The Moscow Times
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Economist Sees Ruble Trouble Ahead

By The Moscow Times

March 23, 2011

The economy should brace for a stronger ruble and painful institutional reforms after the 2011-12 election cycle, as a weak currency can no longer drive growth, a top government expert told Reuters.

Prime Minister Vladimir Putin has asked a panel of experts to rework Russia's long-term economic strategy after the global financial crisis put ambitious development goals out of reach.

"A weak exchange rate can no longer play a role as the driver of economic growth, nor can it heal policy failures in attracting investment," economist Vladimir Mau, who co-chairs the panel, said in an interview. "It was obvious 5 to 7 years ago that relatively high inflation was better than ruble appreciation. That's changed," Mau said. "A stronger ruble implies lower inflation and interest rates."

The panel is due to report before State Duma elections in December, ensuring that an economic platform will be in place before the March 2012 presidential vote in which Putin or incumbent Dmitry Medvedev may run.

Mau said the panel had a mandate from both Putin and Medvedev and the program will not be tailored for a specific candidate. Putin launched a dash for growth during his 2000-08 presidency, but the slump suffered by Russia during the global recession exposed the economy's reliance on energy exports and foreign capital.

Policymakers have since struggled to turn the economic crisis into an opportunity to hold inflation in the mid-single digits, and consumer price growth is now once again approaching double digits. Mau argued that the policy of curbing the ruble's exchange rate, practiced throughout the 2000s, was a legacy of the 1998 economic crisis, when a sharp devaluation spurred recovery.

Growth in imports and capital outflows despite weakness in the ruble in late 2010 have shown that such a policy is no longer working, Mau said, adding that Russia should let the ruble float under a modified inflation targeting regime.

Mau said net private capital outflow of $38.3 billion in 2010, which prompted some economists to question Russia's standing in the BRIC group of major emerging economies, was partly a result of corruption and institutional weakness.

"It is a sign of bad health. Some of it was the money pumped into the economy as part of anti-crisis measures. Some stuck to someone's hands," Mau said, pointing out that part of the money was transferred from the regions in small amounts.

"Some of the outflow was medium-sized businesses hedging their bets," he said, adding that corruption is becoming "a macroeconomic factor" in Russia. Mau said institutional reforms stalled in the mid-2000s when Putin was still president and when Russia faced an influx of petrodollars with growth accompanied by a slide down international ratings for corruption and the investment climate.

"By the mid-2000s it became clear that most economic problems cannot be solved without a significant increase in the efficiency of political and law enforcement institutions. Everything possible had already been done," Mau said.

Mau said political reforms were more difficult now, and even moves such as a return to elections for regional governors, abolished by Putin in 2004, would not necessarily work since Russia's political opposition is so marginalized.

Mau said Russian society did not generate sufficient demand for modernization, which he defined as a drive to narrow the gap in gross domestic product per capita with developed countries, and it remained a personal project of Putin and Medvedev.

"Demand for reforms is coming from the president and prime minister. Nobody else in Russia is fighting for it," Mau said. Mau said many of Russia's 1,000-plus banks as well as some industrial dinosaurs would fall victim to a new round of reforms that would happen after the election regardless of the outcome.

"We have successfully dealt with the immediate threats from the crisis but the problems have not gone anywhere. The problem of 1,200 banks is still there. The problem of industrial monsters is still there."

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