

## IS RUSSIA DIVERSIFYING ITS ECONOMY OR ONCE MORE STRENGTHENING ITS ALREADY STRONG SECTORS?

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From the Soviet period the Russian Federation inherited a rigid industrial structure on which it has built its present-day productive system with substantial continuity. The strict configuration of the Soviet planned economy has left Russia with few big industrial complexes which were for the most part less efficient and productive than the western European ones. The main and driving economic sectors were at the time, and remain today: energy, weapons manufacturing and steel and aluminium production. The peculiar soviet economic policies prevented any significant diversification until the early nineties, when a general economic collapse and the loss of the satellite states economies support led to an arrest in any possible productive development. The far-reaching privatization wave that occurred after the fall of communism has partly reshaped these traditional economic divisions, leaving a good slice of the biggest factories in the hands of the public sector through its state-owned or state controlled enterprises and the holding companies. This change happened,

especially under the Eltsin government tenure, without any effect on the whole productive structure except for the ownership of some of the more profitable state enterprises.

The internal political and financial scenery emerged in this way and brought Russia to the new millennium with a roughly tripartite economic structure. The first segment is composed by a number of small enterprises and activities which suffered huge technological backwardness and isolation from the rest of the country's economy. The second segment is made up of an extended public sector which stretches to cover the majority of strategic financial and productive enterprises once owned by the soviet regime. The control over these strategic economic strong points is exerted through public holding companies or by the federal government directly. The third economic part, which came to light at the beginning of the new millennium, is constituted by the state enterprises or some of their branches that the so called "oligarchs" were able to gather at the time of the vast, non-transparent and suspect post-soviet privatizations. This situation led to an almost motionless economic structure, where a small number of primary sectors have been advantaged at the expenses of dynamic, widespread and balanced economic development. At the same time the majority of Russian human and monetary resources have been devoted to those sectors, leaving only a minor role to all other activities. From Putin's rise to power in 1999 onwards, this unbalanced trend has been going on without any interruption and is still evident today. Nevertheless the last eleven years have seen the rising need to cope with the lack of economic alternatives outside of the above mentioned pillars, that historically have been the backbone of Russia's productive system. The necessity to enlarge the economic options has been felt by Moscow as a priority on paper, but it hasn't been already addressed successfully.

Throughout the ten years of Putin's hold on power, there have been some efforts to solve the problem of imbalance between overdeveloped and underdeveloped economic sectors. However, the various attempts to diversify Russian economy have been, it seems, in vain. It is also possible to affirm that in the same period of time, what could have been considered as a temporary weakness, caused by the understandable post-soviet financial and institutional difficulties, has become Russia's permanent structural feature, keeping the national economy from being helpful to the bulk of the population. In this context the last ten years have seen the funding of the three key Russian productive sectors (defence, energy and steel) rise until the great majority of the total state investment spending. If we take into consideration 2010 and the beginning of 2011, we can easily observe that the tendency described above hasn't changed considerably. On the contrary, in October 2010, Prime Minister Putin and Energy Minister Shmatko announced at a conference held in gas-rich Siberia that investments in the gas sector will escalate until 2030 to an amount of approximately 450 billion dollars. The plan hinges on the national gas monopoly of Gazprom, the state company which is the strategic point on which Russian economic and political powers rely.

Moreover the nuclear energy and oil production output will be augmented through large supplementary investments made by public and private Russian agencies. The defence sector will have an even larger share of the investments at hand for the future, confirming the past trend. By 2020 the military spending will reach almost 2% of Russian GDP, with a extensive army and renewal of heavy weapons worth 650 billions dollars up to the same year. The steel industry is following the same path, mostly for two reasons: the unquenchable Asian demand that keeps alive the profitability of the production, and the home consumption stirred (directly or indirectly) by state economic activities. These huge investment plans, focused on the

few already-developed economic sectors, will absorb most of the public financial resources in the approaching decades. It's a situation that reveals the misleading nature of the declarations and actions taken by the Russian political authorities ahead of an urgent and widely recognized need to diversify the Russian economy.

In fact the necessity and the will to work effectively for the diversification of the economic structure has been a central issue in the official statements made by Moscow, more than once in the last years. For what concerns the policies oriented towards this goal, the agreements with the European Union in the spring 2010 whose content went from know how and technology transfer to bilateral cooperation in research must be underlined. Furthermore a national plan to modernize and upgrade the productive activities in Russia has been launched in the fall 2010 with a massive commitment by the government, but which remained largely on paper. Even though something has been done, the endeavours made by the public authorities have so far fallen apart, generating activities separated and isolated from the general (and frail) economic net. This outcome has tragically resembled the national outlook depicted by the three main national sectors inside a weak economy. In addition, it must be noted that technological research and the productive activities which have flourished in the last years as a consequence of the efforts made by Moscow to encourage innovation and diversification of the economy, have kept a strong association with the three main national economical sectors. In this way the possible benefits of an enlargement to the whole economy of dynamic and new activities have remained limited to little circle of industries linked to the main ones. The Special Economic Zones (SEZs), established in the last decade as a tool to attract investments and start new enterprises on the Russian territory, are to be considered as another example of failed attempt to enlarge the economic participation of a wider segment of the population. They didn't generate the expected effect on the country's wellness as a whole, only improving

artificial arithmetical indexes, sacrificing labour rights and environmental laws without a real positive outcome for the majority of the people.

The same goes for the Foreign Direct Investments in Russia. They have been mainly directed to the three driving sectors of the national economy, almost without touching other parts of the national economical structure that are in need of support. While in terms of foreign investments draw the gas and oil industry kept on gaining ground in the last few years, the rest of economy, especially the small and medium enterprises, lagged behind almost to a standstill. The poor judicial and institutional accountability, holds investors from risking something in other activities than the ones already developed whose attachment to state interests assures a sufficient degree of certainty in the mid-term repayment. The strong pledge of Moscow in attracting foreign investments, emerging in the last decade, has risen simultaneously to a lack of internal autonomous economic action, apart from the three main sectors and a few others. This circumstance is still present and yet the ineffectiveness of this strategy has not been fully understood and overturned by political authorities. In fact it prevents the economy from acting autonomously and the political actors from taking the proper role in shaping a complete, modern and balanced industrial policy. The concentration of the foreign investments in a small number of productive sectors has caused a mounting vulnerability of the three sectors themselves. As the weight of foreign capitals grew in these segments of national economy, so did the potential risks involved in a sudden downturn or retirement of investments. It happened in the last three years with the effects of the international financial crisis. In 2009 foreign direct investments in Russia fell by 13% against 2008, while the 2010 figure was even worse. This sharp and harmful drop was generated by the concentration of foreign capitals in the primary and narrow part of the national economy.

Another problem connected to the missed diversification of Russian economy and thus its polarized and imbalanced nature, is its exposure to the oscillations of world market trends. This is especially true for the energy sector, which is mainly export oriented and makes up for the majority of the state monetary resources and reserves. In fact the fluctuation of oil and gas prices is dangerous for Russia, given the lack of flexibility in its economy, and the prominence of this sector inside the national economic setting. A proof of the difficulties explained above has been given recently by the 15% fall in gas and oil sales to EU during 2009 and 2010. At the same time the economic growth is diminished by 8% in 2009. This explains briefly but clearly the damaging effect caused by the low range of productive options present in the Russian economic structure, especially in times of financial turbulence or market prices variations. Another example is given by the very high unemployment rate observed in some of the biggest Russian cities which are dominated by an almost single sector industry. The so called "mono-industrial" cities represent the tip of the iceberg and the most apparent icon of the neglected productive diversification in the country. The awful, direct and immediate result on the population of those cities, in terms of job losses and consequent distress, is a mirror in which Russia can reflect its larger but similar structural economic problems on a national level.

The existence of the three mentioned sectors in a privileged position inside the Russian economy has favoured the creation of economic, financial and political centres of power. As receivers of the highest amount of monetary resources and investments from abroad as well as from the government, those industries have developed a big influence ahead of the other economical players in the country. Being the backbone of the Russian productive economy, they have precedence over other issues and are now able to direct reforms so as to avoid any structural reform of the Russian economic system. The stronger this influence is, the more difficult will be to change the present

unfair and polarized economical pattern. This in turn strengthens the influence held by the three sectors themselves. This condition, as it is easily understandable, holds very negative implication for the rest of the economy as well as for the economic structure as a whole, and in the end for the Russian population. At the moment, the most visible of the detrimental effects is the absence of the relocation of wealth produced among the society and the harsh inequality which is a trademark of post soviet Russia. In this context, it is almost impossible for medium and small ventures to prosper and to broaden the economic options for citizens and government, which is a result of the shortage in public support, political strategic vision and allocation of resources to more receivers than the accustomed ones. The energy sector surely plays the biggest role in offering the successive Russian governments an enormous monetary (also political and electoral) revenue which has discouraged (and still does) the productive diversification of the economy.

The three pillars of Russian economy (energy, weapons and steel) have created the image of the state abroad as a and have shaped the post-soviet country's structure both politically and economically. It seems that this trend it's not turning around and that the envisaged change towards diversification has a long way to go yet. Apart from the consequences already exposed, there are two more reflections to be made. The development of these three sectors is harming the environment producing goods in an unsustainable way for unsustainable purposes. Hydrocarbons, vast quantities of steel and heavy weapons are old fashioned products belonging to the "old economy" of the twentieth century, whose usage will be less and less frequent in the upcoming years (unfortunately apart from the weapons). What's more, the production, on an extremely large scale, of heavy weapons has a double moral repercussion. On one side the export of weapons and war technology in general produces violence in other parts of the world; on the other side the huge defence spending at home is removing

(and will even more so in the near future, given the plan outlined above) essential resources otherwise vital to face many social and economic problems which badly affect Russia. The three sectors are still gaining ground inside the crisis hit Russian economy, developing rapidly but in a quantitative way (more steel, more weapons, more gas, more aluminium etc.). Rather than taking into account the need to raise significantly the quality standards and, most of all, consider other goals for the future of its economy and society, Russia is still chasing after an economic model both unsustainable and already out of time.



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