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Can Russia's Mega-Projects Deliver Broad Economic Growth?

By Alexey Eremenko

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The opening ceremony of the Winter Olympics in Sochi.

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From the 2012 APEC summit in Vladivostok to the upcoming bridge to Crimea, the Russian government has shown it likes to dream big — enough so to earmark a fresh 472 billion rubles ($13.5 billion) for infrastructure mega-projects earlier this week.

The government has a weakness for using mega-projects to drive the economy: The state has thrown more than $75 billion at such projects over the last two years alone, earmarked about another $90 billion within the next six years, and that is not counting the elephant in the room — an Army revamp program worth $700 billion through 2020.

There is nothing wrong with mega-projects per se: They can be a boost to big business, analysts said. And besides, in a vast country like Russia, most infrastructure projects tend

to be big. But big projects only work if they are part of a balanced economy that sees as much effort put into a positive investment climate and support for small- and medium-sized businesses — which is not the case in Russia.

Previous mega-projects in Russia have underperformed, but the government will continue to invest in them because it is the easier, if ineffective road to economic development, and because they benefit the graft-prone bureaucrats, according to analysts polled by The Moscow Times.

"We stand to simply lose the money we invest in them," said Igor Nikolayev, director of the Strategic Analysis Institute at consultancy FBK.

Rails, Reactors & Other Necessities

The $13.5 billion committed on Monday will cover about half the bill for seven giant infrastructure projects, including a nuclear plant in Finland to be built by state-run Rosatom and a coal mining and railroad project in the Siberian republic of Tuva, according to the Economic Development Ministry.

The cash will come from the National Wealth Fund, one of Russia's oil-revenue-funded piggy banks, which currently has about $90 billion in its coffers, Vedomosti said Monday, citing the ministry's internal memo.

This is only a fraction of what the government has on the cards. Other plans include a four-kilometer-long bridge to and waterworks for the Crimean peninsula, annexed from Ukraine in March, an upgrade to Russia's two Siberia-spanning railroads, the 2018 World Cup and a sweeping $20 billion rearmament program.

Expenditure on mega-projects is supposed to create additional wealth by having a multiplicative effect on the economy, officials have said. But practice has not always matched the theory.

Russia has accumulated a track record of massive projects in recent years, including the APEC summit in Vladivostok, which cost $20 billion; the 2013 Summer Universiade in Kazan, with a price tag of $6.5 billion; and the biggest dream of all, the $51 billion Sochi Olympics held this year.

The problem is that these have so far failed to translate into prosperity: Economic growth slid from 4.3 percent in 2011 to 1.3 percent in 2013. Zero growth, or even a recession, are forecast for this year.

Only on the local level can officials feel vindicated — the projects did effect regional development, just as they were intended, said Yaroslav Lissovolik, chief economist of Deutsche Bank in Russia.

He cited Kazan as a prime example. The capital of Tatarstan was 5th of 30 Russian cities in the latest "Doing Business in Russia" survey by the World Bank, released in 2012. Sochi was not on the list, while Vladivostok, the host city of the APEC summit, ranked a modest 15th.

Don't Forget the Small Ones

For nationwide economic growth, the government must look beyond mega-projects, and get serious about "pressuring the regions and the country in general to restructure the economy and create a fair playing field," Lissovolik said.

Valery Mironov, deputy head of the Development Center Institute at the Higher School of Economics in Moscow, agreed — big undertakings are needed to aid growth of big companies, he said, but sustainable economic development will not follow if they are not combined with measures to support smaller enterprises.

This is not happening in Russia, where corruption is rampant and entrepreneurs have to struggle with increasing taxation and pressure from the law enforcements.

At least 650,000 individual businessmen have disappeared from the state register over six months in 2013 alone due to burdensome state policies, according to business lobby group Delovaya Rossiya.

Russia was 127th of 175 countries in the latest Corruption Perceptions Index by Transparency International. It ranked 92nd in the 2014 Doing Business rating by the World Bank, though that represented a rise of 19 places from the previous year.

Graft & Simplicity

The allure of mega-projects is partly their simplicity as an economic strategy, said Nikolayev of FBK.

"Improving the investment climate and the judiciary and combating corruption is dreary. Mega-projects are simpler and faster," he said.

Such projects also give businesses and officials more opportunities to get rich through overpriced tenders and outright corruption, Mironov said.

Up to half of the $51 billion of the Sochi Olympics budget may have been embezzled, according to anti-corruption crusader and opposition politician Alexei Navalny.

The Kremlin has staunchly denied large-scale graft in Sochi and other such projects.

Mega-projects' boost to domestic industry is also limited because much of the equipment and material for projects such as Sochi is imported, not produced at home, Mironov said, "which curbs their multiplicative effect on the economy."

Everybody Else Is Doing It

Admittedly, Russia has done no worse on mega-projects than many other countries —

Lissovolik of Deutsche Bank cited the examples of the 2004 Athens Olympics and the 2010 World Cup in South Africa, both of which left organizers deep in the red. Sochi's organizing committee reported earning $150 million on the Games, though that did not include the mammoth infrastructure costs.

And building big is an old habit: Moscow's love of big projects dates at least to Soviet times, a prime example being the Baikal-Amur Mainline in Siberia, built 1976 to 1984 with a price tag of about $14 billion, which made it the most expensive economic project in Soviet Union's history. The railroad has yet to turn a profit.

Some projects proposed in Soviet times were even more epic, such as the plan to reroute the great Siberian rivers southward to supply water to arid Central Asia. The plan, which had disastrous environmental implications and an incalculable price tag, never made it off paper.

But the love of mammoth undertakings never went away: Just last March, Russian Railroads head Vladimir Yakunin pitched the idea of a "Trans-Eurasian Development Belt," which he priced at "trillions of dollars."

But if the government really wants to help the economy, grandeur should be either curbed or complemented with measures to support entrepreneurs beyond big businesses: "Life has shown that betting on mega-projects is not enough to boost economic growth," Nikolayev said.

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