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**Is Russian Economic Crisis Really Over?**

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Vladimir Tikhomirov\*

## Is Russian Economic Crisis Really Over?

### Abstract

To the surprise of many observers, the Russian economy began to show signs of growth within a few months of the August 1998 crisis. The depreciation of the rouble brought about extensive import substitution in the economy, and as a result, production of consumer goods, such as clothing, is rising briskly. Certain export-oriented sectors, such as non-ferrous metallurgy, also took off. Among the most encouraging aspects of the current Russian economy, the author notes growth in investments, machine building and certain high-tech industries. Even so, most Russian exports are still commodities. Thus, the author argues that economic sustainable recovery will require a shift in the export structure of Russian industry towards advanced, value-added products.

**Key words:** Russian economy, economic growth, import substitution, foreign trade

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Nearly a decade ago, Russia embarked on one of the greatest social and economic experiments in its history. The envisioned transformation, both in scope and effect, was perhaps comparable only to the 1917 October Bolshevik revolution. Its basic objective was to convert the authoritarian political and state-dominated economic structures of Soviet Russia into a democratic multiparty state based on an efficient, privatised market economy. As we now know, the road of transition proved bumpier than originally envisaged. By the mid-1990s, many Russia observers and analysts had internalised a view that whatever policies the Russian government pursued, such policies were unlikely to halt the continuing decline in the country's economic and social performance. Pessimists would not even accept the slight increase in Russia's economic output registered in 1997, preferring to view it as a result of statistical manipulations rather than a turnaround in the negative development trend.<sup>1</sup> On the other hand, the economic decline in Russia was so persistent that some analysts dismissed the official figures altogether and sought explanations outside the officially collected data. They argued that the state of the Russian economy could not be as bad as reported and that what was actually happening was that the economic growth was taking place outside the official economy.<sup>2</sup>

In any event, the logic of Russia's economic development was abruptly short-circuited in August 1998 by a wide-scale financial crisis. Some reports suggested that the prospects for economic growth in Russia had become even more distant than ever.<sup>3</sup> The general feeling was that Russia was falling rapidly into political chaos, which was certain to have extremely negative effects on its ailing, struggling economy.

These fears never materialised. Within a few months of the crisis, the Russian economy started to register signs of steady economic growth. Two years on, these signs had transformed into encouraging growth indicators and upbeat forecasts by Russian officials. Nevertheless, a great deal of uncertainty remains today as to how long this growth will continue and how sustainable the current economic miracle really is. The veil of secrecy that still covers much of Russian government's plans in the areas of economy and social development does not make the situation any clearer.

According to the latest Russian statistics,<sup>4</sup> during the first eight years of the Russian reform (1990-97) the country's Gross Domestic Product (GDP) contracted almost 40% (Table 1). It continued to decline in 1998, but in 1999 GDP increased by 3% and during the first half year of 2000 a further 8% growth was registered. Assuming Russia retains the current GDP growth rate, it will return to the 1990 GDP level by 2007.

Two major social indicators – dynamics of real per capita incomes and unemployment – are particularly encouraging. The 1998 financial crisis resulted on average in a 20% drop in incomes (per capita, real average incomes), and incomes continued to fall further in 1999. The trend reversed in the first months of 2000, and by mid-2000, the average incomes of Russians in real terms rose to 54% of 1990 incomes. Unemployment, which was close to zero at the start of the 1990s, was up remarkably by 1997 and continued to rise in 1998 and 1999. In January-June 2000, however, a decline of more than 15% in numbers of unemployed was registered.

The immediate effect of the 1998 financial crisis was the depreciation of the rouble against major foreign currencies.<sup>5</sup> After the crisis the payment system partly interrupted and several large commercial banks almost collapsed. This had direct and very painful implications for many Russians, whose savings were wiped out or decreased in value within weeks from the start of the crisis. But it was the *de facto* return to an overall state control over the majority of foreign currency operations that had the most significant effect on Russia's post-crisis development.

**Table 1. General Social and Economic Trends, 1990-2000** (indices, %, PP=100)

	Index,	Index,	Index,	Index,	Index,	1990 level to be reached	
	1990-1997	1997-1998	1998-1999	1999-2000 (6 months)	1990-2000 (est.)	(a) In months	By
Gross Domestic Product	60.5	95.4	103.2	108.4 (a)	64.6	75	2007
Real Per Capita Income	72.6	81.5	84.9	108.2	54.4	121	2011
Unemployment	437412	104	106.8	87.9	427055	...	...
Consumer Price Index	629155	184.4	136.5	109.5 (b)	1734065	...	...
Average Monthly Salary in US Dollar Equivalent	2717 (c)	33.0 (d)	125.1 (e)	97.0 (f)	1088 (g)	-	-

## Notes:

- (a) January-March 2000.
- (b) July 2000 to December 1999.
- (c) December 1991 to December 1997.
- (d) December 1997 to December 1998.
- (e) December 1998 to December 1999.
- (f) December 1999 to June 2000.
- (g) December 1991 to June 2000.

Sources: Own calculations based on *Rossiiskii statisticheskii ezhegodnik. 1999*. Moscow: Goskomstat, 1999, pp. 16, 143, 547; *Uroven' zhizni naseleniya Rossii*, Moscow: Goskomstat, 2000, pp.8-9; *Sotsial'no-ekonomicheskoe polozhenie Rossii, 1999 god*, Moscow: Goskomstat, 2000, pp. 7, 177, 182; *Sotsial'no-ekonomicheskoe polozhenie Rossii, yanvar'-iyun' 2000 goda*, Moscow: Goskomstat, 2000, p. 7; Vladimir Tikhomirov, *The Political Economy of Post-Soviet Russia*, London: Macmillan – New York: St. Martin's Press, 2000, p. 193.

There were three major factors that played crucial role in the foreign currency market:

- (1) bankruptcy of some large commercial banks has led to the disappearance of important players on the Russian currency market;
- (2) the regulations passed by the Central Bank soon after the crisis made it compulsory for exporters to sell the foreign currency they earned; and
- (3) implementation of state policies aimed at keeping the exchange rate of the rouble low and creating barriers to unlimited growth of salaries in the national economy.

Between July and December 1998, the rouble-dollar exchange rate dropped 3.3 times from 6.238 to 20.65.<sup>6</sup> During the same period, the average per capita monthly wage in the national economy had risen 1.3 times from 1099 roubles to 1463 roubles.<sup>7</sup> Salaries decreased substantially in dollar terms. In July 1998, an average Russian earned over US\$ 176; by December of the same year his salary was less than US\$ 71. Consequently, the average salary in dollars fell by two-thirds during 1998. In 1999, it recovered some 25%, but during the first two quarters of 2000 it fell again by 3% (Table 1).

The depreciation of the rouble and decrease in salaries made most imported consumer goods and foodstuffs too expensive for normal Russians. The result was a dramatic and rapid decrease in imports. Between July and December 1998, Russian monthly imports fell by 1.6 times from US\$ 5.7 billion to just US\$ 3.6 billion.<sup>8</sup> This, in turn, caused a scarcity of consumer goods and foodstuffs on the local Russian market, which was immediately exploited by Russian industry and agriculture.

In other words, import substitution was a major outcome of the 1998 financial crisis. Two factors explain this. First, the Soviet economic policy had as its major objective development of self-sufficiency of the state. Since the first days of its existence, the Soviet Union found itself in competition and confrontation with the West. Through the years of confrontation and the Cold War, the USSR developed a huge, albeit rather inefficient, economic potential in almost every area. Second, during the last decade of the existence of the Soviet Union and during the years of reform experiments this potential was largely under-utilised. Nevertheless, the potential capacity was still there. Many Russian enterprises and plants had production capacities far higher than their production levels.<sup>9</sup> Consequently, under favourable circumstance such as those created after the 1998 financial crisis, certain industries and sectors of the Russian economy could easily register a rapid growth – even without large investments. This is exactly what happened.

The turnaround in the Russian economy began to register as early as late 1998. By 1999, only two sectors of the economy were still in decline – foreign trade and retail trade. Both areas were directly linked to a dramatic decline in the population living standards in the post-crisis period. Following the crisis and the dramatic depreciation of the rouble, imported consumer goods and foodstuffs became too expensive for most Russians to buy (hence, the decline in foreign trade turnover). In fact, this drop in the average person's income was so large that most of expensive consumer goods, irrespective of their origin, became unaffordable, which had a direct impact on retail trade (Table 2).

At the same time all other sectors of the Russian national economy registered growth, although rates of this growth differed greatly from sector to sector. In 1999, Russian industry demonstrated high growth rates (over 8%). Funding for science, research and development (R&D) also increased, but investment levels in the economy remained low. During the first half of 2000, the trend reversed, and investments registered high growth rates (14.3%). In January-June 2000, a combination of high world prices for crude oil with an overall improvement in the economy and real incomes of Russian population (see Table 1) further reversed the negative trends in foreign and retail trade.

In Table 2, I have presented growth developments in major sectors of the Russian economy. I have also made estimates of the time when each of the sectors can achieve the pre-reform level of 1990, given that growth rates registered during the first six months of 2000 remain constant in the future. The table shows that within next 1-2 years Russia can reach its late Soviet levels in the area of foreign trade and retail trade. At the same time, the increase in the real economic output is certain to take longer: industry could reach 1990 levels in 2009, agriculture in 2029.

One very promising trend is the turnaround in investment. For the first time for over a decade, Russia registered positive growth in this area. Moreover, most new investments in 1999-2000 came from companies and enterprises. The growth of the local demand and production volumes has finally opened ways for accumulation of capital for investment.<sup>10</sup> This is important development from a strategic perspective, because it creates a hope that someday Russia can finally start to deal with the Soviet-inherited problems of its economy. These are linked to the imbalanced structure of industrial production, e.g. monopolisation, the dominance of military and the many loss-making enterprises that still exist.

**Table 2. Performance of Major Sectors of the Russian Economy, 1990-2000**  
(indices, %, PP=100)

	Index, 1990-1997	Index, 1997-1998	Index, 1998-1999	Index, 1999-2000 (6 months)	Index, 1990-2000 (est.)	1990 level to be reached (a)	
						In months	By
Foreign Trade Turnover	82.3	82.2	86.6	135.3	79.3	9	2001
Retail Trade Turnover	90.9	96.7	92.3	107.6	87.3	23	2002
Industry	49.0	95.0	108.1	109.8	55.3	100	2009
Industrial Construction	32.6	95.0	105.4	112.0	36.6	174	2015
Investment	23.9	93.3	101.0	114.3	25.7	243	2021
Housing	53.0	93.8	104.3	103.8	53.8	272	2023
Cargo Transport	37.5	96.6	105.2	105.6	40.2	318	2027
Agriculture	64.5	86.8	102.4	100.8	57.8	1096	2092
R&D Funding	9.5	99.0	107.4	...	10.1 (b)	1444	2121

Notes:

- (a) An estimate of the time (in months and by what year) when the 1990 level would be reached if the current rate of growth remains constant.  
(b) Data for 1990-1999.

*Sources:* Own calculations based on *Rossiiskii statisticheskii ezhegodnik. 1999*. Moscow: Goskomstat, 1999, pp. 295-411, 437, 467-488, 561-580; *Sotsial'no-ekonomicheskoe polozhenie Rossii, 1999 god*, Moscow: Goskomstat, 2000, pp. 7-83; *Sotsial'no-ekonomicheskoe polozhenie Rossii, yanvar' 2000 goda*, Moscow: Goskomstat, 2000, pp. 80-104; *Sotsial'no-ekonomicheskoe polozhenie Rossii, yanvar'-iyun' 2000 goda*, Moscow: Goskomstat, 2000, pp. 7-117.

It is important to note here that estimates presented in Table 2 can be used only as very rough indicators. The reality may well turn out to be different. First, it is unrealistic to expect that growth rates will remain constant. Many important internal and external factors may determine the tempo and direction of restructuring and growth in Russian industry and in the economy in general. Second, there is a major limitation when making forecasts about the future of the Russian economy. Due to the gross under-utilisation of its production capacities, as noted above, Russian industry can fairly quickly reach certain levels of production. However, prospects for a sustained growth in the economy will greatly depend on the ability of Russian enterprises to finance the needed restructuring and modernisation, and how well enterprises are able to introduce new products and goods. In other words, Russia can easily utilise production capacities created during the Soviet times, but if it wants to surpass these levels, it will need to substantially increase investment and R&D expenditures.<sup>11</sup> Finally, any forecasts for the future of the Russian economy must take into account the world markets for Russia's main export commodities (crude oil, natural gas, metals and minerals), and the ability of the Russian government to service its debt obligations.<sup>12</sup> These two factors will directly influence the prospects for increased investment in the economy and R&D.

A closer look at the dynamics of recovery in various branches of Russian industry (Table 3) shows that, in contradiction to the widespread gloomy forecasts of the Russian industrial performance during the 1990s, there is one industry that even before the 1998 crisis had already exceeded its pre-reform production levels. Pharmaceuticals production in 1999 was already 11% above the 1990 level, and production has continued to rise in 2000. Other industries that have registered a rapid recovery in the last two years are light industry (mainly clothing) and chemicals, which further speaks for the importance of import substitution.



The recent growth in some basic industries, including metallurgy and machine building, was mainly driven by the needs and demands of the internal Russian market. In the case of machine building, growth is also due to a significant increase in state funding to the military-industrial complex.<sup>13</sup>

During first half of 2000 foreign trade has grown by an amazing 35% (Table 2). This is directly linked to an extremely favourable situation on the world markets for several of Russia's major export commodities. The surge in crude oil prices pushed up the value of Russian exports in the first six months of 2000 by an amazing 51% (Table 4). At the same time, Russia retained a low level of imports (1.5 times lower than before the August 1998 crisis and 2.5 times lower than in 1990).

**Table 3. Performance of Major Industries, 1990-2000** (indices, %, PP=100)

	Index, 1990-1997	Index, 1997-1998	Index, 1998-1999	Index, 1999-2000 (6 months)	Index, 1990-2000 (est.)	1990 level to be reached (a)	
						In months	By
Pharmaceutical	104	96	111.1	119.4	132.4	-	-
Ferrous Metals	58.6	92	114.4	122.7	75.7	17	2002
Chemical & Refinery	46	93	121.7	118.8	61.9	40	2004
Non-ferrous Metals	56	95	108.5	115	66.4	41	2004
Food-processing	50.6	98	107.5	112.4	59.9	65	2006
Forestry	36.5	99.6	117.2	117.1	49.9	71	2006
Machine Building	39.9	93	115.9	115.3	49.6	80	2007
Fuel	68.2	98	102.4	104.8	71.7	99	2009
Light	14.2	89	120.1	135.2	20.5	132	2011
Construction Materials	35.2	94	107.7	111	39.6	167	2014
Electricity	76.7	98	100.2	101.6	76.5	231	2020

Notes:

(a) An estimate of the time (in months and by what year) when the 1990 level would be reached if the current rate of growth remains constant.

Sources: Own calculations based on sources for Table 1 and *Promyshlennost' Rossii. 1995*, Moscow: Goskomstat, 1995, pp. 27-28, 31-32, 122-216; *Promyshlennost' Rossii. 1998*, Moscow: Goskomstat, 1998, pp. 28-29, 157-220.

**Table 4. Russian Foreign Trade in 1990-2000** (indices, %, PP=100)

	Index, 1990-1997	Index, 1997-1998	Index, 1998-1999	Index, 1999-2000 (6 months)	Index, 1990-2000 (est.)	The level of 1990 will be reached (a)	
						In months	By the year
Foreign Trade Turnover	82.3	82.2	86.6	135.3	79.3	9	2001
Exports	98.3	84	100.1	151.3	125.1	-	-
Imports	68.3	80.1	69.5	108.2	41.1	209	2018

Notes:

(a) An estimate of the time (in months and by what year) when the 1990 level would be reached if the current rate of growth remains constant.

Sources: Own calculation based on sources for Table 1.

Recent favourable world market developments for oil producers and Russian state policy aimed at keeping a low exchange rate of the rouble (the new financial protectionism) are the elements of today's "economic miracle." Even so, the structure of Russian foreign trade is still basically the same (Table 5). If anything, the mineral-based nature of Russian exports has become even more pronounced. In the first quarter of 2000, exports of minerals and metals accounted for almost 77% of total exports from Russia compared to about 70% during 1994-1997. The structure of imports also did not change significantly with imports of machinery, food products and chemicals making up about three-quarters of total Russian imports.

The development of various industrial products and commodities (Table 6), gives even more detailed picture of the current economic recovery in Russia. By mid-2000 in certain export-related areas Russia had exceeded pre-reform production levels (in 1990). Growth has been particularly strong in non-ferrous metallurgy (copper, lead, zinc, nickel and aluminium). It is important to note that the recovery in this industry was driven by both external (exports) and internal factors; the latter is a direct result of the general recovery in the Russian economy and the consequent growing demand for intermediate goods.

**Table 5. Structure of Russian Exports and Imports (as % to the total)**

	<i>Exports</i>				<i>Imports</i>			
	1994-97	1998	1999	Q1-2000	1994-97	1998	1999	Q1-2000
Machinery & Vehicles	9.7	11.3	10.7	7.0	34.1	36.1	33.9	33.1
Foodstuffs & Agroproducts	3.5	3.0	2.7	2.4	26.5	24.5	25.9	23.2
Minerals	45.6	42.3	44.4	56.9	6.2	5.5	3.6	6.5
Chemicals	8.7	8.6	8.6	6.6	12.6	15.0	17.0	17.9
Textiles & Footwear	1.3	1.1	1.4	1.1	5.6	4.1	5.2	5.5
Metals & Precious Stones	24.9	27.4	25.1	20.0	8.0	7.0	7.2	7.0
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

*Sources:* own calculations based on *Rossiiskii statisticheskii ezhegodnik. 1999*. Moscow: Goskomstat, 1999, pp. 568-69; *Sotsial'no-ekonomicheskoe polozhenie Rossii, yanvar'-aprel' 2000 goda*, Moscow: Goskomstat, 2000, pp. 96-98, 101; *Sotsial'no-ekonomicheskoe polozhenie Rossii, yanvar'-iyul' 2000 goda*, Moscow: Goskomstat, 2000, pp. 100-101, 104.

Perhaps an even more promising sign for the future of Russian industry is the recent growth in more technically demanding areas such as machine building. By July 2000, instrument-making in Russia had exceeded its 1990 level by almost 27%. This is particularly impressive considering that in 1997-98 production in this sector stood only at about one-half of the 1990 level.

The boom in the local production of consumer goods had generated a rapid increase of machinery production for the light industry. For instance, the production of equipment for the textile industry had grown by 16.3 times during the first 6 months of 2000 (compared to the same period of 1999), and the production of TV sets, which was almost non-existent in 1997-99, had grown by 5.5 times (Table 6). Between January and June 2000 significant tempo of growth was registered in many other areas of the consumer goods' sector, which includes production of textiles, clothing and radios. Production of industrial machinery and agricultural machines also grew rapidly, due to the general growth of local demand for these products and the increased state subsidies for certain sectors, e.g. agriculture.

Indeed, the situation in the agricultural sector is very complicated. While the rise of prices for imported food had caused a growing demand for local agricultural produce, the rates of growth in production of different foodstuffs varies greatly. In those areas where production can be increased fairly easily and within a short period of time, growth has been quite impressive. For instance, during 1999 Russia made significant steps towards overcoming of its dependency on imports of sunflower oil and white sugar. In just one year production of sunflower oil increased by more than 38% and production of sugar beets by more than 40% (Table 7). Recovery in some other areas, like fishing and wine production, was slower and came in 2000.

**Table 6. Indices of Production of Selected Industrial Products and Commodities, 1990-2000** (indices, %, PP=100)

	Index, 1990-1997	Index, 1997-1998	Index, 1998-1999	Index, 1999-2000 (6 months)	Index, 1990-2000 (est.)	1990 level to be reached (a)	
						In months	By
Copper	150.8	102.1	117.5	106.2	192.1	-	-
Lead & Zinc	127.5	96.4	126.5	102.5	159.4	-	-
Nuclear power	105.4	97.2	115.7	120.4	142.7	-	-
Nickel	120.9	97.1	105.1	103	127.1	-	-
Instrument-making	53.1	103.4	140.8	163.8	126.6	-	-
Aluminium	105.7	103.3	104.9	104.9	120.2	-	-
Textile Equipment	2.7	106	97	1630	45.3	2	2001
Construction Ceramics	54.2	105	130.7	127.7	95.0	3	2001
Gold	84	88.7	103.2	123.2	94.7	3	2001
Synthetic Fibres/Plastics	49.7	99.7	136.2	130.1	87.8	6	2001
TV Sets	6.9	100.5	84	550	32.0	6	2001
Steel Pipe	29.4	81.4	114.7	154.7	42.5	30	2003
Synthetic Paints	16.5	84.3	136.8	165.4	31.5	40	2004
Paper Industry	40.7	107.5	124.6	115.7	63.1	45	2004
Chemical & Oil Machinery	33.2	96	120.7	125.7	48.4	51	2005
Cast Iron	55.3	90.7	116.2	112.3	65.5	52	2005
Steel	54.1	90.1	117.9	111.5	64.1	59	2005
Electric Machine-Building	21.9	85.7	127	140.1	33.4	60	2005
Iron Ore	66.3	102.6	113.1	104.3	80.2	69	2006
Coke Coal	56.3	99.5	114.4	106.1	68.0	93	2008
Clothing	19.7	105	104.6	129.3	28.0	106	2009
Crude Oil	59.3	99.1	100.3	105.1	61.9	144	2012
Cast Aluminium	14.2	97.1	135.6	124.5	23.3	162	2014
Steel Shapes	18.8	96.3	128.2	118.7	27.6	170	2015
Textiles	14.4	83.6	127.7	128.6	19.8	171	2015
Cement	32.2	97.4	109.6	109.7	37.7	204	2017
Metal-Cutting Machinery	16.4	82.2	99.6	123.7	16.6	255	2022
Wood Processing	29.9	91	108.4	108.3	31.9	309	2026
Tractors & Agro Machinery	3.6	70.8	159.3	153.5	6.2	338	2029
Forestry	34.2	92.3	113.4	105.1	37.6	390	2033
Auto Industry	56.4	88.5	114.7	101.7	58.2	507	2043
Radios	5.6	69.2	120	121.1	5.6	953	2080
Machinery for Light Industry	0.8	90.6	115.8	112.4	0.9	10162	2847

Notes:

(a) An estimate of the time (in months and by what year) when the 1990 level would be reached if the current rate of growth remains constant.

Sources: Own calculation based on sources for Table 2.

On the other hand, many areas of agricultural and food production showed no signs of growth by mid-2000, notably production of meat and milk. The decline in the numbers of cattle, cows and sheep has continued in 2000 (although the decline was slowing). Because it will take years for these industries to recover to pre-crisis production levels, Russia is likely to stay import-dependent on meat and dairy products. During the 1990s, meat and milk consumption in Russia fell substantially, and it is likely that consumption of more expensive foodstuffs will remain at current low levels for some time to come.<sup>14</sup>

**Table 7. Indices of Food Production and Dynamics of Cattle Numbers in Russia, 1990-2000** (indices, %, PP=100)

	Index, 1990-1997	Index, 1997-1998	Index, 1998-1999	Index, 1999-2000 (6 months)	Index, 1990-2000 (est.)	1990 level to be reached (a)	
						In months	By the year
Sunflower Oil	82.4	107.1	138.4	...	122.1 (b)	-	-
Vegetables	107.8	94.6	116.5	...	118.8 (b)	-	-
Potatoes	120.1	84.9	99.4	...	101.4 (b)	-	-
Sugar Beets	43	77.7	140.9	...	47.1 (b)	33	2003
Fish Production	59.6	89.4	91.7	117.7	57.5	51	2005
Food Processing	56.5	103.7	120.2	107.1	75.4	56	2005
Grains	75.9	54.1	114.2	...	46.9 (b)	96	2008
On-Farm Meat Production	48.5	96.2	92.4	106.5	45.9	218	2019
Wines	16.2	94.1	110.5	119.9	20.2	239	2020
Egg Production	67.8	101.7	101.6	101.1	70.8	449	2038
Meat & Dairy Industry	31.5	93.8	94.7	104.8	29.3	603	2051
Hog Numbers	47.8	96.9	103.6	101.9	48.9	660	2055
Spirits & Alcoholic Beverages	60.1	103.8	154.6	86.7	83.6	(decline continues)	
Cattle Numbers	76.4	92.8	95.6	97.8	66.3	(decline continues)	
On-Farm Milk Production	61.2	97.4	96.5	98	56.4	(decline continues)	
LHC Numbers	59.7	91.1	96	98.3	51.3	(decline continues)	
Sheep Numbers	37.2	83.6	89.2	96.4	26.7	(decline continues)	

Notes:

(a) An estimate of the time (in months and by what year) when the 1990 level would be reached if the current rate of growth remains constant.

(b) Data for 1990-1999.

Sources: Own calculations based on sources for Table 1 and *Narodnoe khozyaistvo RSFSR v 1990 g.* Moscow: Goskomstat RSFSR, 1991, pp. 400-477; *Sel'skoe khozyaistvo v Rossii. 1998*, Moscow: Goskomstat Rossii, 1998, pp. 32, 50-79.

We may conclude that if the current growth trend continues, within next five to ten years, we should witness a gradual real recovery of the Russian economy. At present, however, it is still too early to conclude whether this recovery is sustainable or whether it will be accompanied by much needed modernisation and restructuring of the Russian economy. There still remains a great uncertainty as to whether Russia has already passed through the most critical phase in its post-Soviet development or whether it will encounter another major economic and social crisis in the future.

The rate and scale of the current economic recovery in Russia depends on a number of important domestic and external factors. The future prospects for the development of the Russian industry and agriculture greatly depend on which economic and fiscal policies the government pursues and how effectively the government can control the growth of the popu-

lation's incomes. It also remains to be seen how determined the government will be in streamlining and simplifying state management and economic legislation. So far, the government has managed to resist increasing pressures to raise the exchange rate of the rouble.<sup>15</sup> Failure to keep the current stable exchange rate will immediately undermine the state policy of protecting the local industry from competition with imported goods (in other words, the current policy of import substitution). As the developments of the early 1990s have shown, this is certain to have dire consequences for many sectors of the national economy.

Another important factor that will greatly determine the prospects of recovery in Russia is the ability of the Russian government to resist mounting pressures to raise the levels of state subsidies to local industry and agriculture, as well as grant social expenditures beyond the capacities of the national economy. In modern Russian history, the government has only once attempted to bring state expenditure into balance with incomes, and this was during the first months of Russian reform. Subsequent political and social pressures forced the government to abandon its attempt and retreat to the wasteful model of Soviet-type economic management.<sup>16</sup> Since the 1998 crisis, the Russian government has managed to keep social and political pressures under control, and this has played a vital role in bringing about the current recovery.

Increased efficiency of the system of state management and the continuation of fight against corruption and crime are extremely important developments that, if implemented properly, carry the potential of transforming positive signs of growth into a sustainable recovery. This can not only directly affect the popularity of the government and its leaders, but, if these measures are accompanied by a streamlining of complicated and overtly bureaucratic Russian economic and tax legislation, one may expect that the Russian government's policies will also enjoy growing support from local and foreign investors and businessmen.

In addition to domestic factors outlined above, the future of Russian economic recovery will also depend on a number of external developments. The recent rise of world prices for major Russian exports has resulted in significant financial gains for both Russian industry and the government. If prices remain high, one can expect that Russia will sustain and even increase the pace of its recovery, and at the same time fulfil all or most of its obligations on the repayment of its public debt. However, if the prices for oil, gas, metals and minerals fall back to the mid-1990s levels, the Russian government will find itself in a difficult situation that will inevitably hamper the prospects of economic recovery.

Another important external factor is how successful Russian negotiators will be in trying to reschedule or get write-offs for part of the country's debt obligations. Debt repayment problem is likely to remain one of the Russian government's most crucial problems in the area of external economic relations. Indeed, even with high world oil prices, debt repayments place a heavy burden on the Russian state budget and greatly decrease the amount of resources that can be channelled towards restructuring the economy.

From a strategic perspective, the most important development to watch is probably how fast and how successfully Russia develops its high-tech potential. In recent months, we have witnessed numerous small, but promising, signs such as increased funding for research and development, growth in machine and instrument building, rising production of certain high-tech products in the chemical, pharmaceutical and electronics industries. To a large extent, this growth is associated with increased state funding for the military-industrial complex, which was declared as one of the main spending priorities of the Russian government for 2000. However, as Table 5 shows, this trend had little impact on the structure of Russian exports. If Russia is to achieve a *sustainable* recovery of its economic potential and to in-

crease its weight in the global economy, it will need to increase the share of “new economy” in its economic structure, which currently is still dominated by “old economy” resource and mineral industries.

## Notes

<sup>1</sup> For more on that see Vladimir Tikhomirov, *The Political Economy of Post-Soviet Russia*, London: Macmillan – New York: St. Martin's Press, 2000, pp. 11-12.

<sup>2</sup> These were based on the arguments of criminalisation and growth of a “shadow economy” in Russia. A contrary view is held in the “virtual economy” thesis. See e.g. Clifford G. Gaddy and Barry W. Ickes, ‘Russia’s Virtual Economy’, *Foreign Affairs*, vol.77, no.5, September-October 1998; George Breslauer, Josef Brada, Clifford G.Gaddy, Richard Ericson, Carol Saivetz, and Victor Winston, ‘Russia at the End of Yel’tsin’s Presidency’, *Post-Soviet Affairs*, vol.16, no.1, January-March 2000, pp.1-32 [particularly Clifford Gaddy’s piece, pp. 12-18]; G.Khanin and N.Suslov, ‘The Real Sector of the Russian Economy: Estimation and Analysis’, *Europe-Asia Studies*, vol.51, no.8, December 1999, pp. 1433-54; ‘Goskomstat Estimates 20% of Russia’s Economy in Shadow’, *Russia Notes*, 16 February, 1999; Anthony Phillips, ‘Changing Characterisations of the Roots of Russia’s Problems: a Look at the ‘Virtual Economy’ Thesis’, *Russian and Euro-Asian Bulletin*, vol.8, no.3, March 1999, pp. 1-12; Daniel Treisman, ‘Inter-Enterprise Arrears and Barter in the Russian Economy’, *Post-Soviet Affairs*, vol.16, no.3, July-September 2000, pp. 225-56; David M. Woodruff, ‘It’s Value That’s Virtual: Bartles, Rubles, and the Place of Gazprom in the Russian Economy’, *Post-Soviet Affairs*, vol.15, no.2, April-June 1999, pp. 130-48.

<sup>3</sup> For example, the item ‘Collapsing Economy’, *Online NewsHour with Jim Lehrer*, 27 October 1998 ([http://www.pbs.org/newshour/bb/europe/july-dec98/russia\\_10-27.html](http://www.pbs.org/newshour/bb/europe/july-dec98/russia_10-27.html); accessed on 23 October 2000).

<sup>4</sup> On deficiencies and limitations of Russian official statistical data see Vladimir Tikhomirov, *The Political Economy of Post-Soviet Russia*, pp. 11-12; G. Khanin and N. Suslov, ‘The Real Sector of the Russian Economy’, pp. 1433-54. Note: Here we compare statistical figures to 1990, when the USSR still existed.

<sup>5</sup> In its recent report, the Central Bank of Russia described the policy after the devaluation as a “floating exchange rate and gold and forex reserve accumulation regime” (‘CBR Forecasts 12%-14% Inflation in 2001’, *Interfax*, 2 October 2000).

<sup>6</sup> *Sotsial'no-ekonomicheskoe polozhenie Rossii, yanvar' 1999 goda*, Moscow: Goskomstat, 1999, p. 258.

<sup>7</sup> *Ibid.*, p.262.

<sup>8</sup> *Ibid.*, p.123.

<sup>9</sup> For example, according to the official data, 73% of Russian iron production capacity was utilised in 1997 (94% in 1990). Similar figures for steel were 68% (94%); mineral fertilisers, 49% (75%); tractors, 8.2% (81%); refrigerators, 27% (98%); and cement, 36% (93%). Overall, published data indicate that in every area of industrial production utilisation of production capacity in 1997 was lower than in 1990 (*Promyshlennost' Rossii*, Moscow: Goskomstat, 1998, pp. 61-63).

<sup>10</sup> In January-June 2000, 53.5% of capital investment came from enterprises and only 20.6% from the state budget (*Sotsial'no-ekonomicheskoe polozhenie Rossii, yanvar' -iyul' 2000 goda*, Moscow: Goskomstat, 2000, p. 134).

<sup>11</sup> A significant part of investment should be spent on replacement of outdated and obsolete equipment and machinery at Russian enterprises. For instance, in 1970 the share of obsolete (“worn-out”) equipment in Russian industry was 25.7%. By 1980, it increased to 36.2% and by 1990 – to 46.4%. In 1998, it was already at a level of 52.9% (*Rossiiskii statisticheskii ezhegodnik. 1999*, Moscow: Goskomstat, 1999, p. 311).

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<sup>12</sup> For more on Russian debt problem see Vladimir Tikhomirov, 'Keeping the Titanic Afloat: Russian Debt Problem in the 1990s', *Post-Soviet Affairs* (forthcoming).

<sup>13</sup> A significant portion of production in this sector is military-related. See for details e.g. Alexander Golts, "The Arming of Russia's Economy," *The Russia Journal*, 7-13 February 2000; *RFE/RL Newslines*, Vol.4, No.58, Part I, 22 March 2000.

<sup>14</sup> Between 1990 and 1998, annual per capita household consumption of meat and meat products in Russia fell from 70 kg to 58 kg (-18%), milk and dairy products from 378 kg to 245 kg (-35%), fruits from 37 kg to 27 kg (-27%), and eggs from 231 to 198 (-14%). At the same time, consumption of bread increased by 23% and potatoes by 18% (*Sotsial'naya sfera Rossii. 1995*, Moscow: Goskomstat Rossii, 1995, p. 58; *Sotsial'noe polozhenie I uroven' zhizni naseleniya Rossii. 1999*, Moscow: Goskomstat Rossii, 1999, p. 129).

<sup>15</sup> A spokesman for the Russian Ministry of Finance, quoted in a recent report by *Interfax*, noted that "the [Russian] government and the Central Bank of Russia are taking steps aimed, on the one hand, at bolstering the country's gold and forex reserves, and on the other, at preventing a sharp rise in the ruble's exchange rate in order to maintain the competitiveness of Russian goods." He added that in recent months the Central Bank has been making a major effort not to allow an "excessive strengthening of the ruble," remaining the biggest buyer of export earnings. Between January and October 2000 Russian Central Bank's gold and forex reserves have doubled and reached the all-time record of US\$25 billion ('Analysis: FinMin promises to push ruble down in 2001', *Interfax*, 11 October, 2000; *Radio Free Europe/Radio Liberty Newslines*, vol.4, no.194, 6 October 2000, part I). This Russian policy was heavily criticised by certain neoliberal economists, most notably by US Treasury Secretary Lawrence Summers (see Stanislav Menshikov, 'Neoliberal Utopias in Boston and Strong Realism in Helsinki', *Moscow Tribune*, 13 October 2000).

<sup>16</sup> In 1999, Russian GDP has grown by 3.2%, while real per capita income has fallen by 15.1%. In January-June 2000, the tendency continued: GDP has grown by 8.4% and real per capita income by 8.2% (*Sotsial'no-ekonomicheskoe polozhenie Rossii. 1999*, Moscow: Goskomstat Rossii, 2000, p. 7; *Sotsial'no-ekonomicheskoe polozhenie Rossii, yanvar'-iyun' 2000 goda*, Moscow: Goskomstat Rossii, 2000, p. 7). This is an opposite development to what was happening in 1990-97. As shown in Table 1, in that period GDP has fallen by almost 40%, while real incomes have decreased by less than 28%. This growing discrepancy between GDP and income trends was only possible if supported by a massive borrowing campaign. This latter development could not continue indefinitely and was one of the main factors that caused the collapse of the "Soviet-type economy" in Russia in 1991-1992 and in 1998. (See Vladimir Tikhomirov, 'The Second Collapse of the Soviet Economy: Myths and Realities of the Russian Reform', *Europe-Asia Studies*, vol.52, no.2, March 2000, pp. 207-236).



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