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Russia’s Place in the Global Economy.

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The global economy is a huge organism living according to its own laws, and Russia is an important element in it. In 2004, according to estimates of the International Monetary Fund, the World Gross Product in current prices and at current exchange rates reached $40 trillion, or $53 trillion if based on purchasing power parity. Of this sum, the United States accounts for about $11 trillion, while Europe has a comparable figure. China’s Gross Domestic Product is $1.25 trillion, and its GDP based on purchasing power parity is twice as large.

All developed countries belong to the Organization for Economic Cooperation and Development (OECD), which accounts for about 80 percent of the World Gross Product. China and India account for the bulk of the remaining part. Russia’s GDP at current exchange rates is about $400 billion, and its GDP based on purchasing power parity is three times larger. These figures are the starting point for any analysis of Russia’s position in the contemporary world.

Issues involving the development and modernization of the Russian economy came to the forefront of public debate as Russia recorded its fifth consecutive year of economic growth. One of the problems is the low savings rate in Russia (21 percent of the GDP) despite the high economic growth rate over the five years. The savings rate in Russia is lower than in any of its neighbors, and much less than any in other post-Communist states.

Accelerated growth per se can be achieved through different models of economic development, at least in the short term. The growth of GDP has become a topic of discussion amongst non-economists as well, largely because the Russian government uses this index to evaluate the growth rate of the Russian economy.

Many politicians tend to confuse the growth of the GDP – the result of an increase in employment and productivity – with production growth. A per capita GDP is an actual indicator of productivity and economic efficiency: the nation that produces much over a year is economically developed.

There also exists the notion of purchasing power parity (PPP), which shows the difference in the standards of living. For example, if we calculate the cost of the consumer properties of Russian education, healthcare and housing, it appears that Russians have consumed almost three times more than the amount calculated in current prices. According to the IMF's estimates for 2002, Russia's GDP in current prices stood at about $2,500 per capita, but the same GDP based on PPP reached almost $8,000 a year. In China, consumption calculated at current exchange rates is $1,000 per capita, whereas based on PPP it is twice as much – $2,000. In the United States, the two indices actually coincide, reaching $36,000.

Of the approximately 180 member countries of the United Nations, about 70 are very poor. This group of countries is characterized by the following three criteria: a per capita income of less than $800 a year; high infant mortality and low education standards (social index); and an unstable economy with problems such as, for example, single-industry dependence. The Maldives, which has a per capita income of $2,000, provides a classic example of such a country. At first glance, it would seem this is a rich country. All its wealth, however, was based only on the tourist business, which was undermined first by the war in Iraq and then by the catastrophic tsunami that struck the region on December 26, 2004. This is what is called single-industry dependence. For example, a country might have a quota for tuna fishing, but once it is denied this quota, its GDP will immediately fall, and the country will find itself amongst the underdeveloped states.

More than half of all countries in the world (including China and India) are poor, that is, they have an average per capita income of less than $1,000. This should not be confused with absolute poverty when daily per capita income does not exceed one dollar. Of this sum, 80 cents is spent on consumption. Countries with a GDP of $300-400 (the same one dollar per day) spend all their income on food; they must constantly struggle against poverty. The development of these countries depends on foreign aid.

The GDP of poor countries ranges from $1,000 to 3,000. Russia's GDP, estimated at current exchange rates, could well place it among the poor countries had it not been for the low ruble rate as compared with the ruble's real internal purchasing power.

As for the other post-Soviet countries grouped in the Commonwealth of Independent States, almost all of them rank amongst the poor countries, as well as being single-industry dependent. Using the criteria of the UN Committee for Development Policy, their per capita GDP is below $800. At the same time, if we take social indicators (high infant mortality and low educational standards), the CIS countries do not meet the UN poverty criteria: they still boast fairly sound public health and secondary education services inherited from Soviet times.

The GDP of medium-developed countries ranges from $5,000 to $10,000-12,000. Several post-Soviet countries, many of the Latin American states and some countries in Africa and Asia have a GDP of $3,000 to $5,000. The GDP in the East European countries which have joined the European Union and NATO – Poland, Hungary and the Czech Republic – stands at $8,000 to $12,000. Slovenia is the richest East European country with a GDP of $15,000, which puts it on a par with the medium-developed Spain and Portugal.

The developed countries of Western Europe have an average per capita GDP of $20,000 to $25,000, that is, ten times more than in Russia at current exchange rates. Some countries have even higher GDPs – $35,000 to $40,000.

Also of much importance is the way incomes are distributed within a society. Any country with a relatively long history will inevitably have rich elite. In developed countries, the top richest 10 percent of the population account for about 25 percent of incomes. As a reference point and as a norm, let us take incomes distribution ratio of 20:40:40, that is, 20 percent of the richest people, 40 percent of middle-income people, and 40 percent of relatively poor people. In the developed countries, incomes distribution ratio is 40:40:20, that is, the richest 20 percent of the population receive 40 percent of incomes; the 40 percent of middle-income people receive 40 percent of incomes; and the 40 percent of poor people receive only 20 percent. The lower 10 percent of the population around the world are poor – they account for a mere two to three percent of all incomes.

The incomes distribution in Russia conforms to the Latin American model. Instead of the European 20:40:40 ratio, the Russian population receives incomes at a ratio of 50:35:15. The top 20 percent of the population account for 50 percent of all incomes; the 40 percent of middle-income people receive 35 percent of incomes; and the lower 40 percent have only 15 percent of incomes. Obviously, this is not the best possible social structure. Moreover, the top 10 percent of the Russian population accounts for

35 percent of all incomes – as much as the top 10 percent of the population in Argentina or Brazil. This is an alarming analogy, especially when we consider that the countries of Latin America with skewed incomes distribution are prone to military coups, unstable democracies and numerous social problems.

Russia has the Latin American structure of incomes distribution, although it is located in Europe, enjoys the status of a great nuclear-armed power, a permanent member of the UN Security Council and a member of the Group of Eight leading industrialized nations. Yet Russia's GDP on average is ten times less at current exchange rates than that of the developed countries, or is about four times less if estimated on the basis of the population's purchasing capacity. Certainly, Russia is much better off with its $8,000 of an actual GDP than poor countries in Africa; it is on a level with Latin America and Eastern Europe. Brazil is the country most similar to Russia as regards its development level and economic structure, not to mention the inconvenience of its constitution. Take any data on Brazil, replace its name with Russia, and there is almost no difference.

Yet there is a major difference between the two countries – the lower 40 percent of the Brazilian population are uneducated, and there is no simple and inexpensive way to change this situation; therefore, illiteracy and poverty in Brazil are constantly reproduced. Thus, Russia is closer to Latin America in terms of its social structure and to Europe in cultural traditions, whereas as regards its political status, Russia – as the successor to the Soviet Union which invested huge funds and efforts in the development of a military arsenal – is a great power and a member of the UN Security Council.

The gap between wealthy and poor countries of the world is 40 to 60 times. The gap between wealthy and poor regions in Russia is almost the same, which consequently results in many political, economic and other challenges to the country. Moscow has already caught up with Portugal in terms of its Gross Regional Product, while Russia's Samara Region is on par with Poland. Meanwhile, the economies of many other Russian regions are developing very slowly and are dependent on redistribution from other regions. The leveling of regional economies cannot be achieved by simply leveling regional budgets; this can be done by creating conditions that are conducive to fast growth in the leading regions, which would then spur growth in other territories. An even regional development across the board is simply impossible.

The structure of the Russian economy was built in Soviet times to meet – figuratively speaking – the needs of theoretical World War IIs, because economists, like generals, always prepare for wars that are already history. For half a century, from the 1930s to the 1980s, the Soviet economy was focused on building up heavy industry in anticipation of a global confrontation. Besides, the Soviet Union produced numerous missiles and – useless – tanks, which required a huge amount of titanium and aluminum. In addition, Russia extensively built railroads since it has always been easier to transport cargoes and people across its vast distances by rail rather than road. And although Russia now prefers automobiles, the simple inertia prevents it from constructing highways.

The Soviet Union once controlled (politically) a large economic “camp” which comprised Eastern Europe, then underdeveloped China, Vietnam, some countries of Africa and even Latin America. Even if we do not consider China, the population of the “camp” reached some 600 to 700 million people. The Soviet Union provided subsidies to these nations, gave them patents, trained their specialists, and so on. Those countries purchased Soviet equipment, and Moscow subsidized those purchases in different ways. The entire Soviet machine-building industry worked to supply that large group of relatively undeveloped countries. Before the Communist camp was formed, those countries had been supplied with machinery and consumer goods largely from developed European countries.

Between the 1950s and the 1990s, the Soviet Union, together with Czechoslovakia and East Germany, formed the industrial center of a large political bloc, and supplied the periphery of this bloc with cheap oil (another form of subsidization, albeit a concealed one), weapons, machinery and equipment. When this political system collapsed, Russia’s heavy engineering and metal-working industries lost their politically controlled markets. Since then, the entire machine-building sector (besides automobile production) has never overcome the crisis of the transition period. Although the last three years have seen a significant growth rate in this sector (10-15 percent), this increase began from an extremely low level. Whereas the car-making industry has remained at a high level (70-80 percent of the pre-crisis output), production in the other machine-building and metal-working industries has decreased by five to six times. Perhaps, Russia could have retained some of its former markets where customers were accustomed to using Soviet equipment. But that goal presupposed the implementation of sensible industrial and export policies by Russia in the 1990s, including export financing and crediting (for nuclear power plants, for example), together with efficient corporate management. No such program, however, was ever activated.

Now that the Soviet Union has vanished, we live in a more compact country. Moreover, Russia inherited about 80 percent of the Soviet Union's former territory and the larger part of its natural resources. Apart from Russia, only Kazakhstan possesses extensive natural resources, while Turkmenistan and Uzbekistan possess gas fields. The other natural resources are of an insignificant scale. Russia inherited about 60 percent of Soviet equipment and physical assets; other industrial production was formerly concentrated in Ukraine, Belarus, Armenia and, on a much smaller scale, in the Baltic republics. Latvia shut down three notable Soviet enterprises, which could have been a lucrative source of revenue; these were the Riga-based electric train plant, the factory which manufactured the famous Spidola radio sets, and the plant which built RAF minibuses, which now would be in strong demand.

To sum up, Russia has received 80 percent of the Soviet territory, 60 percent of assets, 60-65 percent of industrial facilities, about 50 percent of agriculture – yet only 51 percent of the population! The other half of the former Soviet citizens have remained largely in Central Asia and Ukraine. These two factors – an expansive territory with a relatively small population – explain the present-day large-scale migration to Russia. This is a classical type of migration of an active labor force to economically active regions, which has been occurring in America since the late 19th century and in Europe since the end of World War II.

Censuses conducted in the post-Soviet countries estimate that about two million immigrants have arrived in Russia from other parts of the former Soviet Union. This number is not very significant. In the U.S., for example, there are some 10 to 12 million illegal immigrants alone, while Europe has several million Turks and approximately the same number of Serbs. In France, there are several million Algerians, while Belgium is home to about one million Kurds and half a million Arabs.

There are about 250,000 Chinese in Russia now, but this cannot be described as a large-scale immigration. In the U.S., by comparison, half a million Chinese live in a compact community in the suburbs of San Francisco alone. They do not speak English since they do not associate with native Americans, nor do they need to know English in order to find a job or get married. Enclaves, like those in France, are not compact settlements, and people living in enclaves adapt to life in their new country. In contrast, immigrants living in compact settlements do not feel the need to learn the local language, and live their own life according to their native customs.

In Russia, there are probably several more million permanent or seasonal migrants who have not been covered by censuses. These are comprised of Georgians, Azerbaijanis, Armenians, Belarusians, and Tajiks who have fled conflicts in their native country, as well as many Ukrainians. Thus, it is obvious that much of the active labor force from the CIS has found work in Russia. This country exports highly educated people to the developed countries and imports inexpensive labor for low-paid jobs; this is a generally accepted practice.

Migrants in Russia create certain problems, of course, but these problems are of a different kind than, for example, the problems that arose in Germany in previous years. Immigrants to Germany were mostly comprised of Turks, Kurds and Serbs who did not speak the German language and did not know German customs. In contrast, migrants coming to Russia know the Russian language; many grew up in the Soviet Union and graduated from Soviet schools. As a result, they adapt to life in Russia very quickly. During the first few years after the Soviet Union’s breakup, very many people with a higher education came to Russia to do unskilled labor. Later, many of them settled in this country and started a business – here or in their own country. These are already different models of adaptation.

Migrants from the former Soviet republics now working in Russia transfer their earnings – about $10 billion a year – to their home countries. At the same time, Russia continues supplying those countries with cheap natural gas. Presently, only three countries in the world attract such a large labor force from abroad – the U.S., Saudi Arabia and Russia. Migrants annually export $30 billion from the U.S., and $16 billion from Saudi Arabia. In this respect, Russia is in good company.

This seems to be a normal state of affairs and this is how things stand in the whole world. The per capita GDP of Ukraine, for example, is $600 a year, while Russia stands at $2,500 – a four-fold difference in the living standards between the two countries. How can one stop a man from crossing an open border in order to earn four times more? Migrants in Russia earn much less than the native population, while most of the new arrivals are denied equal rights with Russians on the labor market. Migrants are inexpensive, and Russian businesses make profits from their labor. The main problem involving migrants in any country is the legalization of their economic activity, their registration, and the levying of taxes on them and their employers. A recently passed law on migrants permits migrants to stay in Russia without a registration for up to 90 days. This was a step in the right direction, but it is also very important that the federal tax inspectorate find all the foreign workers.

It is good that migrants to Russia export a portion of the money they earn, because Russia is interested in the development of the CIS as a market for it goods. If foreign workers produce or build something in Russia, if they earn and then export money, they will later purchase something in Russia – be it goods or services. More importantly, however, the migrants should produce more than they export, as is the case with, for example, the U.S. or Saudi Arabia. Such a scenario conforms to the logic of labor migration.

It is bad that the labor market is splitting. No Muscovite would agree to work as a street-cleaner or an oil industry worker in Tyumen, for example. Russians complain that migrants, who agree to less pay for their labor, take jobs from native-born workers. At the same time, however, Muscovites do not want to accept hard jobs, even if these jobs pay much. There is an obvious tendency toward substituting native Russians with Russian-speaking migrants. There have emerged large segments on the labor market where only skilled migrants work. In Moscow, for example, the drivers of buses and trolleybuses are mostly Belarusians and Ukrainians. This is competition in action. Migrants agree to less attractive terms of employment, and businessmen hire those whose labor costs less. Thus, both the business community and Russia gain from migrant labor.

Now let’s see how Russia is involved in the global economy. It ranks second in the world – between the U.S. and France – in the export of armaments. Russia has always been good at making armaments because the Russian empire developed as a military power. Russian artillery has been the best in Europe since the times of Catherine the Great and this explains why Russia has retained solid positions on the global arms market, despite low funding from the state. Russia has begun to lose ground, however, in other related fields which it could have held, such as the production of nuclear reactors and electric power plants. No one would buy a reactor for cash, as it would be too expensive. The construction of nuclear power plants must be credited; in this way Russia could support exports from its competitive industries. However, Russia has never built an export finance system.

Another aspect of Russia's involvement in the global economy is its human resources. The most active labor force in Russia prefers to migrate abroad. There are now about two million migrants from the former Soviet Union in Germany, and about a million in the U.S. They are all described as Russians there, irrespective of their nationality.

At the Russian universities, the number of applicants for the departments of physics, biology, mechanics and mathematics has once again increased. These professions open good career prospects upon graduation: people who have received a high-quality education in Russia are welcome in other countries since Russians have proven themselves to be competitive workers.

Biological scientific institutions in an average U.S. state use migrant labor, including young Russian scientists. At the same time, Russian professors continue to teach people 'for export.' Economists are another kind of specialists that leave Russia every year. In this way, Russia has exported a large part of its middle class.

On average, educational standards in Russia are higher than international statistics, but in terms of scientific research they have been decreasing due to the lack of scientific equipment. In the last three years, the number of people admitted to Russian institutions of higher learning has equaled the number of high school graduates. In this aspect, Russia has even outclassed American standards. On the other hand, why does Russia need so many educated specialists when it does not create enough jobs for them?

Nevertheless, young Russians want to receive an education, and they cannot be denied this opportunity. In the 1990s, the country reacted to the economic crisis not by degrading educational standards but by adapting them to the new economic situation. The demand for education in Russia has increased, which inspires hope for the future. In the long run, economic and political problems will be solved, and the country, having ceased to be the center of a huge political system, will adapt, even though with much difficulty, to its new role on the international scene.

Energy makes up the third aspect of Russia's involvement in the global economy. However, Russia's energy potential is based solely on oil from Tyumen and Sakhalin, and on the export of aluminum (cheap electric power) and chemicals (cheap gas). The Gross Regional Product (GRP) of Moscow better corresponds with world oil prices than the GRP of Tyumen. In other words, a significant amount of the funds that derive from the regions which produce oil and raw material are invested in other regions – specifically in Moscow. Thus, if we divide Moscow's GRP by the number of people employed in the city, we will have a value that will be four times the average figure for the Central Federal District (excluding Moscow).

Obviously, productivity cannot be four times different on either side of Moscow's borders. The explanation is that Moscow's GRP also features incomes earned in other regions, above all, in the oil-bearing areas. The dimension of this capital flow can be judged by the dynamics of housing construction: in 1995, the Moscow area accounted for 12 percent of newly built housing in the country, and in 2002, it already accounted for over 27 percent. Now more than 25 percent of all new housing in Russia is built in the Moscow area.

Russia's wellbeing is hinged on the energy sector for one simple reason: this is the only sphere of the economy where Russia is guaranteed steady future incomes. During the years of its economic growth, Russia has not introduced a single new manufactured product on the world market. Russia produces few products that can compete with European, American or Chinese goods. Science-intensive goods are almost non-existent in the structure of Russian exports.

As a result, Russia simultaneously exports oil, oil revenues and educated people. Russian biologists, who in Russia earn $5,000 a year at most, move to the U.S. where they stand to earn $50,000-100,000. By encouraging its educated citizens to move abroad, Russia increases the effectiveness of the global economy, but does very little for its domestic economy. Russia has two major kinds of resources – human capital and natural resources, but it only really employs the latter.

Russia exports more than half of its oil, one-third of its natural gas, a huge amount of timber and paper, and much of its nonferrous and ferrous metals, largely because the domestic economy does not need all these resources. Russia is unable to change its place in the global economy – that of a raw-material supplier. Nothing of what Russia produced in the 1980s was accepted by the world market at free prices; since then, this country has produced nothing new since it has had "more important" things on its mind. This is one of the tragedies of the transitional period – Russia has solved many problems, but not the problem concerning its economic modernization. This problem will have to be solved by the next generation.

In 2004, Russia took the lead in global oil production, leaving behind Saudi Arabia. Additionally, Russia remains a major producer of natural gas and is the largest gas exporter in the world. It must be noted that when Russia exports chemicals, fertilizers, ferrous and nonferrous metals, in reality it also exports energy. The production of metals in Russia is the "packing" of cheap electric power in iron and copper. Considering also oil, gas, coal and electric power "packed" in aluminum and chemicals, Russia is the main source of energy resources in the world – now and, possibly, in the future. Russia can retain its leading positions in the world economy if it continues exporting energy within reasonable limits.

During the 15 years of Russia's transitional period, the position it has now assumed in the global economy is not fantastic, while the last five years of its economic growth have served to consolidate rather than improve this place. Russia's economic programs do not look far enough into the future and do not look for solutions to difficult development problems. The historic task of the present generation is to find a way to reinvest revenues from the export of raw materials and energy in machine-building, metal-working and science-intensive products. It is necessary to create new production facilities that would be competitive on the world market, while corresponding at the same time to Russia's high educational levels.

The main challenge that the next generation in Russia will have to address is to determine where and in what industries it should create jobs from revenues from raw-material exports. All present-day discussions of the economic policy boil down to this question: How to reinvest revenues from oil, gas, metals and fertilizers in the creation of normal jobs inside the country?

Russia has extensive resources but few variants for using them. One of them is to continue increasing consumption, modernizing the army and boosting the country's military-political prestige. All this can be easily done with petrodollars while oil prices are still high. Another variant is to try and get out of the track into which this country slid after the 1917 Bolshevik revolution. This will not be an easy task, but if it is not achieved Russia will remain where it is now.

<u>Macroeconomic Indices of Russia's Development in 1997-2003</u>

Indices Average Average	1999	2000	2001	2002	2003	2004*	1997-2000-	1999 2003
GDP growth rate, %	0.7	6.8	6.4	10.0	5.1	4.7	7.3	6.8
Industrial production	2.4	6.8	11.0	11.9	4.9	3.7	7.0	6.4
Investment in fixed assets	–2.3	10.2	5.3	17.4	8.7	2.6	12.5	10.9
Final household consumption	–0.5	8.4	–2.9	7.3	10.1	8.8	7.4	11.3
Inflation (December to December), consumer prices	40.8	16.4	36.5	20.2	18.6	15.1	12.0	11.5
Unemployment (ILO), %	12.5	8.8	12.6	9.8	8.9	8.6	7.9	7.4
Federal budget deficit/surplus, % of GDP	–4.7	1.8	–1.1	1.3	3.0	1.4	1.6	4.8
Foreign debt, % of GDP	59.2	41.0	82.0	57.5	44.1	35.9	26.4	23
Trade balance, $ billion	22.5	53.6	36.0	60.2	47.9	46.3	60.0	78.0

Oil price (Urals), $ per barrel	15.9	25.1	17.2	26.6	22.9	23.6	27.3	35.0
Exchange rate, R/$, as of the end of the period	17.9	29.9	27.0	28.2	30.1	31.8	29.5	27.7
Gold and hard currency reserves, $ billion	14.0	47.3	12.5	28.0	36.6	47.8	76.9	135
Credit rates, %, average for the period	37.9	17.6	40.1	24.3	17.9	15.7	12.6	10.9
S&P rating (end of year)		SD	B–	B+	BB	BB+	BB+	
Moody's rating (end of year)			B3	B2	Ba3	Ba2	Baa3	Baa3

Sources: State Statistics Committee, Bank of Russia, Ministry of Finance.
* Estimation.