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Abstract

This paper looks at how the Russian economy has developed under the leadership of Putin and how it spills over to its neighbours in the CIS region. It stresses the importance of international oil prices as a determinant of policies and outcomes in Russia and highlights how this has impacted macroeconomic performance during Putin's different terms in office. Although Russia is not an economic superpower globally, the size and importance of Russia for the CIS region is significant and thus oil price changes also drive the economic development of non-fuel exporting CIS countries to a significant degree.

Keywords: Russia; Putin; macroeconomics; CIS; transition

JEL: E60; F40; O52

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Introduction

President Vladimir Putin came to power in 2000, just after the Russian economy had started to recover from the general economic mess of transition and its more specific debt and financial crisis of 1998, when GDP fell by 5 per cent. By 2000, the economy was riding the wave of the real depreciation and rapid turnaround of the government's finances that followed the 1998 crisis, which had already given the economy a boost in 1999. By the end of Putin's first year in office, the economy had grown by more than 10 per cent, at that time by far the most rapid growth since the dissolution of the Soviet Union and still the highest growth rate recorded by modern Russia. Gone were the days of a president losing control and overseeing an economic free fall; instead, a powerful new leader was born. This strong association between Putin's becoming the president and increased prosperity grew stronger as rising oil prices fuelled the Russian economy for the remainder of Putin's first eight years in the Kremlin.

To appreciate the change that occurred at the time Putin took over as president, it is useful to look back at the years just before 2000. What caused the crisis in 1998, and how was this crisis handled? First of all, the transition process that started in 1991 with the dissolution of the Soviet Union was associated with massive drops in output across the board in the former Soviet republics; by the time of Russia's 1998 crisis, its GDP had fallen by over 40 per cent since the start of transition (see Becker and Olofsgård 2018). Russia joined both the IMF and World Bank in the summer of 1992, and from then on the IMF and World Bank tried to help Russia create a stable macroeconomic framework and implement institutional reforms that would transform Russia to a modern market economy. By 1997, modern Russia had shown its first year of growth and a certain level of investor enthusiasm had taken hold. The IMF (1999) wrote that 'Expectations reached a high-point in mid-1997, when aggregate output

was at last growing, ... the Moscow Stock Exchange was the best-performing equity market in the world, and inflation had virtually ceased’.

But as in many other run-ups to emerging market crises, the fiscal situation was not under control, and the fixed exchange rate was propped up by not only increased borrowing, mostly foreign-currency denominated, but more and more by domestically-issued rouble-denominated debt. This ‘domestic’ debt, however, was also held by foreign investors, while the foreign exchange risk was off-loaded on Russian banks, so that the diversification of the government’s debt portfolio was largely optical. Without reforms that supported a sustainable government budget (or increasing oil prices), the crisis was bound to come, sooner or later. As the IMF team (IMF 1999) put it ‘...the erosion of federal government revenues... made a robust fiscal consolidation and durable macroeconomic stabilisation impossible.’

Then, at the end of 1997, a massive decline in oil and other natural resource prices hit Russia, and by August 1998 the crisis was on, with full force. The government defaulted on its short term domestic debt (‘GKOs’)¹ and called on the IMF for a financial support package to deal with its funding shortfalls and stabilise the economy. Again, market-oriented reforms, such as improving governance and the rule of law, were part of the program, in addition to the conditions regularly placed on reserves and deficits to ensure that the Fund eventually gets its money back. But again, little progress was made on these reforms, and Russia only received the first tranche of the loan from the Fund before the program was derailed. In the meantime, the macroeconomic forces of a large real depreciation and rebounding oil prices helped the economy recover and provided the foundation for Putin’s early economic success.

¹ GKO comes from the Russian term *Gosudarstvennoye Kratkosrochnoee Obyazatelstvo*.

Several important lessons were learned, or could have been learned from this period. Fiscal order is crucial to macroeconomic stability and independence from the Fund and other external forces that could constrain the policy choices of the president. The exchange rate is a crucial tool for managing the macroeconomy, but fixing the exchange rate is only possible when foreign exchange is abundant, so the accumulation of reserves is also a way to create independence from foreign influence. Finally, deep reforms aimed at governance and the rule of law, to help build a modern economy with strong investor confidence and protection, were always part of reform packages, but never implemented. Contrary to what some commentators seem to think today, this reluctance to implement serious, market-oriented reforms existed long before Putin entered the Kremlin.

Russia was of course not the only country that had to transform its planned economy in the early 1990s; the IMF (2014) provides a comprehensive overview of 25 years of transition in Europe's former communist countries. The report's authors state that countries that undertook early and comprehensive reforms benefitted from stronger growth and income convergence. This is related to a very substantial academic debate on shock therapy versus gradualism, and a full account of this is beyond this paper. However, in a recent policy paper, Djankov (2015) claims that there was no real alternative to the early privatisation that created many of the oligarchs, and describes the more recent developments as Russia's going from crony capitalism to state capitalism. Shleifer and Treisman (2005) point out that many observers in the early 2000s viewed Russia as a disaster, where most things went wrong. But, according to them, this was not an accurate description, since in many ways Russia was neither more nor less messy than other middle-income countries. With this perspective in mind, Russia had become a 'normal' middle-income country in the early years of the new millennium. Becker and Olofsgård (2018) take a narrower perspective on the issue of

‘normal’ countries, and look at how well transition economies conform to a parsimonious and robust economic growth model. Their study shows that Russia, early on in transition, 1991-99, underperformed expected growth by 10 percentage points, while in the period 2000-15, Russia was growing exactly in line with the model’s prediction. Thus, from a growth model perspective, Russia has been a “normal” country during the time that Putin has been in power.

This paper addresses how the Russian economy has developed since Putin took command in 2000, and how, 25 years after the dissolution of the Soviet Union, it is still an important driver of economic development in other countries in the Commonwealth of Independent States (CIS). The paper is organized as follows. It first provides a summary of how the Russian macroeconomy has fared during President Putin’s tenures in office, and to what extent Russia has been transformed into an economic (and not only military) superpower during these years. It then discusses the main driving force behind Russia’s macroeconomy – international oil prices – and how Russian macroeconomic policies have developed to deal with the economic challenges Russia faces due to its oil dependence. Russia’s economic ties to other CIS countries are then described in some detail, followed by an analysis of the impact of Russia’s macroeconomic developments on its neighbours.²

² The term CIS is used here in the same way as in the IMF classification, which acknowledges that Turkmenistan, Georgia, and Ukraine are not formal CIS members, but includes them ‘for reasons of geography and similarity in economic structure’.

Macroeconomic developments

As noted above, when Putin first became president, the Russian economy had been through a rough time; the country he took over was by no means viewed as an economic ‘superpower’. The concept of being an economic superpower is not as straightforward as that of being a military superpower, which is a title that Russia (and the Soviet Union before that) has long held. Here, the concept of superpower is more context-specific, and aims to paint a picture of the economic clout Russia could be expected to have in different arenas – globally, regionally, or in different international clubs or organizations – to pursue its own agenda, and to have others adjust their policies or preferences in economic as well as more generally political matters.

In 2000, in terms of size and using market exchange rates (the first column in Table 1), Russia was ranked as only the 19th economy in the world. GDP at market exchange rates makes sense when comparing the economic muscles of different countries in the global arena, but incomes adjusted according to purchasing power parity (PPP) are more relevant when comparing the standard of living of the citizens, or what can be consumed in the different domestic markets. Since the price level in Russia is lower than in most high-income countries, the world rank for Russia in PPP terms in 2000 (7th place) was a bit more impressive. However, even with this measure, in 2000 the Russian economy was only 16 per cent of the US economy.

For the welfare of people living in the respective countries, per capita measures of GDP are clearly more relevant. In this regard, Russia was certainly no superpower in 2000, ranking 92nd or 60th in the world, depending on whether market or PPP-adjusted exchange rates are used. Even so, in 2000, Russia was far ahead of China, regardless of the measure used.

TABLE 1. RUSSIA'S ECONOMIC PLACE IN THE WORLD

	2000		2016		2000		2016	
	USD	rank	USD	rank	PPP	rank	PPP	rank
	GDP (bn)				GDP (bn)			
USA	10285	1	18569	1	10285	1	18569	2
Japan	4887	2	4939	3	3405	3	5238	4
Germany	1956	3	3467	4	2430	4	3980	5
China	1215	6	11218	2	3699	2	21292	1
Brazil	655	10	1799	9	1580	9	3141	7
India	477	13	2256	7	2078	5	8662	3
Russia	279	19	1281	12	1635	7	3800	6
	GDP/cap				GDP/cap			
Japan	38534	2	38917	22	26850	26	41275	30
USA	36433	5	57436	8	36433	10	57436	13
Germany	24009	18	41902	19	29837	17	48111	20
Brazil	3779	70	8727	72	9108	67	15242	84
Russia	1906	92	8929	71	11170	60	26490	52
China	959	123	8113	74	2918	121	15399	82
India	463	148	1723	145	2019	138	6616	127

Source: Author's ranking based on the IMF's World Economic Outlook database April 2017 for 192 countries

Notes: PPP—purchasing power parity.

This was followed by more than a decade-and-a-half of Putin in charge, either as Russia's president or its prime minister, where significant progress was made in terms of both the overall size of the economy and per capita income. Income at market exchange rates produces the most favourable growth evaluation when comparing 2016 to 2000, with a growth of more than 4½ times, while the PPP measure 'only' shows half of that growth.³

Despite these very impressive growth numbers, it is hard to argue that Russia (at the end of 2016) has been transformed into an economic superpower. It was still only ranked in either

³ 2016 is clearly not the end of Putin's tenure, but the most recent year for which there is data when this is written.

12th or 6th place, depending on whether market or PPP exchange rates are used, and at market exchange rates the economy was only 7 per cent of the US economy, or 11 per cent of the Chinese. China is of course the extreme case in terms of growth in this time period (a ninefold increase at market exchange rates) and has truly become an economic superpower. Using PPP rates, China surpassed the US in 2014, and was with some margin the world's largest economy in 2016, according to this measure. Focusing on the BRIC⁴ countries, and considering their collaboration in the BRICS Development Bank (now the New Development Bank, NDB, or NDB BRICS) and other fora, China's economic weight relative to its BRIC peers cannot be overstated when it comes to the distribution of power in these discussions. As in 2000, Russia was still the smallest of the BRIC economies in terms of the size of the economy at market exchange rates at the end of 2016, and is not even an economic superpower in this group.⁵

Despite the lack of economic superpower status in the global or BRIC arena, the average person in Russia had a much higher income in 2016 compared to 2000, even after having been through the global financial crisis and the more recent reduction in oil prices, as well as the sanctions and counter-sanctions following Russia's annexation of Crimea and its military involvement in eastern Ukraine. The development of household income is no doubt an important policy issue, with direct links to the president's long-term popularity rating, even if other factors can overshadow this during certain periods and, in particular, when there are outside enemies to unite against. The question now, with regard to income, is when people will start to focus more on future rather than past developments.

⁴ Brazil, Russia, India, China, and later adding South Africa to become BRICS, the largest emerging market countries in the world.

⁵ In 2010, the original BRICs club was extended to include South Africa with the new acronym BRICS. In this gathering, South Africa is by far the smallest economy in terms of 2016 GDP.

During his time in power, Putin has been through very different economic phases with the Russian economy. Table 2 provides a more detailed account, both over time and across different indicators, of the progress that can be seen in terms of income in Table 1.

TABLE 2. A MACRO SCORECARD OF PUTIN’S AND MEDVEDEV’S PRESIDENCIES

	Putin I and II		Medvedev		Putin III	
	2000	2008	2008	2012	2012	2016
GDP/cap USD	1906	10885	10885	14586	14586	8929
GDP/cap 2008 RUB	180814	299443	299443	313479	313479	301591
Real GDP growth (% per year)		7.5		1.3		-0.5
Oil price (Brent USD/barrel)	24	104	104	110	110	55
Inflation (% year)		14		9		9
RUB/USD	25	24	24	30	30	61
Int.reserves (USD bn)	13	538	538	519	519	376
Stock market (RTS index)	180	2201	2201	1489	1489	1152

Source: Author’s calculations based on data from the IMF, CBR, and MICEX

Note: Presidencies shift in May and the data reflect this for 2008 and 2012. GDP data is split accordingly, while other data is based on observations as close as possible to the shift. For 2000, Putin was already acting in the first months of 2000, before being elected in May, so the data is from the start of 2000.

It is quite striking how the time periods compare, with very strong growth in income and other indicators during Putin’s first two presidential tenures; as well as during the seemingly stagnant period of Dmitry Medvedev, which included the massive decline related to the global financial crisis and then the relatively quick recovery; and, finally, the very poor economic performance that Russia has experienced so far, during Putin’s third term. The reasons for this latter phase are discussed in more detail below, but it is evident that every indicator, except inflation, has moved in the wrong direction in this period, from the stock market, via the exchange rate and reserves, to income and growth. And this is despite the fact that the quality of the macroeconomic management of the country is at an all-time high, which is also discussed below.

The stark contrast between Putin's first and second versus third term highlights that external economic forces can be more important than the president in determining the economic outcomes of Russia (as in most other places). This does not imply that the president is without power to affect economic outcomes. For Russia, a key economic policy issue is exactly to develop institutions and modernize the economy, so as to reduce the vulnerability to external shocks. Another area where the president and his economic team play an important role regards policies to mitigate the shocks that will continue to hit the economy as long as its structure is not changed. Nevertheless, within the existing institutional framework and economic structure, external shocks are extremely important for the Russian economy. This needs to be kept in mind, either when Putin (or other leaders) is hailed for the economic success, or blamed for the economic failure, of the country.

Oil prices driving the economy

In Table 2, there is one variable that is exogenous to economic policies in Russia, and that is the international oil price. Although Russia is a major oil producer (around 13 per cent of world production in 2016) and exporter, its own actions are not a significant determinant of oil prices. Furthermore, for most of the period in question, Russia was not an important part of OPEC negotiations to limit production in order to affect prices. More recently, Russia agreed to cut production in collaboration with OPEC, but this was a relatively marginal contribution, with little real effect on oil prices. A more speculative argument that could be made is that Russia affects oil prices indirectly, by affecting the global security situation in general, and developments in the Middle East more specifically. Although this may be true during some limited time periods, it is not one of the fundamental drivers of international oil prices that matter to the Russian economy in the longer run. In sum, for all practical purposes,

Russia is a price-taker on the international oil market and thus oil prices can be viewed as exogenous relative to the economic policies of Russia.

The issue of exogeneity of oil prices is extremely central to understanding macroeconomic developments in Russia, since it limits the scope of what Russian policy-makers, including the president or prime minister, can do to affect important economic outcomes. Becker (2017) shows that, depending on which income measure is used, between 60 and 90 per cent of Russia's growth can be explained by changes in international oil prices. Furthermore, the ability to make growth forecasts is severely limited by the fact that oil price changes are so important for growth. Over 80 per cent of the one-year-ahead forecast error in real GDP growth can be explained by errors in oil price projections. The well-known problems in forecasting oil prices therefore spill over to those ministries and authorities in Russia that try to make budgets and plan their activities for the next year or years.

Between 2000 and 2004, oil production grew by 40%, or 7 per cent per year, and during the next twelve years, by 16%, or 1 per cent per year.⁶ Since domestic demand has also increased, the export volume of oil peaked already in 2004 and almost all the variation in the value of exports has come from price changes. This is another way of saying that Russia is not in control of its oil income, the world market is. Natural gas is another significant generator of export revenues, but here the export values are even more strongly associated with price movements, rather than changes in exported volume. The pricing of gas is more complicated than oil, but there is a significant correlation between these prices, and since

⁶ To what extent this is due to the government's taking over Yukos is beyond the scope of this paper, but not an irrelevant point when it comes to handling the resource wealth of the country in the most efficient way.

there has been no real increase in gas exports, this is again a case where Russian policies do not control how the value of their exports develop.

The challenges posed by volatile and easily appropriated natural resource revenues have led the academic community to study the so-called natural resource curse, which basically says that the presence of natural resources creates problems, instead of generating wealth, for most countries. The literature then nuances this general conclusion to state that natural resources may be wealth-creating if the appropriate institutions are in place before the oil, gas or minerals are discovered.⁷ This is hardly the case in Russia, and therefore a common perception is that natural resources create more problems than benefits for Russia.

Although this may be true if we look at the institutional developments in Russia, Becker (2017) argues that in terms of economic outcomes this is not the case when the Russian growth experience over the last decade-and-a-half is compared to different peer groups. Both when compared with transition countries that joined the EU in 2004 and with BRIC peers, Russia's average growth in the last decade-and-a-half was only outpaced by China's. However, volatility in Russia has been at a relatively high level in these comparisons, so again, this is the real challenge posed by natural resources. Put differently, the average Russian would not have been richer without oil, but may have slept a bit easier at night, not having to worry about exchange rates and incomes tomorrow.

Although natural resource wealth seems to have helped Russia in terms of income levels in recent history, it has not been enough to generate incomes comparable to the EU average or Western high-income countries more generally. In 2016, Russian incomes were still less than

⁷ See, for example, Sachs and Warner (2001), Boschini et al. (2007), and Wright (2001).

60 per cent of the average of the 15 'old' EU countries, and the average incomes of the 10 transition countries that entered the EU in 2004 and 2007 were also somewhat higher than Russia's. More generally, the limits of natural resources in generating income in modern economies have been clearly shown in the World Bank's (2011) study, *The Changing Wealth of Nations*. The study provides estimates of how much wealth per capita the countries of the world possess in different types of assets. Russia's natural resource wealth is indeed impressive, but when it is divided by its relatively large population, the value is less than \$30 000 per Russian citizen. Modern western economies—with good institutions, education, and other factors that contribute to new ideas and companies, according to the World Bank—have intangible capital on the order of \$5-600 000 per capita. Russia's intangible capital, in contrast, is only at a level similar to its natural resource wealth, or a fraction of what countries such as the US, Sweden, and Germany are estimated to have.

The bottom line of Russia's oil, gas, and mineral wealth position is that it provides an opportunity to be a successful economy, but to materialize this, policy-makers need to manage the inherent volatility in income that these assets entail. This includes a good macroeconomic framework, institutional reforms that support other sectors of the economy, and, possibly, more innovative financial solutions, with the aim of offloading some of the risks associated with natural resources on global financial markets. In addition, the natural resource wealth should be complemented by a much higher level of intangible wealth, if Russia is to close the current income gap relative to Western high-income countries.

Economic policies to deal with oil dependency

The volatility that comes with natural resources is not unknown to Russian policy-makers, but their desire and ability to deal with this challenge have varied over time and between individuals in key positions. One prominent strategy to deal with oil and other natural resource wealth is to create some type of fund that accumulates wealth in times of high prices or extraction, and save that for less-favourable market conditions, or future generations, when the natural resources are expected to be exhausted. This type of sovereign wealth fund is found in several oil-exporting countries, with the Norwegian fund being the largest (worth more than \$1 trillion in the fall of 2017). Russia started its own Stabilization Fund in 2004, with the aim of providing a buffer for the government's budget, and reducing liquidity and inflationary pressure. In 2008, the fund was split into two parts, the Reserve Fund and the National Wealth Fund. The first was, again, a tool to stabilize the budget, while the second was set up with the aim of making the pension system sustainable over the longer-run.

From a macroeconomic perspective, there is little doubt that Russia's creation of these funds is a success. The funds accumulated substantial assets during the period of increasing oil prices, and in early 2009 the combined value of the funds had reached \$225 billion, with the Reserve Fund accounting for 60 per cent of this. During the global financial crisis, when oil prices dropped, these funds provided readily-available financing to plug the government's deficits, and, by mid-2010, about \$100 billion (or 6 per cent of 2010 GDP) of the Reserve Fund had been used. The fund then declined a further \$15 billion, in 2011, before it started to accumulate in 2012. The fund then increased for a few years, before oil prices again dropped, and around \$90 billion of the fund was used in 2015-16. By early 2017, the Reserve Fund was down to \$16 billion, and since it was set up, it varied from over 12 per cent of GDP to around 1 per cent before it was merged with the National Wealth Fund in 2018. During its

existence, the fund clearly provided the government's budget with a valuable buffer and has facilitated a more counter-cyclical fiscal policy that has dampened the adverse effects of significant international oil price fluctuations.⁸

The other macroeconomic pillar for dealing with fluctuating oil prices is the exchange rate. For a long period of time, having a stable exchange rate was a key policy objective and viewed as a critical policy for maintaining the trust and support of the population. Given the transition experience and the 1998 crisis, this is not hard to understand. The fixed exchange rate policy then allowed the Central Bank of Russia (CBR) to accumulate significant international reserves during the years of increasing oil prices.⁹ From 2000 to 2008, international reserves went from \$13 billion to over \$500 billion, while the exchange rate to the dollar was left more or less unchanged, at around RUB25/\$. The fixed exchange rate regime then came under severe pressure during the global financial crisis, and with international oil prices falling at the same time as the private sector and banks had borrowed extensively abroad, this was too much for the CBR to counteract. From the fall of 2008 to the spring of 2009, it had used more than \$200 billion of its reserves to prop up the exchange rate. The exchange rate still depreciated by over 30 per cent in this period, but this was not enough, compared with the much larger decline in oil prices. As a result, the economy contracted by 8 per cent in 2009. Although this was a painful lesson, it was probably a key reason for letting the exchange rate adjust more quickly when oil prices fell in 2014; in

⁸ Although the National Wealth Fund was not used to support the budget directly, around \$20 billion has been used over the years. However, it was not used to support pensions, as originally intended, but instead used to support industrial policies or companies and banks that needed financial support.

⁹ For many years, the IMF's formal classification of Russia's exchange rate regime was 'other managed arrangement' based on a currency basket of dollars and euros with interventions to smooth fluctuations but since this for most of the time meant a fixed exchange rate that implied massive accumulation of reserves in terms of increasing oil prices, the term fixed exchange rate regime is used here as a somewhat casual label for a more complicated system.

November 2014, Russia formally eliminated the exchange rate corridor, cancelled its regular intervention in the foreign exchange market, and moved to a free-floating exchange rate.

The depreciation of the exchange rate from RUB36/\$ in the fall of 2014, to around 80 in early 2016, was not appreciated by everyone, and especially not by those with loans in foreign currency or savings in roubles. But oil prices had fallen from \$100/barrel to less than \$30 in the same period, or a decline of 70 per cent. This would have been a massive blow to the government's budget and the current account if this rapid depreciation of the rouble had not taken place. Instead, the depreciation meant that in rouble terms, the oil price had 'only' fallen by around 30 per cent. In other words, compared to 2009, this time the exchange rate was allowed to absorb much more of the oil price shock and, as a result, the decline in output in 2014 and 2015 was limited to 1 and 3 per cent, respectively.

Good macroeconomic management has certainly been important in mitigating the effects of volatile and falling oil prices. But fiscal and monetary policy can only deal with temporary oil price changes and is not capable of generating sustainable, long-term growth on their own. This will instead require far-reaching, market-oriented reforms that provide people and companies the right incentives to produce new ideas, products, and services that will be provided by Russian companies to both the country's own citizens and the world. This is not a new insight in any way, but as the world tries to reduce its carbon footprint, Russian policy-makers are running out of time for making this change happen. President Putin is clearly struggling with this insight; in several speeches, he has at one point indicated that the world is moving to a green economy, while at another point saying that the hydrocarbon world is going to be around for a long time to come. The problem is that what may seem to be a long time for Putin may not be as long for Russia's younger generations.

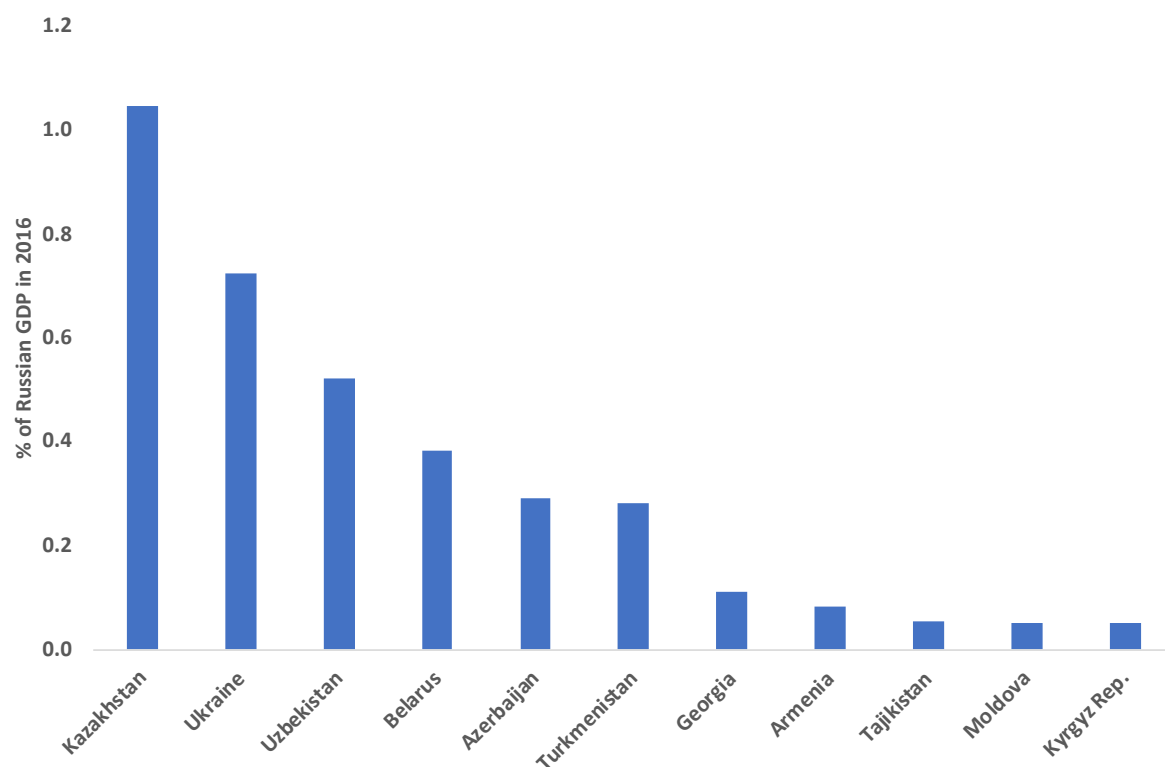
Becker and Olofsgård (2018) show that Russian oil dependence has not declined over time, but that the correlation between growth and changes in international oil prices has been around 0.8 for all of Putin's years in power, despite several claims that diversifying the economy is a top priority. Stephen Fortescue (in this book) argues that it is unlikely that the government will shift its attention and resources away from the natural resource sector in order to develop other sectors that would be key to diversifying the economy. As has often been argued before, reforming basic market institutions will be key to developing other sectors of the economy. On a general note, Roland (2014) points out that many transition countries have done well in terms of catching up economically, but that institutional evolution has been much slower. For Russia, more specifically, Ofer (2010) presented a detailed study of how the failure to transform institutions hampers a more dynamic, market-based growth model. Former minister of finance Alexei Kudrin, and the head of the economic expert group Evsei Gurvich (2015) presented a new growth model for Russia that would focus on growth in businesses that act on the right market incentives, and are supported by efficient government administration, where property rights are protected and regulatory burdens reduced. It remains to be seen how this is received by the president and if any of this will be included in the presidential election program.

Economic ties and impact in CIS region

The economic ties between Russia and other CIS countries are a natural consequence of a common history as well as geographic proximity. After the dissolution of the Soviet Union, countries diversified their trade and became more integrated in the global economy, and the share of trade within the region thus declined. However, in recent years, there has also been

strong political movement to reinforce the economic links in the region, by developing and expanding the Eurasian Customs Union and other collaborative projects in the region that have been promoted by the Eurasian Development Bank. As Yaroslav Lissovlik and Aleksei Kuznetsov (in this book) point out, there are strong reasons for considering joint regional projects for overcoming natural development obstacles, such as the large, land-locked situation of the countries, or areas therein.

FIGURE 1. CIS COUNTRIES' ECONOMIC SIZE RELATIVE TO RUSSIA (% OF RUSSIAN GDP)



Source: Author's calculation based on the IMF's World Economic Outlook database April 2017

As can be seen in Figure 1, Russia is by far the largest economy of the CIS countries and accounts for almost 75 per cent of total GDP measured in US dollars and, as such, is likely to affect economic development in the other CIS countries. In this context, the economic superpower label is indeed relevant. Russia's effect on other CIS countries can come through

different channels and Table 3 shows the degree to which the countries are connected to Russia via exports and remittance.

TABLE 3. ECONOMIC LINKS TO RUSSIA (ANNUAL AVERAGES 2006-2016)

	Remittances from Russia		Exports to Russia	
	(% of GDP)	(% of total)	(% of GDP)	(% of total)
Armenia	11.8	68.3	2.3	17.8
Azerbaijan	1.9	70.2	1.3	4.3
Belarus	0.4	28.8	20.2	38.0
Georgia	5.0	50.6	0.7	4.9
Kazakhstan	0.2	203.9	3.3	8.3
Kyrgyz Republic	23.6	92.8	3.9	15.3
Moldova	14.6	51.9	6.0	20.9
Tajikistan	40.1	104.5	2.1	11.7
Turkmenistan	0.1	96.8	0.5	1.9
Ukraine	1.5	31.0	8.2	21.7
Uzbekistan	7.8	101.7	3.0	16.4
CIS ex Russia	9.7	81.9	4.7	14.7
CISF ex Russia	0.8	123.6	1.7	4.8
CISNF ex Russia	13.1	66.2	5.8	18.3

Source: Author's calculations based on data from the CBR, the World Bank's World Development Indicators, and the IMF's Direction of Trade Statistics.

Notes: CISF– CIS countries with large shares of fuel in exports (Azerbaijan, Kazakhstan, Turkmenistan, and Russia); CISNF– CIS countries that are not in the CISF group.

Note that in the table, the data on countries' exports and remittances come from the CBR, while that on countries' total exports and remittances comes from the IMF, which in turn is based on data from the national authorities. It is a well-known issue that international transactions are often not consistent between home and foreign countries and therefore remittances to Russia can be more than 100 per cent of the total. In other words, the home authorities document fewer remittances coming to their countries than what the sending country, Russia, records as outflows. This means that there is a degree of uncertainty with these types of numbers that should be kept in mind when looking at the data. Nevertheless,

this is the best data available and it is likely a good indication of the general strength of the economic links between Russia and other CIS countries.

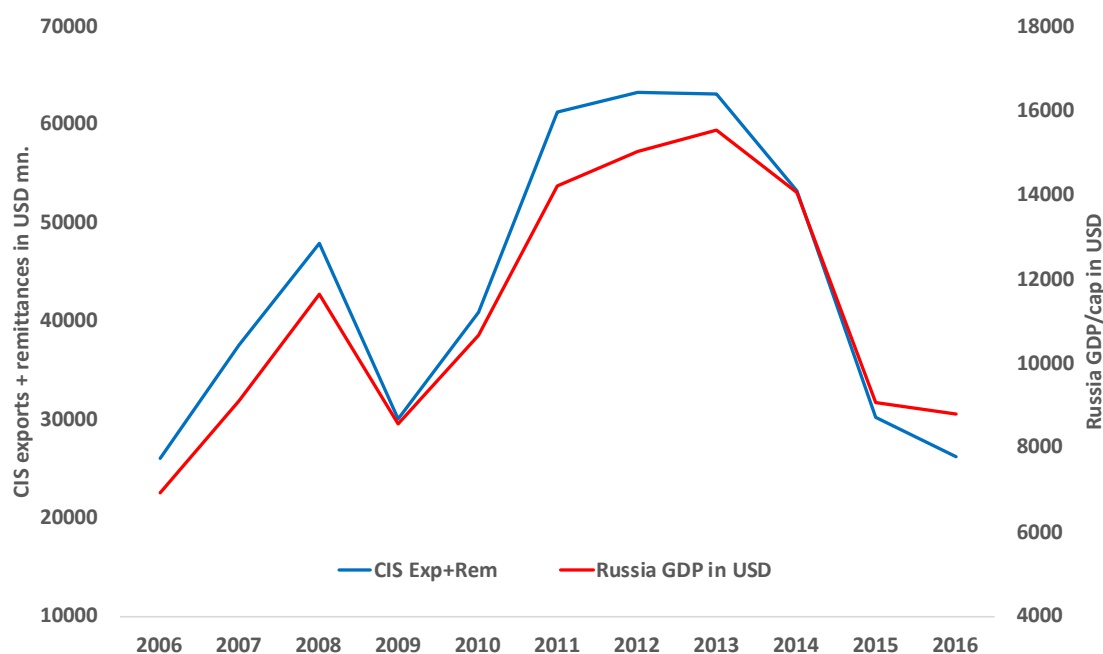
Taking the numbers at face value, they provide a picture of the strong links many of the CIS countries have with Russia. The links are particularly strong between those countries that do not export fuel (CISNF) and Russia, and that have a combined remittance and exports inflow from Russia of almost 20 per cent of GDP in an average year, while the fuel exporting countries (CISF) are less strongly connected to the Russian economy (at less than 3 per cent of GDP).¹⁰ Although trade is the focus of the Eurasian Customs Union (EACU) and of many discussions regarding the links to Russia, remittances from Russia to other CIS countries are twice as large as exports to Russia in terms of share of GDP. The importance of remittances from Russia is even more striking when looking at the share of total remittances (keeping in mind the pitfalls with this data, as discussed above); for the CISF countries, basically all of their (relatively small) remittances come from Russia.

Figure 2 shows how developments in the Russian economy spill over directly into remittances and trade with other CIS countries. From 2006 to 2016, there has been a remarkably strong link from the Russia economy to the region. It may be tempting to discuss the causal relationship between the lines in the chart, since Russia is also to some extent dependent on the other CIS countries. However, given that Russia's GDP development can be explained so well by changes in international oil prices, and that the size of the Russian economy is almost ten times the second-largest CIS economy, causality does not seem to be

¹⁰ The group 'CISF ex Russia' include Azerbaijan, Kazakhstan, and Turkmenistan, and this is based on the IMF's classification of countries that have major exports of fuel, where Russia is also included. The eight other CIS countries are part of the group 'CISNF ex Russia'.

much of a concern here; developments in Russia clearly determine exports from and remittances to other CIS countries.

FIGURE 2. EXPORTS AND REMITTANCES IN CIS DEPEND ON RUSSIAN GDP



Source: Author’s calculations based on data from the CBR, the World Bank’s World Development Indicators, and the IMF’s Direction of Trade Statistics.

The aggregate picture of how exports and remittances develop is evident in Figure 2, but there is also the question of what this means for other macroeconomic indicators in the other CIS countries. Are the trade and remittances links so strong that they also affect overall GDP growth, exchange rates, government budgets, and current accounts in the region? Table 4 shows that the correlation between the other CIS countries with the same Russian variables is quite high for GDP growth and exchange rate movements (around 0.5), while government budgets and current accounts are less correlated with the same Russian variables (or with Russian GDP growth, which is not shown in Table 4).

TABLE 4. MACRO CORRELATES FOR CIS AND RUSSIA

	GDP/cap growth			Exchange rate depreciation			Gov't net lending			Current account		
	Mean	St.dev	Corr RU	Mean	St.dev	Corr RU	Mean	St.dev	Corr RU	Mean	St.dev	Corr RU
Armenia	6.9	7.3	0.9	-0.2	9.5	0.7	-3.3	2.0	0.7	-8.1	4.8	-0.1
Azerbaijan	8.8	10.0	0.6	4.8	15.5	0.5	3.5	7.0	0.0	7.6	19.4	-0.4
Belarus	5.3	4.9	0.8	34.2	62.3	0.3	-3.1	2.9	0.2	-5.6	3.9	0.5
Georgia	6.6	4.1	0.7	1.3	9.5	0.9	-0.8	2.5	0.8	-11.1	4.6	0.3
Kazakhstan	5.8	4.3	0.8	7.3	15.7	0.6	2.4	3.9	0.7	-1.1	3.8	0.0
Kyrgystan	3.1	3.3	0.2	3.9	9.1	0.8	-4.0	2.9	-0.1	-2.5	7.1	0.3
Moldova	4.8	4.0	0.6	4.4	11.3	0.8	-1.5	1.9	0.7	-7.2	4.4	0.1
Russia	3.9	4.8	1.0	7.1	16.5	1.0	1.3	4.0	1.0	6.3	3.7	1.0
Tajikistan	5.5	2.0	0.7	12.5	16.8	0.4	-2.6	2.2	0.1	-4.5	3.9	0.5
Turkmenistan	6.9	3.9	0.1	...	...	...	2.7	3.2	0.2	-0.4	11.4	0.5
Ukraine	3.4	7.0	0.9	13.4	24.9	1.0	-3.1	1.6	0.5	-0.8	5.6	0.7
Uzbekistan	5.5	1.7	-0.3	...	...	...	2.2	3.3	0.1	4.1	3.3	0.1
CISxRU	5.7	3.3	0.5	7.9	13.0	0.5	-0.6	1.4	0.4	-2.7	1.7	0.2
CISFxRU	7.2	4.6	0.5	4.1	10.0	0.4	2.8	3.5	0.3	2.0	8.1	0.1
CISNF	5.1	3.2	0.6	9.3	16.1	0.6	-1.9	1.2	0.4	-4.5	2.8	0.3

Source: Author's calculations based on World Bank and IMF data

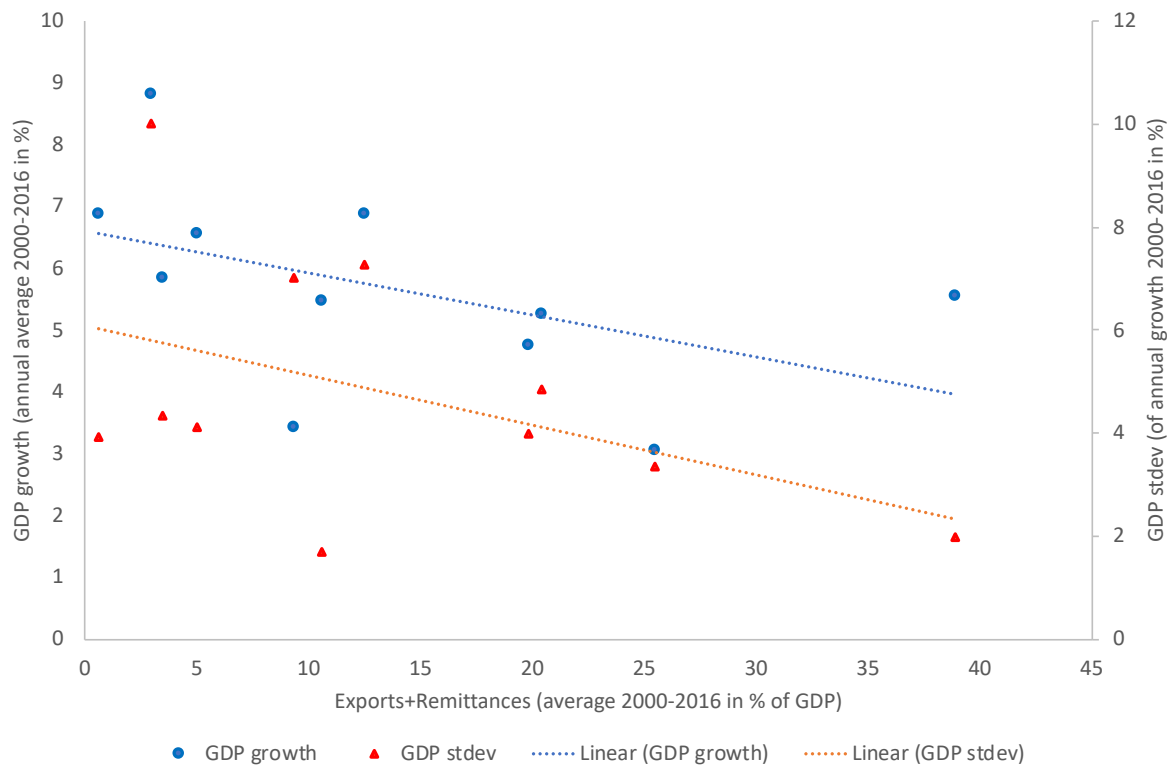
Note: 'St.dev' stands for standard deviation, and 'Corr w. Russia' stands for the country/variables correlation with the same variable for Russia

Given that the other fuel exporters are subject to the same shocks in international oil prices that we know drive Russian GDP, it is perhaps somewhat surprising that their correlation with Russian GDP is not stronger than for the non-fuel exporting group. Instead, the trade and remittances links that the CISNF group has with Russia seem to generate a slightly higher correlation with Russian GDP growth than the common oil price shock. In this way, the non-fuel exporters are also facing the challenge of dealing with international oil price shocks, despite not exporting any oil themselves. This is a bit ironical, but shows how important Russia is as an economic superpower in the region.

As is evident in Table 3, there is significant variation when it comes to the strength of the economic links with Russia, with Tajikistan having a combined remittance and exports of over 40 per cent of GDP, while the corresponding number for Turkmenistan is less than 1 per

cent. Combining this information with the growth statistics in Table 4. Figure 3 shows how the CIS countries' economic ties with Russia correlate with GDP growth and volatility. It may be expected that strong ties with Russia would generate relatively high but volatile growth, given Russia's own experience with occasionally high growth followed by sharp downturns. This does not turn out to be the case, however; instead, strong economic links, in the form of exports to and remittances from Russia, are correlated with lower but less volatile growth. In both cases, the correlation is -0.5, which would translate to a univariate r-square of 0.25, which is not trivial. Put differently, a quarter of the differences in growth experienced between CIS countries are related to their economic ties with Russia.

FIGURE 3. THE RISK/RETURN TRADE-OFF WITH STRONG ECONOMIC LINKS TO RUSSIA



In terms of other economic forces in the region, China has increased its economic links with some of the countries, and overall exports going to China from CIS countries, excluding Russia, rose from around 4 per cent of total trade in the years before the global financial crisis, to 11 per cent in 2016. However, this is mainly due to energy exports from Turkmenistan and Kazakhstan, but even with this increase, exports to Russia are significantly greater than in 2016. More importantly, there are virtually no remittances from China to these countries, while remittances from Russia are a major item for many CIS countries, and an important driver of these economies, as discussed above. In short, China has increased its economic links with CIS countries, and is the main export destination for Turkmenistan, but Russia is still the economic superpower in the region.

Conclusions

The Russian economy has come a long way since 2000, when Putin first became president. Income levels increased significantly during Putin's first two terms as president, with GDP growth of 7.5 per cent per annum. Then came the global financial crisis, just as President Putin became prime minister and Medvedev became president, in the 'tandemocracy,' as this arrangement was called by commentators both in Russia and abroad. The crash in 2009 was relatively short-lived, and the talk of reforms in Medvedev's early presidential years soon died out, as oil prices and the Russian economy started to grow again. The 2012 return of Putin, as president, did not deliver any growth in income by the end of 2016, in stark contrast to his first two tenures in the Kremlin. Nevertheless, the growth Putin oversaw in his two first terms in office lifted Russia several rungs on the international ranking of GDP, and the accumulation of fiscal and foreign reserves gave the Russian leadership much more room and dimensions to manoeuvre in, but also, in more recent times, poor growth. Much of this was

achieved with improved macroeconomic management that was well-adjusted to the realities of volatile international oil prices. Even so, the Russian economy did not reach superpower status, neither in the global arena, nor in the BRIC's smaller one. This is not to say that this should be a policy goal; focusing on closing the gap with the richer economies in terms of GDP per capita would be a more relevant goal.

Where Russia actually is an economic superpower is in the CIS region, where it accounts for 75 per cent of aggregate GDP. The countries in the region are closely linked with economic developments in Russia, through trade and the workers who travel to Russia and send money back to their home countries. Although many countries in the region have reoriented some exports to the EU and other markets, the link with Russia is still a major determinant of their own economic growth. The EACU is one initiative that aims at strengthening regional cooperation and, to some extent, cementing Russia's position as the regional economic superpower. More trade and closer integration could of course benefit all the countries in the region, but the risk is that it diverts attention from other collaborative arrangements, be they with the EU, China, or other parts of the world. The more general issue of trade creation versus trade diversion in relation to non-universal free trade agreements is of course not unique to this region and its agreements, but may be particularly important, given how this may restrict interactions with larger or more dynamic markets elsewhere. The EU should also think more carefully about what Russia's status as economic super power in this region means for its own interaction with the countries in the region, and what it is prepared to offer as an alternative to closer integration with Russia.

An issue that will affect both Russia and the other CIS countries is how the transformation from being a natural resource exporter to a modern knowledge economy (or something less

attractive) will come about. Policy-makers, businesses, civil society, and people in general are focusing on solving the problem of global warming and reducing the use of hydrocarbons. President Putin is obviously aware of this, and has stated several times that we are all moving towards a green economy, but then diminishes the importance of this by saying that the era of hydrocarbons will not end any time soon. The problem is that the transformation to the green economy should happen much sooner than oil exporters would like, and once green technologies become more cost-efficient on a large scale, the Russian government will no longer have any significant incomes from oil and gas. This income will then either have to come from elsewhere, or the Russian economy will be in for its most severe shock ever.

Although good macroeconomic management can be used to manage oil-price-induced volatility, it cannot counter a large, permanent shock to oil prices. This can only be handled by fundamentally reducing the dependence on oil and gas incomes, which can be done through real or financial diversification. Real diversification means that other sectors of the economy are allowed to prosper, which will require serious institutional reforms, while financial diversification would have to entail selling off more natural resources today, in exchange for a well-diversified financial portfolio. On the face of it, the latter strategy is much easier to achieve within a limited time-period, but implies that the Russian leadership hands over control over what they view as the country's strategic assets to domestic and foreign investors. Although this would make sense from an economic point of view, it is likely not realistic in the current political context. That leaves the option of real diversification, which again is a much slower process that would require deep institutional reforms that would transform the way the Russian economic, legal, and political system interacts.

The likelihood of reforms and how they would happen is discussed in, for example, Fortescue (2019) and Aleksashenko (2019), but my personal note is that it is going to be hard, regardless of which diversification route Putin chooses. That said, the potential that is embedded in economic reforms in Russia is substantial, and it is high time that the leadership delivers this to its population. In addition, the success of Russia will spill over to other CIS countries, as well as the larger and richer neighbours to its east and west.

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