Problems of Russia's Resource Export Dependent Economy

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Figure 1. Commodity Structure of Exports of Russia (Percentage of Total Exports)

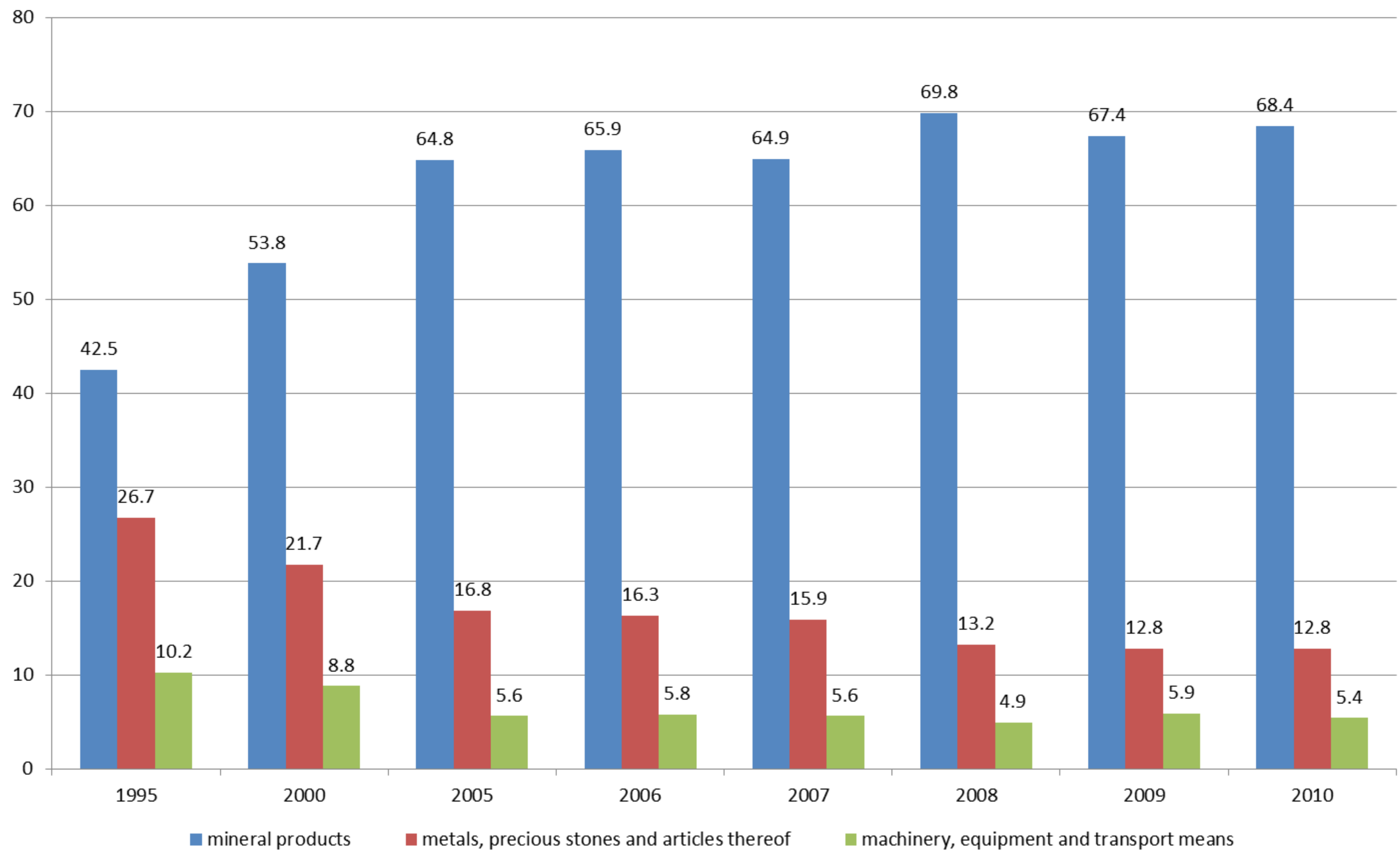
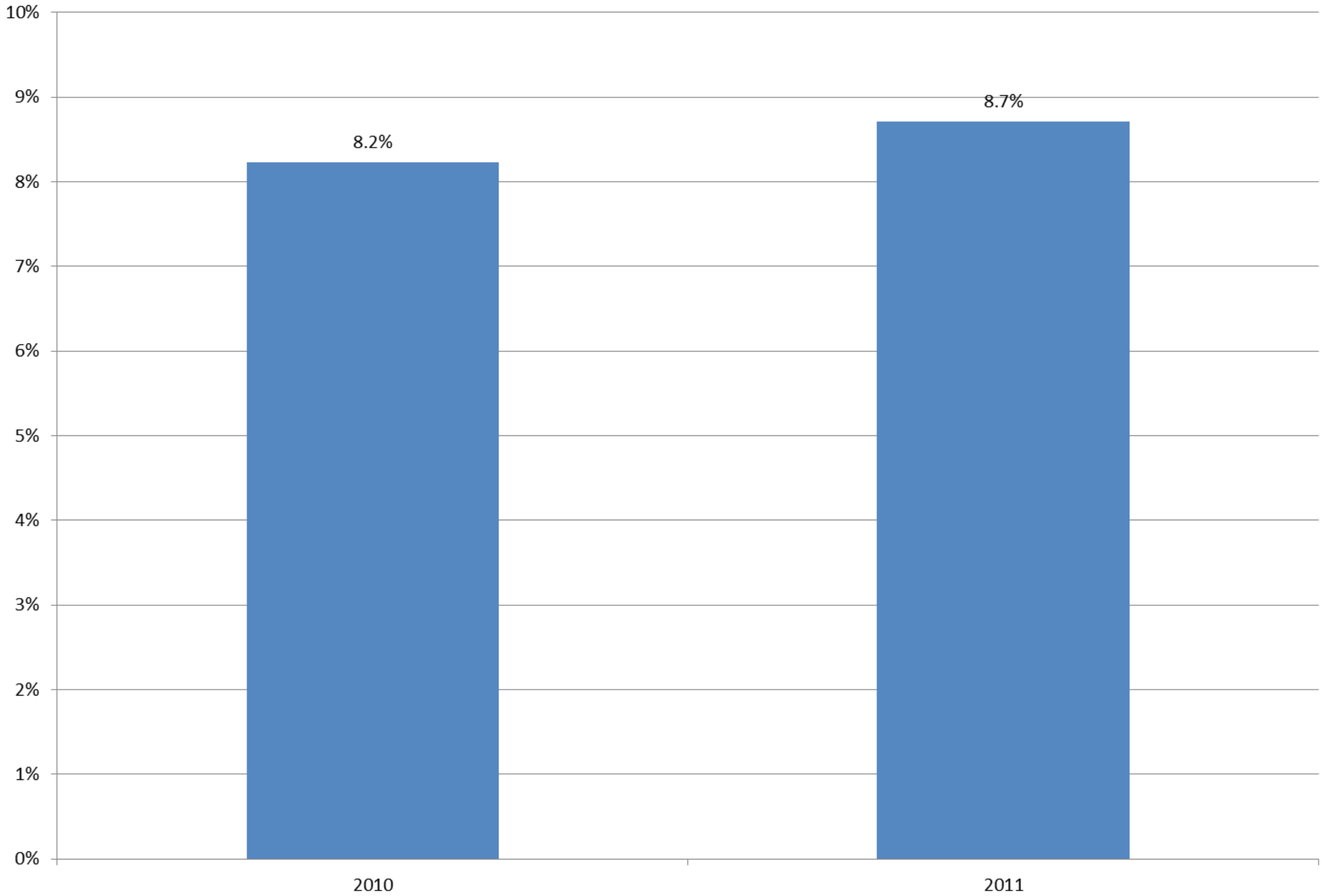


Figure 2. Net Exports as a Percentage of GDP for Russia



Problems of a High Net Export Ratio

1) Russia’s growth is highly dependent on unpredictable world market demand.

2) Russia’s own consumption and investment are 8% less than what it produces.

A large percentage of Russia’s output goes to provide consumption and investment in other, typically richer countries.

Problems of Resource Export Dependence

1) Dependence on resource exports leaves a country at the mercy of unstable prices of natural resources, as well as unstable quantitative demand.

2) Eventually natural resources will be exhausted.

3) Dutch disease: Export of valuable resources ➔ overvalued currency ➔ undermines domestic industry by making imports cheap.

Additional Problem for Russia

Russia’s resource export economy does not match its population.

Unlike Kuwait or Saudi Arabia, Russia has a large population and one that is urbanized and highly educated.

A resource export economy has no place for most of Russia’s population.

Why Russia's Economy Became Dependent on Resource Exports

At the end of the Soviet period, Russia had a diversified, industrialized economy.
However, Soviet/Russian industry was designed to operate within a centrally planned economy.
The neoliberal strategy for transition from central planning to the market destroyed Russia's industry.
The transition was very rapid and the state played little role in guiding the transition.
Russian industry was left to fend for itself in the chaotic conditions created by rapid marketization and privatization.

Neoliberal Policies in the USA

The US began to pursue neoliberal policies around 1980, resulting in significant deindustrialization.

However, the US neoliberal policies were less drastic than those in post-Soviet Russia.

Also, the US already had a capitalist economy, which lessened the negative effect of neoliberal policies on industry compared to their effect in Russia.

Corruption

Export of valuable resources generates a large revenue flow with low costs.

This is an invitation for corruption, as various groups compete to get hold of part of that revenue flow.

All resource export economies tend to have this problem.

Retarding Development of Industry

The profit motive steers effort and energy toward whatever activity is most profitable – and in Russia that is resource development and export. Profit from producing manufactured goods is limited by the fact that the cost of production is always a substantial portion of the selling price. But the cost of obtaining and selling natural resources, which are a gift of nature, can be a small part of the selling price.

Retarding Development of Industry (continued)

If available natural resources are used for domestic development, they are a blessing.

If they are used mainly for export to gain revenue, they become a curse.

Mismatch between Population and Economy

Resource export is the central economic activity in Russia.
But relatively few people are required to develop and export natural resources.
Russia has a large population that is urbanized and well educated.
This resource-export economy offers no place for most of Russia's people.

Mismatch between Population and Economy (continued)

The continuing natural decline in Russia's population since 1992, due to the death rate exceeding the birth rate, has several causes.

However, it can also be seen as a response to the mismatch between economy and population.

If people are not needed in this economy, they tend to decrease in numbers through a low birth rate and high death rate.

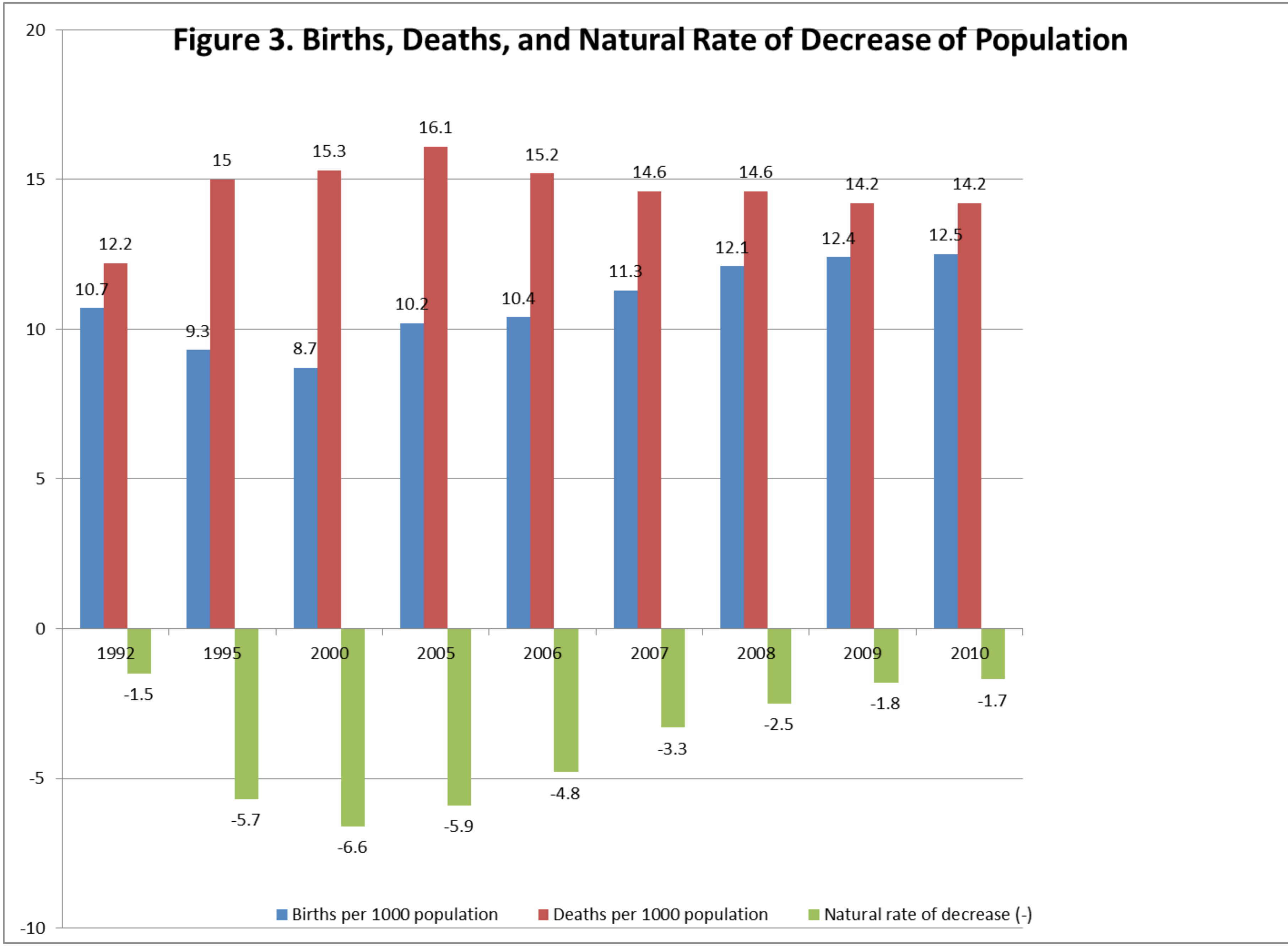


Figure 3. Births, Deaths, and Natural Rate of Decrease of Population
20
15
10
5
0
-5
-10
10.7
12.2
-1.5
9.3
15
-5.7
8.7
15.3
-6.6
10.2
16.1
-5.9
10.4
15.2
-4.8
11.3
14.6
-3.3
12.1
14.6
-2.5
12.4
14.2
-1.8
12.5
14.2
-1.7
1992
1995
2000
2005
2006
2007
2008
2009
2010
Births per 1000 population
Deaths per 1000 population
Natural rate of decrease (-)

Russia is Weakened in the World

To remain a great power, a country must have a strong industrial base as well as a sizeable population.

That is an essential underpinning of the economic and political strength required to function as a world power.

Russia’s current world power status rests upon its past industrial achievements.

Escaping from Resource Export Dependence

The market forces that are the center of a neoliberal model cannot redirect Russia’s economy.

Market forces only reinforce the current structure, since they expand whatever is most profitable in the short-run.

A reorientation of Russia’s economy would require a shift to a developmental state model.

Developmental State

The state regulates the economy aimed at moving it “up the economic ladder” toward a more technologically advanced, stronger, more diversified economy.

The state can resist short-run profitability incentives and aim for healthy economic development over the long run.

Examples of Developmental States

USA in the 19th Century

Japan in the 19th Century and post-World War II

South Korea after World War II

China since 1978

A Developmental State Strategy for Russia

1) Industrial policy aimed at promoting the long-run development of key industries.

2) Financial policy aimed at directing cheap credit toward productive purposes rather than speculative activities.

3) State investment in infrastructure (transportation, communication, power), science and technology, and education.

A Developmental State Strategy for Russia (continued)

4) State direction of the use of Russia’s natural resources, to emphasize domestic development rather than export revenues.

5) Regulation of Russia’s interface with the global economy, in order to
  a) protect infant industries where necessary
  b) encourage needed foreign direct investment while discouraging short-term and speculative capital inflows and outflows.

Investment and a Developmental State

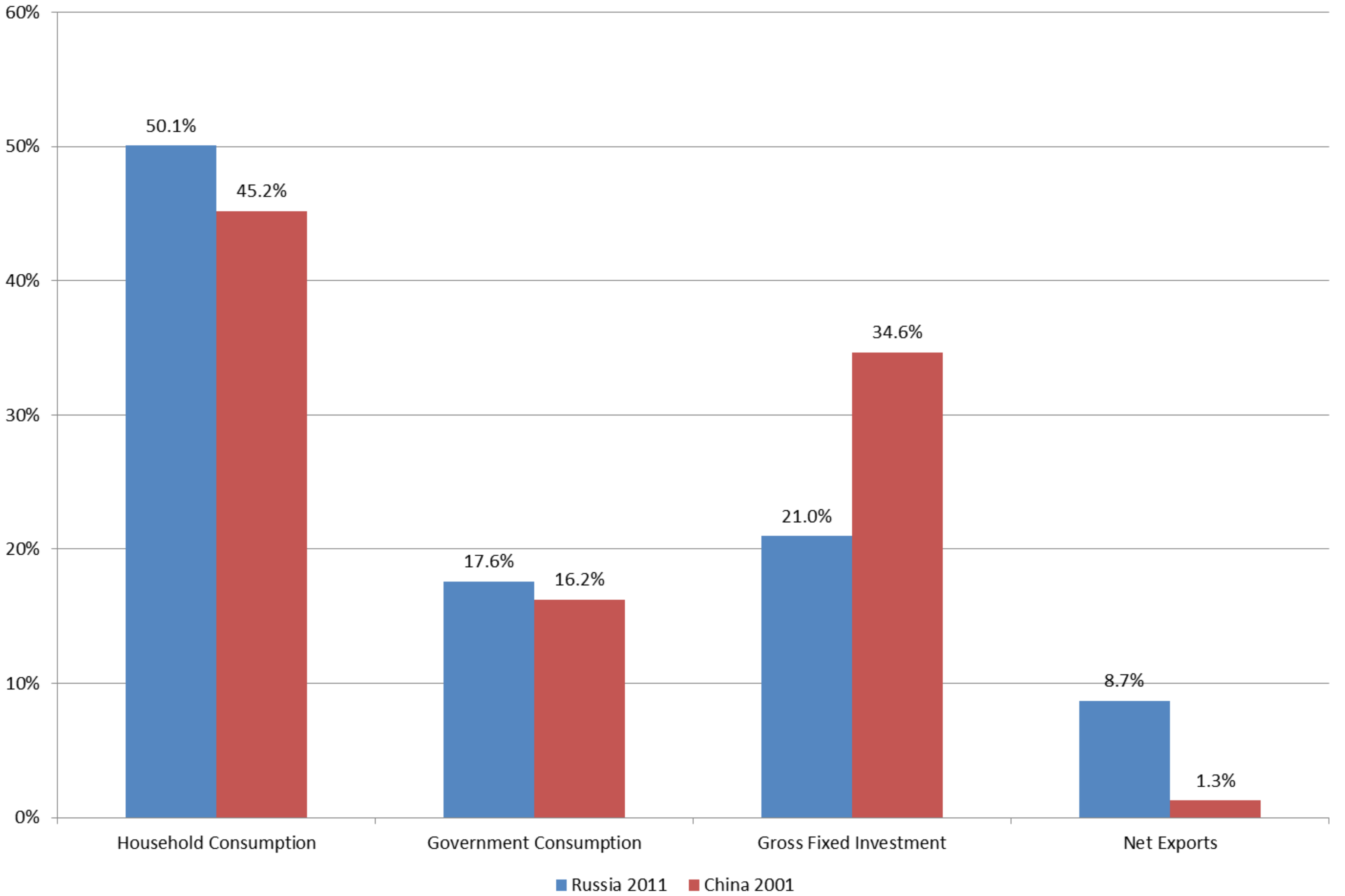
A key requirement for pursuing a developmental state strategy is to increase fixed investment.

Fixed investment is too low in Russia, at about 20% of GDP.

That is a reasonable percentage for a mature capitalist economy.

It is too low for a country that requires a reorganization of its economy.

Figure 4. Shares of Major Components of GDP, Russia and China



Investment and Net Exports

If Russia moved its trade balance to near zero, it could raise its fixed investment share by almost 9 percentage points of GDP, to almost 30% of GDP.

That would enable Russia to pursue a developmental state strategy, including reserving more of its natural resources for domestic use.

Potential Benefits of a Developmental State Model for Russia

1) A diversified, industrialized economy that fits its population

2) An economy that provides the basis for long-term development of its people

3) An economy that would enable Russia to continue to play a major role in the world

If Russia stays with its current resource export dependent model, economic and political decline will be Russia's future.