

Quo vadis Rusland?
Toekomstscenario's voor Rusland

Politieke situatie

Economische situatie

Risico's en problemen voor de
toekomst

Political situation

Putin

- Former FSB Chief
- Former President of Russian Federation
- Future Prime Minister
- New Party leader of United Russia, that has absolute majority in Duma
- A liberal in Russian eyes and an autocrat in our eyes

Different perceptions



Russian perceptions

Russians' Confidence in Putin

	<u>Lots/ Some</u> %	<u>Not Much/ None</u> %	<u>DK/ Ref</u> %
Spring, 2007	84	10	6=100
Spring, 2006	75	17	8=100
May, 2003	76	22	1=100

*How much confidence do you have in Putin to do the right thing regarding world affairs a lot of confidence, some confidence, not too much confidence, no confidence at all.

Why is Putin so popular?

- Competing theories
 - State control of media (certainly for television)
 - Preference for butter over freedom
 - Preference for a strong leader over democracy
 - Luck because of high oil prices
 - Wise macro-economic management
- All of these may be there to stay

About butter and freedom:

Russians Prefer a Strong Economy to a Good Democracy

	Good <u>Dem</u>	Strong <u>Econ</u>	DK <u>Ref</u>
	%	%	%
Russia			
Spring, 2007	15	74	*1=100
May, 2005	14	81	5=100
Summer, 2002	11	80	8=100
Spring 2007			
Ukraine	19	76	5=100
Russia	15	74	*1=100
Bulgaria	23	67	*0=100
Poland	30	56	*4=100
Czech Rep.	54	42	3=100
Slovakia	49	46	5=100

*If you had to choose between a good democracy or a strong economy, which would you say is more important?

Longing for a strong leader?

Best Kind of Governance for Russia

	<u>Dem</u> <u>Gov</u> %	<u>Strong</u> <u>Ldr</u> %	<u>DK</u> <u>Ref</u> %
Spring, 2007	27	63	11=100
Spring, 2006	29	61	10=100
May, 2005	28	66	6=100
Summer, 2002	21	70	9=100
Fall, 1991	51	39	10=100

*Some feel that we should rely on a democratic form of government to solve our country's problems. Others feel that we should rely on a leader with a strong hand to solve our country's problems. Which comes closer to your opinion?

Medvedev

- Legal background (assistant professor St. Petersburg State University 1990 – 1999)
- reputation of being a liberal
- no connections with the security services
- long term connections with Putin dating back to St-Petersburg period
- Power base in Gazprom (Chairman of the Board of Directors since June, 2002)

Advantages of the new structure I

- Russia has a superpresidential system
- Putin as a strong prime minister
 - Will be more accountable than before as a president
 - But will make the government stronger
 - creating more balance between the president and the government
- Putin as a party leader
 - leader of strongest party becomes the prime minister
 - creates the concept of a party-government
 - creates a more stable political landscape in long run
 - KPRF and LDPR have no clear future
 - Need for a more stable and worthy opposition

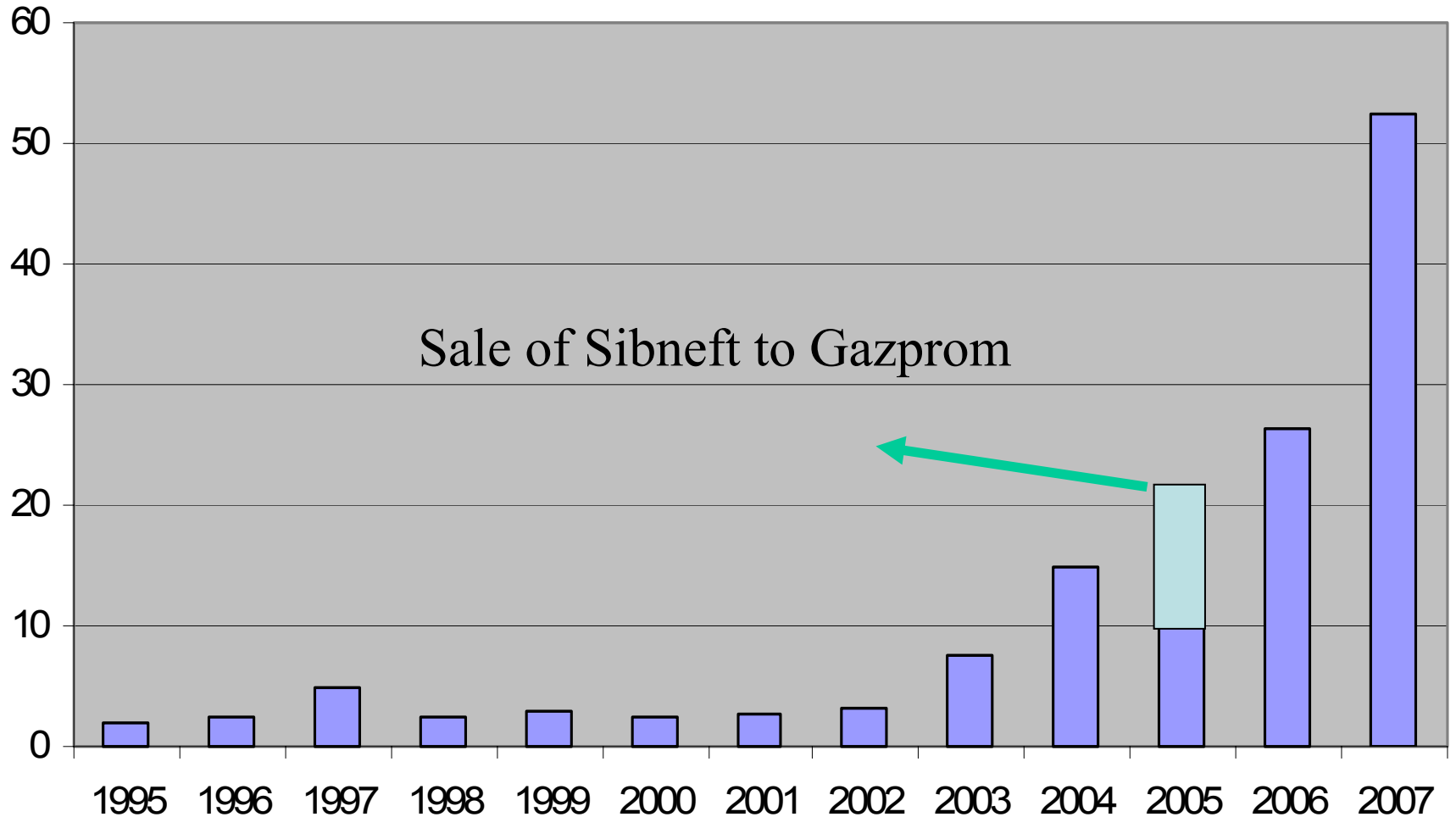
Advantages of the new structure II

- Medvedev is more than we could hope for
- Western fears
 - Putin will have the constitution changed and stay on as President for ever
 - Central Asian countries, Azerbaijan, Belarus, almost Venezuela, ...
 - Putin will be followed by a hardliner
 - Sechin, Ivanov, ...
 - Putin will nominate an old rubberstamp and return in 2011 as president

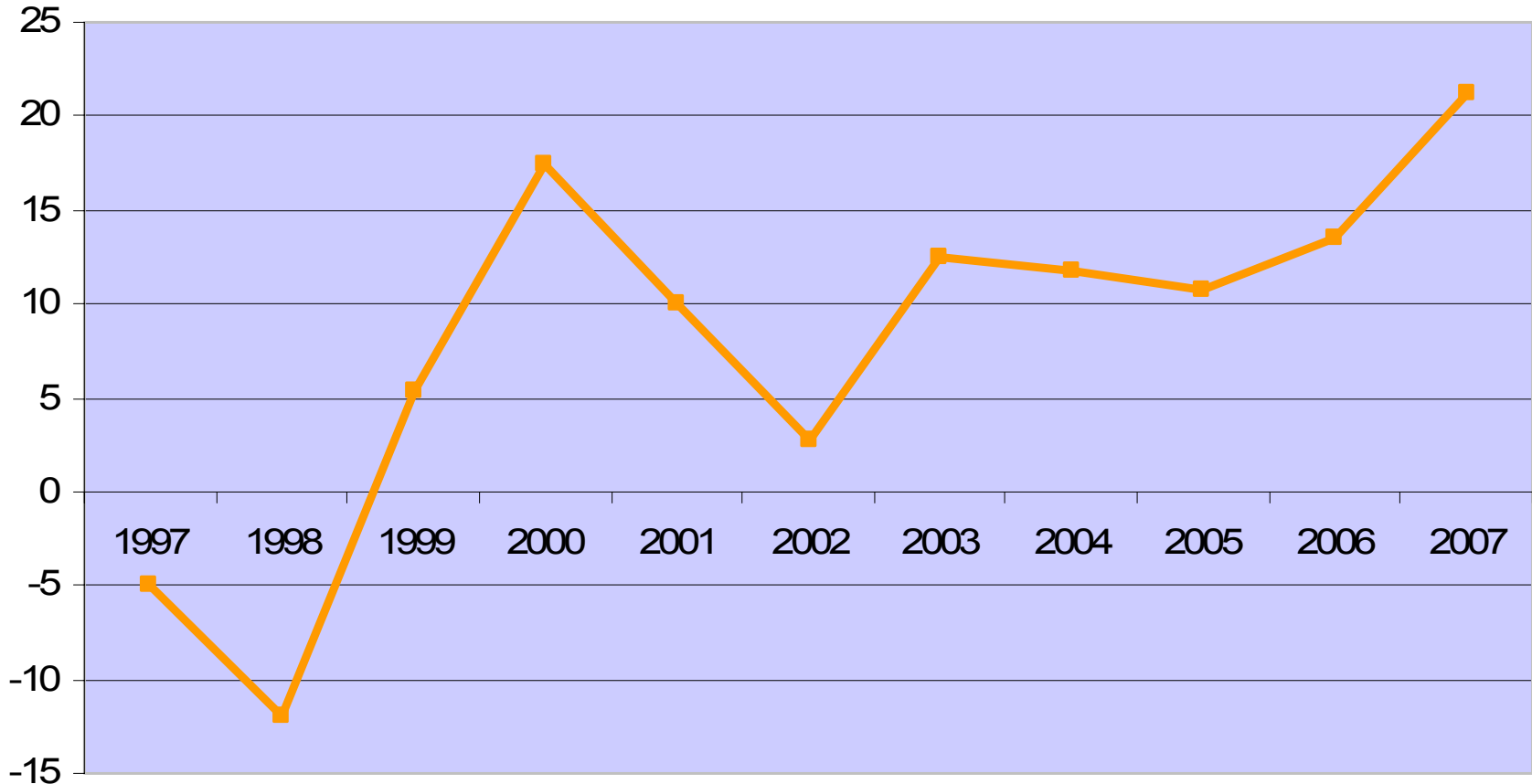
Advantages of the new structure III

- Some stability for investors
 - Foreign investment boomed under Putin
 - Domestic investment is strongly recovering
 - Investment in manufacturing is taking off
- Policy of national projects
 - Investment in national champions and strategic sectors
 - Investment in education and social sphere
 - Investment in health care
- Wise management of oil wealth

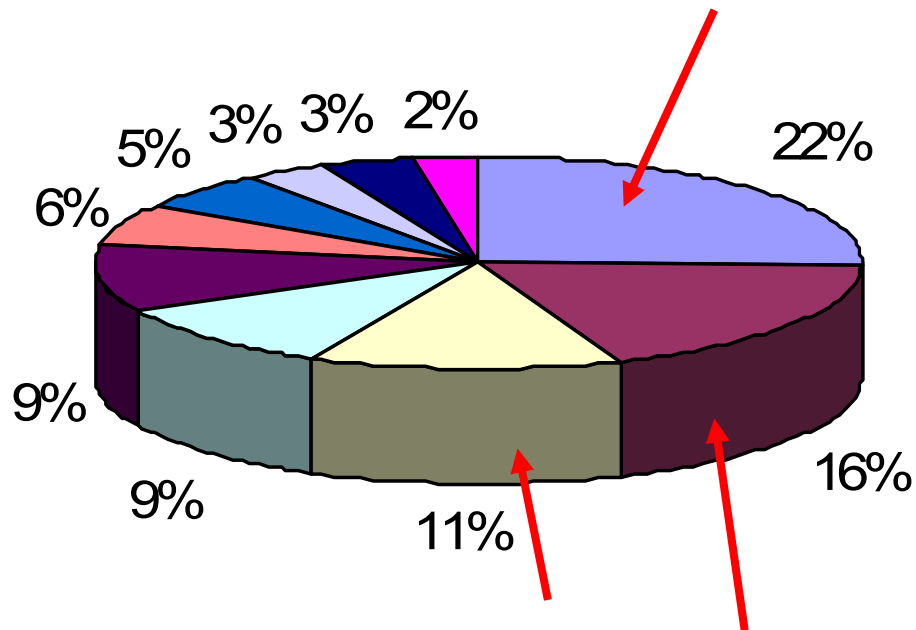
FDI inflows (CBR, US\$ bn)



Growth of domestic fixed investment (% of GDP)



Revenue sources of consolidated Russian government

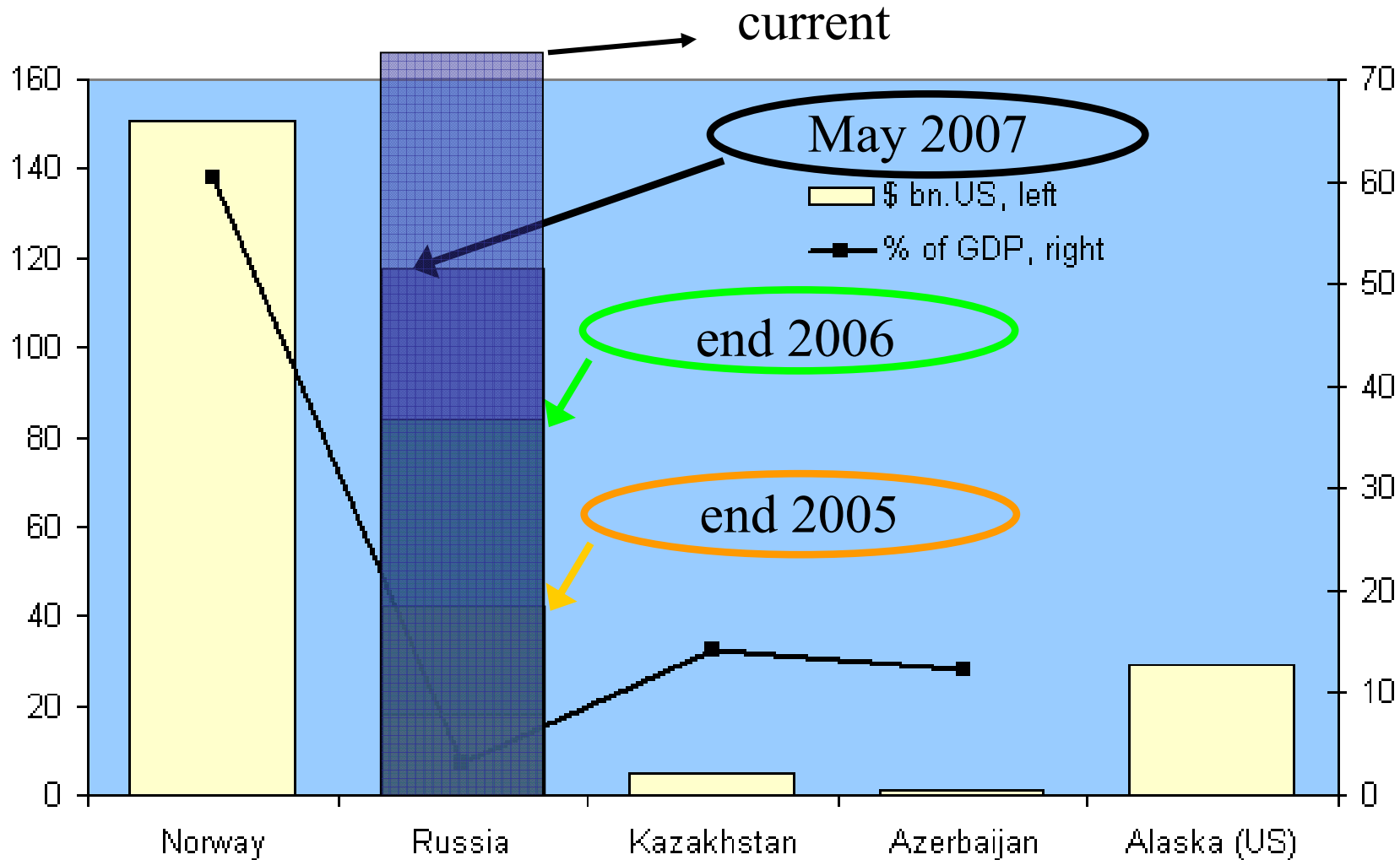


- custom duties
- corporate income tax
- natural resource taxes
- individual income tax
- VAT domestic goods
- VAT imported goods
- single social tax
- property tax
- use state/ municipal property
- excise taxes domestic goods

The Oil Stabilization Fund

- Revenues due to a higher than budgeted oil price go to a special fund
- Set-up of the fund
 - Function of the current urals crude price (treshold just increased)
- Has grown very quickly
 - Only two years of low oil prices
 - Needs to be increased
- How to spend the excess money
 - Debt pre-payment
 - Pension funds
 - No consumption
- Recent reform (February 2008) into a National Reserve Fund and a Fund for Future Generations

Worldwide sovereign funds, 2004



Main future problems

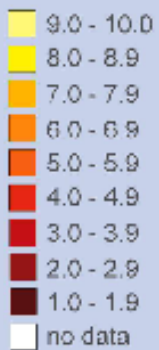
1. Corruption and political capture of court system
2. Demographic crisis
3. Dutch Disease

Corruption in Russia

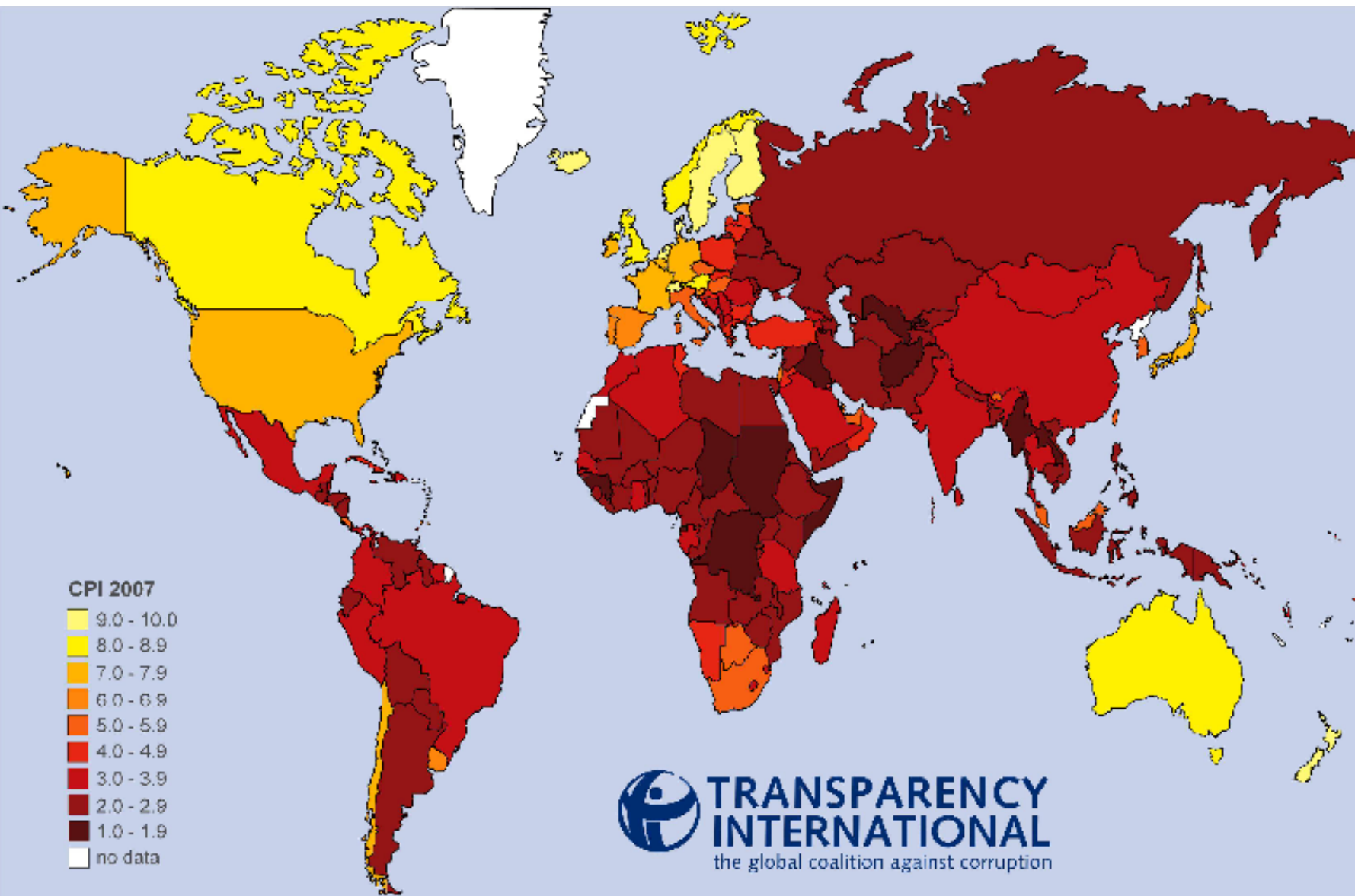
How bad is it?

How to deal with it ?

CPI 2007



**TRANSPARENCY
INTERNATIONAL**
the global coalition against corruption



Country Rank	Regional Country Rank	Country /Territory	CPI Score 2007	Confidence Intervals	Surveys Used
64	1	Croatia	4.1	3.6 - 4.5	8
64	1	Turkey	4.1	3.8 - 4.5	7
79	3	Georgia	3.4	2.9 - 4.3	6
79	3	Serbia	3.4	3.0 - 4.0	6
84	5	Bosnia and Herzegovina	3.3	2.9 - 3.7	7
84	5	Montenegro	3.3	2.4 - 4.0	4
84	5	FYR Macedonia	3.3	2.9 - 3.8	6
99	8	Armenia	3.0	2.8 - 3.2	7
99	8	Mongolia	3.0	2.6 - 3.3	6
105	10	Albania	2.9	2.6 - 3.1	6
111	11	Moldova	2.8	2.5 - 3.3	7
118	12	Ukraine	2.7	2.4 - 3.0	7
143	13	Russia	2.3	2.1 - 2.6	8
150	14	Kazakhstan	2.1	1.7 - 2.5	6
150	14	Belarus	2.1	1.7 - 2.6	5
150	14	Tajikistan	2.1	1.9 - 2.3	8
150	14	Azerbaijan	2.1	1.9 - 2.3	8
150	14	Kyrgyzstan	2.1	2.0 - 2.2	7
162	19	Turkmenistan	2.0	1.8 - 2.3	5
175	20	Uzbekistan	1.7	1.6 - 1.9	7

Bribery and economic welfare

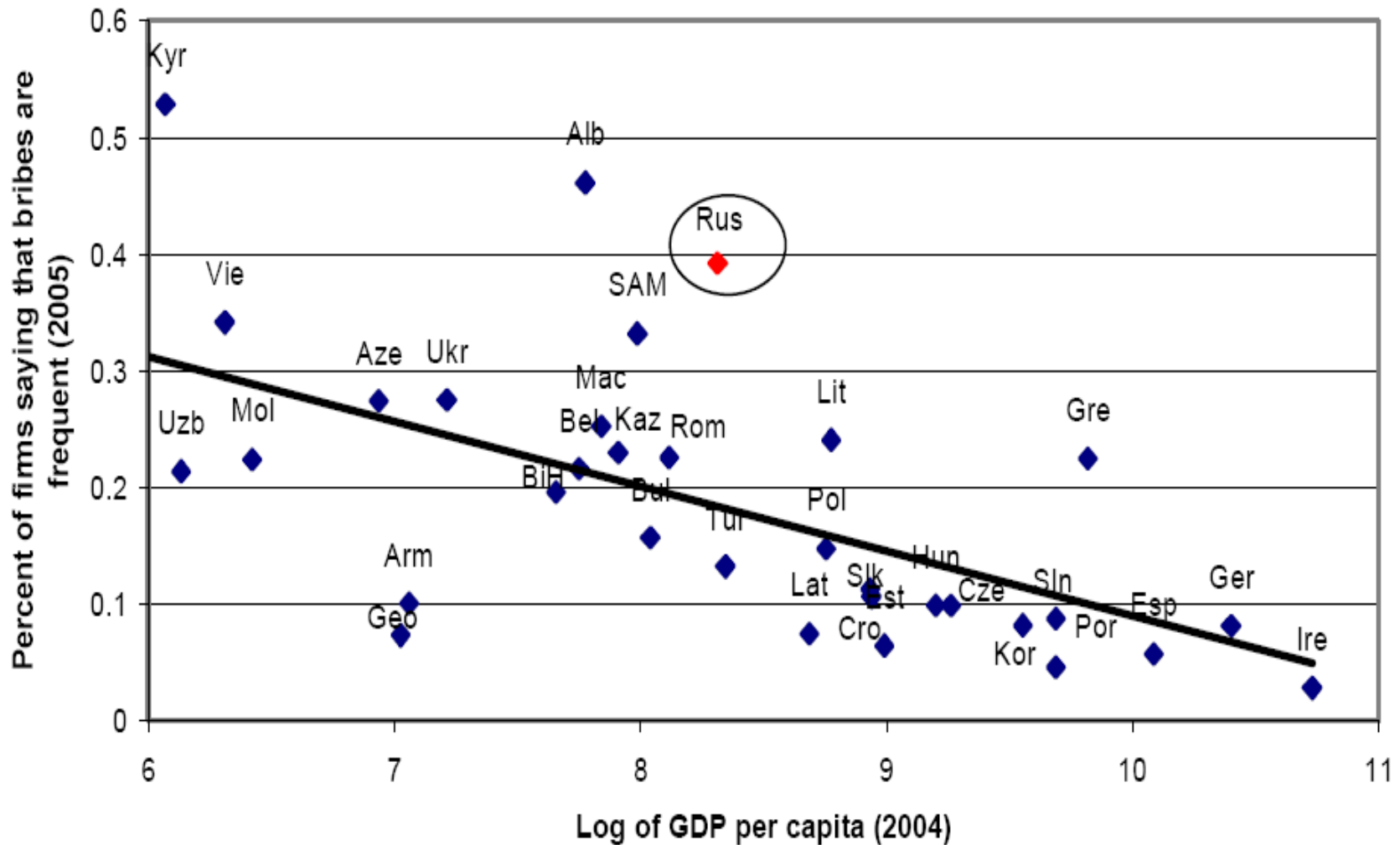
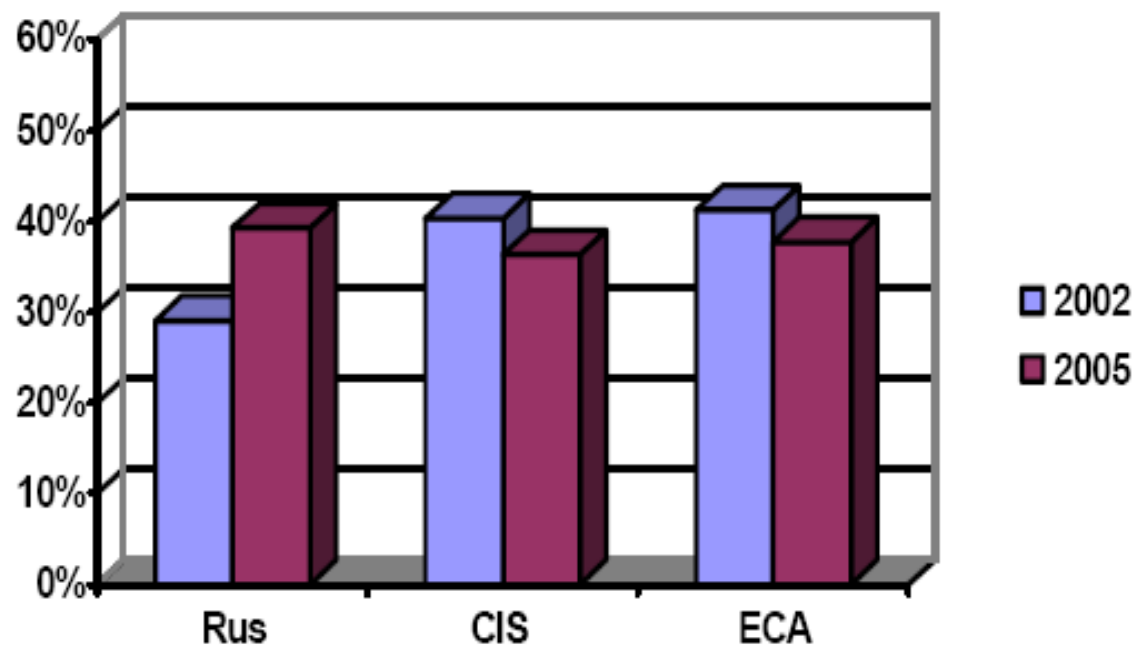


Figure 2-3: Corruption as a Problem Doing Business BEEPS

(Percentage of firms saying corruption is a problem for the operation of their business)



Source: BEEPS 2005

Bribe Frequency (Percent of firms saying unofficial payments are frequent)

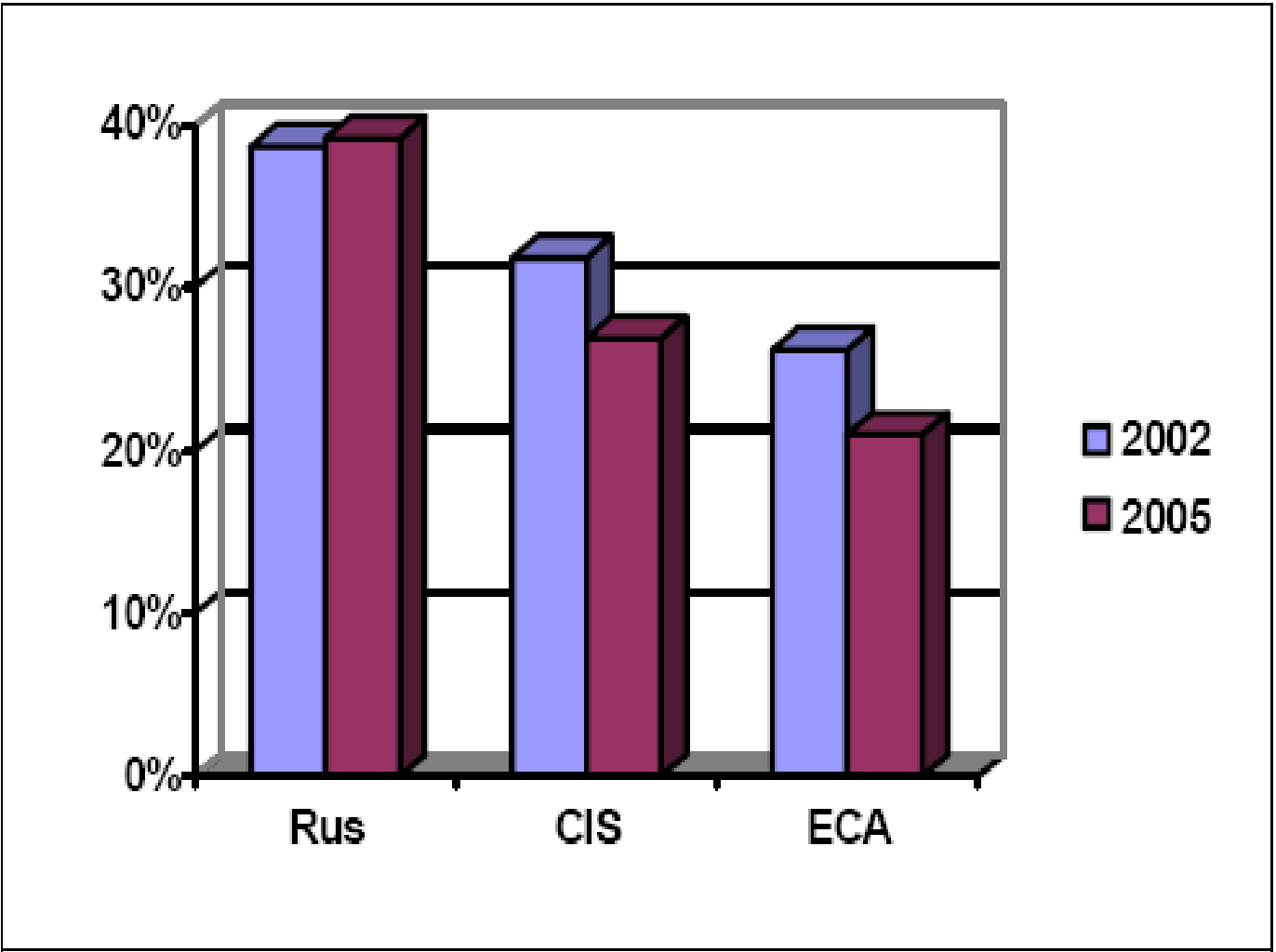
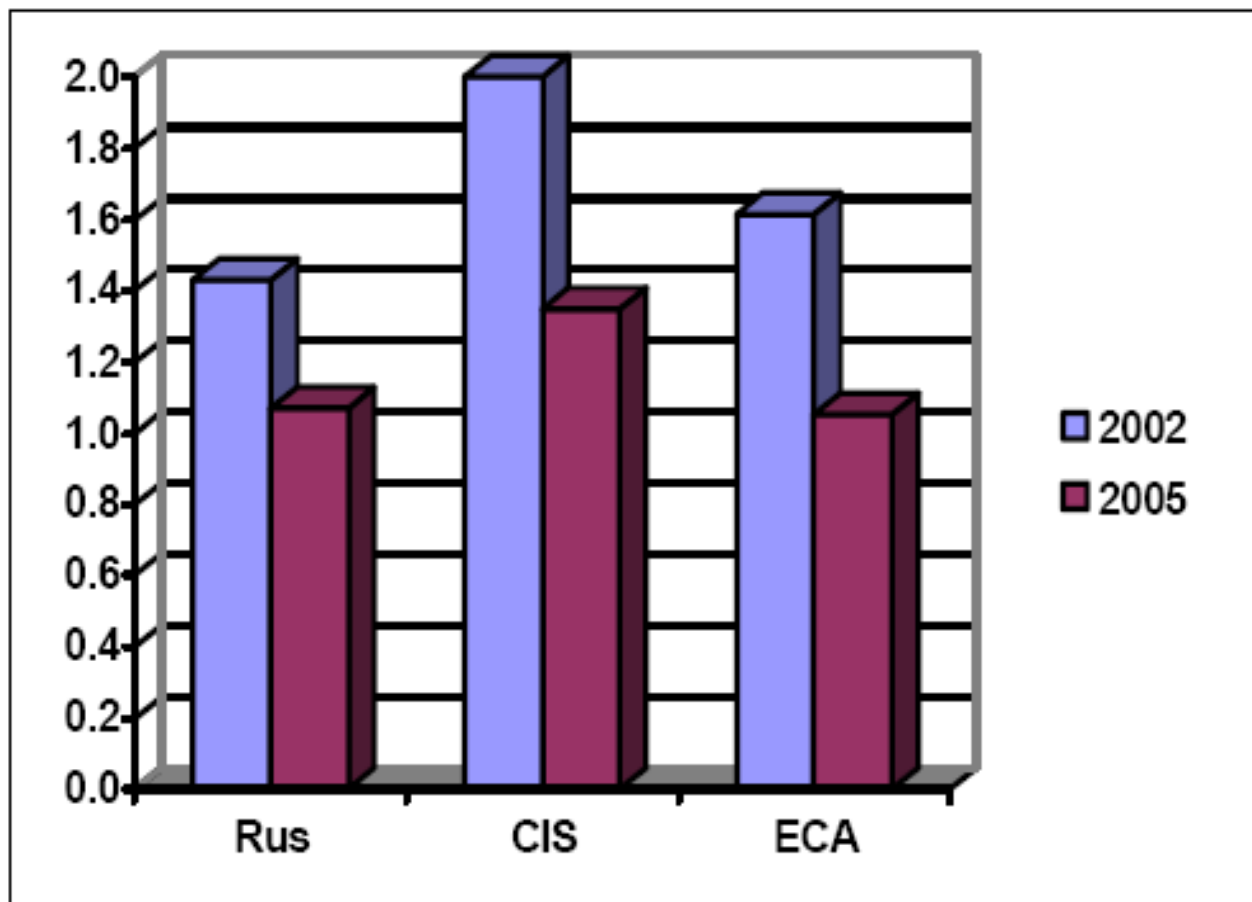


Figure 2-4: Bribing
Bribe Tax (Bribes as a share of annual sales)



Demand for corruption

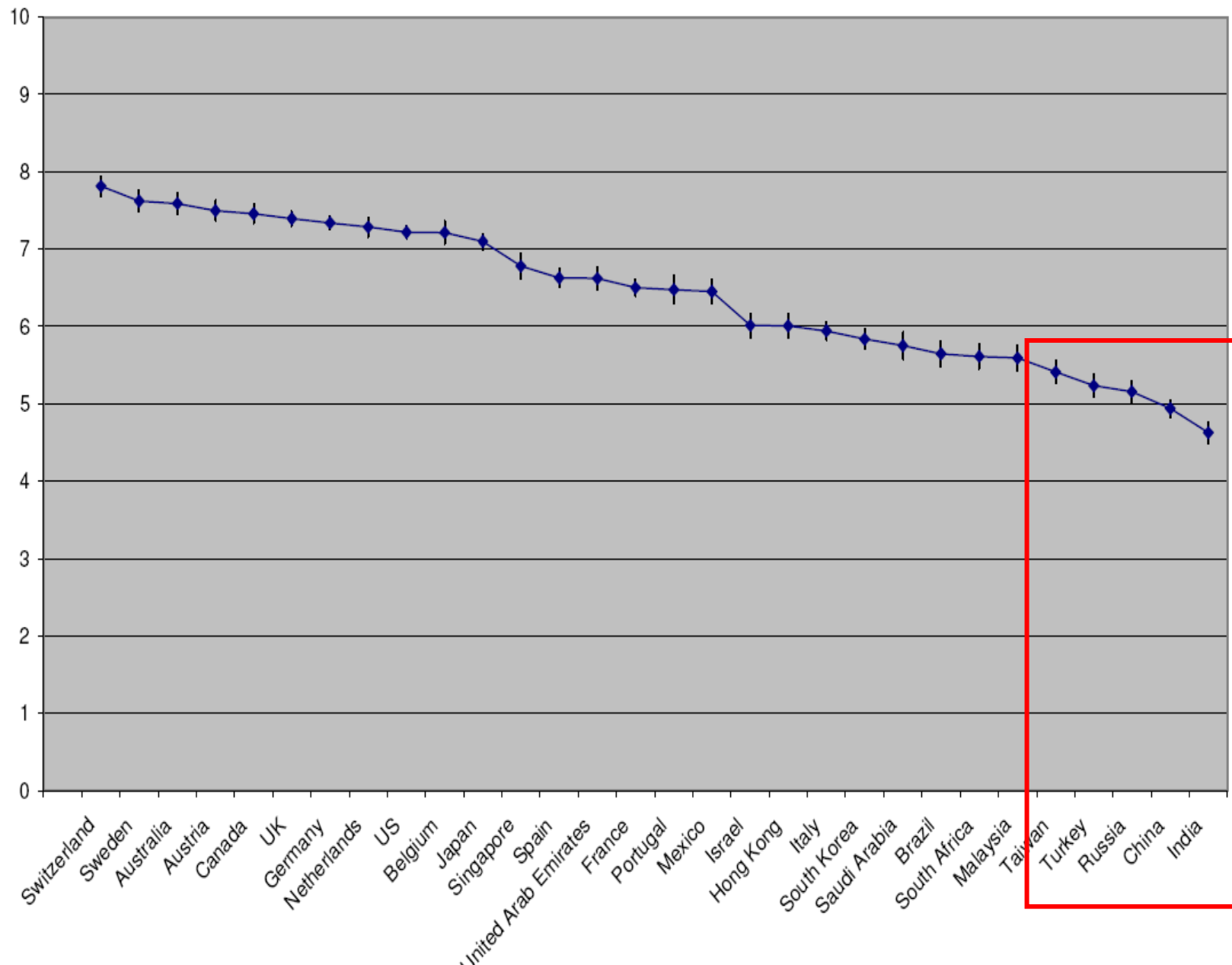
‘In your experience, to what extent do firms from the countries you have selected make undocumented extra payments or bribes?’

- Transparency International Bribe Payers Index 2006

Table 1: The full results of the BPI 2006

Rank	Country / territory	Number of respondents	Average score (Scale 0-10)	Standard Deviation	Margin of error (at 95 % confidence)
1	Switzerland	1744	7.81	2.65	0.12
2	Sweden	1451	7.62	2.66	0.14
3	Australia	1447	7.59	2.62	0.14
4	Austria	1560	7.50	2.60	0.13
5	Canada	1870	7.46	2.70	0.12
6	UK	3442	7.39	2.67	0.09
7	Germany	3873	7.34	2.74	0.09
8	Netherlands	1821	7.28	2.69	0.12
9	Belgium	1329	7.22	2.70	0.15
	US	5401	7.22	2.77	0.07
11	Japan	3279	7.10	2.87	0.10
12	Singapore	1297	6.78	3.04	0.17
13	Spain	2111	6.63	2.73	0.12
14	UAE	1928	6.62	3.09	0.14
15	France	3085	6.50	3.00	0.11
16	Portugal	973	6.47	2.79	0.18
17	Mexico	1765	6.45	3.17	0.15
18	Hong Kong	1556	6.01	3.13	0.16
	Israel	1482	6.01	3.14	0.16
20	Italy	2525	5.94	2.99	0.12
21	South Korea	1930	5.83	2.93	0.13
22	Saudi Arabia	1302	5.75	3.17	0.17
23	Brazil	1317	5.65	3.02	0.16
24	South Africa	1488	5.61	3.11	0.16
25	Malaysia	1319	5.59	3.07	0.17
26	Taiwan	1731	5.41	3.08	0.15
27	Turkey	1755	5.23	3.14	0.15
28	Russia	2203	5.16	3.34	0.14
29	China	3448	4.94	3.29	0.11

Figure 1: BPI 2006 scores and 95 percent confidence intervals



The supply of corruption and its moral foundation

- Line between private and public service of a private individual has been completely erased.
 - Flats were from the state, then they became private
 - Firms were from the state, then private property of managers and workers
 - But a civil servant cannot privatize his position
 - Army general, police officer, fire inspection, customs official, tax inspector, health and safety inspector....
 - So they privatize the state
- The real problem is one of moral foundation:
 - What is the meaning of the word private?

Rule of law versus rule of person

- Most Russians do not understand the meaning of the concept rule of law
- Russia is built of old on the rule of persons
 - I know him, he knows me,
 - He owes me a favor, I owe him a favor.
 - Clan-like system of favors and deals between individuals
- Slowly the rule of law is sinking in

Institutionalized corruption

- It's a double system of supply and demand that goes back to soviet times.
- There's the official level
 - Shown in the books to minimize taxes
- And the real wheeling and dealing between
 1. enterprises that demand corruption
 2. officials that supply corruption.
- Russian contemporary corruption is a direct consequence and consolidation of Soviet past.

How bad is it really?

- For ordinary Russians
- For Russian business
- For exporters and investors
 - Lower propensity to demand corruption
 - Makes you a less interesting prospect to offer corruption

#	everyday corruption market	2001		2005		Δ
1	Free medical service (out-patients' clinic, hospital)	1093	8	1423	11	0,57
2	School: to enter required school and to finish successfully, education process	1238	7	2312	8	1,64
3	Higher education institution: to enter, transfer to another one; exams etc.	4305	2	3869	4	-0,19
4	Pensions: paperwork, calculation etc.	50	14	2250	9	
5	Social payments: paperwork, calculation etc.	250	13	3467	6	
6	Solving problems related to the conscription procedure	3250	3	15409	1	7,06
7	Employment: to get a required job or career development	963	9	2448	7	2,91
8	Land area: to obtain some territory (for a country cottage or some own farming entity)	2000	5	3713	5	1,62
9	Dwelling: to obtain and/or legalize a relevant proprietary interest	2529	4	5548	3	2,25
10	To get dwelling maintenance & repair work services	292	12	400	14	0,70
11	To obtain justice in law-court	13964	1	9570	2	-0,59
12	To get assistance and protection from militia authorities	1715	6	930	12	-0,86
13	To get registration, domestic or foreign passport at the place of residence	664	11	1426	10	2,17
14	To solve problems with road police authorities (obtaining driver's license, technical examination, road traffic etc.)	896	10	920	13	0,05

Practical problems for investment and trade

- Customs
- Licenses for all kinds of activities
- Access to utilities
- Predatory inspections of all kinds
 - Tax inspectors, fire and building inspectors, health and safety inspectors, ...
- Lock-in and lock-out situations
- Protection money

Customs

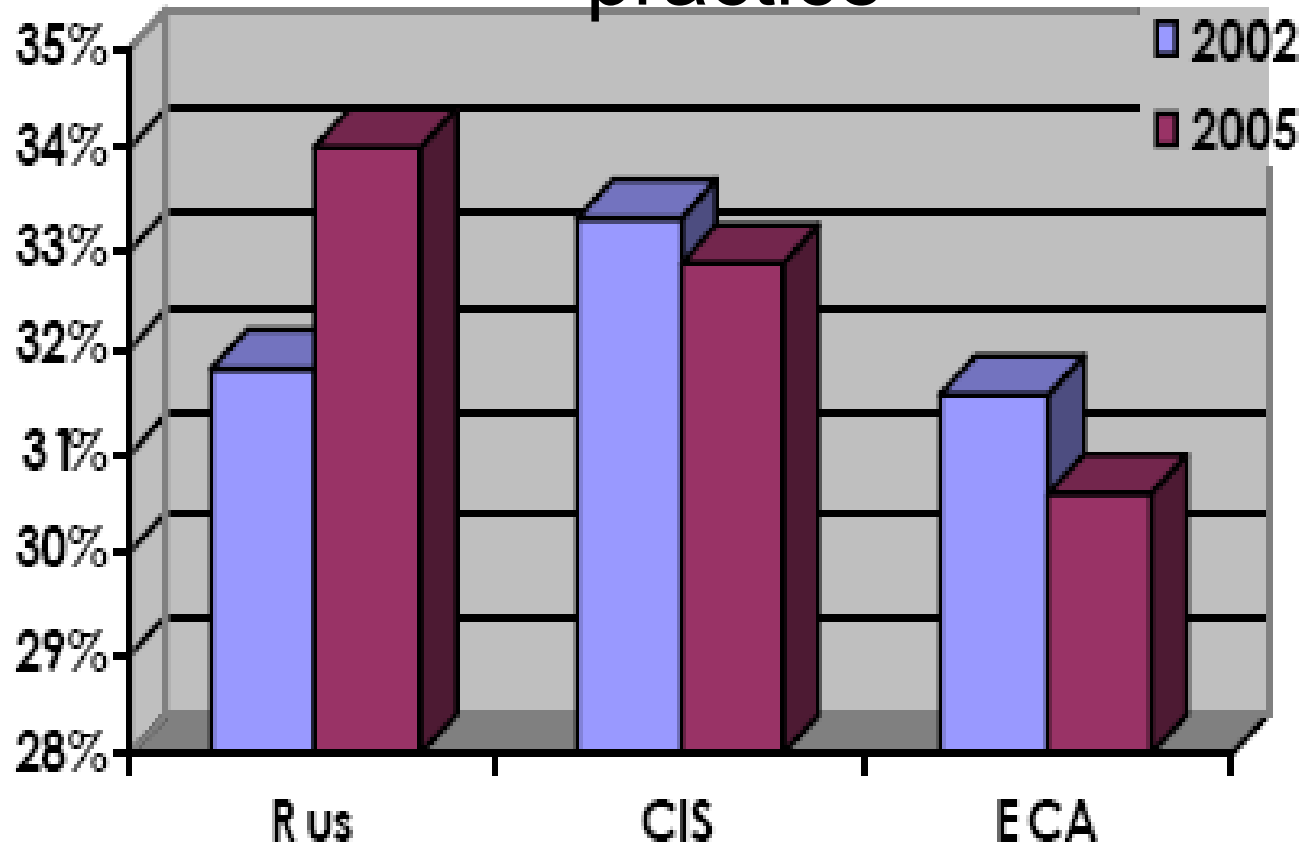
- Officials can use their discretionary power to keep your goods tied at the border
- But
 - Corruption at the customs has gone down
 - The legislation has improved greatly and there are more rights of appeal
 - Long relations with custom points work
 - Being well prepared is very important in order not to give officials any pretext to bother you

Licenses

- Firms need licenses for all kinds of activities
 - Construction
 - Hazardous materials
 - Etc
- Cost-benefit analysis of bribes
 - Officials offer faster treatment in exchange for bribes
 - But paying signals your type to other suppliers of corruption
- Solution
 - Be prepared and patient so that you can wait
 - Buying a brown-field that has the needed licenses is always a good option
 - Local partners can be very helpful to solve this

Unofficial payments for business licensing

% of firms stating that it is a frequent practice



Access to utilities

- Examples
 - Connection to the road
 - Electricity
 - Water distribution
 - Sewage systems
- Large differences across regions
 - Often depends on good relations with local authorities
 - The attitude of local governments is very important
 - Listen to experience of other (Belgian) investors
- Liberalization is strongly improving matters

Predatory inspections of all kind

- Civil servant versus privatizing the state
- Solution
 - Always treat them well and be friendly
 - But never give in to a direct offer of corruption
 - You will exhaust them
 - For the ‘civil servant’ you become a less interesting prospect if you do not pay to him personally
 - But this requires time and deep pockets
 - Goodwill to local community always helps

The Russian demographic crisis

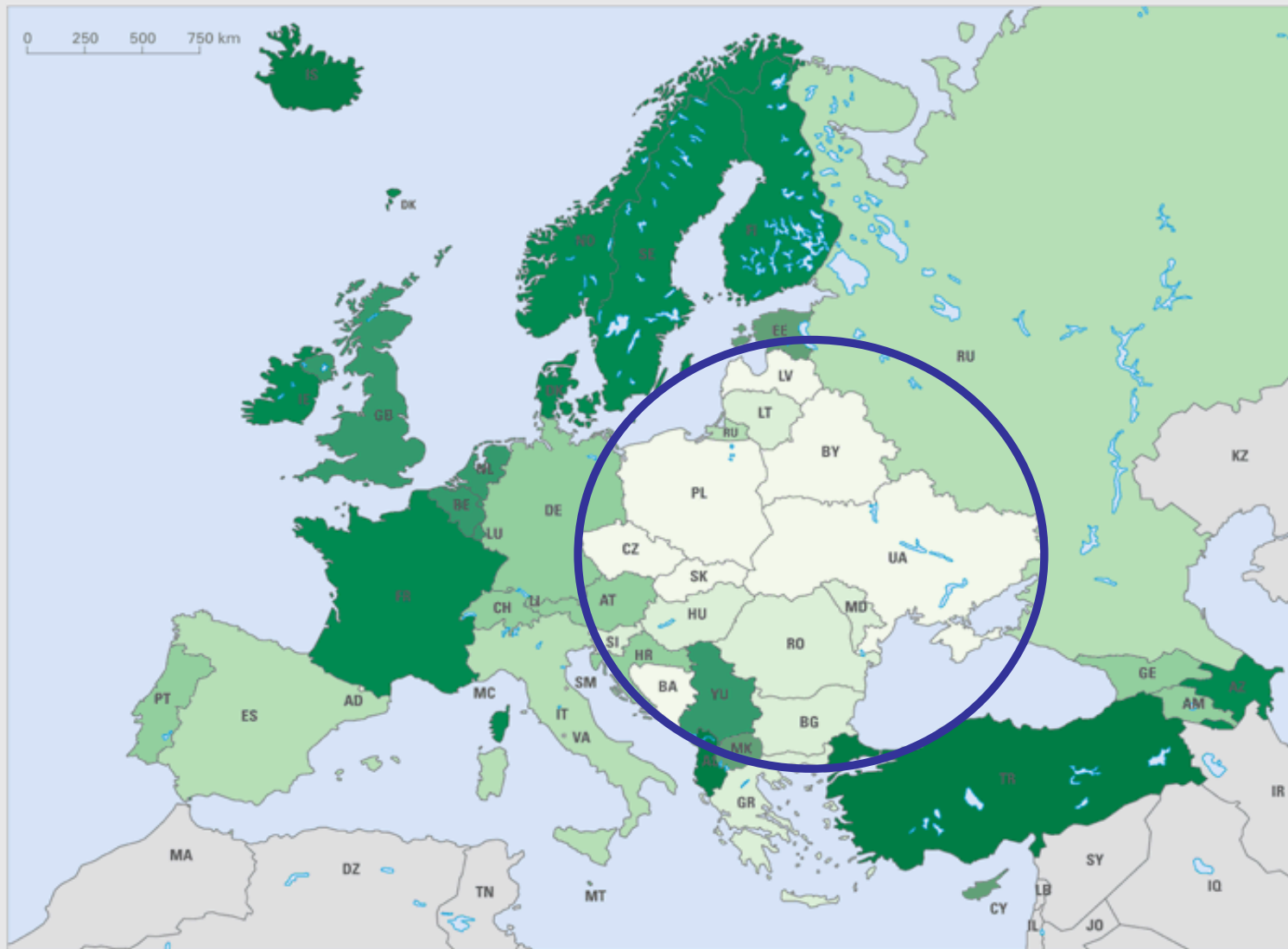
Children per woman in Europe, 2004

Durchschnittliche Zahl der Kinder je Frau
Nombre moyen d'enfants par femme



keine Daten verfügbar
données non disponibles

* Median (1,39)
* Médiane (1,39)



UTS:
nomenclature des unités
territoriales statistiques

renze / Frontière

Länder (NUTS 0)
Pays (NUTS 0)

Total Fertility in Russia

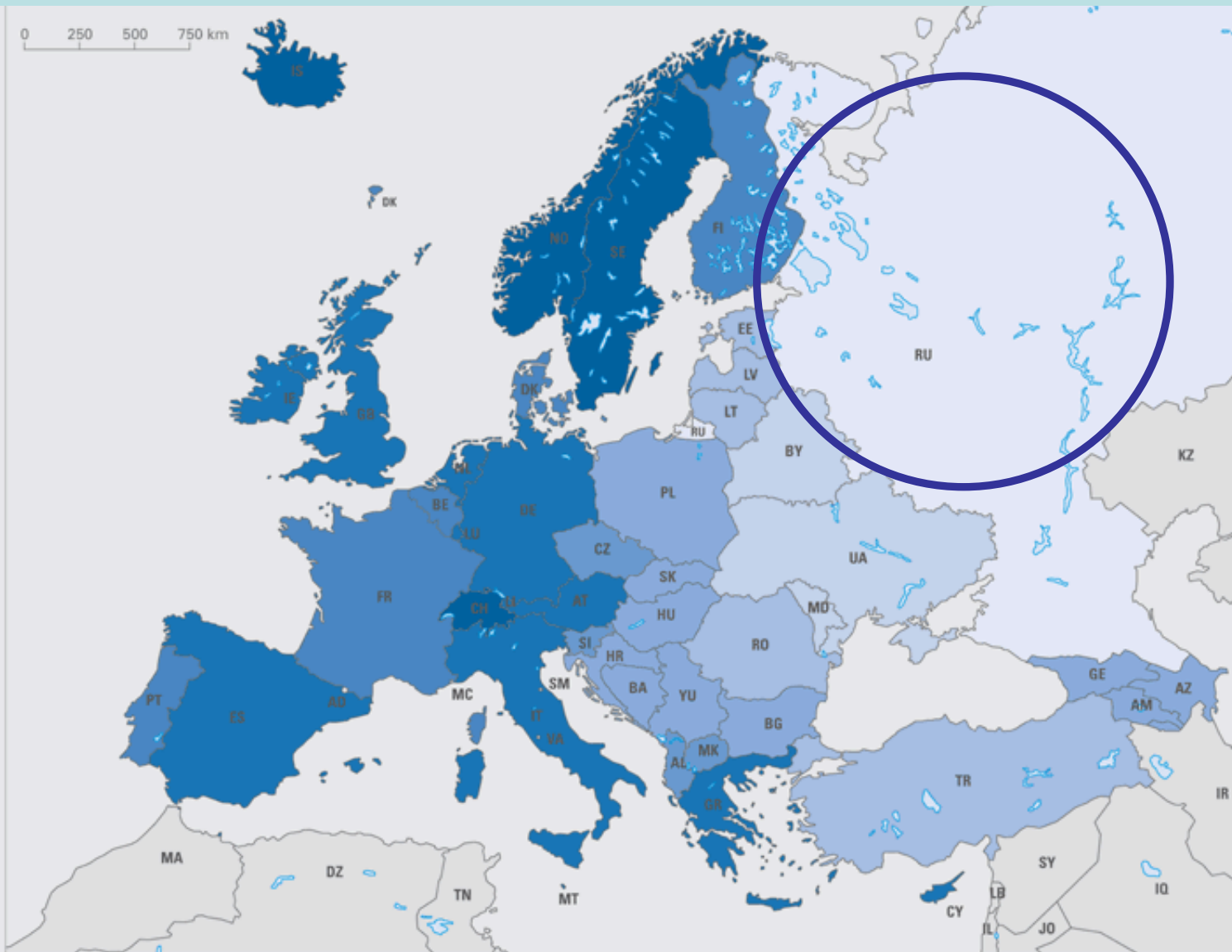
- Russian fertility is very low
 - Decreased strongly after collapse of SU
 - Persistent below replacement levels
 - Government programmes to stimulate fertility
- But fertility in EU10 CEE is even lower
 - lowest ever recorded in history of mankind

Male life expectancy at birth, 2004

Lebenserwartung, in Jahren
Espérance de vie, en années



* Median (73,1)
* Médiane (73,1)



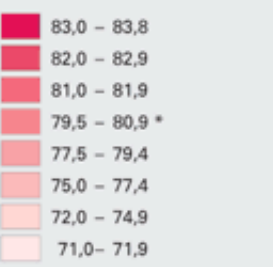
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Grenze / Frontière

— Länder (NUTS 0)
— Pays (NUTS 0)

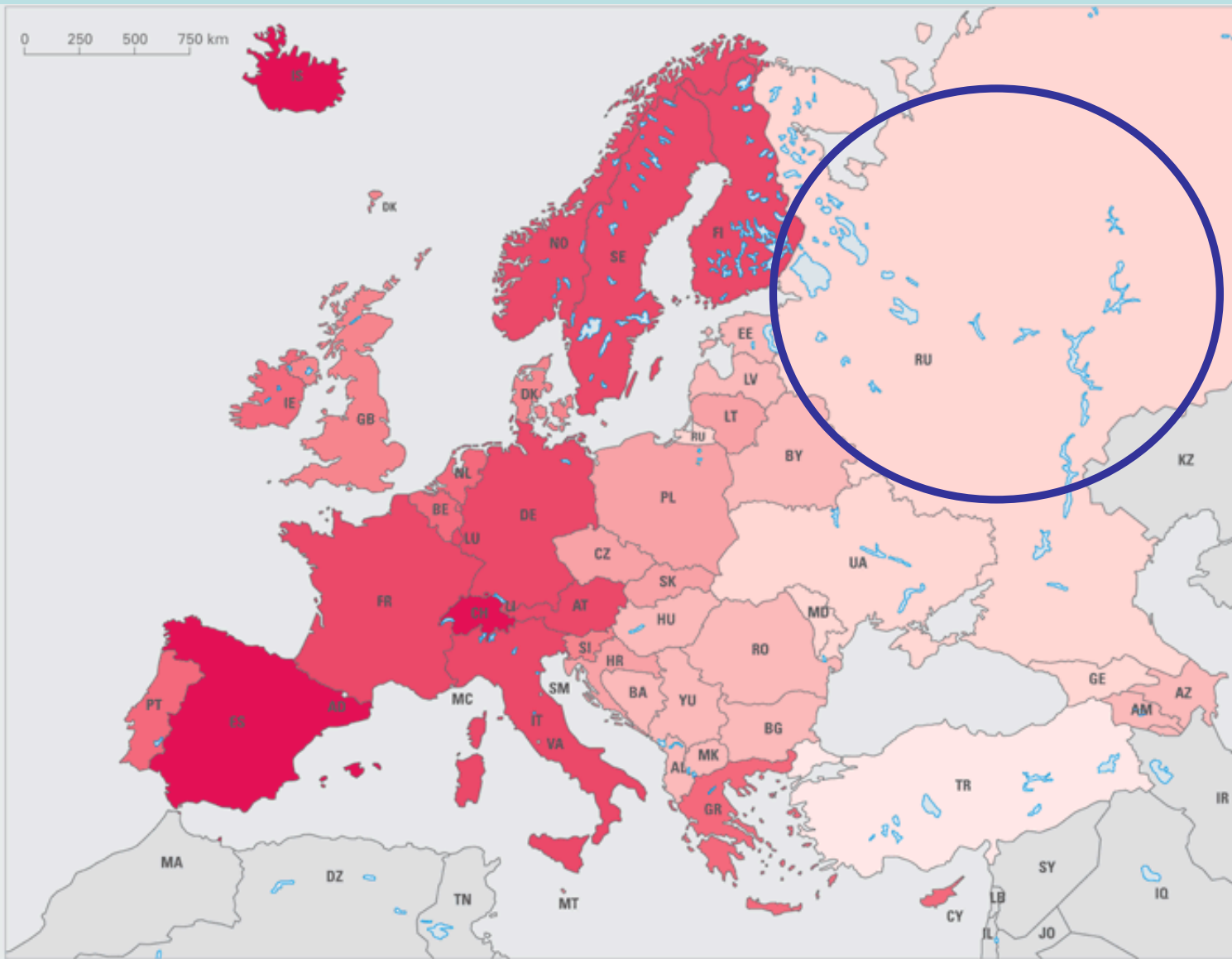
Female life expectancy at birth, 2004

Lebenserwartung, in Jahren
Espérance de vie, en années



keine Daten verfügbar
données non disponibles

* Median (79,7)
* Médiane (79,7)



UNTS:
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Life expectancy in Russia

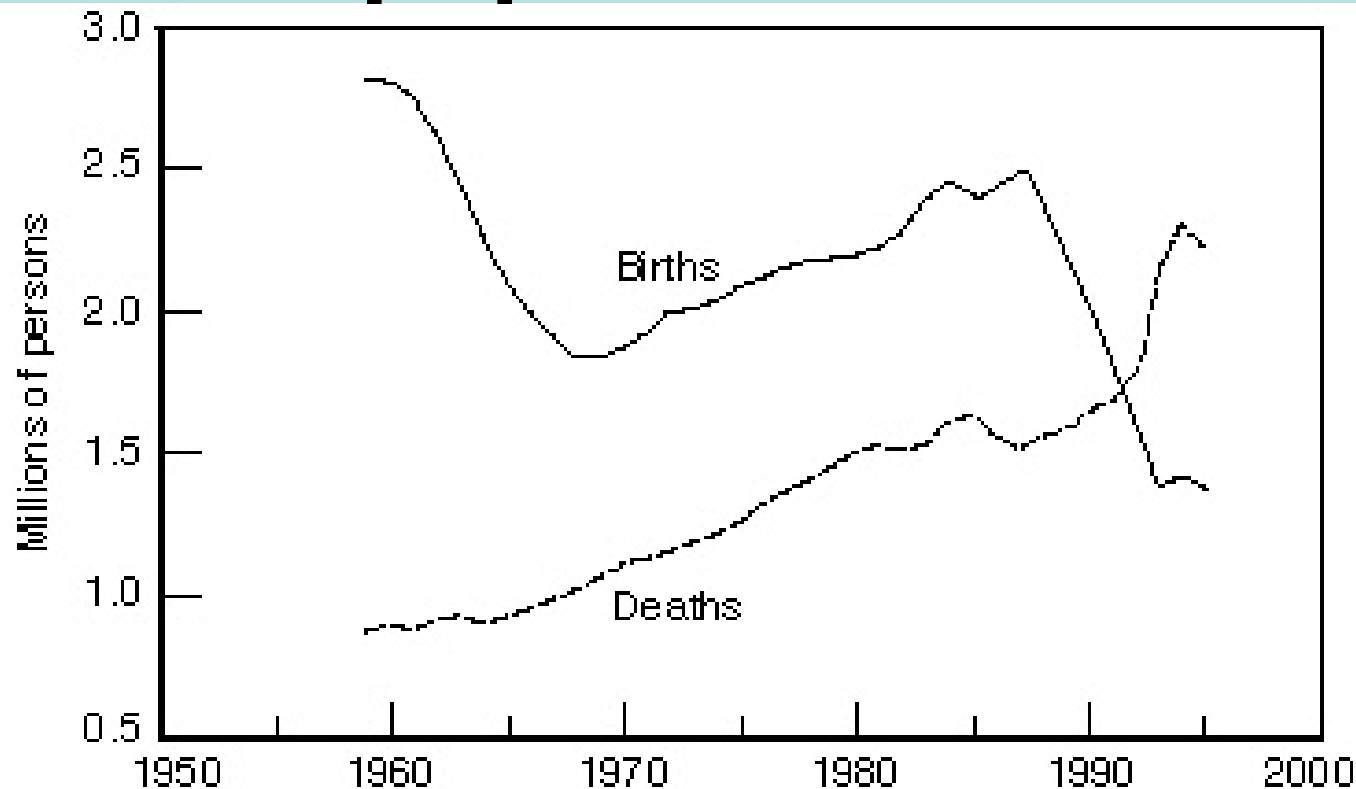
- Male life expectancy well below EU average (13 years lower)
- Female life expectancy also below EU average (8 year lower)
- Causes
 - Collapse of real income of population
 - Socio-economic stress of transition
 - Collapse of health-care system
 - Alcohol consumption
 - Eating patterns

Alcohol and male deaths



SOURCE: Data provided by Vladimir M. Shkolnikov. Mortality rates are age-standardized using the "old" WHO European population standard.

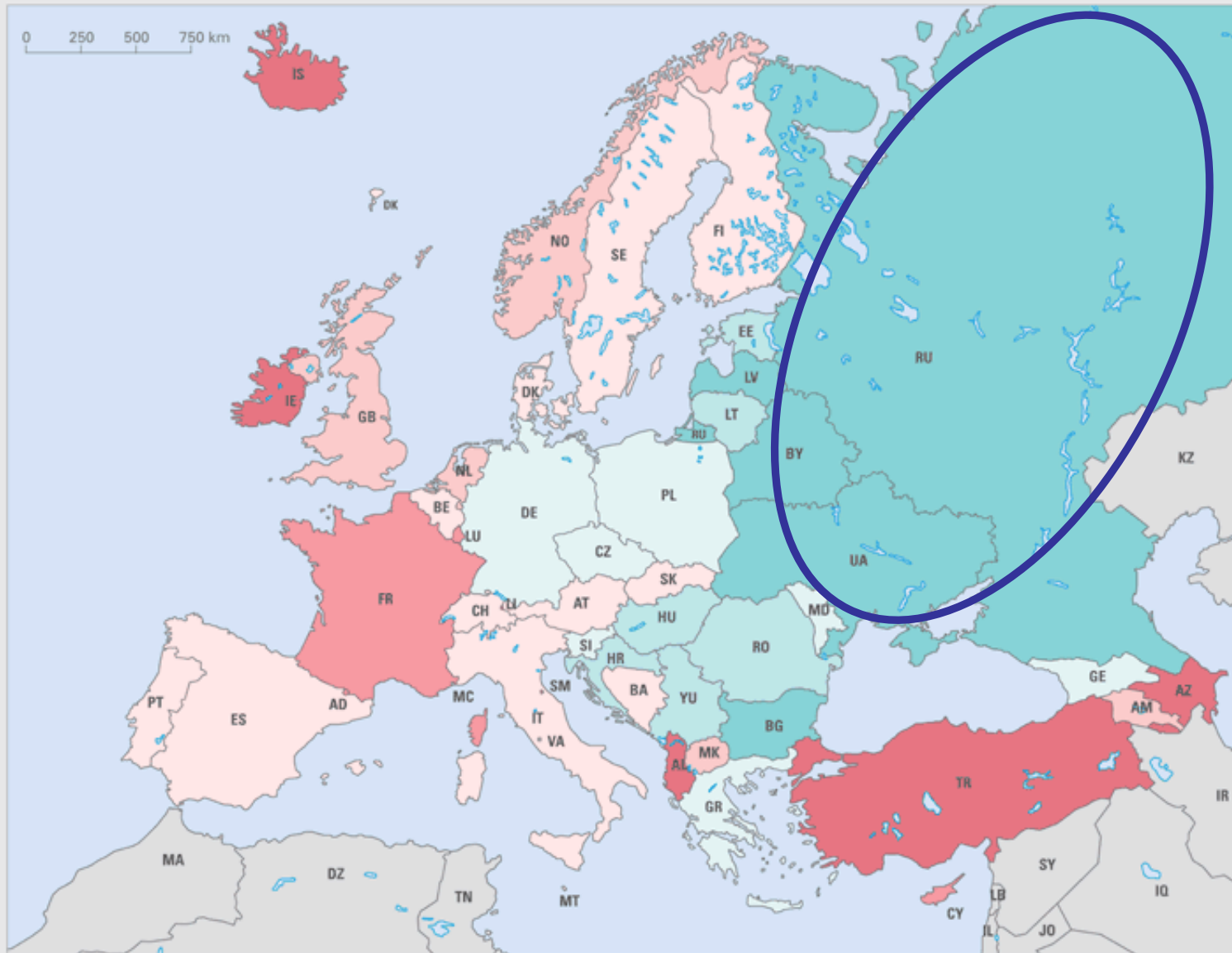
The collapse of the Soviet Union and population decline



SOURCES: For 1959–1992 data: Anatoly G. Vishnevskiy, "Family, Fertility, and Demographic Dynamics in Russia: Analysis and Forecast," in Julie DaVanzo, ed., *Russia's Demographic Crisis*, Santa Monica, Calif.: RAND, CF-124-CRES, 1996, p. 32. For post-1992 data: Institut National d'Études Démographiques, http://schwyz.ined.fr/~blum/situation_Russie/Conjoncture/

Balance of births/deaths, 2004

geburtenüberschuss, in %
croissance naturel, en %



Balance of births/deaths in Russia

- Russia reports an considerable excess of deaths over births
 - Decline of native population
 - This is likely to continue
- This is also the case in other former Soviet republics
 - Ukraine
 - Belarus
 - Some Baltic countries

The "Dutch Disease"

- An economic phenomenon in which the revenues from natural resource exports damage a nation's productive economic sectors by causing an increase of the real exchange rate and wage increase
- The consequence is that sectors such as agriculture and manufacturing become less competitive in world markets
- the term "Dutch disease" was coined in 1977 by The Economist to describe the decline of the manufacturing sector in the Netherlands after the discovery of natural gas in the 1960s

The first Dutch disease?

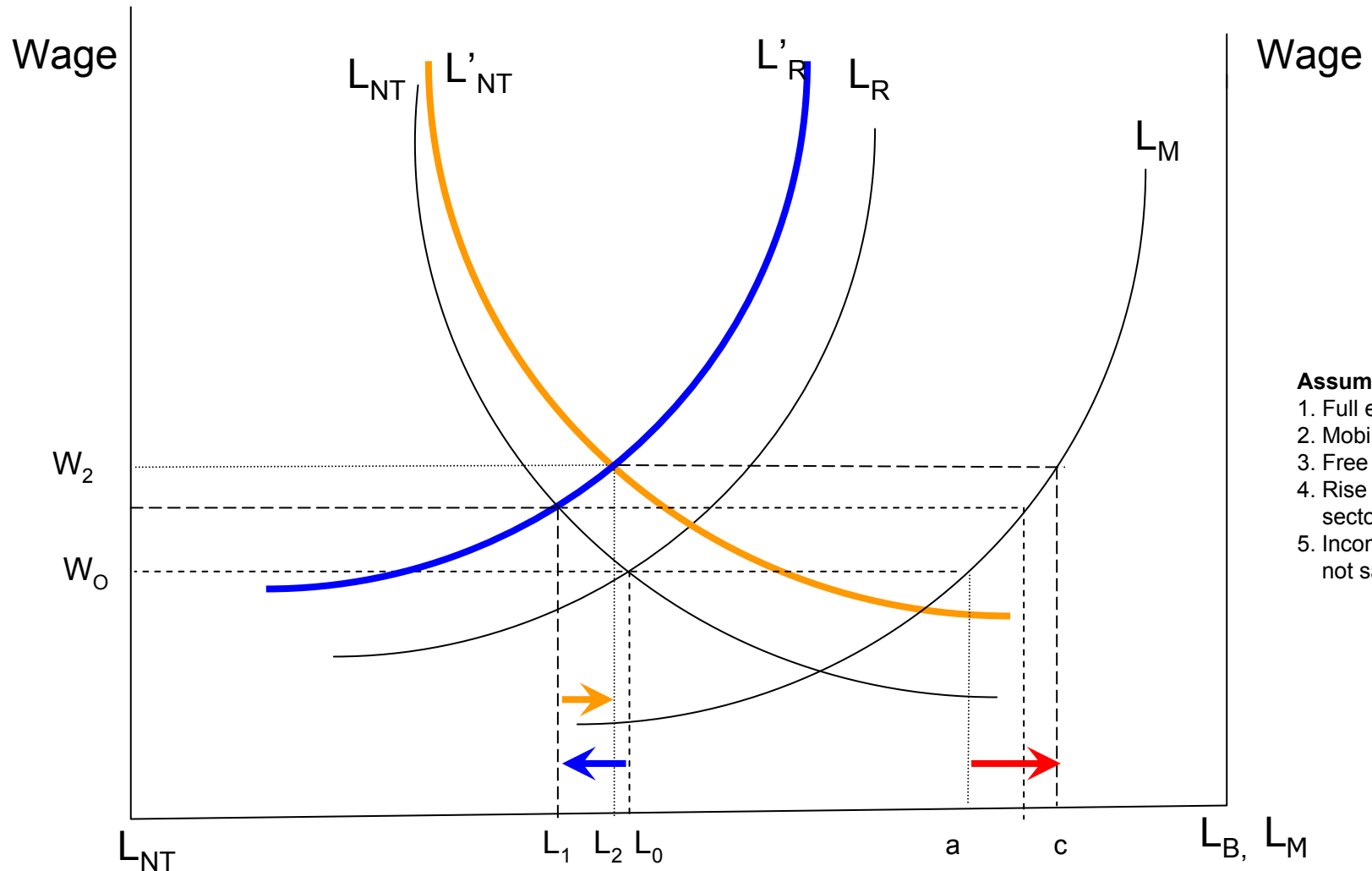
- Natural gas discovery in Holland in the 1970's → exogenous export revenue (about \$3 billion) → large capital inflows → expected growth.
- Instead, unemployment rose from 3% to 11%, high inflation, and dramatic decline in *manufacturing* (tradable) sector
- A “disease” in the sense that it increased both unemployment and inflation (*Stagflation*).
- Inflation increased because of the increase in capital inflows → increase in money supply → increase in spending → inflation.

Note that the increase in export revenue is *exogenous* i.e. it is *not* related to the *endogenous* productive capacity of the economy.

Dutch disease symptoms

	Output	Employment	Wage	Price
Resource movement effect				
oil sector	+	+	+	given
manufacturing sector	-	-	+	given
services sector	-	-	+	+
Spending effect				
oil sector	-	-	+	given
manufacturing sector	-	-	+	given
services sector	+	+	+	+
Combined effect				
oil sector	indeterminate	indeterminate	+	given
manufacturing sector	-	-	+	given
services sector	indeterminate	indeterminate	+	+

Dutch Disease Model of Labor Allocation during a Boom



Assumes:

1. Full employment
2. Mobile labor
3. Free trade in manuf.
4. Rise in price in boom sector price.
5. Income rise spent, not saved.

1. Boom in resource sector price shifts out the L_R curve – **Resource Movement Effect**
2. Rise in demand shifts out the L_{NT} curve – **Income Spending effect**
3. Net Effect – **Decline in labor in manufacturing** (L_M), shifted to NT and resource sector

So, what are the symptoms

- Increasing reliance on resource sector
- Decreasing reliance on manufacturing sector
- Increasing wages
- Increasing prices for non-tradables
- Real exchange rate appreciation