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The review “Russian Economy. Trends and Outlooks” has been published by the Gaidar Institute since 1991. This is the 41th issue. This publication provides a detailed analysis of main trends in Russian economy, global trends in social and economic development. The paper contains 6 big sections that highlight different aspects of Russia's economic development, which allow to monitor all angles of ongoing events over a prolonged period: global economic and political challenges and national responses, economic growth and economic crisis; the monetary and budget spheres; financial markets and institutions; the real sector; social sphere; institutional changes. The paper employs a huge mass of statistical data that forms the basis of original computation and numerous charts confirming the conclusions.

By contrast to the previous publications the present issue includes also a short analysis of the first three months of 2020 from the perspective of the COVID-19 pandemic impact on the Russian economy development.

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6.7. The strategic development prospects of the North Caucasus federal okrug¹

Last year (2019) was the tenth year of the implementation of the Strategy of Socioeconomic Development of the North Caucasus Federal Okrug until 2025, adopted in 2010. The Strategy aims at achieving significant economic growth across the North Caucasus regions, as well as modernizing their social structure and stabilizing their socio-political situation. In order to achieve economic growth in the North Caucasus, the Strategy focuses on the creation of a tourism cluster, accelerated development of the region's transport system, and the emergence of new centers of economic development. The Strategy's targets that should serve as the indicators of its successful implementation (under the optimal scenario) are the gross regional product growth of 7.7% per annum in the regions of the North-Caucasian Federal Okrug, and industrial production growth of 10.1% per annum over the period from 2010 through 2025. The Strategy also aims at creating not less than 400,000 new jobs, reducing the official unemployment rate to 5% (from 16.5% in 2010), and decreasing the share of households with incomes below the subsistence level to 9.2% (from the regions average of 15.5% 2010).

By way of implementing the Strategy, a number of special legal entities with state participation were created, first of all North Caucasus Development Corporation (NCDC) OJSC and Northern Caucasus Resorts OJSC. The goal of NCDC OJSC (from 2010 to 2017, its sole founder was VEB; in 2017, 100% of its shares were transferred to the ownership of the Russian Federation), as stated in the corporation's official presentation, is to develop investment projects in the North Caucasus by attracting investors and co-investing in the economic projects launched in the regions. Northern Caucasus Resorts OJSC manages the special economic zones created inside the North Caucasus Tourism Cluster. So far, 6 special economic zones have been created in the tourism cluster's territory in the areas where resort construction projects are currently underway: Arkhyz in the Karachay-Cherkess Republic; Elbrus in the Kabardino-Balkarian Republic; Matlas and the Caspian coastal cluster in the Republic of Dagestan; Armkhi in the Republic of Ingushetia; Veduchi in the Chechen Republic, Mamison in the Republic of North Ossetia – Alania (the latter was established for a second time as a special economic zone and incorporated into the tourism cluster in September 2019).

Over the ten years that have passed since the adoption of the Strategy, the progress of its implementation has been repeatedly the target of caustic criticism. In 2019, the problems that arose in the course of the Strategy's implementation were addressed by a number of expert-analytical and control inquiries carried out by the Accounts Chamber of the Russian Federation.² One of the obvious problems reflected in official statistics was the *extremely low*

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² In 2019, the Accounts Chamber implemented two development assessment initiatives addressed to the North Caucasus regions: the expert-analytical initiative 'Assessment of the progress, in 2018, of the government programs of the Russian Federation being implemented in the North Caucasus Federal Okrug for the purpose of providing comprehensive solutions to the issues of creating adequate conditions for socioeconomic development of the North Caucasus', and the control initiative 'Audit of the targeted and efficient use, in 2018 and the last

implementation of the targets set the Strategy. Thus, according to data released by the Federal State Statistics Service, the average unemployment rate in the regions across the North Caucasus Federal Okrug in 2011–2018 stood at 12.12% vs the target of 5% set in the Strategy, and after 2014, its decline has been only by 0.2 percentage points. Over the period 2010–2018, the average relative share of households with incomes below the subsistence level in the regions of the North Caucasus Federal Okrug amounted to 16.8%, i.e. almost twice as high as the target set in the Strategy. Overall, as the Accounts Chamber stated in 2019, out of the 50 targets laid down in the Government Program ‘North Caucasus Federal Okrug Development’ that was devised on the basis of the Strategy, only 20 target were actually met or exceeded. In some regions, a particularly critical level of underachievement in the framework of the Strategy was observed: thus, none of the targets of the socioeconomic development subprograms for the Republic of Dagestan for the period 2016–2025 of the Government Program ‘Socioeconomic development of the Republic of Dagestan and the Republic of Ingushetia over the period 2016–2025’ were met, and under the similar subprograms for the Kabardino-Balkarian Republic and the Chechen Republic, only 25% of the targets were met. According to the Accounts Chamber, the goal of implementing 150 new investment projects in the North Caucasus Federal Okrug, which had been laid down in the strategic documents of NCDC OJSC back in 2011, was not achieved, either.¹

Another reason for criticism of the decade-long implementation of the Strategy, which also remained relevant in 2019, was *the vagueness of strategic guidelines and performance indicators* for the state-owned organizations set up for the purpose of carrying out the Strategy. Thus, in the texts of strategic documents of NCDC OJSC, where the corporation’s objectives were specified for each particular year, the targets established by the Government Program ‘North Caucasus Federal Okrug Development’ could not be found. According to the materials released by the Accounts Chamber, the investment cost-effectiveness indicators stipulated in the budget-funded investment agreements signed by Northern Caucasus Resorts OJSC are not consistent with the goals of the Government Program ‘North Caucasus Federal Okrug Development’ and the specific tasks of constructing the resort infrastructure entities that Northern Caucasus Resorts OJSC was expected to perform in the framework of that program. These formal inconsistencies make it difficult to objectively assess the implementation of the Strategy of Socioeconomic Development of the North Caucasus Federal Okrug, and so the performance of all the key actors in the economic development of the North Caucasus Federal Okrug cannot be properly evaluated within the framework of a uniform and sufficiently simple system of parameters.

This particular problem is closely linked to another one, that of *fiscal transparency and spending efficiency in the framework of the Strategy*. That problem is manifest, in particular, in

reporting period of 2019, of the federal budget funding allocated to the charter capital of the joint stock company ‘North Caucasus Resorts’, and the achievement of the goals set in the subprogram ‘Development of a tourism cluster in the North Caucasus Federal Okrug’ of the government program of the Russian Federation ‘Development of the North Caucasus Federal Okrug’ for the period until 2025’. The results of the control estimation completed in 2018 ‘Audit of the substantiation for and effectiveness of the allocation, in 2016–2018, of budget funding to the charter capital of the North Caucasus Development Corporation earmarked for the creation of a medical cluster in the territory of the Caucasian Mineral Waters region and the implementation of investment projects in the North Caucasus Federal Okrug’ were no less relevant in 2019, because they have revealed a number of systemic problems in the Strategy’s implementation.

¹ It should be noted that some of the Accounts Chamber’s conclusions were disputed by CRNC JSC. URL: <https://tass.ru/ekonomika/5908483>.

the high relative share, in the costs of the state-owned companies involved in the Strategy's implementation, of purchases made on non-competitive basis, and the sizable chunks of money spent by those companies on their own needs. The share of purchases made in 2018–2019 on non-competitive basis by Northern Caucasus Resorts OJSC, according to the Accounts Chamber, amounted to 39.8% of the total value volume of its procurement contracts, and 59.7% of these purchases were made to satisfy the company's own needs. Meanwhile, the total amount of budget funds saved by the company as a result of its purchases in 2018–2019 was only RUB 23.7 million, or 0.7% of the total amount of initial purchase prices.

Another serious problem that arose in the course of the Strategy's implementation was *the inefficient interaction with investors*, i.e., the absence of an adequate mechanism for selecting and supporting investors consistent with the achievement of the Strategy's goals. These problems vividly illustrate the current state of affairs in the special economic zones that were specifically created to attract investors willing to participate in the implementation of the tourism cluster projects. Actually, among all these SEZs, only three are currently operating: Arkhyz, Armkhi, and Veduchi. As of 2019, a total of 34 resident companies were registered there (30 of them, in the Arkhyz SEZ); they had created 619 jobs, and built and put in operation 81 engineering infrastructure facilities. Over the period from the launch of these SEZs until January 1, 2019 (at the moment of preparing this material, no data for 2019 was yet available), the total proceeds of sales of goods, works, services, less VAT and excises, received by the residents of the SEZs amounted to less than RUB 1 billion (RUB 851.7 million). The volume of investment attracted by the residents of the SEZs was also insignificant, amounting to RUB 2,079.5 million over the entire period of their existence (8.3% of the initially declared volume, according to the Accounts Chamber). These data convincingly demonstrate that the SEZs are still far below the level of development that could enable them to exert a significant influence on the economy of the North Caucasus as a whole, and to become major employers on a regional scale. The input of the SEZs into the creation of new jobs envisaged in the Strategy is likewise meagre. As far as the motivation of the residents of the SEZs is concerned to make an effort for the sake of implementing the Strategy, there are also some obvious problems. Out of the total volume of investment attracted by those residents over the entire period of existence of these SEZs, 75.2% is accounted for by just 4 out of the 34 residents actually registered in their territories. At the same time, as the Accounts Chamber noted in 2019, 29 residents had been neglecting their obligations regarding their investment in SEZ facilities; over the entire period of existence of the SEZs, violations (failures to fulfill contractual obligations) were committed to the total value of RUB 21,447.1 million. The total area of land plots inside the SEZs is 46,799 ha, while the share of land plots suitable for leasing to residents is negligible and amounts to 344.8 ha, or 0.7% of the total area.

Another issue that hinders the tourism business development in the North Caucasus Federal Okrug, which is one of the Strategy's cornerstones, is that neither Northern Caucasus Resorts OJSC nor representatives of the government bodies supervising the implementation of the Strategy for the socio-economic development of the North Caucasus Federal Okrug, did not offer (at least publicly), in 2019 or earlier, any systemic response to the new challenges that have recently been faced by the tourism business in the North Caucasus. Such challenges include, in particular, the development of ski resorts in a number of post-Soviet states (Georgia, Kazakhstan), which fit into the same price segment as the existing resorts situated in the subjects of the North Caucasian Federal Okrug. In this situation, the competitive advantages of the latter have not been sufficiently clarified to the potential consumers. The question as to the real

existence of any such advantages has remained open. It is not clear how the expected tourist inflow was determined, and if any algorithm was applied in its calculation.

The official recognition, in 2019, of the existence of problems in the implementation of the core measures planned within the framework of the Strategy of Socioeconomic Development of the North Caucasus Federal Okrug was followed by a radical reorganization of the federal economic programs' management system in the Okrug. In January 2020, the RF Ministry of North Caucasus Affairs was liquidated. Its functions were transferred to the RF Ministry of Economic Development. Besides, a discussion was launched concerning the possibility of updating the existing strategic documents on the development of the North Caucasus Federal Okrug.

In this connection, the conceptual options that must be considered prior to planning the future strategic development of the North Caucasus once more come to the fore. The current strategy, with its core idea of the North Caucasus being a poor region that lacks its own resources for development, relies on the model where investors should be attracted to the region from the outside with active government support. Such a model, which outwardly looks like a logical approach to the modernization of backward territories, has already been used in a number of countries, but the results of its actual implementation were often quite different from what had been expected. The main reasons for this model's unsatisfactory performance are as follows:

- the development guidelines turn out to be too optimistic, the existing problems are downplayed, the promising indicators are not based on an analysis of authentic information;
- the bureaucratic structures designed to promote development begin to operate on a self-sufficient basis and no longer focus on the goals and objectives initially set for them;
- the motivation of investors in face of the sizable state support becomes distorted, and the project's effectiveness ceases to be their primary incentive;
- the outside investors begin to compete for resources with the locals, who often use those resources outside of the formal legal framework, thus giving rise to conflicts and alienation of the people from the modernization projects.

The ten-year experience of implementing the Strategy has confirmed the existence of the same problems as were faced by the other countries that attempted to implement this model. In this situation, if the Strategy is to be adjusted, we are faced with the following choice: either to try to improve the existing model by strengthening control and making some moderate changes, or to switch over to some fundamentally different approaches, by rebuilding the entire system of support for the modernization of the region. An alternative modernization strategy could be based on the following principles:

- the reliance primarily on the internal resources available for the development of the region;
- avoidance of gigantomania;
- a focus on the changing institutional environment;
- the support, in terms of expansion, modernization, and creation of new jobs primarily within the framework of ongoing projects, that have already proved their effectiveness and ability to function in the specific conditions of the North Caucasus;
- the support of business projects in the local communities.

These approaches were already proposed by some experts during the elaboration of the current Strategy, but at that time, a different approach was chosen. Now, it is more difficult to make a sharp turn, because we have to make a choice not from scratch, but in the context of the already well-established (albeit ineffective) development institutions, normative backing, and support mechanisms. Nevertheless, there do exist some precedents in world practices of a

complete policy reversal in the context of modernization promotion in backward regions. Thus, the Southern Development Fund (Cassa per le opera straordinarie di pubblico interesse nell'Italia meridionale') was liquidated in Italy; it was the institution responsible for the modernization of the South of Italy and pursuing a policy that was very similar to that outlined in the Strategy of Socioeconomic Development of the North Caucasus Federal Okrug. The modernization support concept was altered entirely, and the new approaches that relied on the region's internal resources proved to be much more successful than the originally applied ones. Such experiences can be borrowed in order to develop a new strategy for the North Caucasus Federal Okrug.

The option of a policy reversal has particularly gained in importance in view of the current economic and social turbulences caused by the coronavirus pandemic and the economic crisis. On the one hand, in such circumstances, the search for some mechanisms that could promote modernization without significant budget expenditures becomes critically important. On the other hand, the highly uncertain prospects of the inevitable changes in the structure of society's needs and market demand in response to the coronavirus pandemic can mean that the future economic development will depend on the ability of economic subjects to flexibly adapt to a changing market situation, and this is typically done with greater ease by small and medium-sized businesses.