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PUTIN 3.0: THE ECONOMIC PLAN

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ANALYSIS

The Political Economy of Putin 3.0

Peter Rutland, Middletown, CT

Abstract

President Vladimir Putin has been extremely active since returning to the Kremlin in May 2012. However, he has been unable to turn his plans for economic reform into real change on the ground. Rather than prioritize economic reform, Putin has instead sought to strengthen the “power vertical” in the executive branch.

The Putin System

During his first two terms in office, Vladimir Putin forged a curious hybrid economic system, standing on two legs. One leg was a strong state with a controlling stake in important sectors such as oil, gas and the defense industries, and no compunction about intervening in defiance of rule of law in other sectors of the economy. The second was a cluster of wealthy and feisty oligarchs who controlled perhaps one third of the country’s economic activity through corporations under their personal control.

Alena Ledeneva has characterized the Putin model as elements of the Soviet system adapted to the conditions of a market economy.¹ There seems to be no contradiction between authoritarian rule and capitalism, neither in Russia nor China. On the contrary, Lilya Shevtsova argues that “Economic liberalism has served as Viagra for Russian authoritarianism.”²

During the years 2000–08 Putin’s model seemed to be working, with the economy growing at an average of 7% per year and real wages rising at a still faster rate. Skeptics argued that this growth was driven by the rise in the world oil price, and that the underlying inefficiencies in the model would ultimately lead to economic stagnation and subsequent social unrest.

There was also the problem of mounting social and regional inequality. There is a fundamental mismatch between the industrial society which Russia inherited from the Soviet Union and the extractive economy which generates huge wealth from a handful of resource-rich provinces. (The top 10 of Russia’s 83 regions alone account for 52% of national GDP.³) Putin seemed to be offering Russians a new social contract: rising living standards and a robust social safety net in return for them giving up on Western-style democratic participation. But did the state have the capacity—and the will—to redistribute sufficient resources to keep the masses content?

The 2008 global financial crisis hit Russia harder than most countries, with the double-whammy of a collapse in the world oil price and a massive outflow of private capital from Russia’s over-extended banking and construction sectors. The state spent down one third of its \$600 billion reserves stabilizing the ruble, rescuing Russian banks and bailing out manufacturing enterprises. But when the dust had settled, in 2010 the economy resumed its growth path. While a decade earlier the 1998 financial crisis had caused a massive restructuring of Russia’s political and economic system, in contrast the Putin regime survived the 2008 crisis unscathed.

Political Vulnerability

In 2008–12 Russia was ruled by the uneasy “tandem” of President Dmitry Medvedev and Prime Minister Putin. Medvedev made halting efforts to “modernize” the Russian economy. This ranged from introducing more open electronic government to a series of expensive infrastructure projects, such as the East Siberia–Pacific Ocean oil export pipeline and the Skolkovo innovation park.

In 2011 we learned that the threat to Putin came not from the economy, but from the inadequacy of the ruling political institutions. In September 2011 Putin announced that he was returning to the presidency. This exposed the phony nature of Russia’s “managed democracy,” triggering large-scale street demonstrations in Moscow in the wake of the December 2011 State Duma elections, widely perceived as rigged.

Putin’s re-election as president in May 2012 was never in doubt. But Putin saw the need to overhaul the political system, combining tighter authoritarian controls over the opposition with a series of speeches and articles in which he laid out an ambitious agenda for his return to the presidency. The economic system was to be left more or less as it was, while the role of the “power vertical” in managing the economy was strengthened.

Renewed Vigor

Putin seemed to be energized by his brush with political mortality in the winter of 2011–12. During the first year of his third term he applied the same sort of vigor to ruling Russia that he had brought to the office back in 2000–01. When he moved from the prime minister’s office to

1 Interview by Tonya Samsonova, “Tekhnologiya stabilizatsii,” *slon.ru*, 22 April 2013. http://slon.ru/russia/tekhnologiya_stabilnosti_kak_privyazat_elitu_k_kormushke-934775.xhtml

2 Lilya Shevtsova, “Russia XXI: the logic of suicide and rebirth,” Carnegie Endowment, January 2013. <http://carnegie.ru/publications/?fa=50874>

3 *Vedomosti*, 23 January 2013.

the presidency, he brought half-a-dozen former ministers with him as aides, forming what Yevgeny Minchenko dubbed a new Politburo.⁴ The presidential administration, headed by Putin's long-time confidante Sergei Ivanov, is the nerve-center of the new political regime.⁵

The notion of Putin exercising "manual control" over the economy first came to attention during the 2008 crisis, when Putin was a flurry of (televised) activity, prodding bureaucrats and businessmen to action. The iconic event was when he "threw the pen" at Oleg Deripaska, owner of Basic Element, while persuading him to reopen a bankrupt factory in Pikalevo in June 2009.

Soon after resuming the presidency in May 2012 Putin issued a series of decrees ordering his ministers to draw up plans to implement a broad range of spending programs aimed at improving government services. Even though Medvedev had replaced Putin as prime minister, Putin was effectively taking direct command of the government.

Putin's decree no. 596 "On the state's long run economic policy" of 17 May 2012 laid out a dozen ambitious long-term goals, including: 25 million new job places by 2020; investment to reach 25% of GDP by 2018; a 30% increase in high tech products; a 50% increase in labor productivity; and increase Russia's World Bank ease of doing business rating from 120th place to 50th by 2015 (and 20th by 2018).⁶ He even included goals for increasing the average lifespan to 74 years and birthrate to 1.753 per woman by 2018. The government was tasked with preparing a strategic plan and new budget policies by October 2012; creating an ombudsman for the defense of small business by December 2012; and reviewing the status of state corporations by March 2013.

Many of these programs focused on increased delivery of services in health and education at the regional level. Former banker Oleg Govorun was appointed regional development minister in May 2012. He was reprimanded by Putin for failing to implement the May program, and replaced in November 2012 by Kostroma governor Igor Slyunyaev.

Reporting to the State Duma in April 2013, Medvedev said that the government had fulfilled 73% of its targets.⁷ Putin had issued 218 instructions, and 110 of the 150 tasks which were to be met within one year had been fulfilled. This included the passage of 29 new

laws, with 25 more working their way through the State Duma. Spending on wages in education and health care rose by 18% and 20% respectively. In January 2013 the Ministry for Regional Development prepared a draft program "Regional Policy and Federative Relations" to promote a new vision of "competitive federalism" combining independence with accountability.

However, Putin told the government meeting on 7 May 2013 that many of these measures were mere formalities ("ticking boxes"), lacking concrete goals for implementation.⁸ Deputy Prime Minister Vladislav Surkov, co-chair of the commission for implementing the presidential decrees, responded "After what you have just said, there is almost no point in my reading my report."⁹ Surkov resigned the next day. Putin gave the ministries two weeks to draw up new plans, and explained he will meet personally with each minister to assess their performance.¹⁰

Another measure aimed at increasing oversight was new legislation prohibiting Russian officials (and their immediate family) from holding bank accounts abroad or owning foreign-issued shares and bonds, which came into force in May 2013.¹¹ (Officials had been required to report their incomes since 2008, but not assets.)

Meanwhile, the state's role in the economy continued to expand. Rosneft's \$55 billion takeover of TNK-BP was announced in October 2012 and completed in March 2013, with much of the money to finance the acquisition having been borrowed from China. Spending on the infrastructure for the 2014 Sochi Olympics will reach \$50 billion, providing a rich source for corruption and incompetence.¹²

The state and oligarchs have achieved a *modus vivendi*. In the words of political guru Sergei Markov, "the oligarchs of the 1990s spit on the state, while those of today respect it."¹³ According to Stanislav Belkovsky's latest report on the oligarchs, there has been no 'statization' of the economy under Putin 3.0 because the state itself consists of an agglomeration of private interests.¹⁴ How is one to categorize figures such as Igor Sechin,

4 Yevgeny Minchenko, "Vladimir Putin's Big Government: Politburo 2.0," August 2012, http://minchenko.ru/netcat_files/File/Big%20Government%20and%20the%20Politburo%20_0.pdf

5 Elizaveta Surnacheva, "V apparatnom stroyu," *Kommersant Vlast*, 8 April 2013 <http://www.kommersant.ru/doc/2156014>

6 <http://graph.document.kremlin.ru/page.aspx?1610833>

7 Maksim Tovkailo, "Medvedev otvetit za predvybornye obeshchaniya Putina," *Vedomosti*, 29 April 2013.

8 Andrei Kolesnikov, "Rukovosyashchie prikazaniya," *Kommersant Vlast*, 8 May 2013.

9 <http://www.business-gazeta.ru/article/79859/>; <http://президент.рф/%D0%BD%D0%BE%D0%B2%D0%BE%D1%81%D1%82%D0%B8/18039#sel=>

10 "Putinu ne khvatilo konkretiki," *RIAN*, 7 June 2013.

11 Kira Latukhina, "Shchet, pozhaluista!," *RG*, 4 April 2013. <http://www.rg.ru/2013/04/04/schet.html>

12 Boris Nemtsov and Leonid Martinyuk, "Zimnyaya Olimpiada v subtropikakh," <http://www.nemtsov.ru/?id=718789&PHPSESSID=13c7a42a3061422d0aa0f559163b74e9>

13 Natella Boltanskaya, "Skol'ko prozivet vlast?," *Ekho Moskvy*, 25 July 2012.

14 Stanislav Belkovsky, "Gosudarstvo i oligarkhiya: 10 let spustya," *slon.ru*, 4 June 2013. http://slon.ru/russia/embargo_do_21_gosudarstvo_i_oligarkhiya_10_let_spustya-949243.xhtml

simultaneously CEO of Rosneft and head of the presidential energy commission? The new program to privatize some of the remaining assets in state hands is seen by skeptics as motivated not by the pursuit of efficiency, but by a desire to reward members of the elite.¹⁵ For example, between them the oligarchs Mikhail Prokhorov and Suleiman Kerimov have bought nearly \$1 billion stock in the state-run VTB Bank as it was privatized in early 2013. Oligarchs who run into trouble can still expect assistance from the state. For example, in November 2012 Rusal won a 75% discount on its electricity from Rosatom to prevent it from closing the Bogoslavskii aluminum plant in Sverdlovsk oblast.¹⁶

Economic Growth Slows Down

While Putin was re-establishing his position at the apex of the “power vertical,” Russia’s sluggish economic growth was worrying observers. The economy’s lackluster performance was dissected in two thorough reports from the World Bank and the World Economic Forum.¹⁷

At first glance Russia’s macroeconomic outlook looks stable. The growth rate for 2013 is expected to be in the range of 2.4–3.4%.¹⁸ The higher estimate is from the IMF, the lower estimate is from the Russian economics ministry, and reflects a slowdown in the first three months of 2013. Unemployment is a modest 5.4%, and inflation is running around 7.1%. With the oil price on a plateau of around \$100 a barrel, Russia’s foreign trade current account shows a sizeable surplus, and the federal budget is even close to the break-even point.

This growth rate is respectable enough by the anemic standards of contemporary Europe—but it falls below what Russia needs if it is to rebuild its infrastructure and establish an internationally competitive manufacturing base. In the 2000s the country had been growing at 7% a year—and now it has to settle for growing at half that rate. Dreams of doubling GDP by 2020 have receded.

There are also clear signs that Russia’s short-run stability may be coming at the cost of long-term economic performance.

The labor force is already emerging as a serious constraint on growth. Due to the aging of the population, the labor force is shrinking by about one million a year—

and the influx of 200,000–300,000 migrant workers per year is already causing a rise in inter-ethnic tensions in some Russian cities. The national unemployment rate of 5.4% conceals substantial regional imbalances: unemployment is a mere 3% in the central federal district, including Moscow.

In the longer term, Russia is set to see its elderly dependency ratio rise from 18% to 36% by 2050, which will increase the burden on the federal budget—especially given the failure of the attempted privatization of the pension system.¹⁹ A decision on what to do with pension reform has been pushed back to 2015.

Russia remains heavily dependent on its oil and gas industry, which accounts for about 20% of GDP and 50% of federal budget revenue. Perhaps even more of a problem than the budget’s dependence on an oil price above \$100 is the squeeze on investment in developing new fields. The government gets \$78 for each \$100 per barrel of oil—leaving little incentive for companies to expand output, especially given the higher costs of developing East Siberia or Arctic offshore fields. Gazprom’s rosy future has been cast in doubt by the tumbling international gas price in the wake of the U.S. shale revolution, which has forced it to pay over \$4 billion in rebates to its European customers.²⁰ Gazprom suspended development of its giant offshore Shtokman field in 2010. But in late 2012 Putin decided to go ahead with the Chayadinsk field in Yakutia, building a pipeline to Vladivostok, and to build the South Stream export pipeline across the Black Sea.

Diversification of the economy away from oil and gas is not happening. January 2013 saw a monthly decline in industrial output for the first time since 2009. Capital flight amounted to \$76 billion in 2011 and \$46 billion in 2012. The business climate is still poor—the World Bank ranks Russia at 112 out of 185 in its ease of business rating for 2013,²¹ while the World Economic Forum Global Competitiveness report places them at 67 out of 144 countries surveyed.²²

Russia did finally join the World Trade Organization in 2012, but the impact of WTO entry is likely to be modest. Predictions of a 2–3% annual boost to GDP are based on heroic assumptions about the possible impact of liberalization on Russia’s domestic financial markets. Putin seems more interested in turning the Eurasian Economic Union into a fully-integrated economic entity, building on the Common Economic Space introduced between Russia, Belarus and Kazakhstan

15 Minchenko, op.cit.

16 Sergei Aleksashenko, “Spasenie oligarkhov,” *Ekho Moskvy*, 4 November 2012.

17 World Bank, Russian Economic Report 29, Recovery and Beyond, 26 February 2013; <http://www.worldbank.org/en/news/press-release/2013/02/26/russian-economic-report-29>; World Economic Forum, Scenarios for the Russian Federation, January 2013; http://www3.weforum.org/docs/WEF_Scenarios_RussianFederation_Report_2013.pdf

18 Isabell Gorst, “Russia and less than \$100 oil,” *Financial Times*, 17 April 2013. <http://blogs.ft.com/beyond-brics/2013/04/17/russia-and-less-than-100-oil/#axzz2QomXKvEv>

19 World Bank 2013, p. 26

20 Guy Chazan and Neil Buckley, “A cap on Gazprom’s ambitions,” *Financial Times*, 6 June 2013.

21 <http://www.doingbusiness.org/rankings>

22 <http://www.weforum.org/issues/global-competitiveness>

in January 2012 (following the 2009 Customs Union). However, there are only modest efficiency gains for Russia from integrating with those two much smaller economies, and the prospects for significant new members such as Ukraine joining the project appear to be slim.

One dramatic development which showed the perils of international integration Russian-style was the financial crisis which erupted in Cyprus, a member of the Euro-zone, in March 2013. As a condition for a \$10 billion bailout, the European Union forced Cyprus to freeze €5.8 billion in accounts larger than €100,000 in selected banks. Half of those accounts were thought to belong to Russian companies and individuals, who have longed used Cyprus to hide their earnings from prying tax authorities. The Russian government was furious, but decided not to intervene (by offering its own rescue package to the Cyprus government, for example). Putin described the EU plan as “unfair, unprofessional and dangerous.”²³

About the Author

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²³ Ilya Arkhipov, “Putin says Cyprus bank-deposit levy is dangerous,” Bloomberg, 18 March 2013.

²⁴ <http://archive.premier.gov.ru/eng/events/news/17888/>

Russian government leaders are all too aware of these structural problems: Putin published an article in *Vedomosti* on 30 January 2012 titled “We need a new economy.”²⁴ The problem is that Putin has been calling for a new economy year in and year out since 1999—but he does not explain the lack of progress after his 13 years in power. A combination of bureaucratic resistance and political caution in the face of potential social unrest means that Putin is unable to translate his rhetorical commitment to economic modernization into policies that actually change the situation on the ground. He is relying on an old Soviet style mobilization campaign, transmitted through the ministerial apparatus, to improve state performance while somehow trying to encourage the oligarch-run economy to invest in Russia’s long-term development.

ANALYSIS

Economic Growth and Strategies for Economic Development in Russia

Richard Connolly, Birmingham

Abstract

Recent evidence indicates that economic growth in Russia has begun to slow. While some of this slowdown may be attributed to exogenous factors, it is also possible that Russia may be entering a period of slower growth due to domestic constraints on growth that may be structural in nature, or caused by defects in economic policy. This article considers recent forecasts for Russian growth rates, the potential for faster growth in Russia, and the role that longer term strategic plans for economic development might have in promoting faster growth in the future.

The Economy Begins to Slow...

A near decade-long period of economic expansion between 1999 and 2008 in which the annual growth rate averaged around 7 per cent was rudely interrupted by a severe contraction of nearly 8 per cent of GDP in 2009, the most severe recession of any G20 country during that period. Nevertheless, although post-crisis growth rates failed to reach pre-crisis highs, annual growth rates of 4.3 per cent in 2010 and 2011 were considerably faster than in Russia’s richer European neighbours, and higher

than many other middle-income countries, such as Brazil and Turkey, during the same period. Even as global growth slowed from 4.3 per cent in 2011 to 3.2 per cent in 2012, growth in Russia slowed to a still respectable 3.5 per cent in 2012. However, economic growth in Russia has slowed significantly in recent months. With an annualized growth rate of just 1.6 per cent in the first quarter of this year, fears are rising that Russia is in the midst of a more serious and possibly protracted slowdown. Projections for economic growth in 2013

have been quickly revised downwards: the Ministry of Economic Development has cut its growth forecast for 2013 from 3.6 per cent to 2.4 per cent, with the International Monetary Fund revising its forecasts down from 3.4 per cent to 2.5 per cent. The most extreme revision has come from the European Bank for Reconstruction and Development (EBRD), which revised its forecast down from 3.5 per cent to 1.8 per cent.

...But Why?

Accounting for this slowdown in Russian growth is not easy, if only because of the sheer number of competing explanations, which range from assigning responsibility to exogenous factors beyond the control of Russian policy makers, to laying the blame at the feet of a Russian leadership that is now paying the price for its reluctance to undertake much-needed structural reforms over the past decade.

Looking at external factors, it is clear that Russia's largest trading partner, the EU, is languishing in a state of economic stagnation as it struggles to solve its fiscal and banking crises. According to Commission estimates, the EU average growth rate declined from an anaemic 1.5 per cent in 2011 to a recessionary -0.3 per cent in 2012. It should therefore be no surprise that Russia has suffered some ill effects. Just how much the EU's malaise is responsible for Russia's slowdown, however, depends on which forecast is referred to. For instance, the IMF revision is consistent in magnitude with the revisions made to forecasts for many of Russia's other neighbours, suggesting that a common explanation, such as the weakness of the Eurozone, might lie behind a wider slowdown. However, the EBRD's downward revision for Russia is considerably more pronounced than for its neighbours, suggesting that internal problems are aggravating the effects of an external slowdown.

If the EBRD is correct in its forecast of a sharper slowdown in Russia than its neighbours, then several contributing factors stand out. First, Russian growth statistics are suffering from the 'base effect' after public spending was ramped up in advance of the 2012 presidential election. Consequently, year-on-year figures exaggerate the extent of the slowdown in Russia. Second, the size of the indigenous labour force has been shrinking since 2010. As a result, supply-side bottlenecks are becoming more evident as employment and capacity utilisation in manufacturing remain at record high levels. Third, revenues from energy extraction and exports, while still historically high, are growing much more slowly as the global prices of oil and other commodities have slowed or declined. The volume of energy extraction is also at a post-Soviet high, ruling out the potential for any sudden increase in growth rates in the near future.

Fourth, the rapid expansion of consumer credit, which, along with growth in real incomes, has supported robust consumer spending in recent years, has moderated. Fifth, Russia's business environment—which has reached levels of notoriety that are perhaps unwarranted—continues to be viewed by many as a serious impediment to economic activity. Finally, these factors have coincided with, and in some ways contributed to, a deceleration of investment growth, with Central Bank data indicating that investment has contracted over the past twelve months. Given that investment already accounts for a relatively low share of Russian GDP, this tendency is perhaps the most worrying of all.¹

Without a sustained increase in investment, it is difficult to see how the Russian economy might experience the sort of sustained increase in productivity that is required to relieve pressure on the level of industrial capacity utilization, enable a smaller and older population to generate higher levels of output, and allow the government to meet its growing list of spending obligations. If we take generating robust and sustained investment growth as the most important task confronting Russian policy makers, two immediate questions emerge. First, how fast should the Russian economy be growing? Second, what is the most appropriate path to achieving that rate of growth?

How Fast Should Russia Be Growing?

There are several methods available to identify what might constitute an appropriate rate of economic growth for Russia. The first way would be to start with the basic components of Russian GDP and examine what rates of growth would be achievable for each component given the supply side and policy constraints that currently exist. Thus, given the government's stated desire to avoid any substantial fiscal deficits, and in light of both the diminishing indigenous labour force and narrowing trade surplus, there is limited room for a growth model based on either public spending, consumer spending or net exports. Consequently, investment would be required to do the heavy lifting as far as an increase in growth is concerned. Under such parameters, if consumption growth were to moderate, public spending to grow modestly (i.e., around 1 per cent annually), and the trade balance to continue to narrow, investment growth of around 10 per cent per year would likely result in annual GDP growth of around 4 per cent in the short run. Such an annual increase would not be unreasonably high; investment grew at a faster rate in every year

1 Russia's level of investment is just over 20 per cent of GDP. This compares to around 45 per cent in China, around 30 per cent in India, and around 20 per cent in Brazil.

between 2002 and 2008. Moreover, if investment were to grow at anything close to the pre-crisis highs of over 20 per cent then GDP growth might be expected to rise to closer to 6 per cent.

Another way to identify what might approximate a reasonable rate of growth for Russia is to examine the historical evidence from cross-country studies on episodes of growth accelerations and decelerations. A recent study by Eichengreen et al (2013) examines the incidence and correlates of growth slowdowns in fast-growing middle-income countries. Such a slowdown is labelled the 'middle-income trap'. They argue that while there is considerable dispersion in the per capita income at which slowdowns occur, the mean GDP per capita is around \$16,000 in 2005 constant U.S. dollars at purchasing power parity. At this point the growth of per capita income slows on average from 5.6 to 2.1 per cent per annum. By comparison, Russia's per capita GDP was just under \$15,000 in 2011, suggesting that Russia is now at the point where it might hit the middle-income trap. The authors argue that slowdowns are more likely in countries where high-technology products account for a relatively low share of exports, an area where Russia performs comparatively badly. This means that if Russia were to follow the path of the average fast growing middle-income country of the past, growth would likely slow to somewhere around 2 – 2.5 per cent per annum. If, however, growth rates were higher—say, at around 4 per cent—then Russia could be considered to have performed relatively well.

What does all this mean for Russia's potential growth rate in the immediate future? First, achieving a rate of around 4 per cent is feasible even within the parameters of supply- and demand- side constraints currently present in Russia. This will only be possible, though, as long as investment grows at a rate of 10 per cent or more for a sustained period of time. Second, achieving an average annual growth rate of around 4 per cent—which would equate to an even faster increase in per capita terms due to Russia's dwindling population—would, if sustained over a decade or so, represent an excellent achievement, especially as many countries at Russia's income level have tended to experience growth slowdowns in the past. Third, and in light of the above two observations, calls for growth of over 5 per cent per year might be somewhat optimistic. Indeed, given the structural constraints outlined above, it is likely that a faster rate of growth would be only be possible through an imprudent expansion of credit, perhaps allocated through direct state intervention. Under these circumstances, the short-run benefits of faster growth would likely be outweighed by the long-run costs of a higher debt-GDP ratio and nega-

tive distortions caused by the large-scale misallocation of resources.

Government Strategies for Economic Development

If a growth rate of around 4 per cent is taken as a desirable goal, how might policy makers help make this possible? Examining the full range of policy options available to decision makers in Russia is beyond the scope of this short article. Instead, the remainder of the article will address the role of several prominent government strategies for economic development developed in recent years.

From Concept...

In autumn 2008, just as the global economic crisis was entering its most tumultuous stage, the Concept of Long-Term Socio-Economic Development of Russia to 2020, formulated by the Ministry of Economic Development (Minekon), was approved by the government. The objective of the Concept was to lay out a strategy for transforming Russia into one of the world's leading states by 2020. The authors of the Concept outlined three scenarios of economic development: one based on an increase in the role of energy and raw material exports; a second based on 'inertia', or simply maintaining the current course; and a third scenario based on innovative development. In particular, the innovative scenario aimed to show what would be required to overhaul the structure of the Russian economy away from energy and commodity exports and towards the production of innovative, knowledge-based goods and services. Such a transformation would, its authors hoped, make Russia the best place in the world to live and a leading geopolitical actor for years to come. To achieve this goal, the Concept stated that the average annual rate of economic growth between 2008 and 2020 would need to be 6.5 per cent, with faster growth in the earlier years and a slight moderation towards 2020. This scenario envisaged an increase in the share of GDP devoted to education (to 6.5 – 7 per cent, from 4.9 in 2007), health (to 6.7 – 7 per cent, from 4.2 in 2007) and research and development (R&D; to 3 per cent, from 1 in 2007). The Concept also acknowledged the importance of well-functioning institutions, such as courts and the state administration, for creating a more favourable business environment in which investment and innovation could increase.

...to Strategy

The global financial-economic crisis meant that the formulation and implementation of programmes to support the goals of the 2020 Concept were stopped before they had even begun. Instead, the Russian government

reverted to 'manual control' (i.e., day-to-day management of the economy in response to problems that arose rather than behaving according to any plan or strategy). Only after economic growth returned to respectable rates over 2010 and 2011 did the government, then under the leadership of Vladimir Putin in his position as Prime Minister, revisit the formulation of an updated strategy for Russia's long-term economic development. This time the strategy was drafted by an expert group under the leadership of Vladimir Mau, Rector of the Russian Academy of the National Economy and State Service (RANKh i GS), and Yaroslav Kuz'minov, Rector of the National Research University Higher School of Economics (NIU HSE).

The final version of what was now known as 'Strategy-2020' was published in March 2012. As with the 2008 Concept, three scenarios for development were presented, with the clear indication that the innovation scenario was the preferred course of action if Russia were to embark on a new trajectory of economic development. It is in this Strategy that a rate of economic growth of not less than 5 per cent was considered appropriate if Russia hoped to reach new levels of human development and build a post-industrial economy. As with the 2008 Concept, the emphasis on the development of a new, knowledge-based path of economic development demanded an increase in spending on education, infrastructure and R&D to around 4 per cent of GDP for each, and a reduction in spending on defence, public order and security to just 2 per cent of GDP. This budgetary 'manoeuvre' was termed '+4 -2'.

The Strategy also emphasises a return to fiscal discipline, proposing new budget rules to limit spending so that annual expenditure is limited by a commitment to balance the budget at a 'base level' world oil price. However, the authors of the report introduce two approaches to budgetary policy. The first envisages balanced budgets, while a second permits modest budget deficits of up to 1 per cent of GDP so that the government could fund selected projects. Under the latter approach, the stock of Russian public debt would be permitted to rise to 25 per cent of GDP by 2020.

Unlike the Concept, Strategy-2020 was less vocal in asserting in the importance of any institutional reform for improving the wider business environment. Instead, anything that might have been taken as a call for wider political reform, such as stronger property rights or greater accountability of the authorities, was largely absent from the final report.

Soon after the publication of Strategy-2020, the Ministry of Economic Development revealed a draft forecast of socio-economic development to 2030. Forecast-2030 represents the next stage in the evolution of

the original Concept, with the parameters adjusted to reflect the economic objectives outlined by Vladimir Putin prior to his election as President in May 2012.

Obstacles to the Operationalization of Strategy 2020

The policy options presented in Strategy-2020 are, for the most part, perfectly reasonable, at least from a conventional liberal economic perspective. It is conceivable that a policy programme based around the core initiatives contained in the Strategy would help raise investment growth above the 10 per cent annual growth rate required to generate growth of 4 per cent and above, although this would not be assured: structural economic reform of the sort envisaged in the Strategy does not always result in an immediate expansion in output. What would be required for such a programme to generate the desired effects is political credibility. In the absence of a credible commitment to reform from Russia's political leading actors, an increase in policy uncertainty would be a more likely outcome than any increase in investment and economic growth.

However, it is in the realm of politics that the Strategy shows its limitations. The authors of the report avoided any consideration of the role of political reform in facilitating any economic transformation. But significant change in the political balance of power would be required to, for example, execute the '+4 -2' manoeuvre. In recent years, increased military spending, and especially a commitment to implement the state armaments programme (GPV) to 2020, has constituted a central component of government policy and has powerful supporters. Reversing this policy course in favour of education and infrastructure spending would be extremely difficult for any Russian leader to implement. Indeed, recent pronouncements from the defence industry and from elements of government have indicated that increased defence spending might act like a locomotive of economic modernisation.

Thus, the types of economic policies contained within the Strategy should be viewed as just one view from a multitude of potential policy preferences from within the Russian ruling elite. The lines articulated in both the 2008 Concept and the Strategy-2020 could be considered as consistent with the policy preferences of the Ministry of Economic Development. The more fiscally orthodox scenarios are closer to the thinking emanating from the Ministry of Finance. However, other powerful ministries, lobbies and individuals—the defence industry and energy complex, for example—would have radically different policy preferences to those expressed in the Strategy. In Russia today, it is precisely these interests that possess the greater political influence.

Prospects for Economic Growth in 2013

The short-term prospects for economic growth in Russia are more likely to be shaped by the vicissitudes of the global economy than by any bout of renewed economic reform in Russia. While the recently drafted Strategy-2020 document (as well as other strategy documents, such as the Forecast-2030) represents a sensible set of policy suggestions, the array of powerful political forces opposed to its recommendations will likely

ensure that it exerts only a modest influence over economic policy in Russia. Moreover, if the Russian government's response to the recent 2008–09 recession offers any insight into crisis management in Russia it is that any future recession will likely see the dominance of 'manual control' in economic policy rather than any long-term strategy. In this respect, Russia is perhaps no different to its richer European neighbours.

About the Author

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Further Reading

- Cooper, J. (2012) 'Reviewing Russian Strategic Planning: The Emergence of Strategy 2020' *NATO Defense College Research Review*, Rome: NATO Defense College, URL: <http://www.ndc.nato.int/download/downloads.php?icode=338>
- Eichengreen, B., D. Park and K. Shin (2013) 'Growth Slowdowns Redux: New Evidence On The Middle-Income Trap,' *NBER Working Paper Series*, Working Paper 18673 available at: <http://www.nber.org/papers/w18673>

ANALYSIS

Prospects for Russia as a Global Food Exporter

Stephen K. Wegren, Dallas

Abstract

Russian agriculture has rebounded from the depressed conditions of the 1990s. Most importantly, Russia has become a significant global exporter of grain. However, the animal husbandry sector has struggled in some areas, although there are pockets of growth. Assuming that these trends continue, Russia will remain an exporter of grain and an importer of meat.

The Soviet Model

Soviet agriculture was known for its inefficiency and an inability to feed its population. During the last decade of Soviet rule, grain and meat production stagnated, average consumption leveled off, and the USSR imported more than 20 million tons of grain a year, including a high of 44 million tons in 1985, mostly to feed its livestock.¹ In the immediate aftermath of market reform, agricultural production plummeted. By the mid-1990s, food production had declined an estimated 40 percent. Post-Soviet Russia became a large importer of meat in the 1990s.

But this is not the whole story. Less publicized is the fact that since the late 1990s the value of Russian agriculture has increased significantly (see Figure 1 on p. 8). Crop production in Russia has rebounded from the depressed conditions in the 1990s, whereas the animal husbandry sector is still struggling, although there are pockets of growth. The near-term prospects are mixed for Russia as a global food exporter, as it will continue to export grain, but will rely on imported meat.

Grain Production and Exports

Although average grain production remains below the level of the 1986–1990 period, Russia has turned from a large grain importer during the 1980s and early 1990s into a significant grain exporter. Russia achieved two

1 *Narodnoe khoziaistvo SSSR* (Moscow: Goskomstat SSSR, 1989), 654.

stellar harvests in 2008 and 2009, with the 2008 harvest reaching a post-Soviet high of more than 108 million tons. In 2012, however, Russia experienced its second disappointing harvest in the last three years for weather-related reasons. In 2010, Russia's grain harvest sank to a post-Soviet low when one-third of the harvest was lost due to drought and extreme heat. After rebounding in 2011, dry conditions in 2012 again led to a decline, including the smallest wheat harvest in 10 years, with the worst performance in the Southern Ural and Siberian federal districts (see Figure 2 on p. 9). Even so, of the \$16.5 billion of export revenue earned in 2012 from raw and processed foodstuffs, cereals accounted for \$6.2 billion, or almost 38 percent. The early forecast for the 2013 harvest is about 90 million tons, but the actual volume ultimately depends on weather conditions. Contributing to larger harvests have been improved output per hectare and an expansion in cultivated area. While the general trend for Russia's grain production has been upward, critics point out that Russia has the ability to produce as much as 200 million tons of cereals annually, which would allow it to export up to 100 million tons. In contrast, the United States, which is the global leader in grain exports, sold 73 million tons abroad in 2011.²

Russia has considerable grain reserves, more than 25 million tons at the beginning of 2013, in both government stocks and privately-owned elevators. With domestic consumption averaging 75–77 million tons, favorable grain harvests have allowed Russia to become a large grain exporter. In 2009 Russia was the third largest exporter of grain in the world, trailing only the U.S. and Australia. Russia dropped to eighth place after the poor harvest in 2010, and rebounded to third place in 2011 in the aftermath of a good harvest. Another poor harvest in 2012 dropped Russia to fourth place in global rankings of wheat exports (fifth place if the EU is considered a single exporter). Going forward, President Putin, and before him Medvedev, stated Russia's ambition to become the number two grain exporter in the world and to double its grain exports to 40–50 million tons by 2020. In contrast, the United States Department of Agriculture forecasts that by 2021 Russia will have total grain exports of 27.5 million tons, as both cultivated area and yields are predicted to rise slowly.³ Due to the vagaries of weather, Russia's actual grain exports have fluctuated in recent years (see Figure 3 on p. 9). Even

so, Russia is likely to remain a net grain supplier to the global grain market.

Grain Policies

To reach its goal of doubling grain exports by 2020, the Russian government has introduced a number of measures, including increasing the number of cultivated hectares by expanding irrigation and land reclamation, and by redistributing abandoned land for agricultural production. As a result, cultivated acreage has increased by about one million hectares in recent years, although total cultivated land remains far below levels of the 1980s. Further, during the past several years the government has subsidized several aspects of grain production, including the price of fuel, rail transportation, the acquisition of agricultural equipment and machinery, seasonal and investment credit, and crop insurance against catastrophic loss. Some of these trade-distorting subsidies will have to be phased out in coming years as Russia comes into compliance with WTO regulations.

The Russian government is also increasing the export capacity for cereals. Present export capacity is about 25 million tons. The expansion of export capacity is necessary because several ports have limited storage or loading capacity. The Novorossiysk port on the Black Sea has the largest export capacity at about 11 million tons and underwent expansion and modernization in 2010–2011. Other projects include construction of a new deep water terminal in Taman on the Black Sea with a shipping capacity of 6–8 million tons by 2014; construction of a grain terminal in Vanino on the Sea of Japan with a shipping capacity of 2.5 million tons; and construction of a terminal in Ust-Luga on the Baltic Sea with a capacity of 6 million tons a year.

Where do Russian Grain Exports Go?

At present, the largest purchasers of Russian grain are Saudi Arabia, Egypt, and Turkey. In Europe, Russia does not have preferential trade terms with the EU and therefore faces high tariff rates. Grain producers in the EU enjoy higher levels of subsidization, higher productivity, and benefit from generous export subsidies. These factors, in addition to Russia's higher cost structure and lower productivity, limit the potential expansion of Russian grain exports to the EU.

The main region Russian policymakers are eyeing for an expansion of grain exports is Asia. At present, Russia has a very small presence in grain trade in the Far East. At the beginning of the 2011–12 agricultural year, no East Asian country ranked in the top 40 of recipient nations of Russian grain. Moreover, transportation costs for Siberian grain to export terminals in the Far East are significantly higher than grain deliveries from

2 Alexander Chetverikov, "Can Russia do Better in Grain Production?" *Russia Behind the Headlines*, November 22, 2012, http://rbth.ru/articles/2012/11/22/can_russian_do_better_in_grain_production_20343.html

3 Olga Liefert, William Liefert, and Eric Luebehusen, *Rising Grain Exports by the Former Soviet Union Region*, WHS-13A-01, February 2013, www.ers.usda.gov

southern Russia to Black Sea terminals. Expanded trade with Asia has domestic implications and is linked to the economic development of Russia's Far East, and a Ministry for the Development of the Far East was created in Putin's new government, headed by Viktor Ishaev. The Asia-Pacific region holds 4.2 billion people, or 60 percent of the world's population, and is where an estimated two-thirds of the world's undernourished people reside. Russia hopes to become an important regional food supplier to combat hunger. Further, Russia is a member of the Asia Pacific Economic Cooperation organization (APEC). In their September 2012 meeting, APEC members continued to work toward a regional free trade agreement (RTA) that would include agricultural trade.

Animal Husbandry

The animal husbandry sector has been slower to rebound from the depths of the 1990s. During the 1990s Russia became the largest poultry importer in the world. More generally, as real personal incomes increased after 2000, the volume of meat imports grew from 1.2 million tons in 2000 to a high of 2.9 million tons in 2008 (see Figure 6b on p. 11 and Table 1 on p. 12). Moreover, herds of beef cattle and milk cows have declined significantly since the 1990s and continue to contract, although the rate of decline has stabilized in recent years due to special government programs. There are pockets of growth, as the number of pigs has increased from 13.8 million in 2005 to 18.8 million in 2012 (see Figure 4 on p. 10). Pork production in Russia grew about 25 percent during 2008–2011. The Russian government also supports the development of the domestic poultry industry. The number of poultry has increased from 357 million in 2005 to 473 million in 2011, and as a result the production of poultry meat has been growing rapidly, up by more than 200 percent compared to 2005. While poultry production has grown, the production of beef has declined slightly compared to 2005 and is just above the 2001 level (see Figure 5 on p. 10). On the positive side, Russia has been importing pedigree cattle from the US, Australia, and the EU. These pedigree cattle yield more milk per milk cow and also more beef per meat cow. Therefore, higher output per cow keeps production from declining.

Ultimately, however, imports are necessary to fulfill domestic demand. In 2011, domestic production fulfilled only 70 percent of the nation's demand for beef and 77 percent for pork. As a high-value commodity, meat imports account for the bulk of the value of food imports into Russia. The dollar expenditure on food imports grew from \$7.4 billion in 2000 to \$42.5 billion in 2011 before declining to \$40.2 billion in 2012. In 2012, the gap between revenue from food exports and expenditures on food imports was \$23.7 billion.

Expenditures on food imports greatly surpass the level of financial support that the agricultural sector receives from the government.

High dependence on meat imports has spurred concerns over food security. In June 2009, former President Medvedev argued that high levels of dependence on foreign meat and poultry are "dangerous."⁴ In January 2010, former Minister of Agriculture Elena Skrynnik indicated that food security is "one of the central and prioritized problems in the system of national security."⁵ Food security is included in the National Security Strategy (NSS) that was adopted in May 2009. In January 2010, former President Medvedev signed into force a national Food Security Doctrine. The doctrine calls for "food independence of the Russian Federation" based upon quantitative and qualitative measures as established by Russian law. Section 2, article 8 of the doctrine establishes quantitative indicators for food supply that domestic production should fulfill. Food security is defined as Russia's ability to produce 95 percent of the grain it consumes, 95 percent of its potatoes, 85 percent of its meat and meat products, 80 percent of its fish products, and 90 percent of its milk and milk products.⁶

In July 2012 the Russian government adopted a new program for the development of agriculture for 2013–2020. The broad goals are to attain food independence for the nation, increase competitiveness of Russian agricultural productions on domestic and foreign markets within the parameters of the WTO, improve the financial condition of Russia's food producers, and create sustainable rural communities. The program identifies meat and milk production as a first-level priority. Toward this end, the program envisions the expenditure of R499.3 billion on the development of animal husbandry and a further R65.3 billion for the development of the meat cattle sector. The state program includes subsidies for the acquisition of pedigree cattle, provides funding to major meat producing regions, and subsidizes interest rates for loans used to construct sheds for beef cattle. In all, the development of animal husbandry and the beef cattle sector are scheduled to receive 43 percent of all expenditures during the 2013–2020 program. The goals of the program are to increase animal husbandry production 20 percent by 2020 compared to 2012, reaching 14.1 million tons of meat and poultry and 38.2 mil-

4 *Sel'skaya zhizn'*, June 25–July 1, 2009, 1.

5 E. Skrynnik, "Prodovol'stvennaia bezopasnost'—vazhnaia sostavliaiushchaia sistemy natsional'noi bezopasnosti Rossii," *APK: ekonomika, upravlenie* 1 (2010), 3.

6 Doktrina prodovol'stvennoi bezopasnosti Rossiiskoi Federatsii," www.mc.ru/documents/document/show_print/12214.19.htm. This document is no longer available on the website of the Ministry of Agriculture.

lion tons of milk. These levels of production will bring the level of self-sufficiency for meat and poultry to 88 percent and 90 percent for milk, thereby meeting the targets in the Food Security Doctrine.⁷

Assessment

Going forward, Russia faces three critical issues. First, under the terms of the WTO the Russian domestic food market, particularly for processed foods, but also for unprocessed meat products, will be more open and less protected. Tariffs are scheduled to decrease and direct production subsidies will be phased out. It will be interesting to see how Russia tries to protect its producers, a

goal that Putin supports, with fewer protective mechanisms. Second, although poultry and pork production is on the rise, the question is whether production can match rising consumer demand. Short-term forecasts are for these imports to rise. Beef imports may increase as well due to rising consumption, while domestic production is stagnant and government programs have not had the desired effect so far. Third, for the foreseeable future, therefore, Russia is likely to remain an importer, not exporter, of meat and animal husbandry products, which means that Russia will continue to spend much more on food imports than it earns from grain exports.

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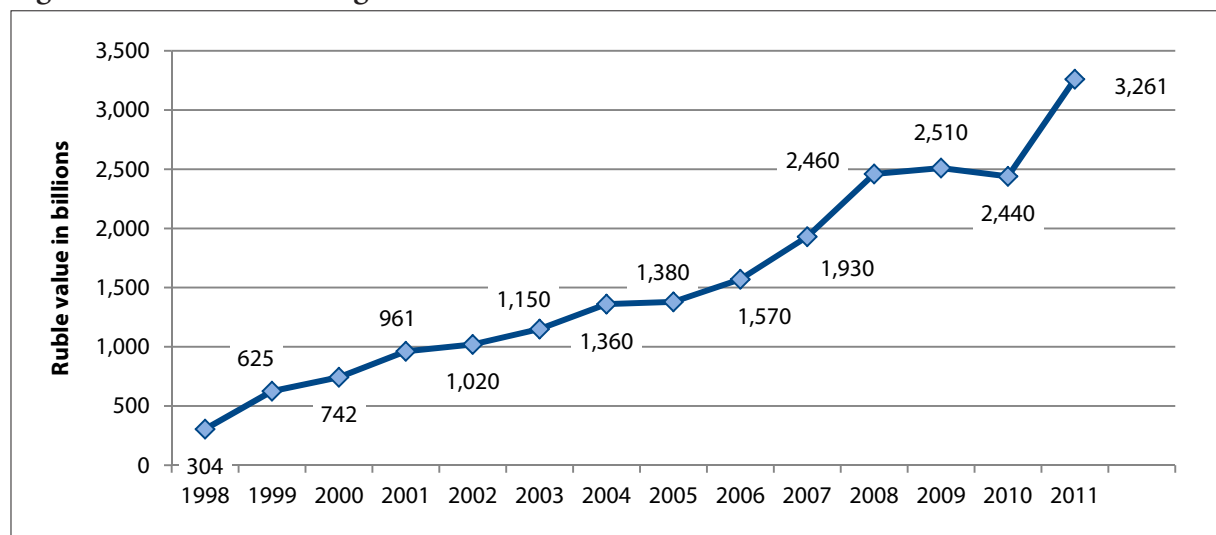
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⁷ *Gosudarstvennaia programma razvitiia sel'skogo khoziaistva i regulirovaniia rynkov sel'skokhoziaistvennoy produktsii, syr'ia i prodovol'stviia na 2013–2020 gody* (Moscow: Ministry of Agriculture of the Russian Federation, 2012), 45–80, www.mcx.ru

TABLES AND GRAPHS

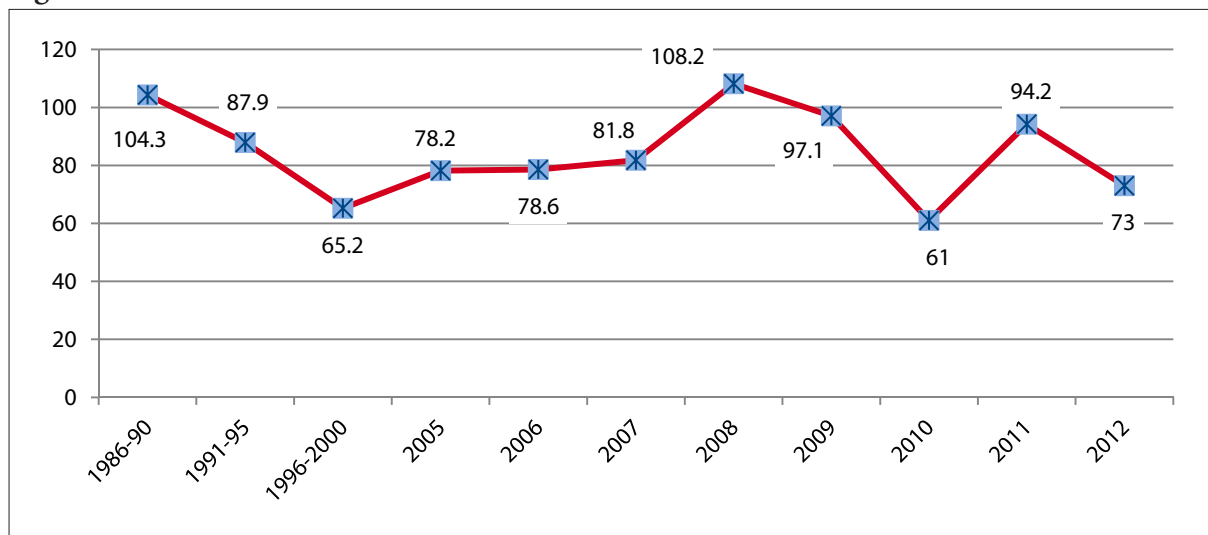
Selected Russian Agricultural Statistics

Figure 1: Ruble Value of Agricultural Production, 1998–2011



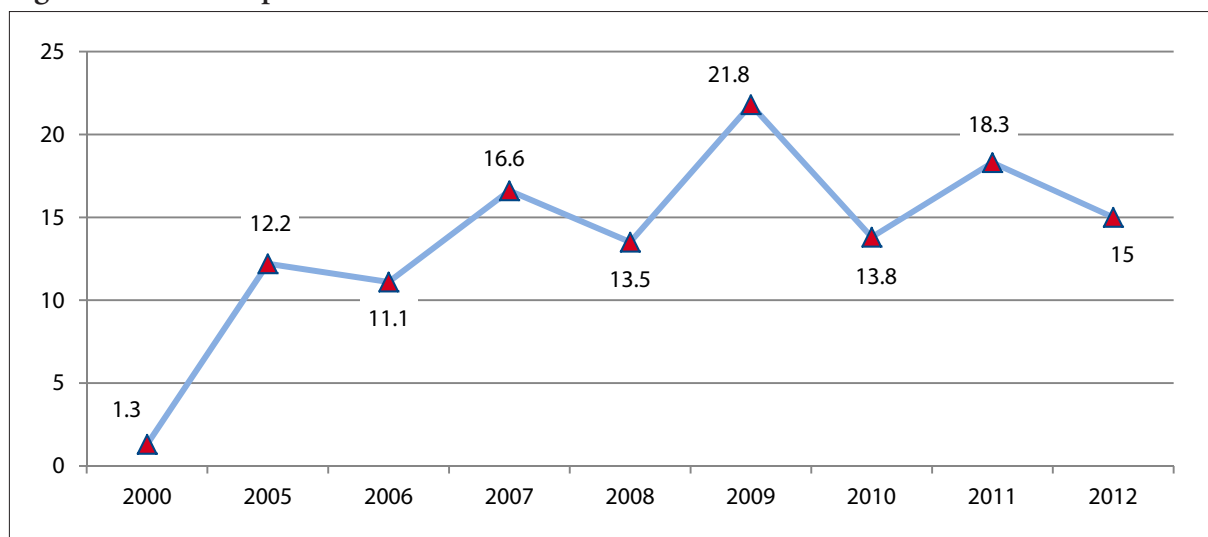
Source: Rossiiskii statisticheskii ezhegodnik (various years).

Figure 2: Grain Production, 1986–2012, in million tons



Source: Rossiiskii statisticheskii ezhegodnik (various years).

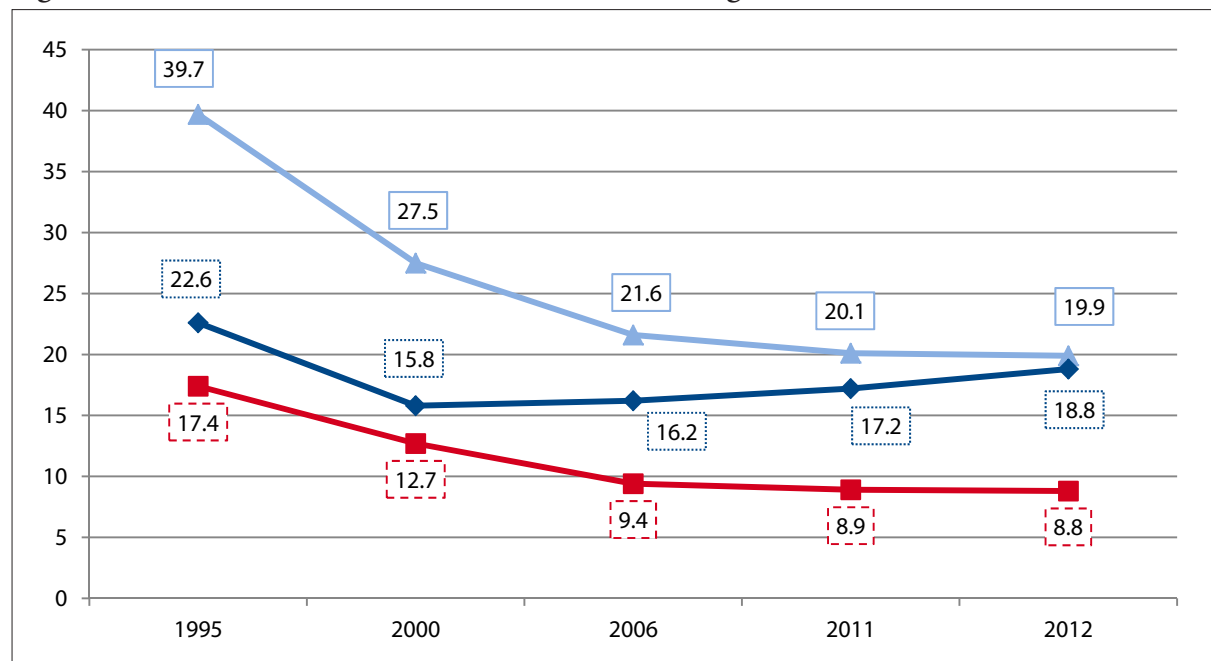
Figure 3: Cereal Exports, 2000–2012, in million tons



All dates are agricultural years (July 1–June 30). Data for 2012 are estimated.

Source: Rossiiskii statisticheskii ezhegodnik (various years).

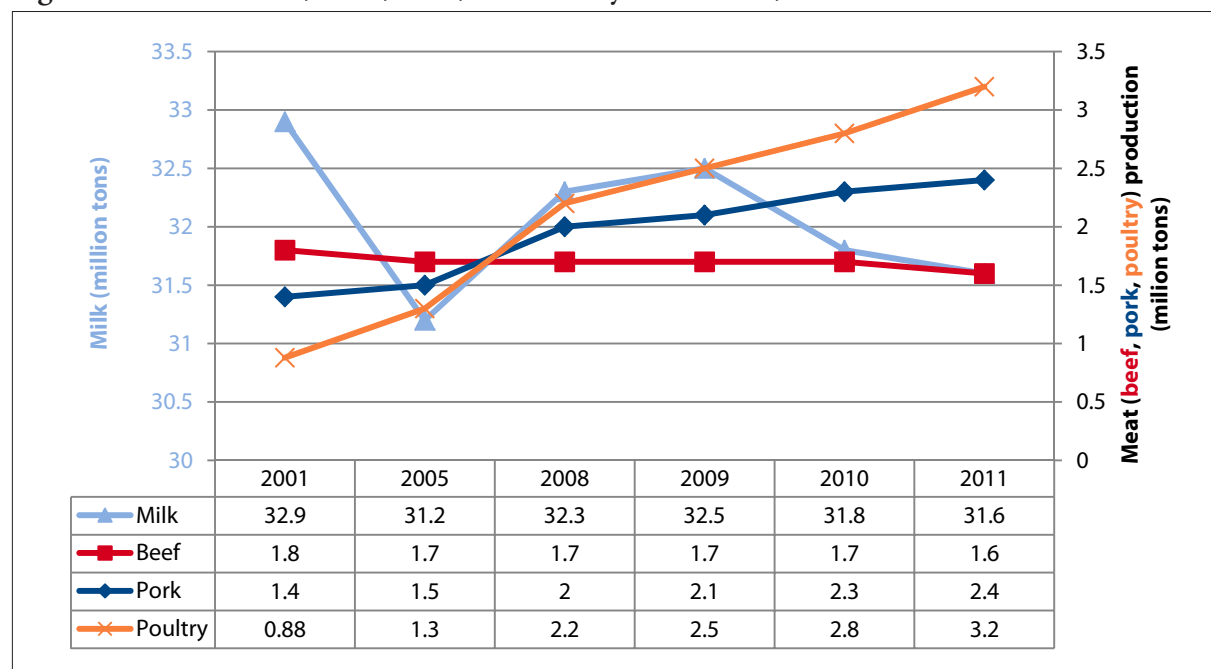
Figure 4: Herd Sizes for Beef Cattle, Milk Cows, and Pigs, 1995–2012 (million head)



Data are for all categories of farms.

Source: Rossiiskii statisticheskii ezhegodnik (various years).

Figure 5: Russian Beef, Milk, Pork, and Poultry Production, 2001–2011

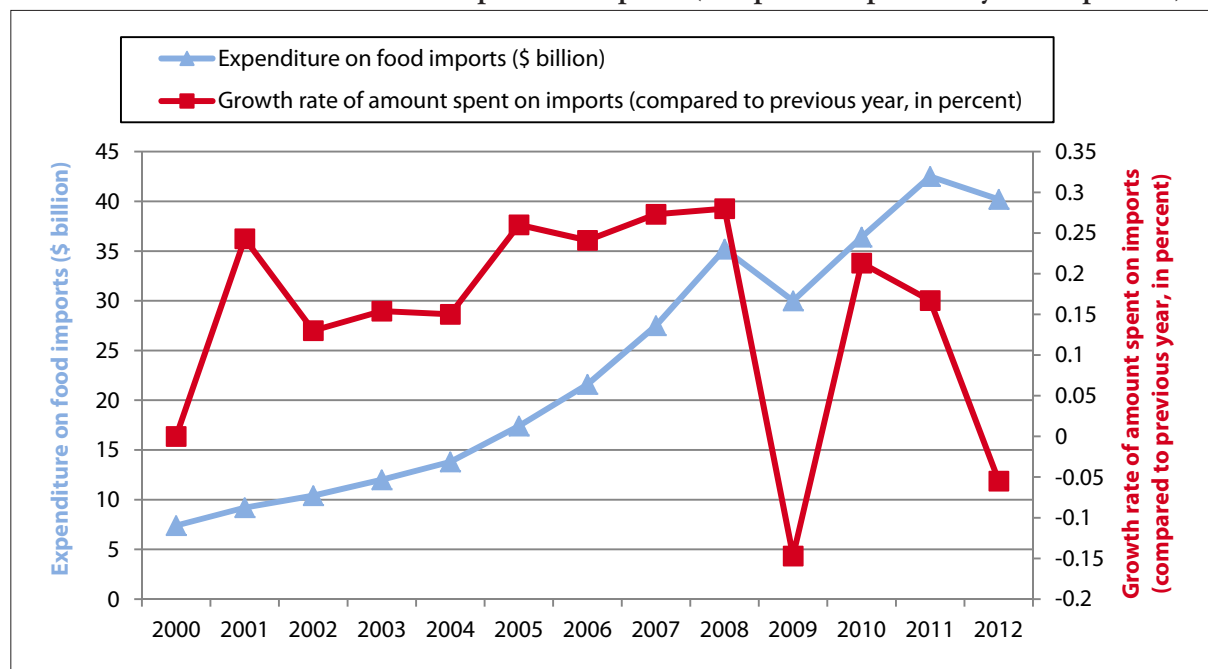


Meat production given as live weight at slaughter, million tons; milk production in million tons.

Data are for all categories of farms.

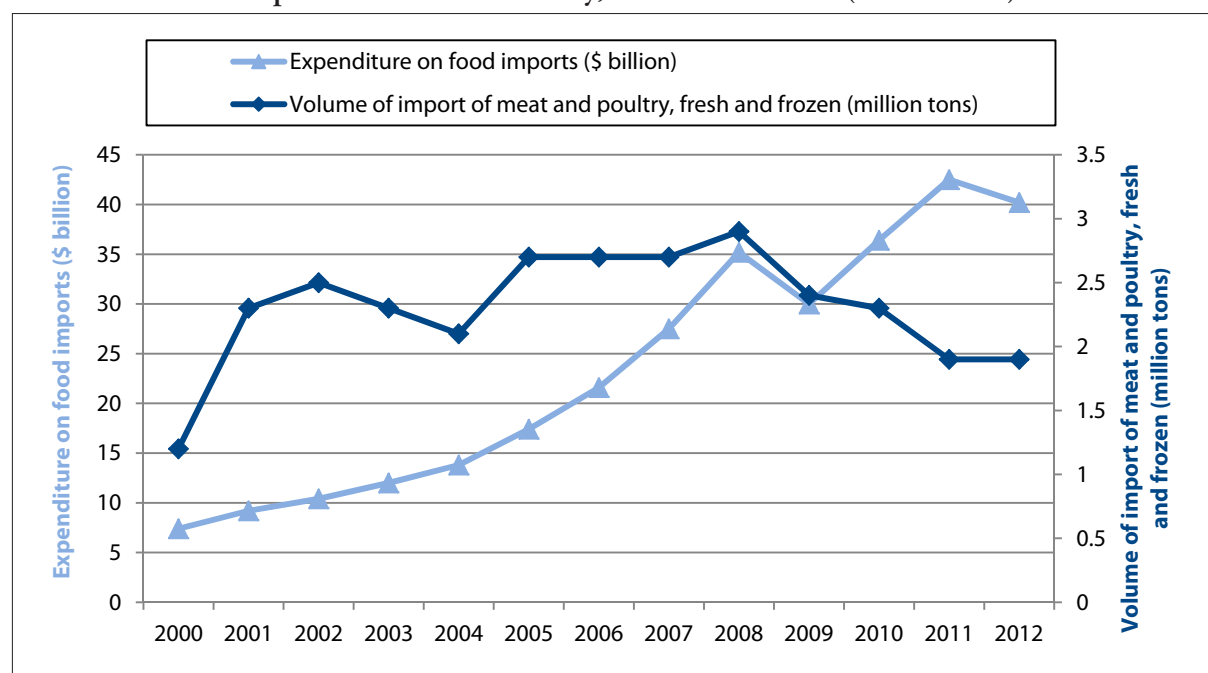
Source: Rossiiskii statisticheskii ezhegodnik (various years).

Figure 6a: Russia's Food Imports, 2000–2012: Expenditure on Food Imports (\$ billion) and Growth Rate of Amount Spent on Imports (compared to previous year, in percent)



Source: Rossiiskii statisticheskii ezhegodnik (various years), and author's calculations.

Figure 6b: Russia's Food Imports, 2000–2012: Expenditure on Food Imports (\$ billion) and Volume of Import of Meat And Poultry, Fresh And Frozen (million tons)



Source: Rossiiskii statisticheskii ezhegodnik (various years), and author's calculations.

Table 1: Russia's Food Imports, 2000–2012

	Expenditure on food imports (\$ billion)	Growth rate of amount spent on imports (compared to previous year, in percent)	Volume of import of meat and poultry, fresh and frozen (million tons)
2000	7.4	–	1.2
2001	9.2	+24.3%	2.3
2002	10.4	+13.0%	2.5
2003	12.0	+15.4%	2.3
2004	13.8	+15.0%	2.1
2005	17.4	+26.0%	2.7
2006	21.6	+24.1%	2.7
2007	27.5	+27.3%	2.7
2008	35.2	+28.0%	2.9
2009	30.0	-14.7%	2.4
2010	36.4	+21.3%	2.3
2011	42.5	+16.7%	1.9
2012	40.2	-5.5%	1.9

Source: Rossiiskii statisticheskii ezhegodnik (various years), and author's calculations.

ABOUT THE RUSSIAN ANALYTICAL DIGEST

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