

Energy Bonanza and Unsustainable Russian Growth

The Political Economy of a Petro-State

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Abstract

In this paper we will attempt to analyze the growth model of the Russian Federation since it emerged as an independent state in the aftermath of the collapse of the Soviet Union. By far the largest Soviet republic, Russia inherited the growth model of the USSR, which was based on a centralized industrial-military complex, fed by immense energy (oil, natural gas, coal) and other mineral reserves. The Russian economy, after the shock therapy strategy of the early 1990s, recovered primarily because it had an important foreign exchange earning energy export potential available which could become operational relatively quickly. The privatization of public assets led to the “piratization” of Russia (Goldman, 2003), and the emergence of a small group of oligarchs in a very short period of time, powerful new tsars who became the owners of the extremely rich energy and mineral reserves of Russia, with some of the strategic energy wealth remaining in state hands, in particular through the company Gazprom.

Growth recovered only by 1997, mainly because of the energy bonanza in which Russia quickly emerged as an important oil producer and the world’s largest exporter of natural gas. However, with a weak financial system, full of political intervention and “phantom” banks, the Russian economy entered into a deep financial crisis of 1998. The price of oil was extremely low that year, around 10 USD/Barrel, which cut most of the income of the Russian budget, and caused a fiscal squeeze. After the financial crisis, Russia showed sustained growth rates until 2008, it attracted substantial FDI in the energy and minerals sectors, benefiting from the rapidly rising energy prices (and food prices in 2007-2008). However, the Russian economy overall did not diversify, remained for a large part de-industrialized, and turned itself into the equivalent of a *petro-state*, completely dependent on oil, natural gas and metals exports. Although some of the increased GDP was redistributed through improved social services, poverty was reduced, also income disparity grew. All elements that point into a “resource curse”, although the curse is more caused by the political economy of the Russian growth model and institutional framework, rather than the presence of abundant resources. The global economic crisis of 2008-2009 also affected Russia, as demand for its exports dropped, as well as energy prices, but while other economies were struggling to recover, Russia went rapidly from a strong dip in 2009 to high growth rates in 2010 onwards. By 2013 it seems that growth is slowing down to much lower level, partly induced by a bad harvest in 2012, but also the growth model has become unsustainable, and is still (as in Soviet times) dependent on the demand for energy of others. In particular the slow growth of the EU is affecting Russian growth negatively. Finally, this slowing down of growth might well become a mid-or even long-term phenomenon for Russia, if it does not diversify and re-industrializes its economy. The main reason is a new global energy bonanza, now not in Russia, caused by the discovery and exploitation of shale gas. This development can change world energy markets dramatically, in spite of the problematic environmental risks shale gas production (with the fracking technique) brings with it. Main reserves have been found in the US and China, and in Poland on the European continent, and much less in Russia, while Russian natural gas and oil reserves will possibly will be exploited in only a few decades more, and are already coming largely from Siberia, produced at high costs and under difficult circumstances. In this new world energy market Russia is likely to lose, and with a non-diversified economy and a political economy of a petro-state the future is much less bright than the Putin regime wants the Russian people to believe. The Russian growth model that has emerged will become unsustainable.