Introduction

Economic Growth and Challenges of the Coming Decade

Whilst discussing socio-economic challenges facing modern Russia, it should be noted that the debate very often is conducted «out of context», i. e., with no account of other nations' experiences, primarily post-communist ones. One can have an impression that those conducting research into Russian realities ignore the respective experiences of almost three dozens of nations that after abandoning socialism face the challenges similar to ours[1].

The above fully concerns the hottest issue of the debate on economic growth problems that has started in Russia in 1999. The domestic literature is dominated by two explanations of the nature of this particular growth: while the first one relates it to an actual depreciation of the Ruble following the 1998 crisis and a favorable state of affairs on the oil markets, the other attributes the growth to reforms the Russian government has pursued in the conditions of political stabilization in the wake of 2000 elections. No doubt, the reforms are important to ensure a long-term sustained growth, and indeed, the oil prices and the real exchange rate appear crucial macroeconomic policy factors that affect growth, however, the nature of the current growth appears different.

If one analyzes Russia's growth in the context of other nations' experiences, it becomes evident that at present practically all the countries of the post-Soviet zone have their GDP growing. Interestingly, none of them witnessed this particular process at the first stage of their abandonment of socialism, i. e. between 1992 to 1994. Since 1995 there have been the first signs of growth in place, primarily in the Baltic countries (Lithuania, Latvia and Estonia), as well as in the states that had earlier been involved in military conflicts or found themselves under blockade (for instance, in Armenia, Azerbaijan, and Georgia).

The period between 1996—98 saw first signs of economic growth in other post-Soviet states, though unsustainable and interrupted by slumps they were. Since 1999, however, their growth has become stable and took place across nearly all the countries, except Ukraine. Since 2000, growth has taken place everywhere (except for Kyrgyzstan in 2002) *(see Table 1).*

So, growth is not directly related both to a political regime (they are different in the said nations) and reforms similar to Russian ones of 2000-01, nor it is connected with oil prices (the group of post-Soviet countries comprises both net exporters and importers of oil and oil products). In addition, if one follows real exchange rate dynamics of the noted countries' national currencies over 1995-99, there are those that experienced a substantial real appreciation of their currencies (Kazakhstan, Kyrgyzstan, Moldova, and some others), while there also are those countries where the national currency has appreciated substantially (Azerbaijan, Armenia, Georgia, and the Baltic states).

[1] More specifically, it is highlighted by L. Aron who commented that discussions on Russia, as a rule, are held 'out of the context' and their participants attribute this to a huge size of the country. (L. Aron, Structure and Context in the Study of Post-Soviet Russia: Several Empirical Generalizations in Search of a Theory).

Table 1

The increment rates of the physical volume of GDP in the post-Soviet states between 1996–2001

	1996	1997	1998	1999	2000	2001
Azerbaijan	1,3 %	5,8 %	10,0 %	7,4 %	11,1 %	9,9 %
Armenia	5,9 %	3,3 %	7,3 %	3,3 %	5,9 %	9,6 %
Belarus	2,8 %	11,4 %	8,4 %	3,4 %	5,8 %	4,1 %
Georgia	11,4 %	10,6 %	2,9 %	3,0 %	2,0 %	4,5 %
Kazakhstan	0,5 %	1,7 %	–1,9 %	2,7 %	9,8 %	13,2 %
Kyrgystan	7,1 %	9,9 %	2,1 %	3,7 %	5,4 %	5,3 %
Moldova	-5,9 %	1,6 %	-6,5 %	-3,4 %	2,1 %	6,1 %
Russia	-3,4 %	0,9 %	-4,9 %	5,4 %	9,0 %	5,0 %
Tadjikistan	-16,7 %	1,7 %	5,3 %	3,7 %	8,3 %	10,2 %
Uzbekistan	1,7 %	5,2 %	4,4 %	4,4 %	3,8 %	4,5 %
Ukraine	-10,0 %	-3,0 %	-1,9 %	-0,2 %	5,9 %	9,1 %
Latvia	3,3 %	8,6 %	3,9 %	1,1 %	6,6 %	6,5 %
Lithuania	4,7 %	7,3 %	5,1 %	-3,9 %	3,9 %	4,0 %
Estonia	4,0 %	10,4 %	5,0 %	-0,7 %	6,9 %	4,5 %

Source: Sodruzhestvo nezavisimykh gosudarstv v 2001 g. Statistichesky ezhegodnik. Mezhgosudarstvenny statistichesky komitet SNG. Moskva, 2002; Transition Report 2001. EBRD, 2001.

Table 2

The real exchange rate of national currencies to USD in post-Soviet states (calculated on the basis of CPI), 1995=100

	1996	1997	1998	1999	2000	2001
Azerbaijan	126 %	135 %	131 %	104 %	99 %	93 %
Armenia	107 %	104 %	106 %	104 %	95 %	93 %
Belarus	110 %	89 %	44 %	56 %	39 %	46 %
Georgia	130 %	134 %	99 %	107 %	105 %	103 %
Kazakhstan	118 %	131 %	125 %	80 %	84 %	85 %
Kyrgystan	86 %	100 %	64 %	55 %	60 %	63 %
Moldova	113 %	120 %	70 %	72 %	86 %	87 %
Russia	120 %	125 %	45 %	63 %	71 %	78 %
Ukraine	166 %	187 %	113 %	89 %	113 %	134 %
Latvia	110 %	111 %	118 %	116 %	110 %	104 %
Lithuania	121 %	129 %	133 %	131 %	128 %	126 %
Estonia	110 %	103 %	118 %	102 %	95 %	93 %

*Source: C*alculated basing on the data from International Financial Statistics 2002. IMF, 2002.

Thus, each post-Soviet state bears its specificity, which manifests itself exclusively against the background of economic growth. This leads to an assumption that sources of both the given growth and the preceding decline in economic activity should lie with other processes.

Let us first attempt to analyze causes for the production slump in 1992-94 followed by economic growth.

The phenomenon of post-socialist recession is well studied into, and main factors that determine its intensity are fairly understandable. It is worthwhile to focus on the nature of so-

cialist gross domestic product. In fact, the traditional concept of GDP applicable to a market economy cannot be used for the purpose of evaluation of a socialist one. An accurate use of this concept implies the existence of certain constraining factors, such as: the presence of market economy, a relatively small share of the government (budget) in it, and the presence of democratic control over the formation of public expenditures. This in turn implies a fundamental principle used in computation of GDP: given that people (either individually, as consumers, or collectively, as taxpayers) pay for some goods and services, it means that the latter bear some value to them, which forms a necessary condition of inclusion the given produce in the computation of wealth[2].

Obviously, the above does not match the socialist economy realities, where output and produce distribution are under strict control, with no markets and democratic control over public expenditures in place. Under such circumstances, a considerable volume of economic performance does not form a contribution to the overall growth in wealth. Rather, it often turns growth in GDP in a statistical illusion. In the Soviet time, the bay of Kara-Bogaz-Gol was drained to stop the lowering of water-level in the Caspian sea; then Volga-Chagrai channel was built to divert water from Volga and stop the rise of the Caspian sea. Should we consider both cases from the perspective of socialist economy, they both added to GDP.

So, as far as socialism is concerned, the concept of GDP appears very conventional, because socialism does not always allow the existence of basic prerequisites that would allow to consider a certain economic activity to be justified, sound and aimed at satisfying actual needs. In other words, needs and incentives in socialist economy and market one appear incomparable: what is sound in the former may prove to be an absolute nonsense in the other. This strictly limits the possibility to compare GDP=s measured in value units (money). Once socialist system collapsed, these qualitative differences became visible, and one understands that a considerable part of a socialist economic activity is such that under market and democratic conditions no one, whether acting as a consumer, or a taxpayer, would ever be keen to pay for it.

That is why the process of post-socialist transformation comprises primarily a gradual re-distribution of resources from those kinds of operations and those enterprises that are incapable to operate in market conditions in favor of those that enjoy an actual demand. At the first stage the volume of unfrozen resources is always in excess of the volume of their use in a new production, which predetermines a slump. The economy consequently passes through the 'inflection', when volume of resources involved in production becomes greater than the volume of resources freed out of earlier inefficient sectors. This is what constitutes the nature of the post-socialist transition and growth.

There consequently arises the problem of modernization associated with the collapse of an old economic system and the time period needed to get market institutions work. This is another important factor that determines the course of post-socialist recession. Once the market institutions have been established and begun functioning, there starts post-socialist recovery.

[2] Discussions on a 'correct' measuring GDP sometimes involve paradoxical comments testifying to the importance of such assumptions: thus, A. Pigou argued that the marriage to the own housekeeper should contribute to a decline in GDP, because the housekeeper's spouse discontinues to buy the respective services, while S. Kuznets raised a question as to while measuring GDP in the ancient Egypt, it is appropriate to consider the specificity of funeral rites in ancient Egypt, i.e. to divide the nation's per capita output into the living population or to add the first generation of the deceased

The group of main factors that determine the length and intensity of post-socialist recession comprises:

a) the scope of a sector of an economy whose goods and services are not demanded by markets;
b) the scope of using market instruments under socialism;
c) the information on pre-socialism market institutions existing in the population's social memory.

Proceeding from the above, one can understand, for instance, why the recession in Eastern European and the Baltic states that had experienced socialism just for two generations was shorter than in the most of the post-Soviet zone, where socialism had been lasting for as long as three generations.

In other words, the emergence of a market system of economic ties, redistribution of a critical mass of resources in favor of market sectors, management adapting to market conditions constitute major factors of the transition towards the stage of post-socialist growth. This particular process was taking place first in Eastern Europe in the early 1990s and consequently in the CIS countries in the late 1990s. While considering the process, one should also take into account specifics of a national macroeconomic situation, price dynamics for major exports and imports, and exchange rate policy. These particular parameters have a substantial impact on national paths of growth, but only with account and in the frame of the overall post-socialist recovery growth process.

The growth we see in the country today is not unique in Russia's history. It bears a great deal of similarity with the recovery growth noted under the New Economic Policy (NEP) that followed the October Revolution and the Civil War, which was also mirrored in economic debates of that time. More specifically, it was then that renowned Russian economists V. Bazarov and V. Groman introduced the concept for recovery growth to economics[3]. They found out that with all colossal losses during the Revolution and the Civil War, it was the collapse of economic ties that constituted the most crucial factor of the production decline at the time[4].

Obviously, the current recovery growth in Russia appears substantially different from the one that had followed the Revolution and the Civil War.

First, the level of the production decline in 1991-98 was substantially lower than during the Revolution and the Civil War – that is why the current recovery rates are also lower than those of that time.

Second, with all its specificity, the Russian economy of the NEP period basically was a market one, as well as that of 1913. With all it specifics (a substantially smaller proportion of foreign trade in GDP, a smaller proportion of sales in the agrarian output, a greater role played by the public sector, etc.) it resembled the structure of the Russian economy of 1913 to

[3] See: Bazarov V. O "vosstanovitelnykh processakh" voobsche I ob "emmissionnykh vozmozhnostyakh" v chastnosti//Ekonomicheskoe obozrenie, 1925. # 1; Perspektivy nashego narodnogo khozyastva na 1925/26 gjd.//Ekonomicheskoye obozrenie, 1925, #8; Groman V. O nekotorykh zakonomernostyakh, empiricheski obnaruzhivaemykh v nashem narodnom khozyastve//Planovoe khozyastvo, 1925.# 1,2

[4] " No matter how great the direct destructions were in the fire and in battles of the Imperialist and the Civil Wars - deaths, destruction of buildings, machinery, final consumer items, they are far smaller than the functional breakup, i.e. a temporary discontinuation of economic creative processes".-see: Groman V. O nekotorykh zakonomernostyakh, empiricheski obnaruzhivaemykh v nashem narodnom khozyastve//Planovoe khozyastvo, 1925.# 1, p.101

a far greater extent than the structure of the current, basically market, Russian economy resembles the structure of the socialist economy of RSFSR of 1990.

Notwithstanding, a number of processes characteristic of the recovery growth of the NEP period manifest themselves in modern Russia, too.

According to Groman, none of Gosplan experts expected the economic growth rates to be so high between 1923 to 1924, right in the aftermath of the monetary reform and stabilization of money circulation. Gosplan projected that between 1923 through 1927, lacking large-scale investment, economic growth could boost the national income of the USSR to the level roughly accounted for the half of Russia's national income in 1913[5]. In reality, however, it hit the level close to 100 % of Russia's GDP in 1913[6].

Likewise, in their 2000 budgetary projections, the current Russian government considered economic growth to be within the range between 0.2 % to negative 2.2 %, while yet in spring 2000 the IMF forecasted a 1.5 % rise in Russia's GDP. In reality, however, the country's GDP soared up to 9 %, while the industrial output rose by 11 %. (Notably, the IMF forecasted a 3.5 % growth in the Ukrainian GDP for the year of 2001[7], while the actual rate accounted for 9 %.)

The causes for such inaccurate forecasts are understandable and appear closely connected with the nature of recovery growth. Whereas the GDP forecast methods are based upon extrapolation of tendencies of a prior period, as well as forecast dynamics of production factors and the state of affairs in an economy, it is easy to realize that they all are hardly applicable to forecasting a rise in economic activity determined by a stabilization of economic ties.

However, one consequently has to face another, unpleasant surprise. One finds out that recovery growth is a withering phenomenon by its nature, and growth rates begin to decline. The essence of this particular process is understandable: as recovery growth is secured by the use of existing, 'old' capacities and 'old' qualified workforce and takes place under relatively insignificant capital investment, the volumes of both resources tend to run out relatively fast and the problem of their shortage arises.

Thus, between 1998 to 2002 the number of those employed in the national economy grew by 8.9 mln. (from 58.4 up to 67.3 mln.) The shortage of qualified workforce was mirrored by a rapid rise in real salaries and wages: more specifically, over the period between 2000 through 2002 alone they grew 1.7 times, and the analogous trend was noted across other CIS states (*see Table 3*).

[5] V. Groman. Konyunkturnyi obzor narodnogo khozyastva SSSR za pervoe polugodie 1924-25 goda//Planovoye khozyastvo, 1925, # 6.
[6] See: The Economic Transformation of the Soviet Union, 1913-1945, ed. By R.W. Davies, Mark Harrison, S.G. Wheatcroft. Cambridge University Press, 1994
[7] World Economic Outlook. October 2000. Focus on Transition Economies. International Monetary Fund

Table 3

The increment rates in real salaries and wages in CIS countries between 1996–2001 гг.

	1996	1997	1998	1999	2000	2001
Azerbaijan	19,0 %	53,0 %	20,0 %	20,0 %	18,0 %	16,0 %
Armenia	13,0 %	26,0 %	22,0 %	11,0 %	13,0 %	5,0 %
Belarus	5,0 %	14,0 %	18,0 %	7,0 %	12,0 %	30,0 %
Georgia	53,0 %	37,0 %	25,0 %	2,0 %	3,0 %	22,0 %
Kazakhstan	2,0 %	5,0 %	4,0 %	7,0 %	12,0 %	13,0 %
Kyrgystan	1,0 %	12,0 %	12,0 %	-8,0 %	-2,0 %	11,0 %
Moldova	5,0 %	5,0 %	5,0 %	-13,0 %	2,0 %	15,0 %
Russia	6,0 %	5,0 %	-13,0 %	-22,0 %	21,0 %	20,0 %
Tadjikistan	-14,0 %	-2,0 %	29,0 %	0,3 %	8,0 %	11,0 %
Ukraine	-5,0 %	-2,0 %	-3,0 %	-6,0 %	1,0 %	21,0 %

Source: Sodruzhestvo nezavisimykh gosudarstv v 2001 g. Statisticheskiy ezhegodnik. Mezhgosudarstvenny statisticheskiy komitet SNG. Moskva, 2002

Interestingly, in his papers of the 1920, V. Groman also referred to an advanced rise in real salaries and wages vs. labor productivity[8].

The IET business surveys show a drastic change in the balance of estimates of sufficiency of production capacities for satisfying the envisaged demand over the period between 1998- 2001. As well, estimates of the need in workforce due to the envisaged growth also undergo changes: shortages of equipment and qualified staff are increasingly interpreted as a serious obstacle to the rise in output[9].

A decline in growth rate after reaching peak values and involvement of the most accessible resources into economic turnover almost inevitably leads to economico-political debates on causes of the fading growth rates and the respective remedies. Given that the power and expert community conceive genuine extremely high growth rates as a pleasant surprise, consequently both the political elites and the society get accustomed to orient to these abnormally high rates as a policy landmark, a measurement unit for further evaluation of a policy underway.

The experts dealing with the 1920s, i. e. the NEP period, are well aware of such a situation[10]. The attempt to accelerate industrialization in 1925/26 that resulted in the rise of inflation in the fall 1925 and the collapse of the convertibility of the 'chervonets' was related to the eagerness to retain the growth rates. However, in 1925/26 recovery growth was still there and its rates were fairly high. That is why, even with the emergence of the respective problems – a strained budget and clear signs of inflation, – the conflict was remedied by means of deceleration of rates of investment and monetary expansion that helped stabilize the economy. But, when the next analogous economico-political dilemma occurred (1927), by the time growth rates had fallen several times compared with their peak values of the recovery period, and against such a background the attempt to boost them resulted in the collapse of the whole NEP mechanisms, rather than a new stabilization.

[8] Groman V. O nekotorykh zakonomernostyakh, empiricheski obnaruzhivaemykh v nashem narodnom khozyastve//Planovoe khozyastvo, 1925.# 1, p. 132
[9] Economic and political situation in Russia. Monthly Reviews. M., IET
[10] See: Mau V. Reformy i dogmy: 1924-1929 gg. M., 1993, pp. 152-78

Nowadays, luckily, the debates on what shall be done to stir 'fading growth rates' up so far have not led to such tragic consequences. However, they are capable of exercising a serious and dangerous impact on the overall economic policy.

A relative exhaustion of the sources of 'recovery growth' poses a new problem of securing an economic growth that goes beyond the boundaries of recovery itself, i. e. such an economic growth that already implies creation of new, rather than involvement of old, production capacities, capital assets renewal, and attraction of a new, qualified workforce.

The solution to this particular challenge lies with intensification of economic reforms. In our view, overall, the government actions in this area are sound, however, one should bear in mind that this is a long-lasting process with a long time lag between an action and its effect. In this regard, for instance, it is quite natural to consider the US economic growth in the '90s to be closely related to R. Reagan's economic reforms of the '80s, with the time lag accounting for nearly ten years.

In the meantime, those who would like to stir the current growth up are guided by the logic, as follows: 'President trusted the Government and invested a huge political capital in their program. The Government began implementing their program and launched some reforms, and, as a result, growth rates fell twice'. They proceed with a conclusion that there arises a need to change the course, and this is the threat that now poses a serious challenge facing Russia.

In light of the above, a possible break in growth over 2003-05 bears a certain risk. Such a pause by itself is not dangerous, for the significance of ways the economic growth rates in 2003-05 can affect Russia's long-term prospects appears fairly limited. Rather, it is a pause, if not a cease, in implementation of structural transformations, which, considering the current Russia's situation, when recovery growth resources have been practically exhausted, are far more important than short-term fluctuations of growth indices. The only sound option would be to accelerate structural reforms and retain a conservative monetary and financial policy to shape prerequisites for a sustained economic growth basing on a set of efficient market institutions.

At the same time, it should be remembered that structural reforms require a high level of complementariness. Establishment of a favorable investment climate requires not just a completion of a tax reform, maintaining a sound exchange rate policy and lowering public expenditures – one also needs an efficiently operating judicial system, a real protection of property rights, and less corrupted red tape. All this suggests a long spade-work, with zero growth rates to appear already in the coming years.