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Russia Can't Grow and Steal at the Same Time

By Anders Åslund

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The Kremlin's two key goals are to maintain political power and to enrich the ruling elite. At best, economic growth is the third-ranking goal, and it contradicts the two primary aims. Logically, the current Kremlin policy leads to economic stagnation.

Political analyst Yevgeny Minchenko captures the new system best with his concept of Politburo 2.0. This is no vertical of power but an old-fashioned feudal system, where the ruler functions as an arbiter or godfather between nine major lords: three private businessmen from St. Petersburg, three top state enterprise managers and three leading state officials. This system of rule is reminiscent of Soviet leader Leonid Brezhnev's Politburo in 1980, which stood out for its petrification. It can maintain political power for a long time, but it cannot be reformed. Such a system can only collapse.

The second goal of the ruling elite is its own enrichment. The concept of conflict of interests is unknown in Russia, and senior officials are never accused of corruption. The quickest road to riches is to receive an overpriced pipeline or road contract from the state or a state

corporation without competition. Alternatively, a state manager can buy a private company expensively and demand a kickback. Or he can sell a state company cheaply and request a kickback from the private buyer. There are many other ways of corrupt revenues, such as extortion by private businessmen, theft and embezzlement, but they are more labor-intensive and generate less remuneration. Sometimes the perks are legal, as when the presidential administration distributes luxury housing to deserving officials. Yet all these means of elite enrichment are parasitical and harm economic growth.

During Russia's growth spurt from 1999 to 2008, growth was generated by the market reforms of the 1990s, ample free capacity, rising oil prices and redundant human capital. By 2008, the free capacity had largely been exploited, and the oil prices have leveled out at $100 to $120 per barrel with some fluctuations. No significant market reforms have been carried out since 2002.

From 2010-12, the growth rate moderated to 4 percent. A major cause of the lower growth was that the government bailed out the worst big state and private corporations during the crisis in 2008-09, so that they crowded out more productive companies. Arguably, the growth came from two sources: human capital and international economic integration.

Persistently, economic growth has come from the private sector, consisting of tycoons, small and medium-sized businesses and large foreign investors. The old oligarchs are now tightly circumvented. They are allowed to sell their companies to the state — when the state so desires — at a price determined by the state, but they are not allowed to buy other big companies, only medium-sized firms. Therefore, the biggest tycoons have little choice but to take their money out of the country. They have ceased being an entrepreneurial force.

The small and medium-sized enterprises are checked from all sides. Many have hit a glass ceiling and sell to the country's wealthiest businessmen for whom the glass ceilings are so much higher. Small enterprises are facing tougher taxation and government extortion, and hundreds of thousands have chosen to close down this year. The announced amnesty of 100,000 dubiously jailed businessmen dwindled to 1,000. President Vladimir Putin is now advocating harder tax repression of private firms through the Investigative Committee, which of course will aggravate corruption and further enrich officials of that agency. As the total number of enterprises declines, competition diminishes and productivity stagnates.

Paradoxically, the happiest companies in Russia may be large multinational corporations producing in the country. They roll in with their high technology and enjoy minimal competition, which drives up both sales and prices, though admittedly costs increase as well. Yet, their share of Russia's economy remains tiny, so they do not contribute much to economic growth.

Management consultants point to the shortage of good managers as the greatest bottleneck in the country's economy, followed by roads. The thieving at the top makes it impossible to build roads, so corruption is the key problem.

Until recently, much of the growth could be ascribed to skillful new managers moving to more poorly managed companies. With state companies expanding their dead hands over the economy, this process has gone in reverse. When Rosneft bought TNK-BP, one of Russia's best-managed big companies, Vedomosti reported that 90 percent of the 1,600 employees

in the TNK-BP headquarters left, presumably many of them emigrated. Instead, Igor Sechin, an apparatchik without management experience, took over Rosneft and imposed his micromanagement.

Similarly, Russia adopted many liberalizing laws to enter the World Trade Organization, which helped open up the economy to more global competition. When Russia finally joined the WTO last year, this process also went into reverse. The Customs Union with Belarus and Kazakhstan is a harebrained protectionist scheme that will damage the Russian economy through trade diversion and by compelling the Kremlin to pay large subsidies to other countries that agree to participate.

Russia's economic problems are not financial. The budget remains close to balance and will be so even with a falling oil price because of the novel floating exchange rate. Although the current account surplus has dwindled, it is still in surplus, and Russia's international reserves are impressive at more than $500 billion.

Any fiscal or monetary stimulus would only cause higher inflation and more illegal immigration because Russia's economy is working at full capacity. Unemployment is low at 5 percent, while inflation remains a concern at 6 percent. Russia's investment rate is too low at 21 percent of gross domestic product and probably much lower in reality because of the extraordinary kickbacks. Russia needs to fight its top-level corruption before it can start building roads.

Unperturbed, at each of his many crisis meetings about falling economic growth, Putin proposes another mega investment that will undoubtedly aggravate corruption.

As long as the president pursues an anti-growth and pro-corruption policy, no economic growth is likely.

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