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Sailing Toward Soviet Stagnation

In recent years, the St. Petersburg International Economic Forum has become a major event in Russian business and political life. The forum is the meeting point for global CEOs and policymakers with an interest in Russia. It is also the place for the key speeches of Russia's top leaders, including the president and ministers.

But the St. Petersburg forum is more than just a meeting place. Since it is an annual event, we can look back to the previous year's forum and check the difference between what was on leaders' minds back then and what is relevant now.

Even this year's agenda shows that Russia is now less preoccupied with the crisis and more interested in longer-term issues. Last year's mood of uncertainty has been replaced by the understanding that, crisis or not, Russia is facing serious structural challenges. The country has to vastly improve governance, create incentives for raising productivity through innovation and investment, build modern infrastructure, integrate better into the global economy and make every industry and region more competitive. Two years ago, these challenges were already clearly recognized by both the government and business leaders. This year, forum participants will probably reflect what progress has been made since then.

One other important takeaway from the 2009 forum was a survey of global oil company executives taken during Deputy Prime Minister Igor Sechin's session "The Price of Oil." When asked to predict the price of oil for the year to come, the majority selected a range of $70 to $80 per barrel. Looking back, their forecast turned out to be amazingly accurate. What's more, this range seems to be sustainable for the medium term.

This prediction has affected public debate in an unexpected way. The last time the price of oil remained in the $70 to $80 per barrel range for an extended period was in the late 1970s and early 1980s. This has led to the idea of the "70 to 80 scenario," which holds that if the price of oil stays in this range, Russia will start to resemble the Soviet Union of the 1970s and 1980s, which was marked by the complacency and inertia of the country's leaders, domination of the state in economic and social life, and lack of competition and change. In the last year, comparisons between Vladimir Putin's Russia today and Leonid Brezhnev's Soviet Union have become commonplace.

At the same time, we must not overlook important differences that create strong incentives for modernization. First, Soviet leaders were less competent in macroeconomics. Today, Russia has no sovereign debt and still has a substantial sovereign fund. Second, Soviet leaders did not imagine that the Soviet Union could fall apart. The current Russian leadership lived through the collapse of the country and understand very well that stagnation is a dead end. Third, Russia is no longer isolated — its elites and upper middle class know the world outside of Russia through travel and the Internet.

But we haven't yet seen the changes the country badly needs. There is a strong promodernization rhetoric, but this hasn't been translated into concrete action. Moreover, as the very same government has been running the country for 10 years and has not delivered on quite a few promises before, the public's confidence in the government's words and promises is decreasing. Ten years ago, the government published the "2010 Strategy" of comprehensive reforms, also known as "The Gref Program." According to a recent report by the Center for Strategic Research, only 36 percent of this strategy has been implemented.

Moreover, the government's role in the economy is growing, not shrinking, thus bringing Russia closer to the Soviet model. The crisis is over, but the government's expenditures keep increasing. After running a decade of budget surpluses, Russia is now projecting for 2010 a budget deficit of between 5 and 6 percent of gross domestic product. Moreover, it is likely that we will see even more government expenditures in 2011 and 2012 as a part of the election campaign.

Unsustainable macroeconomic policy is what eventually caused the Soviet Union to go bankrupt. To keep the people from revolting, the government threw more and more money at the country's problems instead of undertaking painful reforms and restructuring. The Soviet debt grew so large in the 1980s that lenders decided not to offer the country any more loans.

Given that Russia today has large reserves and low debt, it is hard to imagine that the country would repeat the fate of the Soviet Union. At the same time however, just 3 years ago it would have been unthinkable that Russian government budget could run a deficit with oil at $70 to $80 per barrel. Moreover, as deficits in the country's pension system are expected to increase sharply over the next 10 years, Russia may have very serious solvency problems by 2020.

Russia will have to reform, privatize, deregulate and open up to competition sooner or later. Hopefully, the leading experts at the St. Petersburg Economic Forum will reach a consensus that we should learn from the fate of the Soviet Union and reform before the cash runs out.

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