

Why the Russian Government Can't Attain Economic Growth

At first glance, the economy is in good shape. But something isn't right.

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Sergei Bobylev / TASS

At first glance, the executive branch is working normally in Russia: the budget has a record surplus, inflation is at a historic low, the ruble exchange rate has untethered itself from oil prices, incentives are in place for entrepreneurs, and new ones are constantly being developed.

But something isn't right. The economy is growing slowly, statistics are greeted with mistrust, the social sector is not being reformed and some aspects of it are deteriorating, the national projects — a sweeping road map for Russia's development — exist only at a bureaucratic level, and the population is getting poorer, and expects that things will only get

worse.

Rapid economic growth has long been a priority for President Vladimir Putin. In 2012, he told both chambers of parliament that Russia's development interests would require annual GDP growth of at least 5–6% for the next decade. The following year, the economy ground to a halt and then started contracting.

By his 2016 address, the president's requirements had become more modest: to reach growth of more than 3% of GDP per year by the start of 2020. This goal is now widely accepted to be wholly unfeasible. The potential for growth in the Russian economy is no more than 2% of GDP, even in the most optimistic scenario, and this is accepted by both the central bank and the Economic Development Ministry. The current forecast is for less than 1% a year, even amid high oil prices.

Government decisions like increasing VAT and continuing to consolidate budget spending have had a serious effect on economic growth. In addition, household incomes have fallen for five years in a row, leading to decreased demand, which ultimately is reflected in economic growth, creating a vicious circle.

Deputy Prime Minister and Finance Minister Anton Siluanov and Economic Development Minister Maxim Oreshkin, the government ministers responsible for growth, blame private business, which they say demonstrates "nihilism" instead of responsible behavior, and the central bank, which they accuse of having "slept through" a consumer credit bubble.

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Siluanov insists the government has already done everything to accelerate the economy, directing funds to national projects, giving discounted loans to small businesses, adopting a plan to increase investment, and promising to liberalize legislation and reform oversight activity.

The government believes that the conditions for an investment boom are already in place and that businesses can be confident, even if they have no government connections, so long as they are operating legally and paying taxes. But the prosecution of businessmen and investors strongly suggests otherwise. Economic unpredictability, a lack of competition and pressure on entrepreneurs has reduced their activity to a minimum. According to one survey, 71% of entrepreneurs consider the conditions for doing business in Russia to be unfavorable and one in two believe the situation will only get worse during the next five years.

In Russia today, the investment climate is determined not by the government, which is responsible for it via laws and regulations, but by the *siloviki*, or security service officials, who stand behind the president. Any move toward limiting the security structures would therefore not only improve the investment climate but also weaken the president's political influence.

Reform of the oversight system is stymied by the same problem: according to several participants of government meetings, it revolves around the words "prosecutor's office." Any liberalization of oversight procedures is treated by prosecutors as corrupt lobbying on the part of business.

In the regions, the situation is even worse. In places where prosecutors and oversight bodies attend meetings with the regional governors, businesses that are an inconvenience to the local authorities — or those that are too successful to be owned by entrepreneurs who are not close to the governor — can be steamrolled by the oversight system, costing the economy several percent of GDP growth.

Budget policy is one of the government's most important regulatory instruments for boosting growth, and a key element of centralization policy. Centralized management of the Russian economy peaked in 2009–2010, when the government frantically battled the consequences of the global financial crisis. Putin — then serving as prime minister — literally managed industries manually, distributing federal budget funds as required.

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Prime Minister Dmitry Medvedev retained that approach, but under his supervision it became considerably less effective. Officials who have taken part in his meetings complain that Medvedev failed to make decisions and would suggest further meetings instead. During his current term as prime minister, Medvedev has lost interest in the budgeting process entirely and delegated responsibility to Siluanov and the Finance Ministry, which also has the final say on how funds are allocated for national projects.

It is expected that a significant portion of financing for national projects will come from non-budgetary sources: i.e., the state will set an example by investing in Russia's infrastructure and development, and then business will follow suit. But despite the large-scale plans announced, growth of non-oil and gas budget revenues (15.5% in the first half of 2019) is not accompanied by the same growth in spending (just 3.7%). This suggests that the revenues received by the tax authority aren't being redistributed to support economic growth, but are being held by the government. In this context, the cautious approach of business to involvement in the national projects looks entirely logical.

For the general population to feel the effect of the growth in income of 2% promised by the president and government, the economy would have to grow by about 4% a year. Nothing even close to that is expected under current the economic policy. The obstacles hindering growth are well known: weak competition between private and state companies, the growing appetites of state capitalists, the underdevelopment of small and medium-sized business, the threat of the *siloviki* and oversight bodies, and the high proportion of ineffective state companies.

It would seem that the government has every opportunity to tackle these problems. It could easily resist lobbying by state capitalists: both the law and regulation would allow that. Instead of embarking on a path of empowerment, however, the government has turned into a place of ceremonial meetings for people with influential positions who are manipulated by officials from the presidential administration and by state capitalists. Instead of targeting growth, the cabinet's day-to-day activities boil down to packaging up the national projects as a panacea.

But selling this *idée fixe* to a population that is getting poorer and that has paid for state projects with its taxes — and amid a lack of economic growth — is virtually impossible. If the

current economic policy is maintained, it's certain that there will be no growth.

Sixty percent of Russians believe that people bear no responsibility for the actions of their government, according to a poll by the Levada Center. When the public doesn't want to listen to the authorities, PR weapons are of limited effectiveness. TV programs, media publications, and even information about the national projects in the metro won't work. It seems that the president will have to take responsibility.

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