, with the clear indication that the innovation scenario was the preferred course of action if Russia were to embark on a new trajectory of economic development. It is in this Strategy that a rate of economic growth of not less than 5 per cent was considered appropriate if Russia hoped to reach new levels of human development and build a post-industrial economy. As with the 2008 Concept, the emphasis on the development of a new, knowledge-based path of economic development demanded an increase in spending on education, infrastructure and R&D to around 4 per cent of GDP for each, and a reduction in spending on defence, public order and security to just 2 per cent of GDP. This budgetary 'manoeuvre' was termed '+4 -2'.

The Strategy also emphasises a return to fiscal discipline, proposing new budget rules to limit spending so that annual expenditure is limited by a commitment to balance the budget at a 'base level' world oil price. However, the authors of the report introduce two approaches to budgetary policy. The first envisages balanced budgets, while a second permits modest budget deficits of up to 1 per cent of GDP so that the government could fund selected projects. Under the latter approach, the stock of Russian public debt would be permitted to rise to 25 per cent of GDP by 2020.

Unlike the Concept, Strategy-2020 was less vocal in asserting in the importance of any institutional reform for improving the wider business environment. Instead, anything that might have been taken as a call for wider political reform, such as stronger property rights or greater accountability of the authorities, was largely absent from the final report.

Soon after the publication of Strategy-2020, the Ministry of Economic Development revealed a draft forecast of socio-economic development to 2030. Forecast-2030 represents the next stage in the evolution of the original Concept, with the parameters adjusted to reflect the economic objectives outlined by Vladimir Putin prior to his election as President in May 2012.

Obstacles to the Operationalization of Strategy 2020

The policy options presented in Strategy-2020 are, for the most part, perfectly reasonable, at least from a conventional liberal economic perspective. It is conceivable that a policy programme based around the core initiatives contained in the Strategy would help raise investment growth above the 10 per cent annual growth rate required to generate growth of 4 per cent and above, although this would not be assured: structural economic reform of the sort envisaged in the Strategy does not always result in an immediate expansion in output. What would be required for such a programme to generate the desired effects is political credibility. In the absence of a credible commitment to reform from Russia's political leading actors, an increase in policy uncertainty would be a more likely outcome than any increase in investment and economic growth.

However, it is in the realm of politics that the Strategy shows it limitations. The authors of the report avoided any consideration of the role of political reform in facilitating any economic transformation. But significant change in the political balance of power would be required to, for example, execute the '+4 -2' manoeuvre. In recent years, increased military spending, and especially a commitment to implement the state armaments programme (GPV) to 2020, has constituted a central component of government policy and has powerful supporters. Reversing this policy course in favour of education and infrastructure spending would be extremely difficult for any Russian leader to implement. Indeed, recent pronouncements from the defence industry and from elements of government have indicated that increased defence spending might act like a locomotive of economic modernisation.

Thus, the types of economic policies contained within the Strategy should be viewed as just one view from a multitude of potential policy preferences from within the Russian ruling elite. The lines articulated in both the 2008 Concept and the Strategy-2020 could be considered as consistent with the policy preferences of the Ministry of Economic Development. The more fiscally orthodox scenarios are closer to the thinking emanating from the Ministry of Finance. However, other powerful ministries, lobbies and individuals—the defence industry and energy complex, for example—would have radically different policy preferences to those expressed in the Strategy. In Russia today, it is precisely these interests that possess the greater political influence.

Prospects for Economic Growth in 2013

The short-term prospects for economic growth in Russia are more likely to be shaped by the vicissitudes of the global economy than by any bout of renewed economic reform in Russia. While the recently drafted Strategy-2020 document (as well as other strategy documents, such as the Forecast-2030) represents a sensible set of policy suggestions, the array of powerful political forces opposed to its recommendations will likely ensure that it exerts only a modest influence over economic policy in Russia. Moreover, if the Russian government's response to the recent 2008–09 recession offers any insight into crisis management in Russia it is that any future recession will likely see the dominance of 'manual control' in economic policy rather than any long-term strategy. In this respect, Russia is perhaps no different to its richer European neighbours.

About the Author

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Further Reading

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ANALYSIS

Prospects for Russia as a Global Food Exporter

Stephen K. Wegren, Dallas

Abstract

Russian agriculture has rebounded from the depressed conditions of the 1990s. Most importantly, Russia has become a significant global exporter of grain. However, the animal husbandry sector has struggled in some areas, although there are pockets of growth. Assuming that these trends continue, Russia will remain an exporter of grain and an importer of meat.

The Soviet Model

Soviet agriculture was known for its inefficiency and an inability to feed its population. During the last decade of Soviet rule, grain and meat production stagnated, average consumption leveled off, and the USSR imported more than 20 million tons of grain a year, including a high of 44 million tons in 1985, mostly to feed its livestock.1 In the immediate aftermath of market reform, agricultural production plummeted. By the mid-1990s, food production had declined an estimated 40 percent. Post-Soviet Russia became a large importer of meat in the 1990s.

But this is not the whole story. Less publicized is the fact that since the late 1990s the value of Russian agriculture has increased significantly (see Figure 1 on p. 8). Crop production in Russia has rebounded from the depressed conditions in the 1990s, whereas the animal husbandry sector is still struggling, although there are pockets of growth. The near-term prospects are mixed for Russia as a global food exporter, as it will continue to export grain, but will rely on imported meat.

Grain Production and Exports

Although average grain production remains below the level of the 1986–1990 period, Russia has turned from a large grain importer during the 1980s and early 1990s into a significant grain exporter. Russia achieved two

1 *Narodnoe khoziaistvo SSSR* (Moscow: Goskomstat SSSR, 1989), 654.