The Washington Post
January 18, 2016

Putin's self-destructing economy

by Vladislav Inozemtsev

A little more than a year after "Black Tuesday," when the ruble lost a quarter of its value in a day, the state of the Russian economy is still uncertain. During the past 12 months, gross domestic product declined 3.9 percent, less than many analysts anticipated a year ago, and the government managed to get inflation below 13 percent. But early official forecasts promising a return to growth by the third quarter of 2015 went unrealized, and subsequent projections of growth resuming later this year also look unrealistic.

Both the international financial institutions and Russia's economic ministry now agree that the economy will not grow in 2016; the International Monetary Fund and the World Bank projected a 0.6 percent decline in December, while last week Russian authorities said they expected a 0.8 percent contraction. Nonetheless, the current consensus is that the economy will resume expanding in 2017. If that indeed happens, one may say that the whole thing was another ordinary economic downturn caused by falling oil prices and Western sanctions.

But if growth doesn't return, then what?

I would argue that Russia's economy is doing much worse than it was even in 2009. Real disposable incomes are down significantly, and nominal wages — recalculated in dollars at current exchange rates — are below where they were in 2005. Retail sales have dipped twice as deeply as they did in 2009. Federal budget receipts, also in dollars, are at 2006 levels. The average price for a new apartment in Moscow has fallen 16 percent below 2014 levels in rubles, and by more than by half in dollars. Office rents in Moscow and St. Petersburg have been pushed back to 2002 rates. The Russian economy suffers from both the effects of diminishing oil revenue and growing bureaucratic pressure, not to mention the country's paranoid foreign policy.

Assessing the Russian economy since the early 2000s, one can see two distinct periods. The first runs from 2000 to 2007, when the economy grew by about 7 percent a year, the RTS stock market shot up and average incomes more than tripled. Taxes were lowered and international cooperation increased. Russia rose.

But then came the second period, which now can be called a standstill. Between 2008 and 2015, average annual growth has been close to zero; capital flight has accelerated; foreign investors have been sidelined; the business climate has deteriorated; and dozens of taxes have been newly introduced or increased. Military expenditures doubled as President Vladimir Putin launched military operations in Georgia, Ukraine and Syria, and he appears to have completely shifted his interest from economic matters to the geopolitical sphere.

This second period is usually depicted as two crises and one recovery, but it is more accurate to treat it as one long period without growth. As Prime Minister Dmitry Medvedev has admitted, Russia had not truly exited the previous crisis before it found itself in the midst of a new one. Viewed in this way, the rise and standstill periods appear complementary, with each running eight or nine years. And with the Russian economy now totally subjugated to politics, and the latter becoming more illiberal, there is little hope for recovery, even if sanctions are lifted and oil prices return to more normal levels.

Russia has weathered crises before, but neither in 1998 nor in 2008 did so many foreign companies abandon their investments. With its "counter-sanctions" against the European Union, tension with Turkey and proclamations that international treaties are overridden by ever-changing Russian law, the government has discouraged domestic and international investors from expanding. In the past year, more than 20 Western corporations, including Opel, Adobe Systems and Stockmann, have terminated their Russian businesses; around 30 production facilities owned by foreigners have been closed. Net emigration from Russia rose from 35,000 people a year from 2008 to 2010 to more than 400,000, by preliminary estimates, in 2015. I do not see any signs that all these trends might change.

If I'm right, and if the Russian economy contracts in 2016 as it did in 2015, it may well be that we have witnessed not another crisis but the start of a prolonged downturn — something akin to what took place in Venezuela from the second half of the 2000s. If so, the standstill phase will move not into a revival but a free fall that may last years — well into Putin's fourth term (or fifth, depending on how you count) beginning in 2018.

The main reason for this is that in the 1990s and early 2000s, Russia — however chaotic it might have seemed — was a country of hope, and investors were attracted to dynamic and improving domestic conditions. That changed after 2012. Now it is a territory of disillusionment.

As 2016 unfolds, I would advise all those tracking Russia's economic performance to tread carefully. If growth does not resume, it could mean the country has entered a time of economic self-destruction that might mark the third phase of Putin's reign.

Vladislav Inozemtsev is a visiting fellow at the Center for Strategic and International Studies in Washington and director of the Center for Post-Industrial Studies in Moscow.