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KOMENTARZE I SPRAWOZDANIA

Ludmila Ilyicheva

Contemporary Russian Economy under the Sanctions

Russian Federation has faced certain external limitations, which have an impact on the rate of economic growth. Forbes columnist Kenneth Raposa says that Western sanctions were to be a blow to Russia, but its economy is now in better shape than many expected. The analyst cites a number of proofs of this assertion. In the latest ranking of the world's human capital (*The Human Capital Report*), prepared by the World Economic Forum, Russia in 2015 rose from 55th to 26th place. Human Capital Index is determined by the expense of skills and abilities of the population, aimed at the production targets. In this ranking Russia is ahead of Israel, Italy, Greece, Portugal and Spain, as well as Brazil. At the same time, Russia has become the best emerging market this year, according to the Market Vectors Russia ETF (RSX), and the ruble has appreciated by 17 percent since the beginning of the year¹.

According to the analyst, despite the fact that investment in Russia does not become a trend, still enjoy the investment interest. In addition, experts say the company JPMorgan assesses the situation in Russia as "fairly healthy" because of low external debt.

From the point of view of Raposa, sanctions against Russia have been introduced because of the country's actions, but it managed to stabilize the economic situation. This helped the Russian economy to stand under the pressure of many negative factors, including the conflict in Ukraine, the sanctions and low oil prices.

Analysts of Forbes point that one of the key factors that helped the economy withstand the tests was the low external debt of the country. If the debt had been

¹ <https://news.mail.ru/economics/22043580/?frommail=1> (28.11.2016).

too high, then the country would have been in a much more difficult situation. Ratio of debt to GDP in Russia is low – about 14%. The economy is hardly burdened by debts, neither the population nor the public sector nor the majority of the companies. This allows Russia to separate itself from the others until the market turmoil will subside. Russia always gets to her feet. Even in spite of the ongoing conflict in Ukraine, the sanctions and low oil prices, Russia is now a »favorite of investors«².

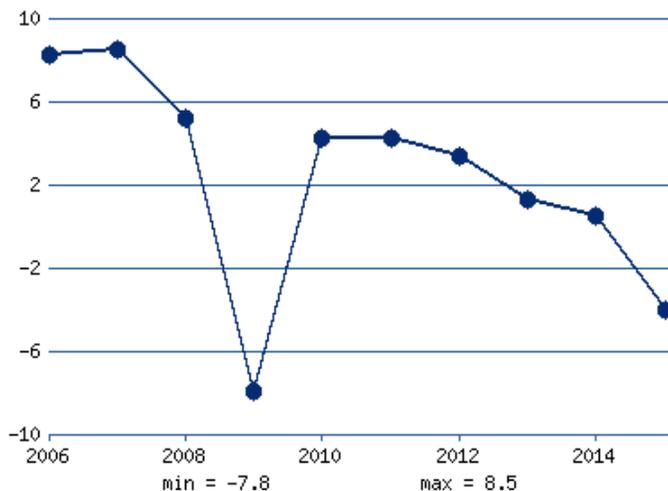


Figure 1. The main macroeconomic indicators of the Russian Federation in 2015 (International statistics)

A source: <http://www.ereport.ru/stat.php?razdel=country&count=russia> (28.11.2016).

Table 1. The rate of growth of Russia's GDP (%)

Year	Value
1	2
2005	6.4
2006	8.2
2007	8.5
2008	5.2
2009	-7.8
2010	4.3
2011	4.3

² РИА Новости, <http://ria.ru/economy/20150503/1062404144.html#ixzz3ZGjrFBeh> (28.11.2016).

1	2
2012	3.4
2013	1.3
2014	0.6
2015	-3.9

A source: CIA World Factbook.

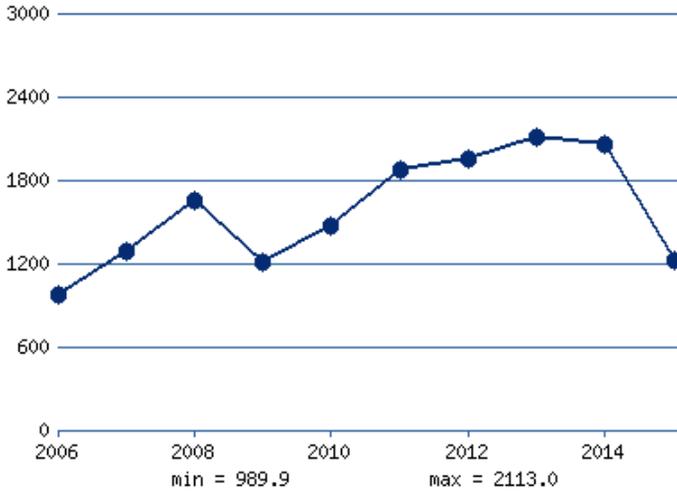


Figure 2. The size of the nominal GDP of Russia (bln. USD)

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Year	Value
2005	763.7
2006	989.9
2007	1 299.7
2008	1 660.8
2009	1 222.0
2010	1 479.8
2011	1 885.0
2012	1 954.0
2013	2 113.0
2014	2 057.0
2015	1 236.0

A source: CIA World Factbook.

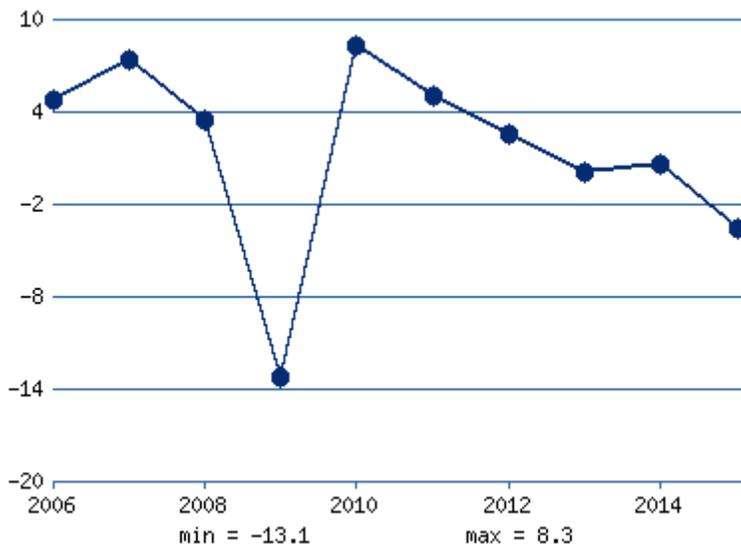


Figure 3. The growth rate of industrial production in Russia (%)

Table 3. The growth rate of industrial production in Russia (%)

Year	Value
2005	4.0
2006	4.8
2007	7.4
2008	3.5
2009	-13.1
2010	8.3
2011	5.0
2012	2.6
2013	0.1
2014	0.6
2015	-3.5

A source: CIA World Factbook.

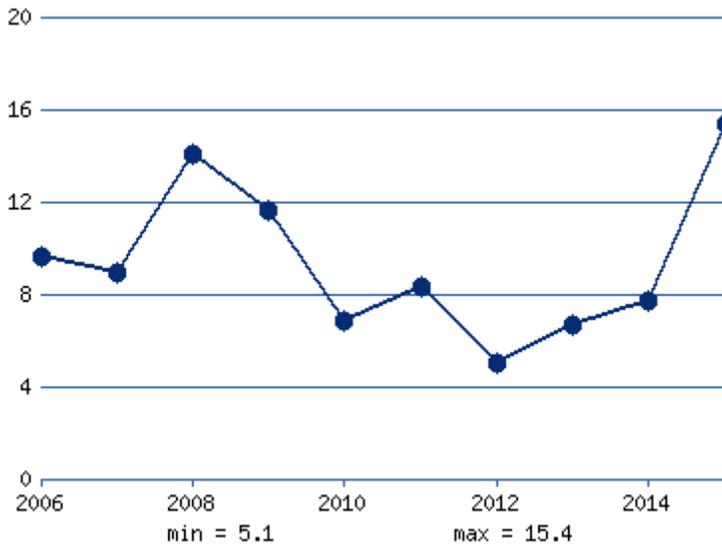


Figure 4. Inflation in Russia (%)

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Year	Value
2005	12.7
2006	9.7
2007	9.0
2008	14.1
2009	11.7
2010	6.9
2011	8.4
2012	5.1
2013	6.8
2014	7.8
2015	15.4

A source: CIA World Factbook.

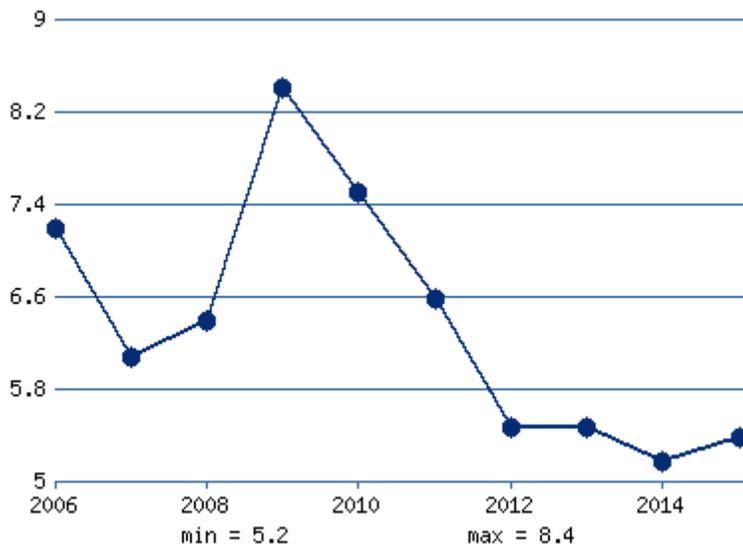


Figure 5. The unemployment rate in Russia (%)

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Year	Value
2005	7.6
2006	7.2
2007	6.1
2008	6.4
2009	8.4
2010	7.5
2011	6.6
2012	5.5
2013	5.5
2014	5.2
2015	5.4

A source: CIA World Factbook.

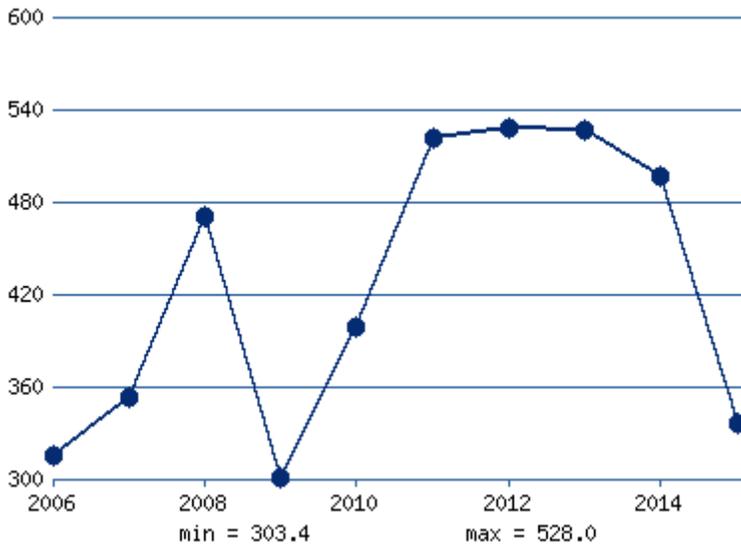


Figure 6. The volume of Russian exports (bln. USD)

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Year	Value
2005	245.0
2006	317.6
2007	355.5
2008	471.6
2009	303.4
2010	400.4
2011	522.0
2012	528.0
2013	527.3
2014	497.8
2015	337.8

A source: CIA World Factbook.

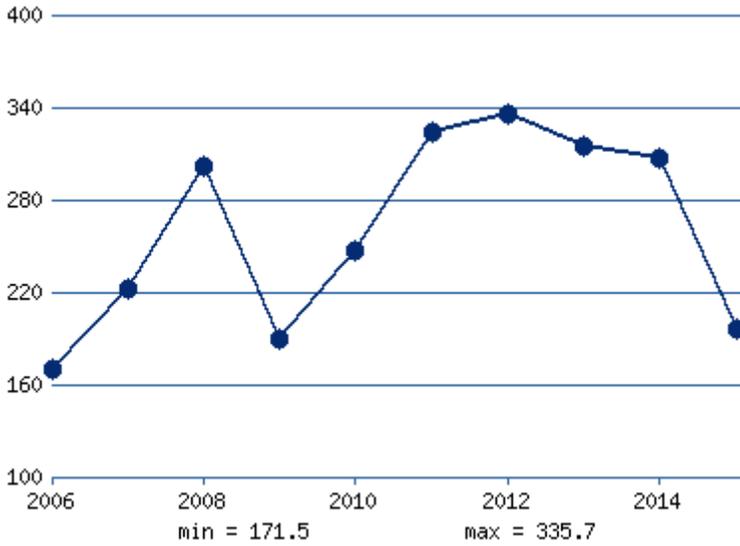


Figure 7. The volume of Russian imports (bln. US dollars)

Table 7. The volume of Russian imports (billion. US dollars)

Year	Value
2005	125.0
2006	171.5
2007	223.4
2008	302.0
2009	191.8
2010	248.7
2011	323.8
2012	335.7
2013	315.0
2014	308.0
2015	197.3

A source: CIA World Factbook.

Industrial output in Russia fell by 3.4 percent in 2015. The decline was a result of lower oil prices and the falling value of the ruble. The most significant reduction was observed in the manufacturing industry, where production fell by 5.4 percent in 2015 compared to 2014. Meanwhile, Russia has increased food production in face of an import ban from a number of Western countries. Pork

production increased by 12.9 per cent in 2015, and cheese production – by 17.1 percent, according to Rosstat.

According to the Ministry of Economic Development, in 2016 production is expected to fall by 0.4 percent, with an average oil price of \$ 40 per barrel.

The inflation rate in Russia reached 12.9 percent in 2015, while according to the UN forecast it will amount to 10.5% in 2016 and 7.1% in 2017³.

During the live broadcast, held on April 16, 2015, Russian President Vladimir Putin noted that Russia's GDP increased by 0.6 percent compared to the last previous year. President marked that, while not significant, it is still an increase. Industrial production rose even more, by 1.7 percent, while the manufacturing industry – by 2.1 percent. New record of oil production has been established, and claimed as the largest in recent history – 525 million tons. One of the largest grain crops was harvested in our recent history – 105.3 million tons. Overall, agriculture has demonstrated excellent results – 3.7 percent growth. President of RF marked positive dynamics in a number of industries, e.g. chemical industry – 4,1 percent, production of mineral fertilizers – 4,2. Overall, the ruble stabilizes, stock markets are growing. We were able to prevent the promotion of inflation spiral. The reduction of capital investment in small businesses became a negative signal. In total, overall capital investment decreased by 2.5 percent last year.

At the same time, excellent results were achieved at the housing construction. Construction workers can be proud that they have demonstrated record achievements in the entire history of the Russian State. Never before, neither in Soviet nor in post-Soviet times, and not in pre-Soviet either, I am sure, there was such result – around 81 or even 82 million square meters.

Finally, we also managed to avoid a sharp hike in unemployment. It did grow last year, from about 5.3–5.4 in the middle of last year to 5.8 now, but we have managed to hold it back.

Meanwhile, the results of the last year show an 11.4 percent growth in consumer prices. However, in March the inflation rate has dropped. The population's disposable income has decreased by 1 percent, while salaries have grown by 1.3 percent.

Despite the significant fluctuations on the financial market, Russia's banking sector has demonstrated sizable dynamics in 2014. The portfolio of loans to the real sector of the economy has grown, and what is especially good is that the overall assets of Russian banks have increased to reach 77 trillion rubles and for the first time they exceed the nation's GDP.

It has to be mentioned that both individuals and legal entities started returning the money they withdrew or exchanged into hard currency at the end of last year. Thus, deposits of citizens grew by 9.4 percent, while those of

³ <http://www.ereport.ru/articles/weconomy/wecon.htm> (28.11.2016).

economic entities – by 40.6 percent last year, and they continue to grow this year. By January, citizens' deposits rose by 2.8 percent and reached over 19 trillion rubles, while those of organizations grew by 5.1 percent to a total of over 26 trillion rubles.

Among the positive outcomes of 2014 were undoubtedly positive demographic trends. Birth rate exceeded death rate. The average life expectancy continues to grow and this bears on the overall positive tendency and public sentiment in general.

Vladimir Mau, a rector of the Russian Presidential Academy of National Economy and Public Administration, states in an article written for the newspaper: "Kommersant" that the theme of modernization must and can be treated seriously. In addition, it has a starting component – structural economic crisis. Moreover, according to Vladimir Mau, it is important to pay attention to the means through which the growth is reached instead of elaborating on economic growth indicators. In his opinion, one may discuss a significant change in fiscal ideology. Nowadays, the program of medium-term measures to create technological and institutional modernization is a central theme in the discussion of anti-crisis policy. Already in 2008, the following phrase gained popularity: it is foolish to miss the crisis and not to make use of it. What to do, then, to take advantage of the crisis?"

To begin with, one should define target settings, criteria of successful policy. Currently, it would be very risky to highlight the issue of economic growth. Undoubtedly, economic growth is essential, but it is important not just for the next year or two, but in a medium term, with a steady progress accompanied by structural modernization.

Obviously, in the conditions of the cyclical drop, the conduct of countercyclical policies of growth stimulation has certain grounds. The issues which we face today are not only and not so much cyclical as structural. In this respect, the growth stimulation might present danger.

You do not have to search far for an example. In the middle of the 1980s, when the Soviet Union's growth was lower than in Western countries, the acceleration policy was announced and implemented. In fact, it was the fiscal maneuver in favor of the investment industry. Its implementation had led to higher growth in the next two years. The price of this acceleration was the rapid growth of the budget deficit and public debt, which was followed by an economic disaster. We must learn the lessons of 1986–1990 well, not to repeat these mistakes in the future.

What indicators would signalize the beginning of progressive changes? They include: the reduction of interest rates on commercial loans, the growth of the share of non-oil exports, and the growth of labor productivity.

The first criterion requires special explanation, since, for a professional economist, the sharp political debate around it is rather strange. Increase in the access of credit resources, i.e. decrease in interest rates, should not be confused

with the administrative pressure on the banks to reduce interest rates and increase the availability of loans. Rate level is a synthetic indicator, behind which are two factors: the level of inflation and the level of confidence in the economy (including economic policy). This criterion is important for Western economies, but with the opposite sign – an indicator of success for their anti-crisis policy is the rise in interest rates, indicating the exit from a deflationary trap.

Clarifying the criteria allows us to formulate a number of priorities of economic policy for the perspective of the next three years.

Consequent disinflation, which serves as a natural basis for lower interest rates, social stability and increase in country's investment activity. Naturally, it is possible to live and even grow with high inflation. However, this argument is akin to that in the case of fire: it is possible to survive for some time and avoid freezing, to boot.

The situation in this area is politically difficult, there is a risk of “inflationary spiral”. As in the 1990s, a powerful pro-inflation block has formed. As before, three influential forces are interested in the preservation of high inflation: banks, for which inflation gives additional opportunities of solving stability issues; trade, because inflation favors the industry with short term capital turnover; inefficient enterprises, to whom money gives an opportunity to avoid the inevitable change of management and ownership.

However, current movement towards the course of disinflation would be beneficial to both the current government and the majority of society – business and ordinary citizens alike. The target 4% inflation rate by the year 2018 would be important from political, economic and social perspectives. Politically, it would be the strongest argument at presidential elections. Economically, because the solution of this task would allow business (if authority proves the seriousness of their intentions) to make plans, especially investment-oriented. Socially, as it would become a factor in preventing the growth of social tension which is always accompanied by high inflation.

Nowadays, disinflation is not only required but also possible. With current oil price level retention, Russia is virtually free from the “Dutch disease”. In previous years, decrease of inflation was held back by the risk of declining competitiveness due to excessive (i.e. not related to the labor manufacture growth) ruble stabilization. Currently, in the absence of significant increase in oil prices, a risks to the economy will appear. Nevertheless, there is an additional incentive for macroeconomic recovery.

There were many disputes about the effectiveness of budget policy in recent years, However, the availability of cheap money did not contribute to the practical implementation of these objectives. We may highlight four directions: budget maneuver, budget procedure improvement, increase in the efficiency of the budget network and refinement of the budgetary rules with accumulated experience and contemporary realities.

As many studies show, the most important, from this perspective, are investments in human capital and infrastructure. Meanwhile, expenses that help to enhance the quality of the factors of production (labor and capital), as well as total factor productivity (efficiency of use of factors of production, especially investment in infrastructure), have not increased in recent years, but even decreased for some items in terms of GDP. At the same time, the proportion of unproductive expenditure increased – for defense, government bodies, law enforcement. Understanding the political importance of some of these costs, we cannot ignore that this structural shift limits the effectiveness of budget policy.

It is necessary to improve the budgetary procedures towards binding of spending with fulfilling the tasks by budget receivers, and not to the budget calendar dates. In particular, it significantly concerns the investment costs.

A serious problem is the perspective (future) of a fiscal rule. While oil prices tend to decrease, this question may seem irrelevant. However, it makes sense to discuss it. The current fiscal rule stipulating outflow of rental revenues in sovereign funds was a reaction to the Soviet experience of spending a full rental income, which made the country vulnerable to shocks of market fluctuations. However, the experience of years 2009 to 2012 demonstrated a serious cons of this model: the “safety cushions” discourage modernization. The time of crisis is encouraging modernization, but the presence of a financial reserve policy allows the logic of “business as usual”.

It is required to rethink the ideology of using conjunctural superprofits and, accordingly, budget rules. In consideration of Russian political realities, it would be reasonable to determine the cut-off of conjunctural revenues in a tougher way (to fix it at a low level) and to balance the current budget (i.e. the budget of renewable liabilities) on income level, maximizing its protection from the fluctuations of external factors. In case of a growth of additional rental income, it should be directed to the formation of the development budget, i.e. to finance the costs with a finite time horizon. Such a model would allow to more actively invest in the development when conditions are favorable and would not create problems with the temptation to pour money on the problems in the time of the crisis.

Support of non-oil exports is another important priority nowadays. It is fashionable, today, to talk about import substitution. However, import substitution should not be that much glorified, especially when we are talking about domestic goods of poor quality and at a higher price, manufacturers of which require additional financial aid from the budget. We really need import substitution, but one that would be competitive in an open market. In other words, it is necessary to stimulate export-oriented import substitution. Support for non-commodity exports and import substitution support must go hand in hand.

For this purpose it is necessary to comply with several conditions. First of all, not to create obstacles to the non-oil exports. Meanwhile, calling for the promotion of exports, we are currently beginning to talk more about its tariff

and non-tariff barriers. Only in recent months it was decided to limit the export of grain, it is also being discussed to put restrictions on the export of metals. After this, the restrictions on the export of chemical products, and other products may follow. The problem is clear: in a period of devaluation, exports become very attractive, and there are difficulties for the fulfillment of the internal market. However, all these difficulties (potential future difficulties, as domestic demand falls too) should not be a reason for non-recovery of the structure of Russian exports. There are enough levers to satisfy the internal market, without hindering external expansion of our producers.

Secondly, one should not create export restrictions, artificial barriers to entry of foreign competitors in the Russian market. Currently the exchange rate is a sufficient barrier to protect domestic producers, but imported goods, as paradoxically, in a number of positions, in this situation, would be able to contribute to the stabilization of prices.

Thirdly, it is important not to interfere with efforts at improving and restructuring of domestic enterprises. It will be accompanied by a rationalization of employment that, with all the pain, would be a very important element of modernization. Rationalization is important for both export-oriented enterprises and for the ones focused primarily on import substitution.

Attracting private investment (domestic and foreign) is once again becoming one of the priorities of economic policy at both the federal and regional levels. In case of rental income inflow it was not as important, because budget injections could compensate for the failures of the investment climate. Improvement of Russia's position in the ranking of Doing Business is an important reference point, but the present value of it in the current geopolitical situation is very limited and conditional.

Deregulation, the protection of rights of entrepreneurs and development of SMEs (small and medium sized enterprises) – are different, but closely related economic policy priorities. Legislation should in principle be friendly to business, helpful to attract people to business, and not repelling from it. Meanwhile, even at the level of regulation titles, the deterioration of attitude towards business can be traced. When, before, the relevant law was called “Protection of rights of legal entities and individual entrepreneurs in the exercise of state supervision and municipal control”, now a draft law “On the federal, regional and municipal control” is being developed. The issue, of course, is not the title, but the practice which is definitely not conducive to entrepreneurial activity, despite an increase in Russia's place in the ranking of Doing Business and direct instructions of the President “as much as possible to remove restrictions from the business, relieve it from the obsessive surveillance and control”.

Sets of measures to stimulate competition should be developed. This is particularly important in the current macroeconomic and geopolitical situation, when devaluation and the sanctions are significantly limiting access of competing

goods and services to the domestic market. Policies to promote competition cannot be identified with the policies of restriction of monopolies, which in some cases are directly opposed to each other. Currently, competition policy is needed, not “fight against monopolies”, which is sometimes understood as restrictions on those who have achieved success in the market.

The above mentioned problems are not fulfilling the modernisation agenda in the current crisis. Other important areas of institutional and structural reforms should be highlighted, such as industries of human capital (education, healthcare, pension system), which are now closely intertwining social, fiscal and investment factors. New approaches to social policy, foreign economic activity, and spatial development are required. In conclusion, the urgent tasks which require creative institutional solutions for further transformation of the economic system of Russia are:

- pulling up to date the most important components of market infrastructure (banking systems, stock market, infrastructure, support for small and medium-sized businesses, and others);
- determined opposition against the sprawling corruption and other forms of negative shadow relations in the economy;
- taking effective measures to implement major structural changes in the economy, associated with the departure from the raw material model and the conversion to innovation-oriented model of economic development;
 - creating an effective national innovation system;
 - re-creation of the long-term forecasting system, strategic and indicative planning and programming of social and economic development, at a new level in the country;
 - discovering of effective forms of project-based approach to solving repetitively emerging large-scale scientific, technological and socio-economic problems on a national scale;
 - the creation of a more effective mechanism of interaction of enterprise structures and the state in the implementation of relevant national issues;
 - significant improvement of the system of regional management of the economy, which should contribute to the expansion of centralized influence towards more balanced territorial development and stimulation of initiative efforts of the regions in addressing socio-economic problems on the ground.

Current objectives determine the perspectives of development of Russian economy and economic policy’ priorities of the state. The success of their implementation is directly connected with the specific characteristics of the institutional structure of the country and its civilizational peculiarities, its values and interests of the major economic actors that are forming a real mechanism of public policy.