Russia's Economy

Signs of Progress and Retreat on the Transitional Road

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Summary

Of the numerous economies considered to be "transitional," Russia—with a gross domestic product (GDP) about one-fifth that of China, but a per capita product twice that of China—has the second largest. Exactly where the Russian economy lies in the market-oriented gamut of transitioning economies, however, is not yet clear: between, say, Cuba, Belarus, Uzbekistan, and Vietnam at one end, and some of the Balkan and central European states and China at the other end? Also unclear, and probably more important, is the pace of the Russian economy's transition and whether it is headed forward, toward market-oriented, decentralized resource allocation; backward, toward centralized, state-controlled allocation; or is, instead, oscillating between these two. These issues are controversial and vigorously debated within Russia.

Despite some statistical shadows and ambiguities, it is evident that Russia's aggregate economic growth since 1998 has been relatively strong. In 2004, President Putin announced a goal of doubling the Russian GDP over the next 10 years, implying an annual growth rate of more than 7 percent, which is only slightly above the average rate realized by the Russian economy since 1998. Since that date, Russia's annual GDP growth rate of over 6 percent has been about three times that of the (unweighted) average of the other G8 members: Japan, Germany, France, Canada, Italy, the United Kingdom, and the United States.

Within this context, our study focused on four questions whose answers shed light on some of the ambiguities surrounding Russia's status as a transitional economy:

1. How much of Russia's relatively strong, yet varying, economic growth is attributable to oil and natural gas prices, production, and exports?
2. To what extent have other institutional and structural changes—such as the growth of private enterprise and marketization—affected Russia's economic growth and its prospects?
3. What have been the scope and composition of Russia's economic transactions with several of its trading partners, specifically the Central Asian states (Kazakhstan, Uzbekistan, Turkmenistan, Tajikistan, and Kyrgyzstan), the "proliferation-risk" countries (Iran and North Korea), and China?
4. How has the economy's transition affected Russia's defense spending, defense industry, and arms exports?

To address the first question, we reviewed extensive data on oil and natural gas prices, production, and export revenues, and the links among them. We conclude that between one-third and two-fifths of the variance in Russian economic growth in the past decade is explained by changes in oil and natural gas prices and their concomitant effects on aggregate production and export revenues.

In addressing the second question, on other institutional and structural changes associated with the Russian economy's transitional progress, we focused on the impressive increase since 1996 in the number of privately owned enterprises and the volume of employment in the private sector, comparing these numbers with those for the state-owned and the mixed public-private sectors.

We also looked at the enhancement of Russia's sovereign debt status from "junk" status to investment grade by the major securities' rating agencies as a complementary indicator of transitional progress.

For the third question, we reviewed the debate on Russia's expanded economic relations with the Central Asian states and with China. It is our opinion that expanded economic relations in these cases are more appropriately and objectively viewed as a reflection of the Russian economy's relatively high rate of economic growth, rather than as a significant instrument of economic penetration and expanded Russian economic influence in these countries. Russia's exercise of economic "leverage" through its energy exports is a legitimate U.S. concern, but one that is likely to be limited—at least in the medium and longer term—by the fact that these transactions are increasingly occurring at market rather than subsidized prices. As for the two proliferation-risk countries, Iran and North Korea, Russia's expanded economic relations with them inevitably add resources to their ongoing and prospective weapons of mass destruction programs, a spillover effect that should be of serious concern to the United States.

Finally, with respect to the fourth question, we conclude that Russia's defense sectors—military spending, the defense industry, and arms exports—have thus far not prospered in the course of Russia's recent and continuing economic transition. These sectors experienced acute resource deprivation in the immediate post-Soviet period. Based on a brief review of the relevant data, it appears that the trough of this deprivation has passed and that these sectors are likely to experience larger and continuing benefits from the sustained growth of the Russian economy.