Chapter 6: Conclusion

1. Introduction

In this report we have analyzed the potential barriers to Russia's long-term growth, and the mistaken policy directions that might result from misunderstanding those barriers. Our argument throughout this report has been that it is too easy to misdiagnose the sources of Russia's problems. In a general way it is easy to understand the nature of the barriers to Russia's long term growth. The Russian economy is less efficient than it should be, its market institutions are less effective than they can be, and its political economy is more problematic than it should be. But the key analytic problem is to understand the specific sources of these problems.

It is critical, for example, to understand the nature of Russia's institutional problems. We can think of two types of such problems:

- "typical set"– efficiency loss due to weak property rights, corruption, etc.
- legacy preserving institutions

It is easy to collect information about the problems that make up the "typical set." Russia always fares very low in corruption rankings (taking high as good). Problems with property rights enforcement are legion. But these problems are symptoms of deeper underlying problems. Focus on the "typical set" makes it seem that these problems can simply be overturned with sufficient will. But they stem from deeper causes. They are the outgrowth of legacy-preserving institutions.

Russian institutions serve to preserve a legacy of misallocation. They preserve the poor location choices and the poor use of assets that is endemic in Russia. This makes the bad equilibrium self-reinforcing. Normally, when assets are woefully misallocated the decisions will be undone over time. New investments and new activities will reallocate resources. The costs would then dissipate over time. In Russia this does not happen. Its bad institutions provide incentives to preserve the misallocations, and its resource wealth makes it feasible to preserve them.

The problem is that the symptoms (like corruption) cannot be fixed without attacking fundamental factors. As long as Russia remains a resource dependent country the key element of its political economy will be its rent management system (see Appendix).

This report has been about "Bear Traps." That is, our aim has been to warn about what not to do, as we emphasized the kinds of seemingly self-evident policies that would have either no effect at all on growth or even negative effects. It might appear that we have offered nothing in the way of a positive agenda of what should be done? While a comprehensive attempt to draw up such an agenda would require a separate study, in fact, there are some basic points that flow from what we have said so far.

A fundamental theme of our findings is that Russia's problem with its stocks of physical and human capital, at present and in the future, is less about the pure quantity of the capital and more about its quality. And the dimension of quality that counts the most is the capacity of that capital to react and adapt to new and changing circumstances — in short, its capacity for reallocation. The goal of investment policy as well as institutional reform is to make physical and human capital as potentially mobile as possible.

The critical difference is between what we referred to as installed capital versus new capital. This applies to both the physical capital and to the dimension of human capital associated with education. Enhancing the stocks of physical capital and educational capital is important for growth but only if conditions exist to free these investments from the constraints of the inherited structures. Otherwise, big investment programs could end up making Russia's problems worse. They would perpetuate the inherited economic structures and thus inhibit opportunities for long-term growth.

And as far as investment in health and human capital is concerned, we showed that such investment is unlikely to produce any positive growth effects at all. In fact, spending to improve health in Russia is properly regarded not as investment at all but as consumption.

Improving Russia's human capital is important for welfare, but it should not be seen as a solution to Russia's long-term growth prospects.

Another of our findings was that even under optimal conditions for investment, any dream of creating a "non-oil" Russia that could perform as well as today's commodity-based economy is unrealistic. The proportion of GDP that would have to be invested in non-oil sectors is impossibly high. This suggests that the only realistic future for Russia is one that continues to be based on the commodity sectors.

Yet, contrary to conventional views, this does not have to be a negative outlook. Russia would, however, need to take a radically different approach to its energy and commodity sectors than at present. Right now, Russia is constrained by its addiction to commodity rents. In this environment, oil and gas abundance reinforce the inherited structures at the expense of entry and thus creation of new structures. This means that it is impossible to truly modernize Russia without modernizing the oil and gas sectors. They need to be in the forefront. Truly modern oil and gas companies would not support addiction. They would not participate in the various informal schemes to share their rents with dinosaur enterprises. The playing field would be leveled for new entrants in all sectors of the economy. Meanwhile, oil and gas companies themselves would be relieved of the heavy burden of informal taxes and political constraints on their business activity. With the oil and gas companies in the lead for modernization, Russia would become a genuine energy superpower, an "energy superpower in depth."