

**Russian Economic Growth and Development:
Some New and Old Dilemmas**

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Summary

This paper aims to contribute to recent discussion, both in Russia and internationally, about Russian strategies of economic development. The debate is focused on the dangers associated with present resource-oriented (practically: oil- and gas-oriented) development, and the need for, as well as, constraints of, a change to priority development of non-resource, mainly high-tech sectors in manufacturing and services. The controversies are linked, among others, to diverse interpretations of the content and the likely economic consequences of the protracted conflict between the Russian state (the President) and the private oil industry (the “oligarchs”).

The problems with Russian oil and gas industries are approached here in historical perspective. Hydrocarbons production and, especially, exports were of overwhelming importance for the Soviet and, later, the Russian economy. However, priority development of the oil sector has become a clearly discernible fact following the financial crisis of 1998 only. During most of the previous century, growth was concentrated on that of the machinery industry (within machinery, in the first instance, the military industry, as well as the branches serving it). Development of oil and gas, as well as of other mineral resources was considered a necessary evil and a constraint to economic and military development. When nowadays contrasting Russia’s resource-based and non-resource sectors, it should be born in mind that military industry is among the few sectors that could effectively (however, to a limited extent only) contribute to the country’s incomes from exports in case proceeds from oil and

gas decline for any reason. As modernisation of army is now on the political agenda, defence sector is an important candidate to benefit from state-managed industrial restructuring. The tragedy in Beslan in September 2004 has strengthened the position of those in Russia who consider the terrorist assault not as the most terrible act of an internal armed conflict, but as a “war”, “diversion” supported by the West (the United States) and aiming at “undermining the Russian state” (“подрыв Российского государства”), and, for that reason, press for the multiplication of the country’s military budget (Leontyev 2004).

However, as far as economy is concerned, under present circumstances there is no alternative to parallel development of resource-based and non-resource sectors of the Russian economy with a view of maintaining and widening the scope of the dynamic sectors and branches. In the foreseeable future, exports growth will obviously be based on oil and gas (and some metals) as well as military industry products. The biggest challenge for the Russian economy, however, is to increase production of up-to-date goods and services both for production and consumption uses – from food and textiles to information technology – that can compete with foreign firms on domestic and international markets. Success or failure in those fields (whether related to growth in oil and gas sectors, and/or defence, or not) will realistically indicate, how deep and progressive structural changes in the Russian economy are.

Introduction

In 2003, President Putin declared doubling of the country's Gross Domestic Product in ten years as the priority task of Russian economic policy. Following further improvement of macroeconomic data, the target year of the ambitious plan, set originally for 2012, was brought forward to 2010. Accordingly, GDP would have to increase by an average annual rate of about 9 percent during the remaining years of the decade. While, at first glance, dynamic economic growth in the aftermath of the crisis of 1998, having been supported by vigour and firmness of political leadership, seems to suggest that the President's idea is not totally outside the realm of the feasible, economic profession in Russia (economic policy-makers in the government included), as well as public opinion by no means believe that the project may come true. What is more, according to the critics of the plan, Russia has a lot of more serious tasks than hunting after the acceleration of growth.¹

In a way, scepticism is due to the still alive memory of aborted attempts at „catching up and overcoming”, or „stepping-up growth” of the last century associated with the names of Stalin, Khrushchev, as well as, Gorbachev. Attempts at large-scale engineering of the economic development of post-Soviet Russia during the 1990s had stumbled against economic and political realities: the planned “great leaps forward” from socialism to capitalism only deepened chaos and decline in the country. The developments between

1991-1998 led not only to discrediting Russia internationally, but – more ominously – to the loss of confidence of the Russian population, which was cheated and deprived of its total savings on several occasions.

The present situation of Russia's economy and society is, in many respects, clearly different from that in the Soviet times but also from that of a decade ago. Accomplishments of Russian economy following 1998 are highly appreciated internationally. What is growing in Russia is not only production and exports, but consumption as well – at an impressive annual rate of 8 percent since 2000. Real wages increased by 82 percent during 1999-2003, and are 28 percent above pre-crisis level. However, mistrust prevails. History aside, it should also be attributed to the general assessment of underdevelopment, low efficiency and low international competitiveness as well as enduring structural weaknesses of the Russian economy. Most importantly, scepticism is the consequence of everyone's uncertainty concerning the future development of Russia and its society.

The President himself is aware of the difficulties due to the post-Soviet collapse. As he puts it: “During the long economic crisis Russia lost almost the half of its economic potential. In the last four years we have been able to compensate for about 40 percent of the fall. However, despite that, we have not succeeded in ‘reaching ourselves’ of the pattern of the year 1989.”²

¹ “У России есть более серьёзные задачи, чем гонка за ускорением роста...” As a Russian economist sarcastically puts it in an interview to the newspaper “Известия”: “However, if the economy is told to grow at a rate of 9.3 percent, we will depict (i.e. make) it.” (“Но раз экономике велено расти на 9,3%, то мы пририсоваем.”) (Короб 2004)

² “За время длительного экономического кризиса Россия потеряла почти половину своего экономического потенциала. За четыре последних года мы смогли компенсировать около 40 процентов падения. Но, несмотря на это, нам пока не удалось ‘догнать самих себя’ образца 89-го года.”

As to the question “why acceleration is necessary”, Putin’s answers in many respects resemble those of his predecessors mentioned above. He aims at “obtaining leading positions” (“занимать ведущие позиции”) internationally, and wants to double GDP in ten years for the sake of “reducing poverty, improving the living standards of the people, and *modernization of the army*” (“уменьшение бедности, рост благосостояния людей, *модернизация армии*”). (Poslanie 2004, my italics – A. K.)³ In the aftermath of the hostage drama, the President, in a most conspicuous and nostalgic way, called the „mighty“ and “great“ Soviet Union to mind – „a country that had proved, regrettably, non-viable in a rapidly changing world”.⁴

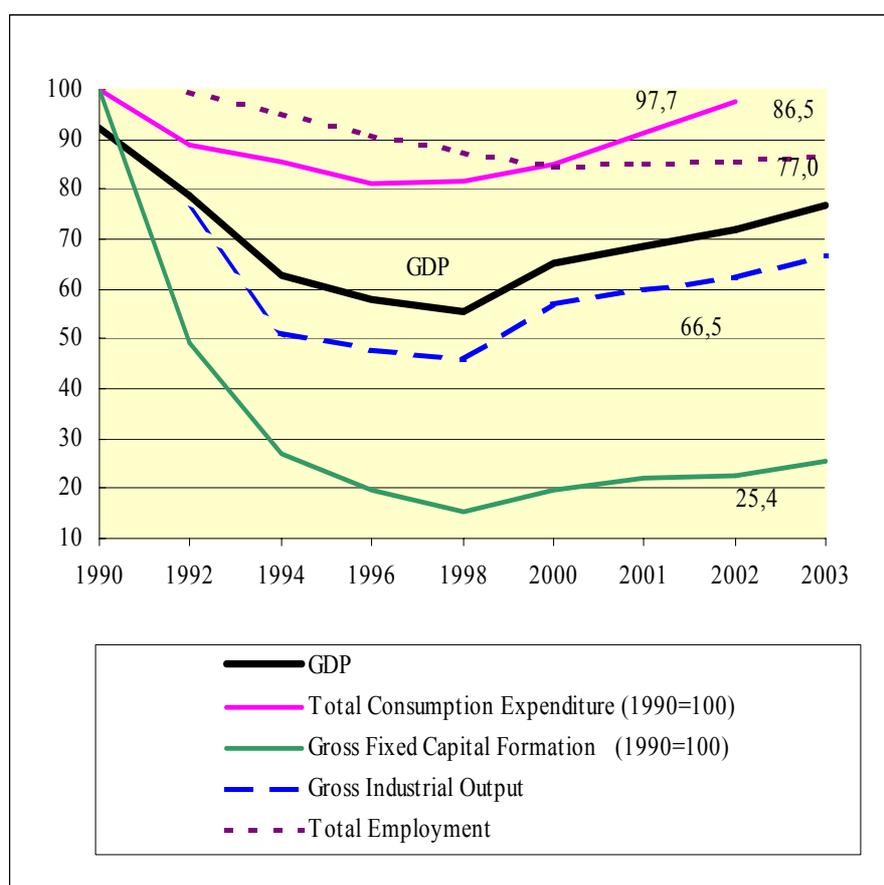
According to the UN ECE (2004, p. 190) statistics, the GDP of the Russian Federation in 2003 was 77 percent of the level of 1989 – just *below that of 1980* (78.1 percent). Russian growth performance in the period 1989-2003 has been somewhat better than that of the average of the other CIS countries (69.5 percent), among them most notably Ukraine (51.9 percent), however it falls much behind Central Europe in whose 5 countries (Poland, the Czech Republic, Slovakia, Hungary and Slovenia) the average GDP in

2003 was 22 percent *above* the level of 1989, and even South-East Europe (86.6 percent of 1989), the Baltic states (88.6) and the resource-rich Central Asian CIS countries (94.7). The problems concerning development level are, of course, much deeper. It is common knowledge that the Soviet economic potential of 1989 was also modest, at least for a great power with global ambitions.

3 It should be added, that as a policy document, Putin’s presidential message, in its general approach to the country’s economic and social needs, stands near to those internationally in vogue. His central themes are housing, health, education, budgetary reform and taxation, transport infrastructure (which includes, in case of Russia, oil and gas pipelines as well) – and defence. Also, in his conception, acceleration of growth should be realized parallel to disinflation, full rouble convertibility, etc.

4 “Сегодня мы живём в условиях, сложившихся после распада великого государства. Государства, которое оказалось, к сожалению, нежизнеспособным в условиях быстро меняющегося мира. Но, несмотря на все трудности, нам удалось сохранить ядро этого гиганта – Советского Союза.” (Obrashchenie 2004)

Some Macroeconomic Indicators of Post-Soviet Russia, 1989-2003
(Indices, 1989=100)



Source: UN ECE (2004), Kopint-Datorg (2004)

As the end of the reconstruction period nears, sustaining high growth rates of the GDP will be increasingly difficult. Productivity growth in industry – very dynamic since 1999 – will be to a lesser degree supported by restarting under-utilized antiquated productive capacities.⁵ Oil-based growth may prove shaky for external and internal reasons as well. Prudent fiscal and monetary policies of the recent years may be imperilled, if external or

domestic environments eventually change. The financial system remains unstable, as shown by the banking “mini”-crisis of this summer. According to a recent poll of the public opinion research institute VTsIOM, 47 percent of the Russian population is convinced that a financial crisis similar to the default in August 1998 may happen any time (Izvestia, 17 August, 2004). It is indicative of the difficulties involved that following four years of dynamic growth in 1999-2002, the most important demographic indicators continue to deteriorate.⁶

5 The average age of industrial equipment is higher than any time during the last 30 years: from 8.42 years in 1970 it has continuously increased to 19.4 years in 2001 (Goskomstat 2002, p. 356). According to a recent survey, obsolete equipment is the single most important factor behind the low competitiveness of the Russian industry (Golovachev, 2004)

6 The authors of the OECD Survey (2004, p. 45) appositely remark: “Public spending on healthcare in Russia, at below 4 percent of GDP in post-crisis

Russia's internal armed conflicts (such as those related to Chechnya), as well as military and political clashes in the "near-abroad", are heavy, intensifying, and most difficult to solve. The relationship between political leadership (the President) and big business has recently become strained. According to some observers, business sentiment is deteriorating. Much needed foreign investment may be discouraged following the case of Yukos. Foreign criticisms and fears are clearly expressed in the recent OECD Survey of Federation of Russia: "The arbitrary exercise of state power remains one of the main threats to the security of property rights in Russia as well as a major barrier to the development of many businesses, especially small and medium enterprises." (OECD 2004, p. 12)

years, remains low compared with the OECD average..." One of the most important demographic indicators, life expectancy at birth of men has declined from 60.8 years in 1997 to 58.5 years in 2002. (To compare: this indicator came to 62.4 years in India in 1999, according to Goskomstat 2002, p. 637.) "...Growth alone will not be sufficient to bring major improvements in health and other social indicators. Increased expenditure on, and reform of, the health sector are urgently needed, as the provision of resources to insure adequate treatment for the less well off."

The question however remains, how those noble aims are to be made consistent with mainstream views and the international organizations' general demands to reduce public engagement in human sector development, including health. Recent social policy steps of the Russian government do not point to any determination to ease the burdens of those in want.

The Need for Changes

As for the prospects of Russian economic growth, the OECD is cautiously optimistic: „Concerns remain about Russia’s capacity to sustain high growth over the longer term, especially in view of its heavy dependence on export-oriented resource industries, particularly oil. There are dangers associated with such resource-oriented development, including vulnerability to external shocks, the risk of ‘Dutch disease’ and the institutional pathologies often associated with heavy reliance on natural resource sectors.” (OECD, 2004)

Rightly, “pathological” or “healthy” institutions play an increasing role in today’s thinking about conditions of economic growth. In place of earlier theories emphasizing the role of physical infrastructure, or somewhat later, of liberal economic policies (opening up internationally, reducing the role of the state, privatisation, encouraging competition, etc.) as the main movers of economic development, today... “experts emphasize the ‘software’ of the economy: the institutions, customs, laws, and social cohesion that help to create and sustain markets. Good software can come in many forms...Conversely, economies without the right software will falter...” (Birdsall and Subramanian 2004, pp. 79-80)

Stressing the importance of the ‘software’ seems to be quite correct; however, recognition of its importance in itself is not helpful enough for settling the sharp controversies concerning which “software” is “right”, and which is “wrong” (which “structural reforms”⁷ are necessary, and which may prove

harmful) in a given country in a given period. To find the right “software” for its own country – different from, or similar to, those prevailing internationally –, to introduce and sustain it even in face of external and domestic pressures, is the most challenging and difficult task for any responsible government.

Even if problems concerning institutional development are far from being clear, nobody contests the need for structural changes in the Russian economy. According to a widely held view, *in a longer term*, Russian economy should be based on priority development of non-resource, particularly high-tech, sectors in manufacturing and services. The change of priorities is the single most important task for economic policy. It should create an appropriate (regulatory, etc.) environment (including budgetary tools) conducive to re-allocation of sources of growth from resource-dependent ones into those mentioned above. Structural changes, however, depend on government policies. Some Russian analysts think that this circumstance is a most important constraint to restructuring. In their view, despite declarations to the contrary, the predominance of oil and gas suits very much the interests of the political leadership – provided it can take control of the hydrocarbons industry.

However, analysts also seem to agree, that *in short- and medium-term*, growth in Russia will mostly depend on the performance of resource-based sectors. As stated by the OECD (2004, p. 46.): Russia’s revealed comparative advantage (RCA) in recent years has been in natural resources, especially hydrocarbons. More than 50 percent of Russian exports consist of crude oil, oil products and

7 In present-day economic literature, “structural reforms” is the codename for the totality of those institutional, legal and regulatory changes (changes in “software”), which, according to the mainstream perceptions, would contribute to long-

term balanced economic growth within an appropriate macroeconomic environment.

gas (together with base metals, steel, steel products and gold – about 75 percent). Even if Russia managed sharply to increase exports of more sophisticated manufactures, their contribution to total export growth would remain modest for some years to come, given their small share in current exports.

According to the calculations by UN ECE (2004, pp. 112-113), in recent years (1996-2002) the share of machinery and transport equipment in total Russian exports was 9-10 percent of which about 80 percent are exported to non-CIS markets. Exports of “high-technology” goods account for 2-3 percent of the total. This reflects the fact that “Russia largely continues to export what it exported during the Soviet era. The changes that have occurred in the structure of Russian exports since the 1990s have reinforced the country’s status as a raw material producer.”

Among the many factors that have led to preservation of the obsolete pattern of exports some are related to the changes having taken place on the international political map.⁸ Since 1989, Russia as a machinery exporter has lost its – very moderate, in the Soviet times, as well – weight, mostly because other transition countries (formerly leading importers of Soviet machinery) have largely re-oriented their investment goods imports from the former Soviet Union to the West.

More significantly, also as a consequence of the global political turn-around, geographical patterns of Russian oil exports have considerably changed since the late 1980s. While until 2000, total quantities of Russia’s crude exports did not surpass those of the Soviet Union during the 1980s, the patterns of the

exports have become quite different. The predominant part of Soviet oil exports in the 1980s was directed towards CMEA countries in the framework of intra-CMEA financing arrangements, at terms worse (from the Soviet point of view) than those on the international market. Out of total Soviet crude exports (127 million tons in 1989), only 27.2 million tons were paid for in convertible currencies. As against that, the overwhelming part of Russian crude exports today (138 million tonnes out of 162 in 2001) is going to non-CIS countries at terms similar to those generally accepted in international trade.

According to the UN ECE, about four fifth of total Russian exports in 1996-2001 were due to natural resources, whether unprocessed or processed. The remaining one fifth were processed to varying degrees *and* unrelated to natural resource endowments. Among them “low technology” manufactures represented 4-6 percent of the total. The very modest share of this group is due to the fact that, until now, Russia (as different from other transition countries) has not participated to any significant extent in outward processing trade arrangements with Western multinational firms. “Medium-tech” manufactures (machines, automobiles, industrial chemicals – mostly traditional items of the country’s exports) accounted for 12-13 percent of total.

All that means that further dynamic increase of oil and gas production and exports is an unavoidable condition of economic growth in Russia, at least, in the period until President Putin’s target to double the GDP is fulfilled. That means for policy-making in the years to come that changes in policy priorities should be realized in a most careful way. According to the OECD study referred to above: “The authorities will need to pursue policies that allow for further development of these (i.e. resource-dependent) sectors while acting to

⁸ Other factors are related to domestic policies: for example, according to the critics of the government policies, subsidies for exports of manufactured goods are insignificant.

mitigate the risks associated with resource-dependent growth.” In other words, the main issue of Russian economic development in the early twenty-first century is whether and how restructuring and modernisation of the

economy can materialise while there is no short-term alternative to dynamic development of resource-dependent industries (mostly, oil and gas).

Constraints to Changes

The above sequence is the *résumé* of some of the most important factors that will determine structural development of the Russian economy in the years to come. However, there are some additional reasons for a careful approach to the conceived changes in the sectoral priorities described in general outlines. For example, there are a lot of constraints to increasing exports of Russian manufactured goods from the point of view of *demand*, or, of that of access to the markets.

While the European Union’s (which is Russia’s main export market, especially following Eastern enlargement) future policies concerning imports of Russian gas are also not crystal-clear (the EU wants to import more gas from Russia while avoiding growing dependence on the Russian gas), protectionist attitudes of the Union towards the imports of manufactures from Russia may be taken for granted. Protectionism has been the moving force behind the EU’s demands to raise domestic gas prices in Russia to prevent (branded as “unfair”) the practically non-existing (in the EU15) or fairly limited (in the former CMEA countries) competition of Russian manufactured goods on the international markets. At any event, the coming increases of gas prices for domestic industry (already decided by the Russian government) will put a check on price and cost competitiveness of processed goods from Russia in the future.

In a somewhat more general perspective, the outside world is *strategically* interested in Russian oil and gas, especially considering

the persistently unstable situation in the Middle East,⁹ but the fates of the Russian manufacturing industry (except for a single important sector – armaments) are far from being seen as a globally interesting issue. This circumstance must have strengthened the otherwise correct argumentation on the part of international analysts favouring that changes from the present resource-based development to a non-resource-based one should be accomplished in a *careful and gradual way*.

Apart from the external constraints mentioned, there are other factors (related to the domestic Russian development) that render the future choice between oil and gas (and some energy-intensive metals) *on the one hand*, and everything else, *on the other*, a most complicated issue. While it is clear that the structural change should result in a smaller share of oil and gas in the GDP (as well as industrial production) in a longer perspective, it is quite uncertain, what would come *instead*, which industries and services would replace hydrocarbons.

Mainstream economists would argue that it is unnecessary and dangerous to predetermine the sectoral patterns of economic develop-

9 This circumstance does not prevent the developed world (principally, the U.S.) from supporting oil and gas development in former Soviet republics (notably, in Central Asia) increasingly competing with Russian hydrocarbons – not always in a friendly to Russia way (for example, by building export pipelines that keep clear of Russia). Getting Central Asian oil and gas, while keeping clear of Russia, is in the strategic interest of the U.S. and some other countries, as well.

ment. The structure should be shaped by the market, not the government. The government's only role is to create adequate institutions and make them function correctly. The government should not manipulate exchange rates, should not allow creation of a black market, high inflation, or large fiscal deficits, and..."it would be most desirable to have a less corrupt bureaucracy". This is advice from the former Prime Minister, executor of the first Russian shock therapy in 1990s, Yegor Gaidar (2004). He cautions policy-makers against sectoral priorities of any kind.

It would be senseless and counter-productive to try to imitate any historical precedents, or theoretical schemes of priorities. Each and every country has its own specifics, while the international environment of economic development is rapidly changing in many respects (technologies, products, communication, organizations, networks, etc.). This argument may sound strong in Russia: Soviet industrialisation in the middle of the 20th century, as to its sectoral priorities, resembled the pattern of industrial development of the most developed countries in 19th and early 20th centuries. Soviet leadership continued to insist on the primary development of smokestack industries (the "heavy" industry), and the senseless discrimination between "productive" and "non-productive" sectors of the economy to the detriment of the latter, at a time when in the advanced countries it was mostly the service sector that shaped the structure and the rate of economic growth. This kind of imitative development led to collapse.

While history is really illuminating, arguments of "the market knows better" type are not, and not only because of the ideological bias inherent in them. To say it with a bit of sarcasm, if the market knows better where *to go*, it should also know where *to stay*, and the whole exercise at structural changes directed

by the state is, by definition, counter-productive.¹⁰ In reality however, the need for restructuring is generally acknowledged, and it is the state that, mostly through budgetary means, is managing it. There is no way to avoid enforcement of the state's preferences or dispreferences (sectoral and other). In fact, despite the almost general present-day official condemnation of sectoral policies in the world, it is a most frequent practice on the part of the governments in most countries to support (under various headings) or to neglect (discriminate against) different sectors, to subsidise investors who are investing in some sector (and not to support other would-be investors). Russia of the coming years will not be an exception.

¹⁰ The whole syndrome of a "Dutch disease" is about this: the "market" knows the market (if all goes well), the state knows the economy (better: must understand, how it works, and what it needs). The market knows that there are high profits in the extraction of some natural resources, and there are low profits in, say, manufacturing; the market knows that it is worthwhile to invest into former, and disinvest from the latter. The state should know something different: if there are high profits in extraction and low ones in manufacturing industries, then there may arise a persistent current account surplus, domestic currency will appreciate, savings will fall, etc., and, *therefore*, the state should follow policies that prevent the economy from catching this illness, or, if the malady is already there, contribute to fighting it back.

Resource-based Sectors *versus* the Defence Industry?

In the former Soviet Union, the conflicting views concerning economic policy priorities (resource-based sectors *versus* non-resource based ones) have had an utmost unequivocal meaning. What should be preferred while distributing scarce development sources: raw materials or armaments, extracting or defence industries? What are the “right” proportions between investments into those sectors? Despite present insistence of analysts that growth in Russia has a resource-based character, as a matter of fact, for the most of the previous century growth was concentrated on that of the military industry (and other industrial branches serving it), and the whole economic development and economic system had been shaped to serve the strengthening of the military power of the country. As in our days, oil and gas development, as well as that of other natural resources, were usually considered a necessary evil and a constraint to economic and military growth.

Following the end of the Soviet Union, defence industry in Russia lost its role in the maintenance of the global military balance. “With the end of the Cold War, the country no longer needed at least 20 percent of its industrial output, which heretofore had been dedicated to the military industrial complex.” (Goldman, 2003-2004, p. 24) Defence industry steeply declined in the early 1990s. While capacities had not been reduced, officially no plants had been closed, they had just been allowed to decay or find new ways to occupy themselves (Defence, 1999). In this way, restructuring of the production structure *within* the defence industry, in order to cover civilian needs (known as “conversion”), was put on the agenda. By the year 1999, 45.7 percent of the military industry complex output was civilian products, ac-

ording to TS-VPK News Agency. From another point of view, a large share of the production of defence industry was exported: 48.2 percent of total production; including two-thirds of the military products manufactured by the defence industry. The industry has survived the economic and political transition largely state-controlled. It has revived (parallel to other sectors) in the years 2000-2003, and by 2003 arms exports hit a post-Soviet record, with a value of close to \$5.6 billion.¹¹ Russia ranks second on the list of arms-exporting nations, behind the United States (Chivers, 2004).

In other words, defence industry products comprise the most significant group of Russia’s manufactured goods exports. Arms sales abroad are promising in the long run, given the persisting international conflicts, the “war on terror”, and the ceaseless military ambitions of countries – small and large. Military industry is an important candidate to effectively (of course, to a limited extent) contribute to the country’s incomes from exports in case proceeds from oil and gas decline (in absolute or relative terms) for any reason (price decreases, shortfalls of production, trade barriers, etc.). Exports have helped to manage to protect the military industrial base when domestic orders were lacking.

Modernisation of the army is now on the agenda, and defence industry (whose products will be increasingly demanded both abroad and at home) is a leading candidate to be beneficiary of the state-managed industrial restructuring, as well. As announced by President Putin, in 2005 defence outlays

¹¹ (Pyadushkin, 2004, with reference to the announcement by President Putin). The most important partners are India, China, South-East Asia and the Middle East. The single biggest item of exports is aircraft, followed by naval equipment.

would increase by an impressive 40 percent as compared to 2004 (Oboronny, 2004). Supporters of harsh policies in the fields of defence and domestic order emphasize that Russia has the necessary resources for developing its military industry, whose reinforcement will serve “principally” the aims of economic growth, as well. As a matter of fact, the military industrial complex has the links to the unique innovative, high technology sectors of the Russian economy. (“Besides them, we do not have anything.”) (Leontyev, 2004)¹²

The present weakness of the Russian armed forces, as well as the never-ending global military and political tensions may suggest that increase of defence-related government expenditures is, in itself, a reasonable policy undertaking, even if there are other (non-satisfied) priorities of vital importance, as well (health, education, old-age pensions, etc). In the short run, significant increase in military outlays may have a positive effect on economic activity, indeed. However, the planned reorientation of budgetary priorities would take place in an overheated domestic atmosphere. Primarily internal conflicts (such as that in Chechnya) are frequently ascribed to evil intervention from outside. The real factors behind the protracted animosity are relegated to the background. All that may eventually lead to undesired consequences that are well known from Russian and Soviet history. Militarization of the economy, as well as that of the life and thinking of the society, growing hostilities to the outside world, (re-) isolation would really impede longer-term growth and development. In the words of the Russian economist Yevgeny Yasin in an interview to *Nezavisimaya Gazeta*, “Russia has left behind the situation

when methods of authoritarian state can prove useful”. (Samedova 2004)¹³

Strategic decisions concerning the fates of the Russian defence industry are (will be) made quite independent of general considerations about useful or harmful character of sectoral economic policies. Judgements of those decisions are outside the scope of economic analysis. What is clear, however, is that avoiding Soviet-type predominance of the military industry over all other sectors, and evading the industry’s isolation from the civilian sectors within and, perhaps, outside the country are *sine qua non* for the defence industry to play a positive role in Russia’s future economic development.

¹² “Кроме них, ничего нет.”

¹³ “Россия уже вышла из того состояния, когда для неё методы авторитарного государства могут быть полезны.” As to the increase of the defence budget, Yasin makes a most important and harsh point: “Опасно не то, сколько мы будем тратить денег на это, а то, что мы будем восстанавливать ‘оборонное’ сознание, ощущение, что вокруг нас ‘враги’. Эта обстановка особенно хорошо для того, чтобы ‘закрутить гайки’ и добиться от своего народа всего, чего хочешь...” (“What is dangerous is not how much money we will spend on it, but the fact that we will re-create ‘defence’ awareness, the feeling that there are ‘enemies’ around us. This situation is especially suitable to ‘tighten the screws’, and to get from the people everything you wish.”)

Oil and Growth

There is ample literature on why raw material richness of a country is a setback to economic development,¹⁴ especially in case of concentration of raw-materials production and exports on a limited range of commodities. The concentration of that kind in Russia – though not an OPEC country – has been a historical fact for many decades, and has become extraordinary significant in the last five years as a result of booming (from a very low level) oil production and high international oil prices. Although estimates vary, according to one by the World Bank, the oil and gas sectors may have accounted for up to 25 percent of Russian GDP, while employing less than 1 percent of the population in 2003 (EIA 2004).

The war in Iraq, as well as the obscure future of Iraqi oil made it once more opportune to analyse the specific economic problems and policy options of the oil producing countries. The most widely cited general problem with oil-based development is uncertainty and risk as a consequence of the notorious volatility of international prices. “Fluctuations in price can create a dangerous cycle in which governments spend wildly when they are flush, only to be forced into costly and disruptive spending cuts... when prices fall.” Raw materials boom can hurt domestic manufacturing sector as the country’s currency becomes stronger and domestic manufacturers find it increasingly hard to compete with imports (and exporters of manufactured goods find it hard to compete in foreign markets).¹⁵

However, “the most important explanation for the oil curse...is... impeding the devel-

opment of a society’s economic and political institutions... Natural resources, unlike output created by human endeavour, yield large ‘rents’, which are rewards in excess of effort. But such rents are easy to appropriate – either by the state or by the few who control the resource’s extraction... The state is relieved of the pressure to tax and has no incentive to promote the protection of property rights as a way of creating wealth. As for the country’s citizens, because they are not taxed, they have little incentive and no effective mechanism by which to hold government accountable. This can lead to the unchecked abuse of state power and can undermine the process by which political systems reconcile conflicting interests and demands. Indeed, such conditions make it very hard for political institutions to develop.” (Birdsall-Subramanian, 2004, p. 81)¹⁶

¹⁶ According to OECD (2004, p. 52), there are other potential macroeconomic problems as well that arise because of resource-dependence: “First... a larger share of natural resources in exports is related to more corruption... Secondly, a higher natural resource share in the economy is often accompanied by greater inequality of incomes... Thirdly... the allocation of talent in natural resource economies is biased in favour of the resource sector. Highly capable individuals may focus on securing resource rent rather than building successful businesses in sectors with more potential innovation. Fourthly, resource wealth may favour the development of political and economic institutions which... favour rent-seeking over entrepreneurship...”

All those arguments are correct for many countries in different periods of time. However, similar problems can be observed in a lot of fields of economic activities other than natural resources’ extraction. Present-day fortune hunters are but distant relatives of those during the Gold Rush in the 19th century. Big infrastructure projects have been breeding ground for swindling, the classic case being that of the Panama Canal construction. Corruption and rent seeking have recently been related very emphatically to the IT-sector of the United States economy, and the Blue Chips on the

¹⁴ I remember to have heard this thesis the first time in the mid-1970s from a Soviet economist explaining Japan’s successes and the Soviet Union’s difficulties of economic development.

¹⁵ A “Dutch disease” mentioned above (Footnote 10)

The long passage – quoted from a recent article in the most highly esteemed journal of the American foreign policy establishment – clearly indicates mainstream present-day views concerning resource-based development. A large part of the above ideas are convincing. Especially important is the reference to the interrelationship between taxation and democracy – a point often forgotten by liberal economists. Another point, closer to the main sequence of this writing, is that both the state and “the few who control the resources’ extraction” may abuse their (quasi-) monopolistic position if the political system (created and sustained according to their vested interests) allows.

However, what we are witnessing now, is but a most recent chapter of the endless discussion about the role of the natural resources in economic development. Some decades ago resource-based development was declared detrimental to the developing countries for another reason: the *lasting deterioration* of raw materials’ terms-of-trade *vis-à-vis* manufacturing goods.

The other way round, following the oil price explosion of the 1970s, and the first report of the Club of Rome, raw materials-*importing* countries both in the East and the West were concerned with what they conceived “a new price revolution”, i.e. unavoidable long-term changes of terms-of-trade *in favour of resource-based economies*. The anxieties have proved unfounded, so far. As it is frequently emphasized in these days, even subsequent to price hikes in the spring and summer of 2004, *real* oil prices (relative to those of manufactures) remain below the level of the early 1980s. While recent progress in indus-

stock exchange. Large defence orders are also to be mentioned. In general: the bigger the value of a “normal”, or “standard” deal in any sector of business, the more corruption and cheating are possible, largely irrespective of which industry the given transaction is listed in.

trialisation and motorisation of more and more large areas and countries (like China and India, as well as almost the whole of South-East Asia) have increased the world demand for energy and raw materials, the prevailing of services in developed economies, energy savings, and global advance of information technology have led to a less raw-materials and energy-intensive way of economic development.

However, calling high and volatile international prices the problem *for exporting countries* is another approach. In the view of the present author, as contrary to the generalized assertion concerning “rents” constituting “rewards in excess of efforts”, the main problem with resource-based development (for the *countries* where those resources are found and extracted, as distinct from problems facing foreign investors into the resources) is that in most cases and in most of the times investing in raw materials is *more expensive, riskier, more time-consuming, while having much smaller rates of return*, than investing into manufacturing or services.¹⁷

This is especially the case with the Russian hydrocarbons industry, which, from the early 1970s to this day, has developed in Siberia, where the climate is most bitter. At present, 66 percent of Russian oil, and 91 percent of gas are being mined in the Tyumen region in Western Siberia¹⁸ (data for the year 2001 in Goskomstat 2002, p. 352). The extraordinary large costs of exploiting Siberian oil and gas, as well as transporting them to their main

¹⁷ Except, among others, the Arabic peninsula and its neighbourhood.

¹⁸ The Yamalo-Nenets Autonomous District within the Tyumen Region accounts for 87 percent of the Russian natural gas production. The dissolution of the Soviet Union contributed strongly to the unique geographical concentration of oil and gas production, as most of Soviet oil and gas fields outside Siberia were outside the Russian Federation as well.

users in European Russia and other European countries, explain the everlasting adjournment of strategic decisions on oil and gas development in the Soviet Union in spite of the exceptional significance of hydrocarbons in Soviet exports to both East and West, as well as the eternal shortage of raw materials in the Soviet economy (due both to the wasteful economic system and the primary development of materials- and energy-intensive heavy – first of all, armaments – industry.)¹⁹ Depletion of the reserves, inadequate amounts of investment, as well as lack of high-tech Western technology in oil and gas sectors, explain the culmination and back-fall of Soviet oil production starting in the early 1980s from which Russian industry has not recovered since.

Despite the dynamic increase of oil output between 1998-2003 (from 303 million tons in 1998 to 348 millions in 2001 and 421 millions in 2003) and the economic growth based on the resource-rich sectors, the fact of the matter is that oil output of the Russian Federation is now about 120 million tons *less* than it was in 1980 (547 million tons).²⁰ Gas production in 2003 was also under the level

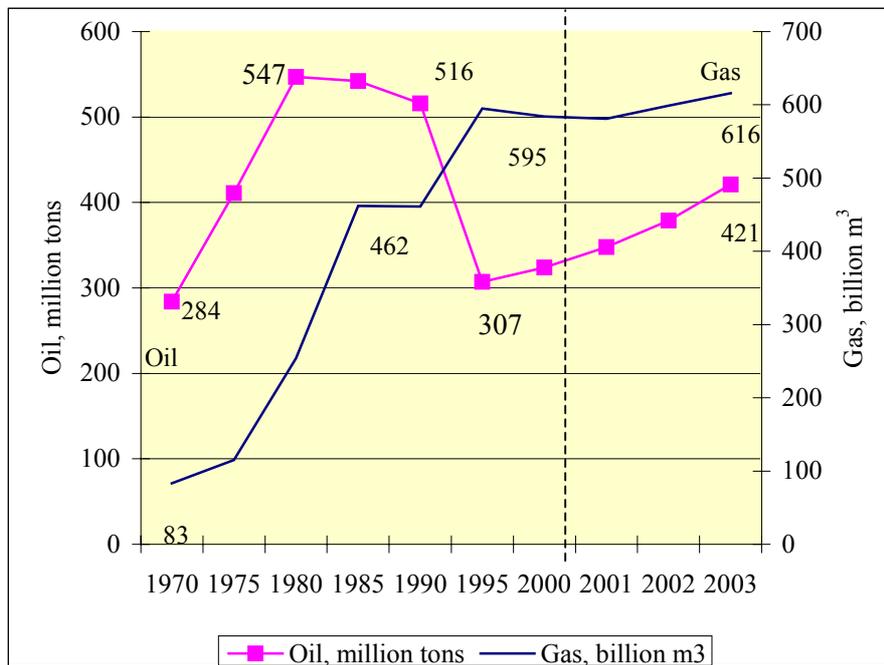
of 1990 (616 billion cubic meters as compared to 641 billions). In other words, hydrocarbons industries were no exception from the long economic depression of Russia; what is more, oil production started to stagnate and decline years before the general collapse of the Soviet economy in the years 1989-1991 (see **Graph 2**).

According to the general perceptions about the resource-based structure of economic growth in Russia, oil (and gas) industries have attracted the most of investment in the recent years. In the period between 1997-2003, their share of *industrial* investment was roughly 40 percent (OECD 2004, p. 25). In 2001, investment in oil production came to 14.4 percent of *total* gross fixed capital investment, while investment in oil and gas sectors together – to 21.2 percent. Added the 23.1 percent investment share of transport (a significant part of it – investments into pipelines construction), the picture showing recent efforts to primarily develop the hydrocarbons sector seems to be convincing. To compare, in the same year (2001), machine building and metalworking had a share of 3 percent of total investment.

¹⁹ The first big projects of Soviet-American and Soviet-Japanese cooperation in the development of Siberian oil and gas date back to the early 1970s. Beyond economic considerations, international politics have also played an important role in dropping or protraction of those plans. Some much-publicised present projects (in the phase of planning, realization – or rethinking, once more) are offspring of those 30 years before. This concerns the one to carry West Siberian crude oil to United States via the port of Murmansk (to reach the U.S. much faster than by shipping oil from the Middle East or Africa), the Sakhalin gas projects, as well as the Eastern oil pipeline options (Angarsk-Nakhodka), eventually making it possible that Russian oil be shipped in tankers to North America. Other projects (notably, pipelines to China, the “Adria Reversal” project, or the Blue Stream natural gas pipeline to Turkey) are new.

²⁰ Soviet oil production totalled 603 million tons in 1980 (and 607 in 1989), according to the Soviet statistical office (Narodnoye 1989, p. 377).

Russian Production of Oil and Gas, 1970-2003



Source: Goskomstat (2002), OECD (2004)

However, despite recent growth, investment ratios in Russia remain modest in international comparison.²¹ What is more, the distinct preference for oil and gas sector development has been but a recent phenomenon in the Russian economy. In 1995 for example, the combined share of the two sectors in total fixed investment was 12.7 percent only. Prior to that, in the Soviet times, their relative weight had been even less, although increasing (4.5 percent in 1970, 5.4 percent in 1975, 7.3 in 1980, and 10.4 in 1985). Except for the latter year, investment into machinery had always exceeded those numbers. In 1970, the latter's share in total investment was 8.9 per-

cent, in 1975 – 9.5 percent, in 1980 – 8.4 percent, and, finally, in 1985 – 8.3 percent.²²

Finally, data concerning recent (1994 to 2001) increase of *gross* industrial production by sectors (though not a reliable indicator of policy priorities) also raise some doubts as to the longer-term preferential development of the oil sector.

²¹ In 2002, investment ratio in Russia reached 17.9 percent of GDP, while the average of the OECD was 21 percent, of the Eurozone – 20.2 percent. Among the emerging countries, Poland (19.1 percent), Hungary (22.3 percent), Korea (26.8 percent), and China (42.2 percent) all have investment ratios surpassing that of Russia. (OECD 2004, p. 61)

²² All data are from Goskomstat (2002, p. 578).

Table 1

Gross Industrial Production by Sectors in 2001
(Indices)

	1994=100	1998=100
Industry, total	116	130
Electric energy	93	103
Fuels	105	114
Oil extraction	108	115
Oil processing	101	107
Machinery	117	150
Iron and Steel	131	135
Non-ferrous Metals	134	133
Chemicals	145	150
Food industry	105	128
Memorandum item		
GDP	122	138

Source: Computed from Goskomstat (2002), UN ECE (2004)

A Weak Link: Machinery Exports

The defence industry's predominance in machinery sector was already mentioned. Clearly, Soviet machinery production was never export-oriented (most of its products were developed and produced for internal use only, or, for exports to the CMEA).²³ Therefore, in contradiction to the preference for developing the machinery industry, exports of machines and transport equipment from the Soviet Union, as well as Russia, have been *historically* non-significant – what is more, their trend has been declining.

As to the present, in 2001 6.3 percent of Russian exports consisted of machinery and transport equipment – to be compared with 41 percent share of this commodity class in the world exports, and its 35.7 percent share in the exports of the *developing* countries as a group.²⁴ Machinery is in the background, not only in relation to the exports of the raw

materials sectors, but within the manufacturing group as a whole, as well. Machinery exports amounted to about 17 percent of total manufacturing exports of Russia in 2001.²⁵

Remarkably, machinery trade *has lost ground* in the country's total exports in a longer-term perspective as well. From above 20 percent of the total in 1970 (*before* the first oil price explosion, and the dynamic development of Siberian oil and gas fields), the share of machinery exports declined to 14-16 percent in the 1980s. The overwhelming part of the exports (including large volumes of military equipment) went to the soft markets of the CMEA or those of the "friendly" developing countries. In Soviet exports to the CMEA, the share of machinery had oscillated between 17-23 percent.²⁶ The higher machinery shares of the exports to the CMEA were result of import-substituting policies on the level of the CMEA as a

²³ Defence goods were exported to "friendly" third-world countries as well in big quantities – Soviet defence goods were competitive, but sales, in most cases, politically motivated and related to military objectives.

²⁴ Computed from UN (2002).

²⁵ Computed from UN (2001). To compare: the same share (Metal Manufacturing to Manufacturing as a group) in the same year in Mexico was above 75 percent.

²⁶ All data are taken from Narodnoye (1990, p. 663).

whole, but also due to the distortions of the intra-CMEA trade prices in favour of manufactures, and to disadvantage of raw materials.

The above may be interpreted in such a way that the Soviet Union, though a global super-power, was in economic sense, a medium-developed country, at best. (Schleifer and Treisman 2004).²⁷ Soviet trade patterns even with her CMEA partners were much resembling those of a less developed country of the period: Even before the oil price shock of the 1970s, Soviet economists warned their counterparts in the CMEA countries that exchange of Soviet raw materials to East European machinery (and, in some cases, food) cannot last forever as the backbone and main content of intra-CMEA trade. However, they failed to analyse the deep structural factors (economic and political) behind this situation, and declared, in a false and misleading way, the partners to be

responsible for the maintenance of this pattern of trade.

CMEA exists no more. Former partners of present Russia have radically changed the pattern of their trade, its commodity composition included, except for that of trade with Russia, which has maintained to be focused on the exchange of Central European manufactures for Russian oil, gas, and some other resource based products. The stubborn survival of the dominance of hydrocarbons in Russian exports of Soviet and post-Soviet times suggests that the factors behind this situation are deeply rooted in autarchic economic strategies of the Soviet period, and priority development of the military industrial complex.

²⁷ This statement leads the two American professors to conclude that there is a large gap between the overwhelmingly negative assessments (in the West) of post-Soviet Russia and the facts. "Many Western observers thought of Russia in the early 1990s as a highly developed, if not wealthy, country... (However) Russia was never a 'developed' country." They continue the narrative in a way that can be interpreted both as a commonsensical judgement of, and an apology for, what has happened to Russia since 1991: "...thinking about Russia as a normal middle-income country helps put extreme forecasts in perspective. Most countries in this category end up somewhere between textbook democracy and full-fledged authoritarianism. Their democracies are incomplete, unpredictable, and subject to temporary reversals as incumbents seek to manipulate the process to stay in power. When they grow at all, middle-income countries tend to grow in spurts that are often interrupted by financial crises. Russia has probably now destroyed enough of the vestiges of central planning to continue operating as a market economy, albeit with flawed institutions and an unhealthy dose of state intervention." (Shleifer-Treisman 2004, p. 38)

Resource-based Development: An Asset or A Liability?

Back to the oil and other raw materials, there are a lot of ambiguities in assessing their role in economic development. This concerns all countries, Russia including. Is it really resource-based growth that brings about impediments to institutional development? Or, to the contrary: political and social institutions that have been brought about during previous decades or centuries of historical development promote resource-based industries and hinder the development of other sectors? Or both theses are correct to a certain extent, and they are mutually reinforcing each other?

What does history prove, if anything? There are examples both for and against any explicit judgment concerning the role natural resources have played in economic development of different countries in different periods. History certainly shows that richness in raw materials is not enough for ensuring lasting development of a country. The most telling case is that of Spain in the seventeenth century having fallen behind other countries despite its richness in gold and silver robbed in America. Equally resource-rich countries or territories could have developed in quite different ways as a consequence of dissimilar policies and/or institutions of theirs.

However, industrialization and modernization of the most important pioneering countries (Britain and the United States) and of many others started from development, industrial use (processing) and exports of domestically produced raw materials.²⁸ In modern times, as well, richness in natural resources may be an asset, not a liability, to

economic development, even if founding the proper way from growth of raw materials production and exports to sustainable economic development and better living conditions for the people of the country concerned is not an easy undertaking.

Oil, especially as the single most important commodity in international trade, with its strategic (military and economic) significance, and the exceptional geographical concentration of its reserves and production in the Middle East, perhaps the most instable region of the world, is a specific sort of raw materials. Oil richness should be handled, therefore, in a specific way. Birdsall and Subramanian – the authors referred to above – are addressing the developmental problems, first of all, of the OPEC countries. They suggest ways and means of “Saving Iraq from its oil”, and consider three options: “Privatising oil resources, creating special oil funds that limit government discretion in spending the money, and transferring the proceeds from oil directly to the people” (pp. 84-85), and they opt for the latter version. They would prefer Iraqi oil production to remain in Iraqi state ownership. Not surprisingly, they derive this conclusion, among others, from experiences of the disappointing, in their view, Russian way of privatisation of the oil industry. “The resulting oligarchic capitalism has undermined Russia’s market economy, making it more difficult to foster public trust in market institutions such as private property, the rule of law, and the sanctity of contracts.”

²⁸ Natural resources have played a most important role in the development of agriculture – a sector, largely ignored in the present discussion about resource-oriented versus not resource-based development.

Saving Russia From Its Oil and Gas?

The latest events around Russian oil industry (the fall of the Yukos oil company) undoubtedly support this view, whatever one thinks about the legal and political content (and the possible economic consequences) of the conflict between the Russian state and the country's biggest oil producer (as well as with oligarchs in general). In the retrospect however, the years between 2000-2003, i.e. the years of the oil boom *before* the Yukos scandal, were considered by Western analysts as having been characterized by reduced uncertainty about property rights. This situation "contributed to a boom in oil-sector investment". Private oil companies "directly accounted for somewhere between one fifth and one quarter of GDP growth... They have played a crucial role in keeping Russia's external balance in surplus." (OECD, pp. 32-34) Output of crude and condensate production by the three largest financial group owned Russian oil companies (Yukos, TNK, Sibneft) increased by 90 percent between 1998 and 2003, their non-CIS exports of crude – by 139 percent. In the same period, output of state-controlled oil companies grew by 13 percent, their exports to non-CIS countries – by mere 9 percent (OECD, pp. 61-63).²⁹ (See **Table 2**.)

The modest performance of state-owned oil companies (and of other state-controlled companies in non-oil sector) leads the authors of the OECD Survey to conclude that the latter's "examples... would appear to suggest that Russia's leading private oil companies would not have achieved the growth performance of the last few years if they had remained under state control" (p. 34). Paradoxically or not, "oligarchic capitalism" have

undermined the Russian market economy (a view shared by many), while, at the same time, it has been the driving force behind the country's dynamic economic growth (a fact supported by macroeconomic data), at least, most recently. It remains to be seen, if the ongoing efforts to advance the state influence in the oligarchs-dominated oil sector will allow for maintaining the dynamics of the recent years.³⁰

²⁹ There is a third group of companies: "oil industry insider owned". The production of this group increased by 31 percent.

³⁰ Besides the existing state-owned oil companies, oil exports pipelines are in the exclusive disposal of the state-owned Transneft company. The mentioned government efforts comprise not only criminal investigation, but streamlining and empowering state administration, raising oil exports taxes, creation of an oil fund of the budget (see later).

Table 2

Russian Oil Sector: Investment, Output and Exports

(As a Percentage of 1998 Figures)

	2000	2001	2002	2003
	Upstream capital spending			
Total	148	215	167	
Financial group owned	117	188	160	
of which 3 largest	122	225	202	
Oil industry insider owned	169	229	174	
State controlled	173	244	169	
	Output			
Total	107	115	125	139
Financial group owned	105	116	136	158
of which 3 largest	119	138	162	190
Oil industry insider owned	111	128	135	144
State controlled	100	103	106	113
	Non-CIS crude exports			
Total	118	125	139	164
Financial group owned	111	129	142	180
of which 3 largest	147	178	190	239
Oil industry insider owned	100	111	124	131
State controlled	104	97	99	109

Source: OECD (2004)

From a point of view of international trade, Russia, though an important player in the oil market, has always been a price-taker; its production and exports had not have a significant effect on the oil price developments. Suddenly, the Yukos affair made the country a price-maker – at least to the extent that it is partly responsible for sustaining the high prices. Concerns about the future of the Yukos company (producing 2 percent of the world's output, 80 million tons – more than Libya –, and alone providing 16 percent of Russia's non-CIS crude exports), related to the clashes of uncertain outcomes between the President and the oil industry, may eventually eclipse the internationally established picture about "safe" Russian oil as against "unsafe" one from the Middle East. Added the spectacular production growth of the recent years, all that may be part of explanation for Western resentment with the Yukos affair, and some sympathy with the oil tycoons – at least, concerning their conflicts with the President. As some authors express it in a cynical way: for the sake of the suc-

cess of Russian capitalism, the origins of private oil-wealth should be forgotten.³¹

Understandably, OECD is less enthusiastic about Russian gas industry – the world's largest.³² First, there has not been any boom

³¹ This is the viewpoint of Anders Aslund, Director of the Russian and Euroasian program at the Carnegie Endowment for International Peace, and an advisor to the Russian government in the early 1990s. "The U.S. robber barons were more similar to the Russian oligarchs than people realize. Half of them made their fortunes in the railways, and the secret of their success was their acquisition of land from the state for free. Does that not sound like loans for shares?... Many European properties derive from outright gifts from a monarch, many of them exempt from taxation until recently. Capitalism requires private property, and how it can be established is always a matter of politics. The secret of successful capitalism is to respect property rights regardless of how they originally emerged." (Aslund 2003-2004, p.26)

³² The Russian natural gas sector generated around 8 percent of the country's GDP and accounted for roughly 20 percent of export earnings. At the end of 2002, Russia possesses 30.5 percent of the world's proven reserves, 22 percent of world natural gas production and 30 percent of exports. Russian gas supplied about 20 percent of gas

in the gas production in the recent years (although the fall in production from its peak was more modest than in the case of oil). Second and more important: the *ownership structure* of the industry is different from that of oil industry. The difference is, at least partly, apparent, and applies to the *formal ownership structure*. While oil industry is commanded by *some* vertically integrated monopolies,³³ the gas sector is dominated by *one* state-controlled monopoly – *Gazprom*. (Until recently, the state has held 38 percent of the *Gazprom* shares. It controlled *Gazprom* with the aid of additional 16 percent of shares held by the company itself.) “The natural gas industry is probably the least marketised sector in the Russian economy... The domestic gas market is not really a market at all. It is rather a rationing mechanism...” (OECD 2004, pp. 130-132) Domestic gas prices are officially regulated (held at a relatively low level). According to the OECD, aggregate “implicit subsidies” provided to the rest of economy by the gas (and electricity) sectors reached about 5.0-5.5 percent of GDP in 1997-2000; thereafter they were substantially reduced. “Gas sector reform”, comprising a whole set of proposals at

reorganisation of the industry, suggested by the government (and successfully opposed by *Gazprom*) is generally regarded an urgent need by international organizations. As referred to above, low domestic gas prices were *apple of discord* between Russia and the European Union during the negotiations concerning Russia’s WTO accession.

While the EU is in need of importing more natural gas from Russia, from fear of excessive dependence, it suggests that member countries should limit the share of their domestic gas demand to be covered from any one source. There are signs indicating that this kind of controversial duality in the EU’s approach to gas imports from Russia may cause some uncertainty in determining strategic targets for Russian gas industry.

To sum up this line of thought, everyone should be warned against drawing some generalized conclusions from the Russian experiment concerning privatisation *or* state ownership of oil production. As oil is a very specific commodity in international trade, and it plays an exceptionally large role in the national economies of both producers and consumers, there are important considerations for the state in the oil-producing countries to effectively control the industry, and even to retain it in its own hands. Oil (energy in general) can be treated very much like utilities, physical infrastructure, environmental protection, and other public goods, whose procurement (production) in needed quantities and in adequate quality is more important for the development of the economy and society as a whole, than the assessment of the eventual gains and losses related to the “production” process.

However, this conclusion has little (or nothing) to do with the actual developments of the industry in Russia. At present, there are a lot of arguments both for finding oil industry privatisation in Russia – from a macroeco-

consumption in the EU-15 and two-thirds in Central Europe (OECD 2004, p. 130). *Gazprom* alone produces 90 percent of Russia’s natural gas, and operates the country’s gas pipeline network.

³³ Analysts, however, emphasize the little-competitive character of oil industry, as well as the non-market ways and means of the struggle among the oil companies: “...Oil companies have been struggling one with another in the fields, far away from the market ones.. Competition in the oil sector consists of almost pure and refined conflicts of people having specialized in relations to governmental organizations.” (“Нефтяные компании сражались и сражаются друг с другом на полях, далёких от рыночных... Конкуренция в нефтяной отрасли представляет собой почти чистое и рафинированное противостояние специалистов по связям с правительственными организациями...”) (Butrin, 2004). The oil industry is infamous for the same lack of transparency and market-conform competition as the gas sector.

conomic data point of view – extraordinary successful, and, from a point of view of longer-term sustainability of growth (and from its political and social aspects) in the country mostly dubious. Notwithstanding the fact that in the last years private companies have been responsible for the most of oil production and exports growth, and state-controlled companies have performed modestly at best, it would be difficult to allege that given the international circumstances of the recent years (oil price hike, demand for Russian oil internationally, striving of Western oil companies and financial groups to invest in Russian oil), Russian oil production, if basically state-controlled, would have developed much differently from the way it has effectively did. The Russian case only supports the general thesis concerning the importance of the “software” of an economy (“the institutions, customs, laws, and social cohesion”) for its development. The really important questions to be asked concerning

Russian oil and gas are not about “oligarchs” or state. One should ask: “what sort of state”, “what kind of government”, “what kind of privatisation”, “what kind of private property”? The possible answers to those questions do not look very comforting.

To refer to a recent publication in a Russian journal (Delyagin, 2004), in present-day Russia official (state) regulation of the economy is exceptionally weak and fragmentary: environment is devastated, capital is fleeing, state money is used for private purposes. There are no purposeful anti-monopolistic policies. There are a lot of depressed regions – tens of millions of people have been left out from any kind of development. Protection of property rights is an unresolved issue (i.e. protection of property rights of all others from the expansion of the big capital, while the latter’s own protection rests upon its personal relationships). As a matter of fact, the recent uncertainty of the oligarchs (the private oil

sector), is but an indication of dangers to economic stability despite dynamic macro-economic growth.³⁴

³⁴ The recent banking crisis in Russia (which, at the time of writing in August-September 2004 may be over or not) is another indication of dubious reliability of growth. Together with the struggle between the state and the oligarchs, it can contribute to further loss of much-needed (lost already many times in the previous decade) confidence by (foreign and domestic) investors, as well as the country’s population in how reasonable it is to invest into development of Russian economy, or place their money in the Russian banks. Inauguration of a deposit insurance system, aimed at increasing public confidence in the banking sector and promoting financial stability, is in retard.

Oil Funds and Distribution of Oil Wealth

The creation of oil funds with constitutional or other restrictions on the use of revenues is not an alternative to privatisation: the fund can be created irrespective of private or state ownership of the oil sector. Maintenance of the fund for a longer time would help to insure against volatility of international prices. According to Birdsall and Subramanian however, the experience with national oil funds in other countries (except for Norway) has not been encouraging, as in the countries without strong government institutions and healthy democracy the rules stipulating the functioning of the oil funds are not stable enough and change often, according to varying actual political needs. To add, while creating an oil fund seems to be a very good idea to avoid the negative macroeconomic consequences of price volatility, it can play a significant role in the re-allocation of sources (from the oil sector to non resource-based ones) only if international prices remain high (and do not fluctuate very seriously) for a longer period of time.

Recently, such fund was created in Russia, as well. The purpose of the Stabilization Fund of the Russian Federation is to insure the federal budget against price volatility. “Surplus” revenues – resulting from the natural resource extraction tax and the crude oil export duty above that which would accrue at an oil price of USD20/bbl for Urals type of crude – are automatically transferred to the fund. Until the fund accumulates a total of Rb500bn (roughly 3.8 percent of 2003 GDP), the revenues may be spent only to finance the federal deficit arising as a result of oil prices below the baseline USD20/bbl. Once the fund exceeds that sum, the additional revenues may be spent for unspecified other purposes. Among them, the Russian authorities may consider

accumulating additional windfalls in the fully funded pillar of the state pension system (OECD, 2004, pp. 48-49).³⁵

As far as direct distribution of oil wealth to the people is concerned, it has been in practice in the U.S. state of Alaska and the Canadian province of Alberta, i.e. in certain *regions* of some developed *non-OPEC* countries, where the *interest from oil funds* rather than oil revenue itself is distributed. In those cases, direct distribution is part of functioning of the oil fund. However, Alaska and Alberta do not have the kind of macroeconomic balancing problems, which are typical of many OPEC countries, as well as Russia, and which are constraints to the use of the funds. In a big and populous country, any meaningful distribution of the income from the oil fund to the population would lead to the neglect of macroeconomic stabilizing function and possible development targets of the fund. As to the direct distribution of oil wealth *instead* of creating the oil fund, it looks like an illusion. It reminds of the aborted experiments with the voucher privatization in several transition countries early last decade which gave the *semblance* of resolving the problem of efficient use of the former state property without having effectively changed the way of its functioning.

³⁵ Seen from Hungary, the latter is the Russian equivalent of the Hungarian second pillar of mandatory pension insurance, under which benefits depend on yields generated on the investment of the citizens' contributions – except, among others, that Russian citizens have the right to assign the management of the fully funded portion of their contributions both to private management companies and a state management company, while Hungarians may choose among private companies only.

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