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A 'To Do' List for Growth in Putin's Next Term

By Chris Weafer

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The election is over, Prime Minister Vladimir Putin will be the next president, and the stock market has recovered all of the ground that it lost during December when the perception of political risk reached record highs.

The economy is in relatively good shape, with the current price of Urals crude delivering almost $900 million each day from oil exports alone. This suggests another year of budget surplus in 2012. So does that mean that everything is fine and Putin's next government can slide back into the reform complacency that characterized his last administration? Absolutely not.

The game has changed in significant ways — and not just since the State Duma elections. The drivers of change started to become evident in early 2009. But the people factor is one of the most important drivers of expected change. People want change, and they want the quality of their lives to continue improving. Even with the overwhelming vote for leadership continuity, it has become very clear that people want the nation's leaders to make changes.

Any government that ignores those demands is heading for inevitable trouble. Russia's government has had a small taste of what might come in a more determined fashion later this decade. Putin has always tried to deliver on real demands from real people, and I believe that investors will be surprised on the upside with actions taken over the next one to two years.

A number of catalysts have emerged over the past several years that make it clear that the next government no longer has the luxury of relying on rising oil revenues to fund growth and buy internal stability. It is human nature that we rarely take the tough course unless there is no other choice and the consequences of not doing so become greater. Governments are no different. Putin's next government will have to take those tough choices or risk slowing economic growth, not to mention better-organized and stronger protests before the end of his presidential term.

Russia's economy needs a new growth driver. The federal budget requires more than $115 per barrel average to balance, and this figure is likely to rise as a result of the spending promises Putin has made during his election campaign. Thus, the growth driver for the economy can only come from an increase in investment outside of extractive industries and a big increase in economic efficiency. To attract investment, Russia needs to improve the business climate, to make it easier for new business startups and to reduce perception of high investment risk. To improve economic efficiency, the government needs to bring in more competition, to make it easier for foreign companies to operate in Russia and to set in place the conditions that will lead to more partnerships between Russian and foreign enterprises in the industries targeted for growth.

Everybody is familiar with the "to do" list. Its top three entries are tackling corruption, reducing bureaucracy and improving the enforcement of existing laws. It is now time to start delivering on these promises.

Despite many reported successes, strategic and industry investors have been very frustrated at how difficult it has been to establish and run a business in Russia. But the next government will be forced into a sort of proactive pragmatism. The political protests simply add an additional catalyst to a list that has been building for several years. The recession in some industrial cities like Tolyatti, the country's auto-industry heartland, in the summer of 2009 was first to shake the previous oil-induced complacency. Putin's personal involvement in trying to acquire an equity stake in Opel, General Motor's German unit, was as a reaction to the public protests in those cities over how little had been done during the boom years to help diversify single-industry cities. At that time, Putin acknowledged that Russian industry needed strategic partnership to improve efficiency and to grow investment. In the end, a revised deal with Renault achieved the huge growth we have seen in the industry over the past two years.

In addition, during this period the attitude toward membership in the World Trade Organization shifted from indifference to pragmatism. WTO membership, after 17 years of dithering, is also a very tangible sign of how the government's attitude toward the business environment is changing.

The accident at the Sayano-Shushenskaya hydroelectric plant in August 2009 added a second catalyst for change. After this tragedy, it became clear that Russia cannot achieve targeted growth or even sustain existing growth without major investment in infrastructure, largely ignored since the Soviet era, and in new infrastructure to cater for the expanding economy. In addition, the August 2010 shortages in the agricultural sector added a further catalyst, as they exposed just how little has been invested in core industries since the 1980s, how dependent the country had become on imported food and how inefficient the agriculture sector was.

All these catalysts are finally having an effect on government policy and will determine the key priorities for the next Cabinet. The next government cannot afford to be complacent like during the past decade. If allowed to continue, low investment and economic inefficiency will lead to a declining rate of growth and greater public dissatisfaction with political leaders than we see today. Although we heard this before, it was never from the leader or ministers. That makes a material difference.

Of course, it is naive to assume that all will be well immediately. There are entrenched interests, poorly motivated bureaucrats and far too many people making money from corrupt practices to allow any quick changes. But just as the indifference from top government officials allowed these practices to increase over the past decade, a new attitude from the Kremlin and Cabinet can start to make changes that filter down the line.

The bottom line is that Russia can no longer rely on oil- or other commodity-based revenues to deliver growth momentum in the economy. Russian enterprises, outside of the extractive industries, are investing too little and showing efficiency gains far too slowly. If Russia is to achieve the average annual growth that it has targeted for the remainder of this decade — from 5 percent to 6 percent — the government will have to make it easier and more attractive for many more of the world's largest enterprises and investors to come to Russia.

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The views expressed in opinion pieces do not necessarily reflect the position of The Moscow Times.

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