The role of the BRIICs in the globalization process: Russia

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Russia has come a long way since 2000

	2000	2007
Federal budget surplus, %/GDP	1,5%	5,5%
Public sector expenditure, %/GDP (federal)	35,0 (15)%	33,4 (18)%
Central bank reserves, months of imports	8,0	25,0
Net capital flow	-24,8 BUSD	81,2 BUSD
Foreign currency share in savings	32,5%	13,2%
Government debt, %/GDP	51,2%	3,6%

Is it all a matter of good luck?

- Spiralling export prices
- Preceding institutional change
- Price competiveness boosted by 1998 ruble depreciation
- Stability-oriented consensus created by previous crises (and forced by 1998!)
- Possibility of not-investment-based (cheap) growth due to low capacity utilisation
- Low monetisation, facilitating incoming currency flow absorption
- And others…

Or a matter of policy also?

- Main achievement: macroeconomic stability
- Gref programme; much at least partially implemented
- Watershed in 2003-2005: Yukos, export prices
- Little reformism after 2005
- But: previous reforms generally not annulled, long-term effects continue
- In World Bank Doing Business in 2008 report, China ranks 87, Russia 106, India 110 and Brazil 122.
- Relative position in e.g. perceived corruption indexes even worse: does Russia suffer from reputation bias?

Macroeconomics is changing

- From capacity utilisation to investment
- Melting away of current account surplus
- Melting away of public sector surplus
- What happens to capital account?
- Surge in inflation; how to answer it?
- Slower growth in global economy; resource prices uncertain, and impact the above forecasts.
- Slow growth, if any, in oil and gas; uncertainty in export volumes subject to domestic efficiency and imports from Central Asia

Russia is between low-cost Asia and high-tech Europe

- Which way out?
- Putin 2007: learning how to extract more value out of resources
- S. Ivanov 2007: learning from the experience of military industries
- Medvedev 2008: innovation, infrastructure, institutions, investment (intellect, ICT…)
- Now, who could possibly take exception with that?

What does growth theory ala Aghion et al say?

- Divide economies into two groups. Some are at the technological frontier (aka efficiency frontier). Others are inside, perhaps deep.
- Those at the frontier function well, producing high incomes and distributing them (usually) in a somewhat equitable way. They already produce modern commodities, using best technologies and institutions. They (we) have to invent everything new by themselves. This is slow, costly and subject to mistakes.
- Therefore, well functioning economies grow slowly.

Growth theory continued

- Economies inside the frontier function badly with low and usually widely differing incomes. They have worse than possible commodities, technologies and institutions.
- These economies have the potential of catching up by adopting better commodities, technologies and institutions, which have already been developed, tested and introduced. Catching up economises in time, cost and effort.
- Therefore, badly functioning economies have the potential to grow fast by imitating.

The fifth I-word

- Growth by catching up implies that emerging economies are by character heterogenous
- Russia is particularly so due to its peculiarities as an emerging economy:
- Geology (natural resource endowments)
- Geography (Central Europe, Arctic, Far East, Central Asia)
- History (former superpower, and a peculiar one)
- Note that all peculiarities imply both strengths and challenges
- E.g. more evidence for Resource Curse than Dutch Disease
- They, in particular, explain the unwillingness of Russia's elites to contemplate growth by imitation (catching up)

Working on a new economic programme

- The draft 2020 economic programme notes rightly that Russia is peculiar by being both in catching up and at the frontier. But it seems to overemphasise innovation and downplay imitation. This is due at least to history.
- This obviously has implications for the kinds of institutions, infrastructure and investments needed in Russia.
- Also note the (not inevitable) top-down character of the programme.

Labour productivity growth in BRIC-countries

	1987-1995	1995-2007
Brazil	0.2	0.6
Russia	-6.8	4.2
India	3.8	4.6
China	6.2	7.5

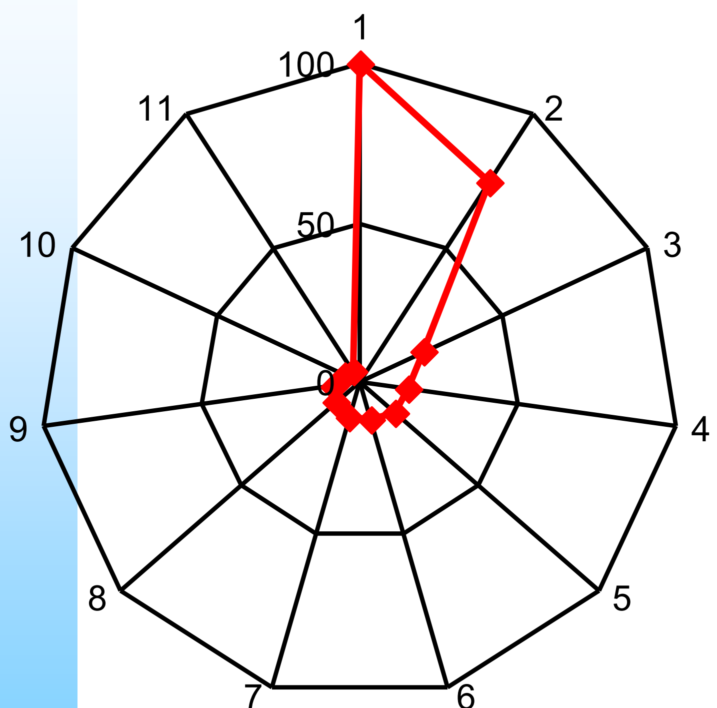
Russia in 1990-1995

Source: van Ark 2007

Some of Nabiullina’s examples on labour productivity

	Russia, % of comparitor
Aircraft industry, civilian	7
military	30
Motor vehicle industry	15-20
Civilian shipbuilding	15-20
Missile-space industry	3-13
Petrochemicals	30

РАССТОЯНИЕ
до мировой технологической границы:
трация на основе соотношения производительности
труда в России и США

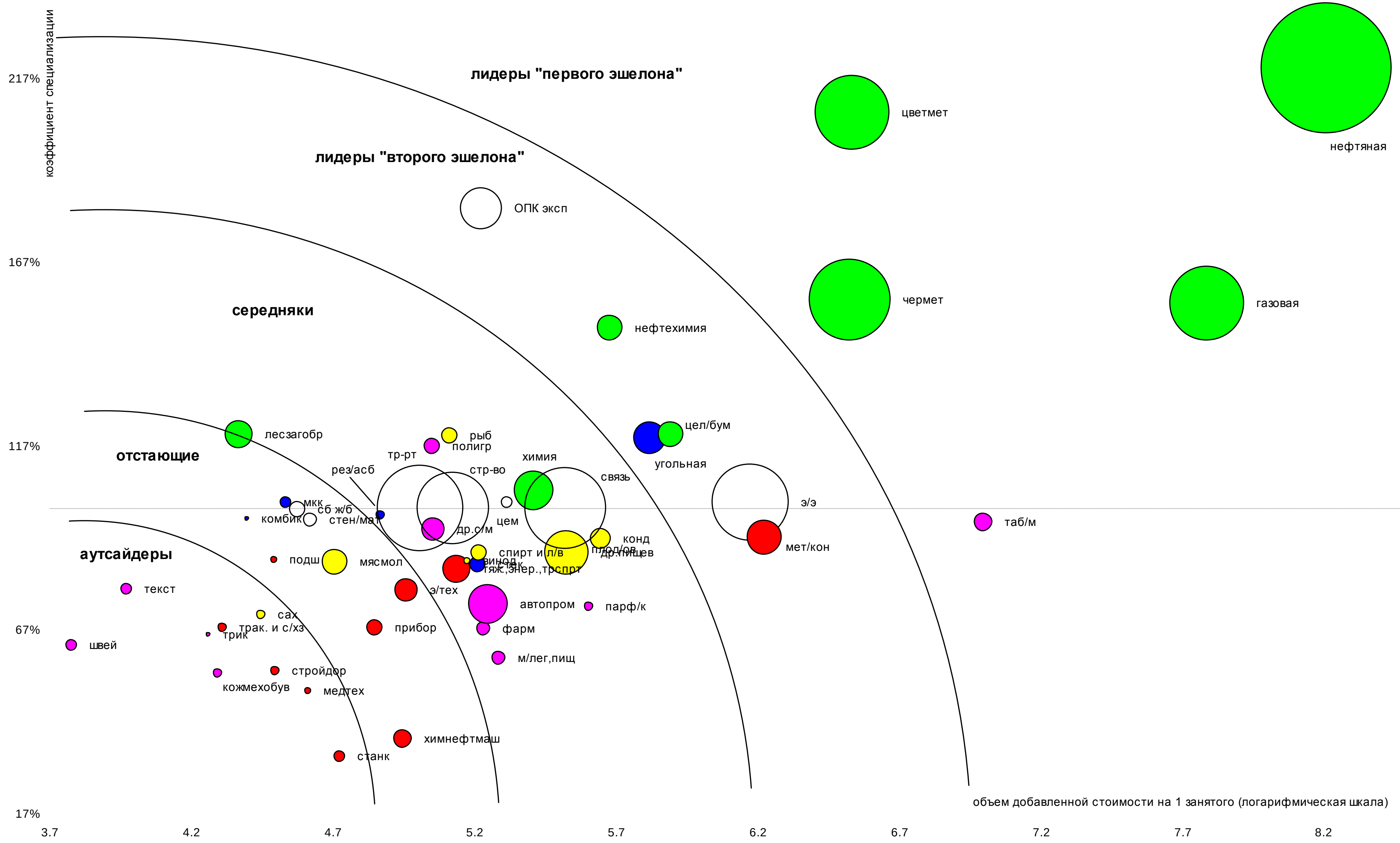


производительность труда в США = 100%

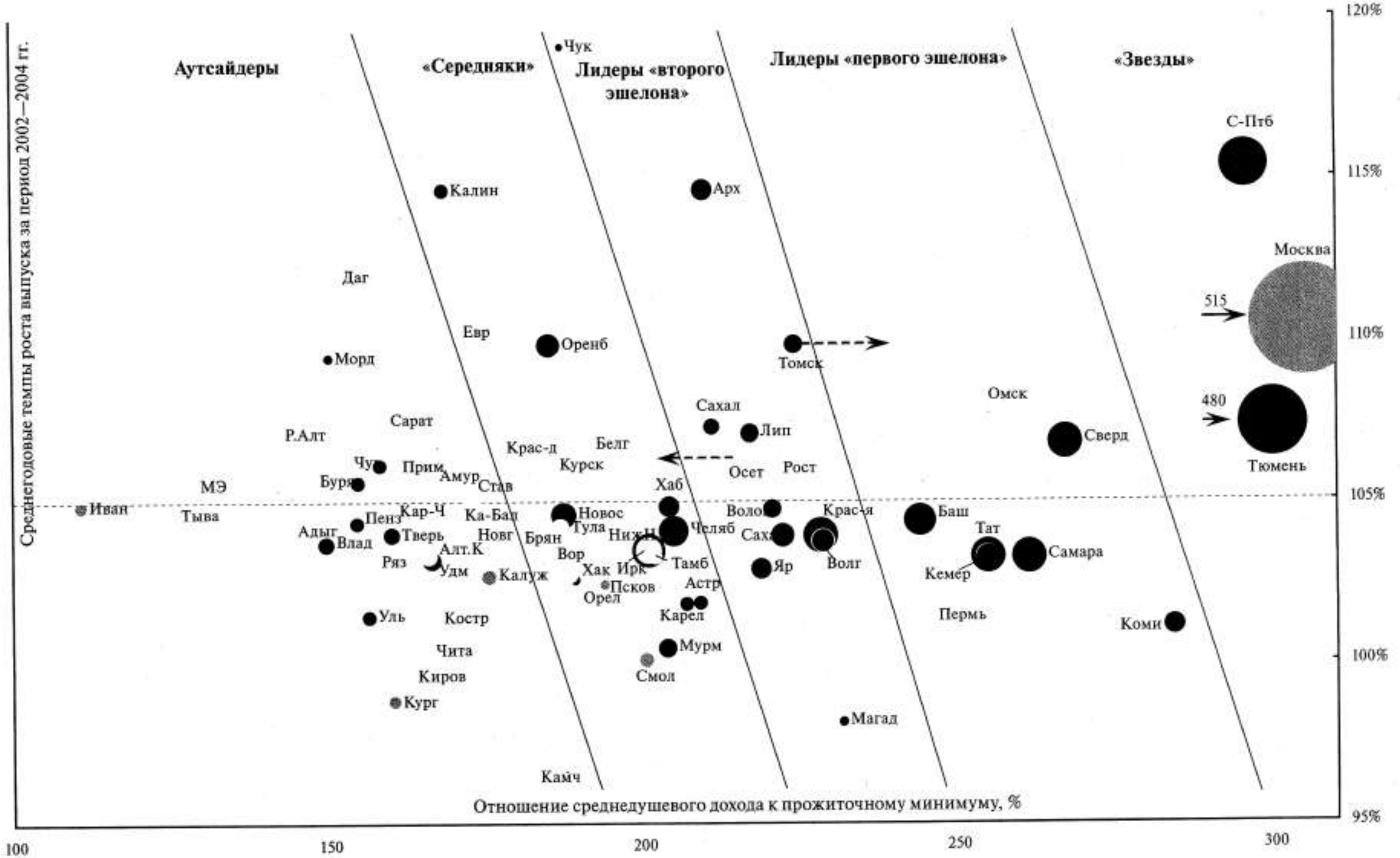
1 -Отдельные машиностроительные предприятия
2 -Отдельные предприятия сетевой розничной торговли
3 –Туризм
4 –Образование
5 –Металлургия
6 –Наука
7 -Топливная промышленность
8 -Пищевая промышленность
9 –Машиностроение
10 -Лесная и лесоперерабатывающая промышленность
11 -Химия и нефтехимия

Источник: Strategy Partners

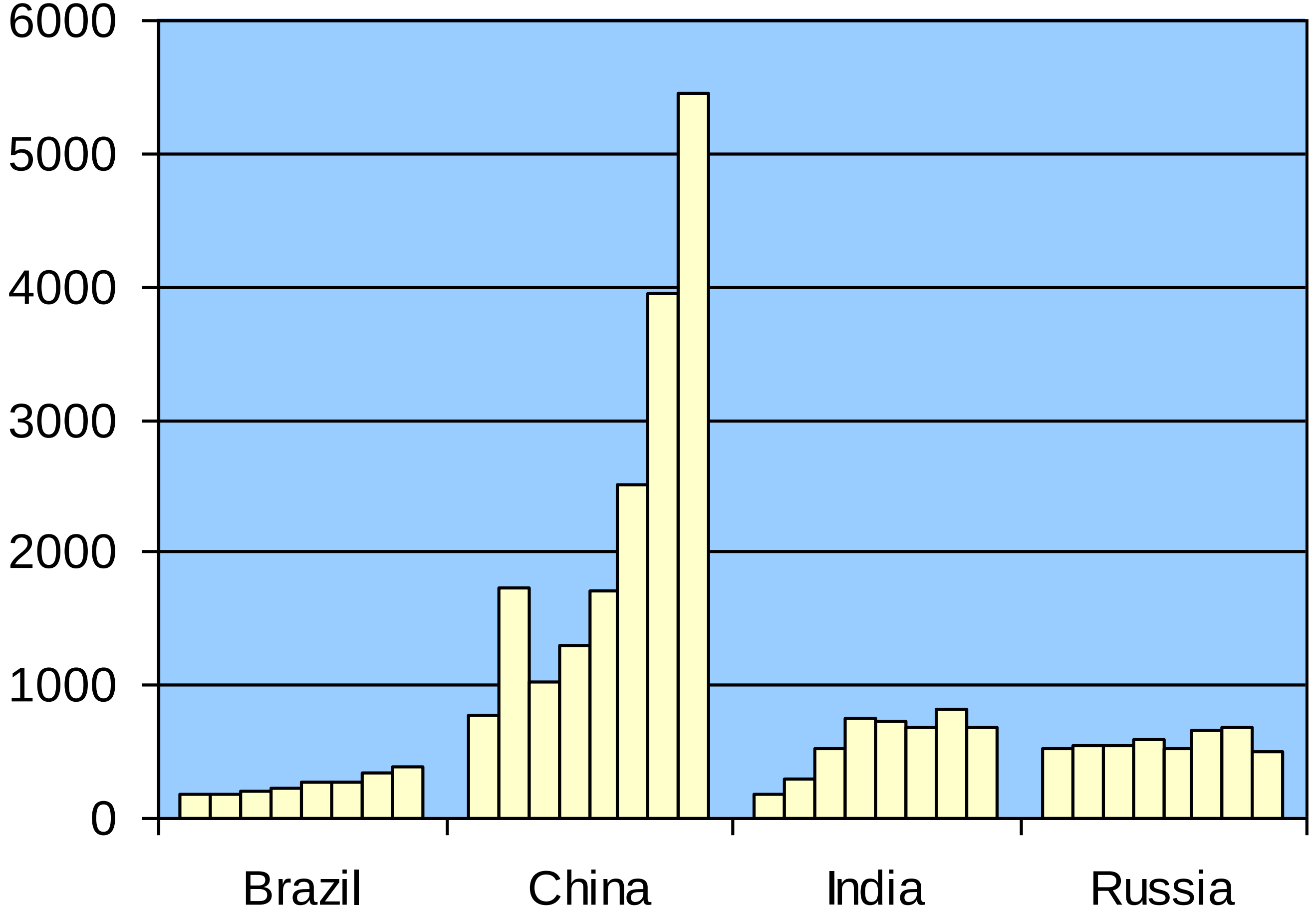
Competitiveness across branches according to a MERT study



Competitiveness across regions according to a MERT study



Number of international patent filings from BRICs in 2000-2007



Source: World Intellectual Property Organization (www.wipo.int)

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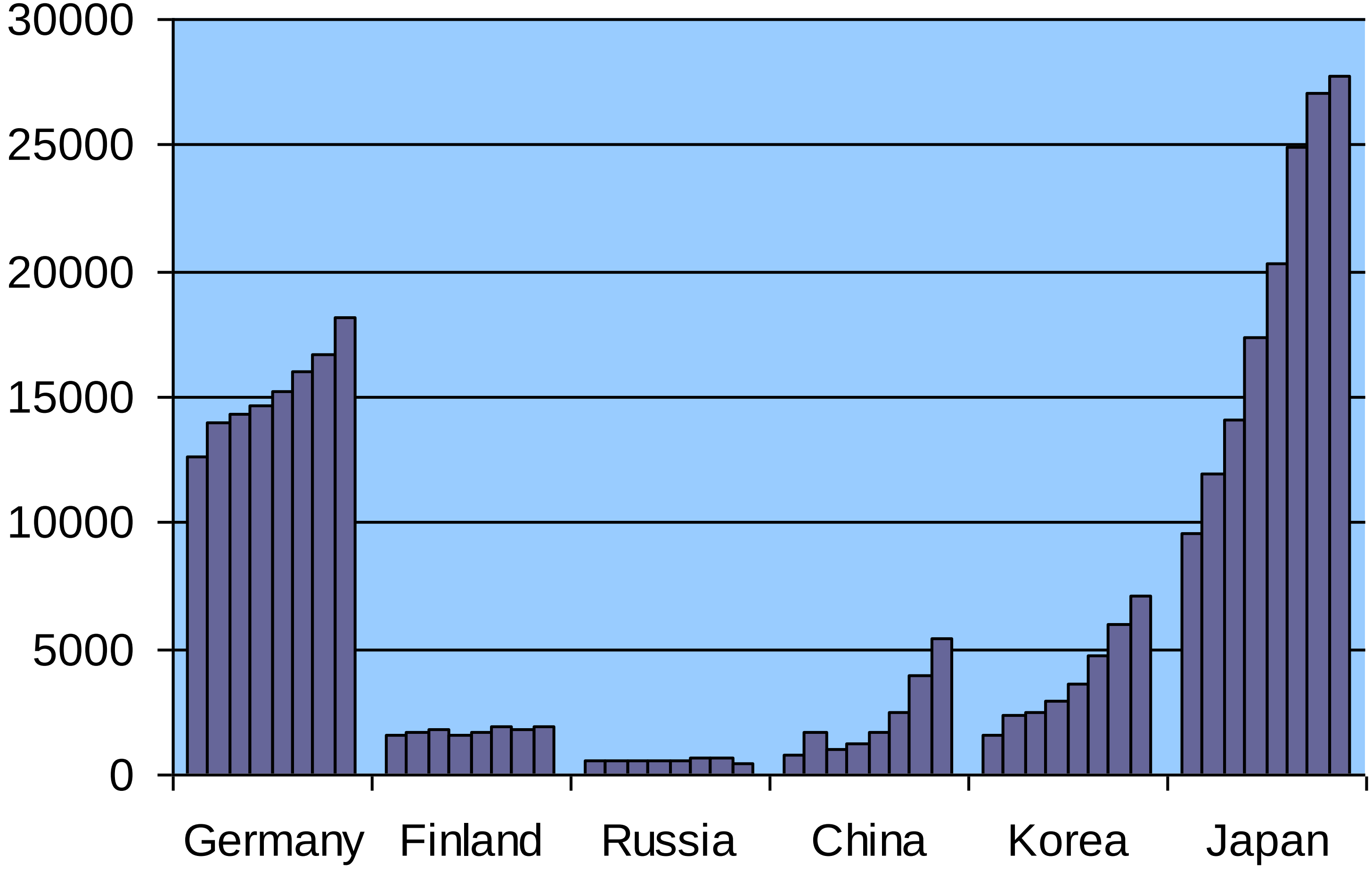


Source: World Intellectual Property Organization (www.wipo.int)

Competitiveness: additional comments

- With higher income levels, Russian consumers like elsewhere prefer world-class quality, choice and brands. Imports have recently risen roughly 30% annually in euros.
- Interesting points of comparison include textiles (with high import duties, Russian officials complain about grey imports from China and India, in particular) and cars, where Russia is becoming Europe's largest single market (domestic brands vs imports vs domestically assembled).
- In exports the relative success story of military equipment is also experiencing problems in China (upgrading originally Russian/Soviet technologies, also for exports), Algeria (complaints of quality of Russian aircraft) and possibly India (tender for aircraft). Connolly (forthcoming) shows that in medium-to-high tech export performance Russia lags behind most emerging economies.
- World Bank logistics performance index puts Singapore first, with e.g. Finland 15, the Baltic countries about 40-60 and Russia 91.

- A major Russian study (HSE 2007) estimates that by branch, 10-40% of companies are currently competitive, with petrochemicals leading. This is however usually based on a) having inherited most capital stock (almost) free of charge in privatisation, on b) so far cheap labour, and on c) cheap energy and resources. All of these will change.
- R&D share of 1.5%/GDP is not low, but is primarily financed by state and often aims at military applications. Most companies do (almost) no R&D.
- With stagnant export volumes, Russia will face a current account constraint.
- With energy extraction and transport only accounting for 1.5% of jobs, it will also face an employment constraint.

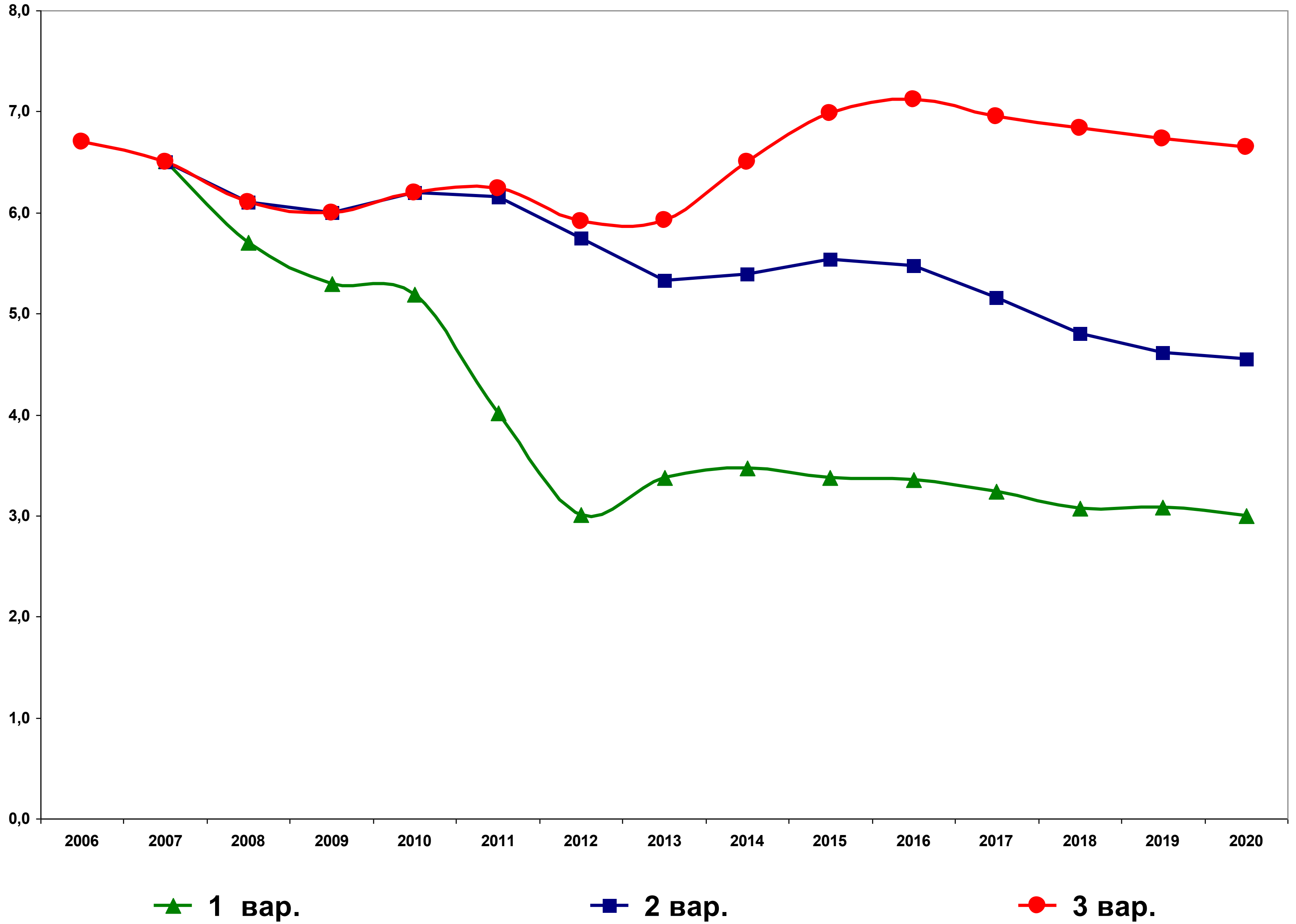
A note on FDI flows in 2007

- In 2007 inward FDI surged from 32.5 BUSD to 52.5 BUSD, but this was much due to three major ownership arrangements. 2008 figure might be < 40 BUSD. The central bank forecasts a 35 BUSD net private capital inflow, against 81 BUSD in 2007. In 2008Q1 this flow was -23 BUSD.
- Geographically, Cyprus, Netherlands and Bermuda lead the table before Germany.
- Branchwise, consumer-oriented non-export-revenue generating industries dominate.
- In outward FDI, Russia is notable among emerging economies with 46 BUSD in 2007. This concentrates on energy and other resource industries. Geographically, the same countries dominate as in inward FDI. This probably confirms the dominance of Russian entities in FDI.

While important challanges remain…

- Deteriorating demography, esp. size of labour force, young cohorts; problems of labour inflow
- Ability to maintain energy production and export volumes
- Huge variation in competitiveness across branches, regions, inside branches. Low general competitiveness of jobs
- Loss of cost advantages: labour, energy, utilities
- Deterioration of infrastructure, education, health care, armed forces…
- Social issues, pensions systems…

MERT growth scenarios until 2020



Some targets for 2020

- Fifth largest economy in the world, biggest in Europe
- ”Best place on earth for humans to live in” (Putin 2008)

GDP, % 2007	226
Investment, % 2007	368
Population, million	143
Life expectancy	75
Share of middle class, %	50-70
Average pc income (2007 6000 USD)	30000
Exports, % 2007	154
Energy intensity, % 2007	55-60

Innovation-based development: targets for 2020

	2007	2020
Russia in world hi-tech exports, %	0.3	2.0
Russia’s share in world economy, %	3.2	4.3
R&D expenditure, % of GDP	1.05	3.5-4.0
Hi-tech/knowledge sectors, %GDP	10.6	17-20
Enterprises innovating, %total	13	40-50
Education expenditure, %GDP	4.8	5.5-5.6
Health expenditure, %GDP	4.4	6.5-7.0
Living in poor ecolog sitn, %	43	14

Praise for the draft programme

- Thinking about the future; warning against complacency: without innovation-based development we ”will not be able to ensure either the country’s security or its normal development, and we will put its very existence under threat” (Putin).
- Acknowledgement of technological backwardness and diversity
- Acknowledgement of the limits of being energy-based:
- Growth of gas production at about 2% annually
- Growth of oil production down to 0.5 and then 0.2% annually
- Declining share of energy in GDP, declining growth contribution of GDP (35% in 2004, 23% in 2008, 14% in 2010)
- And at 165 pages, it is comprehensive!

Main priorities in the draft 2020 programme

- Education
- Helath
- Ecology
- Housing
- Pension system
- National innovation system
- Competitiveness of high-tech branches
- Financial infrastructure
- Energy and energy efficiency
- Transport infrastructure
- Eurasian economic space
- New centres of regional development

Critical comments on the draft 2020 programme

- Assumption for global growth at 4% is high, given recent developments
- Assumption for Russian population is high; much trust in labour-market and regional policy oriented immigration policy
- MERT and Presidential Administration downplay recent inflation as reflecting overheating, as Minfin and Central Bank say. Draft is very growth-oriented vs stability. Minfin working on a financial programme till 2023. Draft is very straightforward on monetary policy: as capital inflow balances current account deficit, shift to floating exchange rate (and inflation targeting?)

Comments continued

- Regional policy goals seem inconsistent with popular preferences
- A linear view on innovation, emphasising R&D expenditure, relatively neglecting competition
- A huge, overburdened policy menu
- Up-down emphasis on institutional development
- But having said that, the 165 pages also contain much in favour of democracy and market economy. But there is a lot of confused thinking.

Example: First Deputy Prime Minister Igor Shuvalov, St. Petersburg Economic Forum 8 June 2008

- ”…new goals: become a country with developed institutions of modern democracy, with a post-industrial economic structure, to create one of global financial centres”
- ”For at least 300 years the idea of catching up with and surpassing the West has been a fixed idea of Russian political and intellectual elite. In practice that often meant a less than successful copying of some forms of foreign economy and foreign lifestyle, which consciously condemned the country into backwardness.”
- ”We have lacked our own model of modernisation, based on Russian values and leadership ambitions.”
- ”Most importantly – we need to target leadership. It means that we must build an economy which itself would provide goals of imitation for others.”

Current trade related Russian policy goals

- WTO membership not a matter of ”blackmail”
- EU ”new PCA” attitude remains to be seen
- OECD membership negotiations remain to be seen
- Reform of global economic architecture (IMF, IBRD etc)
- Financial cooperation between surplus and emerging economies
- Energy: new sources, new routes, new customers; ”Gas OPEC”?
- Logistics: landbridge between Asia and Western Europe; North-Eastern Passage?

- Inward immigration
- Reciprocity: level playing field or equality of outcomes? Example: investment flows

The peculiar case of Great Eurasian Economic Space

- Turning EvrAzES into a customs union and an economic space, establishing joint financial institutions of development
- Turning ruble into leading regional currency and establishing an Eurasian ruble zone
- Turning Russia into a global financial centre with an independent national infrastructure guaranteeing Russia the leading position in Eurasian financial markets
- Establishing free movement of people and a common cultural and educational space in Eurasia

- There will be (a) countries with an integration process with Russia (EvrAzES) and (b) those with close economic relations with Russia, participating in Great Eurasian Economic Space as a space of common development
- Russia is the leader and organizer of GEES ”due to its economic might and geographic position, as the link between Europe and Asia”
- GEES cooperation is open to ”all or some” Eurasian countries, does not include EU members, China or India

What does GEES do?

- Joint labour markets
- Joint transport, energy and telecommunications infrastructure
- Cooperation in the use of water resources
- Ensuring food security
- Technical overhaul of basic industries
- Joint sphere of education
- Joint investments in energy, transport, water
- Cooperation in production
- Facilitation of mutual trade and investment
- Cooperation in standards and regulation, facilitating movement of factors of production, goods, services and objects of intellectual property
- Making Russia into the regional financial centre (in one place not just of GEES, but of ”CIS, Central and Eastern Europe!)

Why does Russia need an independent financial system?

- Globalisation risks losing independence of financial system, making it into a peripheric segment of European markets
- This may increase transaction costs; prevent access to finance by many Russian companies; exclude many categories of investors, like households and pension institutions, from receiving finance; increase dependence of social and economic development from external factors; and lead to unstable growth