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## Crisis: Economic or Institutional?

### GOLD MEDAL

*Pavel A. Minakir*

Pessimistic estimates and forecasts of economic growth in Russia, characteristic for 2015–2016, have been replaced since the end of 2016 by the growing optimism of both official agencies and individuals and experts. It would seem that there is indeed a reason for optimism. After seven quarters of a continuous fall in the country's GDP in the 4<sup>th</sup> quarter of 2016 there came a turning point. Rosstat reported a GDP growth of 0.3 % compared to the fourth quarter of 2015. Is this really a fracture?

Of course, the situation is exacerbated by the fact that in 2016 Russia's GDP still fell by 0.2 %. And it is quite possible, and even more, since Rosstat officially corrected the macroeconomic estimates for the 1<sup>st</sup> and 2<sup>nd</sup> quarters of 2016, lowering the estimates of the rate of decline, respectively, from 1.2 % to 0.4 % and from 0.6 % up to 0.5 %. It is optimistic that in the 1<sup>st</sup> quarter of 2017 the growth compared to the same quarter of 2016 was 0.5 %.

All this gives the government grounds to even challenge the positive forecasts of the growth of the Russian economy in 2017, which are given by international organizations predicting growth in 2017 at 101.4 % (OECD and IMF) and 101.3 % (World Bank). Encouraged by the positive values of the quarterly indicators, the Minister of Economy, the Deputy Prime Minister of the Government, followed by the Russian Federation's President, confidently predicted an increase of 2 % for the Russian economy in 2017, although according to the forecast of the Ministry of Economic Development in January the growth of about 100.6 % was carefully predicted for 2017.

The reason for improvement in domestic and international forecasts is the expected revival in the sphere of investment and international trade, in particular, aggregate exports at the global level. Of course, the general increase in demand in the world economy will lead to a certain increase in demand for Russia's main export positions, which is reflected in the experts' expectations. Certainly, one can say that there was the change of the indicator of macroeconomic expectations, which was reflected in the revision of the sovereign rating of Russia by the rating agency S&P from stable to positive.

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However, the main issue is still different. Has there been a change in the fundamental foundations that determine the long-term trend in the development of the country's economy? Or, still, are hopes related to the future change in the trend of world prices for hydrocarbons? These hopes can be justified, but they may not be justified. The probability of the latter is very high.

First, even an improvement in the global macroeconomic environment is not a guarantee of a gap in supply and demand in the global hydrocarbon market because of the current excess of potential supply over potential demand. During the period of low prices almost all manufacturers and state budgets of producing countries suffered significant losses in the form of lost revenues. Any improvement in the market situation will be considered by them, most likely, as a signal for increasing the supply to the maximum possible extent for redistribution in their favor of the excess revenues accumulated in the previous period by importing countries. The result may be a disruption in the supply and demand balance already at the new levels of demand and the return of export prices to low levels.

Secondly, rapid technological progress changes the structure of energy consumption and specific consumption standards, objectively reducing global demand. So far, one can obviously only talk about the short-term structural and regulatory effects that supported the economy, which, however, are more connected with external factors, rather than with fundamental changes in the Russian economy itself. Growth in the food industry and in the agro-industrial complex as a whole is driven by an increase in investment against the background of import substitution. The gain in metallurgy is caused by the improvement of the market situation. State orders in the military-industrial complex and the infrastructure sector also supported the economy.

The fundamental factors of growth for the Russian economy are currently net exports and domestic demand. The dynamics of net exports under the existing export structure is oppressed by the external situation and can be activated only in case of a real structural and technological modernization of the Russian economy, that is, in the case of the replacement of other goods and services by the volume of hydrocarbon exports. This cannot be done in a short period. But in a long-term aspect, this involves intensive investment in production and management technology.

What is the source of investment? There are basically two of them – savings and total debt. Over the past 25 years, since the declaration on the transition to a market economy, the ways of transforming the savings of the population into investments have never been found. Given the extremely low level of mutual trust between the state, private business and the population, it is highly doubtful that this method can be 'opened' in a short period. It is not surprising, therefore, that Sberbank analysts are calling for an increase in the aggregate rate from the current 100 % of GDP to 150 %, *i.e.*, attracting about

40 trillion rubles of investments to the economy within 10 years. Given that external sources of financing corporate debt for Russia are likely to remain inaccessible for a long time, it is an internal debt, that is, the aforementioned transformation of savings into investment.

And consequently, this recipe, which is acceptable from the arithmetic point of view, becomes economically (behaviorally) unrealistic. And this implies some other source of investment, which by definition, in a closed economy from the financial and investment point of view can only be a state budget. Internal demand for goods and services for industrial purposes is, in the long run, determined both theoretically and practically by the size of the accumulation, that is, by the increase in the output of goods and services, and also by the degree of its diversity.

Therefore, there again arises the problem of the source of investment and structural modernization of the economy. As noted above, both these tasks do not have a simple and unequivocal solution within the accepted economic and political paradigm. The situation is no better with domestic consumer demand. In 2016, the reduction in the size of retail trade continued. It was not as large as in 2015 (4–5 % vs. 15 %), but it is likely that the ‘improvement’ was achieved through the indication in the Rosstat statements for 2016 of the aggregate indicator, which includes wholesale trade, vehicle repair, motorcycles, household products and personal items (in 2015, reported on the indicator ‘retail trade’). In any case, the decline in consumer demand continues. A change in trend is possible, but for this purpose it is necessary to restore the dynamics of household incomes and, most importantly, to change the indicator of macroeconomic expectations in households, without which it is impossible to hope for a change in their consumer behavior. The result is the next vicious circle.

The presence of such vicious circles explains the general pessimism of macroeconomic forecasts of the Russian government, international organizations, and experts. The most optimistic assessment of the forthcoming economic growth in 2017–2020, if it takes place and is not thwarted by extreme external or internal factors (the collapse of oil prices, the collapse of the ruble exchange rate, the excessive strengthening of the ruble, *etc.*), are in the range of 1.5–2 % of annual growth. In this case, the Russian economy may face a prolonged stagnation with periodic recessions as a result of cyclical or external economic conjectural shocks generated by non-economic reasons. One of such non-economic shocks has just been indicated in the form of legislative formulation of anti-Russian sanctions in the United States.

Thus, the choice of a strategy for the development of the Russian economy, which would guarantee a ‘breakthrough’ in the field of stable economic growth, has long been exaggerated in the expert community and in official forums and turns into a kind of shamanism. Rational choice does not exist and it remains to appeal to the ‘higher forces’ which in some miraculous way will tear off at least

some of the loops of positive feedback that tightly wrapped up the national economy. In fact, it is becoming increasingly clear that this is not so much about choosing a rational mode of economic behavior in the macrosphere, but rather about the recipes for development within an increasingly closed economy, all the mechanisms and interrelationships of which are oriented and geared toward an economy functioning within the global reproduction cycle.

We already know how to build a mobilization-type economy, and know what, how much and who will have to pay for it. It is obvious that strategists should find solution how to make the economy, while remaining market and globally oriented, develop at a rapid pace, *i.e.*, to increase competitiveness in a global sense, relying only on one's own strength. In fact, the Russian economy faced the problem of a 'new two-track path': to exist in a global world based on the Juche ideology. Whether there is the 'light at the end of the tunnel' depends in this sense on the fundamental possibility of determining the 'optimal' economic development strategy under the above assumptions and conditions of an economic and ideological nature. This is a difficult question, considering that the desire to build an 'ideal' economic development strategy over the past 30 years has become an obsession for the Russian political class and the expert economic community.

Starting with the '500 Days' Program, an avalanche of strategies and programs covered Russian society in general and the elite in particular, giving rise to almost certainty that the secret of success in the economy lies in 'good strategies' and the failures in the economy, on the contrary, in failed strategic projects. The development of strategies has turned into a kind of virtual life for elites and numerous expert groups serving them. There is a conventional conviction which does not become less popular as it is a misperception: it is enough only to develop a 'correct' strategy, to accompany it (this is the most important thing) with a detailed 'plan of implementation measures' and it is possible with a sense of accomplishment to calmly wait for an economic miracle in the form of high growth rates, popular rejoicing and envy of enemies.

At the same time, there is still no answer to the simple question: why, with an abundance of strategies, almost no results in terms of stable growth rates, stable economic and social development, improvement in the quality of life have not been achieved. Note that, until recently, there was no mention of any 'two-track path' in the spirit of 'Juche-globalistics'. And it was necessary to overcome 'only' internal conflicts of the strategies of social and economic development.

This internal conflict of strategies for socio-economic development, which is practically absent in strategies of production and technology, aimed at achieving certain parameters of supply and exchange, is due to their focus on the parameters of income and distribution. At the same time, it is almost impossible to determine in an explicit manner the goal, whose methods of achieving

are the strategy. Indeed, how can you design a strategy for achieving such a goal as 'to ensure a high quality of life', 'to ensure some growth rate', 'to increase labor productivity', 'improve demographic indicators', 'improve the investment climate', *etc.*?

Such goals, firstly, are subject to extremely strong, multi-level decomposition, during which it is found that there is simply no single strategy for achieving them, but there is a combination of overlapping and competing strategies of specific economic, social and other actors of the social process. Secondly, economic goals themselves are only fragments of the synthetic goals of social progress.

From this point of view, the currently discussed socio-economic development strategies essentially reproduce the choice that the authorities and experts faced in the late 1980s and early 1990s: the gradualist strategy of 'improving institutions' in terms of limiting the money supply, the ongoing strict control of inflation, lower budget expenditures and higher taxes or a shock strategy of 'monetary investment pumping' by increasing the money supply, maintaining a moderate inflation rate, increasing budget expenditures in the event of tax reduction and increased public investment in infrastructure projects. Then the choice was predetermined not by the actual economic calculation of 'costs-results', but by the influence of one and the other strategy on the fundamental foundations of the socio-political and socio-economic structure of the country.

The goal was not the rate of growth, and even not the efficiency of the economy, but the changing property relations and the associated change in the political structure of society. This was the meta-goal. And the instrument for achieving it was reformatting the mechanisms of the functioning of economic agents and motivating their behavior. This meta-goal was achieved by the early 2000s.

Favorable external conditions in the form of high prices for hydrocarbons, which made it possible to conserve the institutional dynamics and socio-political processes in the country, focusing on the accumulation of export rents, made it unnecessary at this time to formulate a new meta-goal, although in the politico-ideological sphere such a necessity all the time came to the surface in the form of searching for a 'national idea'. The meta-goal set in the late 1980s was adjusted and reformatted to a partial restoration of the former socio-economic institutions, provided that the liberal shell of macroeconomic regulation was preserved, but replaced the concept of quasi-perfect competition with the concept of state monopoly and market oligopoly.

This probably explains the 'invisibility' of numerous strategies, for example, the '2020' strategy. If there is no goal, one may get whatever any beautiful and soothing about the accuracy of the canons text. One will not get the strategy in this case.

Now the situation has changed. The liberal envelope cannot be supported by external resources in the form of export rents and has begun to rebuild, absorbing domestic resources, especially the sectors of 'state social trusteeship'. Fierce competition has arisen between the state's obligations for social and corporate guardianship, on the one hand, and military-political, on the other hand.

In fact, the Russian economy is in a systemic crisis, which is the classic Marxist crisis of overproduction. The maintenance of proportions and fulfillment of balanced obligations (which in the conditions of the victorious state monopoly have turned to a large extent into state obligations) is only possible under existing proportions of 'prices' (rental income of the budget, savings, final expenditures, corporate profit, ruble rate, interest rate, *etc.*). External shocks destroyed this balanced system, and there were no mechanisms for its automatic correction. They are blocked by the same state monopoly and corporate oligopolism, which were formed throughout the first decade of the new century.

Thus, external shocks are not the main problem. They are inevitable, of unknown form, time and size, but it is known that they will happen. The main internal problem is the lack of effective arbitration, the 'frozen' political and social formats, conflict between the pseudo-market and state-monopoly sectors in the economy.

Accordingly, numerous discussions on a new development strategy aimed at providing a new 'acceleration' and 'efficient economy' actually implicitly include the question of the need to replace the meta-goal, which automatically results in the necessity to discuss the content and form of social development as a whole. As a matter of fact, the fierceness of the discussion is due precisely to the greater or less willingness of the disputants to recognize this fact. An illustrative description of the bitterness present in all these 'strategic' discussions was given by Ruslan Grinberg who moderated round-table discussion on 'The Russian Economy at the Crossroads: The Battle of Strategies' (April 20–22, 2017, at St. Petersburg State University): 'Many experts want to save the Russian economy, but are ready to sacrifice the economy itself, if they do not agree with the recipe for salvation'. This is a very precise description of the essence of the discussion itself.

After all, the dispute is not about a new meta-goal, but about determining the ways to achieve it, this is the essence of strategy. The dispute is about the ways, but by default it is assumed that these are different paths to the same goal – the preservation of the status quo. The fact that this state of the status quo is the cause of the crisis and the impending long-term stagnation not that escapes attention, but apparently, it seems so 'politically incorrect', so falling out of the general line that it is not very good to talk about it.

And therefore, a lingering search for new arguments or new nuances of the scholastic dilemma continues: a reform of institutions while maintaining a

'two-track' model of building the economy or reform of instruments while maintaining these 'tracks'. Practical recipes are well known. The first one is about modernization of the structure and change of the quality of institutions against the background of monetary and fiscal stabilization. The second one is about budget-monetary stimulation of investments against the background of modernization and improvement of the quality of institutions.

It is true that after the St. Petersburg Economic Forum, the economists started talking about the third recipe – the 'digital economy', but this concerns the refinement of structural predilections, and not the logic of macroeconomic decisions, which are actually referred to in the context of 'recipes'.

The supporters of the first recipe are sure that the skills of maneuvering of financial reserves and maintaining macroeconomic stability in monetary sense are sufficient to provide the economy with an opportunity to automatically search for a state of dynamic equilibrium. It is not clear, however, why and how maneuvering and maintaining stability, which for more than two decades have been the cornerstones of Russian macroeconomic policy, will suddenly lead to the restoration of the dynamics, although up to now this dynamics has been suppressed from time to time. Obviously, the answer should be sought in persistent calls to improve the quality of institutions and accelerate reforms.

At the same time, we mean that the problem of the quality and stability of institutions should be solved at the expense of 'political will'. Of course, this is utopia. Without any systemic transformation of the socio-political foundation for the formation and guarantee of protection of motives for economic behavior there will be no positive results.

But there is one more serious problem which was pointed out during the discussion at the above-mentioned meeting of the round-table discussion by Prof. M. Yu. Urnov. It is conceivable that any strategies, if they are understood only as a certain set of tools for manipulating macroeconomic resources to achieve the most common goals, such as rates of economic growth or statistical indicators of production, consumption, income and distribution, will remain empty words or will disappear. This will not happen only when they are based on the fundamental understanding of nature and the trends in the change of economic and social motivation of actors in economic and social processes. Understanding and accounting for these motivations is a weak link in Russian economic and social policy. The assumption that macroeconomic indicators are themselves a sufficient basis for solving the accumulated and multiplying problems of social well-being and economic activity is not an axiom. Moreover, the complexity and ambiguity of motivations in society are indicative rather of the lack of evidence of this thesis than the confirmation of its axiomatic character.

But after all, the adherents of the first recipe are sure that the 'right' macroeconomic regulation and advanced institutions will necessarily induce eco-

economic agents to find and invest domestic resources, which will give the desired transition to growth and prosperity. Certainly, it will happen not so soon, but very liberally and in full accordance with the neoclassical concept of free trade and maximization of the net surplus of the balance of payments.

The authors of the second recipe have no time to wait, when 'cultivation of institutions' and the education of economic agents will lead to economic growth. They are sure that, firstly, the result should be obtained in the shortest possible time. And secondly, the main way to achieve economic growth should be 'investment pumping' in the form of implementing investment mega-projects on infrastructure development. State reserves (including virtual reserves in the form of total debt) and the means of the consolidated state budget should be the source of financing these mega-projects. During the above-mentioned round-table discussion, the idea of 'investment pumping' was presented in the form of a project of 'contraction of the Russian space' through building a high-speed railway that should replace (or increase the capacity) of the Trans-Siberian Railroad, of course, as always, as regards railway construction, at the expense of the state budget. There is no doubt that investment injection into the economy (and this project is about 15–20 trillion rubles within 7–8 years, *i.e.*, about half of the amount that Sberbank proposes to attract within one decade by increasing the total debt by 1,5 times) will lead to some GDP growth.

Thus, the investment of 30 times less state budget resources in preparation for the APEC summit in Vladivostok has significantly increased GRP of Primorsky Krai, but not for long. The investment is over and growth is over. Maybe, this will not happen in the case of a high-speed railway construction. To be sure, it is necessary to have answers to boring questions that are directly related to the economy in general and to economic growth in particular: which national factor of production localization will be provided? What is the magnitude of the investment multiplier? What is the mechanism and size of the generation of domestic demand? How will the effects of exploitation be distributed? How will transport costs change? How will the situation with labor mobility change? Will the degree of homogeneity of economic and social space increase? Which part of the international transit of container cargo will switch over Russian railways? Will any additional economic and budget profits be received, *etc.*?

However, without basic institutional changes, it is rather pointless to talk about this. But everything may happen exactly the opposite. The level of homogeneity of the country's space as a result of the main high-speed road construction may decrease due to the ease of 'contraction' of the already fragmented economic space to the already existing economic poles around megacities, which relates both to the labor market and the location of production capacities. The huge expenditure of budgetary funds will lead to the creation of a

‘transit Eurasian specialization’ of the Russian economy, which will block the institutional and financial support by the state of private investments into diversification of the national economy and exports. Huge funds will be invested in fact either in confrontation with China’s international infrastructure project ‘New Silk Road’, or in strengthening of China’s satellite status in this project. And the latter is the most probable, given that Russia has already formally joined this project (which was declared in 2015 and formalized by an official intergovernmental statement in May, 2017).

Of course, this is just one of the possible projects. However, the list of questions from the project to the project will vary slightly. But the main problem lies in the assumption that public investment without any changes in basic economic relations and socio-political formats can trigger the mechanism of economic growth, *i.e.*, automatically solve the problem of technology transfer, effective scale of output, the size of aggregate demand, the structure of domestic consumption and exports, productivity of functioning capital, rationality of economic behavior, effective competition, *etc.* The investments at the expense of borrowed capital will hardly solve these problems, even if they do not shake the stability of the money market (which is highly improbable under rational investment).

The number of problems and fundamentally non-untangling loops of feedbacks is extremely large. However, the presence of risks is not the reason to do nothing, but a very good reason to answer the question; what is the ultimate goal of the action? It is time to formulate a new meta-goal – the goal of social development in general and economic development in particular, which should result in the formation of an optimal strategy to achieve this goal, which, of course, will combine both the currently actively discussed strategies of economic regulation.