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High Corruption and Low Growth Spoil 2010

By Anders Aslund

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When Russian leaders review the country's economic development in 2010, they can only be disappointed. There were no great economic disasters, but Russia has clearly underperformed its peers.

Until 2008, the favorite Russian measuring mark was other BRIC countries, but that is no longer so. In 2009, Russia did worse than all other Group of 20 countries with gross domestic product plunging 7.9 percent. This year, growth will be about 4 percent, less than half of India's and China's.

Two years ago, Russia's GDP per capita at current exchange rates was four times as large as China's, but now it is only twice as large. From Moscow's horizon, China looks increasingly like a threat rather than a peer.

The stock market has passed a similar judgment. While other BRIC stock markets have exceeded their prior high marks, the Russian stock market is still 30 percent below its May 2008 peak. A current account surplus persists, but it has shrunk, and large capital outflow in the third quarter was quite a surprise.

Low Russian growth is all the more striking given the unexpected high oil price of $88 per barrel. But inefficient and corrupt state corporations are gobbling up ever more private enterprises, reducing the country's overall economic efficiency.

Government finances have faltered accordingly. The Finance Ministry expects a budget deficit of 4.6 percent of GDP this year. By current Western standards, that is not bad, but deficits are forecast for the foreseeable future, and public expenditures have changed structure. This year, pensions rose sharply by 30 or 40 percent while infrastructure investment was cut, the opposite of investing in the future. Russia's fiscal policy has swung from solidly conservative in 2000-08 to quite populist.

The sad truth is that Russia's anti-crisis policy has greatly reduced the efficiency of the economy. In a recent speech, Lilia Ovcharova of the Independent Institute for Social Policy summarized the distributive effects of Russia's crisis policy. Bureaucrats have defeated professionals and businessmen. Big business has won over small and medium-sized enterprises. With its inadequate incentives, Russia's anti-crisis policy was a policy of stagnation.

Amazingly, Gazprom performed almost as poorly in 2010 as in 2009, which is quite an achievement. Gazprom's poor performance is untenable. The company needs strong, highly qualified managers, not a bunch of predators.

The only two advances concerned Prime Minister Vladimir Putin's two favorite pipeline projects, Nord Stream and South Stream — both of which are unnecessary and overpriced. Even Gazprom's long-term partner, Germany's E.On, has given up on it and sold 3.5 percent of Gazprom's shares. Nobody but VTB wanted to buy it. In addition,

ConocoPhillips gave up on LUKoil and sold its shares.

Another Putin pet project, the customs union with Kazakhstan and Belarus, has been consummated, but, as most observers expected, turned out to be a big flop. In reality, this nonevent had already taken place in 1995 without any real impact on trade relations.

In Ukraine, the Kremlin is supposed to now have a Russia-friendly president in Viktor Yanukovych, but never has Putin suffered a more unpleasant foreign trip than when he went to Kiev in late October. Uniquely, he did not even stay for the official dinner. Ironically, the allegedly closest post-Soviet rulers, Belarussian President Alexander Lukashenko and Yanukovych, now seem Putin's greatest enemies.

To end the misfortunes, Russia declined even further on the Transparency International Corruption Perceptions Index.

These kinds of dismal results often help spark interest in reversing the negative trends. This could breed hope. Moreover, the ruling elite, for their part, are not satisfied with the country's underperformance.

As the customs union took place, and no benefit was apparent, World Trade Organization accession is becoming more important. WTO membership is likely to happen within the next year, and it will change Russia's economic engagement with the outside world.

Finance Minister Alexei Kudrin can always be trusted as the honest broker and truth-teller. Today, he speaks openly of the dangers of runaway public expenditures and the growing pensions bill. He demands that no less than 60 percent of GDP — or $900 billion — be sold off from public corporations and allocated to the National Welfare Fund. That would mean most of the state corporations. Kudrin's argument is impeccable, and during times of confusion and crisis, logic tends to win. If Kudrin's advice is taken, this could profoundly change and improve the Russian economic system.

After so many police scandals and ultranationslist riots, serious police reform must finally take place. How can Russia tolerate crazed neo-Nazis standing, of all places, on the Zhukov monument shouting, "Sieg Heil!"? Law enforcement reform is being drafted, and recent events are bound to make it all the more radical and real.

The emergence of the effective technocrat Sergei Sobyanin as Moscow mayor shows how many things that can be done differently. Why allow parking along the street on crammed major thoroughfares? Why build huge shopping centers without sufficient parking and no roads in the center of Moscow? Why allow more than 50 percent in kickbacks on public procurement? The beauty of a tighter budget is that Russia can no longer afford such large kickbacks, and the advantage of new appointees, such as Sobyanin, is that they can reduce the kickbacks and blame their predecessors. If Russia moved to a more moderate kickback level of 10 or 12 percent — an accepted level in many Arab countries — it would be great progress. Corruption cannot be eliminated, of course, but it can certainly be brought down to more controllable levels.

The Central Bank has moved closer to inflation targeting with a floating exchange rate, but it does need to raise the interest rate to a significantly positive real rate. The current inflation of 8.5 percent is far too high for no good reason.

The Pepsi purchase of Wimm-Bill-Dann in early December was a strong achievement to close out the year. This should be the tune of the future — major international companies entering the Russian consumer market by buying local leaders and thus enhancing competition.

Looking forward, 2011 may bring great improvement for the Russian economy. As the saying goes, "Insanity is doing the same thing over and over again but expecting different results." The Russian leaders can no longer afford to keep doing the same thing.

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