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Why Economic Growth Doesn't Matter in Russia

By Vladislav Inozemtsev

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Many politicians sincerely believe that Russia's economy has virtually stopped growing, in light of current tensions between the West and Russia resulting from Russia's annexation of Crimea and the economic sanctions that followed.

They also believe that Russia's economy may face additional challenges due to new restrictions imposed — and that this will reduce the government's credibility and so create problems for President Vladimir Putin.

For better or for worse, nothing like this will happen. Russia today is a unique place where the rate of economic growth changes neither the behavior of elites nor the loyalty of the population. Upon a closer look, it is easy to realize why — but to do this one must forget how economies are supposed to work.

First, Russia is not an industrial, but rather a resource economy. The well-being of its citizens depends primarily on just one sector of the economy. Export duties on oil and gas, as well as

federal mining tax contribute 49.4 percent of federal budget's revenues — although crude oil and natural gas production has not increased since the mid-2000s. In 2013 only 8 percent more oil was pumped in Russia than in 2006, and 1 percent less of gas.

Both the political situation's stability and the level of popular support for the government depend not on growth in the real sector but from the dynamics of personal incomes — and these hang not so much on development but on oil and gas.

In the crisis years of 2008 and 2009, for instance, real disposable incomes adjusted for inflation fell by 2.7 percent in the U.S. while in Russia, where the drop in GDP was the most significant among Group of 20 nations, they increased by 5.4 percent.

Of course, a fiscal policy driven by oil and gas kills businesses and entrepreneurial spirit, but why should the government fix this if everyone is happily spending money?

Second, Russian officials at different levels are at the same time businessmen, and if not, then they get a significant portion of their income from bribes. In a period of economic growth they become richer due to the expansion of their enterprises or by imposing a "corruption tax"on successful businesses.

But economic crises are even better for corrupt officials. In the event of crisis they are able to pocket even more while distributing state aid and subsidies; moreover, during such periods they are able to purchase impaired assets. Up to 45 percent of purchases of expensive real estate in Moscow in 2009 were made by government officials and members of their families.

In addition, even if officials know that mismanagement is rarely a cause for dismissal, they may be sure that crises allow them to write off even the most egregious "mistakes." Therefore Russian bureaucracy sees nothing bad in a new crisis.

Third, unemployment, which in the U.S. and Europe is considered almost an integral indicator of a government's effectiveness, is not recognized as a big issue in Russia, partly because there is no information available on it. Deputy Prime Minister Olga Golodets recently admitted that the government did not fully understand where 38.2 million people, or 44 percent of the active labor force, actually worked. Therefore Western governments of rising unemployment does not disturb anyone in Russia. Hence, no one cares also about the growth in the real sector of the economy, which could absorb the excess labor.

Fourth, both the authorities and the public have interpreted every serious crisis in the world's major economies in the last 30 years as the result of foreign influences, not as a result of domestic policy.

The financial crash in Mexico in 1994, Asia's troubles of 1997, Russia's default of 1998 and Argentina's of 2001, the "dot com" crash in 2000, as well as the financial cataclysm in the U.S. and Europe in 2008 — all of them were attributed to external causes.

Russian authorities in recent years have been so successful in convincing its citizens that all evil comes from the outside that they may have become convinced of it themselves. The president has often explained economic difficulties as U.S. and Europe's fault, in particular the crisis of 1998, which is depicted as the result of Western advisers'

manipulations.

Some even attribute the collapse of the U.S.S.R. to a joint conspiracy by the U.S. and Saudi Arabia to push down oil prices. In this mind set, a slump in growth confirms not the Russian elites lack of professionalism but the power of Russia's enemies.

Today's Russia is not a normal country. A significant portion of people who can adequately assess the situation either left the country or are leaving it right now. Many entrepreneurs sold their businesses to bureaucrats and pulled money out of the country, realizing the futility of their labors.

But as long as energy resources can be exported and the prices for them are high, the Russian government does not need to worry about the economy. Special budget reserves exceed $175 billion; the public debt is less than 2.8 percent of GDP, the budget still runs a small surplus, and even if it dips into red it may easily be balanced by a soft devaluation of the ruble since the export duties on oil and gas are denominated in dollars.

Of course, the problems are piling up — so sometimes they will come out. But both the speciality of Russia's situation and its difference from these in democratic market economies lies in the fact that the first alarm signals will sound when it will be too late to react. We will probably see a repetition of the dramatic events of the late 1980s — but, of course, this may not happen for awhile. Time during which economic problems will not preoccupy the Russian president — leaving him free to surprise the world once and again with his political follies.

Vladislav Inozemtsev is a professor of economics and director of the Moscow-based Center for Post-Industrial Studies.

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