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THE STATE OF THE RUSSIAN ECONOMY

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The Russian Economy in Spring 2021: Recession and Dubious Prospects

By Alexander Chepurenko (National Research University Higher School of Economics, Moscow)

Macro Data: Recession

The available statistics on the overall state of the Russian economy indicate a recession. In February 2021, Russia's GDP was 2.8% lower compared to February 2020, a larger gap than January's (2.2% lower than January 2020). Moreover, in February 2021, industrial production fell 3.7% year-on-year, and the annual headline consumer price index (CPI) inflation increased to 5.7% year-on-year. Labor market data continued to improve in February, with an unemployment rate of only 5.7%. The federal budget deficit increased to 645 billion rubles in January–February 2021. Such developments have pushed the Central Bank to raise the key interest rate on March 19th by 25 bp to 4.50%, the first increase since December 2018. Moreover, the Central Bank officials proclaimed the return to a neutral monetary policy, being open to further increases in the key rate in the coming months. The recovery of the economy after the pandemic may be rapid, so the Central Bank expects the achievement of a pre-COVID economic state by the end of 2021. However, the sources of the expected further growth are uneven.

Where Can the Growth Effect Come From?

As regards the state of private business, the Composite PMI stood at 54.6 points in March, while the Manufacturing PMI stood at 51.1 points, and the Services PMI at 55.8 points. The business confidence index fell slightly in March (-0.3 index points).

The situation of households was even worse: consumer confidence decreased in the first quarter of 2021 by 21 index points, and the retail sales index decreased by 1.9% in February compared to January, standing at a deficit of 1.3% compared to February 2020.

Foreign investments stood at USD 3.886 billion in the 4th quarter of 2020, which is a rather modest amount compared with the GDP of USD 322.197 billion (constant prices) in the same 4th quarter or even with exports, which stood at USD 29.268 billion (February 2021).

Thus, it seems that neither private business, nor households (due to a significant decrease in purchasing power and financial reserves of families), nor foreign investment (taking into consideration the worsening of relations with the West and the dubious prospects of attracting FDI from elsewhere) can become drivers of economic growth of Russia in the near term.

State Economic Policy: Shift towards a Direct Regulation of Markets?

Given this macroeconomic background, Russian authorities, being worried by the steady increase in prices of food and related articles, began a series of measures to 'decouple' domestic prices from international market trends. The first precedent was established in the beginning of 2021, when the government, for the first time in modern Russian history, started to enforce significant duties on a number of agricultural crops while also bringing into force export quotas and capping the prices of certain foodstuffs. For the period March 1 to June 30, Russia introduced an export duty on wheat of 50 euros per ton, and from March 15 for corn (25 euros) and barley (10 euros). The authorities insisted that this was necessary to containing food price inflation. But such measures would hit farmers' incomes in the new season.

Furthermore, the government began regulating the prices of sugar and sunflower oil after criticism of Vladimir Putin in December 2020 concerning price inflation. According to an agreement with the manufacturers, until April 1, sugar should be sold to retailers at a price of no more than 36 rubles per kilogram and bottled sunflower oil at no more than 95 rubles per liter, respectively. Unfortunately, at the end of March the government decided to extend the agreement on sugar prices until June 1, and on sunflower oil prices until October 1, while promising subsidies to manufacturers of 10 rubles per liter of oil and 5 rubles per kilogram of sugar. However, on April 1, the subsidy regulations were not yet published, leading many sugar manufacturers to stop shipments to retail chains while they waited for the promised state support.

Another manifestation of the same tendency might be found on the real estate market. In Russia as a whole, the primary market prices of residential real estate have risen by 12% year-on-year, and in some regions by as much as 19% to 30%. This increase in prices was spurred by the concessional mortgage, now at an annual rate of 6.5%, which is very cheap by Russian standards. Another reason is lack of competition among developers in some local markets where the population is poor, and thus development projects are very risky. Reacting to this trend, Putin instructed the Federal Antitrust Service (FAS) to "check the validity of the increase in the cost of apartments in new buildings in the country".

Perspectives

The authoritarian state was in 2020 in some aspects more efficient than the Western democracies in combating the

Covid-19 pandemic. However, taking into consideration that the pandemic and its outcomes might plague economies and societies longer than expected, autocratic tendencies can find even more support in public opinion. In addition, the growing role of the state and semi-state owned monopolies, and now also of direct state inter-

ventions, into the process of price formation and competition on different markets is a sign of a new stage in the backslide transition in Russia: growth expectations being too closely connected with state investment activity and public-private partnerships will be dangerous for the Russian economy in the long run.

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»Fortress Russia« Effective in the Corona and Sanctions Environment Short-Term, More Stagnation and Sanctions Ahead

By Gunter Deuber (Raiffeisen Bank International, Vienna)

Russia has come fairly well through 2020 and 2021 in the real economy. With a decline of 3%, output slumped less than the global economy and only about half as much as in Western Europe. This remarkable 2020 performance was a result of Russia seeking short-term and opportunistic cooperation with OPEC. Domestic oil production was curtailed under the OPEC+ agreement. Oil output dropped by 8.5% year-on-year in 2020, lowering GDP growth by 1.0 pp.

Satisfactory Economic Performance Due to Structural and Cyclical Factors

The satisfactory performance has to do with economic structures, policy responses and a better-than-expected global environment. The low complexity of the Russian economy with a low share of services, which are sensitive to Covid-19 restrictions, has prevented a deeper

collapse. Moreover, proactive fiscal countermeasures have been taken, with a federal budget deficit of 4.5% of GDP. For the first time, the government reacted to a crisis by upping expenditures and temporarily blocking the budget rule. Rapidly recovering commodities supported exports, while imports dropped sharply. Lower oil and gas exports were partially offset by growing gold and wheat shipments (exports: -5.1% yoy) while imports declined by 13.7% yoy. Therefore, net exports added +1.4 pp to GDP dynamics.

Some fiscal support will remain—at least in 2021. The National Wealth Fund (NWF) will not be replenished due to temporary changes to the fiscal rule; a replenishment could restart in 2022. Moreover, the NWF's liquid assets are to be invested already in 2021 as their sum exceeds the 7%-of-GDP threshold, presumably in infrastructure projects. Therefore, policy-

induced growth impulses should be set in comparison to the pre-pandemic stagnation. In the context of the 2021 election calendar, increases in social spending and one-off payments were announced during the recent annual state of the nation address to the Federal Assembly. However, Russia's Minister of Finance stressed immediately that the support measures will not require additional debt issuance and financing. However, the speech lacked major announcements in the direction of a far-reaching long-term stimulus package or sweeping reforms. For 2021 a post-pandemic recovery seems to be on track, allowing for a GDP growth of 2–3%. The Covid situation should allow for a decent economic performance in early 2021. Some very upbeat forecasters even project growth rates in the neighbourhood of 5% in 2021/2022, a scenario that looks less plausible given the projected rise in imports as well as chronic structural weaknesses and bottlenecks. Beyond 2021, economic growth is likely to settle closer to potential output growth around 1.5%.

Sanction Hit Avoided, Short-Term “Sanction Bubble” on Markets

The long-awaited tightening of international sanctions against Russia in recent weeks, especially US financial sanctions, has been well coped with. Market effects remained manageable, which has to do with the “Fortress Russia” strategy pursued since 2014. Russia has been preparing for a tightening of sanctions in many dimensions. Foreign debts were repaid, foreign exchange reserves have continued to rise and exceed foreign debts in absolute terms. The positions of foreign banks vis-à-vis Russia have also been stagnating for years. And if the state did borrow money on international markets, it was in euros and not in dollars. All in all, Russia has become less dependent on the international financial market and, to some extent, also on the US dollar and international payment structures. Moreover, the Russian banking sector is in a solid shape following the restructuring in recent years. Government bonds account for only 7% of total assets, compared to 15–20% in other markets. Therefore, local banks can well absorb the partially sanctioned sovereign issuance. In early 2021 there had been the possibility that too much of the market would bet on negative effects of sanctions, with the RUB trading 10–15% below the level that would be justified by fundamentals. Given this “sanction bubble,” markets recovered somewhat following the April sanction round.

There have certainly been some economic policy successes. However, this should not distract from the challenging medium-term outlook. Real incomes have been stagnating or falling since 2014, even if this could turn around marginally in 2021. But there are also risks to this scenario. Currently we see a significant rise in

(food) inflation. Now the central bank has to again take countermeasures to limit inflationary pressure and prevent the RUB from depreciating too much. The latter is also partly a component of the “Fortress Russia” strategy, which in sum does not represent a growth-friendly setup. This is especially true as monetary policy is likely to remain fairly tight in 2021 and 2022. Moreover, income declines have been broad-based and do not only affect the (poorer) rural population. The “Fortress Russia” strategy does not necessarily generate confidence among foreign economic actors. Rather, a stagnation in foreign involvement in the Russian economy is discernible, while there is an inward tilt in Russian supply chains.

Sanctions Outlook: Here to Stay, More to Come

The latest sanctions tightening by the US was well telegraphed. Most importantly for markets, the measures prohibit primary market purchases of RUB-denominated government bonds by US financial institutions. Previously, it had been sanctioned (since 2019) for US banks to buy Russia's foreign currency government bonds on primary markets. The complete sanctioning of Russian government debt is certainly a strong political signal. However, in terms of practical relevance, the impact is limited. Firstly, local state-owned banks have sufficient capacity to absorb the government bond issuance. Secondly, as long as such securities can be traded by US banks on secondary markets, the sanction impact is limited. Moreover, sanction measures in the government bond area are limited to US financial institutions, which limits the effect on US (non-bank) investors, non-US banks and non-US investors. So far, no extra-territoriality is being sought here. Despite harsh diplomatic reactions, the Russian central bank has taken a clear stand. The governor clearly addressed the small size of the impact of the tightening of sanctions on the real economy and financial markets.

So far, the US has shied away from far-reaching measures, such as a ban on secondary market trading or the exclusion of Russian entities from the international SWIFT payment system or US dollar payments. However, the risk of an expansion of sovereign debt sanctions has increased. Even the inclusion of primary market sanctions as part of the latest sanctions package was somewhat surprising but was justified by the urgency of sending a clear signal after the recent round of geopolitical escalation (sparked by Russia's large-scale manoeuvres on its border with Ukraine).

Even if the US sanctions have been moderate so far, a further and notable tightening along the lines of the options sketched previously cannot be ruled out. From a US perspective, the current measured sanctions

approach, combined with efforts to remain in dialogue, should prevent an escalation. However, it does not look like this approach is well understood in Russia. Moreover, we see significant political pressure in the US for more sanctioning. Recent moves are seen just as a “first step” in the right direction; some observers clearly state that sanctions were apparently too light. It should also not be forgotten that sanctions against Russia on international markets driven by the US can be seen as an (indirect) policy signal towards China.

Overall, the risk of further sanctions remains high, and at the least there is no prospect of sanctions being eased. We are currently living in the seventh year of comprehensive Western financial sanctions against Russia, with US tightening especially in 2019 and 2021. The empirics of “successful” Western sanctions regimes, i.e. those in which a change in the behaviour of the sanctioned party was recognisable at some point, point to an ideal sanction regime duration of seven to ten years. Otherwise, sanctions tend to last much longer, sometimes even for decades. In the case of Russia, we can expect Western sanctions to last at least well into the 2020s, or possibly the 2030s. This scenario implies that

there are more risks of ad-hoc and moderate escalation than possibilities for de-escalation. Therefore, the “Fortress Russia” strategy is likely to be continued, despite it being uncondusive to growth and prosperity. Moreover, a “sanctions paradox” seems to be at work in Russia: the government, military and security apparatus are often strengthened in such a setting, as these circles can withstand sanctions even better than private companies.

We see a partly stable equilibrium in US–Russian relations ahead. Currently, we see an explicit commitment to arms control talks—the Kremlin remains open to cooperation in this field. Here the Kremlin has achieved what it wants: the US is talking to Russia at eye level. As long as Russia plays its geopolitical cards well and rightly assesses its macrofinancial way of manoeuvre—as it usually does—we do not expect the US to go for crushing sanctions. For all the rest, Russia is always well prepared. Our baseline view for 2021 and 2022 is that we do not see market-destroying US/Western sanctions as imminent. But well-dosed geopolitical provocations or surprises as well as tough measures to contain the opposition are always possible, and thus further face-saving but rather cosmetic Western sanctions.

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Sanctions Hurt Russian Economy

By Iikka Korhonen (Bank of Finland Institute for Emerging Economies, Helsinki)

Abstract

After Russia’s unlawful annexation of Crimea and undermining of Ukraine’s territorial integrity as well as sovereignty, the European Union, the United States, Canada and many other powers placed various sanctions on Russian individuals and organizations starting in 2014. Multiple types of sanctions are still in place, but arguably those related to finance have to this point had the sharpest bite. In response, Russia has placed sanctions on food imports from countries sanctioning it. Even though sanctions regimes continue to evolve, researchers now have enough data to assess the economic effects thereof. It seems that Russia’s economic growth has been slower due to the sanctions, and Russian banks have become much less integrated with the global capital markets.

Sanctioning Large Countries Unusual

It should be noted that there are no real precedents for sanctioning a country like Russia. Most other countries facing international sanctions are much smaller and less integrated into the global economy—e.g. North Korea and Syria. Historical examples, such as the Soviet Union and South Africa, were also much less integrated with the global economy than present-day Russia. However, it should be noted that Western sanctions have refrained

from hindering Russia’s energy exports, the sector in which Russia is most integrated with the global economy. Instead, sanctions have targeted either very specific product categories related to oil and gas exploration, or finance.

As it is now more than seven years since the first sanctions were levied, a number of econometric studies have looked at the overall macroeconomic effect of the sanctions. The International Monetary Fund (2019) con-

cluded that sanctions shaved 0.2 percentage points off of Russia's GDP growth every year between 2014 and 2018. As Russia's GDP growth between 2012 and 2019 averaged approximately 1%, this is significant. However, the study also notes that changes in the price of oil have a much larger effect on Russia's GDP than sanctions.

Some other recent papers examining the macroeconomic effects of sanctions include Barsegyan (2019) as well as Pestova and Mamonov (2019). Using the synthetic control method, Barsegyan finds that, on average, Russia's per capita GDP was 1.5% lower between 2014 and 2017 than it would have been without sanctions. Pestova and Mamonov find that Russia's GDP was 1.2% lower at the end of 2015 because of sanctions. Korhonen (2019) offers a review of several studies on the topic.

Trade Sanctions

Trade sanctions from the EU, US, etc. have targeted only very narrow categories of goods. Bělin and Hanousek (2021) find that the Western trade sanctions had only a miniscule effect on the value of exports to Russia. It is, of course, possible that in the long-run e.g. reduced access to high-tech oil and gas exploration equipment could curtail activities of Russian energy companies. However, Russia's own counter-sanctions targeting food-stuffs have had a much larger effect on bilateral trade, perhaps up to eight times as large.

It is clear that Russia's sanctions affected different EU countries differently—those with more food exports to Russia were hit harder. On the other hand, alcohol exports to Russia were not affected. More generally, companies in countries with more extensive ties to Russia seem to be more concerned about sanctions, as evidenced by their annual reports (Davydov et al., 2021).

Volchkova et al. (2018) conclude that counter-sanctions have clearly reduced the welfare level of the average Russian household by raising prices of many goods. On average, every Russian has had to decrease consumption of banned items by 2,000 rubles per year.

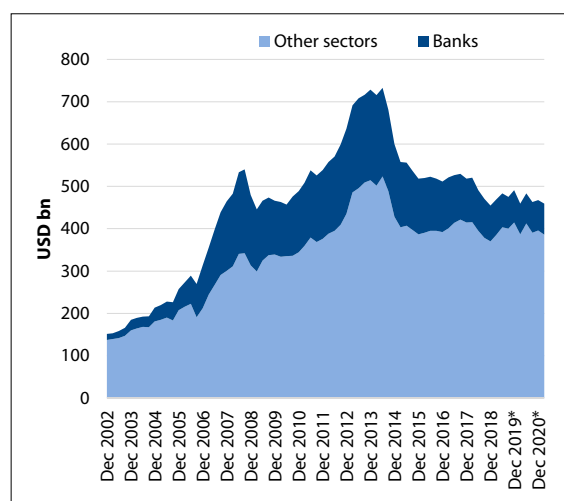
Financial Sanctions

It can be argued that the most important sanctions tool so far has been prohibiting long-term financing for many major state-owned companies. Companies in the banking sector included Sberbank, VTB, Gazprombank, Rosselkhozbank (Russian Agricultural Bank) and VEB (Russia's state-owned development finance institution). For Sberbank and VTB, which together control more than 60% of the Russian banking market, this was clearly a significant step towards isolating a part of the Russian economy from global financial markets. Furthermore, similar financial sanctions were intro-

duced against companies in the energy sector, namely oil giant Rosneft, oil pipeline company Transneft, and oil exploration and refining firm Gazpromneft.

The effect of this isolation can be seen in Russia's foreign debt. From the end of 2013 to Q1/2021, Russia's total foreign debt has decreased by 37%, and Russian banks' foreign debt by 66%. During the past two years the level of foreign debt has stabilized at a new, clearly lower level. It is noteworthy that no Chinese or other non-Western banks have stepped in to replace Western banks in crediting Russian entities.

Figure 1: Russia's Foreign Debt Q4/2002-Q1/2021, USD bn.



* estimate

Source: Bank of Russia

It is clear that reduced access to external finance is damaging to Russian companies' future growth, their stock market valuation, etc. Ahn and Ludema (2020) show that targeted companies performed poorly relative to other companies with similar characteristics. For example, their operating revenue fell by one-quarter and their total assets by approximately one-half in comparison to the control group.

In Conclusion

Economic relations between Russia and Western countries are now weaker and thinner than they would be without sanctions. Moreover, several new types of sanctions—related to use of chemical weapons and human rights violations—have been introduced by both the EU and the US. Based on the current political trajectory, it is hard to be optimistic about speedy removal of any sanctions. Economic effects of sanctions continue to accumulate, both in the West and (especially) in Russia.

Please see overleaf for information about the author and references.

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The Impact of the Covid-19 Pandemic on the Real Sector of the Russian Economy

By Yuri Simachev & Andrei Yakovlev (HSE University, Moscow)

The 2020 coronavirus pandemic caused the deepest recession in the global economy since the Great Depression of 1929–33. However, the economic crisis generated by the pandemic had a number of serious differences in comparison to previous crises. Sanitary measures introduced by national governments to prevent the spread of infection have artificially limited supply in the economy and, above all, in the B2C segment serving end consumers. The service industries and their dominant small firms were the main victims. At the same time, the problems faced by many companies were not related to their competitiveness. Another specific feature of the current crisis is its focused impact and the presence of “aftershocks”. This has led to high uncertainty in supply chains and disruptions in global value chains. All of this has created new challenges for economic policy.

As part of a joint project between the National Research University—Higher School of Economics (HSE) and the Russian Union of Industrialists and Entrepreneurs, implemented in Autumn 2020 to Spring 2021, we tried to assess the consequences of the crisis

caused by the Covid-19 pandemic for the Russian economy. In our analysis, we relied on Russian and international statistics and industry reports, and also conducted over 40 interviews with heads of enterprises and business associations in six large industries: retail, IT, tourism, pharmaceuticals, chemical industry, and automotive.

Our analysis leads to the following conclusions:

- Contrary to the very sceptical forecasts and expectations of Spring 2020, in general, in comparison with the EU countries, the crisis led to a noticeably smaller recession in the Russian economy: the decline in Russian GDP in 2020 was 3.1% against 4.9% in Germany and 8.1% in France. This result can be explained by the structure of the Russian economy, it being far less reliant on the service sector and small business, the areas most affected by sanitary restrictions during the pandemic. The lesser severity of the restrictive measures applied by the Russian government also played a role. At the same time, our interviews showed that one of the reasons for the “soft landing” was the greater resilience of Russian firms associated with their preparedness

for all sorts of emergencies. Many enterprises operating on the Russian market today were able to survive during the acute crises of 2008–9 and 2014–15. Insuring themselves against surprises, they preferred to have bigger inventories and less debt and build flexible labour relations. This strategy was partly due to the lower level of efficiency of Russian firms in comparison with foreign competitors, which limited their growth rates before the crisis, but at the same time it reduced losses for firms in 2020 and allowed them to more easily adapt to the shock of the Covid-19 pandemic.

- While governmental support was fairly limited and delayed, respondents from practically all sectors spoke about increased contacts between the authorities and business in 2020. The initiators of this process, as a rule, were sectoral ministries interested in the prompt receipt of information from business. The consequence of these active communications was the solution in 2020 of some of red tape problems faced by Russian business. However, according to our interviews, although the pandemic and the crisis have led to the exacerbation of many problems at the firm level, almost all of these problems arose before the crisis and had remained unresolved for many years.
- The government's anti-crisis policy has had different effects for different industries and different types of enterprises. In particular, one can distinguish industries with predominantly vertical coordination (mining and metals, machine-building, chemical industry) and industries with predominantly horizontal coordination (trade, IT sector, tourism, consumer services). The first group of industries is more sensitive to the monopoly of their counterparties in the supply chains and switching of suppliers to foreign markets. At the same time, large enterprises prevail there and the government can more easily

interact with them. After the crises of 2008–9 and 2014–15, the Russian government was able to build support mechanisms for these industries. The second group of industries is mainly represented by small and medium-sized firms, which are more sensitive to red tape and a shortage of qualified personnel. It was these industries in 2020 that most needed help, but in interviews, many respondents spoke from personal experience about the “toxicity of state support”—the point when, after the company received financial resources from the budget, inspections and sanctions by various control bodies began.

In general, the crisis showed that the service industries have changed radically since the Soviet era. They are characterized by a high intensity of organizational changes, mergers and acquisitions, and technological innovations. Their mobility contradicts the traditional ideas of the state about possible regulatory mechanisms. As a result, the government responds with a delay to problems and challenges in the development of these industries.

One can also talk about companies' awareness of a set of lessons related to pre-crisis activities and crisis response. The horizontally coordinated sectors have in response to the crisis accelerated digital transformation and the introduction of new business models. The winners were those companies that actively began to master digital technologies even before the crisis. In vertical coordinated industries, the response to the crisis was to improve the reliability of cooperation chains, focus on the development of supply chains and control over the formation of prices, and the introduction of digital technologies to reduce costs. The result is a shift in the focus of company policy from increasing efficiency to increasing reliability. This is likely to result in weak economic growth—combined with a greater ability to withstand external shocks.

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Russian Agriculture and Food Trade

By Stephen K. Wegren (Southern Methodist University, Dallas, TX, USA)

Against the backdrop of economic stagnation, Russia has experienced a remarkable increase in food production that has facilitated ‘food independence’ for the country, helped by state budgetary transfers, tax abatements, and investment into agriculture (Karlova et al. 2021). Since 2014, the agricultural sector has been one of the few ‘winners’ in the economy. In six of the seven calendar years since 2014, the growth rate for gross product from agriculture has exceeded growth in national GDP (based on ruble value). Similar to agricultural sectors in most countries, Russia faces challenges at present and in the future (Serova 2020; Ushachev et al. 2021). Nonetheless, Russia has emerged as a food power during the past decade, rising from obscurity before 2010 to 17th place in food exports in 2020 based on the dollar value of exports. Average annual grain harvests have increased from 87 million metric tons in the period 2008–2013 to nearly 119 million metric tons in the period 2014–2020. Russia has also ranked first or second in the world by volume of wheat exports every agricultural year since 2014/15 (an agricultural year runs from July 1 of one year to June 30 of the next year). Meat production has also risen, linked to the emergence of agroholding companies, which have become dominant actors, particularly in Russia’s south; this dominance extends to production, processing, and distribution (Uzun, Shagaida, and Lerman 2021). For example, in 2019 agroholdings accounted for 69 percent of total poultry meat production, 63 percent of pork production, and 18 percent of beef production (Kulistikova 2020, p. 61). The top two meat-producing companies, Cherkozovo and Miratorg, accounted for 10 percent of the nation’s total meat production in 2019. The increase in food production has allowed Russia’s policy makers to pursue two main goals in food trade policy.

Reduction in Food Imports

The policy goal to reduce food imports dates to 2003 and the introduction of tariff rate quotas (TRQs) for meat and meat products. The intent was to protect, to some degree, domestic meat producers from foreign competition. This soft protectionism was not especially effective. The total value of Russia’s food imports increased from USD 12 billion in 2003 to over USD 43 billion in 2013. Moreover, between 2000 and 2013 the volume of meat imports—pork, beef, and poultry—grew by 50 percent. Thus, TRQs provided some limited protection to domestic producers, but they did not alter the upwards trajectory of Russian meat import volume. In 2020, the TRQ for pork was ended and replaced with a flat import tariff

of 27.5 percent. The tariff on imported pork increased domestic pork production, but led to a decrease in consumers’ real income. Covid-19, and an accompanying shift in consumers’ consumption of pork from restaurants to retail stores, led to a dramatic decline in pork imports in 2020. Overall, meat imports declined to about 600 thousand tons in 2020, down from 1.8 million tons in 2013 (TASS 2020). The TRQ for fresh and frozen beef is likely to be replaced by a flat 25 percent tariff starting in 2022. Consumer demand for beef is already at a ten-year low, so a flat tariff will likely lead to lower imports.

Since August 2014, Russia has employed hard protectionism in the form of a food embargo (countersanctions) which selectively targets dominant food traders in the international food system—the US, Canada, the EU, Australia, and Norway. Countersanctions decreased the volume and value of food imports into Russia, from over USD 43 billion in 2013 to a low of USD 25 billion in 2016, after which imports rose again, reaching USD 29.4 billion in 2020. Countersanctions are selective in that Russia chooses which commodities to ban and which to allow. While most raw agricultural commodities, as well as many processed and manufactured foods, can no longer be imported from Western nations, Russia continues to import high-yield livestock. In 2019, for example, Russia imported nearly 113,000 head of cattle, including over 73,000 breeding cattle, to help rebuild Russian livestock herds (Foreign Agricultural Service 2020). The January 2020 version of Russia’s Food Security Doctrine makes clear that food independence will continue to be a policy priority.

Increase in Food Exports

A second policy goal in food trade is to increase the value and volume of food exports, following Putin’s May 2018 decree on national development that stated overall exports should reach USD 250 billion by 2024, with food exports totaling USD 45 billion. That food export goal was subsequently lowered to USD 34 billion by 2024 and the USD 45 billion target was pushed back to 2030 (Shokura 2020).

The dollar value of Russia’s food exports has increased significantly during the past decade. In 2010, for example, the value of Russia’s agri-food exports was just USD 9.4 billion, rising to a record USD 30.7 billion in 2020. The gap in dollar value between food imports and exports narrowed until 2020, when the value of exports exceeded imports for the first time in post-Soviet history. Grain exports generated the highest revenue in 2020 at USD

9.7 billion, followed by exports of fish and seafood (USD 5.2 billion), oilseeds (USD 4.6 billion), and processed food (USD 4.1 billion) (Ministry of Agriculture 2020). In 2020, China was Russia's single largest food export market, with imports valued at USD 4 billion, followed by the European Union at USD 3.2 billion and Turkey in third place at USD 3.0 billion. Those three purchasers accounted for about 36 percent of the total dollar value of Russia's agri-food exports in 2020.

Russia's emergence as a significant food-exporting country is relatively recent, so it has had to build up an export infrastructure by expanding storage capacity and the number of grain elevators that can protect grain from vermin and spoilage, increasing rail transport capacity and replacing old train wagons with new ones, and modernizing and expanding seaport capacity in the Black Sea and Far East. As a longer-term project, Russia needs to increase cargo capacity by building larger

container ships and bulk carriers. Furthermore, to assist exporting companies, an analytical center within the Ministry of Agriculture now produces market surveys on commodities and specific countries that are freely available on the ministry's website. It also provides consulting advice and assistance for the negotiation and signing of contracts.¹

Conclusion

Russia's agricultural sector continues to account for a relatively small percentage of overall GDP, but positive growth in the sector in recent years has added ballast to an otherwise lackluster economic performance. The Putin administration is committed to national food security and supporting domestic agricultural production. The agricultural sector is therefore likely to remain one of the bright spots in the Russian economy.

About the Author

Stephen Wegren is Distinguished University Professor and Professor of Political Science. His most recent book is *Russia's Food Revolution: The Transformation of the Food System* (Routledge, 2021).

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¹ For more information about the functions of the Center, see its website at: <https://mcx.gov.ru/ministry/departments/departament-informatsionnoy-politiki-i-spetsialnykh-proektov/industry-information/info-podderzhka-malogo-i-srednego-biznesa/>

Russia's Economy: Outlook

By Christopher Weafer (Macro-Advisory LLC, Moscow)

Most world economies will report a strong and broadly based rebound this year. This is because of the base effect from last year's lockdowns and global trade collapse. Russia is no exception. The contraction in GDP was a modest 3.0 percent in 2020, and the recovery this year is expected to be in the range 3.5 to 4.0 percent. But then growth is likely to slip back into the 2–3 percent range, and it will be difficult, or will take many years, to pull the economy into the higher 3.5–4.5 percent growth range required to achieve the ambitious targets for economic and social changes set out by President Putin.

The reason for the relatively small decline last year and the equally small prospects for recovery is the structure of the economy: it is too heavily laden with state-controlled enterprises and extractive industries, especially hydrocarbons, and has far too small a share in SMEs and far too few mechanisms to support entrepreneurs. SMEs account for approximately 25 percent of economic activity in Russia, while in other faster-growing developing economies the percentage is three times higher.

Part of the problem lies in the fact that Russia never materially changed the structure of the economy it inherited from the Soviet Union. The 1990s was a decade of lawlessness, the emergence of oligarchs and very ineffective government. People were impoverished and somewhere close to \$500 billion was removed from the country. The picture changed dramatically from 2000 as Putin's administration brought in law and order and forced the oil and gas sector to refocus on export growth. The country is estimated to have earned close to \$3 trillion from exported hydrocarbons over the period 2000 to 2012.

This revenue sustained one of the most extraordinary economic booms in the history of developing economies, but it left the economy excessively vulnerable to fluctuations in hydrocarbons markets, a vulnerability compounded by meagre investment in new industries. There was indeed significant discussion about using the wealth generated to transform the economy and to create future sources of growth, but decision makers always thought they had plenty of time and there was no need for urgent action.

That changed after 2014, when Russia was hit with a combination of sanctions and yet another oil price collapse. Yet the contraction in headline activity in 2015 and 2016 was much smaller than many predicted. One of the reasons for this was because that crisis, which was partly economic and partly political, finally shook

government complacency. It is often said that "Russia does the right thing only when there is no other choice". That was the situation in early 2015.

The actions initiated since then, although hardly revolutionary, today better position Russia to finally start the process of changing the drivers of future growth and achieving the long-talked-about economic diversification. One should always be wary of saying "it's different this time", but there are observable differences to support pragmatic optimism, though progress is slow.

One of those changes was the reduction of the federal budget's vulnerability to volatile hydrocarbon tax receipts and to remove any "excess" receipts from day-to-day spending. This is the so-called "Fiscal Rule" or "Budget Rule". It sets the budget oil price target at \$44 per barrel and, pre-Covid, set a target of having the budget break even at this level by 2022. It was on track as of 2019, when the budget broke even at \$50 per barrel, down from the \$115 per barrel required in 2013. This year the budget will balance somewhere in the \$50s per barrel (depends on the ruble exchange rate) and, because of the higher average year-to-date, it returned to a surplus in March of this year.

The second major change was the rapid devaluation of the ruble. This was not supported by President Putin, as he considered it might lead to a banking crisis. But by early 2015, the choice was to devalue or risk going broke. Within six months, Putin was convinced of the benefits of a weak ruble in terms of budget management, import substitution and export growth in such sectors as agriculture and food. The devaluation has undoubtedly been very painful for people and industries dependent on imports. But that pain is now absorbed by the broader economy and the benefits in terms of a much more competitive industrial and export base are showing positive results. For instance, Russia has been the world's largest grain exporter for several years since.

The third factor was the adoption of the National Projects programme. This was originally a five-year, \$400 billion spending programme aimed at boosting transport and communications infrastructure, technology, training, and productivity schemes, and improving social infrastructure. This differed from Soviet-era five-year plans in that it was transparently debated over several years, funding was identified, and responsibility for each of its aspects was assigned to newly appointed Deputy Prime Ministers. The newly revamped and strengthened Audit Chamber had a role in overseeing spending and efficiency. The disruption due to Covid-19 has forced a rethink, and the programme has now been

relaunched as a more realistic 8-year programme and with adjusted priorities.

The Fiscal Rule also makes the National Projects, as well as other measures announced aimed at encouraging investment and economic diversification, more achievable. The diversion of hydrocarbon surpluses means that Russia's National Fund is worth almost \$180 billion today. Total national debt is at a still-modest 18 percent of GDP, having jumped from under 13 percent at the start of the pandemic in early 2020. In other words, the government can now afford to fund this better-structured and more transparent recovery and growth programme.

Challenges certainly lie ahead. The legacy of Russia's poor behavior with investors, the most recent example

of which being the Barings Vostok case, and the continuing sanctions threat means that private sector investors will be reluctant to participate too quickly. These investors will be needed in the coming years if the programme to pull the economy out of a low-growth environment is to succeed; the state will not be able to do it on its own. Three oil price shocks since 1998, pressure from Western sanctions and a slowly changing and more demanding population means that the government has no choice. It is now embarked on an irreversible course, as the consequences for social and political stability of doing otherwise are worse.

About the Author

Christopher Weafer is Chief Executive of Macro-Advisory LLC, a Eurasia-based strategic advisory consultancy. He has worked as an economist and market strategist in emerging markets for over forty years, and been based in Moscow for the past twenty-three. He has regularly been voted the best market strategist and forecaster in Russia and for the Eurasia region.

The Covid-19 Pandemic Offers a Glimpse into Russia's Economic Future

By Janis Kluge (German Institute for International and Security Affairs—SWP, Berlin)

Russia's economy survived the Covid-19 crisis with a relatively mild GDP contraction of 3.1 percent. Under the exceptional circumstances of the pandemic, having a less complex and less internationally integrated economy turned out to be an advantage. A relatively short-lived Covid-19 lockdown helped as well, but with excess mortalities during the pandemic rising above 400,000 in Russia, it is becoming increasingly clear that the more vulnerable parts of Russia's population paid an immense price for keeping businesses open.

The unspectacular GDP statistic may not suggest it, but the Covid-19 pandemic has offered a glimpse into Russia's economic future. First and foremost, recent developments on international energy markets and the trajectory of climate policies around the world are spelling the definite end of the era of limitless oil and gas rents. Although Russia will continue to export hydrocarbons for many years, stagnating and eventually falling demand will result in lower long-term average prices. Heightening the pressure on margins and tax revenues, prospective new oil projects such as Rosneft's Vostok Oil in the Arctic are more expensive to develop, and stricter sustainability requirements on international capital markets make financing these projects costlier.

While some Western observers fear that the Russian economy will fall into deeper isolation as the role of hydrocarbon trading diminishes, the opposite is likely to happen. The government's ongoing attempts to achieve economic sovereignty through import substitution and trade barriers is costly. Today, Russia's economic model is based on the redistribution of oil and gas rents to uncompetitive domestic industries, both through government subsidies and cheap domestic energy prices. Once hydrocarbon revenues dry up, it will become more difficult for Russia to finance its isolationist policies. Integration into international value chains will also become more attractive and economically feasible as the symptoms of Russia's "Dutch disease" subside.

The Covid-19 pandemic has also given a boost to Russia's digital economy. The rise of sectors such as IT and communications, but also financial services, runs against the government's intentions of making the economy sanction-proof. Many of Russia's promising growth stories are deeply integrated with Western capital markets and technologies, and are even more prone to sanctions than the country's traditional industries. In 2019, the US and EU accounted for almost 80 percent of Russia's trade in telecommunications, computer and information services, while China accounted for a mere 3

percent. In November 2020, Russia's e-commerce front-runner Ozon.ru raised USD 1.2 billion at the NASDAQ stock exchange during its initial public offering. As Russia's economy transforms, its Western dependencies deepen.

Of course, the Russian leadership does not (yet) accept the reality that economic sovereignty is a dead end, and it is unclear how much damage it is willing to inflict before it changes its mind. Emboldened by apparent successes of import substitution in agriculture, and operating strictly within the mindset of the more-and-more-influential security elites, Moscow is ramping up pressure on international linkages of Russia's digital economy as well. It has delayed the introduction of the next mobile communications standard 5G until 2024 in order to give state corporation Rostec time to develop a Russian-made network solution, which experts believe will never materialize. The gov-

ernment also plans to force critical sectors of the economy to switch to Russian-made software by 2023 and Russian-made hardware by 2024.

Businesses, both state and private, are resisting these plans, with the exception of a small (but influential) group of beneficiaries. Gazprom CEO Alexei Miller has warned that substituting foreign IT with Russian-made alternatives would cost the company 180 billion Rubles (2 billion Euros). Russia's mobile operators have tried for years to block the introduction of stricter import substitution requirements in 5G. Of course, Russian firms are very experienced in watering down unfavorable regulations and shirking overly strict rules, even after they are imposed. However, for Russia to manage its economic transition without calamity, the government's vision of the future urgently needs to be realigned with economic realities. The Covid-19 pandemic has shown that the cost of not doing so will only rise.

About the Author

Janis Kluge is a Senior Associate at the German Institute for International and Security Affairs (SWP) in Berlin, Germany. He holds a PhD in economics from Witten/Herdecke University. His research focuses on Russia's economic development, domestic policy and sanctions.

Russia's Economy: A Possible Vision for the Future

By Michael Rochlitz (University of Bremen)

Imagine it is October 2021. Your political party has just won the recent Duma elections, and you have been appointed Minister of Economic Development of the Russian Federation. Your Prime Minister has tasked you to sketch out a vision for the future development of the economy. What are you going to propose?

The last 13 years have not been good for the Russian economy. In 2021, GDP per capita is lower than it was in 2008, a consequence of two economic crises and a prolonged period of economic stagnation. But Russia is still a rich country, with abundant natural resources, especially oil and gas. These resources will not last forever, and the world's energy mix is changing fast, but you will still have 10 to 15 years to use them. Thus, your first move is to use an annually increasing share of the oil rent for investments into future economic drivers, while setting spending on defense, prestige projects and the bloated state sector to decrease. A part of the newly available funds will be used to upgrade decrepit infrastructure in Russia's smaller cities. You launch a large-scale investment project to transform Russia into a transport hub between Europe, China and Central Asia, making use of the country's unique position as a bridge between

East and West. Finally, decentralized programs will be launched in every region to encourage start-ups and small and medium enterprises by offering cheap credit for newly founded firms.

To facilitate the successful implementation of these programs, your government launches a comprehensive reform of incentives for state officials and the security services. Following the example of China, Russia's regional governors will be evaluated first and foremost with respect to the economic success of their region and their ability to attract investment. Similarly, the success of the regional security services will no longer be measured by the number of arrests, but by the economic dynamism of a region, the number of new firms that manage to stay in business, and the security of property rights.

These measures are just a first step. One of the biggest problems of Russia's economy is the high share of large, state-owned companies that are not competitive on world markets, but face practically no competition at home. As a result, they provide Russian consumers with goods and services that are both comparatively expensive, and of relatively low quality. To change Russia's

economic structure, you initiate a program to increase competition on the Russian market by breaking up and privatizing some of the biggest Russian state corporations. At the same time, entry barriers to the Russian market are reduced, and foreign investors are once again made welcome. To protect domestic manufacturing industries from the initial competitive shock, existing subsidies are transferred into a program of targeted industrial policies. Following the South Korean model, subsidies are made conditional and linked to export success, first with respect to markets in the former Soviet Union, and later with respect to markets elsewhere in the world.

To attract new technology, foreign investors that are willing to enter into joint ventures with Russian companies are provided with preferential treatment. At the same time, a concerted effort is undertaken by all government ministries to increase the level of human capital by increasing investments into health and education. At the end of 2021, the Russian government organizes a global conference for governments, investors and academics to announce its plan and vision for the future: transforming Russia into a globalized knowledge economy, with ideas and information as the resources to replace oil and gas by 2035.

To finance and enable these developments, funding for the police and the internal security services is cut, and a police reform is initiated. The national guard is dissolved. With the exception of Channel One, Russia's media channels are privatized. In early 2022, the Duma passes a law that ends political control over the media and Russia's universities.

In order to stop the current brain drain, the Russian government brings into effect a number of new incentives for young and highly qualified people to return to Russia after having obtained a degree abroad. Collaboration between Russian and foreign researchers is no longer controlled by the government, but encouraged

through a range of programs and initiatives. As a result of active diplomacy by the Russian state, a number of leading global universities start joint ventures with universities in Russian regions.

To increase the attractiveness of living in Russia, a large initiative is launched to promote tourism throughout the country. Tourists who travel to Russia will no longer need a visa for a period of up to 30 days, and can travel wherever they please. Repeating the experience of the World Cup of 2018, Russia opens its arms to the world. The end of the Covid-19 pandemic coincides with a boom of tourism in Russia that surprises even the most optimistic observers.

This vision is obviously a thought experiment. But at a time when most of the forecasts for Russia's economy predict at best continuing stagnation, and at worst an ever-faster decline towards an inevitable crash, the purpose of this article is to show that none of Russia's problems are inevitable or unavoidable. On the contrary, a decisive change in existing policies could change the country's prospects fundamentally. In other words, the problem of Russia's economic stagnation is, above all, political. Most of the problems discussed in this outline are the result of specific policies that could be changed relatively easily. The use of the oil rent to perpetuate existing economic structures, incentives for regional politicians that are incompatible with entrepreneurial initiative, a bloated state sector controlled by members of the government, years of media censorship and propaganda that inhibit the free flow of information, and a multitude of security services that both absorb significant resources and suppress collective action, initiative, research and innovation are all the outcome of a political system that sees its own survival as its only goal. Ultimately, this leaves us with a rather sad and sobering conclusion: the wonderful Russia of the future is within arm's reach, and yet it seems to remain tragically distant, at least for the foreseeable future.

About the Author

Michael Rochlitz is Professor of Institutional Economics at the University of Bremen. His research interests include Russian and Chinese politics, the impact of authoritarian political institutions on economic outcomes, innovation in authoritarian regimes, as well as the role played by collective memories in the Post-Soviet space.

Further Reading

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STATISTICS

The Russian Economy from 1996 to 2020

All data have been taken from “Russia Statistics” offered by the Bank of Finland Institute for Emerging Economies (BOFIT) at <https://www.bofit.fi/en/monitoring/statistics/russia-statistics/> (as of 09 April 2021, accessed 26 April 2021).

Figure 1: GDP, %-Change

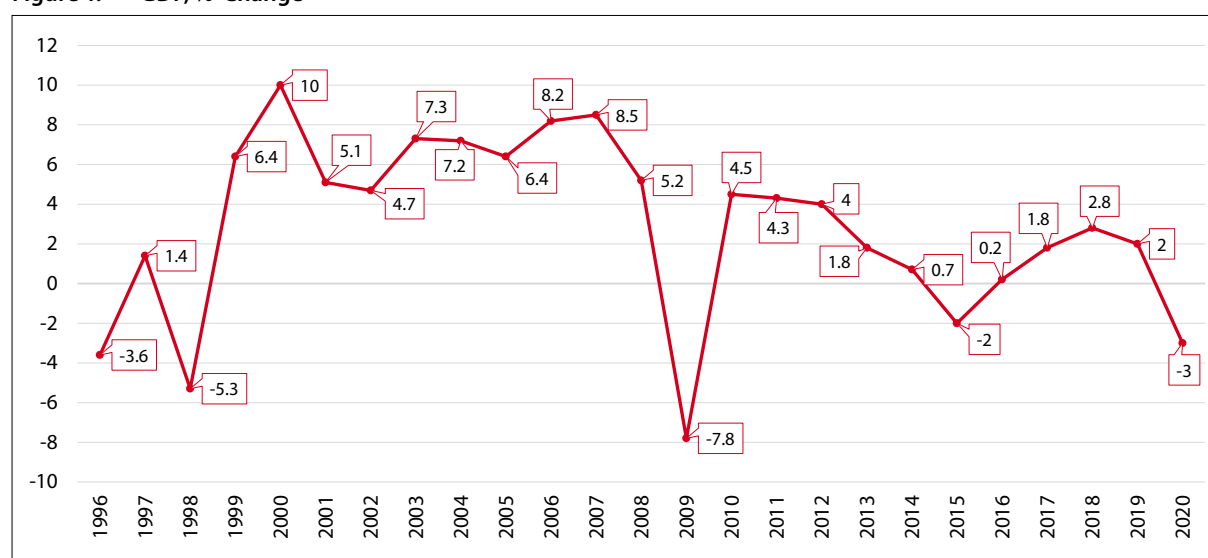


Figure 2: Inflation, %, Year-on-Year

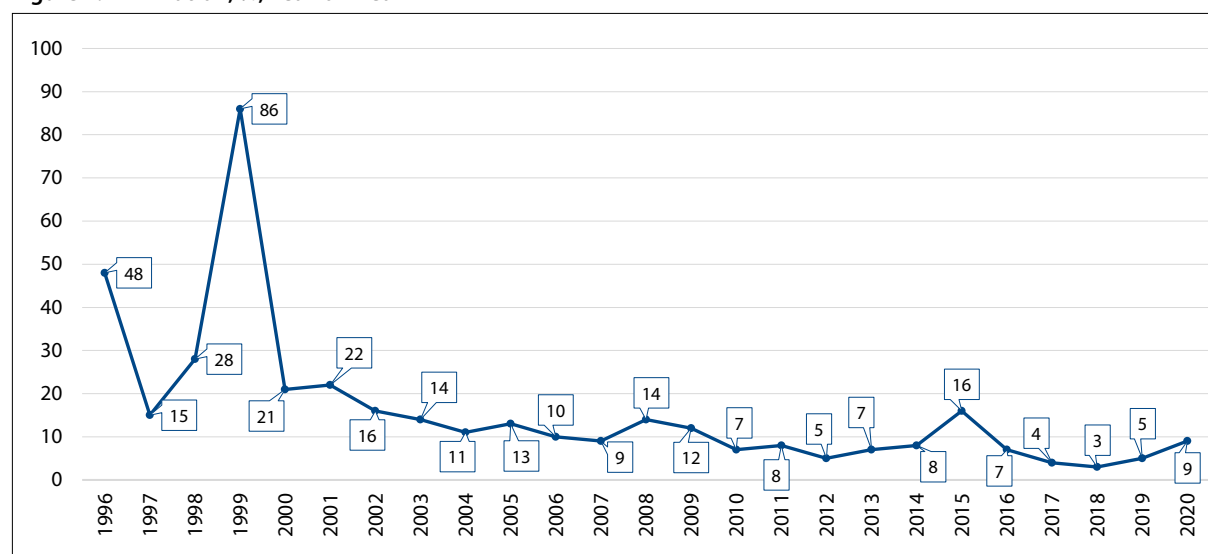


Figure 3: Current Account, USD Billion

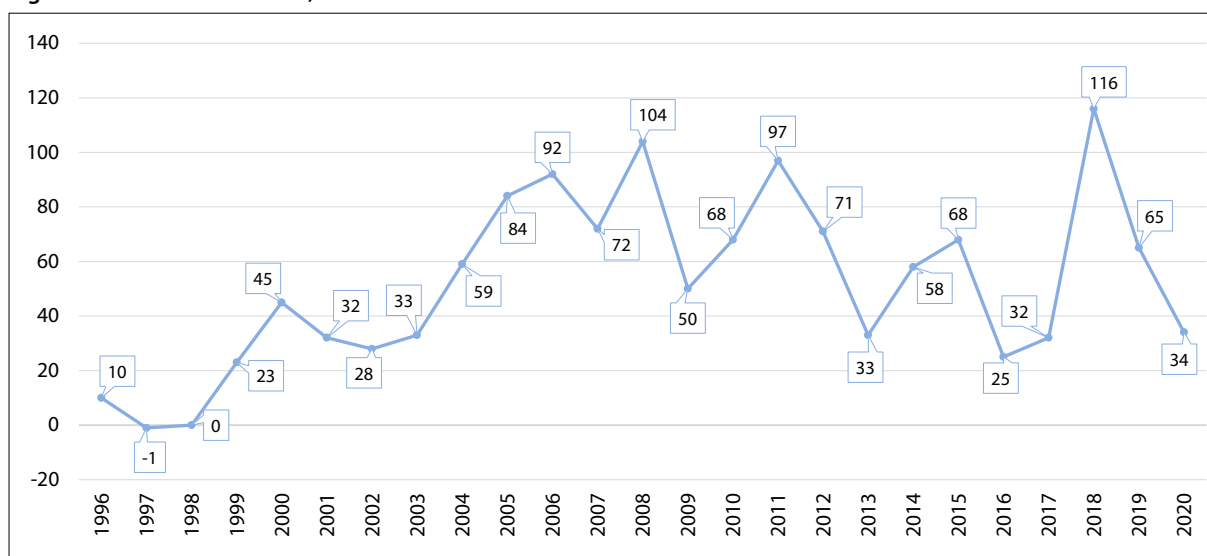


Figure 4: External Debt (Federal Government), % of GDP

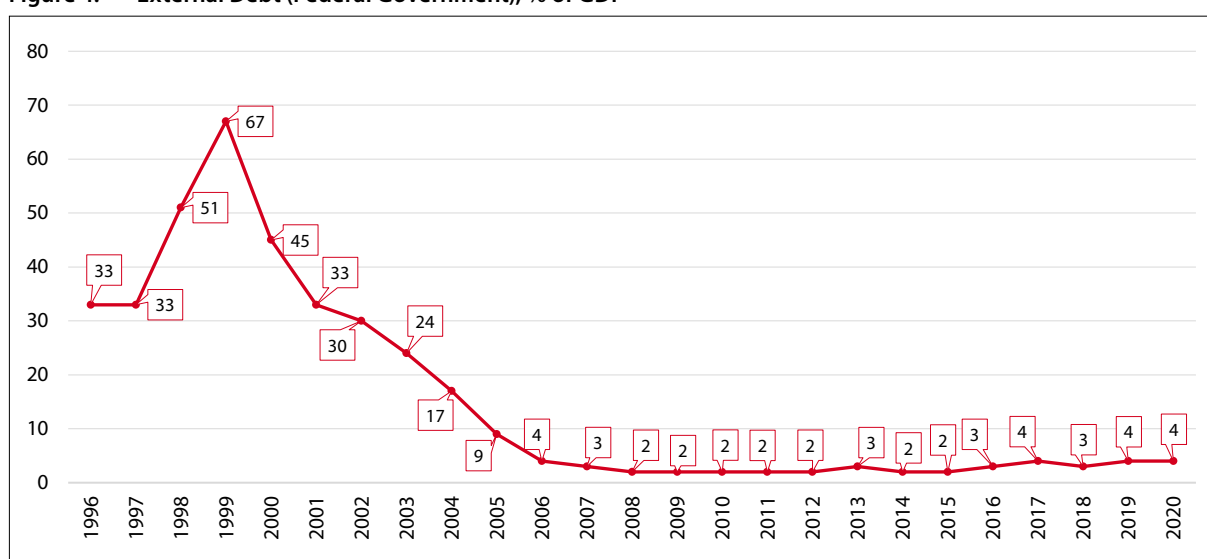


Figure 5: Unemployment, %

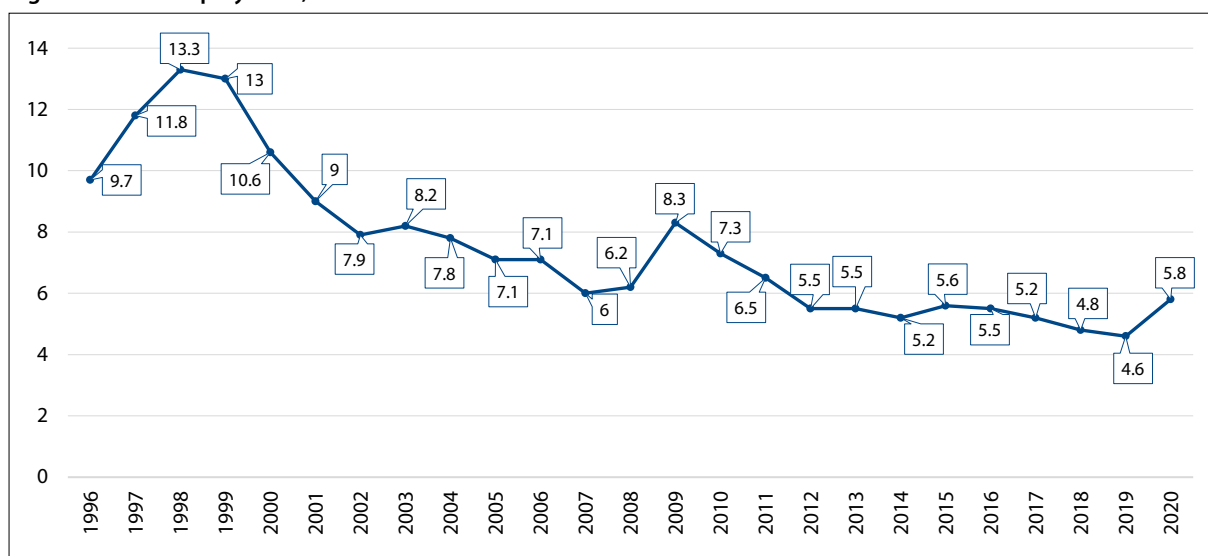
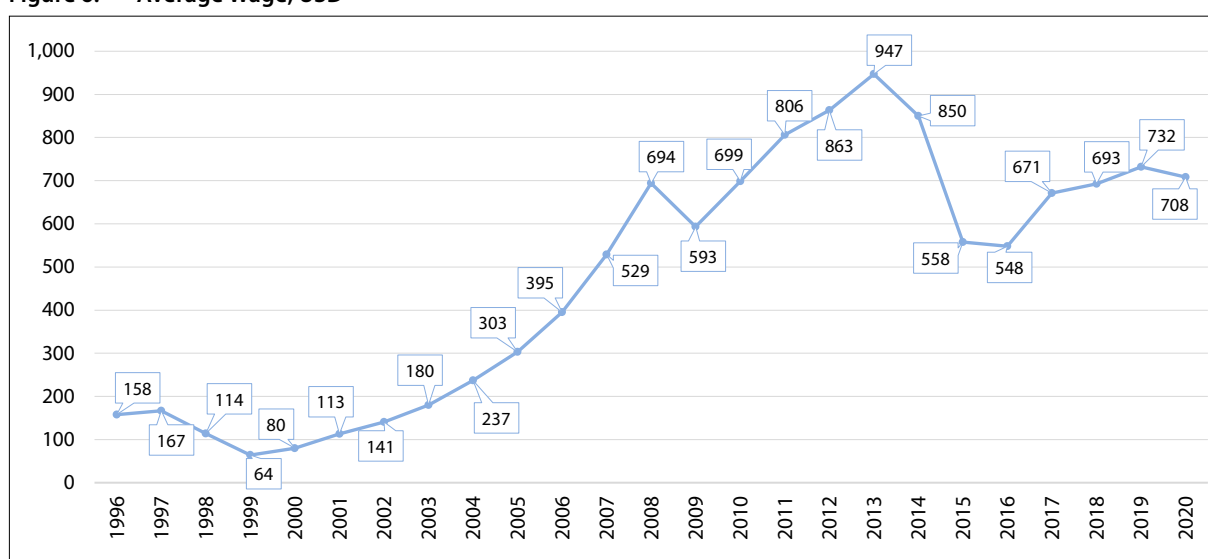


Figure 6: Average Wage, USD



ABOUT THE RUSSIAN ANALYTICAL DIGEST

Editors: Stephen Aris, Matthias Neumann, Robert Orttung, Jeronim Perović, Heiko Pleines, Hans-Henning Schröder, Aglaya Snetkov

The Russian Analytical Digest is a bi-weekly internet publication jointly produced by the Research Centre for East European Studies [Forschungsstelle Osteuropa] at the University of Bremen (www.forschungsstelle.uni-bremen.de), the Center for Security Studies (CSS) at the Swiss Federal Institute of Technology Zurich (ETH Zurich), the Center for Eastern European Studies at the University of Zurich (<http://www.cees.uzh.ch>), the Institute for European, Russian and Eurasian Studies at The George Washington University (<https://ieres.elliott.gwu.edu>), and the German Association for East European Studies (DGO). The Digest draws on contributions to the German-language *Russland-Analysen* (www.laender-analysen.de/russland), and the CSS analytical network on Russia and Eurasia (www.css.ethz.ch/en/publications/rad.html). The Russian Analytical Digest covers political, economic, and social developments in Russia and its regions, and looks at Russia's role in international relations.

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