EVENT SUMMARY

Russia in the World Economy

Seventh Annual Stavros S. Niarchos Lecture

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Petr Aven discussed former Russian president Vladimir Putin's economic achievements and the challenges Russia's new president, Dmitry Medvedev, faces. During eight years of Putin's presidency, Russia registered a high and stable growth rate, enormous central bank reserves at over $500 billion plus $200 billion in stabilization funds (15 percent of GDP), and a current account surplus of 6 percent of GDP in 2007. The only disturbing figure is for inflation, which will surpass 12 percent.

Aven compared Russia's macroeconomic data for 2000–2007 with those of competing countries, including Eastern European countries as well as Brazil, India, and China, emphasizing that with 8 percent growth rate in 2007 Russia is economically stronger than its rivals. Private wealth in Russia has increased much faster than in the rest of the world. Real disposable income has grown by 140 percent since 2000, which to a great extent explains Putin's popularity.

Aven contrasted the current situation with that in 2000, when Putin took office. Russia's economy was weak and still recovering from the economic crisis of 1998. GDP growth was completely correlated with oil prices; 17 percent of the population was employed by the state; it had one of the world's highest fiscal deficits; and its foreign debt was 50 percent of GDP. Capital flight, triggered by oligarchs taking money out of the country, was estimated at around $20 billion a year. Russia failed to attract foreign direct investment despite very low average monthly wages at $79. Banking assets penetration was as low as 34 percent of GDP.

Social problems had worsened in 2000: lack of housing; low living standards, with more than 50 percent of the population living below $4 (purchasing power parity) a day; high income inequality; and persistently high inflation that destroyed savings, fueled dollarization, and lowered deposits-to-GDP ratio to 10 percent.

Aven emphasized that Putin's top priority was to achieve macroeconomic stability through reliable budgetary policy. As a result, Russia has one of the world's largest fiscal surpluses at 5.5 percent of GDP and one of the lowest foreign debts at 3.6 percent of GDP and completely covered by state reserves. Macroeconomic stability accelerated consumption growth to 60 percent of GDP, investments increased to 21 percent, and unemployment fell to 6 percent. According to Aven, Putin's biggest budgetary success is that he used stabilization funds to pay off foreign debt and build strong reserves.

At the same time, Putin's popularity was supported by tremendous improvements in living standards: The number of cars in Russia has tripled since 1991; housing construction has boomed; over 10 million Russians have traveled abroad annually; the number of university students has more than doubled over the past 10 years; the birth rate has increased; and infant mortality has dropped. Real disposable income has grown at 10 to 12 percent a year due to high GDP growth and introduction of consumer loans, which were completely absent in 2000.

Finally, Aven summarized some of the challenges the new president will face during the next few years. First, the increasing number of retired people in Russia will increase public expenditures. The number of pensioners has increased, but at the same time the pension-to-salary ratio has declined. This trend limits Russia's ability to cut public expenditures, which are currently covered by high oil prices and tax revenue at 40 percent of GDP. Therefore, Aven insisted that there is a crucial need for urgent pension reform and promotion of private savings.

Second, he emphasized investment concerns. The Russian consumption boom, brought about by continuous improvement in living standards; inflation; and negative interest rates prevent Russians from saving, which is as low as 11 percent of their annual income. At the same time, when the expectation for further economic improvement is so high, Russia needs to increase investment in its industry. Meanwhile most of the money is being spent on consumption, stabilization funds, foreign debt, and imports, and no restructuring is taking place within Russia.

Another item on Medvedev's agenda will be increased state bureaucracy: The public sector still employs 16 percent of the population, and the number of state bureaucrats increased at least 25 percent since 2000.

Aven concluded that Putin brought macroeconomic stability based on cheap international capital and high oil prices. Fifty percent of the budget revenue comes from commodities, but at the same time oil and natural gas production is not growing. In order to maintain sustainable growth, the Russian economy should be liberalized, pension reform is a must, and most important, the growth paradigm should be shifted from consumption to investment.

Panel Discussion

The panel discussion featured Aven, Mikhail Fridman, C. Fred Bergsten, Anders Åslund, and Peter G. Peterson. Peterson started with his observation that Russians are often viewed as preferring a centralized economy and a more authoritarian political model. Fridman commented that while Russians are not completely satisfied with their level of democracy, they are almost at the maximum level that could have been achieved. At the same time, it is difficult to assess the level of democracy, because there is no benchmark for comparison. Democracy in Russia has been a relatively new phenomenon and was introduced in a wild and unregulated form. The public requested more manageable and strict rules in all spheres of social life. On the other hand, the new generation, which is represented by President Medvedev, looks at democracy from another standpoint, and he, the nation's leader, should move toward a more democratic agenda, which is inevitable for sustainable economic growth.

Discussing productivity and competitiveness in Russia's nonoil sector, Aven mentioned that it remains at the same low level as it did during the Soviet Union era.

Competitiveness could be achieved with strong small and medium-sized enterprises (SMEs), but as of today their share of exports remains low.

When asked about Putin's role in Russia's future in the next five years, Fridman said that the model of sharing powers is not typical for Russia. The success of this model might be discussed no sooner than the end of 2008. On one hand, Russia is a country with a strong tradition of centralized power; on the other hand, Putin is the most popular political leader in the country because of his contribution to the growth of living standards.

Bergsten posed a question about how low the oil price should drop in order to create a new disaster for the Russian economy. Aven suggested that if personal income—which is growing at 10 percent a year—fell to 2 percent a year, it will be viewed as a disaster. He predicted that at oil price under $60 a barrel, fast and crucial reforms will be unavoidable.

Åslund brought to attention that it is impossible to sustain strong growth without further reforms. He asked panelists to comment on how lower oil prices will bring reforms and more democracy to Russia. Aven agreed with Åslund that high oil price postpones reforms, but at the same time if the price of oil dramatically collapses it may raise more serious social issues. Therefore the question of balance is to see oil prices at the level that guarantees reforms but does not destroy the economy.

Fridman added that although it was the government's obligation to utilize the opportunity of high oil prices to implement deep structural reforms, Russia was not prepared for deep reforms and Putin decided to take a break after the many years of chaos, disaster, and low savings.

Q&A Session

Among the questions raised during the Q&A session were steps taken to develop SMEs; declining oil and natural gas production; status of business and corporate law; impact of Russia's WTO accession; and impact of increasing state control over strategic sectors.

Panelists saw deregulation, economic freedom, and promotion of private entrepreneurship as the crucial steps for SME development. They stated that the main reason for declining oil and gas production is high taxes, which deprive companies of investment in new fields. They observed that the Russian legal system was developing as any other institution in Russia. They discussed WTO accession as an additional external rule to discipline Russian internal policies, and finally they predicted state-owned companies in strategic sectors would be privatized and compete with the private sector.