

Russia's Top 3 Obstacles to Economic Growth

By [Delphine d'Amora](#)

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The Russian economy has its fair share of problems, as the government knows all too well.

But as the country slides into a deep recession this year, is the state focusing on the right ones? This question came to the fore last week when the government published a document on its website listing the three "main challenges" it sees to Russia's socio-economic development.

With the economy expected to contract by up to 5 percent this year and relations with the West at a post-Cold War low, the question of how the government chooses to pursue economic growth — and whether it succeeds — has rarely been so urgent.

"This whole crisis has greatly exposed the need for more urgent action on attracting investment and creating diversification," said Chris Weafer, a senior partner with Moscow-

based investment consultancy Macro Advisory.

Here are the top three challenges to Russian socio-economic development, as listed in the government's revised guidelines for action through 2018.

1. Cheaper Oil, Gas and Metals

Number one on the government's list is a global dive in the prices of commodities such as oil, gas and metals.

These price falls are bad news for the Russian economy. Energy exports made up about 65 percent of Russian exports in the first quarter of this year, with exports of metal and metal goods accounting for another 10 percent, The Moscow Times calculated using Federal Customs Service data.

This vulnerability came to the forefront when the price of oil plummeted from a high of \$115 per barrel in June last year to less than \$55 in January, a dive largely responsible for bringing the ruble down 40 percent against the U.S. dollar in 2014.

These changes on the commodity market have a "long-term character," the government document said — meaning Russia will have to learn to live with sharply lowered income from exports.

But while falling oil prices have certainly played a role in Russia's current economic crisis, economists said they are not the core of Russia's economic problems.

Even in 2013, when oil prices averaged more than \$100 per barrel, the Russian economy grew by only 1.3 percent, according to the World Bank — a sign that the old growth model based on steadily rising energy prices had run out of steam.

If oil went back to \$100 per barrel now, the economy might see a two-year boom — but no more, said Neil Shearing, chief emerging markets economist at research firm Capital Economics.

"The key point is that over the past decade Russia could grow without having to invest, but now it has to invest if it wants to grow," Shearing said.

Despite years of discussions, the government has yet to commit to any major efforts to attract foreign investments and diversify the economy away from the energy sector, analysts agreed.

Now the government must strive to jump-start investment with less energy riches at its disposal, and with a new problem — Western sanctions.

2. Geopolitical Tensions

Second in the list came the problems with which the international community is all too familiar: the battle over the crisis in Ukraine and the West's ensuing sanctions on the Russian economy.

Geopolitical tensions have "increased economic and political uncertainty, essentially closed

access to debt financing on foreign markets and restricted use of modern technology from abroad," the government said.

In practice, the biggest impact has come from U.S. and EU financial sanctions, which not only restrict Russian companies' access to global capital but prevent them from refinancing their debts abroad. As of Jan. 1, Russia had a total of \$142.5 billion in external debt and interest repayments falling due in 2015, according to Central Bank data — a sum equal to about 7 percent of Russia's gross domestic product.

Russia currently has about \$360 billion in reserves — enough to service its own sovereign debt and help companies service theirs — but this doesn't mean it will get off scot-free.

"While Russia has enough money to keep the lights on, that is because it's not using the money for anything else. ... It comes at the expense of not investing in any new infrastructure or [economic] diversification," Weafer said.

Western restrictions on technology imports will also have a slow-burning effect, effectively blocking any attempt to modernize Russian industry, he said.

Politicians from countries with sanctions against Moscow, including U.S. Secretary of State John Kerry in his recent visit to Russia, have maintained that sanctions will only be rolled back if agreements on alleviating the war in eastern Ukraine are fully implemented.

Analysts see little hope of the sanctions being lifted this year.

3. Not Enough Workers

The final challenge cited in the document is the shrinking number of working-age people in Russia, a problem that traces back to the economic and social shocks of the 1990s.

Amid the widespread poverty and uncertainty that followed the dissolution of the Soviet system, Russia's fertility rate plummeted from 2.2 births per woman in 1987 to 1.17 in 1999, according to the World Bank.

"In the next few years we expect a yearly drop of about 1 million people in the number of working-age people," the government's document said, adding that this drop will both limit economic growth and increase the burden on Russia's pension system.

Weafer's Macro Advisory expects a 6 to 8 percent drop in the number of available workers, or a loss of 6-7 million working-age people, over the next decade. Russia has a total population of about 144 million.

Reversing this tide will likely require a series of radical reforms, including relaxing immigration rules, improving public health and raising the age of retirement from the current 60 for men and 55 for women.

"But the problem is that each of those areas, and the area of public health in particular, are competing with other areas of spending in a tighter fiscal environment now," Shearing said.

And when push comes to shove, President Vladimir Putin's government is going to strive

to appease its electoral base, which is largely pensioners and state employees.

"It's quite clear that wages and pensions are going to remain the priority," Shearing said.

Contact the author at d.damora@imedia.ru

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