

### Russia's Economy: A Possible Vision for the Future

Rochlitz, Michael

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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)

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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 con-

trolled 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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