

SUSANNE OXENSTIERNA

Future growth of the Russian economy?

Expert article • 1690

Russia experienced high growth in the 2000s up to the economic crisis in 2009 when GDP contracted by almost eight per cent. The economy recovered in 2010-2011, with yearly growth rates of over four per cent, but in 2012 growth declined to 3.4 per cent and in 2013 to 1.3 per cent. For 2014 the forecasted GDP growth was revised downwards from 3-4 per cent to 1-2 per cent during the year. Finally, in October 2014, IMF predicted growth of only 0.2 per cent in 2014 and 0.5 per cent in 2015. What lies behind the dramatic decline in Russia's growth and can the trend be turned around?

The stagnation of global demand for Russian commodities is part of the explanation of Russia's slowing growth as is the confidence crisis following Russia's annexation of Crimea in March 2014 and its continuing aggression towards Ukraine. The ongoing Western sanctions and Russian counter sanctions also hurt the economy. However, I would argue that the main reasons behind the decline of the growth rate are found in deeper systemic and structural elements that have characterized the economy under President Vladimir Putin.

First it needs to be said that the exceptional growth in the 2000s took place after a decade of radical economic reforms transferring the Soviet command system into the Russian market economy. This market economy was not perfect but it became possible to start and develop businesses and small and medium sized enterprises were established and grew. The economy was opened to competition, prices and trade were liberalized and consumer markets expanded making services and goods available that had been rationed, if at all existent, in the old shortage economy. Sectors like trade, private services, construction and IT flourished. Large Soviet state enterprises were privatized, sometimes in a manner that led to higher efficiency and increased competitiveness, sometimes in a way that led to continued state influence and continued politically motivated subsidies.

Despite these shortcomings, dramatic structural change took place and the economy that had been profoundly dominated by defence and heavy industry became more consumer friendly since markets transferred the power from central party bureaucrats and state producers to the citizens-consumers and profit seeking entrepreneurs. When oil prices started to rise again, the government could stabilize public finance and create a stable and credible macroeconomic framework supporting growth.

The lack of further market reforms since the mid-2000s and the backlash in form of more state intervention, less democracy and the return to Soviet priorities for defence and large state led investment projects are fundamental factors behind the declining growth today. Putin consolidated the reforms of the 1990s during his first period in

office, but since 2004 the policy changed. During Putin's second period the siloviki (security sector officials) clearly got a stronger hold of policy and governance efficiency and rule of law started to deteriorate while state corruption surged. Because of high oil revenues, the loss-making, often privatized but with state shares, Soviet-type enterprises could be increasingly subsidised, and all the allocative inefficiencies typical for the Soviet economic system were preserved. Strong public

finance allowed Russia to embark on a military reform with increasing military spending and a new huge armament programme that benefits the defence industry. Prioritized defence companies have been let to operate under soft budget constraints and soft credits, something that might have been affordable as long as growth was 6-7 per cent, but today it has a huge alternative cost. However, the present political leadership prefers political loyalty and support, which these defence

To restore growth the institutional framework need to be renewed and finally become what it was meant to be: the common rules of the game in economic Russia.

companies supply, to economic efficiency.

Accordingly, the market reforms never completely overcame the Soviet heritage that is still embedded in Russia's industrial structure. Both formal and informal behaviour of the socialist system have survived and this explains the difficulties of formal institutions in Russia. New institutions have been established but informal institutions and networks remain and this has undercut the development of real, efficient market institutions. To restore growth the institutional framework need to be renewed and finally become what it was meant to be: the common rules of the game in economic Russia.

Sadly strengthen institutions will be a hard option because some economic actors are better off with informal procedures, where they have special influence and direct access to the political leadership. Moreover, privileged groups will fight back if their position and income are at risk. Entrepreneurs that would profit from strong institutions and common rules lack the influence, as does the civil society in general, after all the imposed restrictions on civic liberties. Restoring growth through addressing structural factors and market institutions would therefore be difficult to achieve as long as Vladimir Putin remains in power. ■



SUSANNE OXENSTIERNA
Dr., Deputy Research Director
Swedish Defence Research Agency
Sweden