

Where is the Russian Economy Going?

William Tompson

Non-Member Economies Division
Economics Department
Organisation for Economic Cooperation and Development

OECD Breakfast Series
Washington, DC
07 December 2004

A Word at the Outset on the Need for Humility...

Growth forecast vs. outcomes

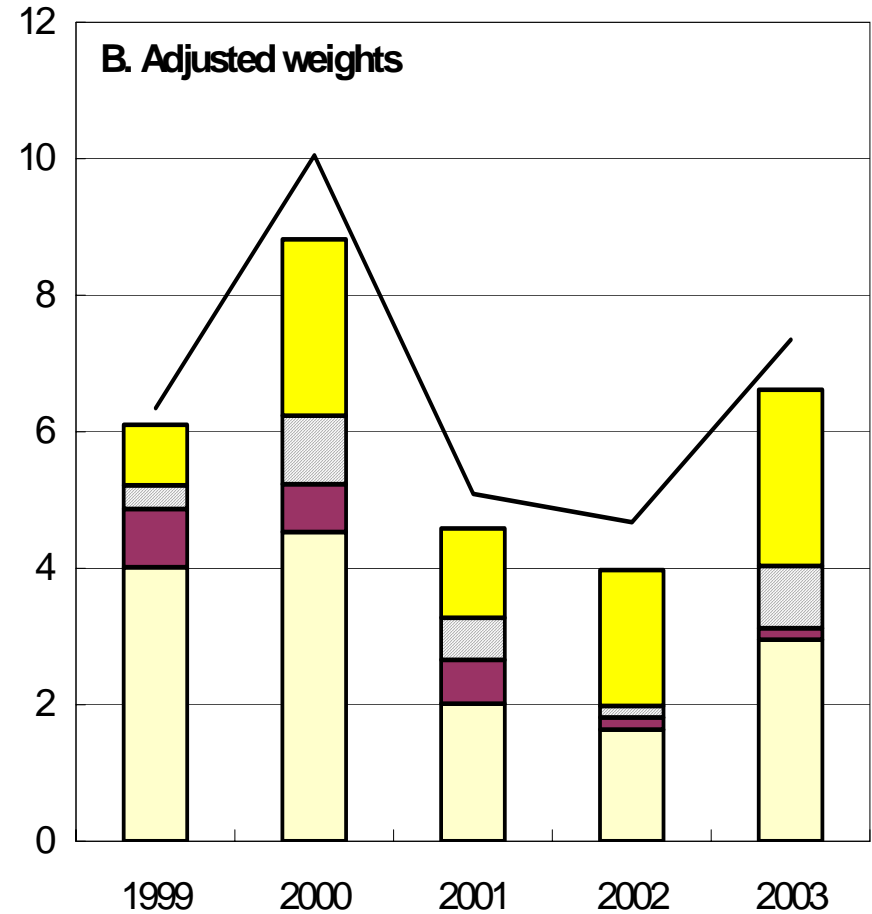
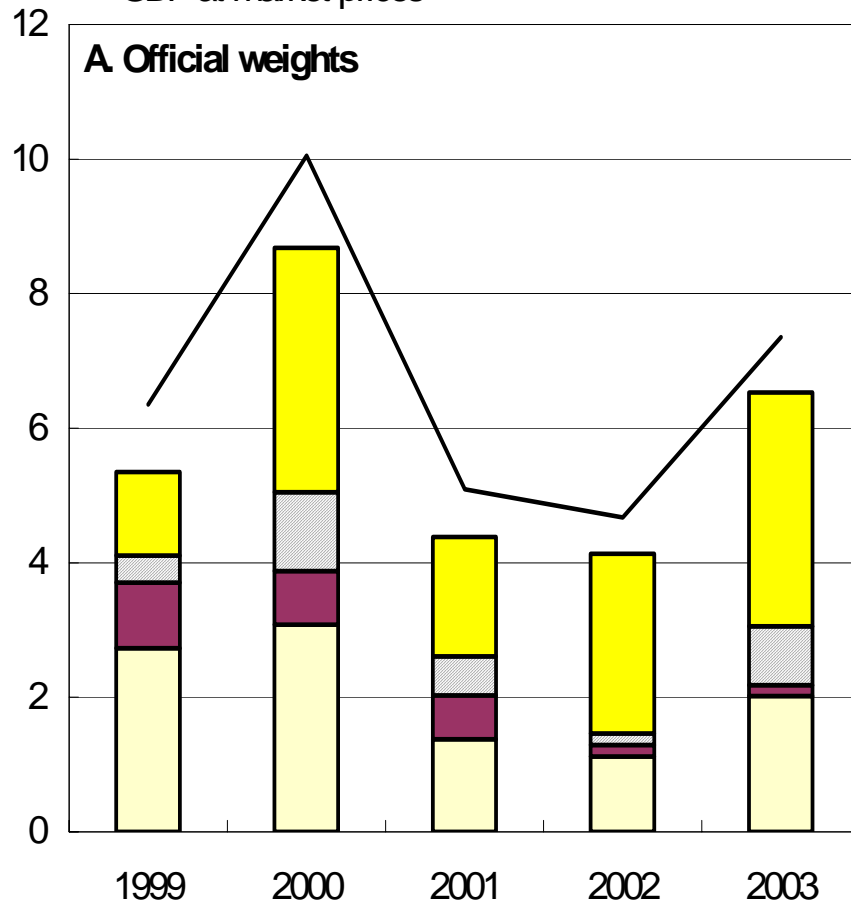
| | Consensus forecast | | OECD | | Actual |
|------|--------------------|-------------------|------|--------------|--------|
| 2000 | 1.5 | (Dec-99 - Jan-00) | 1.0 | EO66, Dec-99 | 10.0 |
| 2001 | 4.0 | (Jan/Feb-01) | 4.0 | EO68, Dec-00 | 5.1 |
| 2002 | 3.5 | (Jan/Feb-02) | 5.0 | EO70, Dec-01 | 4.7 |
| 2003 | 3.9 | (Jan/Feb-03) | 4.5 | EO72, Dec-02 | 7.3 |

Where has growth come from? Can it be sustained?

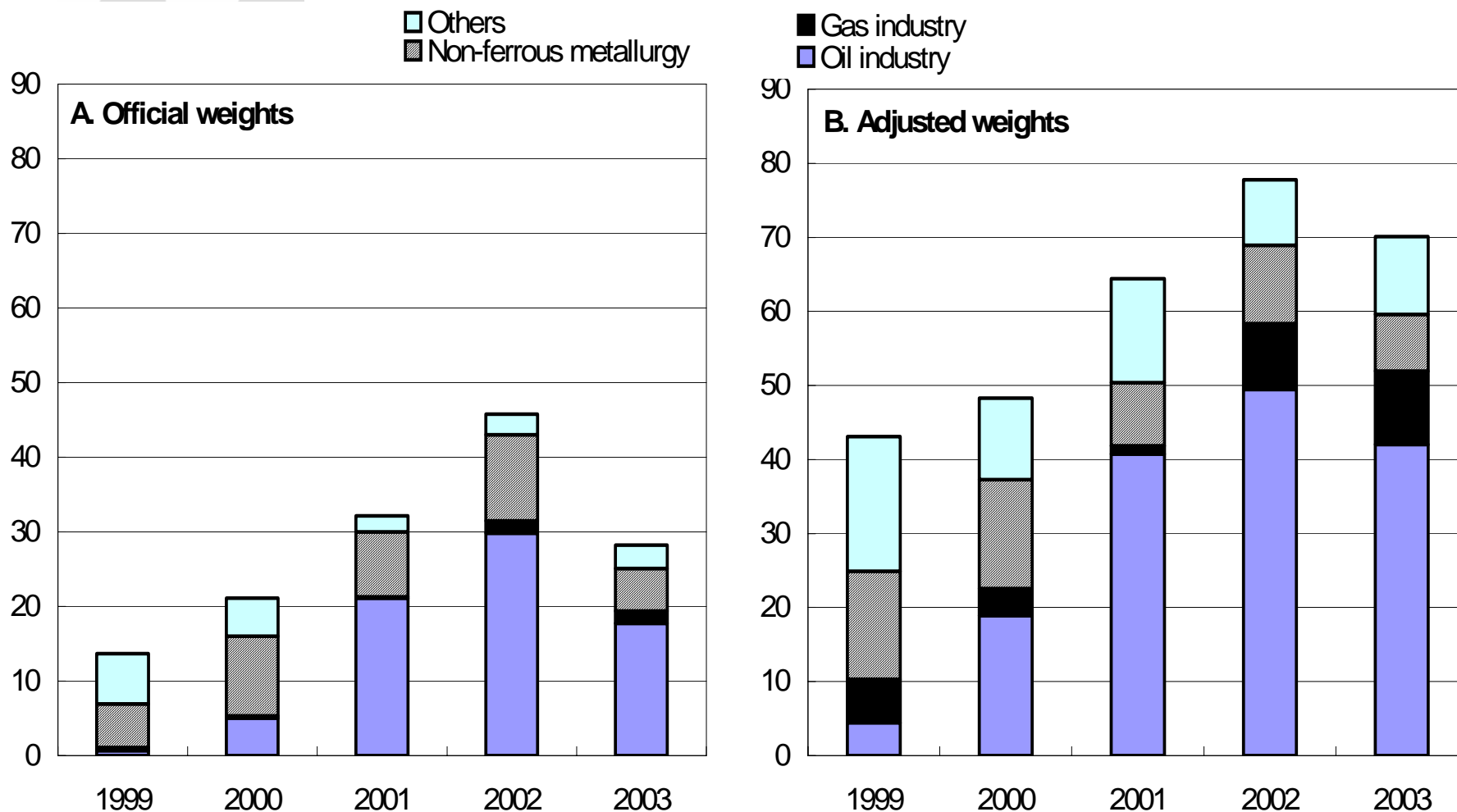
Main points to follow:

- Industry and general and hydrocarbons in particular matter more than the official data suggest.
- The oil sector – and chiefly private oil companies – have largely driven growth since 2000.
- On the demand side, Russia is enjoying a consumption boom, largely financed by oil windfalls.
- Continued growth will require continued export growth.
- Diversification will take time: in the interim Russia must act to mitigate the risks associated with resource-based growth

Contributions to GDP growth



Contribution of resource related sectors to industrial production growth (as % share)



Oil price dependence often exaggerated

Actual and simulated GDP growth rates

| | Actual | Simulated ¹ |
|---------|--------|------------------------|
| 2000 | 10.0 | 6.3 |
| 2001 | 5.1 | 6.1 |
| 2002 | 4.7 | 4.5 |
| 2003 | 7.3 | 6.2 |
| Average | 6.8 | 5.8 |

1. Assuming constant oil prices at long-term average levels (USD19 Urals) from 2000-03.

Oil sector output and exports

As a percentage of 1998 figures

| | Output: crude and condensate production | | | | |
|----------------------------|--|------|------|------|------------|
| | 1999 | 2000 | 2001 | 2002 | 2003 |
| Total | 101 | 107 | 115 | 125 | 139 |
| Financial group owned | 99 | 105 | 116 | 136 | 158 |
| <i>of which 3 largest</i> | 99 | 119 | 138 | 162 | 190 |
| Oil industry insider owned | 102 | 111 | 128 | 135 | 144 |
| State controlled | 98 | 100 | 103 | 106 | 113 |

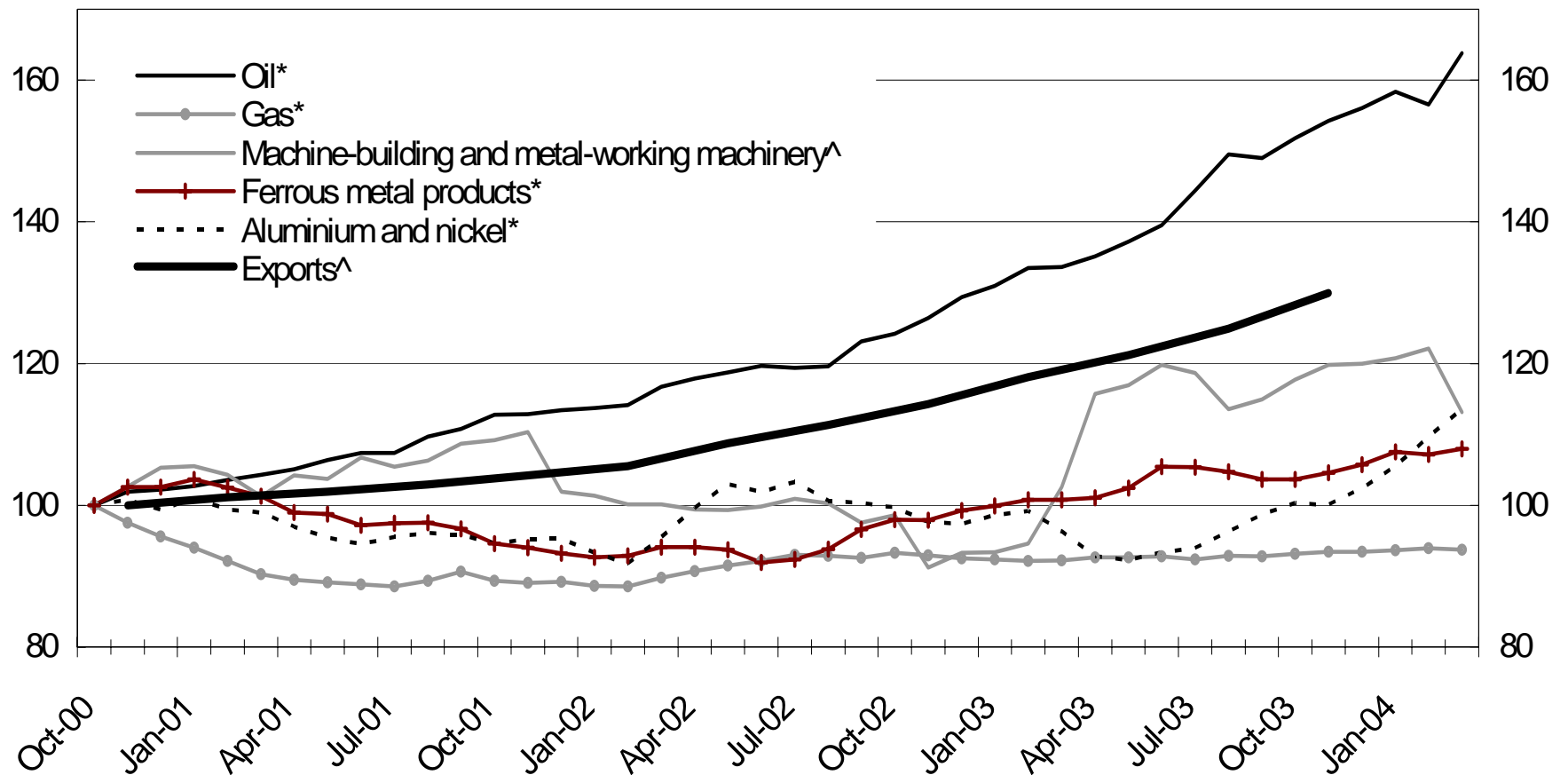
| | Non-CIS crude export | | | | |
|----------------------------|-----------------------------|------|------|------|------------|
| | 1999 | 2000 | 2001 | 2002 | 2003 |
| Total | 98 | 118 | 125 | 139 | 164 |
| Financial group owned | 90 | 111 | 129 | 142 | 180 |
| <i>of which 3 largest</i> | 104 | 147 | 178 | 190 | 239 |
| Oil industry insider owned | 86 | 100 | 111 | 124 | 131 |
| State controlled | 86 | 104 | 97 | 99 | 109 |

Source: Ministry of Energy, InfoTEK, Renaissance Capital estimates, RIANTEC, OECD calculations.

7 December 2004

Washington, DC

Export performance of main sectors



* Physical volumes

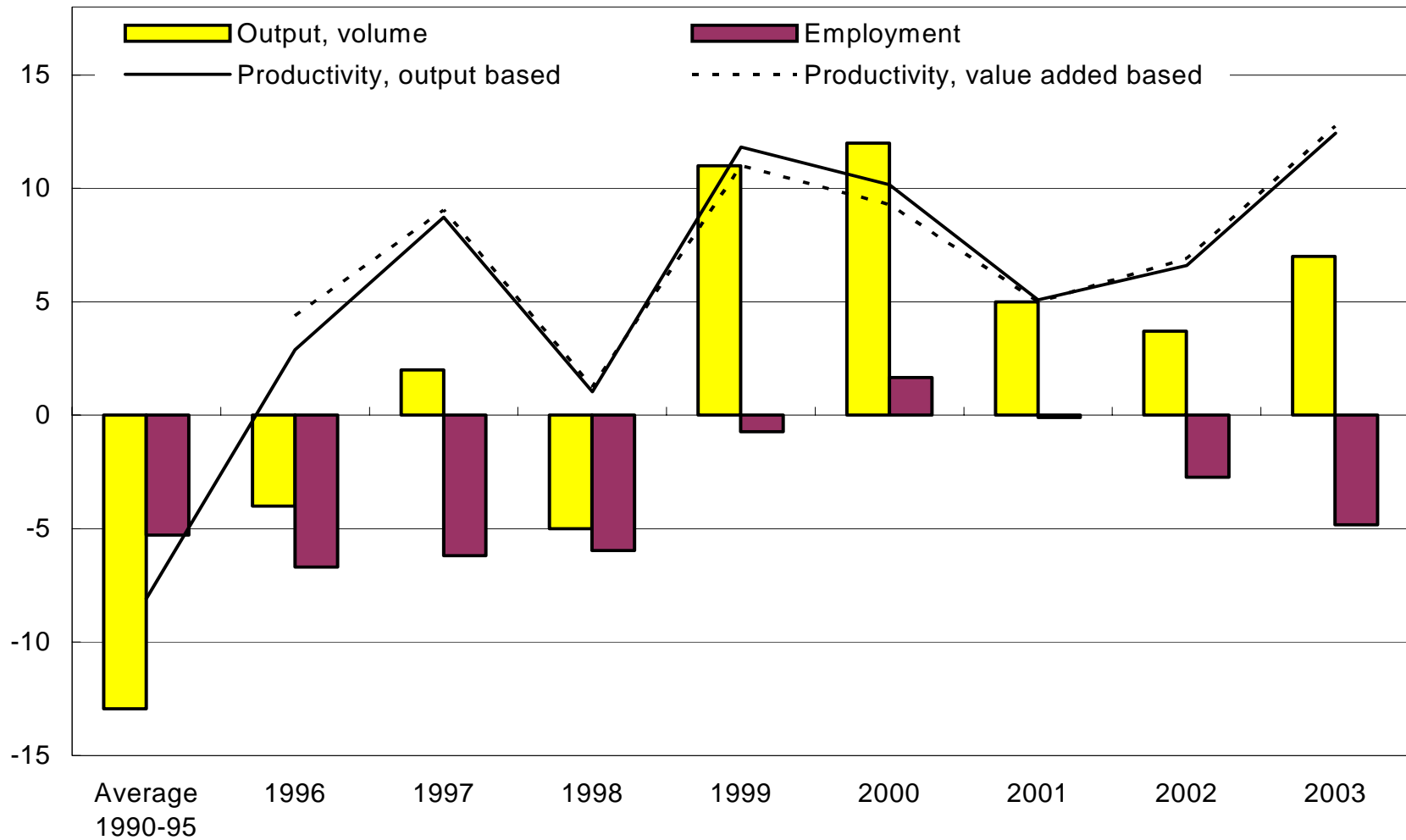
^ Real roubles

7 December 2004

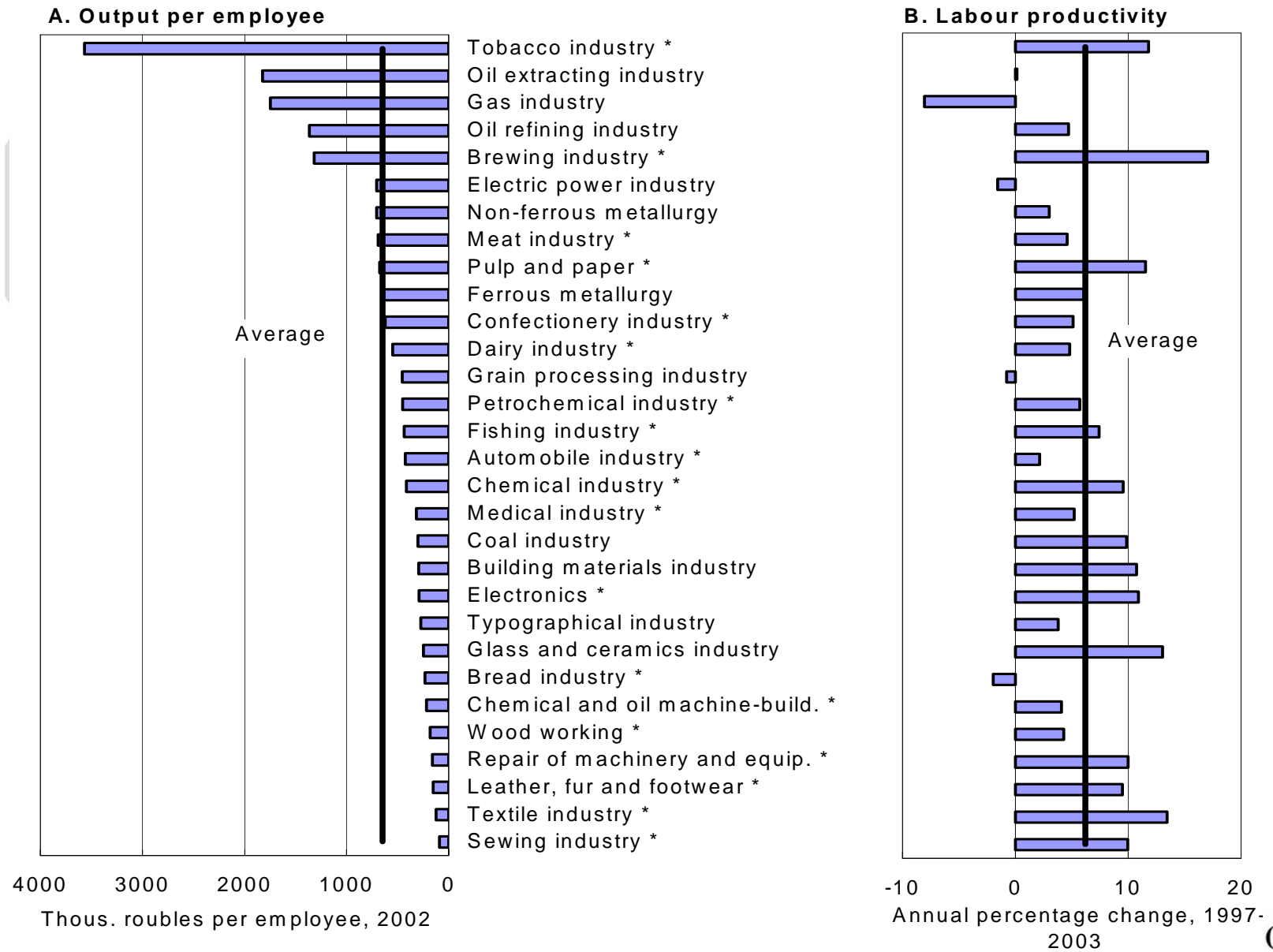
Washington, DC

The composition of industrial productivity growth

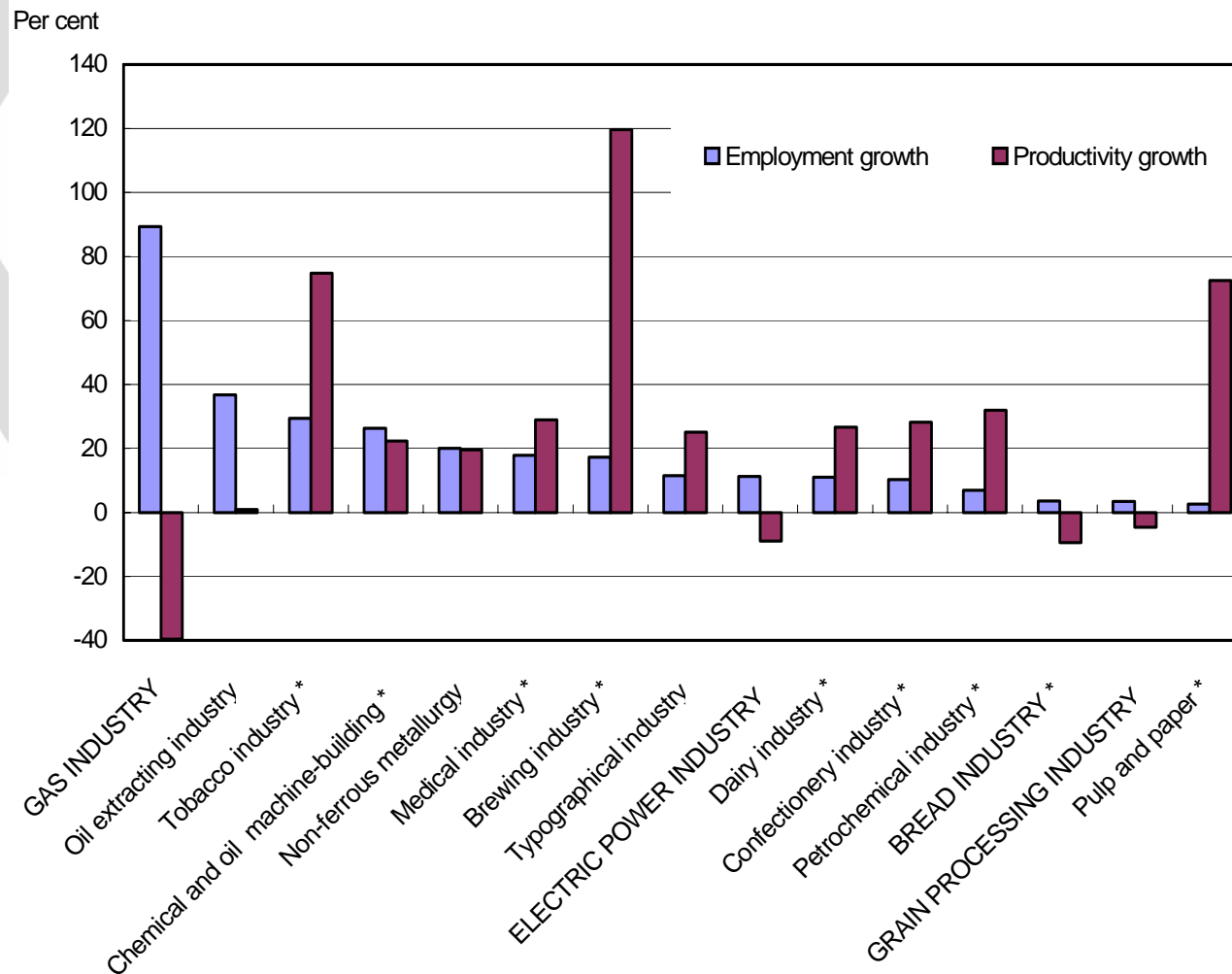
Per cent



Productivity: levels and changes in important industrial sectors



Employment and labour productivity, 1997-2003



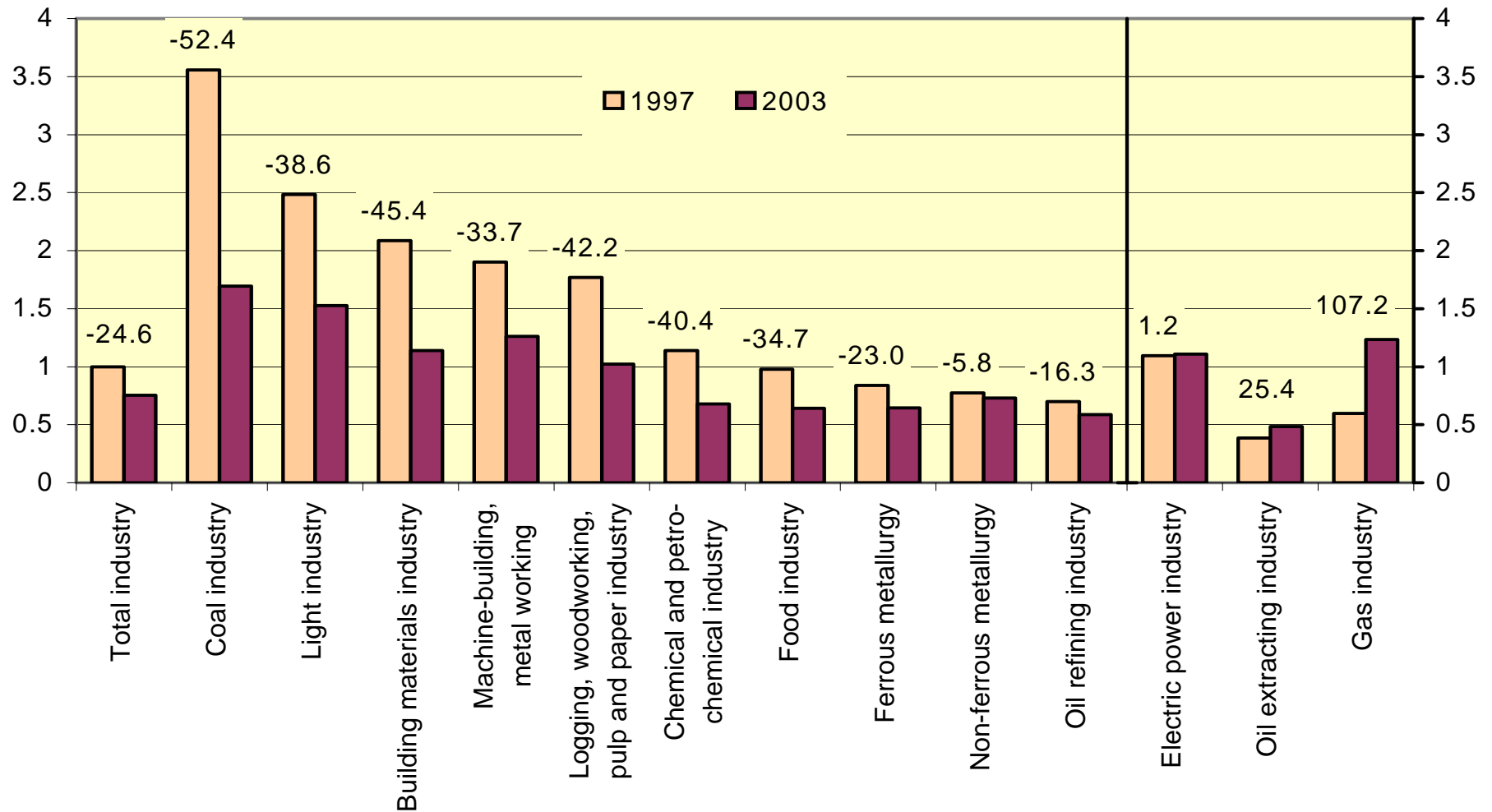
* Data for 1997-2002.

7 December 2004

Washington, DC

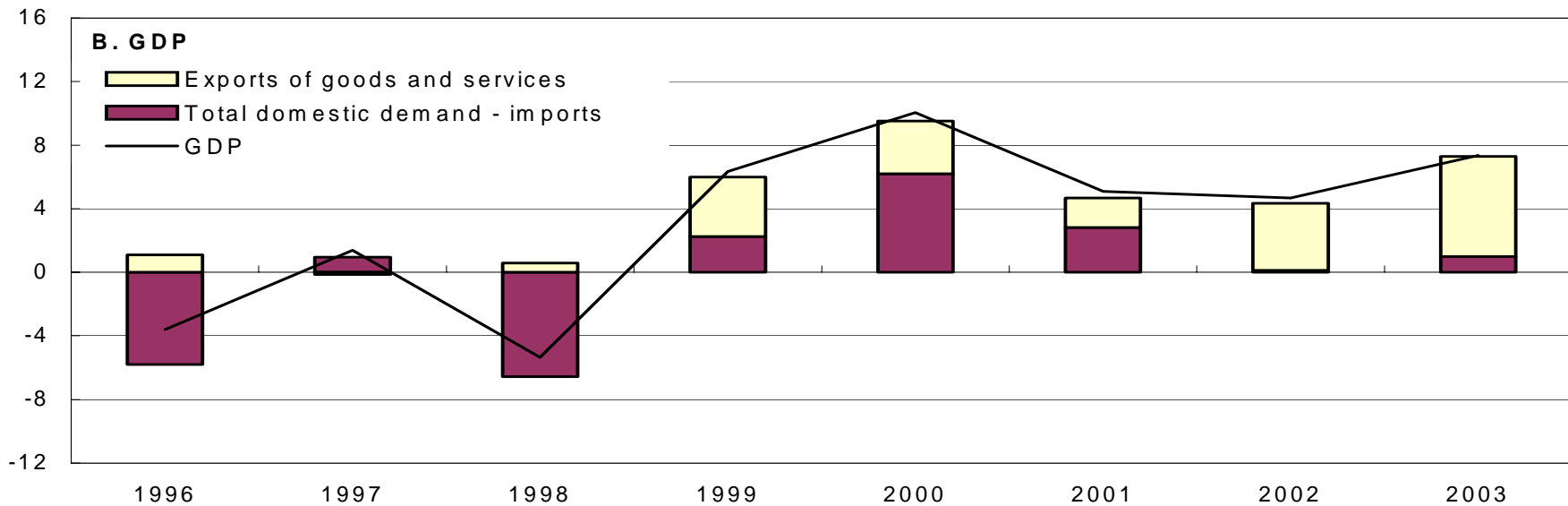
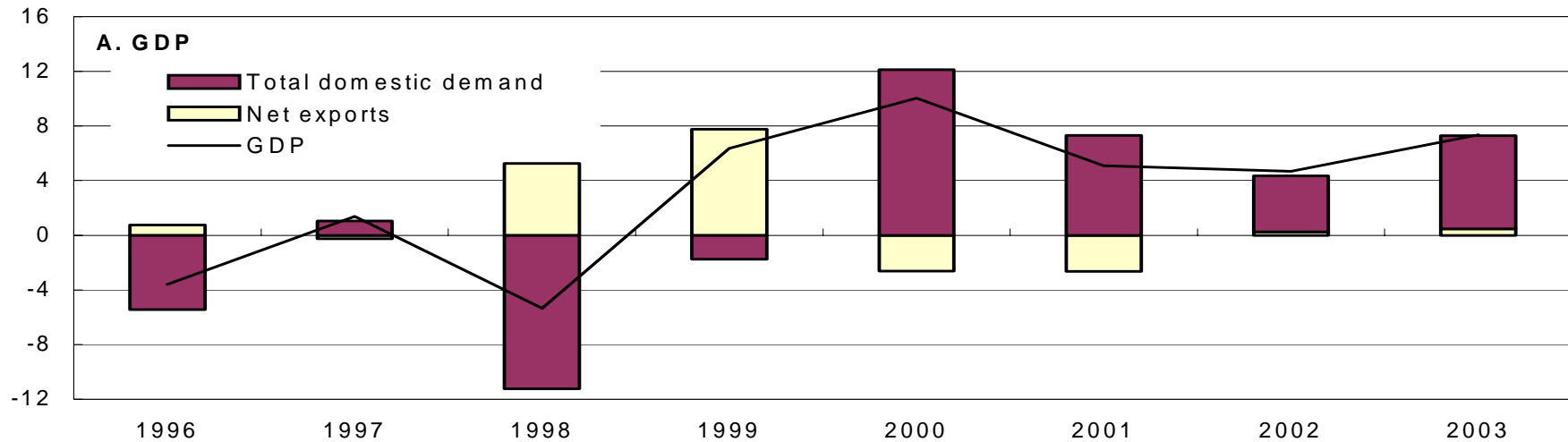
Unit labour costs by industry

Relative to total industry in 1997=1



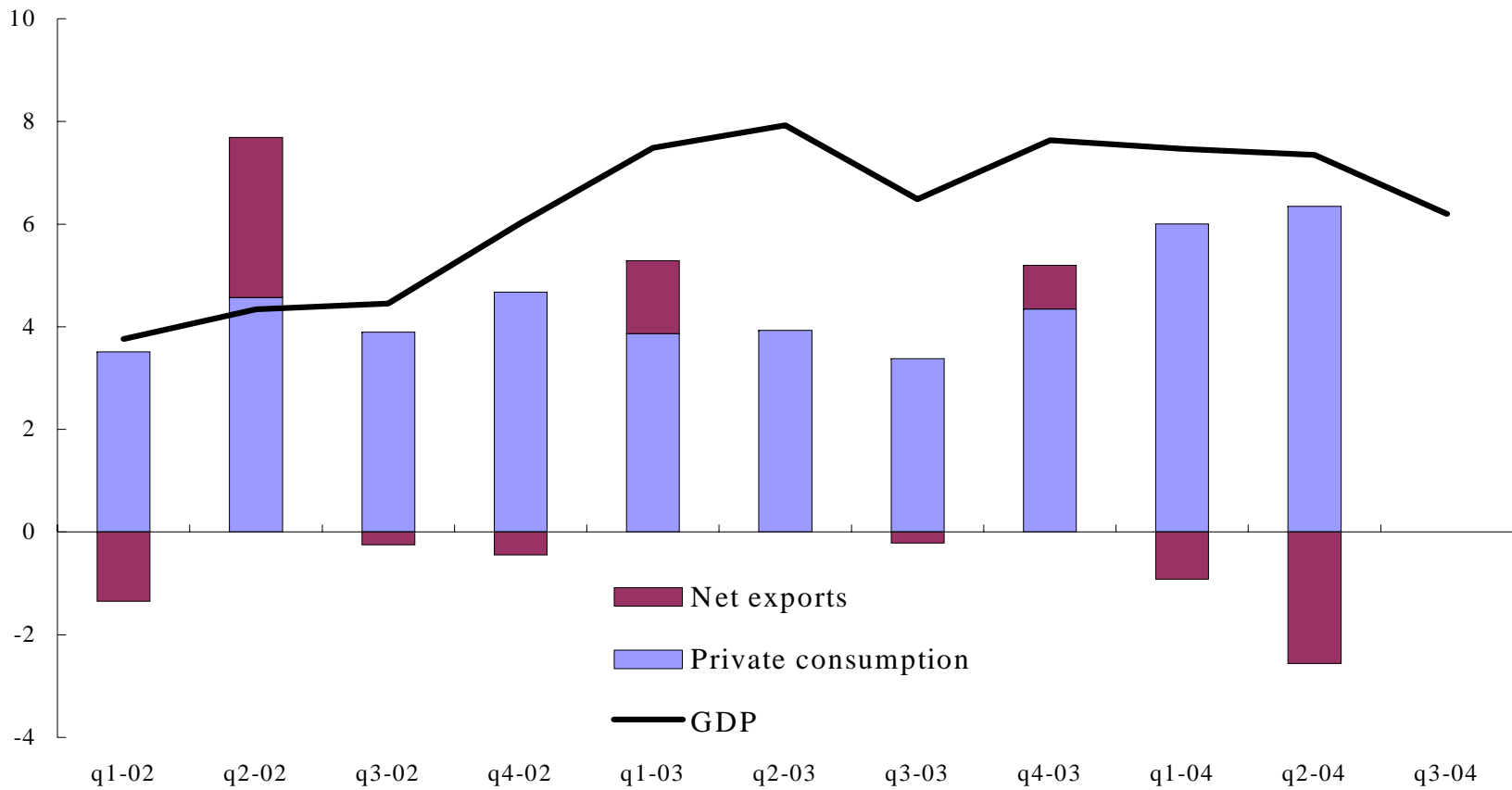
Note : The figures above columns represent percentage growth rate 1997-2003.

Contributions to GDP growth: Demand Side



Contributions to GDP growth: Demand Side Quarterly

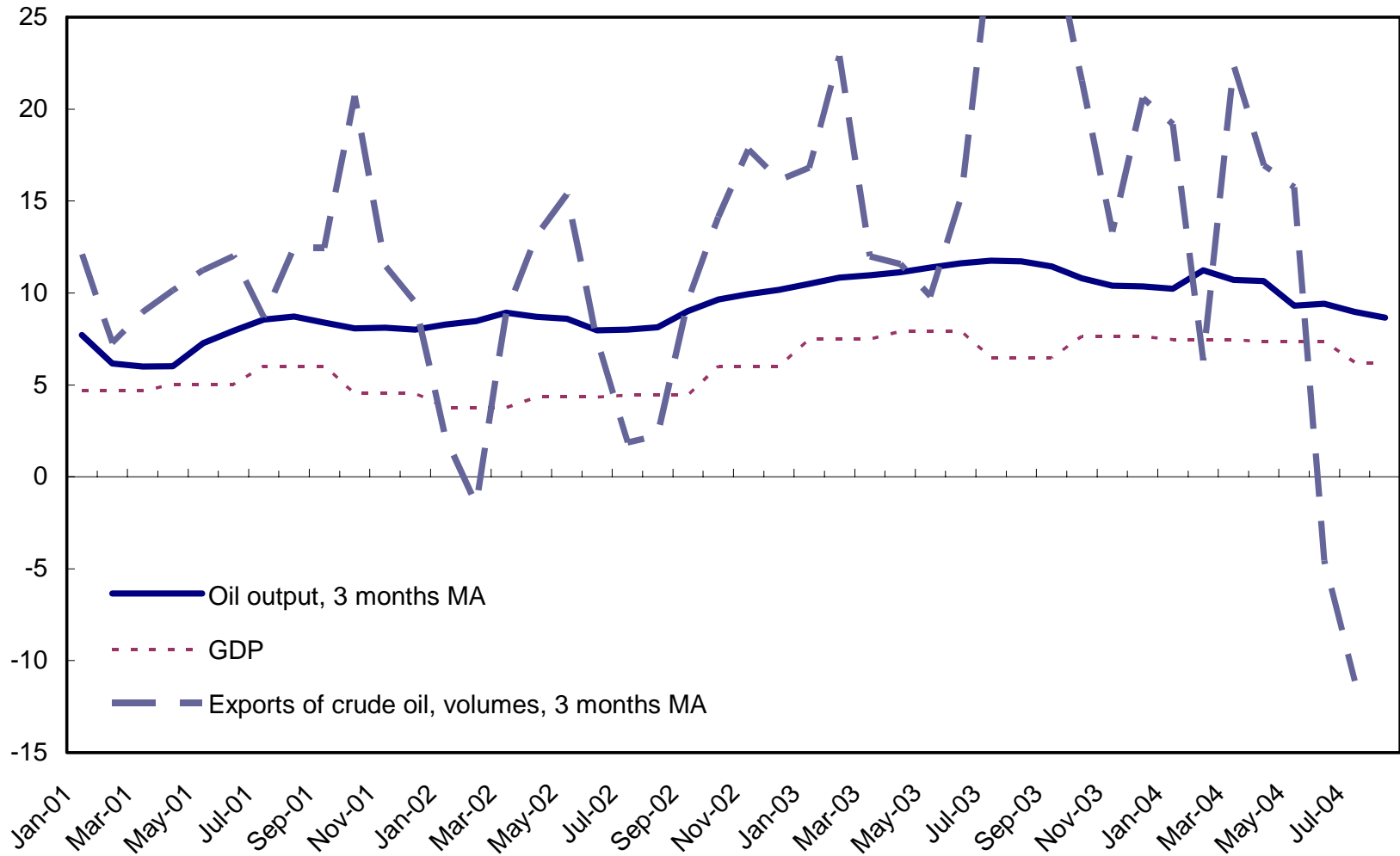
Contributions to GDP growth



Oil Extraction, Oil Exports, and GDP

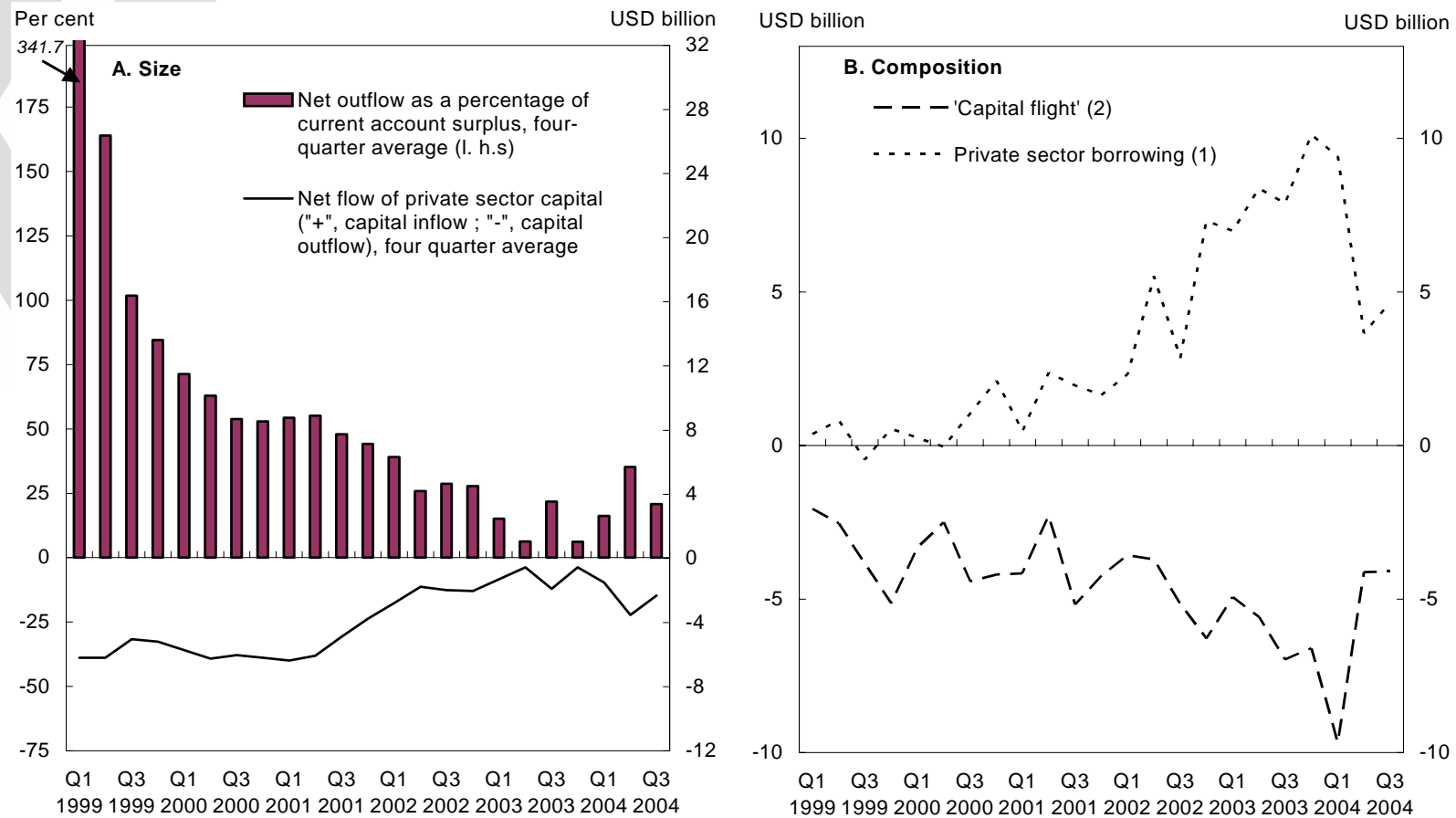
Growth, y-o-y

growth, y/y



Food for Thought for Western Bankers

Net private capital flows



1. Net loans to non-financial enterprises and households and changes in liabilities of banks.
2. Non-repatriation of export proceeds and non-supply of goods and services against import advances plus errors and omissions.

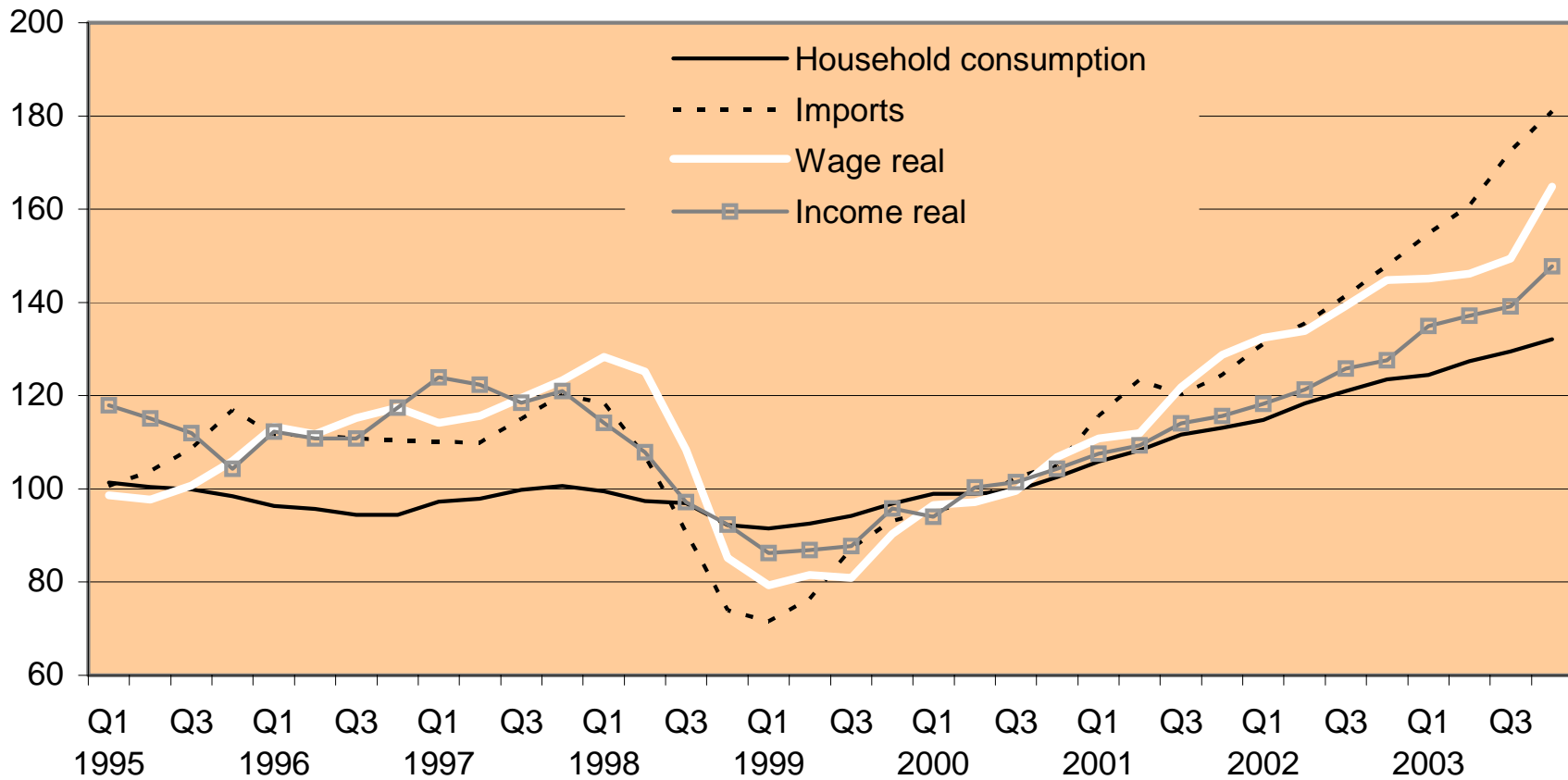
Source: Central Bank of Russia.

The challenge of sustaining growth

- Sustained high growth will in all likelihood bring with it continuing strong increases in imports.
- The current-account surplus could disappear faster than one might think.
- Structural dependence on foreign capital inflows would be a dangerous option for Russia at present.
- Sustaining such growth will therefore require continued strong growth in exports.

Income, consumption and imports

Index 2000=100; SA



Russia's Export Profile Will Not Change Rapidly

- Given the structure of Russian exports, sustaining export growth implies, in the first instance, further increases in resource exports.
- Sustained growth in hydrocarbon exports will probably require new pipeline capacity, as well as gas sector reform and better protection of property rights.
- Even if exports of non-resource goods and services rose rapidly, they would grow from a very small base and thus have only a limited impact on overall growth for some time to come.

What policy challenges does this imply?

To make the most of its current endowments while limiting the risks associated with resource-dependence, Russia will need to:

- cope with external vulnerability;
- counteract ‘Dutch disease’ pressures; and
- work all the harder to create sound institutions.

Coping with external vulnerability

Exemplary fiscal policy:

- Budget must balance over oil price cycle
- Large stabilisation fund
- Avoid using windfalls to finance permanent tax cuts or spending

Also:

- Aim for low external debt (both public and private)
- Support de-dollarisation of economy

Federal budget:

Key variables with different oil price assumptions (as share of GDP)

| | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 |
|--|-------------|-------------|-------------|------------|------------|-------------|------------|
| Actual revenues (excluding Social tax) (1) | 10.8 | 9.2 | 12.8 | 15.5 | 17.8 | 17.2 | 16.7 |
| Revenues assuming average oil price (2) (\$19-Urals) | 12.6 | 10.4 | 13.2 | 14.1 | 16.2 | 15.3 | 15.0 |
| Oil windfall (3) = (1) - (2) | -1.8 | -1.2 | -0.4 | 1.4 | 1.6 | 1.9 | 1.7 |
| Actual budget balance (4) | -7.4 | -5.0 | -1.1 | 1.4 | 3.0 | 1.7 | 1.7 |
| Budget balance assuming average oil price : | | | | | | | |
| (\$19-Urals) | -5.6 | -3.9 | -0.7 | 0.0 | 1.4 | -0.2 | 0.0 |
| (\$12-Urals) | -6.0 | -4.4 | -1.9 | -1.0 | 0.0 | -2.1 | -2.0 |
| Actual budget surplus as a % of oil windfall ((4) / (3)) | | | | 103 | 190 | 88 | 100 |

Combatting “Dutch Disease”

- Resistance to Dutch Disease so far: a lucky side-effect of the Soviet inheritance?
- The need for continued active restructuring in the non-resource parts of industry
- Shift of tax burden towards natural resource dependent activities
- Avoidance of large exchange-rate movements
 - a large, well-managed stabilisation fund and countercyclical fiscal policy
 - better sterilisation possibilities for CB also important

Russia: Recent Policy Developments

Fiscal Easing

- Planned use of oil windfalls to finance tax cuts.
- Retreat from the policy of balancing across the oil-price cycle.

Stalled Reforms

- Paralysis following spring government reorganisation.
- Delays to infrastructure reforms.
- Wobbles on banking reform.

The “Commanding Heights”: Forward into the Past?

- Gazprom’s expansion plans.
- Tightening the state’s grip on ‘strategic sectors’.
- Banking on continued very high oil prices.



Thank you for your attention.

For more information:

www.oecd.org/eco/surveys/russia

William Tompson

william.tompson@oecd.org