



Russian economic transformation

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Learning outcomes of this lecture

Political and socio-economic causes of Soviet Union collapse

Russian economic transformation from central planning economy to a market one: Economic reforms and their consequences

Economic development of Russia in recent years: Overview and comparison with other countries

The end of Brezhnev Era – beginning of the collapse of Soviet system

Crisis in agriculture continued in the 1980s: Necessity to buy grain in the international market:

While **the price of petroleum** was **high** - **financing** the **purchase of grain** from **internal sources** was possible.

When the **price of petroleum fell** in the last 1980's =>

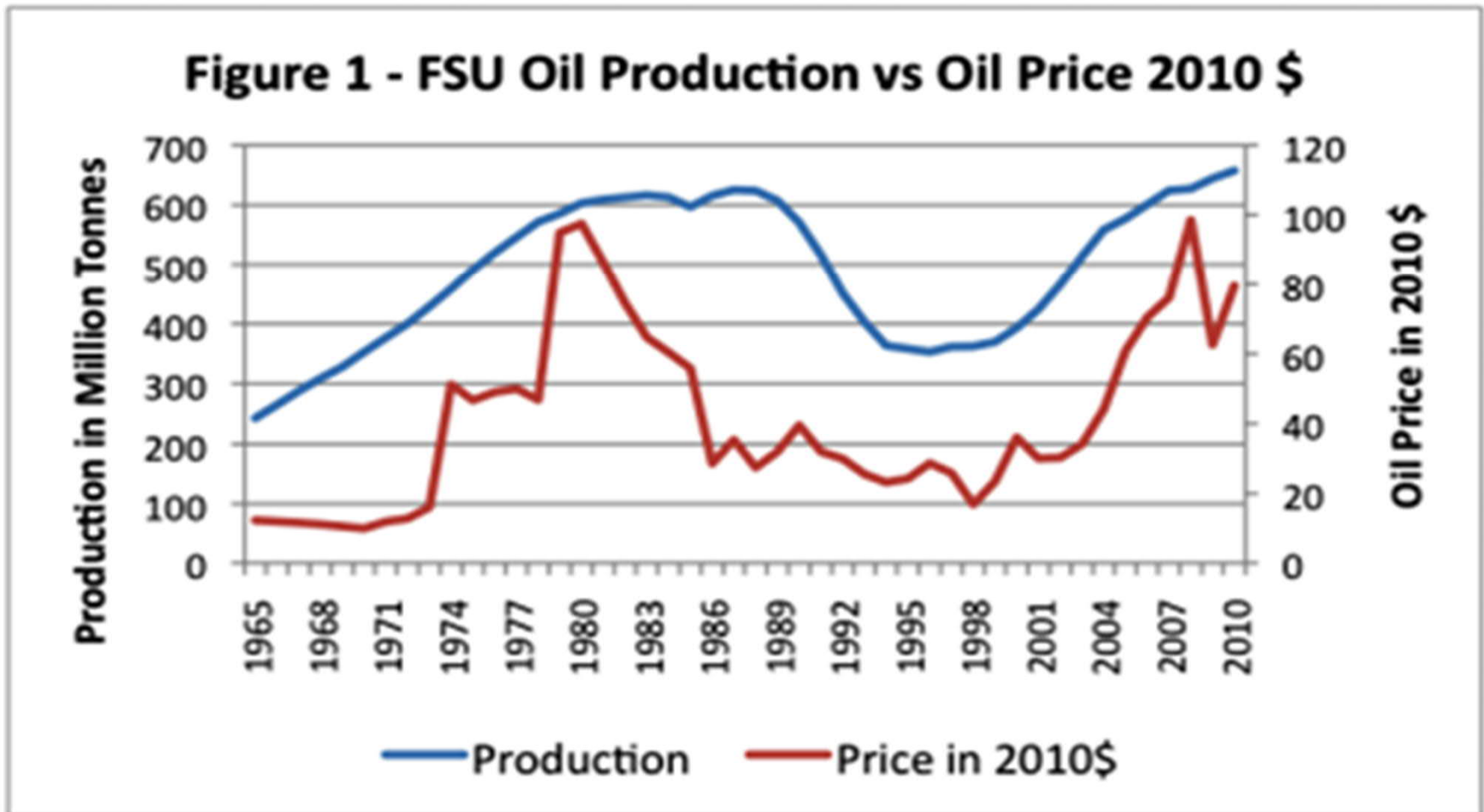
the Soviet Union **needed to borrow** the funds from **Western banks** to purchase the needed grain. =>

This severely **restricted the international activities** of the Soviet Union.

HYPOTHESIS: The reason for the decline in petroleum prices in the late 1980's: **the Soviet Union invasion of Afghanistan.** =>

Saudi Arabia increased its production of petroleum drastically (to punish SU) and consequently the price of petroleum fell.

Collapse of Soviet Union and the world price of oil



"Last days" of the Soviet Union

1982: Brezhnev dies and is replaced by KGB chief Yuri Andropov.

1984: Andropov dies and is replaced by Konstantin Chernenko.

1985: Chernenko dies and is replaced by **Mikhail Gorbachev.**

Political causes of the Collapse of Soviet Union

Eastern European countries (Poland, Hungary, Czechoslovakia) demanded reforms of communism or even did not want communism at all.

Nationalism among Soviet satellite states, democratic opposition movements, and economic crisis.

Mikhail Gorbachev's role. Although his attempt to reform communism was rejected, his reformist positions as Soviet premier/head of government helped open the way for full-fledged political dissidence.

MIKHAIL GORBACHEV (1985-1991)

His reforms hastened the end of communism.

-anti-alcohol campaign.

-the policies of **OPENESS** (RU: glasnost) and **RESTRUCTURING** (RU: perestroika).

-1987: Signs superpower treaty with US to begin scrapping nuclear warheads.

Collapse of the Soviet Union

In just two years from 1989 to 1991:

- The Berlin Wall fell.
- The Soviet Union disintegrated.
- Marxism-Leninism was dumped unceremoniously on the ash heap of history.
- Boris Eltsin becomes the first elected president of Russia in 1991.

Russia in economic transition: from 1991 onwards



Economic Transition of Russia

Yegor Gaidar, the controversial architect of Russia's painful transition to a post-Soviet market economy.

First actual reform program was made in March 1992
(for IMF loan) => **Washington consensus:**

Liberalization (price)

Stabilization

Privatization

Structural reforms

Yeltsin Russia (1991-1999)

Putin Russia (2000 – present)

versus

Washington consensus 10 prescriptions

1. Low government borrowing;
2. Redirection of public spending from subsidies toward broad-based provision of key pro-growth, pro-poor services;
3. Tax reform;
4. Interest rates that are market determined and positive (but moderate) in real terms;
5. Competitive exchange rates;
6. Trade liberalization;
7. Liberalization of inward foreign direct investment;
8. Privatization of state enterprises;
9. Deregulation;
10. Legal security for property rights.

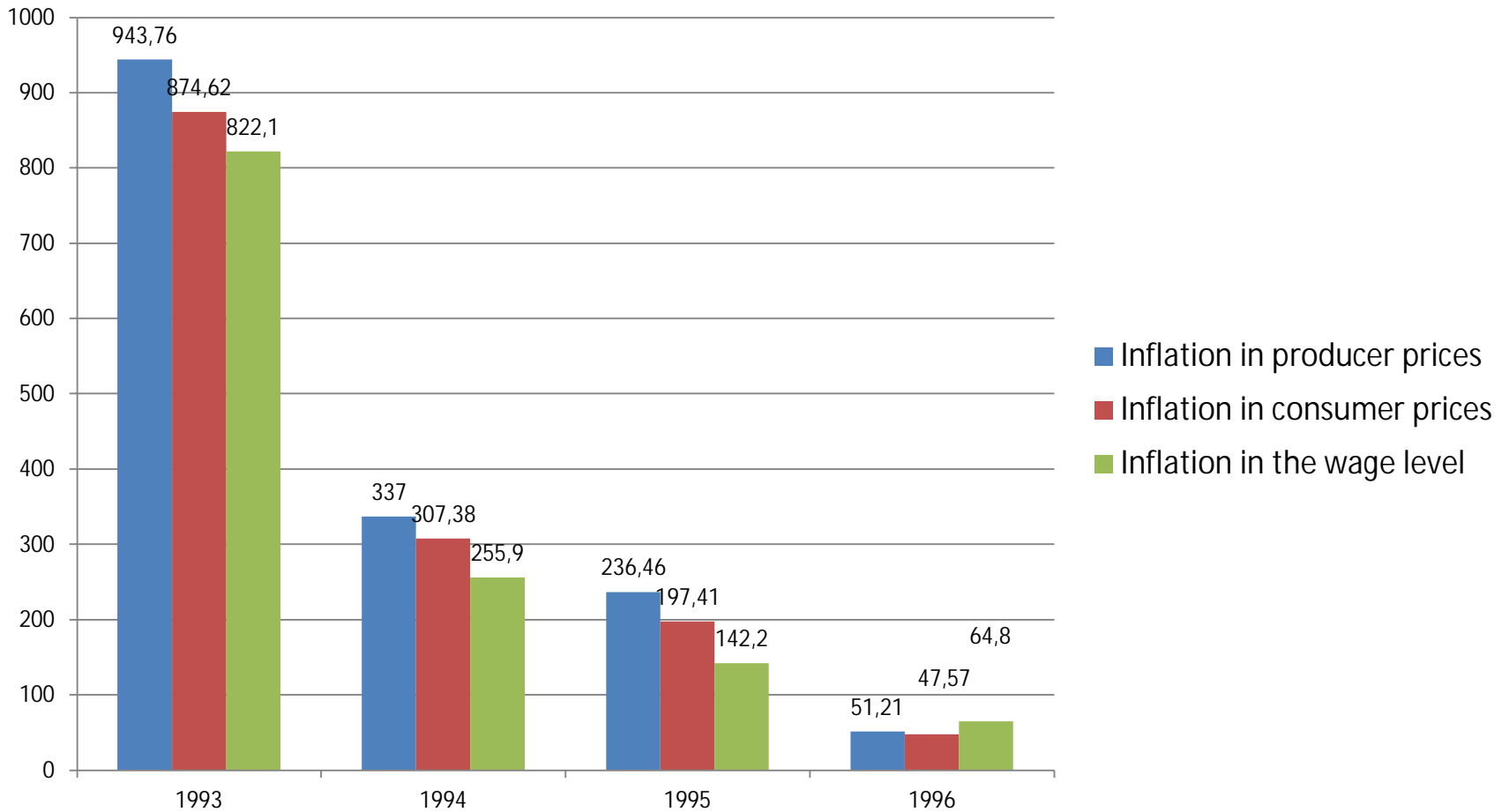
Economic transition: stages

(From **Joseph Stiglitz (NOBEL PL)**, *Globalization and its Discontents*,
2002 Chapter 5)

1. Shock Therapy (Strongly voiced by US and IMF):

- **First round:** Instantaneous price liberalization -- prices freed overnight in 1992. Resulting inflation wiped out savings. First mistake. Capital was used up.
- Prices for natural resources were kept low. People got rich through rent seeking. – Buying oil in Russia and selling it in the West.
- **Second Round:** Stabilization to reduce inflation. Tightened monetary policy by raising interest rates => huge drop in production output; increase of unemployment.
- **Third Round:** Privatization – supposed to bring about positive restructuring of the economy. But this never occurred.

Hyperinflation in Russia, %/year



Stages of privatization

Pre-privatization (commercialization) stage late 1980s-1992

Mass Privatization (I) 1991-1994

- Voucher privatization

Cash privatization or Loans for Shares (II) 1994-1997

- Sales of larger, high-value enterprises to financial/industrial groups.
- Loans for shares.

Voucher privatization



Anatoli Chubais – responsible for Privatization in Russia.

Each voucher nominal value was 10,000 Russian rubles (175 USD): issued in 1992. Duration: 3 years.

Every Russian citizen – one voucher for free.

Vouchers could be used to buy shares of enterprises, voucher investment funds or could be sold.



Cash privatization

Loans for shares:

Government transfers to banks – for temporal control (5 years) – stock of shares of large companies.

In exchange for low-interest loans to the government due to 2000 (can be used for budget expenditures).

During 5 years – the government must sell secured shares and return loans to banks or → Ownership of many important enterprises was turned over to the banks.

Economic reason – budget crisis.

Privatization

(From **Joseph Stiglitz**, *Globalization and its Discontents*, 2002 Chapter 5)

Privatization led to asset stripping/robbing, not wealth creation:

- Pressured by US, World Bank and IMF to privatize quickly, state turned over its assets for a pittance and did so before effective tax system was in place.
- Thereby created a powerful class of oligarchs and businessman who siphoned off funds and deposited them in Swiss bank accounts.
- Russian government borrowed billions from IMF, yet, unable to pay pensions or welfare payments.

Structural reforms

(From **Joseph Stiglitz**, *Globalization and its Discontents*, 2002 Chapter 5)

Radical restructuring failure:

- After 1989, GDP in Russia fell year after year. Recession has lasted over a decade.
- 1990-1999: Russian industrial production fell by almost 60% and GDP fell by 54%.

The failed transition

(From **Joseph Stiglitz**, *Globalization and its Discontents*, 2002 Chapter 5)

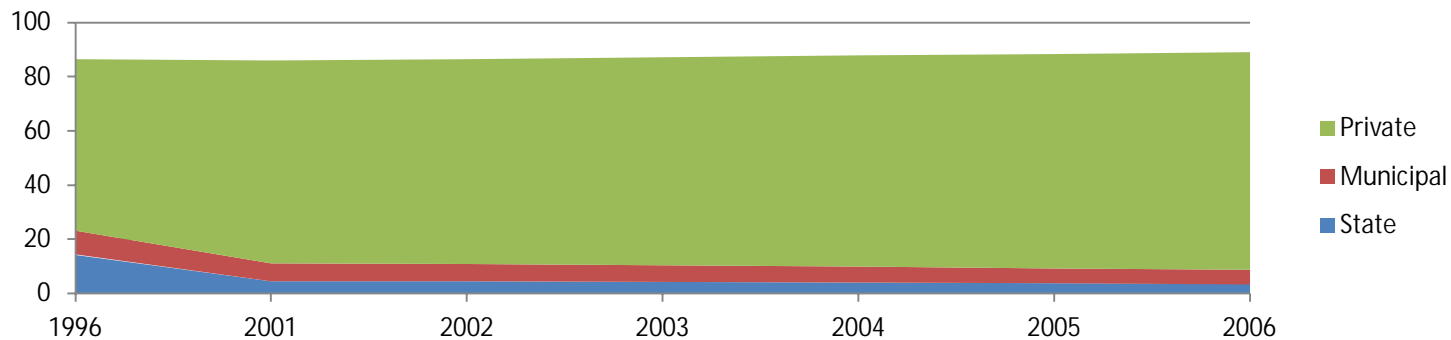
Russia transformed **from industrial country to natural resource exporter.**

Consensus that **most people experienced a marked decline in their basic standards of living.**

Though:

Main market institutions have been established.

Public versus private sector (enterprises` statistics):



August 1998 crisis: background

Reasons:

- ❖ Declining productivity;
- ❖ Artificially high fixed exchange rate between the rouble and foreign currencies to avoid public turmoil;
- ❖ Chronic fiscal deficit.

Reasons according to the IMF:

- (1) weak economic fundamentals, especially in the fiscal area;
- (2) unfavorable developments in the external environment, including contagion effects from the Asian financial crisis and falling prices for key export commodities such as oil;
- (3) Russia's "vulnerability to changes in market sentiment arising from the financing of balance of payments through short-term treasury bills and bonds placed on international markets".

August 1998 crisis: Chronicle

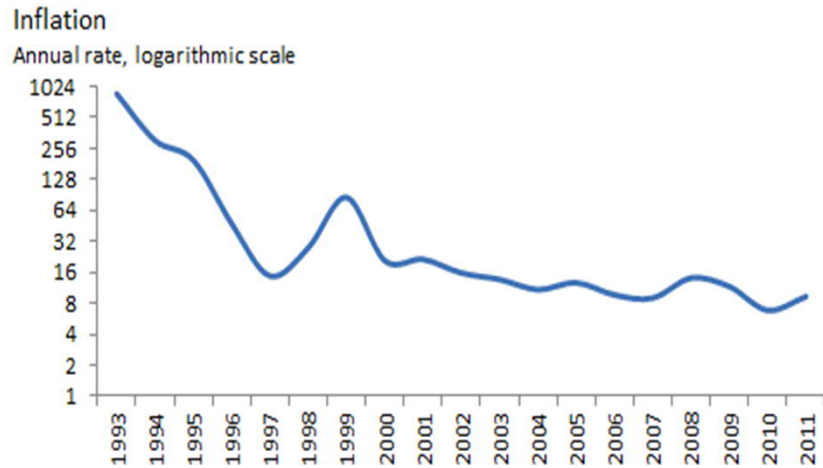
August 13th, 1998: The Russian stock, bond and currency markets collapse.

August 17th, 1998:

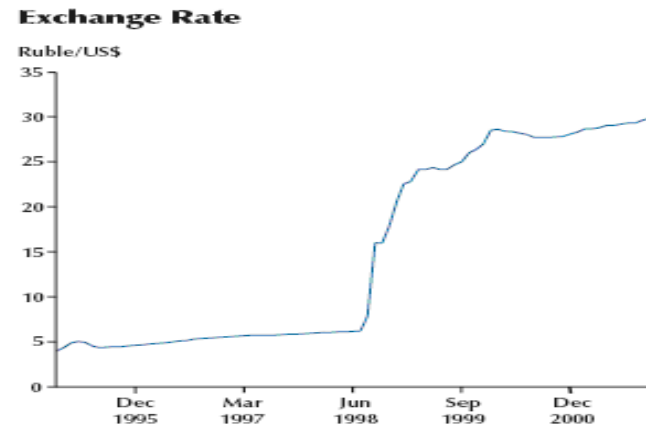
- A significant devaluation of the ruble;
- A default on short-term Treasury Bills known as GKO's, as well as longer-dated ruble denominated bonds named OFZs;
- A 90-day moratorium on payments by commercial banks to foreign creditors.

September 2nd, 1998: The Russian Central Bank's removes the currency corridor and makes the ruble a freely floating currency → sharp depreciation of the ruble → high inflation → social unrest.

August 1998 crisis: some data facts

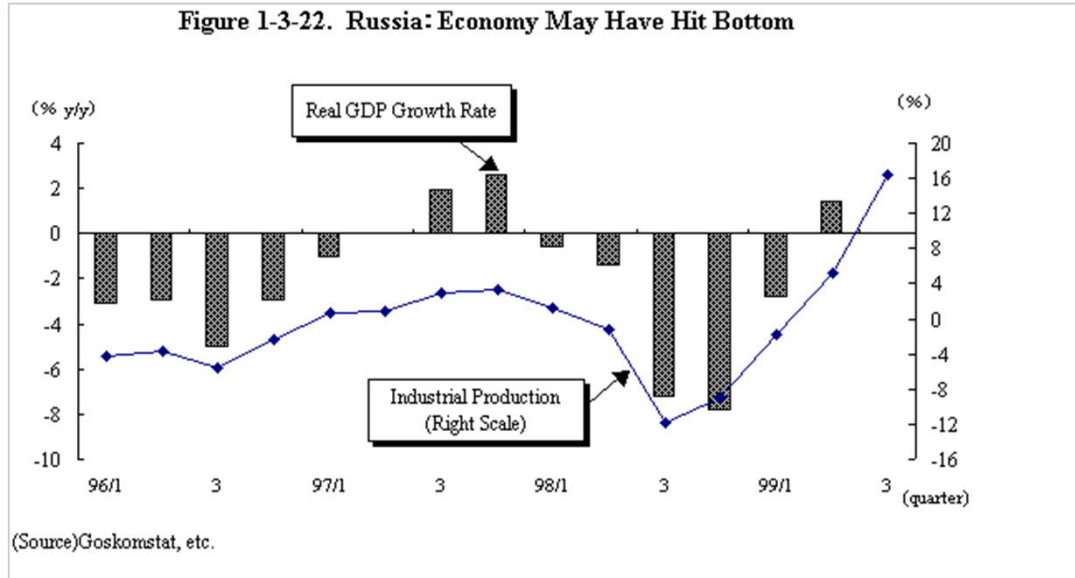


Source: Central Bank of Russia.

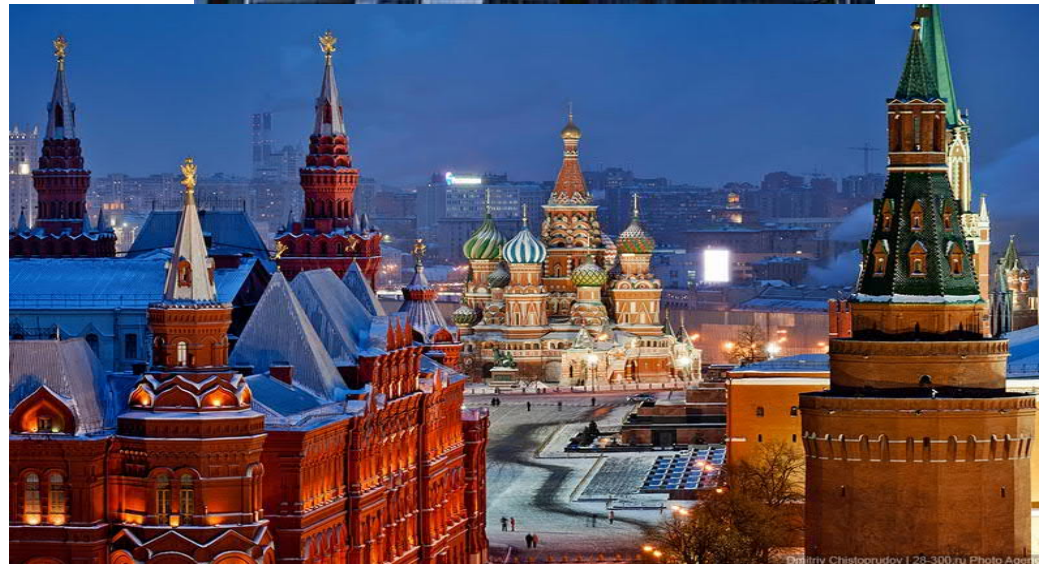


SOURCE: IMF (end of period data).

Figure 1-3-22. Russia: Economy May Have Hit Bottom



Part 2: Russia`s recent economics development: brief overview



Resent economic trends in Russia

- The Russian economy has grown impressively since 1999;
- One of the fastest growing economies in the world in recent decade before 2014.
 - 1999-2008 – Average growth rates 7% - Russia has never had a decade like this.



- Improvement in the standards of living of the average Russian citizen;
 - Dramatic improvement in fighting poverty => explains Putin`s popularity.
 - Economic stability.
- Putin centralized government, reduces accountability and limits freedom.
 - But public is satisfied with income growth.

What is behind the Russian economy rapid growth in recent years before 2014? Macroeconomic policy

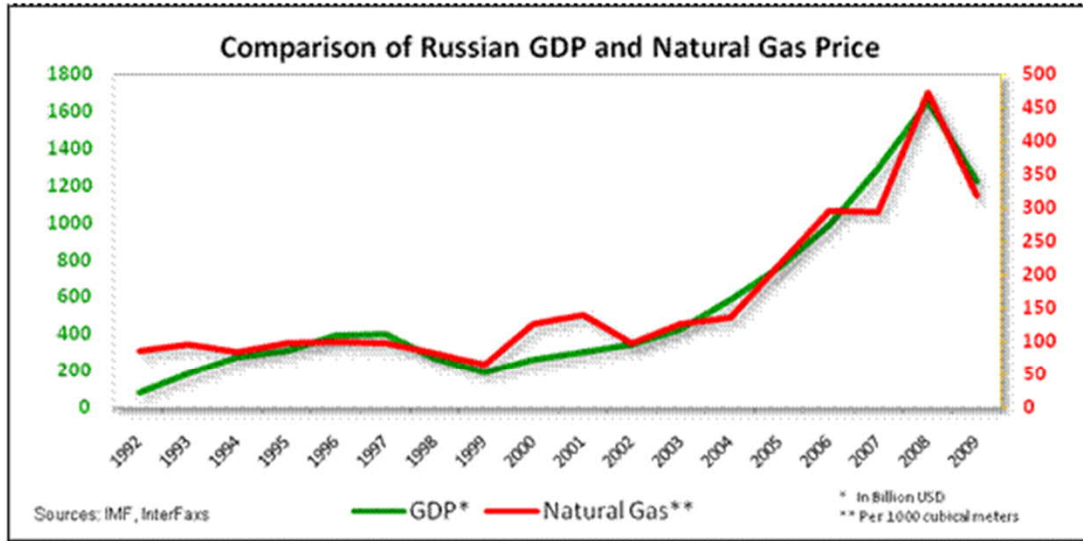
Conservatism in the area of expenditures

Formation of stabilization/reserve fund

Protection of the Central Bank from lobbyists of inflationary financing

(from [Konstantin Sonin](#) livejournal)

What is behind the Russian economy rapid growth in those years? Energy prices



Crisis of 2009

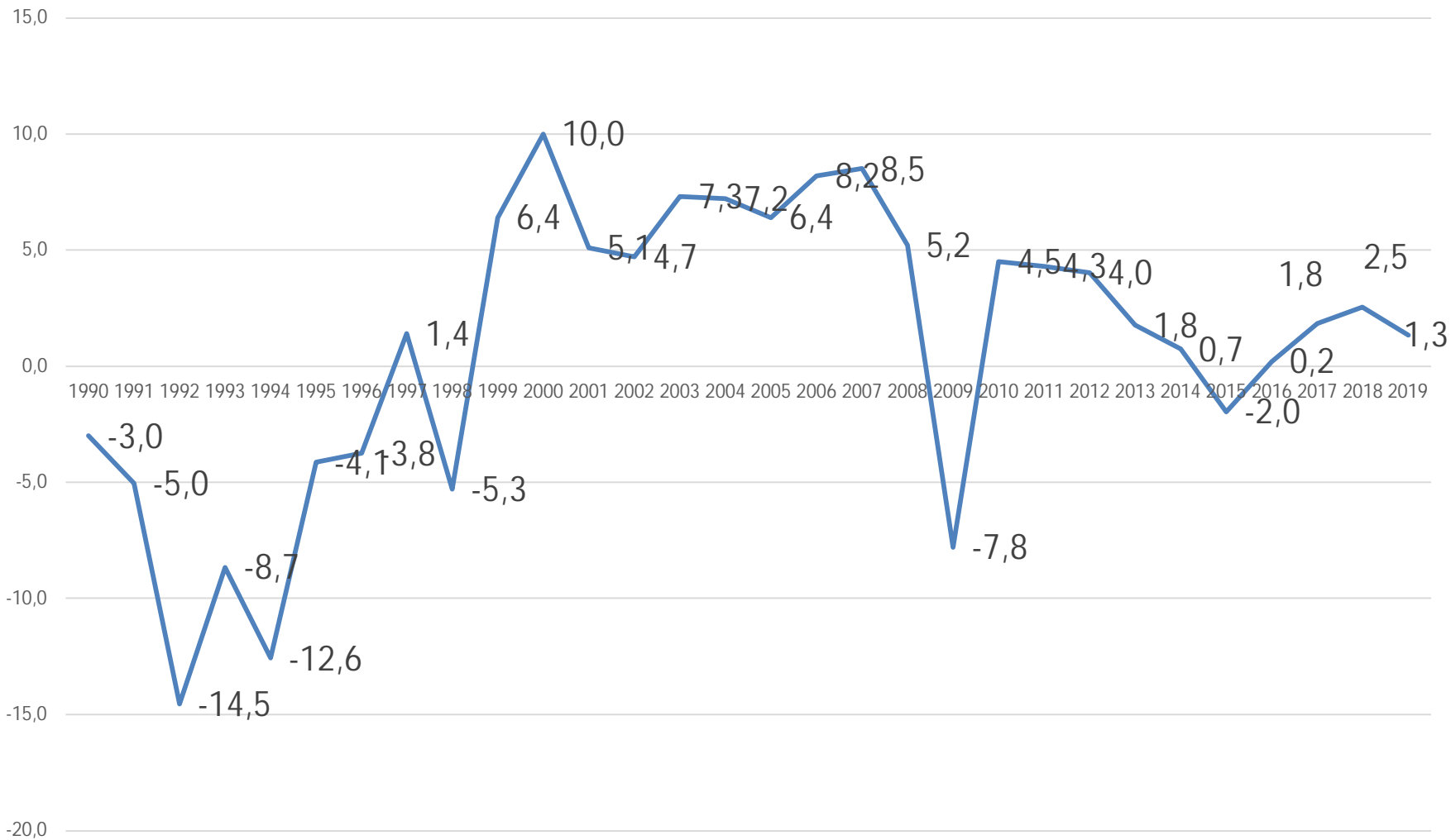
- Oil prices and financial squeeze/compression.
- Plus few policy mistakes (e.g. delayed devaluation).
- Recovery in 2010-2011 – growth of 5% .
- Stagnation – structural nature or cyclical nature?

Structural nature;

External problems – global slowdown.

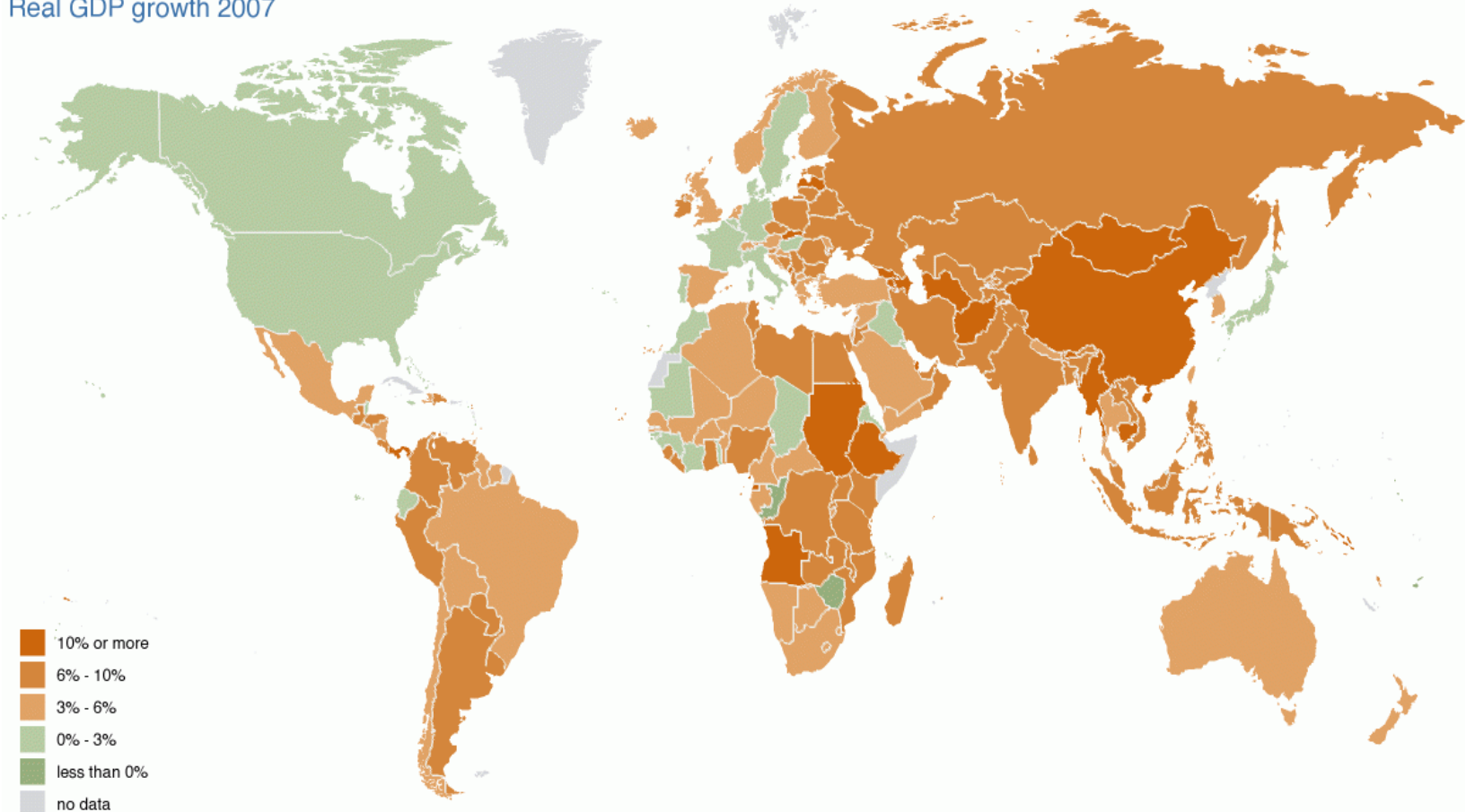
(From [Sergei Guriev](#) public lecture)

Annual percentage growth rate of GDP at market prices based on constant local currency. Aggregates are based on constant 2010 U.S. dollars.



GDP growth rates in 2007

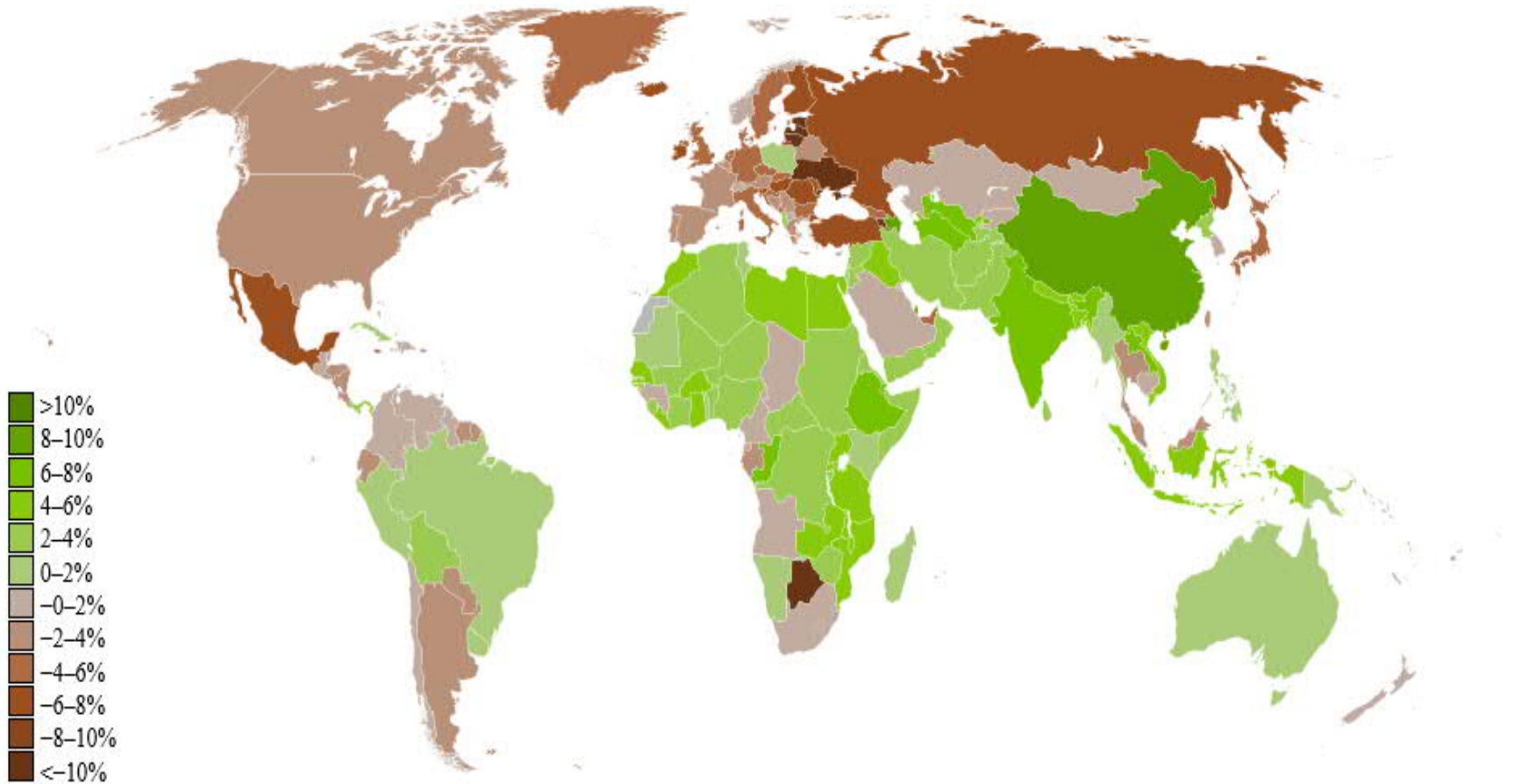
IMF Data Mapper
Real GDP growth 2007



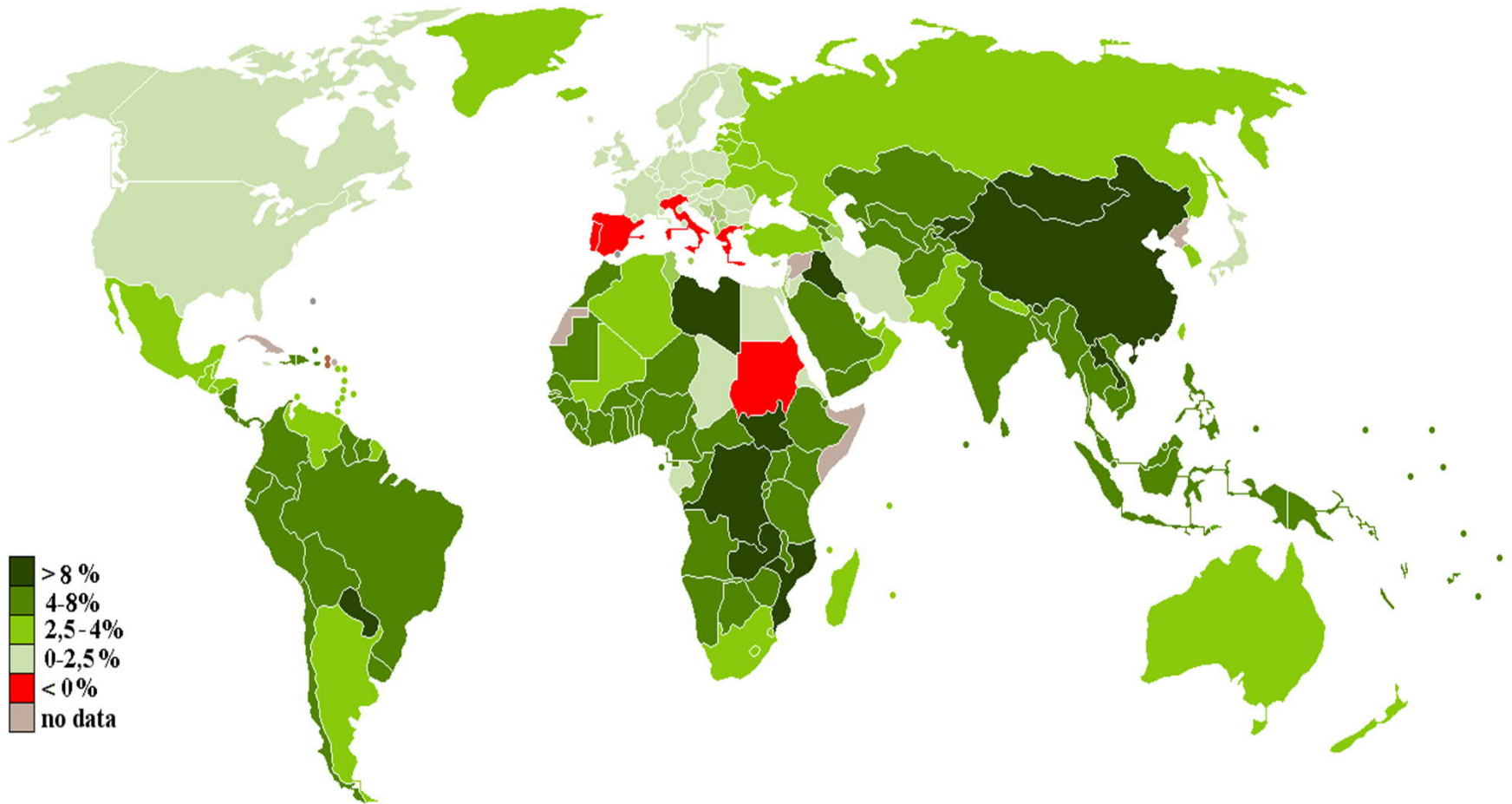
Annual percent change

Copyright: ©IMF, 2009 Source: World Economic Outlook (April 2009) (World Economic Outlook - April 2009)

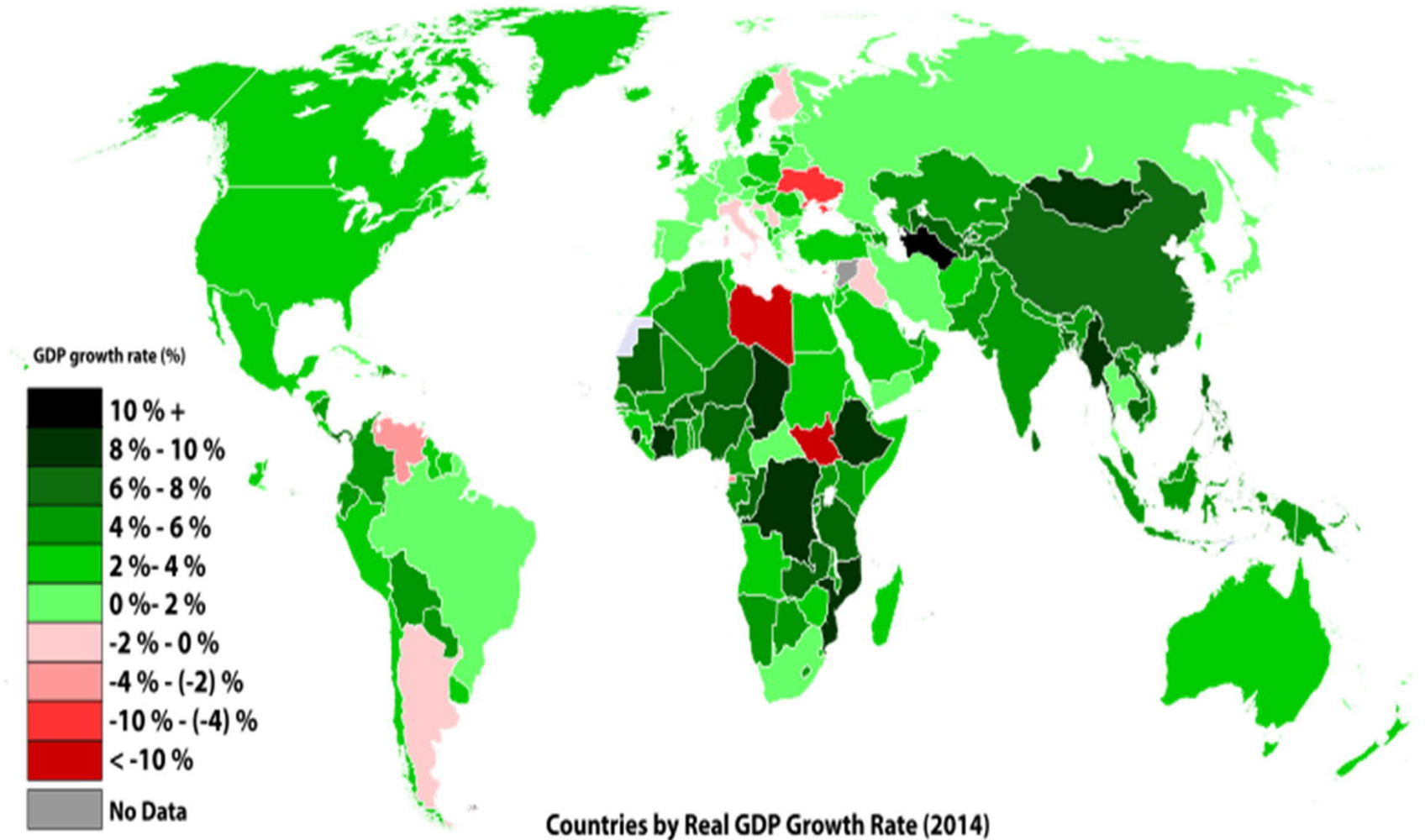
GDP growth rates in 2009



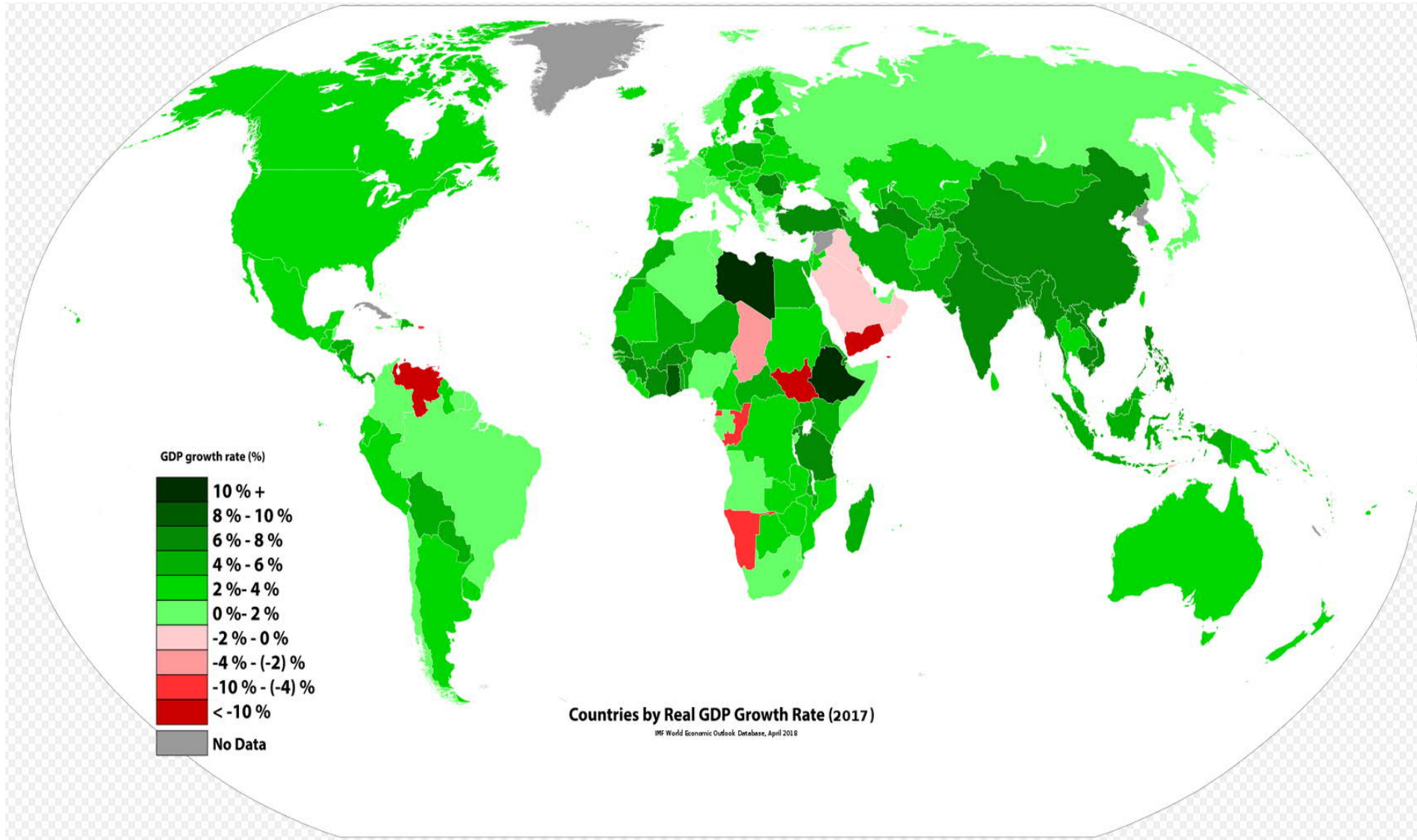
GDP growth rates in 2013



GDP growth rates in 2014

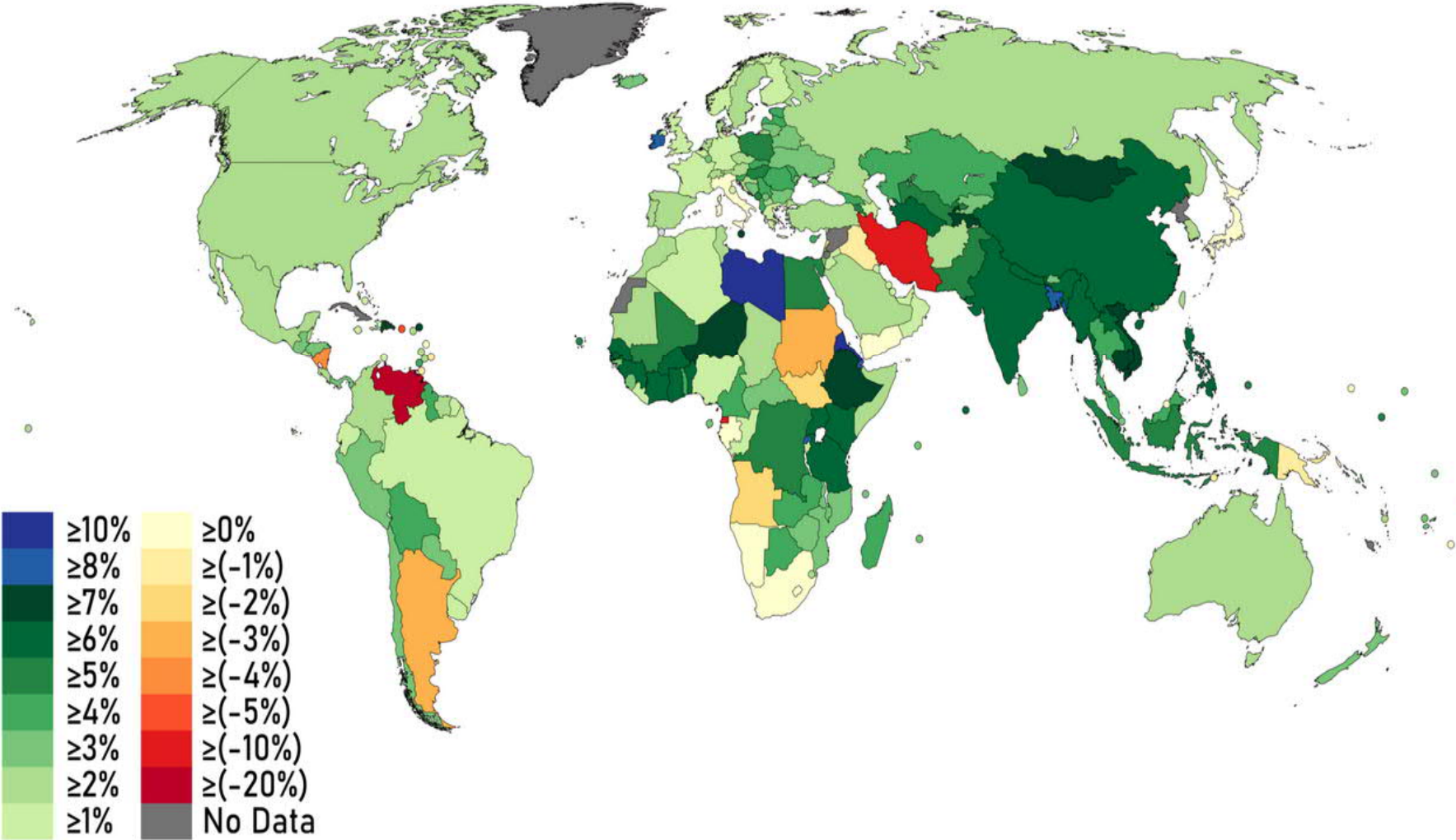


GDP growth rates in 2017

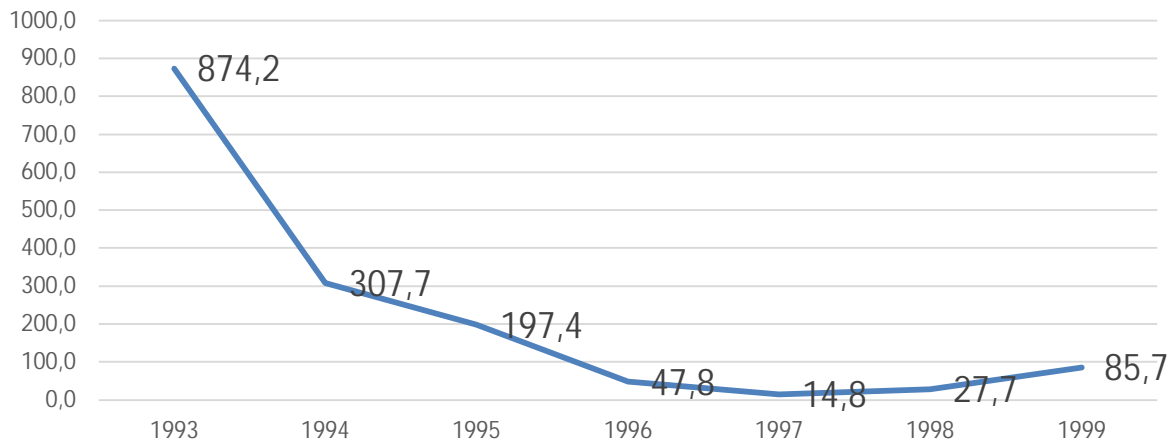


Countries by Real GDP Growth Rate in 2018

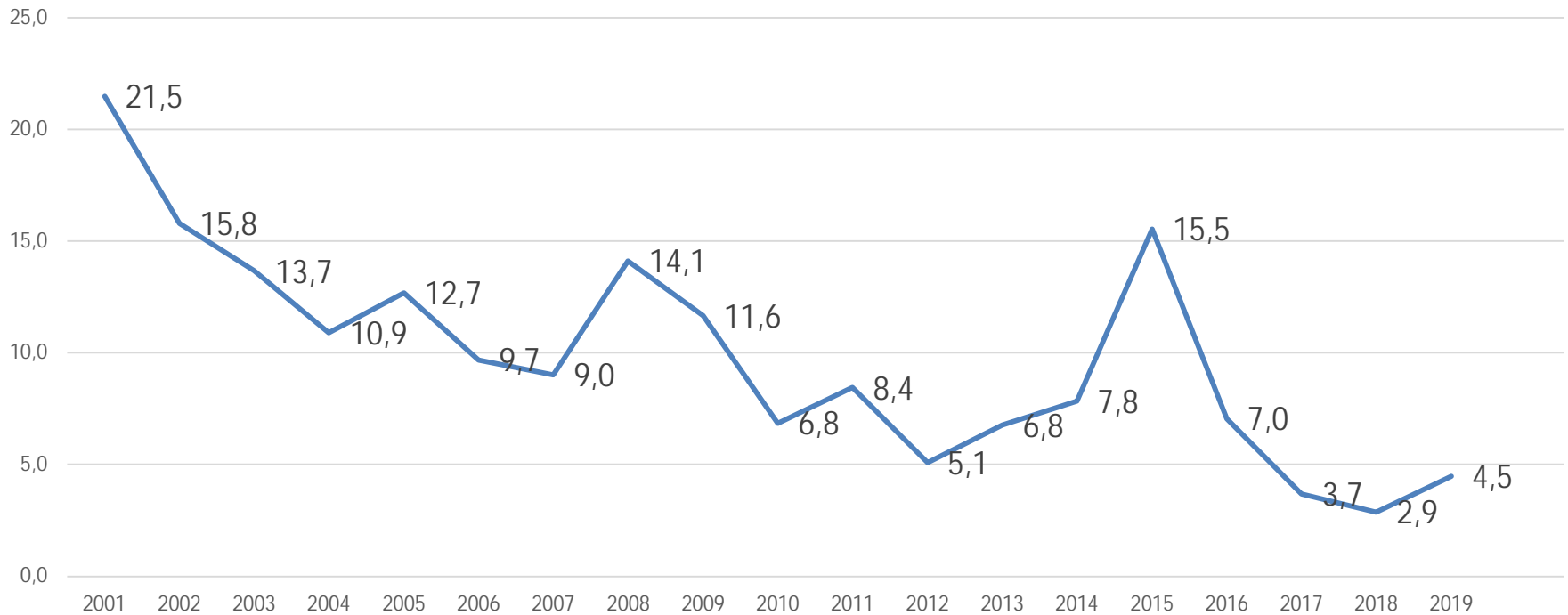
Source: IMF World Economic Outlook Database, April 2020



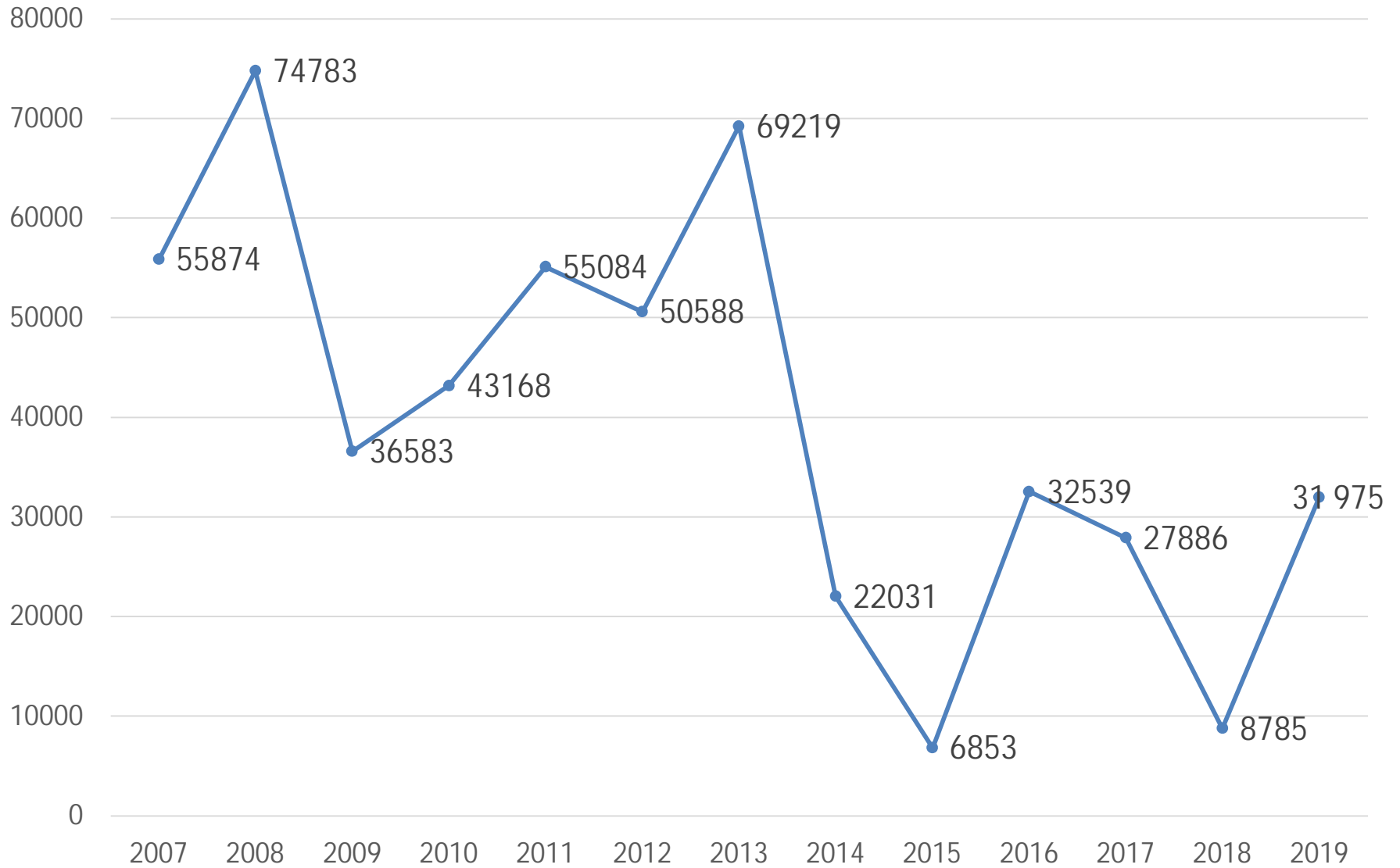
Inflation, consumer prices (annual %)



Inflation, consumer prices (annual %)



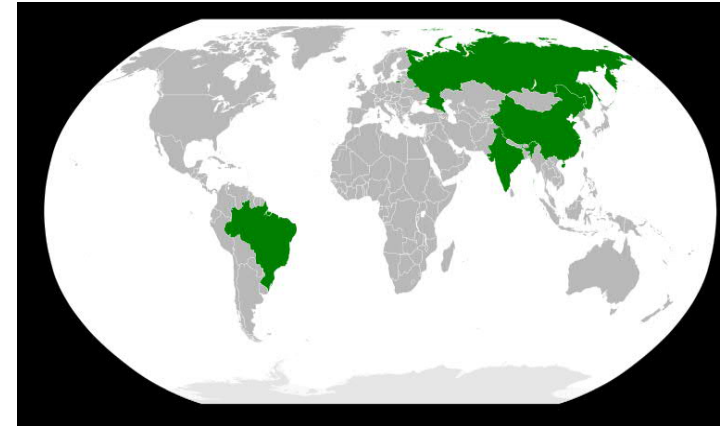
Inward FDI into Russia, million USD



Russia in the world: developing, transition or developed?

According to IMF report 2011: Russia belongs to a group of emerging and developing economies.

BRIC: Brazil, Russia, India, China: are all deemed to be at a similar stage of newly advanced economic development.



Developed: highly educated population; Russia is one of the world's five officially recognized nuclear powers.

Developing: polarization of wealth and poverty; high dependence on natural resources.

Russia is an emerging market

What is emerging market?

Countries with underfunded growth opportunities with problems;

Recent integration with global capital market;

Poorer than those in the developed world but that has capital markets (stock and bond markets) accessible to international investors;

Less developed country but one that has adopted the institutional, legal, and financial structures;

Sufficiently open to the global economy;

Platform for sustainable economic growth

Russia and other emerging economies

Emerging economies

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graph TD; A[Emerging economies] --> B[Developing countries]; A --> C[Transition countries];
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Developing countries
BRICS: Brazil, *Russia*,
India, China, South Africa

Transition countries
Post-socialist,
Post-Soviet
republics (*Russia*)