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Time for Common Sense

By Ian Pryde

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On June 18, 2013, President Putin warned that government revenues would be less than previously expected and that the budget policy for 2014-2016 had to be planned accordingly. He also said that while revenues from natural resources were decreasing, financing from other industries was so far limited.

In its annual review of the Russian economy, the International Monetary Fund has just cut its forecasts to 2.5 percent GDP growth in 2013, down from the 3.4 percent it expected in April, while industrial output fell by 1.4 percent in May from a year ago, against an increase of 2.3 percent in April. The much-hoped for privatization program has also stalled, as was to be expected given Putin's innate caution and Russia's poor record on implementation.

So, yet again, Russia finds itself facing problems due to its failure to think and, far more importantly, to act strategically. The government has increased spending, despite the headwinds in the global economy and despite countless warnings about Russia's dangerous dependence on commodity exports.

But for Russia, these headwinds could be just as bad as the 1980s or 1990s, when oil prices sank to below $10 a barrel. It's hard to see prices falling that far now, but oil prices are notoriously hard to predict and the shale oil and gas revolution in the United States is already contributing to lower global energy prices. In its 5-year oil market forecast published in May 2013, the International Energy Agency stated that despite the huge current uncertainties, a wholesale (upward) reassessment of global reserves could result as unconventional technologies are perfected and go mainstream.

So despite growing energy demand from emerging markets, supplies could show further significant increases. Russia is already facing downward pressure on energy prices in Europe, but hopes to compensate this by exporting energy to East Asia, which hitherto has had little energy reserves and was heavily reliant on imports, nuclear or dirty coal. Hence Russia's 4,000 kilometer Power of Siberia gas pipeline, which is due to be completed in 2016 and will cost an estimated — and eye-popping — $46 billion.

But competition in Asia-Pacific is rapidly emerging from other gas producers, such as the U.S. and Mozambique, while last week, the U.S. Energy Information Administration published a report which stated that China has by far the biggest shale gas reserves in the world (See Table 6, http://www.eia.gov/analysis/studies/worldshalegas/).

China's geology is admittedly much more complicated than America's, and the country already suffers from insufficient water, which is required in huge quantities to extract shale oil and gas using the so-called "fracking" process. Even so, the threat to Russia's whole business model — and possibly political stability is clear.

And yet, Putin's solution last week was the same old failed Russian-cum-Soviet approach of the past: huge state-led infrastructure projects, along with a dose of public-private partnerships (PPPs) and the like.

This is of course odd. Putin knows very well, that his third official term depends more than ever on the economy, and yet, Russia still stubbornly refuses to pick the low-hanging fruit to add several percentage points to GDP and thus increase tax revenues to pay for increased public spending.

Conspicuous by its absence last week was any attempt to encourage SMEs — the small and medium sized enterprises which in every advanced economy account for about 60-70 percent of GDP. Quite the opposite in fact. It is well-known that some 600,000 Russian entrepreneurs are in jail, but Putin recently reacted extremely cautiously to proposals to release them. Is he among the 73 percent of Russian who, according to a Levada Center poll in late May, believe it is impossible to become wealthy in Russia by legal means?

Or does he fear a flourishing SME sector, which would diversify the economy and make it much more dynamic, but which would also, sooner or later, almost certainly start raising many more political demands? That, of course, is something the President is not keen on at all.

Or is it simply a failure to understand basic economics?

Whatever the reason, it is indeed ironic that in view of Moscow's fixation with the U.S., Russia remains a land of limited opportunities at a time when, more than ever, it needs to start —

finally — trusting its own people and introduce common-sense policies to get its sluggish economy moving.

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