

RUSSIA

**From a centrally
planned economy
to a free market system**

Russia and the rise of state capitalism



The
Economist

21.1.2012

Reforming the non reformable

- «It is 70 years since the unforgettable days of October 1917, those legendary days that started the count of the new epoch of social progress, of the real history of humankind. The past—its heroism and drama—cannot fail to thrill our contemporaries. Our history is one, and it is irreversible. Whatever emotions it may evoke, it is our history, and we cherish it. Today we turn to those October days that shook the world. We look for and find in them both a dependable spiritual buttress and instructive lessons. We see again and again that the socialist option of the October Revolution has been correct (...).»
- Gorbachev October 1987
- «Optimal combination of centralism and self-management» that required – to be reached - «a more businesslike and a more democratic attitude»
- Gorbachev, October 1987

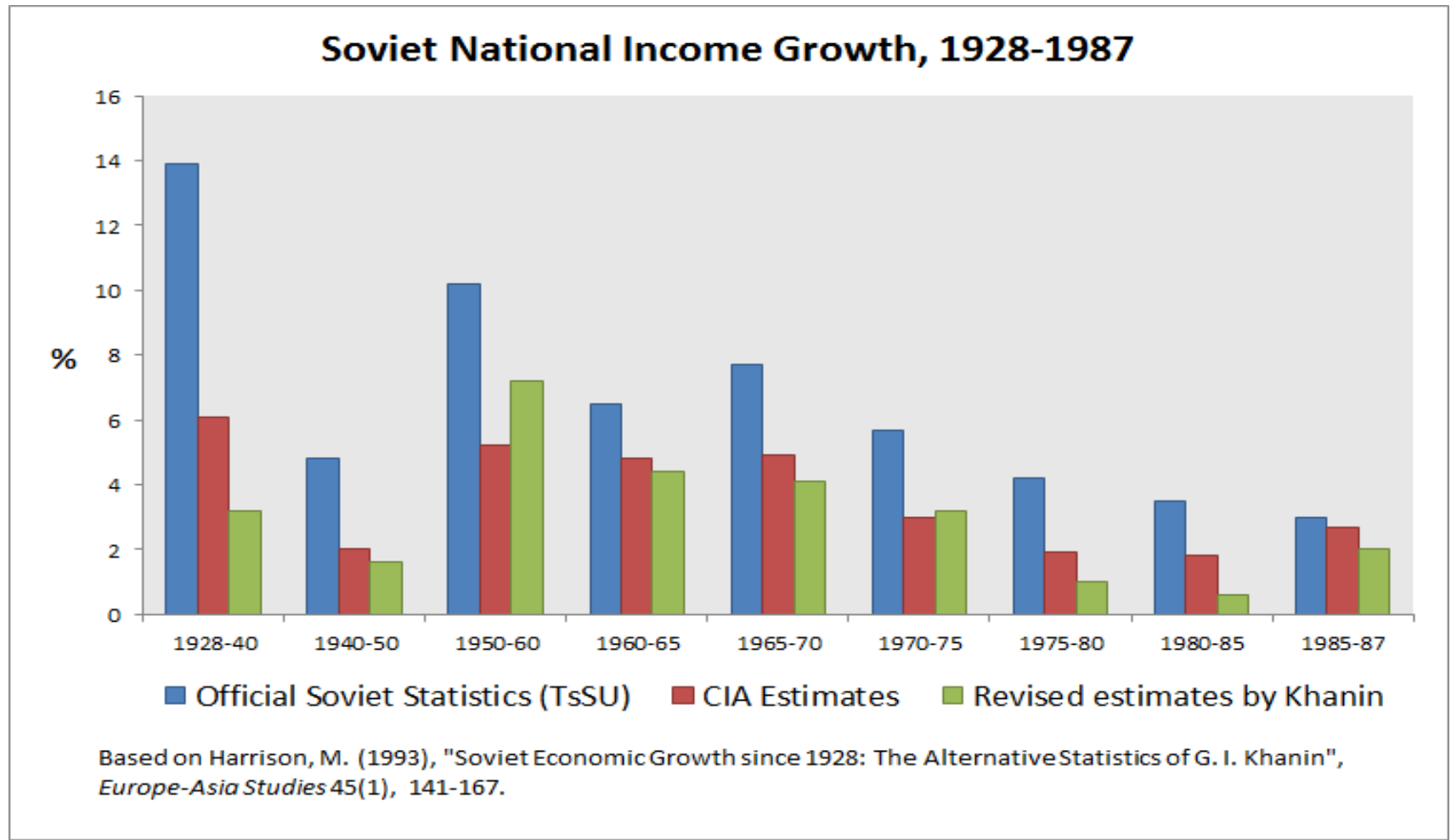
A catch 22 situation

«What can the minister give us? Nothing at all! (...)The devil knows what sort of habit we have got into: everybody keeps waiting for some instructions or other . . . [But] now it really depends on us. We must do our thing.".

«If you have to lose a good factory director to get a good minister, that may be a bad trade»

V. P. Kabaidze, general manager, Ivanova Machine-Tool Building Association (1989)

Soviet statistics revised



The Soviet Union's final years



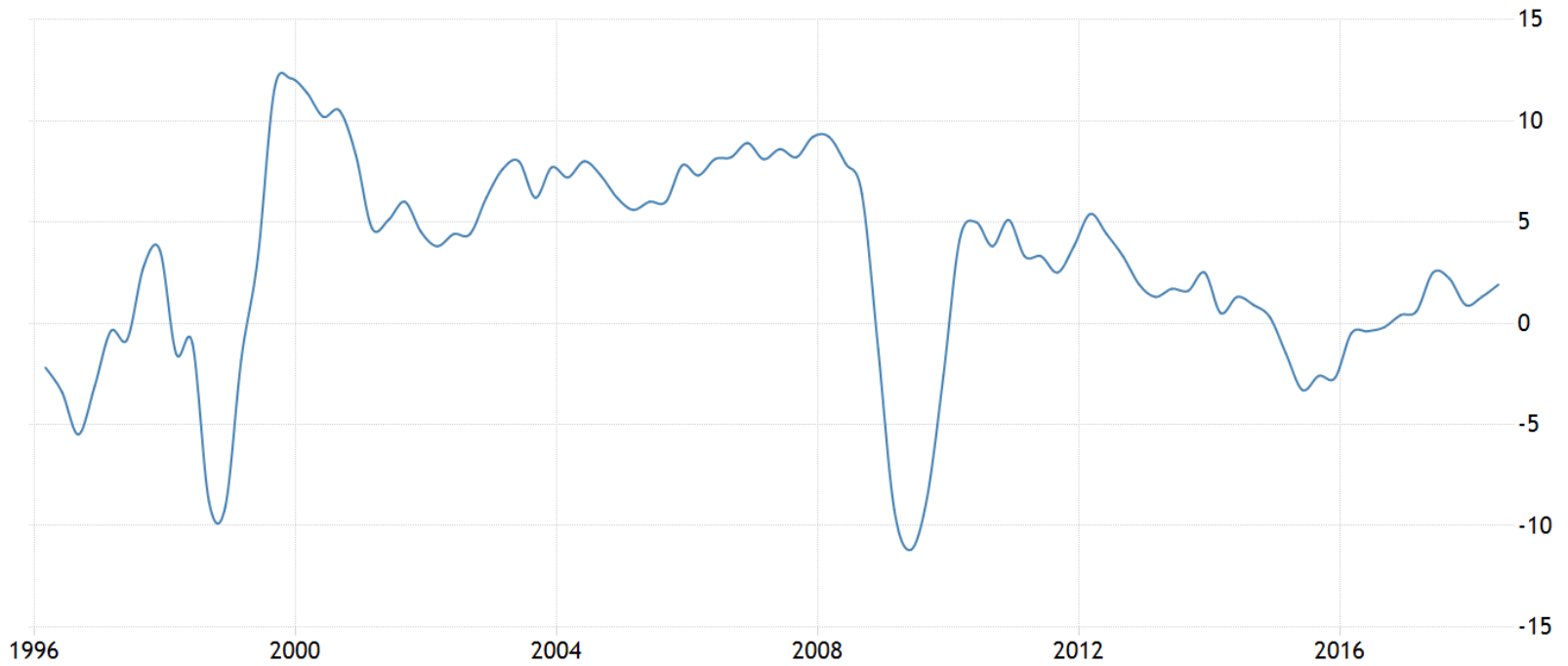
A long and difficult transition



Source: David Horsey, *Seattle Post-Intelligencer*



Russia GDP 1989-2017



SOURCE: [TRADINGECONOMICS.COM](https://tradingeconomics.com) | FEDERAL STATE STATISTICS SERVICE

Russian GDP 1989-2013/15



The (former soviet) gap

- 1991 per capita GDP : \$ 8.210
(close to Ukraine, Argentina, Latvia, and South Africa) =
- 65-70% of Portugal, Greece and Spain; less than 50% of France and Italy; 1/3 of USA

The road to market economy

- The shock therapy (Gaidar)
- The beginning of the (mass) privatization process (10.000 RB – i.e. 25 \$, soon 2\$)
- Loans for shares – Oneximbank (1992)

The results

- Approximately 25–30 percent of citizens sold the vouchers they received, and one-third of these vouchers that were sold went into the hands of foreigners;
- • the sale of shares under certificate-based privatization both directly and through intermediaries—certificate investment funds
- Some 25 million citizens became shareholders in 450 such funds; the certificate investment funds were the first collective investment institution in post-communist Russia;
- The open nature of joint-stock companies created in the course of privatization, which allowed the processes of redistribution of ownership through the free sale of shares to begin.

Table 1 Ownership structure in the Russian industry from different survey data

Unweighted, in per cent

| Survey / Date Owner | Bureau of Economic Analysis (2000) ^a | Russian Economic Barometer ^b (1999) | Blasi ^c (1996) | Nottingham Sample ^d (1995/96) | World Bank Sample ^e (1994) |
|--------------------------------------|--|---|------------------------------|--|--|
| Insiders | 62.3 | 46.2 | 58 | 59.6 | 66.1 |
| Managers | 17.7 | 14.7 | 18 | 14.0 | 19.6 |
| Workers | 34.5 | 31.5 | 40 | 45.6 | 46.2 |
| State | 5.7 | 7.1 | 9 | 9.3 | 15.0 |
| Outsiders | 32.0 | 42.4 | 32.1 | 31.3 | 18.9 |
| Individuals | N.A. | 18.5 | 6 | 6.5 | 5.9 |
| Non-financial firms | N.A. | 13.5 | 15.3 | 10.3 | 6.7 |
| Banks | N.A. | 1.0 | 1.6 | 1.5 | 1.0 |
| Investment funds | N.A. | 3.9 | 5 | 4.6 | 4.5 |
| Foreigners | N.A. | 2.0 | 1.6 | 1.0 | 0.4 |
| Holdings/Investment companies | N.A. | 3.5 | 2.6 | 5.4 | 0.0 |
| Others | 0.0 | 4.3 | 0.9 | 1.7 | 0.0 |
| Sample size | 364 | 139 | 357 | 314 | 235 ¹³ |

The oligarchs, the «piratization» of Russian economy, and Putin



78% Yukos shares
(value \$ 5bn)
for \$ 310 milion

Mickhail Khodorkovsky

- « It is asked, what then should be the relationship with the so-called oligarchs? The same as with anyone else. The same as with the owner of a small bakery or a shoe repair shop»
- Vladimir Putin, January 2000



Boris Berezovsky, Roman Abramovic

Sibneft (value \$ 3 bn) \$100 million

- «When you demand political guarantees for yourselves and for your business from the government –I want to draw your attention to the fact that you built this state yourselves, though a great degree through the political or semi-political structure under your control. So don't blame the reflection of your mirror»

Vladimir Putin, July 2000

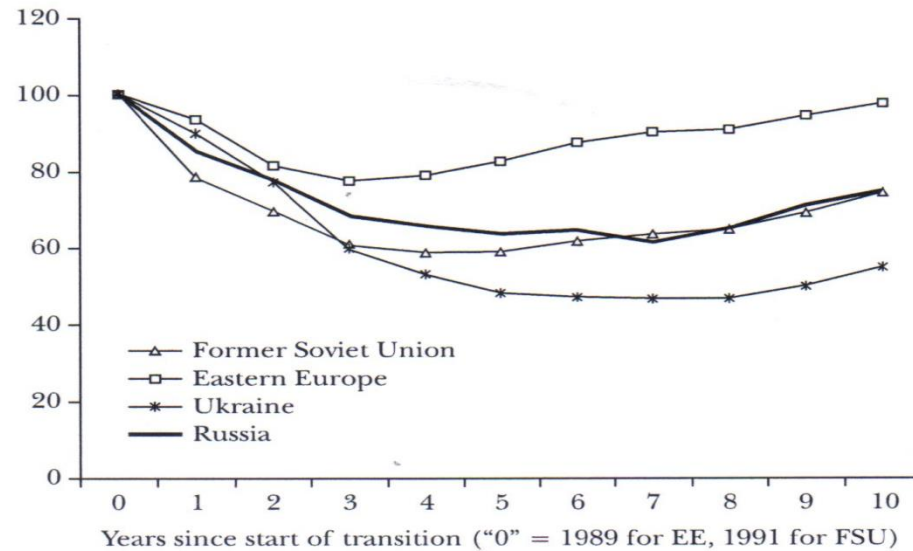
Table 2: Russian Economic Performance Since 1992

| Year | GDP Growth Rate (%) | Inflation Rate (%) |
|------|---------------------|--------------------|
| 1992 | -14.5 | 2,525.0 |
| 1993 | -8.7 | 847.0 |
| 1994 | -12.6 | 223.0 |
| 1995 | -4.1 | 131.0 |
| 1996 | -4.9 | 48.0 |
| 1997 | 0.8 | 11.0 |
| 1998 | -5.0 | 84.0 |
| 1999 | 3.2 | 36.0 |
| 2000 | 9.0 | 20.2 |
| 2001 | 5.5 | 15.0 |
| 2002 | 4.0 | 12.0 |
| 2003 | 7.3 | 13.6 |
| 2004 | 7.1 | 11.7 |
| 2005 | 6.4 | 12.9 |

Recovering...but it takes time

Figure 2

Official GDP Per Capita in Postcommunist Countries, First 10 Years of Transition
(at constant prices)

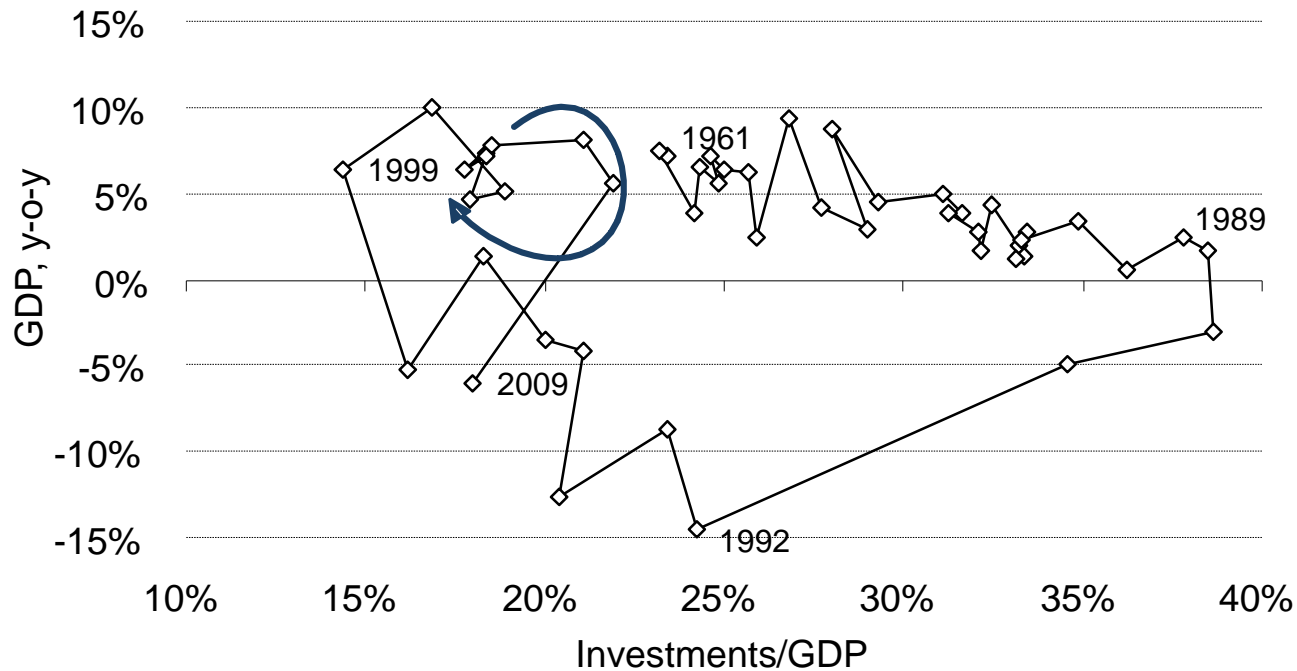


Source: Calculated from World Bank, *World Development Indicators* 2003 and EBRD *Transition Report* 1997. Eastern Europe: unweighted average of Albania, Bulgaria, Hungary, Poland, Romania, Slovakia, Slovenia. Former Soviet Union: unweighted average of Armenia, Belarus, Estonia, Georgia, Kazakhstan, Kyrgyzstan, Latvia, Lithuania, Moldova, Russia, Tajikistan, Turkmenistan, Ukraine, Uzbekistan. Data unavailable for Azerbaijan.

A real “BRIC” country

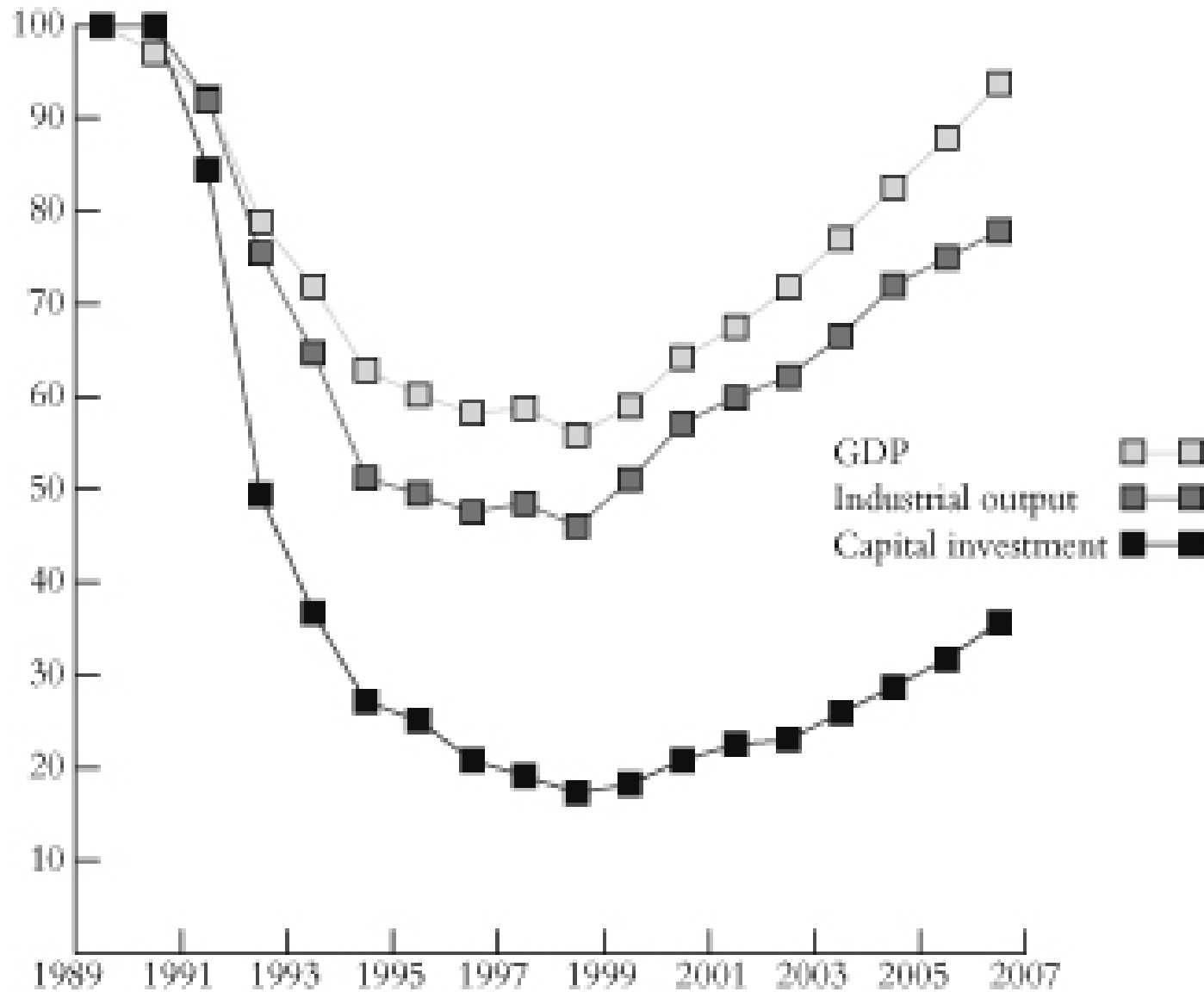


Russia seems returning to more a balanced model of economic development after several years of overheating

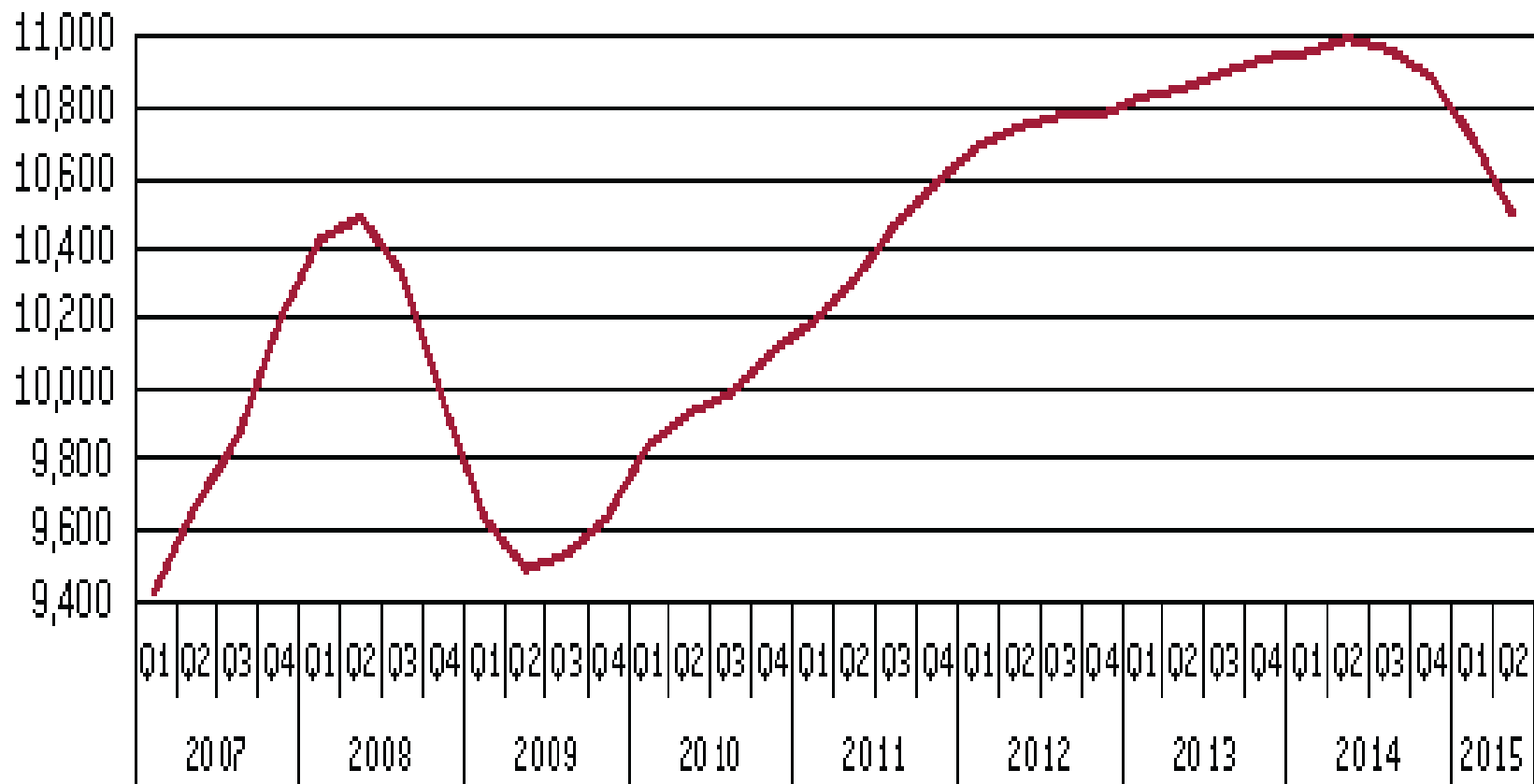


Source: State Statistics Service, Troika estimates

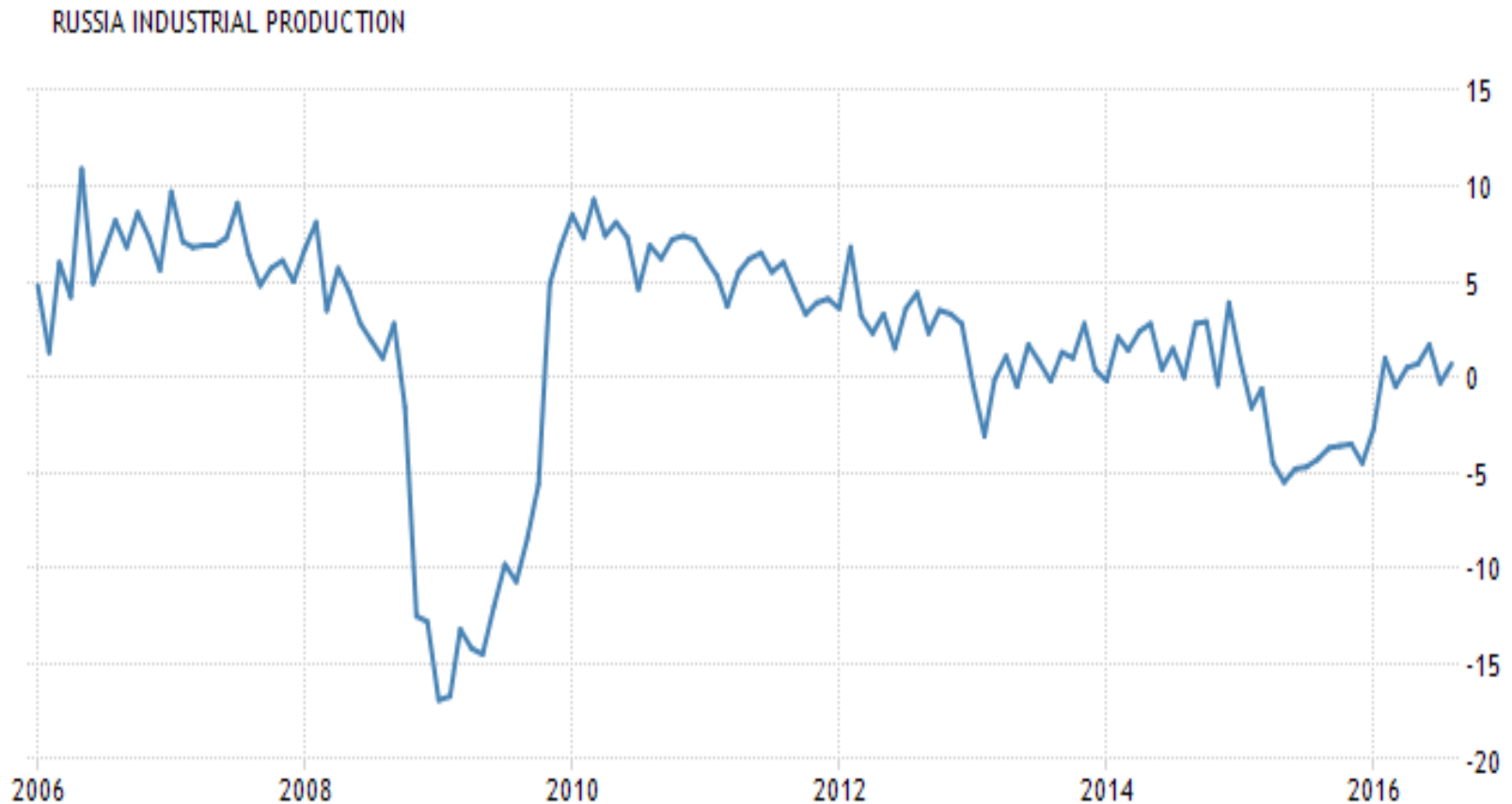
The slow recovery process



The systemic roots of Russia's recession



Russia Industrial Production 2006-2016



SOURCE: WWW.TRADINGECONOMICS.COM | FEDERAL STATE STATISTICS SERVICE

Dutch disease

- The term was coined in 1977 by “The Economist” to describe the decline of the manufacturing sector in the Netherlands after the discovery of a large natural gas field in 1959
- It explains the apparent relationship between the increase in exploitation of natural resources and a decline in the manufacturing sector.
- An increase in revenues from natural resources (or inflows of foreign aid) will make the currency stronger compared to that of other nations, resulting in the nation's other exports becoming more expensive for other countries to buy, making the manufacturing sector less competitive.

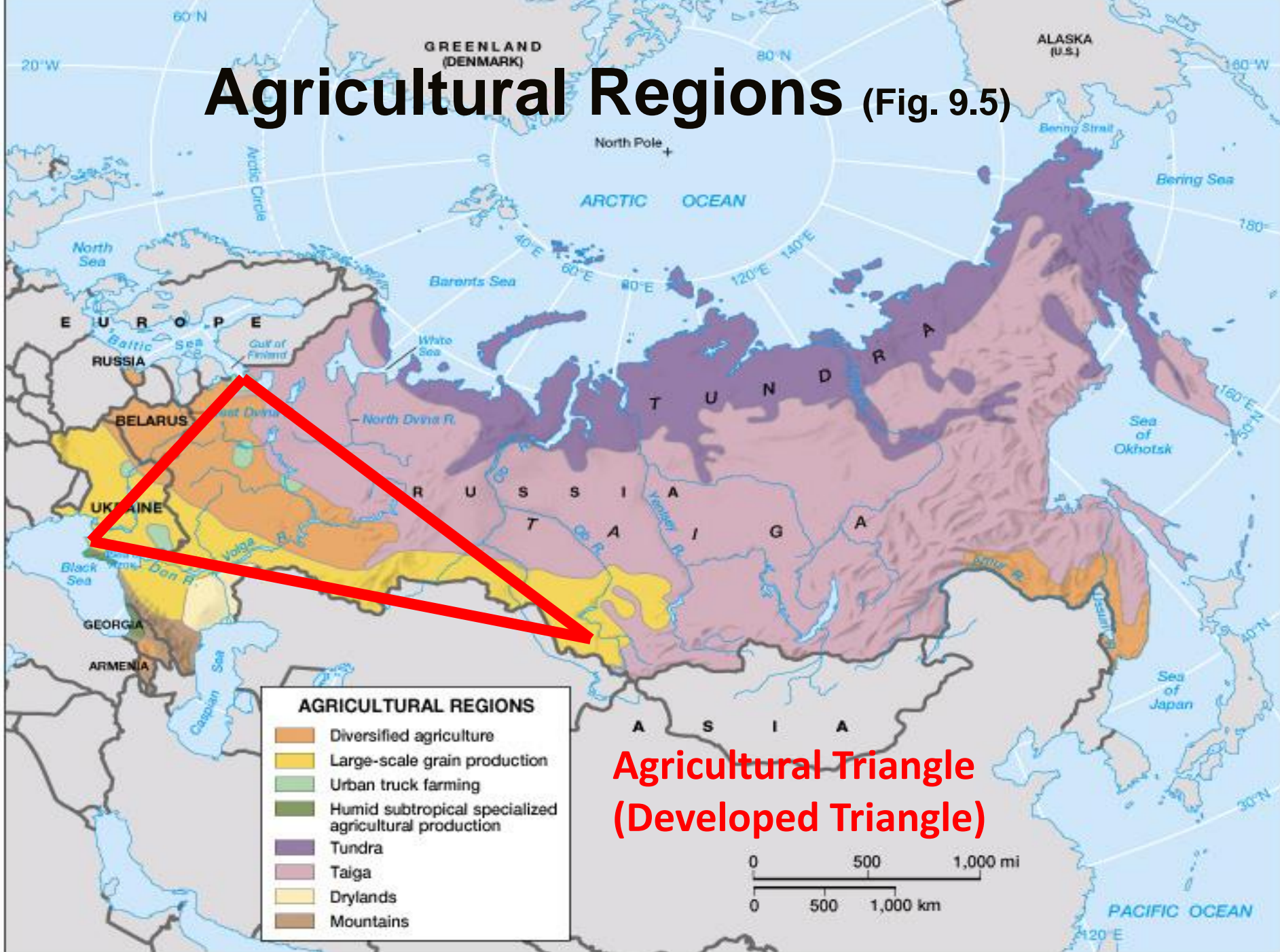
From Ricardo to Dutch disease

- The theory was later developed by Max Corden and J. Peter Neary in 1982
- **direct-deindustrialization**: The "spending effect" occurs as a result of the extra revenue brought in by the resource boom. It increases the demand for labor in the non-tradable, shifting labor away from the lagging sector
- In simple trade models, a country ought to specialize in industries that it has a comparative advantage in, so theoretically a country rich in natural resources would be better off specializing in the extraction of natural resources. In reality, however, the shift away from manufacturing can be detrimental.

**14.3. PRODUCTION INDICES
BY KINDS OF ECONOMIC ACTIVITIES
(1991=100)**

| | 1992 | 1995 | 2000 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2010 percentage of 2009 |
|--|------|------|------|-------|-------|-------|-------|-------|-------|----------------------------------|
| Mining and quarrying ¹⁾ | 88.2 | 70.7 | 74.3 | 99.1 | 101.8 | 105.2 | 105.6 | 105.0 | 108.8 | 103.6 |
| mining and quarrying of energy producing materials | 94.7 | 77.8 | 80.7 | 111.4 | 114.4 | 117.4 | 117.6 | 118.0 | 121.7 | 103.1 |
| mining and quarrying, except of energy producing materials | 71.0 | 52.1 | 60.1 | 62.2 | 64.8 | 67.4 | 68.2 | 63.1 | 67.7 | 107.3 |
| Manufacturing ¹⁾ | 81.8 | 47.5 | 50.9 | 68.9 | 74.7 | 82.5 | 82.9 | 70.3 | 78.6 | 111.8 |
| manufacture of food products, including beverages and tobacco | 80.0 | 50.2 | 54.6 | 75.2 | 80.7 | 86.6 | 88.3 | 87.7 | 92.5 | 105.4 |
| manufacture of textile and textile products | 71.9 | 22.0 | 23.4 | 24.8 | 27.7 | 27.6 | 26.1 | 21.9 | 24.5 | 112.1 |
| manufacture of leather, leather products and footwear | 78.0 | 20.8 | 15.3 | 21.5 | 26.2 | 26.9 | 26.8 | 26.7 | 31.7 | 118.7 |
| manufacture of wood and wood products | 78.7 | 40.7 | 37.4 | 48.5 | 50.3 | 54.3 | 54.2 | 43.0 | 47.9 | 111.4 |
| manufacture of pulp, paper and paper products; publishing and printing | 88.0 | 62.7 | 81.1 | 108.7 | 116.0 | 125.6 | 126.0 | 107.9 | 114.3 | 105.9 |
| manufacture of coke, refined petroleum products and nuclear fuel | 82.8 | 62.3 | 60.2 | 70.8 | 75.4 | 77.5 | 79.7 | 79.2 | 83.2 | 105.0 |
| manufacture of chemicals, chemical products and man-made fibers | 79.0 | 54.7 | 69.7 | 81.9 | 85.7 | 91.4 | 87.2 | 81.2 | 93.0 | 114.6 |
| manufacture of rubber and plastic products | 79.5 | 38.5 | 52.5 | 74.5 | 90.2 | 113.2 | 139.0 | 121.5 | 147.6 | 121.5 |
| manufacture of other non-metallic mineral products | 80.9 | 46.9 | 40.3 | 51.7 | 59.0 | 63.9 | 62.0 | 45.0 | 49.8 | 110.7 |
| manufacture of basic metals and fabricated metal products | 82.3 | 57.6 | 66.8 | 87.5 | 96.0 | 100.3 | 98.1 | 83.7 | 94.0 | 112.4 |
| manufacture of machinery and equipment | 84.4 | 38.1 | 32.3 | 44.9 | 50.2 | 63.6 | 63.3 | 43.3 | 48.6 | 112.2 |
| manufacture of electrical, electronic and optical equipment | 79.8 | 37.3 | 45.2 | 116.1 | 133.5 | 148.1 | 137.1 | 93.0 | 114.2 | 122.8 |
| manufacture of transport equipment | 85.3 | 45.0 | 53.1 | 52.7 | 55.1 | 59.4 | 59.7 | 37.5 | 49.6 | 132.2 |

Agricultural Regions (Fig. 9.5)



Major Natural Resources and Industrial Zones



Ownership Structure

Still highly concentrated

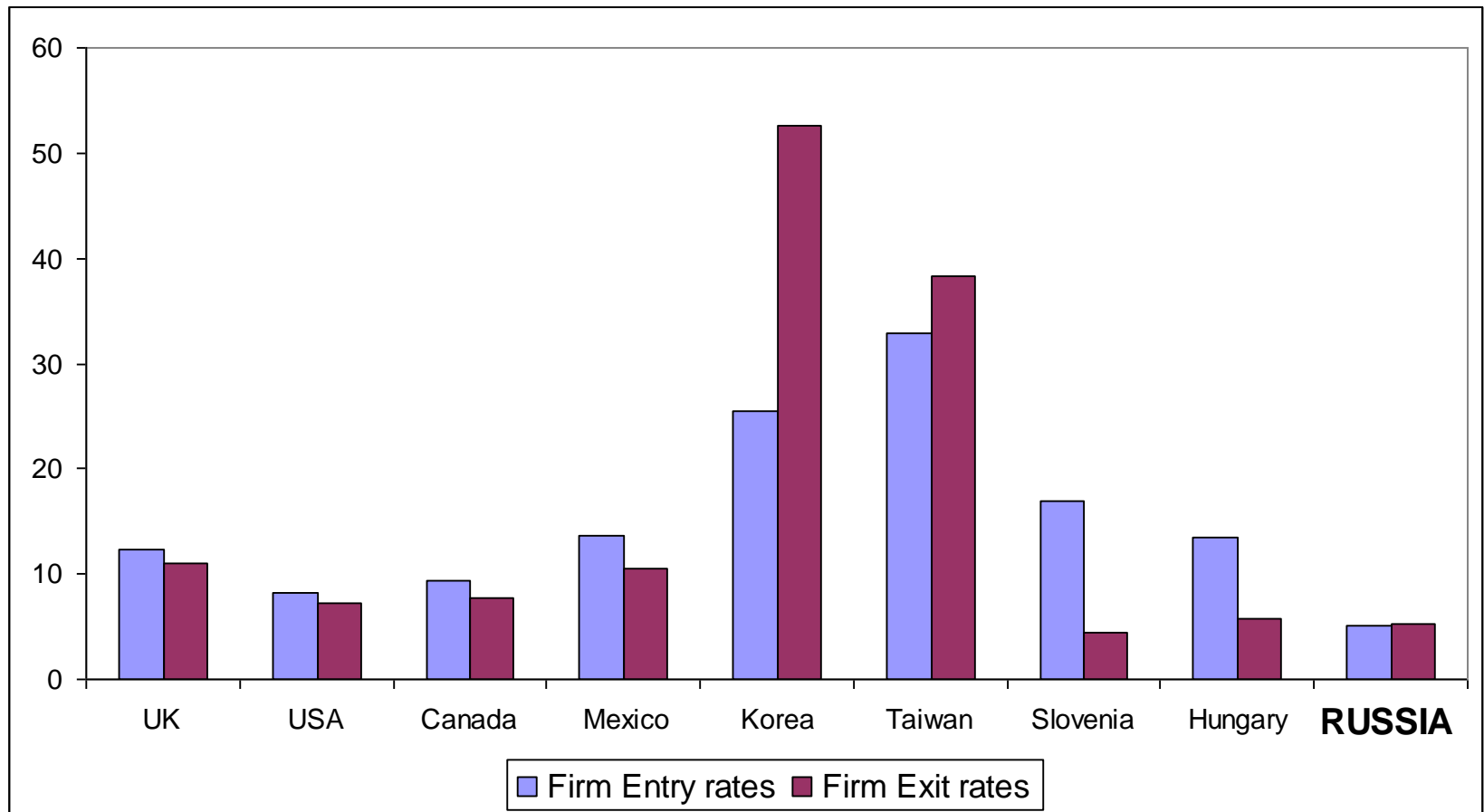
Table 4. Ownership Structure of Companies in Different Sectors (% of companies in the given sector)

| | State owns >50% | State owns 25%- 50% | Largest private shareholder owns >75% | Largest private shareholder owns 50%-75% |
|-----------------------------------|--------------------|------------------------|---|--|
| Machine engineering | 33% | 0% | 17% | 17% |
| Oil and gas | 43% | 14% | 0% | 29% |
| Food | 0% | 0% | 40% | 40% |
| Retail trade | 0% | 0% | 0% | 100% |
| Construction | 0% | 0% | 50% | 50% |
| Telecommunications and IT | 43% | 14% | 0% | 43% |
| Transport | 50% | 33% | 0% | 33% |
| Coal and metallurgy | 0% | 0% | 50% | 31% |
| Management and financial services | 0% | 33% | 0% | 33% |
| Chemistry and petroleum chemistry | 25% | 0% | 13% | 50% |
| Power engineering | 67% | 22% | 0% | 11% |

The sample includes all 78 companies for which the quality measure of corporate governance (NCGS) is available.

Firm turnover plays a smaller role than in other advanced economies

In advanced market economies 5-20 percent of firms enter and exit the market every year. In Russia, only about 5 percent of firms were created or destroyed during the last decade



Foreign Direct Investments (1994-2006)

Chart 3: Net FDI per capita

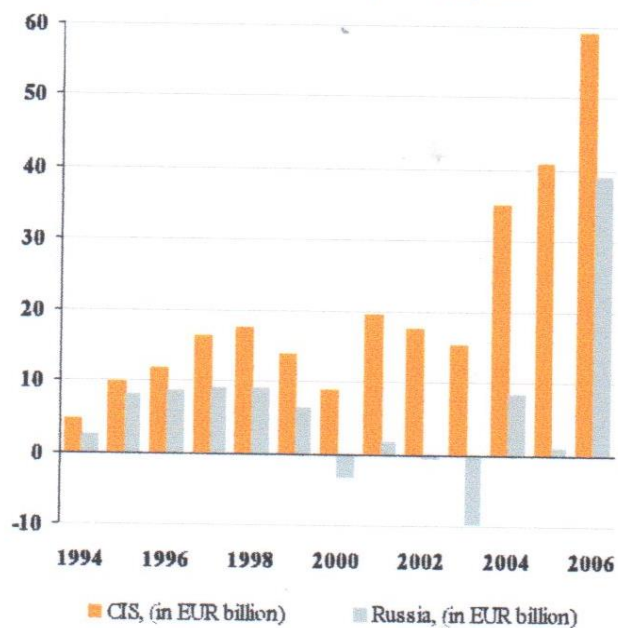
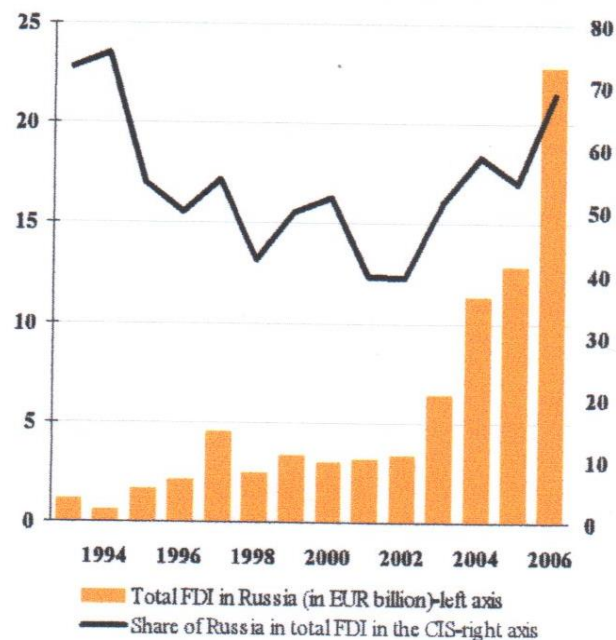


Chart 4: Total FDI in Russia



Source: WDI, UNECE, Central Bank of Russia (CBR) and Author's calculations.

Table 1: Origins of foreign investment inflows into Russia (%)

| | 1995 | 2000 | 2002 | 2003 | 2004 | 2005 | 2006 | 3Q2007 |
|----------------------------|------|------|------|------|------|------|------|--------|
| UK | 6 | 6 | 12 | 16 | 17 | 16 | 13 | 24 |
| Netherlands | 3 | 11 | 6 | 6 | 13 | 17 | 12 | 20 |
| Cyprus | 1 | 13 | 12 | 14 | 14 | 10 | 18 | 14 |
| Luxembourg | 0 | 2 | 6 | 8 | 21 | 26 | 11 | 9 |
| France | 4 | 7 | 6 | 13 | 6 | 3 | 6 | 5 |
| Germany | 10 | 13 | 20 | 15 | 4 | 6 | 9 | 4 |
| Virgin Islands (UK) | 1 | 1 | 7 | 5 | 2 | 2 | 4 | 2 |
| Switzerland | 15 | 7 | 7 | 4 | 4 | 4 | 4 | 9 |
| USA | 28 | 15 | 6 | 4 | 5 | 3 | 3 | 2 |
| Others | 33 | 25 | 19 | 17 | 15 | 15 | 28 | 23 |

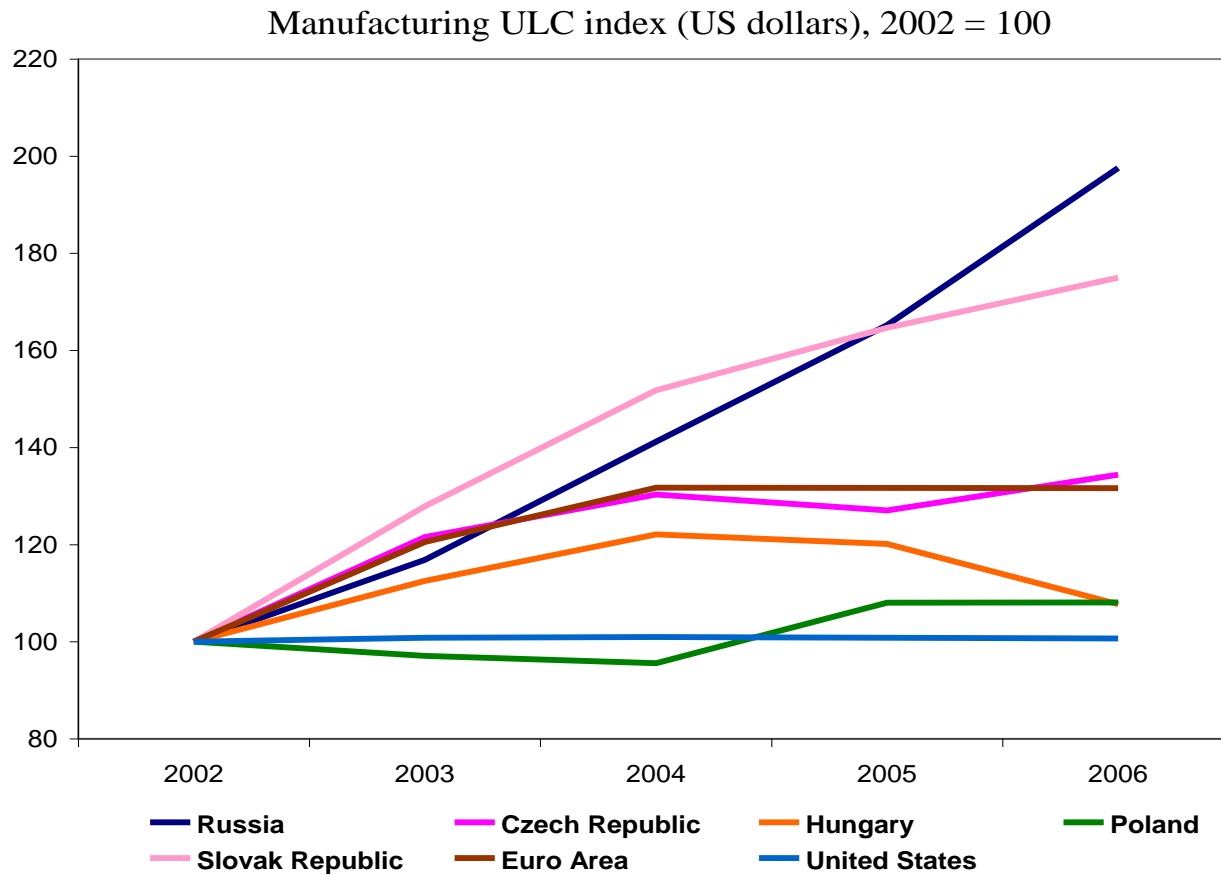
Source: Rosstat and author's calculations.

Table 2: Destinations of foreign investment inflows into Russia (%)

| | 2003 | 2004 | 2005 | 2006 | 3Q2007 |
|--|-------------|-------------|-------------|-------------|-------------|
| Agriculture, Hunting and Forestry | 0.5 | 0.3 | 0.2 | 0.6 | 0.3 |
| Mining and Quarrying | 19.3 | 24.5 | 11.2 | 16.6 | 17.3 |
| <i>mining and quarrying of energy producing products</i> | 17.3 | 21.6 | 9.6 | 14.1 | 16.0 |
| <i>mining and quarrying, except of energy producing products</i> | 2.0 | 2.9 | 1.6 | 2.5 | 1.3 |
| Manufacturing | 22 | 25.3 | 33.5 | 27.5 | 24.6 |
| <i>manufacture of food products</i> | 3.4 | 2.3 | 2.2 | 2.5 | 2.5 |
| <i>manufacture of chemicals and chemical products</i> | 1.2 | 1.9 | 2.7 | 2.8 | 1.2 |
| <i>manufacture of metals and fabricated metal products</i> | 10.3 | 12.6 | 6.4 | 6.8 | 12.6 |
| <i>manufacture of transport equipment</i> | 0.7 | 2.1 | 1.8 | 2.6 | 0.9 |
| <i>manufacture of coke and mineral oil</i> | 0.6 | 0.2 | 15.1 | 7.2 | 3.8 |
| Services | 58.2 | 49.9 | 55.1 | 55.3 | 57.8 |
| <i>construction</i> | 0.3 | 0.6 | 0.4 | 1.3 | 1.2 |
| <i>wholesale, retail, repair activities</i> | 36.1 | 32.9 | 38.2 | 23.7 | 42.3 |
| <i>transport and communication</i> | 3.8 | 5 | 7.2 | 9.6 | 6.5 |
| <i>of which communication only</i> | 2.3 | 3.4 | 6.1 | 8.5 | 2.9 |
| <i>financial intermediation</i> | 2.6 | 2.5 | 3.4 | 8.5 | 2.4 |

Source: Rosstat and author's calculations.

Salaries dynamics



– Globalization and Russia's Petroleum Economy

- Russia has 35% of the world's natural gas reserves
 - Mostly in Siberia
 - World's largest gas exporter



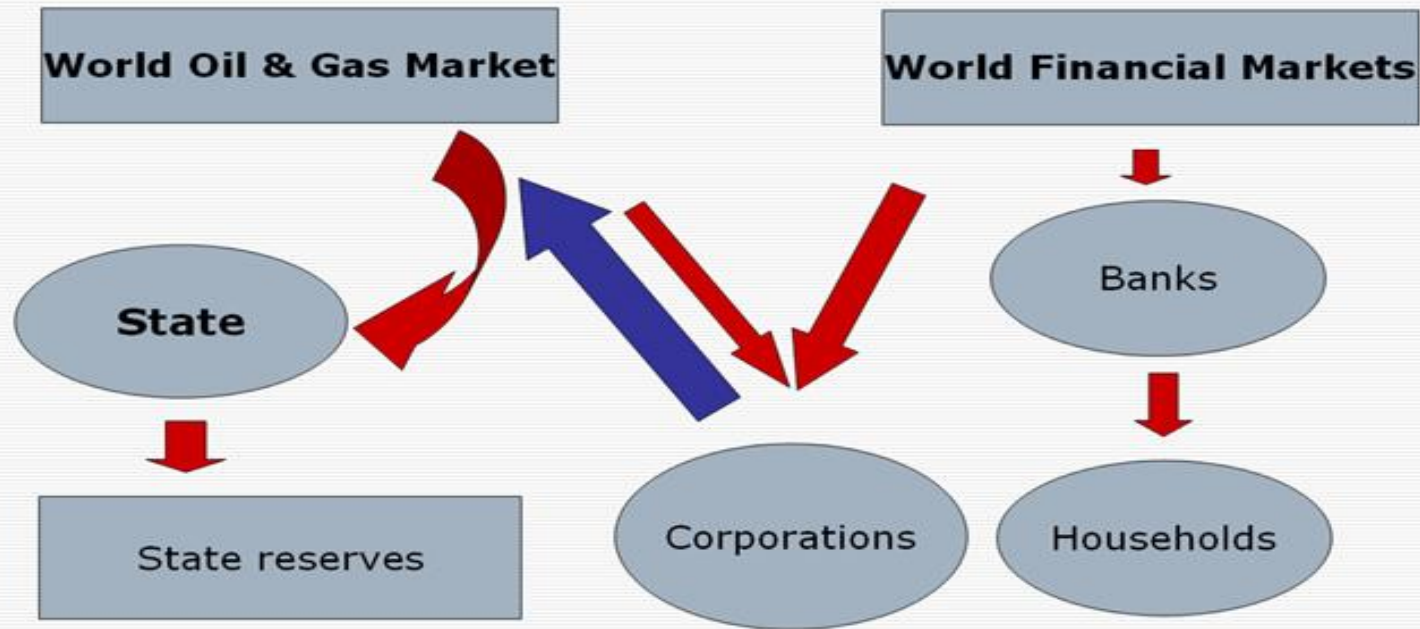
- Primary destination for Russian petroleum products is western Europe
 - Former U.S.S.R. republics depend on Russia's energy
 - Foreign investment in new pipelines, other technology

– Local impacts of globalization

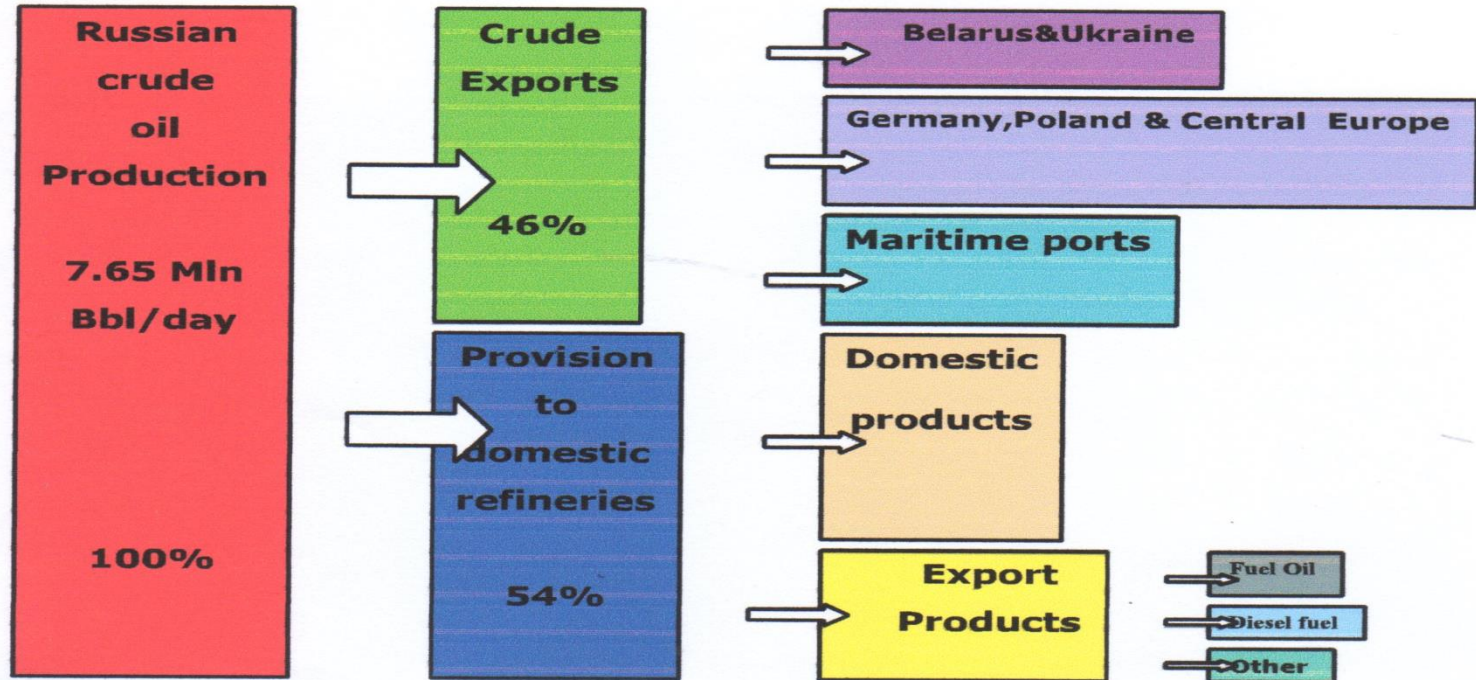
- Vary from place to place
 - Investment in Moscow, Siberia (oil)
 - Local economic declines in older, uncompetitive industrial areas



The Growth model of 2000-2008

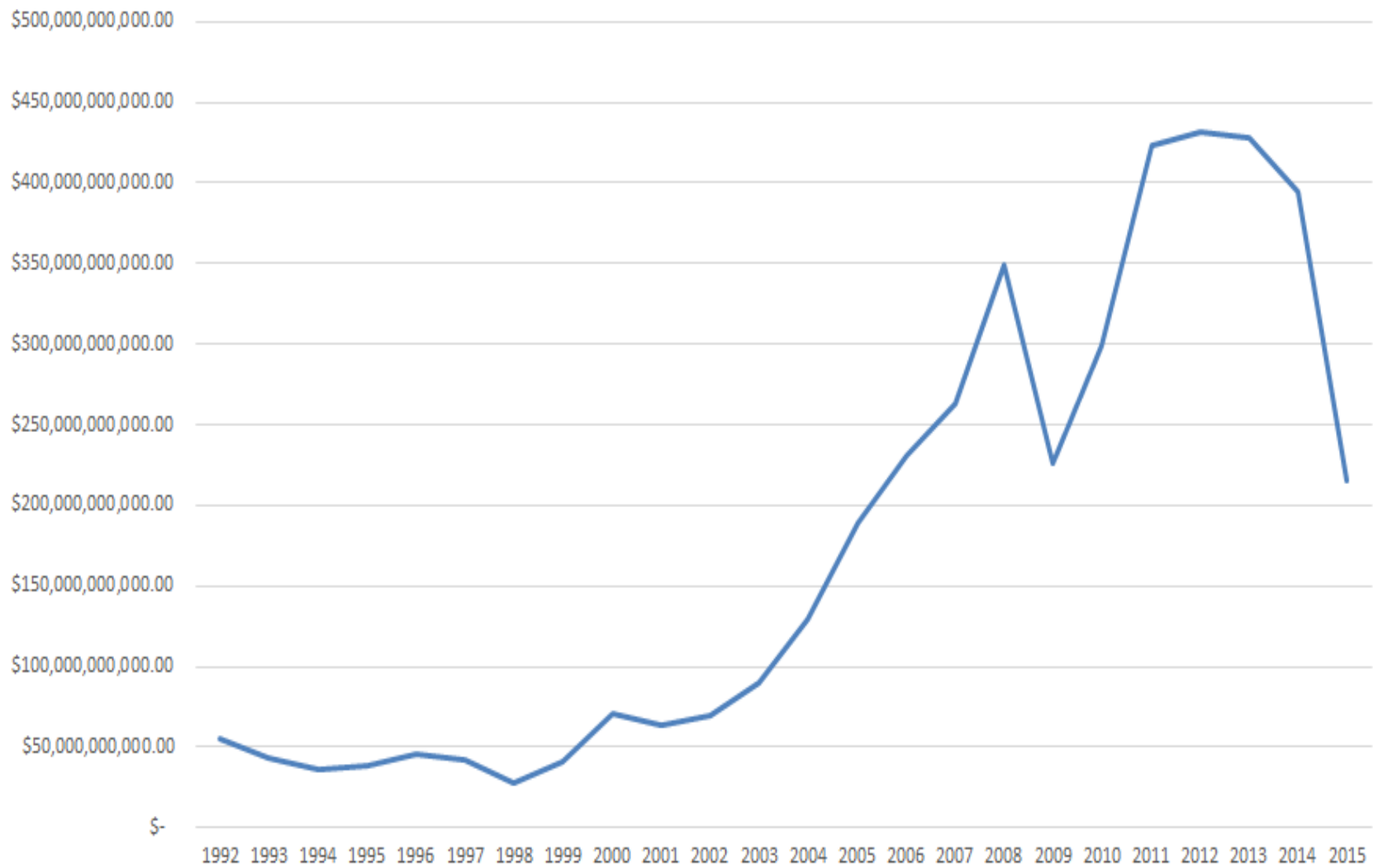


The oil driven economic model



The oil and gas sectors in Russia account for more than 30% of total government revenues. Such strong dependence on resource revenues is a common characteristic of resource-rich countries.

Russian Oil Earnings 1992-2015*



Oil prices growth & GDP growth



Exporting oil, OK, but where

Russia crude oil and condensate exports by destination (2016)

thousand barrels per day

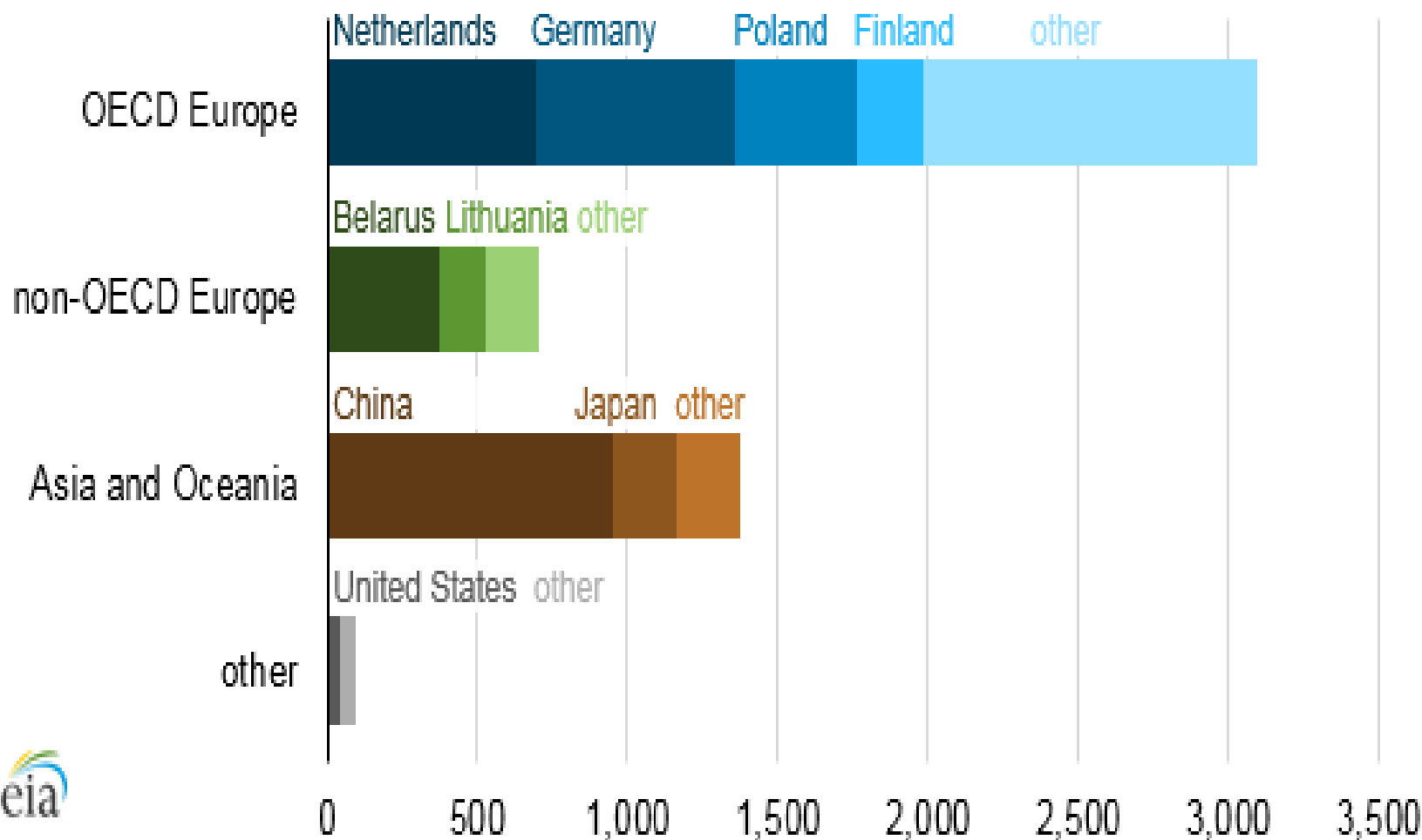
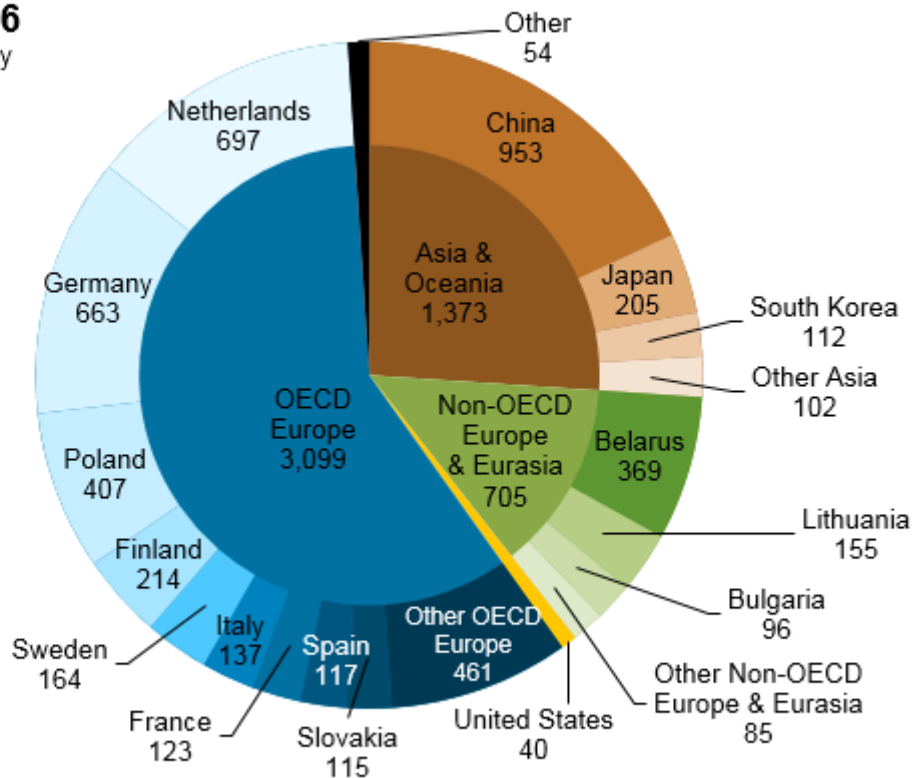

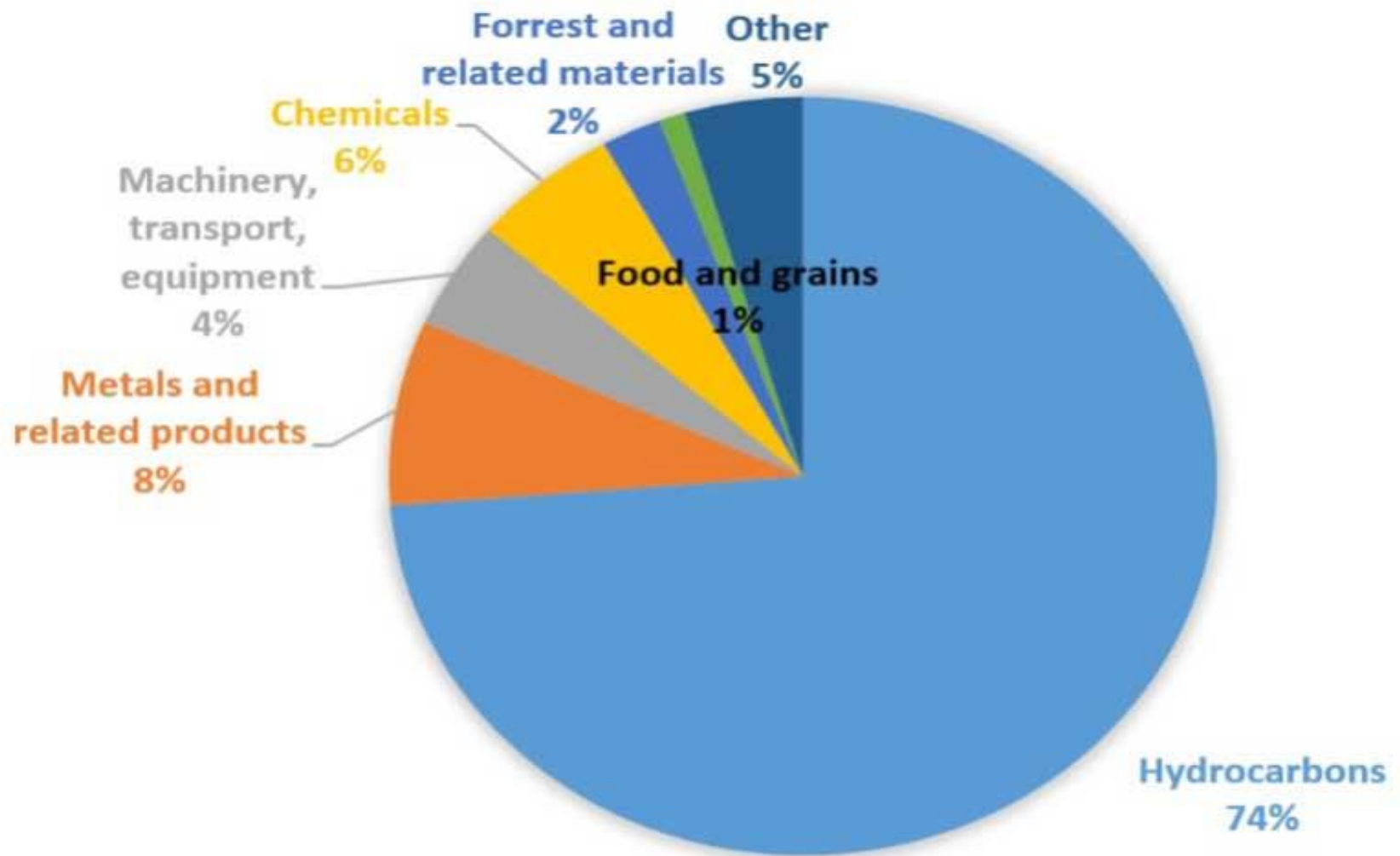


Figure 3. Russia's crude oil and condensate exports by destination, 2016
 thousand barrels per day

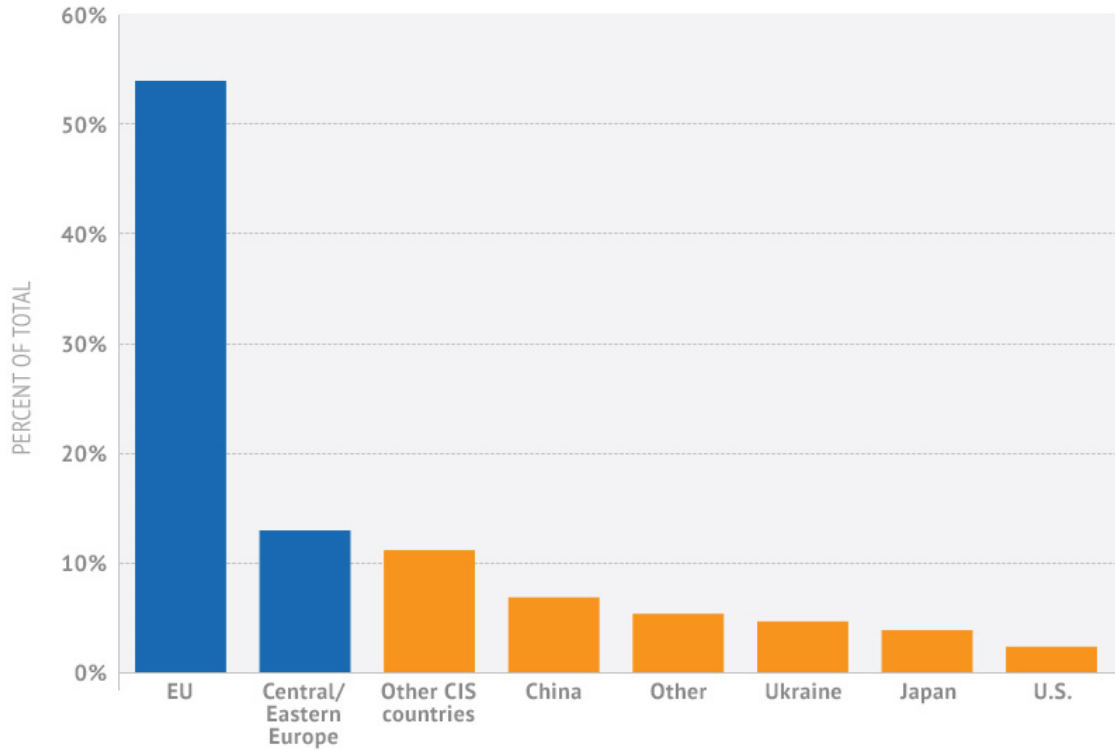


 Source: U.S. Energy Information Administration based on Russian export statistics and partner country import statistics, Global Trade Tracker

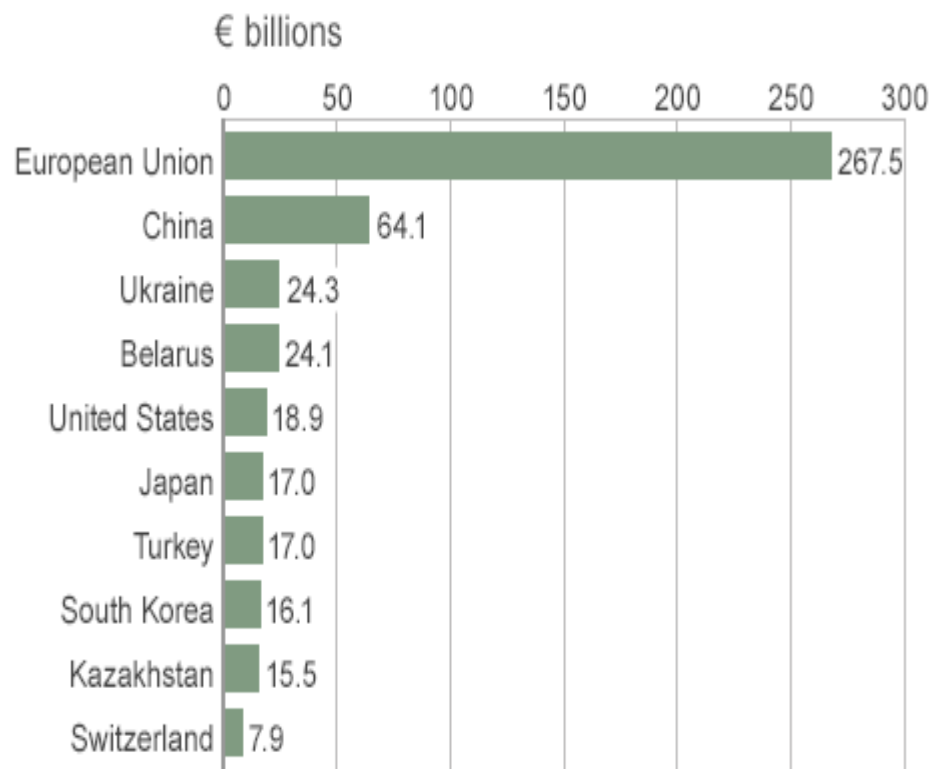
The structure of Russia's Exports 2014



RUSSIAN EXPORT DESTINATIONS

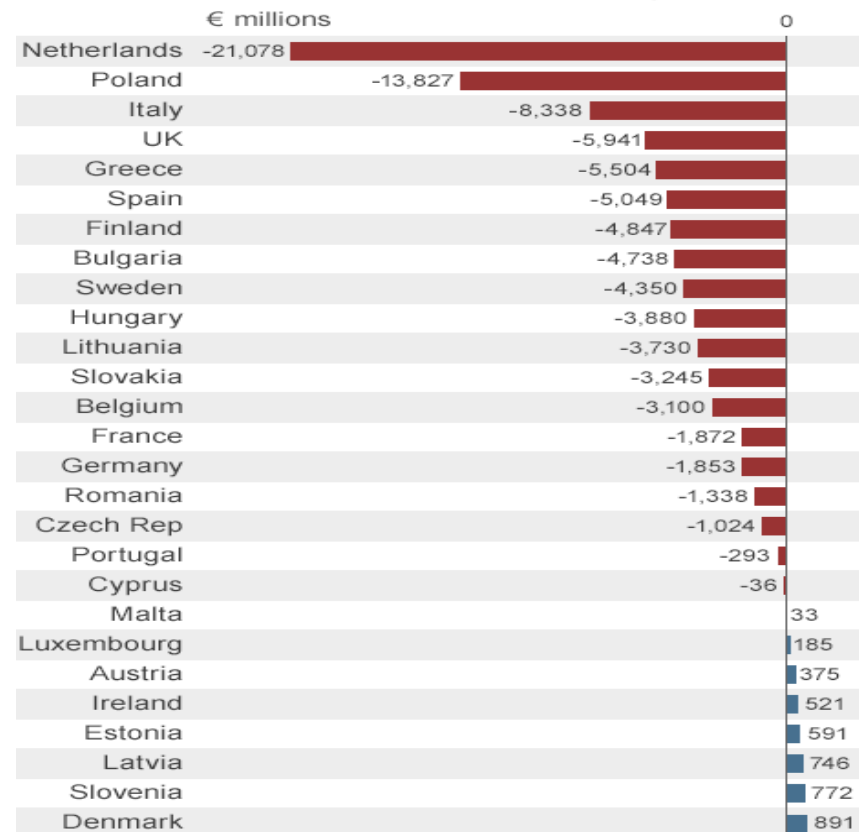


Russia's top trading partners 2012



Source: Eurostat

EU countries' trade balance with Russia, 2012

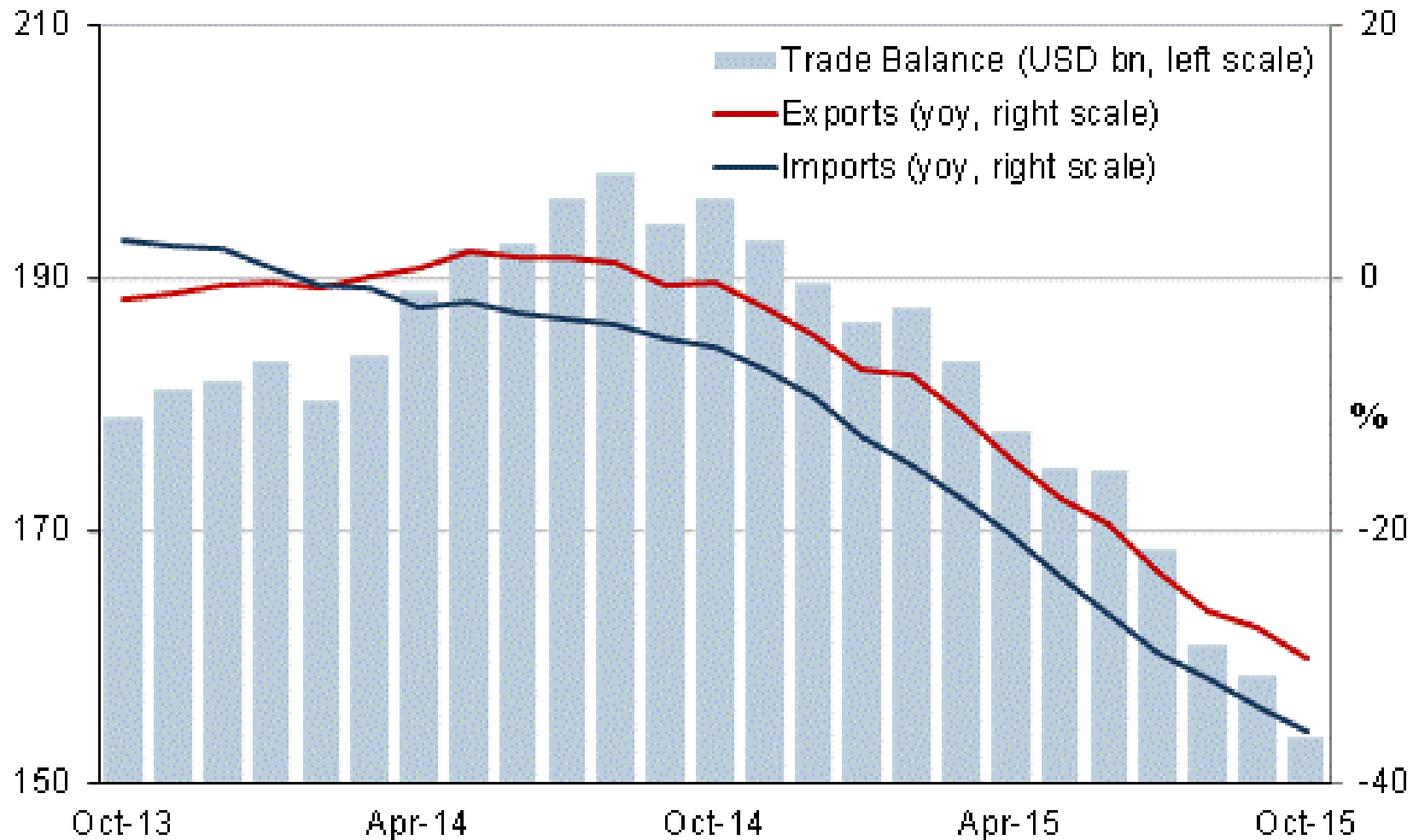


A negative figure shows more imports than exports

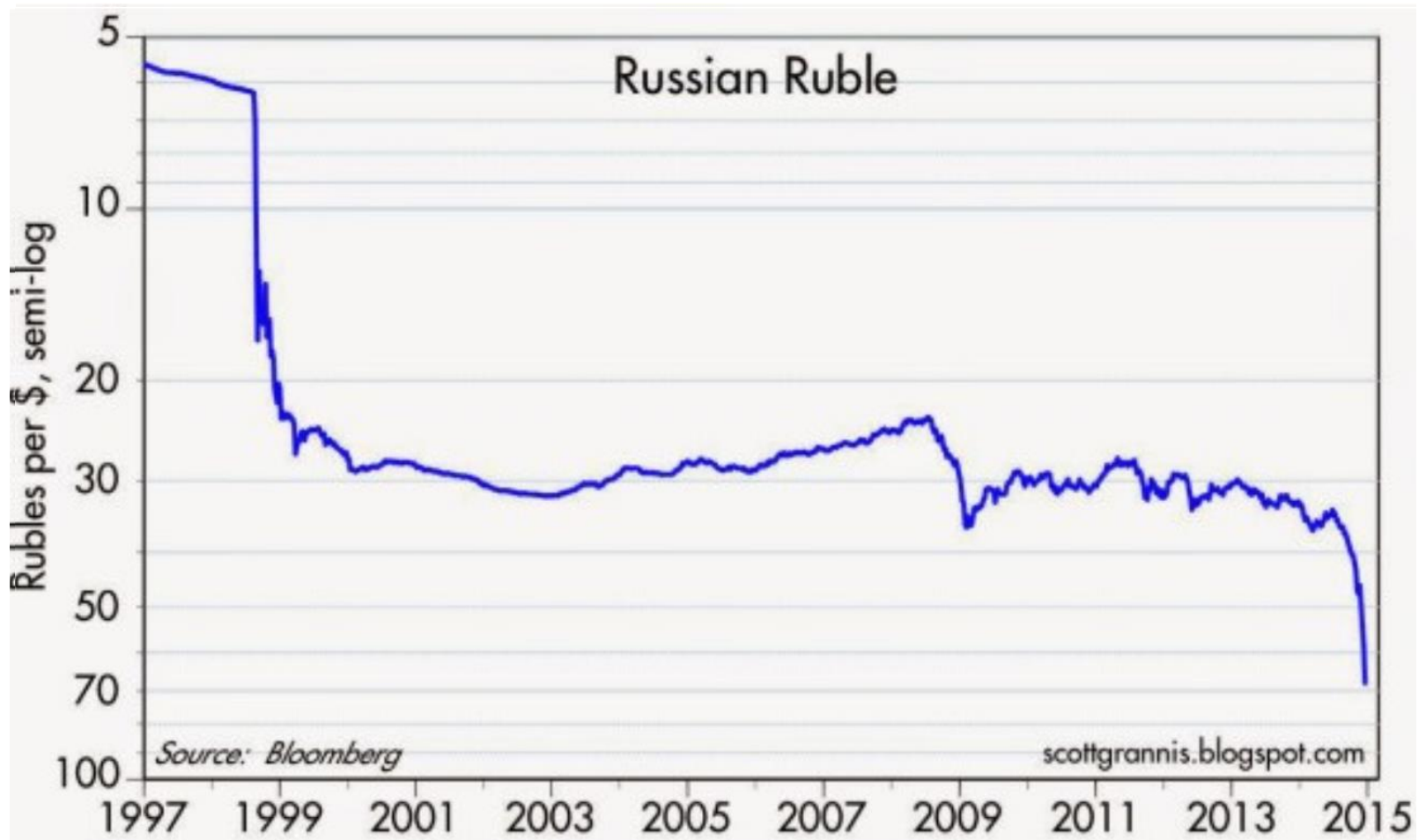
Source: Eurostat

UE-Russia Trade

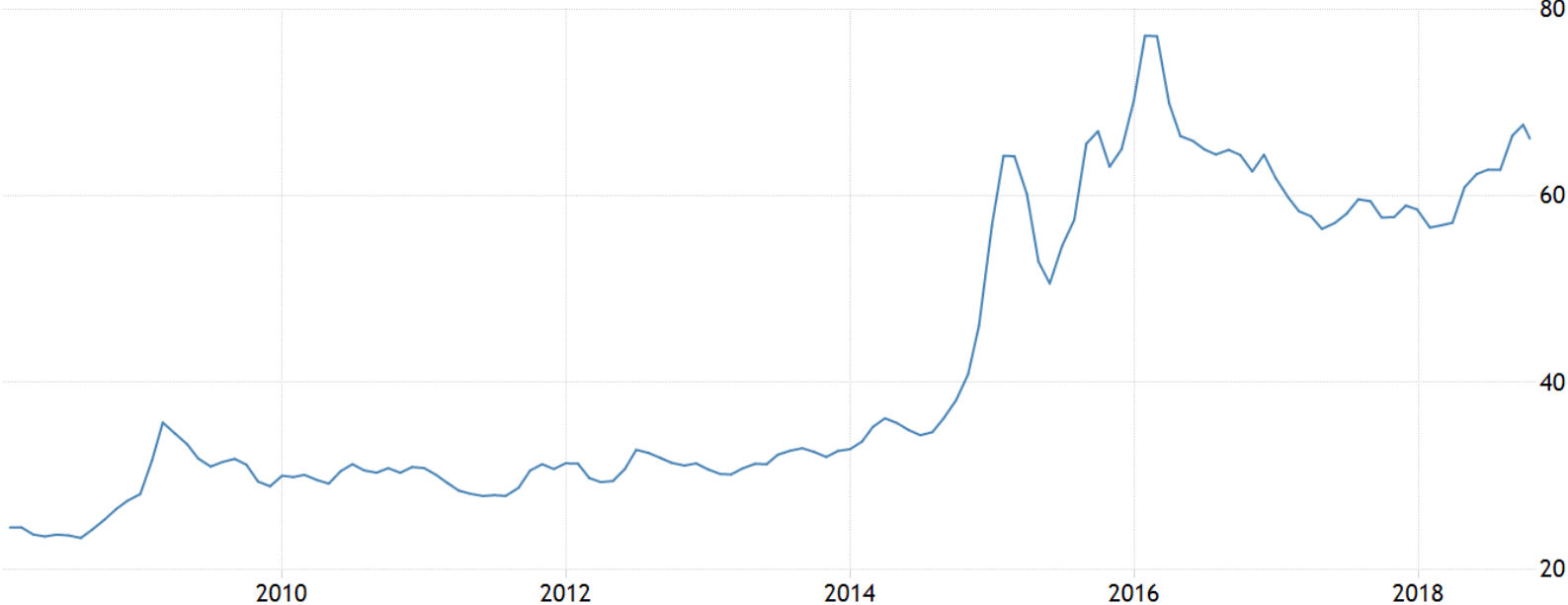
- [https://ec.europa.eu/eurostat/statistics-explained/index.php/Russia-EU %E2%80%93 international trade in goods statistics](https://ec.europa.eu/eurostat/statistics-explained/index.php/Russia-EU_%E2%80%93_international_trade_in_goods_statistics)



Effects of sanctions?



RUSSIAN RUBLE

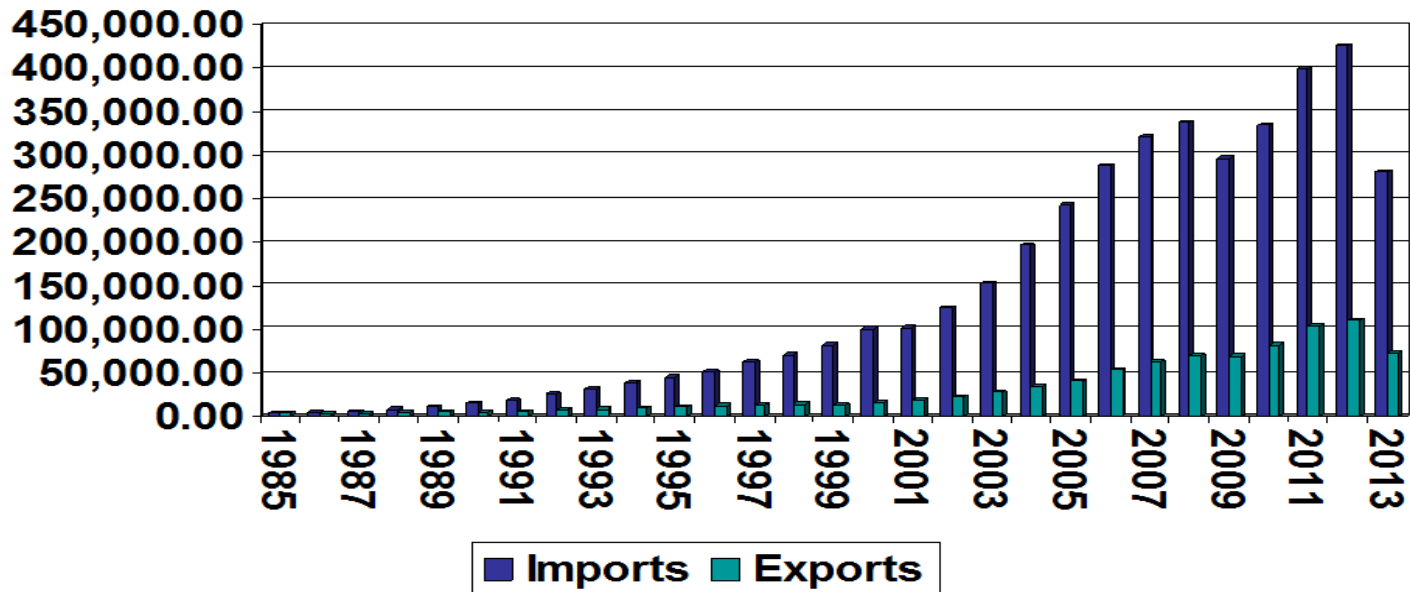


SOURCE: TRADINGECONOMICS.COM | OTC INTERBANK

| Export of Products to Russia (Exported in the Amount Exceeding USD 1 mln in 2013) | 2012 | 2013 (January - October) |
|---|-----------------|-----------------------------|
| | USD Thousand | |
| Total | 45,816.0 | 130,872.3 |
| Automobiles | 15,222.1 | 27,567.6 |
| Natural grape wines | 22.9 | 34,079.8 |
| Mineral and fresh waters | 101.6 | 21,130.3 |
| Electric energy | 9,303.7 | 10,656.0 |
| Ferroalloys | 4,705.6 | 8,669.6 |
| Trucks | 232.9 | 10,096.3 |
| Tubes | 66.1 | 4,411.2 |
| Manganese ores and concentrates | 2,873.1 | 1,528.8 |
| Waters, including mineral and carbonated, with added sugar | 1,402.9 | 2,211.2 |
| Ovens for different purposes | 1,401.3 | 1,621.7 |
| Non-denatured ethyl alcohol, alcohol beverages | 233.8 | 2,583.5 |

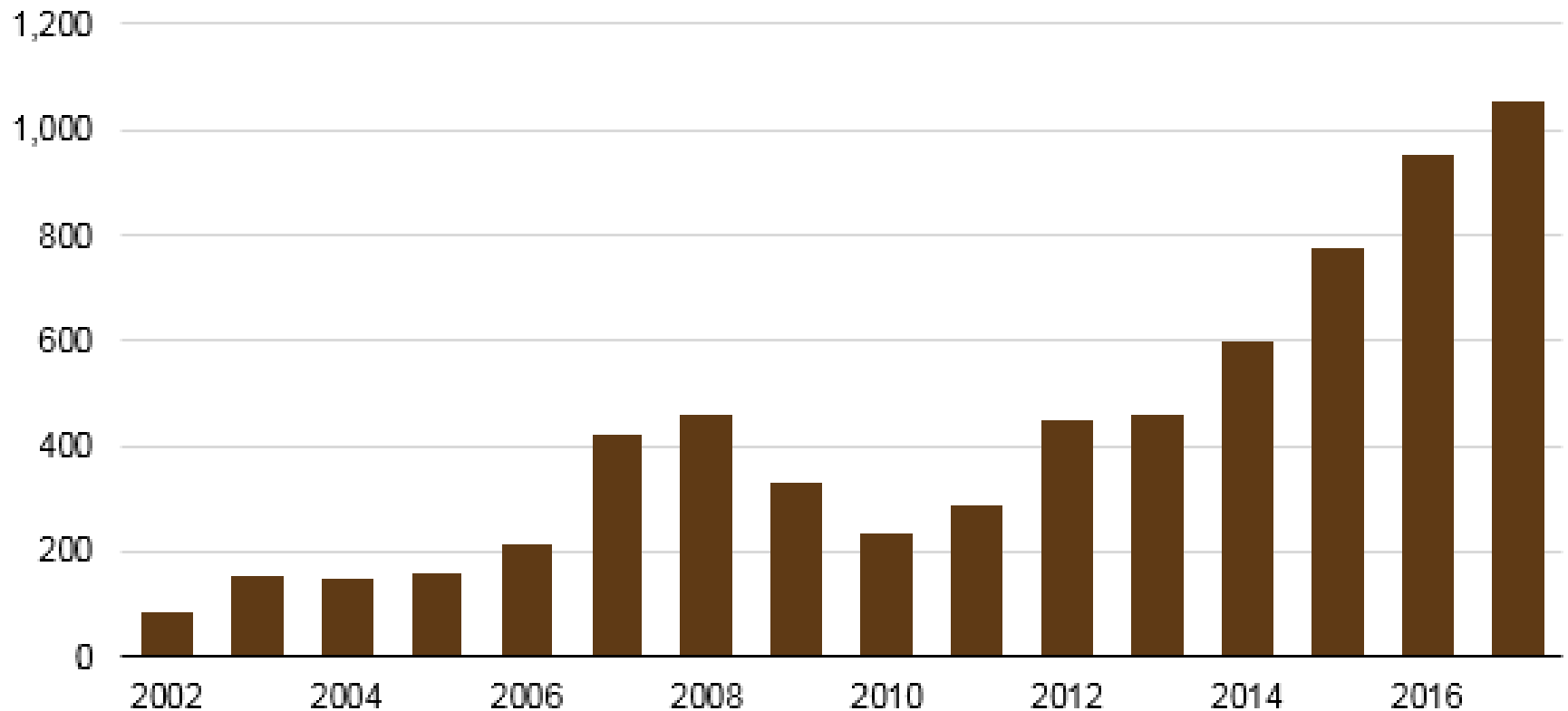
A new old partner

Trade with China (in millions of \$)



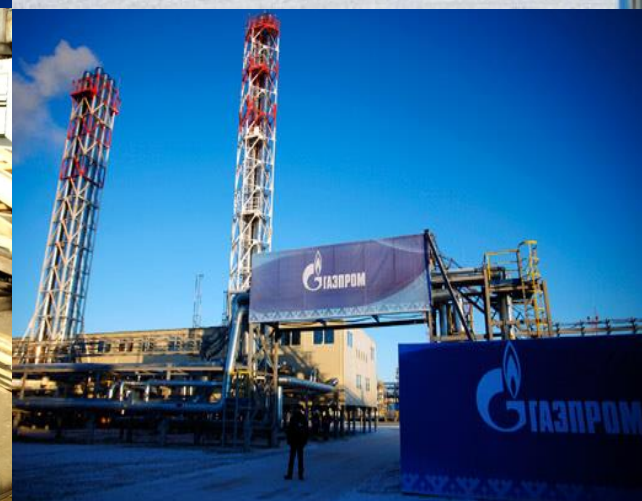
A strong partnership

Russia crude oil and condensate exports to China (2002-2017)
thousand barrels per day

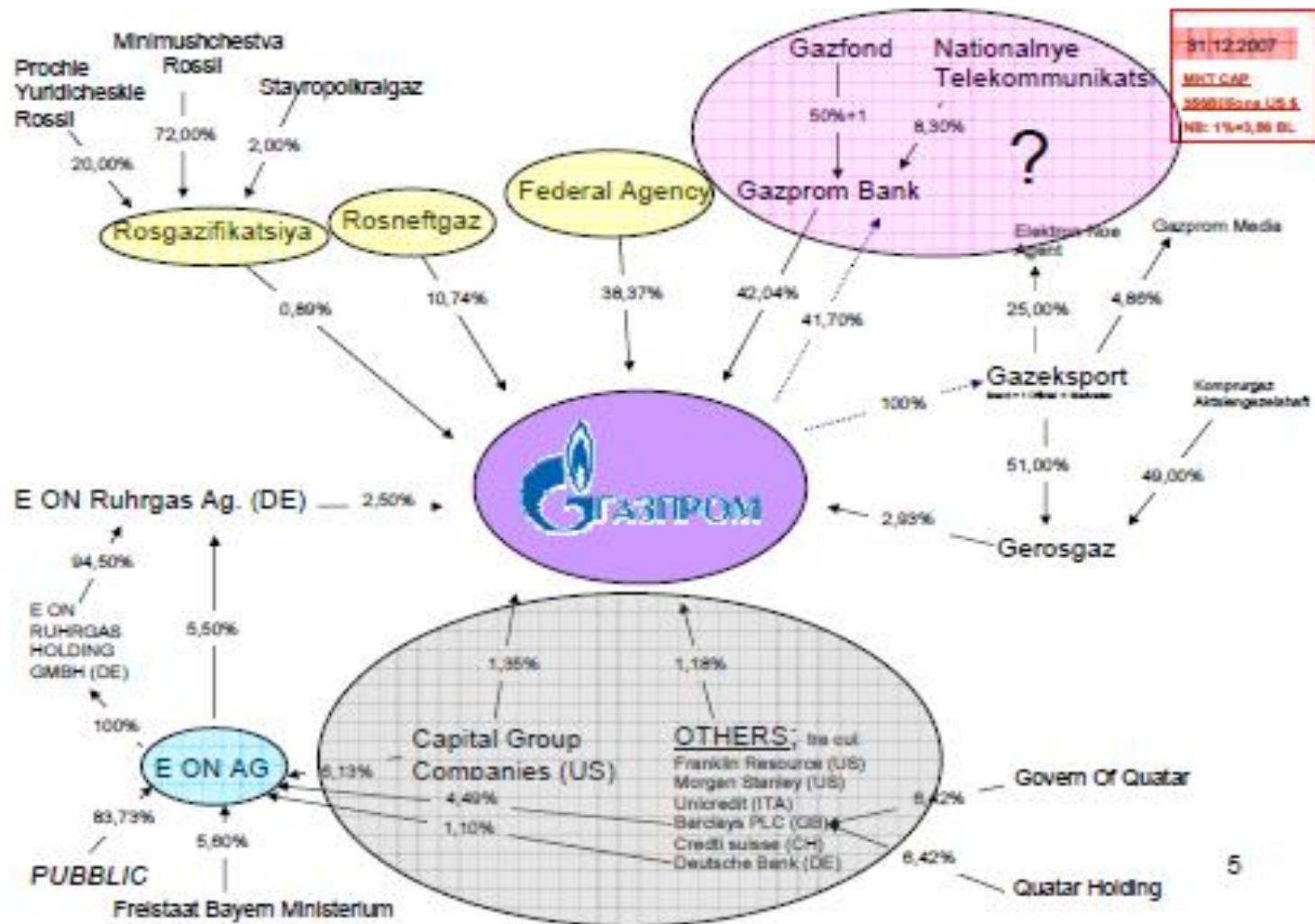




OFFICIAL PARTNER



Gazprom: the State and “something” more...



Primary Russian Oil and Gas Pipelines to Europe (U)

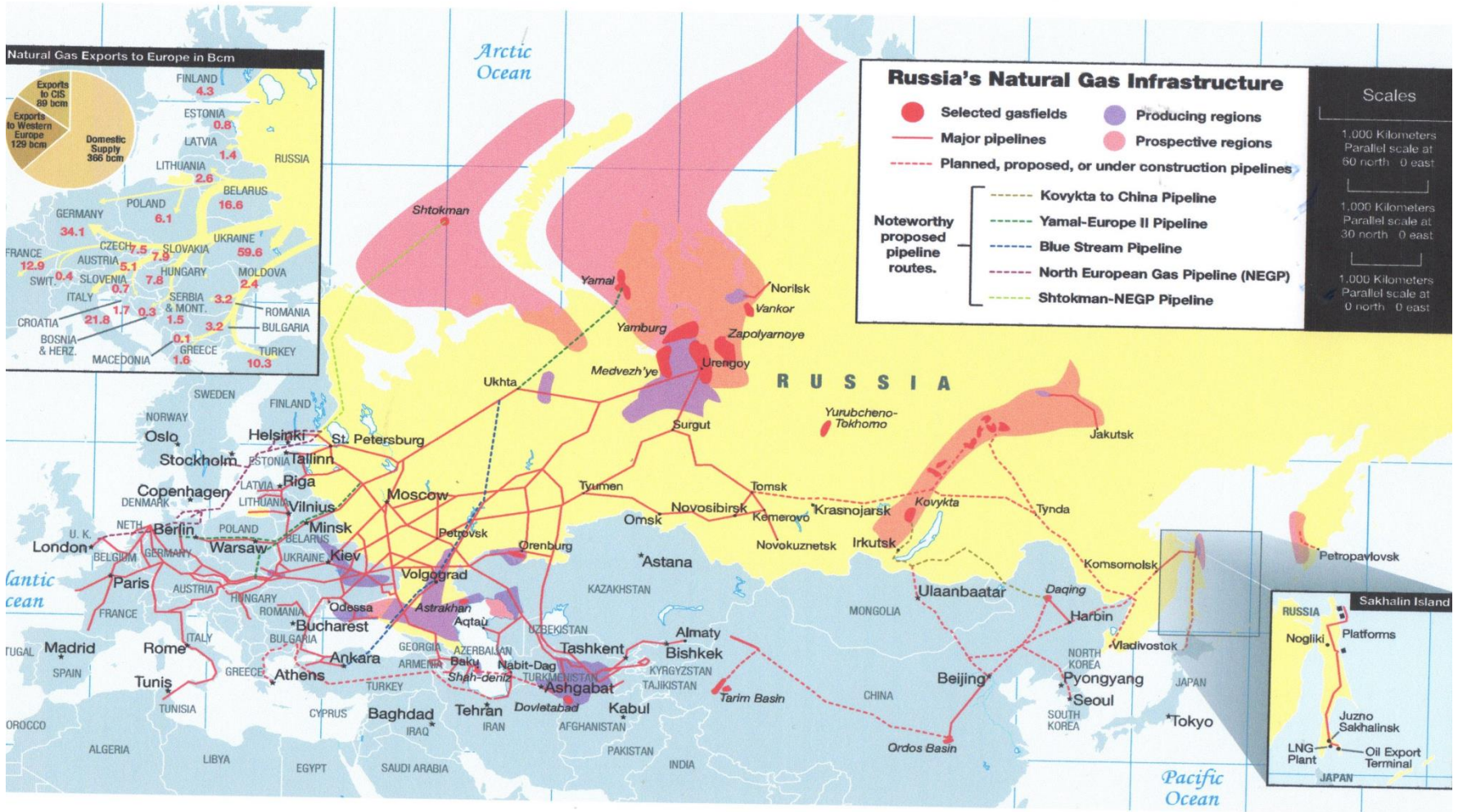
- Oil pipeline
- - - Proposed oil pipeline
- Gas pipeline
- - - Proposed gas pipeline
- Russian-dominated pipeline*
- Tanker terminal

0 500 Kilometers
0 500 Miles

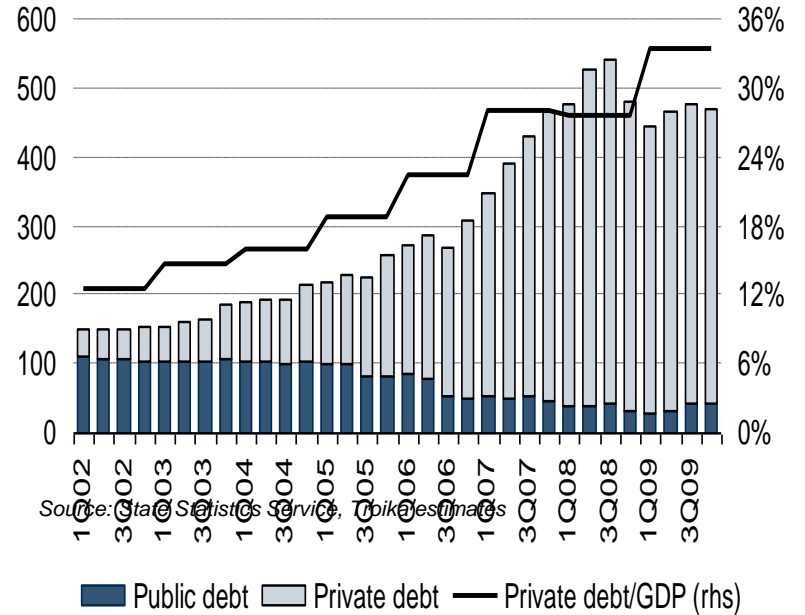
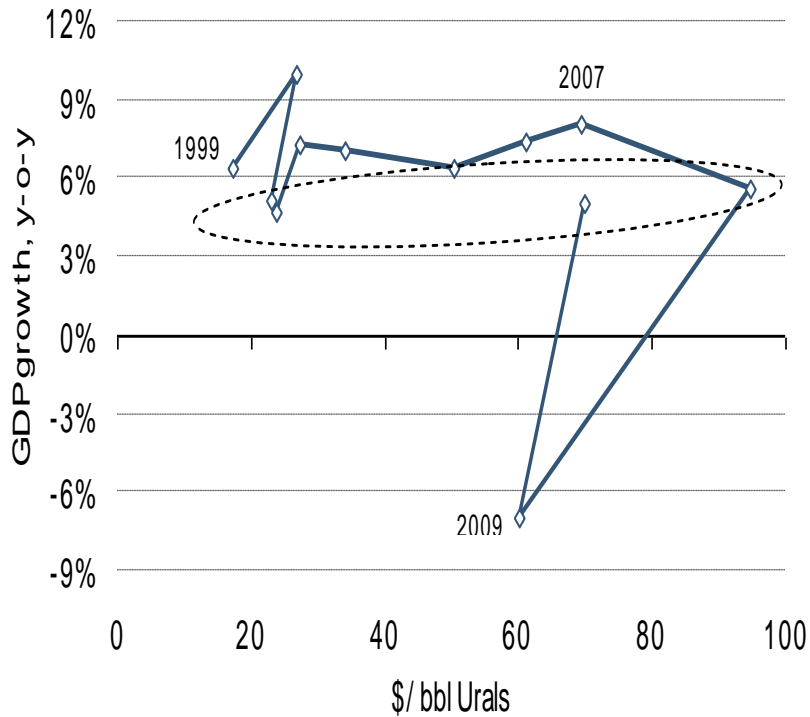
*All or most of the oil or gas moving through a given pipeline is from Russia.



Russian Gas Pipelines



Rising oil price and expanding foreign borrowing failed to accelerate Russia's growth: can Russia grow at any oil price?



Source: State Statistics Service, Ojike estimates

Economic environment related problems

Low productivity of Russian enterprises

High monopolism in the economy

Lack of tough barriers to market manipulation

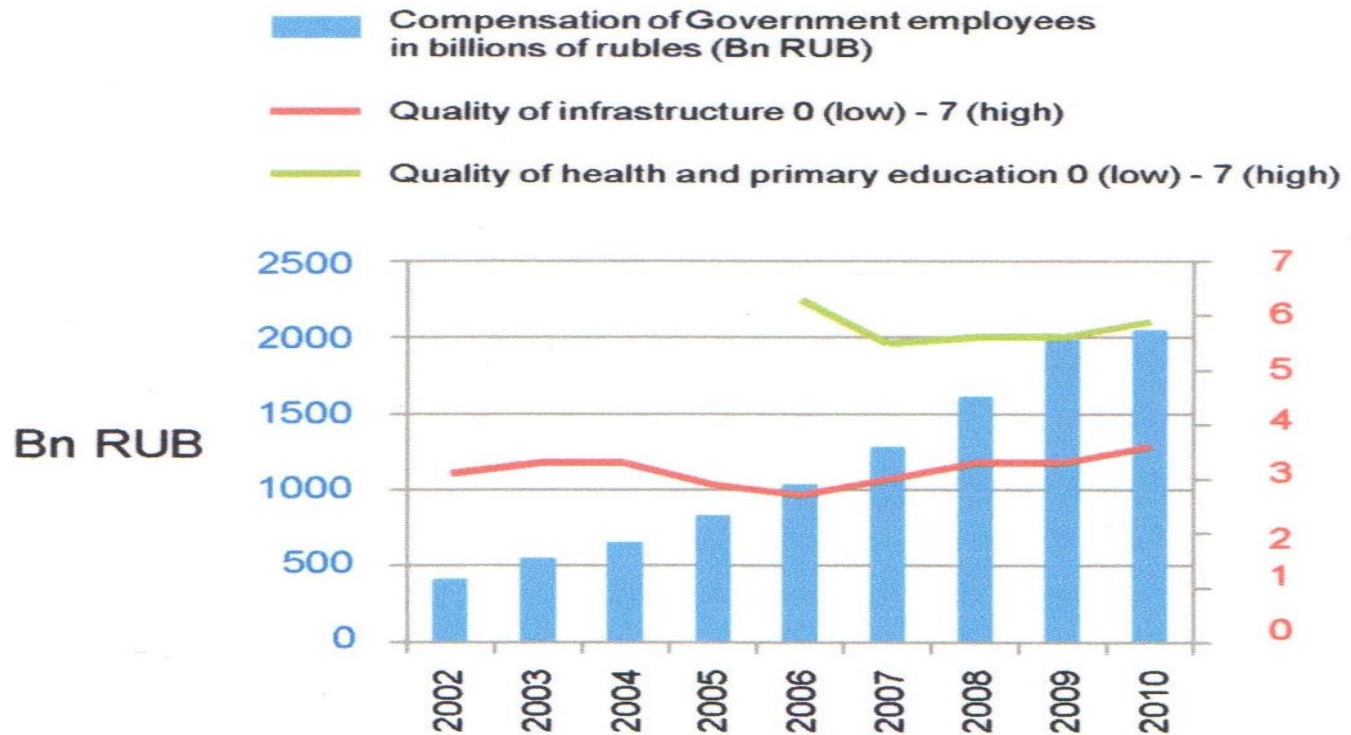
Currency risks that cannot be sufficiently hedged.

Many Russian companies allocate the role of 'honorary guests' to foreign shareholders and investors, while decision-making and monitoring are in hands of an influential majority shareholder. They drew attention to lack of protection of minority shareholders' rights, the existing problems with transparency of financial statements, with identification of the controlling owner and affiliates.

Russian Welfare state

Figure 6: The quality of Russia's health, education and infrastructure has stagnated despite increased government spending

Source: World Bank; World Economic Forum *Global Competitiveness Index*



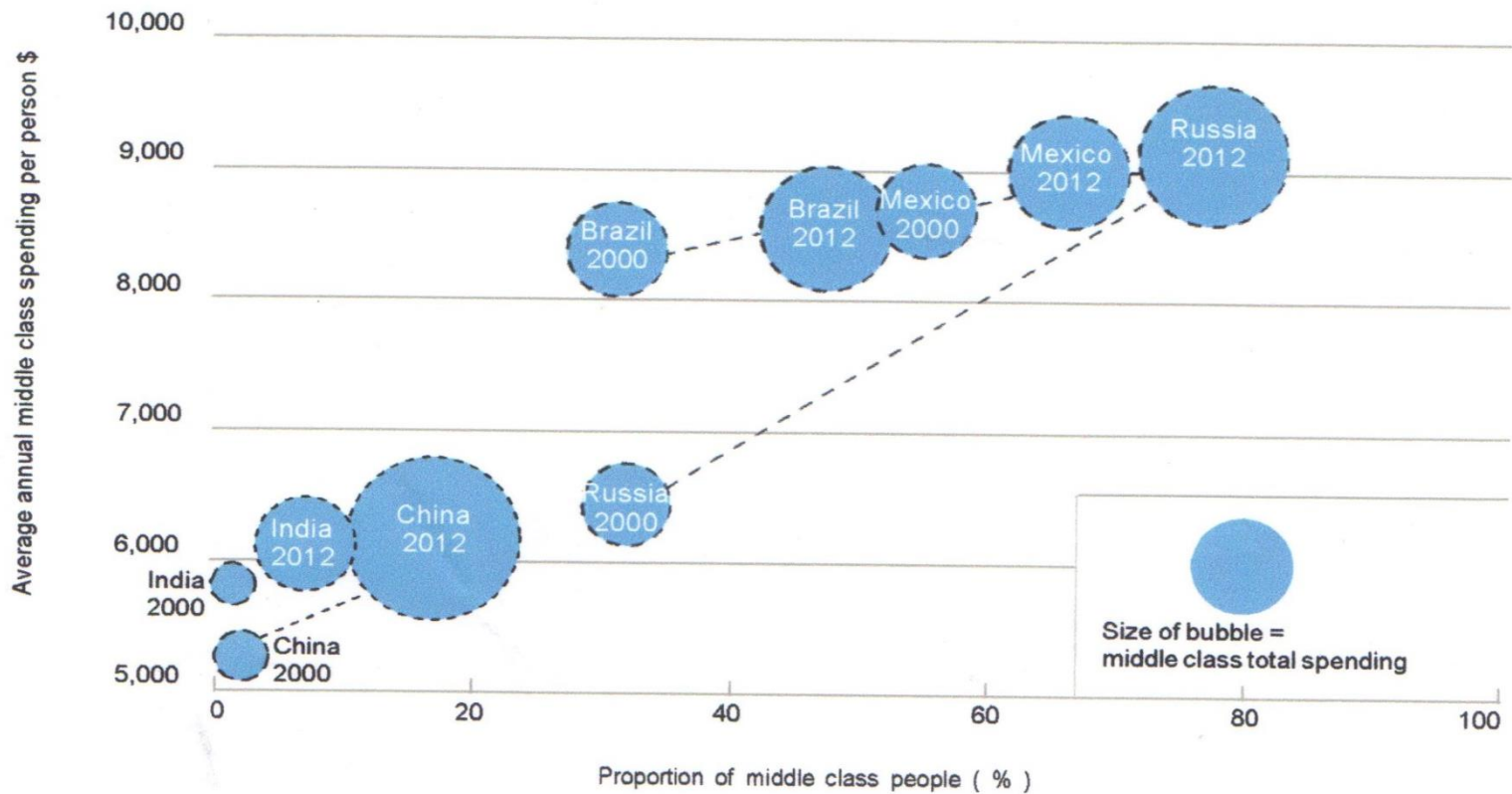
The productivity issue

| Country | US Dollar per/hr productivity |
|---------|-------------------------------|
| Mexico | 18.5 |
| Russia | 23,2 |
| Italy | 47.7 |
| Germany | 59 |
| USA | 62.9 |

Modernization of the Russian economy: how full is the glass?

The full consequences of Russia's significant middle-class growth remain uncertain

Financial Times



Still easy to die

5.7. LIFE EXPECTANCY AT BIRTH¹⁾
(number of years)

| Years | Total population | Males | Females |
|-------|------------------|-------|---------|
| 1992 | 67.8 | 61.9 | 73.7 |
| 1995 | 64.5 | 58.1 | 71.6 |
| 2000 | 65.3 | 59.0 | 72.3 |
| 2005 | 65.3 | 58.9 | 72.4 |
| 2006 | 66.6 | 60.4 | 73.2 |
| 2007 | 67.5 | 61.4 | 73.9 |
| 2008 | 67.9 | 61.8 | 74.2 |
| 2009 | 68.7 | 62.8 | 74.7 |

25 years later

- Russian-US GDP ratio
- 1992
 - 1: 14.3 nominal
- 2017
 - 1: 9.3 nominal
 - 1: 4,9 at PPP



The old-new question: corruption

It's the government, stupid

Biggest obstacles to doing business in Russia*
% of respondents

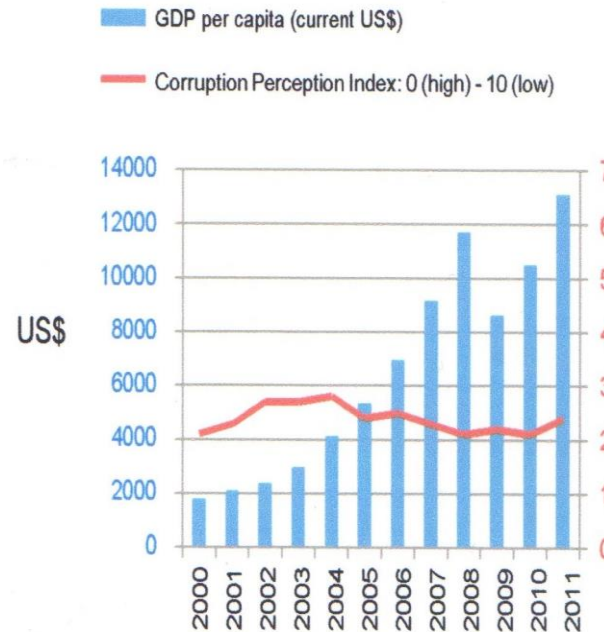


Source: World Economic Forum

* Respondents chose five problems from a list of 15

Figure 7: Corruption has not declined despite substantial increases in GDP per capita

Source: World Bank, Transparency International Corruption Perception Index



Must be the Russian weather

Cost of building a road, 2010, \$m per mile



Source: RIA Novosti; World Economic Forum

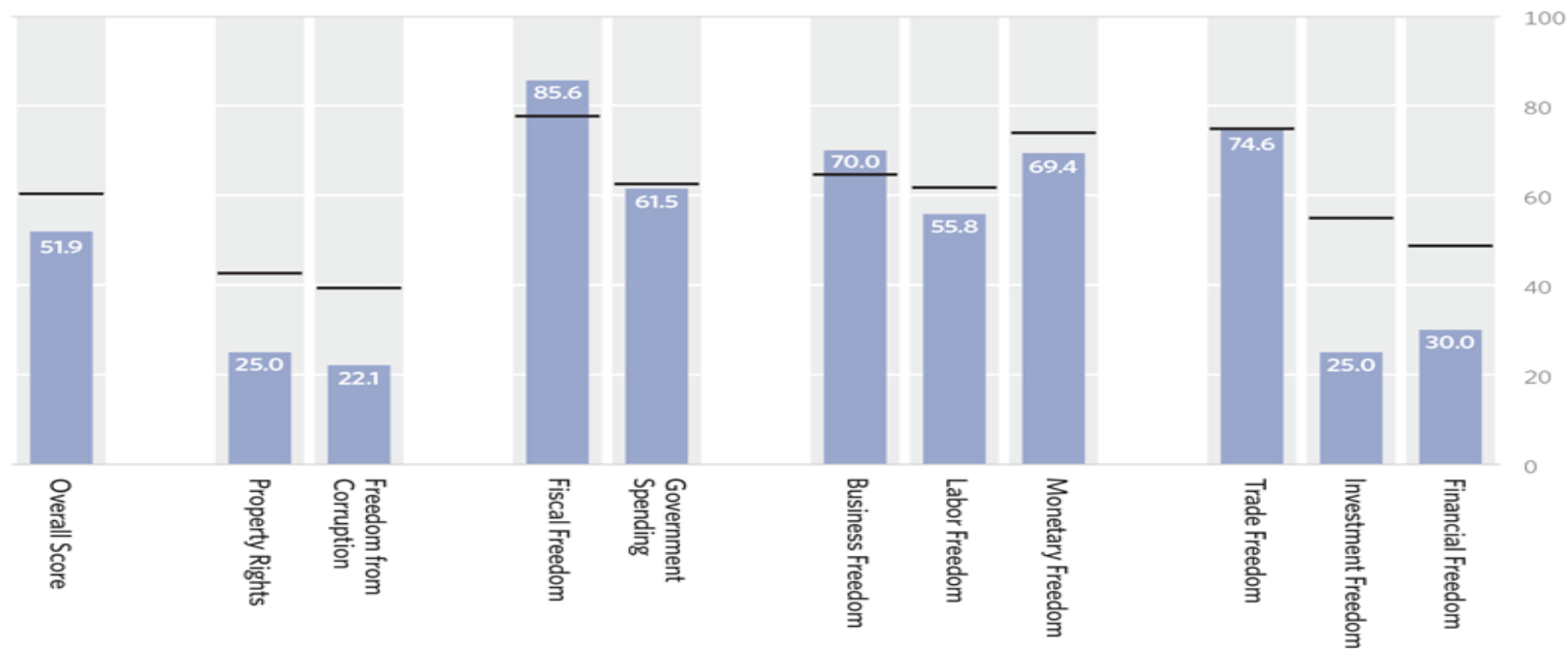
Still a long road

CHART 4

Russia Lags Behind World in Most Categories of Economic Freedom

— Global average
■ Russia score

2014 INDEX OF ECONOMIC FREEDOM SCORES



Source: Terry Miller, Anthony B. Kim, and Kim R. Holmes, *2014 Index of Economic Freedom* (Washington, D.C.: The Heritage Foundation and Dow Jones & Company, Inc., 2014), <http://www.heritage.org/index>.

Crony capitalism or Mafia capitalism in Russia ?

- In 2012 Russian Interior Ministry estimates that Russian mafia controls:
 - 40% of the private economy
 - 60% of the state-run enterprises;
 - 80% of banks in Russia **may be** under mafia influence
 - Protection money, corruption result
- Russian mafia has gone global
 - Money laundering (Russia, U.K., U.S.); gambling (Sri Lanka); drugs (Colombia); legitimate Israeli high tech companies

• **May be or is?**

Maybe somebody knows the answer...



