

SOCHI and the emerging RUSSIA



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FROM MOSCOW TO SOCHI

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NEW YORK – The Winter Olympics in Sochi are the first to be hosted by Russia since the Cold War-era Moscow Summer Games in 1980. Obviously, much has changed politically in the interim. But today's Games also create an opportune moment to look back at Russia's recent economic history – and to peer forward as well.

Many people who remember the collapse of the Soviet Union in 1991 and its tumultuous aftermath believe that Russia's economy today must be impoverished and unstable – and far behind booming China. Wrong. According to the International Monetary Fund, [Russia's per capita income in 2013](#), measured in terms of purchasing power parity, is roughly \$18,600, nearly double China's *per capita* income of around \$10,000. And, according to World Bank data, extreme poverty is close to zero, compared to 11.8% in China in 2009 (the most recent year for which data are available).

Yes, Russia's economy has been buoyed recently not only by sound macroeconomic policies, but also by high world oil and gas prices. In fact, the collapse of world oil prices after 1985 contributed to the severe economic crisis in the Soviet Union and Russia in the late 1980's and early 1990's. This is an important point, given that the economic reforms implemented by former Soviet President Mikhail Gorbachev and former Russian President Boris Yeltsin thus confronted powerful headwinds.

For two years (1992-1993), I was a macroeconomic adviser to Prime Minister Yegor Gaidar and Finance Minister Boris Fyodorov, trying to help Russia to end the high inflation and extreme shortages that characterized the last years of the Soviet era, and to begin Russia's transition to a market economy. I recommended a macroeconomic stabilization strategy that had been highly successful in nearby Poland, and that called for timely financial assistance from the United States, Europe, and the IMF, just as Poland had received.

Unfortunately, the West did not provide the needed financial assistance, contrary to my (and many other people's) recommendations, and the Russian economic and financial calamity was more severe as a result. At the time, I attributed Western inaction to incompetence on the part of the US government and the IMF. Looking back, it is clear that there was also a deliberate strategy by US neoconservatives, such as then-Defense Secretary Dick Cheney, to weaken the new Russian state. The US government was also complicit during the mid-1990's in the plundering of Russian state-owned property, including oil assets that were unscrupulously privatized.

The good news is that Russia was able to bounce back from those terrible years, no thanks to the West or the US government. Russia's market economy, albeit marred by corruption, took root. After several years of political infighting and unnecessary delay, macroeconomic stabilization was achieved, and Russia's economic growth was restored, especially as world oil and gas prices began to rise. From 2001 to 2013, Russia's GDP grew at a robust 4.4% average annual rate.

Russia achieved a good measure of financial stability as well. [The IMF](#) puts Russia's inflation rate at 6.9% in 2013, with unemployment at 5.5%, while the budget deficit was just 0.3% of GDP. Moreover, Russia's [foreign-exchange reserves stand at a healthy \\$500 billion](#).

But Russia could achieve still greater success by basing its economy on two growth engines rather than one. Oil and gas will continue to provide a strong lift to Russia for years to come, especially as China becomes a major customer. Yet Russia also has vast and still under-developed potential in many global high-tech industries.

During the Soviet era, Russia produced a vast array of technology-based industrial products, from airplanes to computers to sophisticated machine goods. Unlike Chinese industry, Russia's manufacturing branches were almost completely cut off from world markets, both by the Cold War and by Soviet planning. When post-Soviet Russia opened itself to trade, its industrial enterprises lagged far

behind cutting-edge technologies, especially in the dynamic information and communications technology (ICT) sector.

Many industries collapsed, owing to neglect, lack of international partners, and financial chaos. Those that survived did so only barely, with greatly reduced output going mainly to the ex-Soviet market.

Russia has the know-how, skilled engineering, and natural-resource base to become a global competitor in a range of major high-tech industries, including nuclear energy, commercial aviation, commercial space technology (including satellites and GPS), ICT hardware and software, electric vehicles, high-speed rail, petrochemicals, and heavy equipment for the mining and hydrocarbon sectors. All of these industries will benefit from the potential for enormous demand growth in large markets, such as China, Africa, and India.

But achieving long-term growth led by high-tech industries requires a business environment that encourages private-sector investment, including openness to foreign players. Moreover, the social and political environment must be conducive to a high-tech labor force, providing an attractive quality of life, ensuring civil liberties, and supporting entrepreneurship and creativity. Finally, economic policies must promote technological advances and global technical cooperation in promising sectors.

It is notable that Russia recently completed an agreement to finance a nuclear power plant in Hungary, and looks likely to do the same in Turkey. The demand for nuclear energy will grow as part of the global effort to decarbonize the world energy system. Russia's new reactors seem to be safe and competitive with those produced elsewhere. Similarly, we might see new Russian-built civilian aircraft entering the global market in partnership with international firms, especially those that can work with Russian companies on advanced ICT avionics.

Back in 1991, many thought that Russia could not end high inflation, adopt a market economy, or compete effectively in world markets. Two decades later, Russia has proved the skeptics wrong. Yes, Russia remains too dependent on oil and gas, and should move further on transparency, openness, and competition in business and governance. Yet the trend is positive: **Russia has become a stable, high-income market economy, with strong prospects for decades of rapid GDP growth and high-tech progress if it pursues a sensible economic strategy in the coming years.**

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