The Moscow Times
30 YEARS
INDEPENDENT NEWS FROM RUSSIA

10 Reasons Why the Economy Will Recover

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November 24, 2010



In my Sept. 3, 2008, column titled "10 Reasons Why the Economy Will Falter," I saw no reason why economic growth would continue. At the time, most economic analysts argued that Russia was a safe haven and predicted growth of 7 percent to 8 percent in 2009. Instead, gross domestic product plummeted by 8 percent in 2009.

During the past two years, the mood in Russia has changed profoundly. Euphoria and complacency have been replaced with cynicism and pessimism. A broad conviction has spread that the country is condemned to a growth rate of, at most, 3 percent to 4 percent a year.

Slowly but surely, people are starting to realize that Russia's economic growth during 1999-2008 was caused by the two market reform waves of 1991-93 and 1998-2002. With reforms a distant memory, a new growth spurt is not likely.

While the energy curse is well understood, it tends to be over-emphasized. At one time, it was

believed that energy-rich countries were guaranteed stable growth; now oil and gas are considered absolute blockages to growth. But neither is quite true.

There are 10 main reasons why Russia is likely to turn around within the next couple of years and enter a higher-growth trajectory:

1. The root cause is the profound sense of malaise in the Russian elite. Nothing is better for reform than malaise. Remember how former Soviet leader Mikhail Gorbachev and former Soviet Foreign Minister Eduard Shevardnadze before assuming power told each other: "We cannot go on like this any longer!" Once again, Moscow is reaching this point.

2. Ideas are also crucial, and a new intellectual paradigm has taken hold. Since February 2008, President Dmitry Medvedev has advocated modernization. While this ambitious idea has dominated the public discourse, little has been done. This contrast between word and action is reminiscent of the Soviet Union in 1987, when Gorbachev had preached acceleration and perestroika for two years but accomplished little. That year, he shifted gear to focus on democratization to shake society up.

3. Russia is finally about to accede to the World Trade Organization within a year, which would be a game changer. The best available studies predict enormous gains for the country. Economists Jesper Jensen, Thomas Rutherford and David Tarr estimate in a World Bank study that Russia should annually gain about 3.3 percent of GDP in the medium term and 11 percent of GDP in the long term. The gains would mainly come from increased foreign direct investment and services. International integration and convergence will drive the country's growth for a couple of decades.

4. One of Russia's largest drawbacks and constant drags on growth is its immense corruption, but Russia is simply too rich, well educated and open to be so corrupt. As the country has failed to extend its road network since 1997, something has to be done. Even former Mayor Yury Luzhkov — the country's "ultimate traffic jam" — has been sacked. Significant progress in the fight against corruption can be made with relatively easy and small steps — for example, public procurement for key infrastructure projects can be significantly cleaned up if a few honest people are appointed at the top.

5. Money is no longer a free utility for the Kremlin. The oil price has risen above $80 per barrel, but at that level Finance Minister Alexei Kudrin foresees a budget deficit in 2010 of 4.6 percent of GDP, and deficits will continue until 2014. Therefore, the government can no longer simply throw money at problems. It has to actually solve some of them.

6. Energy production has leveled off and is not likely to rise significantly any time soon. Therefore, growth has to come from other sectors. Look at the composition of and trends among leading companies on the RTS or MICEX and you will see how Russia has changed. The energy companies are now the laggards, while the many growth companies are in consumer industries.

7. In particular, Gazprom, the old cancer of the Russian economy, is in a serious structural crisis. Its market value has fallen by two-thirds from its peak in spring 2008. As a high-cost producer, it is losing out to independent producers — notably Novatek — and liquefied natural gas in Europe. Gazprom represents the most pressing case for restructuring. The

company has to cut costs by reducing corruption and enhancing efficiency. This means that Gazprom must put an end to its history of being the huge slush fund for Russia's rulers.

8. Russia's greatest resource is its quickly expanding human capital. According to UNESCO statistics, 51 percent of young Russians graduated from higher educational institutions in 2008, placing Russia as the ninth-highest country in the world. Compare this figure with the United States, where only 35.5 percent of the young population completed higher education in 2008. Admittedly, the Russian numbers are swollen by corruption, plagiarism and often low standards, but even with some deduction, the Russian figures remain impressive. Everywhere, you see young, ambitious, well-educated and hard-working Russians, who are determined to succeed.

9. The long absence of any significant reforms has left many low-hanging fruits, such as elementary deregulation. Privatization is becoming inevitable, and it instantly reduces the corruption characteristic of Russian state corporations.

10. Russia's leading businessmen often talk about "the 2012 problem" — that is, their uncertainty about the elite's presidential selection in March 2012, or probably in December 2011, when a presidential candidate has to be nominated.

The choice is becoming increasingly clear: Putin symbolizes corruption, energy dependence and stagnation, while Medvedev presents an image of modernization and reform. These alternatives are becoming as crystal clear as in 1985, when the Soviet elite opted for change.

Medvedev has real levers to exert power. Among other things, he possesses a "nuclear option" — at any moment, he can sign an amnesty for former Yukos CEO Mikhail Khodorkovsky, which could significantly change the presidential race in 2012.

In the end, the choice is between a growth rate of 3.5 percent a year or 6.5 percent a year in the medium term. Would big Russian businessmen prefer stagnation of their companies over healthy growth? Why should they ignore their own interests?

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