Russia in 2012: The Challenge of Reforming the Economy without A Political Reform

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CEEI 2012
Road Map

- Short-term
- How good are Russian institutions today?
- Some politics
- Moving forward
Short-term Outlook
Short-term Looks OK

- Russian economy is recovering in 2010-12:
  - 4% GDP growth in 2010 and 2011
  - Consensus forecast for 2012 and afterwards: 3-4%

- Unless there is a major global financial crisis, Russia will be able to cope
Russia vs. “Neighbors”

Real GDP levels, Q1 2008 = 100

- Central Asia
- Kazakhstan
- Turkey
- EE+Caucasus
- Emerging Europe
- Russia
- Baltics

EBRD Transition Report 2011
Russia vs. Emerging Economies

Growth of GDP in constant prices, % per year.
Source: IMF (World Economic Outlook, April 2011).
Unemployment

Source: Goskomstat, CEFIR
Inflation

Source: Goskomstat, CEFIR
Access to Credit

Average interest rates on bank loans for industrial firms
Source: Gaidar Institute Firm Survey.
Normal Access to Credit

Average interest rates on bank loans for industrial firms
Source: Gaidar Institute Firm Survey.
Consequences for households: huge

Reduction in staple food consumption

- Russia – 35% of households
- Transition countries – 39%
- Central Asia – 27%
- Western Europe – 11%
Consumption Change

Share of households reporting consumption response to crisis

- Reduced staple food consumption
- Reduced consumption of luxury goods
- Reduced consumption of alcohol and smoking
- Postponed or skipped visits to doctor after becoming ill
- Delayed payments of utilities

Data Source: EBRD Survey, Fall 2011

Western Europe
Transition region
Russia
Long-term and Politics
Next South Korea? [2-years-old slide]

Income per capita, purchasing power parity.
Source of data and forecast: World Economic Outlook October 2009, IMF.

Guriev and Zhuravskaya, 2010
Emerging economies may grow faster than developed ones

- accumulation of capital on path to steady state (Solow)
- ‘advantage of backwardness’: technology adoption on path to technology frontier (Gershenkron)

Obstacles to fast growth

- weak institutions that increase cost of investment (North, Acemoglu-Robinson)
Good Institutions

- politically independent courts
- efficient law enforcement
- non-corrupt regulators
Institutions Worse in Russia

Control of corruption
Rule of law
Regulatory quality
Government Effectiveness
Political stability and absence of violence/terrorism
Voice and Accountability

Korea, % rank in 1997
Russia, % rank in 2008
Start-Up Opportunities

% of respondents who successfully set up a business

Russia 2012

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## Index of Economic Freedom 2011

<table>
<thead>
<tr>
<th>Category</th>
<th>Name</th>
<th>Rank</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mostly free</td>
<td>Estonia, Lithuania, Czech Rep., Georgia</td>
<td>14 - 29</td>
</tr>
<tr>
<td>Moderately free</td>
<td>Armenia, Slovakia, Hungary, Macedonia, Latvia, Bulgaria, Romania, Slovenia, Poland, Albania, Montenegro, Kazakhstan, Croatia, Kyrgyzstan</td>
<td>36 - 83</td>
</tr>
<tr>
<td>Mostly unfree</td>
<td>Azerbaijan, Serbia, Bosnia &amp; Herzegovina, Moldova, Tajikistan</td>
<td>92 - 128</td>
</tr>
<tr>
<td></td>
<td>Russia</td>
<td>143</td>
</tr>
<tr>
<td>Repressed</td>
<td>Belarus, Uzbekistan, Ukraine, Turkmenistan</td>
<td>155 - 169</td>
</tr>
</tbody>
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Hermitage Foundation, 2011
Doing Business

Doing business ranking 2011-2012

Institutions
Where Do Institutions Come From?

- Economic institutions are designed and put in practice within a political process.

- Good institutions might be based, politically:
  - on mature democratic institutions
  - on something else [strong central leadership]
Alternative Model

- Institutions that rely on strong, yet non-democratic political authority
- “Institutionalized ruling party”
  - Mexico, 1930-2000
  - communist regimes
  - China
- Personalistic non-democratic regimes
  - Russia
  - Kazakhstan
  - Belorussia
Russia, 2012

- Personalized weakly autocratic regime
- Leader in power for a long-time, since 1999
- ‘Real’ popularity of leaders is not known
  - United Russia, December 2011: 25-35% in Moscow, 35-45% country-wise (49% official tally)
  - Putin, March 2012: 50+% ?
- No well-organized opposition
  - large (by Russian standards) protests
  - no succession path
Is Alternative Model Sustainable?

- “Institutionalized ruling party”
  - Mexico, 1930-2000
  - communist regimes
  - China (“communist regime 2.0”)

- Personalistic non-democratic regimes
  - Russia
  - Kazakhstan
  - Belorussia
  - Uzbekistan

- NB: Direction of evolution is not easily predicted

Jury is out

Not sustainable
EBRD Democratic Attitude Survey

Increase in democracy support vs. Economic growth

Russia 2012

Konstantin Sonin (NES)
Less democratic countries now support democracy more.
Previous crisis experience (post-1990 GDP drop)

Countries with harshest post-1990 crises increased their democracy support

EBRD Democratic Attitude Survey

Increase in democracy support

[Graph showing countries and their democracy support levels]
New Drivers of Growth

- Underemployed labour?
  - no, labour market will be tight already in 2012
  - unemployment is 6.3% - above 5.4% in May 2008, but lower than 9.4% in Feb 2009 (and 14.6% in Feb 1999)

- Spare capacity?
  - no, all capacity utilized, need new investment

- Oil price?
  - unlikely: to move from 4% GDP growth to 6% growth, need oil price to grow by $10-20/barrel every year

- Need productivity growth (investment and innovation)
Key reforms

- Privatization
  - improve corporate governance in state companies
  - create critical mass of further pro-market reforms

- Deregulation and business climate
  - Putin: move from 120th to 20th in Doing Business

- External anchor
  - WTO and OECD accession

- Macroeconomics: inflation targeting and floating ruble
  - foster financial development and inflow of long-term savings from households
  - increase growth of non-resource sectors and mobility of Russians.

- Pension reform
Reality Check on Key Reforms

- Privatization
  - a major nationalization (TNK-BP) under way right now

- Deregulation and business climate
  - not much

- External anchor
  - significant progress (WTO) and talks (OECD)

- Macroeconomics: inflation targeting and floating ruble
  - not clear what is going on

- Pension reform
  - stalled
Conclusions

- In short run, Russian economy is growing

- In longer run, Russia faces serious challenges
  - sources of pre-crisis growth are exhausted
  - need new investment hence need better investment and business climate and better financial sector

- In order to avoid a slowdown, needs substantial reforms
  - otherwise will grow at 2-4% growth
  - if reforms happen 5-6% growth is not impossible
  - politics makes reforms problematic in the short-run