DEVELOPMENTS IN THE RUSSIAN ECONOMY IN THE POST-SOVIET ERA

SOVYET SONRASI RUS EKONOMISİNdE OLAN GELİŞMELER

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ABSTRACT

The economic problems in the last ten years of the Union of Soviet Socialist Republics have deepened after its dissolution, which left the newly founded Russian state in various challenges and successive crises. In the transition period of 1993-2005, Russia had successfully transformed its economy and was able to start its modernization period after 2005. Increases in petroleum products' prices in this period swiftly improved the macroeconomic indicators of the country, the economic progress and modernization cannot be explained with this revenue alone. Effective policies during the crises, determination in fighting with inflation and reduction in unemployment led the way for increases in gross domestic production. In this paper, we studied the most important economic indicators of Russia, comparing it with the Turkic states that gained their independence in the post-USSR period. We also show the role of political stability in the economic achievements of the Russian state.

Key Words: Russia, economic crises, transition period, economic growth, Turkic world.

JEL Codes: E60, F63, H50

ÖZET


Anahtar Kelimeler: Rusya, ekonomik kriz, geçiş dönemi, ekonomik büyüme, Türk dünyası.

Jel Kodları: E60, F63, H50

1 INTRODUCTION

The disintegration of the Soviet Union has given us an unprecedented series of events where whole nations had to unlearn what was taught to them as the best way of living and learn a totally different way of living. Certainly, this was not a painless task. People with no

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experience with free markets had to survive in a seemingly wild world. There were huge lines for a hamburger, something they have never experienced before; or a packet of gum was so original that a soldier would exchange his rifle for that. This transition period, as expected, was not easy. Many crises ensued from the dissolution.

Every crisis, national or global, has its own characteristics of how it started and how it should be ended. Russia has survived its economic turmoil in 1993-1994 and 1998-2000 with extensive economic measures which allowed it to keep a growth trend until the crisis of 2008. Russia confronted the 2008 crisis with a different economic structure than the 1998 crisis.

We tried to depict this long transition period of the Russian Federation and its consequences for the world. In the first section, we analyzed the Russian crises of the post-Soviet period. We elaborated on the 1998 crisis which left deep marks on the country. We reviewed Russian economic policies that founded the dynamics of its transformation in the next section. Finally, we compared Russian Federation to the Turkic states which gained their independences from the Soviet Union.

2 RUSSIAN FEDERATION'S ECONOMIC DEVELOPMENT PHASES

Russia lost a substantial portion of its economic and political strength after the dissolution of the Soviet Union. It lost one sixth of its land and experienced fifty percent drop in its gross domestic product (GDP). The stagnation in the economy that started during the Soviet Union accelerated after its dissolution. The economic crises in this period were due to structural problems that arose from a regime change, from a centrally planned economy to a market based economy. Unlike gradual shifts, there was a total collapse in many sectors of the economy due to high inflation, very low demand to domestic goods, management inadequacy, inexperience and coordination problems in between institutions. Naming the period a transition period is more appropriate than calling it a series of crises according to Elliott and Dowlah (1993).

2.1 Soviet Period

It would be useful to depict the Soviet period first, to have a better understanding of the post-Soviet period. Data before the collapse of the Soviet Union differs a lot. Therefore, we had to choose from different sources to illustrate this period. More information on comparing different sources is available at Harrison (1993). We used data provided by Moorsteen and Powell (1966) and Khanin (1988). The following table is prepared from these sources.

<table>
<thead>
<tr>
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</tr>
</thead>
<tbody>
<tr>
<td>GDP (% change)</td>
<td>5.2</td>
<td>4.8</td>
<td>4.9</td>
<td>3.0</td>
<td>1.9</td>
<td>1.8</td>
<td>2.7</td>
</tr>
<tr>
<td>Output per worker (% change)</td>
<td>5.0</td>
<td>4.1</td>
<td>3.0</td>
<td>1.9</td>
<td>0.2</td>
<td>0.0</td>
<td>2.0</td>
</tr>
<tr>
<td>Inflation Rate</td>
<td>1.2</td>
<td>2.2</td>
<td>4.6</td>
<td>2.3</td>
<td>2.7</td>
<td>NA</td>
<td>NA</td>
</tr>
</tbody>
</table>

It is possible to see the slowdown in the Union’s growth rates starting in the late seventies. Numerous inefficiencies are rooted in the political struggles in between various Communist parties (Carson, 1997). The Union boosted its economy after World War II with shifting its economy from agriculture-based production to industrial production (Davies, Harrison, & Wheatcroft, 1994).
At the beginning of 1980’s Soviet Union started reforms in its development and growth policies. Before, defense and space industries had been receiving the lion’s share in spending, where more emphasis was given to social and economic goals after that period. Such a change was not easy, since many of the Soviet political leaders had regarded these policies as a loss to the Union’s values (Kovnir, 2005). It is possible to understand the lag in Soviet Union’s economy by looking at the competitiveness of the Union’s auto industry, which a symbol of scientific and technological advancement in world markets. It is emphasized that the share of automobile and similar transportation vehicle exports in total exports have declined from 21.5% in 1970 to 13.6% in 1985 (Abalkin, Ivanov, & Sorokin, 2007).

2.2 1990-1998 Period

After the dissolution of the Soviet Union, the newly independent countries prepared economic programs with the help of the IMF and the World Bank. The major proponents of these programs were to reduce high inflation and achieve macroeconomic stability. As a result of these programs the inflation rate, which was around 1500% in 1992, came to down to single digit values in the 2000’s (Efegil & Azerbaidzjian, 2002).

From 1990 forward, the public and the state officials became aware of the need of reforms in the economy. It is no coincidence that in these years Grigory Yavlinsky, who became the leader of the liberal Yabloko party later on, prepared the famous 500 days programme for the transition of the Soviet Union into a free-market economy. The goal of this ambitious plan was to rapidly improve the economic conditions of the Union. But the efforts turned futile as the plan was not extensive enough to cover many unforeseen political and social factors. The union was disintegrated in 1993.

The most fundamental issue after the disintegration was the problem of private ownership. How would the state dispense the state property to its citizens? Neither they were experienced with such a job, nor was anyone else in the world on this scale. The state officials of the time looked at what the United Kingdom did in the early 80’s with its privatization program. Sizable funds were allocated to the study of privatization where many people specialized in this topic. In its first round from 1992 to 1994, twenty thousand institutions were privatized (Boyko, 1999). Although there were big hopes from privatization, expectations did not materialize and economy kept moving on its path downwards.

Table 2: Macroeconomic Indicators for the Period

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP (% change)</td>
<td>-8.7</td>
<td>-12.7</td>
<td>-4.1</td>
<td>-3.5</td>
<td>0.9</td>
<td>-4.9</td>
</tr>
<tr>
<td>Unemployment rate</td>
<td>6.0</td>
<td>7.8</td>
<td>9.0</td>
<td>9.9</td>
<td>11.2</td>
<td>13.3</td>
</tr>
<tr>
<td>Inflation Rate</td>
<td>875.0</td>
<td>311.4</td>
<td>197.7</td>
<td>47.8</td>
<td>14.7</td>
<td>27.6</td>
</tr>
<tr>
<td>Current Account/GDP</td>
<td>NA</td>
<td>2.9</td>
<td>2.3</td>
<td>3.0</td>
<td>0.5</td>
<td>0.4</td>
</tr>
<tr>
<td>GNI per capita (% change)</td>
<td>-8.5</td>
<td>-11.9</td>
<td>-4.4</td>
<td>-4.1</td>
<td>0.9</td>
<td>-7.0</td>
</tr>
</tbody>
</table>

Note: Data taken from OECD statistics and World Development Indicators.

Looking at Table 2 above, we see the inverse relationship in between inflation rate and the unemployment, validating the Phillips for the Russian case. We observe an almost continuous decrease in GDP values, except 1997. This implies that Russia struggled with its real economy during this time. Even though there was almost a constant decline in the real economy, the current account did not suffer from these drops due to oil exports.

3 From the article “Orta Asya üzerine güç mücadeleleri” by Ercan Sancak, pages 119-171.
2.3 1998-2008 Period

The inheritance of enormous structural problems from the Soviet Union is the ultimate cause of the Russian crisis of 1998. These structural problems were so deep, economically, sociologically, and even psychologically, that a rapid recovery to a sensible economic level was almost impossible, not only for the Russian state, but for the other states separated from the Union as well.

There was a widespread belief that the crises were due to the new system, especially within the elderly people. People were comparing their lifestyles with that during communism and making nostalgic remarks like they had been living a spectacular life during those times. In reality, the economic problems were due to the inefficient policies of the Soviet Union going back all the way to early 80’s. It takes a longer time to correct structural problems compared to other basic economic problems.

As it is well known, the Soviet Union had a closed economy, unlike other developed world economies of its time. Therefore, the extent of its economy was limited with its domestic markets. The structure of the economy prevented Soviet Union from using the most suitable technologies in production, which caused great inefficiencies. This reduced the competitiveness of Russian products not only in its own newly opened markets, but also in the countries where it was able to export before the dissolution, the eastern European countries. The public simply preferred fancy western products to old, low-tech Russian goods.

<table>
<thead>
<tr>
<th></th>
<th>98</th>
<th>99</th>
<th>00</th>
<th>01</th>
<th>02</th>
<th>03</th>
<th>04</th>
<th>05</th>
<th>06</th>
<th>07</th>
<th>08</th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP (% change)</td>
<td>-5.3</td>
<td>6.4</td>
<td>10.0</td>
<td>5.1</td>
<td>4.7</td>
<td>7.3</td>
<td>7.2</td>
<td>6.4</td>
<td>7.7</td>
<td>8.1</td>
<td>5.6</td>
</tr>
<tr>
<td>Unemployment rate (% change)</td>
<td>12.3</td>
<td>12.6</td>
<td>9.8</td>
<td>9.0</td>
<td>7.9</td>
<td>8.2</td>
<td>7.8</td>
<td>7.2</td>
<td>7.2</td>
<td>6.1</td>
<td>6.4</td>
</tr>
<tr>
<td>Inflation Rate</td>
<td>28.0</td>
<td>86.0</td>
<td>21</td>
<td>22.0</td>
<td>16.0</td>
<td>13.7</td>
<td>10.9</td>
<td>12.7</td>
<td>9.7</td>
<td>9.0</td>
<td>14.1</td>
</tr>
<tr>
<td>Current Account/GDP</td>
<td>0.1</td>
<td>12.6</td>
<td>18</td>
<td>11.1</td>
<td>8.4</td>
<td>8.3</td>
<td>10.0</td>
<td>11.0</td>
<td>9.6</td>
<td>5.9</td>
<td>6.1</td>
</tr>
<tr>
<td>GNI per capita (% change)</td>
<td>-7.0</td>
<td>7.1</td>
<td>1.2</td>
<td>6.9</td>
<td>4.7</td>
<td>6.6</td>
<td>8.7</td>
<td>6.4</td>
<td>7.9</td>
<td>9.7</td>
<td>4.4</td>
</tr>
<tr>
<td>Poverty headcount ratio at national poverty line (% of population)</td>
<td>NA</td>
<td>NA</td>
<td>NA</td>
<td>NA</td>
<td>24.6</td>
<td>20.3</td>
<td>17.6</td>
<td>17.8</td>
<td>15.2</td>
<td>13.3</td>
<td>13.4</td>
</tr>
</tbody>
</table>

Note: Data taken from OECD statistics and World Development Indicators.

Russian GDP started to improve in 1999 and kept this trend all the way into the 2008 crisis. There were improvements in the unemployment rate with increases in GDP. Again current account balance was positive throughout this period due to oil revenue. There is also a steady improvement in the poverty ratio in this period.

2.4 Beyond 2008

Russia was not prepared for the 2008 crisis. The downfall of the GDP by 7.8% in 2009 shows the effects of the world markets on Russia. During the crisis, the exports and imports dropped sharply and higher levels of inflation caused a pressure on the cost of manufacturing.
Table 4: Macroeconomic Indicators of the Period

<table>
<thead>
<tr>
<th></th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP (% change)</td>
<td>-7.8</td>
<td>4.5</td>
<td>4.3</td>
<td>3.4</td>
</tr>
<tr>
<td>Unemployment rate (% change)</td>
<td>8.4</td>
<td>7.5</td>
<td>6.5</td>
<td>5.5</td>
</tr>
<tr>
<td>Inflation Rate</td>
<td>11.7</td>
<td>6.9</td>
<td>8.4</td>
<td>5.1</td>
</tr>
<tr>
<td>Current Account/GDP</td>
<td>3.8</td>
<td>4.7</td>
<td>5.2</td>
<td>5.5</td>
</tr>
<tr>
<td>GNI per capita (% change)</td>
<td>-7.7</td>
<td>4.0</td>
<td>3.4</td>
<td>2.9</td>
</tr>
<tr>
<td>Poverty headcount ratio at national poverty line (% of population)</td>
<td>13</td>
<td>12.5</td>
<td>12.7</td>
<td>10.7</td>
</tr>
</tbody>
</table>

Note: Data taken from OECD statistics and World Development Indicators.

The reason of positive current account balances during and after the crisis is not the healthy economy but rather the revenue made by sale of petroleum products.

3 DYNAMICS OF THE RUSSIAN CHANGE

3.1 Human Capital

The Soviet Union had a well-established and working education system targeting 100% literacy rate. The workforce of the Soviet Union was already trained in certain areas with relatively higher levels of human capital before the dissolution. Higher education institutions were training students in theoretical and practical sciences in world standards. In 1993, Russia was fourth in the world in number of scientists and engineers to total labor force ratio. Concrete evidence to high levels of human capital is that during the Union, Soviets were able to compete with the United States in mechanical engineering, medical sciences, space and defense industries. In the post-Soviet era, Russia experienced a rapid transition to capitalism and foreign companies, world giants, started investing and operating in the Russian state. Some people easily adapted to the new working conditions in these Western companies with moderate professional development trainings. But we should also mention the fact that a common complaint of these Western companies was lack of efficiency and low levels of professionalism.

During the 1998 crisis, people realized a fact about the Russian workforce. The existing level of human capital was not enough to compete with developed countries. The state officials admitted the need of reforms in training the workforce. The aim of these reforms was to train the workforce to produce high-tech goods and promote innovation in the country. Although there were improvements in human capital, results were barely noticeable.

3.2 Natural Resources

The most important natural resources for the Russian economy are oil and natural gas. Export of these natural resources makes 25% of foreign trade and allows current account surpluses possible (Sancak, 1999b). Even though Russia is trying to diversify its economy, it is still very dependent on oil exports. Having rich reserves of natural resources may help to boost the economy and people’s wellbeing or on the other hand, it may tie the wellbeing of people to the natural resource revenue. Russia is in a relatively better situation compared to other natural resource-rich countries.

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5 Subbotina, p. 55
3.3 Political Stability

Boris Yeltsin was the first elected president of the Russian Republic by popular vote in June 1991. He enhanced his credentials during an attempted coup by the conservatives in August 1991 by standing against the military forces with his famous speech on top of a tank. Russia was recognized as an independent country in December 1991. Yeltsin took on the challenge of reforming an embattled country. The success of his modernization efforts and reforms was very questionable. He gradually lost his health and reputation until he designated Vladimir Putin as his successor.

The political administration of Russia is a type of autocracy, named as “power vertical” by Putin himself. The public, at least some of it, embrace this ideology as the best way of running the Russian state. The popular media and the educational institutions promote this understanding. Political opposition is very weak since the power is held by the running government. The political stability is established with giving up personal freedoms (Stuermer, 2008). There is a strong correlation between political and macroeconomic stability. We believe that there is a bidirectional causal relationship between them.

People who defend the power vertical claim that Russia is new to democracy and therefore, fully and rapidly adapting democracy and freedoms will cause dissolution of the Russian federation. There are many people who also question sustainability of Russian growth under the given political conditions, for example Gidadhubli (2007). There are concerns about growing income inequality as well, Fedorov (2002).

4 POLICIES THAT IMPROVED RUSSIAN ECONOMY

According to Sorokin (2007), the most important reasons of the disintegration of the Soviet Union were not being able to reform the state on time, not being able to prepare the state for a transition and losing public’s trust in state. Being aware of its earlier shortcomings, the new Russian state initiated a wave of new reforms and modernization efforts in many different areas, most importantly, in the economy. They used different policies to do this;

4.1 Incentivizing Domestic Production

Russia provided significant incentives to domestic producers to increase local production in the country. Providing low interest credit to the firms is one of the methods used. Since domestic producers did not have their own resources to finance their expansions or R&D expenditures, they were dependent on external funding. Providing the much needed capital to producers made a big difference on domestic production. The proportion of high-tech goods in domestic production was 10% in 2000 and the government is aiming to increase this ratio6.

4.2 Use of Natural Resource Revenue

An important reason of why Russia suffered substantially in the 1998 crisis was the low price of oil, down to $11 a barrel. But, from 1999 to 2009, price of oil steadily increased together with Russian oil extraction. Annual production was 310 million tons in 1999 where it became 490 million tons in 2009. Petroleum products’ export increased by 1.8 times together with extraction levels.

As it is known, Russia is rich in natural resources of oil and natural gas but marketing these resources was not trivial. European states’ diversification of gas sources forced Russia to

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6 European Bank for Reconstruction and Development, Transition Report 2005
look for new markets. The petroleum and natural gas reserves in the Siberia region were diverted to new emerging markets like China through newly built gas pipe lines. This allowed Russia to diversify its markets.

Even though the Russian government is trying to lessen its economic dependence on oil export revenue, still, big changes in oil prices cause substantial changes in national income. For example, a $10 rise in prices in 2002 to 2003 caused a 7.3% increase in Russian GDP.  

4.3 Export/Import Policies

Although, appreciation of Russian currency, ruble, from 2000 to 2008 hurt manufactured goods’ export, the government did not observe a drop in its oil revenue because of the connections made in this period. Ruble lost value in the 2009 crisis where it fell from 23.5 ruble per dollar to 35 ruble per dollar.

Since Russia is not a member of the World Trade Organization (WTO), it determines its own rules of trade with its trading partners. Russia did not hesitate to apply any arbitrary tariffs whenever tides turn against its own interest in its trade balance. This unpredictability caused harm to its trading partners. Some traders decided to move its production into Russia to overcome such subjective trade policies which eventually helped Russian GDP.

4.4 Defense Industry and Industrial Products

Defense industry was vital for Soviet manufacturing. It was a measure of technological independence and industrial achievement. There was a huge emphasis on mechanical production both in theory and practice; and there were substantial achievements in this area. Universities allocated great resources for theoretical and practical applications of mechanical engineering and this educational system is still in use in current day Russia.

According to Çepenko (2011), lack of technological investment and inefficiencies in production had been deepened with the dissolution of the Soviet Union and caused many industrial production facilities to shut its doors. From 1992 to 2002, Russia lost half of its industrial production facilities. The proportion of industrial production was 30-35% during the Soviet times where it dropped to 20.5% in 1990 and to 18.6% later on. The share of industrial products in exports was no more than 5% at that time. All these developments were a threat to the Russian defense industry but Russian government’s special attention to this industry prevented a catastrophic fall and although not as strong as before, Russian defense products are still competitive in the international arena.

According to one criterion, a country is considered as an industrialized country if its industrial production is 25% of its GDP. In 2008, this was 20% for Russia where it was 46% for the United States, 54% for Germany and 40% for China. Russian production is not as good as many of the Western countries but still competitive in certain areas.

5 COMPARISON OF RUSSIAN ECONOMY TO THE TURKIC STATES THAT GAINED THEIR INDEPENDENCE AFTER THE DISSOLUTION

There were many challenges for the newly independent Turkic states after the dissolution of the Soviet Union. Many authorities were questioning the political and economic permanency of these states at the time of dissolution. At the same time, many Russian news agencies were emphasizing the superior living conditions of Russia, comparing it to these...
states. As expected and similar to Russia, right after their independence these states experienced various crises and poverty rates increased dramatically. The following table gives the poverty rates comparing 1989 with 2009.

Table 5: GDP and Poverty Rate Comparisons

<table>
<thead>
<tr>
<th>Countries</th>
<th>Population (in millions)</th>
<th>Per Capita GDP</th>
<th>Poverty Rate (Percentage of the total population)</th>
<th>Population (in millions)</th>
<th>Per Capita GDP</th>
<th>Poverty Rate (Percentage of the total population)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Russia</td>
<td>148.3</td>
<td>6,577</td>
<td>5.0</td>
<td>142</td>
<td>9,340</td>
<td>&lt;2 (2008)</td>
</tr>
<tr>
<td>Azerbaijan</td>
<td>7.3</td>
<td>4,458</td>
<td>33.6</td>
<td>9</td>
<td>6,920</td>
<td>7.8 (2008)</td>
</tr>
<tr>
<td>Kazakhstan</td>
<td>16.8</td>
<td>7,593</td>
<td>15.5</td>
<td>16</td>
<td>4,840</td>
<td>&lt;2 (2007)</td>
</tr>
<tr>
<td>Kirgizstan</td>
<td>4.4</td>
<td>3,702</td>
<td>32.9</td>
<td>5</td>
<td>870</td>
<td>29.4 (2007)</td>
</tr>
<tr>
<td>Uzbekistan</td>
<td>20.5</td>
<td>5,118</td>
<td>43.6</td>
<td>28</td>
<td>1,100</td>
<td>76.7 (2003)</td>
</tr>
<tr>
<td>Turkmenistan</td>
<td>3.7</td>
<td>4,795</td>
<td>35.0</td>
<td>5</td>
<td>3,420</td>
<td>49.7 (1998)</td>
</tr>
</tbody>
</table>

Note 1: Per capita GDP data for 1989 is computed by Maddison (2007) and for 2009 it is taken from http://www.worldbank.com

Note 2: Poverty rates for 1989 are computed by Atkinson and Mickwright (1992) using Goskomstat data.

Total lack of any experience; and not being aware of free market economic dynamics, Turkic states suffered unrecoverable losses from privatization. For example, Kirgizstan sold many of its state-owned industrial production facilities, for the sake privatization, to new entrepreneurs who had connections with the state officials but no experience in a market economy. Free market economy dynamics, like price and quantity, are determined in the free markets. These entrepreneurs learned the dynamics the hard way and they were not able to survive in this new environment with almost no experience. They had to sell these factories left from the Soviet Union for scrap prices and close them.

The war between Azerbaijan and Armenia in 1993 caused further declines in already low GDP levels of Azerbaijan. According to the European Bank for Reconstruction and Development data, per capita GDP was down to $173 due to this war. Another reason of big drops in production rates was Soviet Union’s political organization of factories throughout the Union (Sancak, 1999a). The factories producing parts of various products were operating in many different states. This way, one state was not able to be independent of other states in producing goods. For example; the tire, the engine and the transmission of an automobile were all produced in different states. The anti-inflationary and other economic reforms started in 1994 bare its fruits in the 2000’s and Azerbaijan finally observed increases in its GDP.


Turkmenistan experience was not much different than other Turkic states. A sudden drop in GDP and living standards caused confusion among people. Reforms started in 1992 to target the high inflation rate. There were price controls on every good before 1992 but it was limited to certain goods, like energy, cereals, dairy products etc. after that date\(^10\). Turkmenistan’s economy was largely dependent on raw products’ export like crude oil. In the late 90’s, state policies aimed at building the infrastructure for economy to diversify its production. (Abalkin & Whatley, 1999)
Although there are many challenges for these young Turkic states, rich natural resources, investments made to improve human capital and geopolitical developments are likely to provide more opportunities.

6 CONCLUSION

The Russian Federation has experienced two major crises after the dissolution of the Soviet Union. The first crisis is right after the dissolution from 1992 to 1994. In this period, the major problem of the federation was the transition from a command economy to a free market economy. The second major crisis was in the 1998. The reason of this crisis was the incoherence in between the financial and the real economy. The distrust that was buildup in the financial markets triggered the crisis. After the 1998 crisis, a comprehensive package of economic reforms is administered in the country. Increase in petroleum product prices helped the effectiveness of these reforms. Political stability is another major factor in economic development. Besides, agreements made with former Soviet Union countries about the sales of Russian natural resources improved its political stance end helped its economy even further.

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