

Witold M. Orłowski

<https://orcid.org/0000-0002-2320-2372>

Vistula University in Warsaw

Déjà vu: economic determinants of Russia's power in the historical perspective (1890–2020)

Zarys treści: Co decydowało o niestabilności mocarstwowej pozycji Rosji w ciągu minionych 130 lat? Analiza, prowadzona dla lat 1890-1913, 1980-1991 i 2000-2019, wskazuje na uderzające podobieństwo strukturalnych problemów ekonomicznych, prowadzących kraj do ciężkich kryzysów gospodarczych i polityczno-społecznych. Mimo różnych źródeł, za każdym razem był to niedostatek oszczędności w stosunku do potrzeb finansowych związanych z programem modernizacji i polityki imperialnej, niska konkurencyjność przemysłu oraz uzależnienie od eksportu surowców. Tworzyło to dla Rosji zagrożenia, które ujawniały się w pełni w warunkach nadzwyczajnych (wojny, blokady gospodarcze, sankcje).

Content outline: What reasons stood behind the instability of the power position of Russia over the last 130 years? This analysis, covering three periods of time: 1890–1913, 1980–1991, and 2000–2020, reveals astonishing similarities of structural economic problems that led to severe economic and socio-political crises. Despite different causes, each time the crisis was triggered by insufficient savings compared to needs resulting from a program of economic modernisation and imperial policy, low competitiveness of industry, and dependence on export of raw materials. These vulnerabilities of Russia became especially apparent under extraordinary circumstances (wars, economic blockades, sanctions).

Słowa kluczowe: siła kraju, wzrost gospodarczy, ekonomia polityczna, polityka rozwojowa, pozycja mocarstwowa, kryzys gospodarczy

Keywords: national power, economic growth, political economy, development policy, super-power status, economic crisis

1. Preliminary remarks

The dramatic twists and turns of Russian history during the last 130 years, and especially its times of trouble and bouts of collapse as a superpower followed by regaining the lost position, make one wonder about the causes that lie behind such an instability. In our view, this instability can largely be explained by factors of an

economic nature that are common for the entire period in question. These resulted mainly from political economy and economic policy dilemmas. Even today, when Russian relations with the West take a more hard-line course, and at a time when the global economy is subject to major crises, it is important to inquire about the real sources of Russia's strengths and weaknesses and the country's resilience to various economic disturbances. While attempting to come up with an answer it is well worth to review Russia's history, as the economic problems of contemporary Russia are surprisingly similar to those that the country witnessed in the past. The main weaknesses, as well as the mechanisms that generate them, appear to have been the same for Tsarist, communist and Putin's Russia.

This article analyses Russia's economic strengths and weaknesses in three periods.

- (a) The Russian Empire in the year 1913 and changes observed from 1890 to 1913 (from the beginnings of French-Russian rapprochement to the outbreak of the First World War).
- (b) The Soviet Union in 1980 and changes observed from 1980 to 1991 (from the invasion of Afghanistan to the breakdown of the USSR).
- (c) The Russian Federation in 2020 and changes observed from 2000 to 2020 (from the ascendancy of Vladimir Putin to power to the pandemic crisis).

The choice of these periods is not a matter of coincidence: they were all characterised by intensified attempts to maintain Russia's status as superpower undertaken at times of rising tensions in its economy and international political relations. The first period was characterised by the effort to industrialise and modernise the tsarist empire, which ended with the Russian defeat in the First World War and the revolution (both events were mostly caused by the collapse of the Russian economy: Pipes, 2006). The second period is the culmination of economic and financial struggle between the USSR and the West in the final decade of the Cold War that hurled Soviet economy into a deep crisis and led to the breakdown of the communist bloc (Gajdar, 1999; Orłowski, 2010). Finally, the third period is the era of Vladimir Putin's rule, during which the Russian economy recouped some of the losses suffered in the early years of transformation, while the Russian state pursued an increasingly hawkish policy towards the West, leading to sanctions and to the threat of economic war (Sutela, 2012).

Russia's economic strengths and weaknesses will be compared based on an analysis of macroportions of economic development, a crucial element in growth theory. Obviously, it should be remembered that, in addition to macroeconomic considerations, growth is greatly affected by institutions (Acemoglu, Johnson, 2005), but this particular factor will be discussed in this article in a much more abridged form.

The basic data about the scale of Russian economy in the periods selected for analysis can be found in Table 1.

Table 1. The economy of Russia in 1913, 1980 and 2013

| | Russian Empire, 1913 | USSR, 1980 | Russian Federation, 2020 |
|-----------------------------|-------------------------|---------------|-----------------------------|
| Population (in millions) | 175.1 | 265.9 | 146.8 |
| – share in world population | 9.8% | 6.0% | 1.9% |
| Share in global GDP | 9.6% | 8.5% | 3.0% |
| GDP per capita | | | |
| – as % of global average | 98% | 142% | 159% |
| – as % of Western Europe | 40% | 46% | 59% |
| | 1890–1913 | 1980–1991 | 2000–2020 |
| Average annual growth rate | | | |
| – population | 1.8% | 0.8% | 0.0% |
| – GDP (in constant prices) | 3.2% | 0.8% | 3.4% |

Note: GDP was measured using the purchasing power parity of currencies

Source: International Monetary Fund (IMF), Maddison 2001, Kennedy, 1989 (detailed information on the sources of data used in tables and charts can be found at the end of the article).

2. Economic strengths and weaknesses of the Russian Empire in 1913

In 1913, the Russian Empire spanned an area of 22.4 million square kilometres and was inhabited by 175 million people. Its economic strength, however, was not on a par with its size. In the mid-19th century, Russia's GDP was still the largest in Europe (but it must be remembered that the empire also covered huge areas of Asia). During the two subsequent decades, Russia was overtaken in this respect by the United States, Britain, and Germany (Kennedy, 1989; Maddison, 2011). This was because Russia, unlike her rivals, did not receive substantial benefits from industrialisation. Although at the beginning of the 20th century, Russia accounted for 9% of global GDP, more than a half of her contribution came from agriculture, while industry and modern transport were still in the early stages of development (Gregory, 1982). An enormous obstacle for modernisation was the low level of education: in 1897, the illiteracy rate of European Russia's population over the age of nine exceeded 70% (Mironov, 2001), while at the same time this figure stood at 16% in France, less than 11% in the United States, and was close to zero in Germany (UNESCO, 1957).

In the late 19th century, Russia began its vigorous industrialisation, which is mostly associated with the long-term minister of finance and prime minister Sergei Witte. His objective was to transform Russia into a “greenhouse of capitalism” by providing investment incentives, fighting socialist movements, intro-

ducing currency based on the gold standard, and significantly expanding railway infrastructure (Heller, 2000; Kennedy, 1989). As a result, the country witnessed a rapid growth of industrial production of about 7% per annum (Fischer, 1994), while the share of investments in GDP rose to about 15–20% (Cheremukhin et al., 2013). Increased industrial production, especially in heavy and machine industry, bolstered the power of the state: on the eve of the First World War its large army, intensely modernised after the humiliating defeat in the Russo-Japanese War, was considered the most powerful in Europe (although slow to mobilise because of the country's inefficient transport network). The total military potential of Russia was considered equal to Germany's and much higher than that of Britain and France (Wohlforth, 1987). These estimates were, however, exaggerated, which became evident after the defeats that Russia suffered at the hands of the Germans in 1914–1915 (Cornish/Karachtchouk, 2001).

Despite a high dynamic of GDP growth, Russia's economy failed to make a quality leap that would allow to defend the country's position as superpower in the global conflict. The development was affected by numerous tensions that led to a collapse:

- (a) The costly industrialisation was not accompanied by a radical modernisation of the country; in particular, there was no suitable increase in the level of education (in 1907, 65% of the population of European Russia were still illiterate), nor were the institutions of the state properly modernised (Pipes, 2006).
- (b) Industrial growth was fuelled by a protectionist policy that put up artificial barriers for imports, reducing the efficiency and competitiveness of production (Gregory/Stuart, 1986).
- (c) The systematic agrarian reform launched by prime minister Pyotr Stolypin, which could have roused Russia's countryside from apathy, reducing poverty and mobilising more resources for the country's modernisation, ended in failure (Heller, 2000).
- (d) Since 1897, when the gold standard of the rouble was introduced, the necessary increase in money supply depended on the capacity of the State Bank to maintain sufficient gold reserves, which in turn could only be secured by a trade surplus. A decisive majority of Russia's export revenues came from selling agricultural products and wood, which in 1890 accounted for 74% of all revenues; the exports of industrial and mining products, while rapidly evolving, did not reach a 10% share by 1913 (Gregory, 2003). Consequently, Russian economy remained dependent on exporting raw materials (mainly grain and wood) to ensure a surplus in trade (up to 3% of GDP per annum); this policy was upheld even in years of poor harvest (Gregory, 1982). It should be added that a policy providing a developing country with a necessary stream of foreign currency through the forced export of raw materials, was nothing out of the ordinary: a similar strategy was pursued at the same time by rapidly industrialising Japan.

Most importantly, however, Russia did not solve the fundamental issue: the shortage of necessary resources (both in the hands of the state and the private sector) that could be used to finance the modernisation of the country. Such a shortage was a result of insufficient level of domestic savings, resulting from the very low income of most of the population and from the low appetite for investment evinced by the upper classes (who preferred relishing in luxury goods rather than saving). This phenomenon is typical for relatively underdeveloped economies that are mostly based on agriculture and characterised by extreme income disparities (Loayza, Schmidt-Hebbel, Servén, 2000). It had, however, a special meaning in the case of Russia, a country which tried to maintain its superpower status, but was economically falling backwards compared to its swiftly developing rivals. This meant the need to simultaneously finance the costly program of imperial policy (especially the expansion of army and navy) and industrialisation (both infrastructure development and a radical increase of investment in the industrial sector). The scale of this challenge can be illustrated by comparing Russia's estimated military spending, which rose by 167% between 1885–1889 and 1910–1913, the increase of public investment (mostly in infrastructure development) by 188%, and the surge of investment in industry by 195%, with GDP growth of 117% only (Gregory, 2003). Although the calculations are based on current prices, they do not deviate strongly from calculations based on constant prices (the gold standard guaranteed that prices remained stable).

Solving the dilemma of resources falling short of needs was of crucial importance for a country that faced huge challenges of an economic, social, and political nature. Although some of the Russian political elites were aware of the scale of the challenge, the tsarist government was not ready to implement radical reforms that could have helped to mobilise the necessary resources (Heller, 2000). The Russian authorities, pursuing a conservative socio-political doctrine, avoided increasing the taxes levied on the upper classes, and especially the great landowners, although the income of these groups did not contribute sufficiently to the domestic investment but was spent primarily on luxury consumption. At the same time, with the low income of the peasants making up 80% of the population, their taxation (mostly through excise duties on spirits, sugar, and tobacco) failed to provide sufficient resources that could ensure the financing of the state's basic development needs (Plaggenborg, 1995). The government allocated the limited resources mostly to the priority armaments: the amounts spent on the military were six times larger than on education and health combined (Kennedy, 1989). As the resources were insufficient compared to modernisation needs, the financing of the investment had to be secured by importing the foreign capital. This happened mostly in two ways:

- (a) The Russian government borrowed money abroad, issuing bonds (mostly on the French market) to finance armaments and development of railway infrastructure. As a result, by 1913 Russia's foreign debt rose to about 40% of GDP

and the costs of its servicing (interests paid to investors) was eating up the majority of the trade surplus (Gregory, 1982).

- (b) Foreign direct investment (FDI) was used as the main tool of financing industrial investments. While this allowed for a provisional solution for countering the shortage of capital in the private sector, Russia's balance of payments deteriorated over time due to the growing transfer of profits abroad (dividend payments). This was inevitable given that in 1913 almost all mines and oil wells, as well as 40% of heavy industry were in the hands of foreign capital (Fischer 1994).

Due to the coexistence of a trade surplus (from exporting raw materials), maintained with tremendous effort, with three systematically growing expenditure categories (costs of foreign debt service, transfer of profits, and foreign spending of the upper classes on luxury consumption), Russia's balance of payments began to show a growing current account deficit that reached 3% of GDP in 1913 and was financed with the further increase of debt (Figure 1).

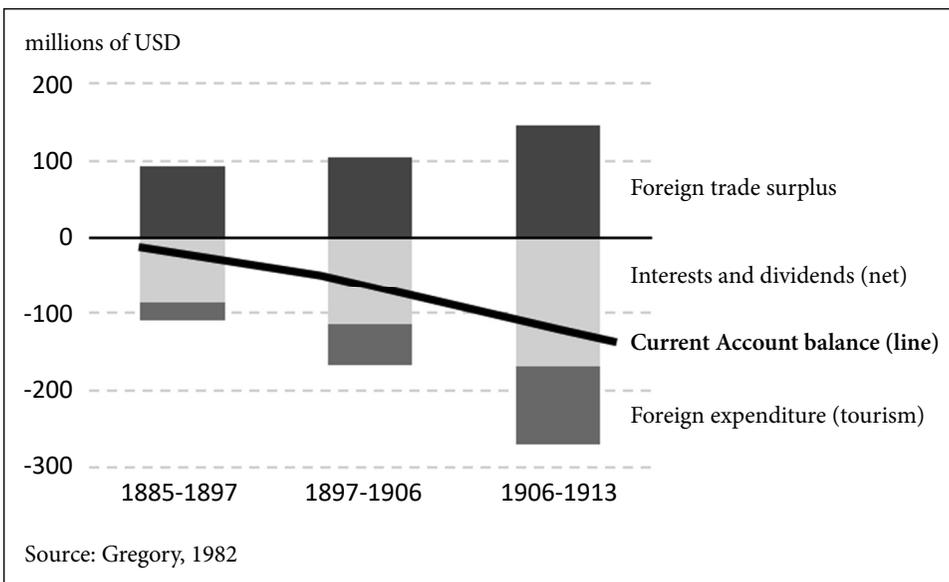


Fig. 1. Current account of Russia, 1885–1913 (annual average in millions of USD).

In a nutshell, Russia attempted to simultaneously pursue a costly imperial policy program and accelerated industrialisation, while facing a chronic shortage of domestic savings due to political limitations. Over time, the stopgap solution of increasing debt and inviting FDI began to fail due to the growing transfer of profits and interests (a natural occurrence when investments do not lead to a rapid increase in competitiveness and trade surplus; Japelli/Pagano, 1994). Industrialisation did not greatly affect the structure of Russian exports by 1913,

and the gold reserves necessary to increase the money supply could be secured only through exporting raw materials at low prices. This means that, despite accelerated growth, Russian economy was incapable of securing a sustainable development, modernisation, and structural change. As a consequence, when the First World War cut the country's access to export markets and supplies from allies, the economy proved unable to operate efficiently. While the British GDP increased by 13% during the war, and in France and Germany declined by 10–15%, in Russia the GDP fall reached almost 40% by 1918 (agricultural production fell by 40% and industrial production by 60%; Markevich/Harrison, 2011). As production collapsed and transport was paralysed, neither the army could have been properly supplied, nor food distributed efficiently to the population. This in turn led to military defeats and social unrest that toppled the empire of the tsars and paved the way for the Bolshevik takeover (Pipes, 2006).

3. Strengths and weaknesses of the Soviet economy in 1980

At first sight, the situation of the USSR in 1980 was totally different from that of the Russian Empire in 1913. The country, with a population of 266 million, was a global superpower, and according to multiple views, during the 1970s its military potential overtook that of the United States (Collins/Severns, 1981). At the same time, the country ranked second behind the US in terms of GDP, although technologically it was falling considerably behind its rival (Orłowski, 2010). Another Soviet asset were the world's largest reserves of energy resources, whose prices reached historical highs in 1980 following the two oil shocks of the 1970s (US Energy Administration Information, 2020). Considering the inflation of other goods, the real level of oil prices in 1980 was more than seven times higher than a decade earlier (a similarly high level was later reached in 2008 and 2011–2013; in 2021 the real price of oil is lower by almost a half compared to 1980).

Paradoxically, in the early 1980s the Soviet economy was facing exactly the same dilemma the Russian Empire did in 1913. The USSR also encountered the growing problem of shortage of resources necessary to maintain the country's position as a superpower while modernising the economy. Struggling to retain this position, in the 1980s the Soviet authorities were forced to pursue three objectives that competed for the same limited pool of resources: (1) stimulating and modernising the economy, which required a high level of investment expenditures (Fischer, 1994), (2) maintaining the quality of life of an increasingly restless population, which required spending more resources on producing consumption goods (Gajdar, 1999); (3) upholding a strategic military advantage over the US, which required high expenditures for armaments (the accurate level of USSR military spending is not known, but is assumed to have been 15–19% of GDP per annum, Collins/Severns 1981). During the 1980s, especially since Mikhail Gorbachev came to power

and attempted to introduce necessary reforms, it turned out that an attempt to finance development and imperial policy simultaneously caused the Soviet Union to suffer from the same malady that led to the collapse of Tsarist Russia, and the pace of its GDP growth was steadily slowing down.

In Western analyses, it is commonly assumed that the Soviet economy was characterised by continuously high rates of savings and investment. Thus, the slowdown of the growth is attributed to: (1) enormous microeconomic inefficiency that led to a sharp decline of investment efficiency and decreasing marginal productivity of capital (up to a negative value in the 1980s, which is an economic absurd; Fischer, 1994; Allen, 2001), and (2) extraordinarily low (for unclear reasons) elasticity of substitution between labour and capital (Easterly/Fischer 1995).

The argument about high rates of savings and investments is undoubtedly true with respect to the Stalinist era. The communist authorities (unlike their tsarist predecessors) managed to mobilise internal resources necessary to finance forced industrialisation and enormous expansion of the military potential (Allen, 2001; Kennedy, 1989). According to some estimates, during the first Five Year Plan (1928–1932), the investment rate was successfully raised from 15% to 25–30% of GDP, while resources were concentrated on a colossal expansion of heavy and defence-related industry (Cheremukhin et al., 2013). The poor, agriculture-based Soviet Union could have achieved it only thanks to the incredibly brutal exploitation of the countryside (leading, in extreme cases, to confiscation of food and millions dying of hunger), forcing urban residents to save (by refusing to provide adequate supplies of consumer goods), and using slave labour on a massive scale (Davies, 1980).

The assumption that this state of affairs continued also after 1950s is, however, erroneous, and commonly accepted estimates showing the investment rate in the 1980s at the level of about 30% (Gregory/Stuart, 1986; WIIW, 1991) are misleading. The issue here is the imperfection of the statistical measurement in conditions in which prices are artificially fixed rather than determined by the market. It should be noted that since the early 1960s the Soviet Union pursued a policy of freezing the prices of basic consumer goods; the officially reported consumer goods index in the period between 1960 and 1989 was rising by just 0.4% annually (actual inflation was higher because of hidden price hikes, but still remained far behind the cost pressure; the resulting shortages and inflation overhang led to hyperinflation after liberalising the prices in the 1990s; Filatochev/Bradshaw, 1992). As it appears, such policy was motivated by the desire to avoid irritating the society, especially since the bloody suppression of the 1962 worker riots in Novocherkassk (Gajdar, 1999). Paradoxically, therefore, the communist authorities, so effective and ruthless in suppressing all individual opposition to the system, grew increasingly powerless with respect to the entire society (and especially the worker class which it purported to represent). The result was an economically irrational policy of avoiding the necessary increase of consumer goods prices.

In a non-market system, price relations may permanently and considerably deviate from the level which would otherwise be set by the market, which distorts economic relations calculated on the basis of statistical data. The result of the three-decade-long Soviet policy of avoiding the increases of prices of consumer goods was that the consumer expenditures reported in statistical data became increasingly undervalued over time, and the value of investment expenditures overvalued compared to what would have occurred had price relations evolved like in free market economies (Orłowski, 2010). Using a correct statistical method for measurement (based on comparing the size of investments and GDP in international prices) leads to the conclusion that the actual investment rate in the USSR gradually fell from 30% in the 1950s to less than 16% in the 1980s (Orłowski, 2010). The relationship between declining investment rates (calculated in international prices) and weakening growth dynamic, obvious from the economic point of view, is shown in Figure 2.

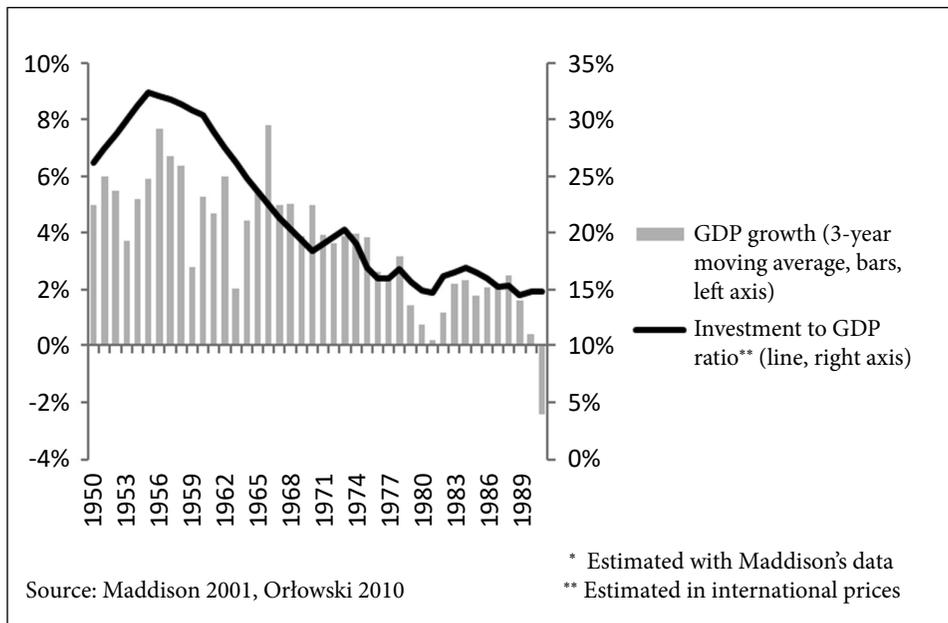


Fig. 2. GDP growth and actual investment rate in the USSR, 1950–1991.

There is no doubt, of course, that the declining pace of investment was accompanied by the growing inefficiency and the widening technological gap vis-à-vis the West. Low competitiveness and technological backwardness of industry (except for some sectors of defence-related industry) compelled the seemingly industrialised country to rely on exporting raw materials and semi-finished products in order to obtain foreign currencies (Gajdar, 1999). In the 1980s, such exports accounted for almost 70% of all export revenues (WIIW, 1991).

It was low savings rate and shortage of capital, therefore, that led to a deficit of resources necessary for the USSR to simultaneously achieve its objectives; due to political decisions, investment expenditures suffered the most. Just like in the late nineteenth century, the only chance for this policy to continue was finding additional financial resources abroad. Given the ideological struggle with the West, Soviet authorities were extremely wary of increasing national debt and banned foreign investments in the economy (Fischer, 1994). As a result, the problem could have been solved only by a sharp increase of revenues from exporting oil and gas. This, however, required the construction of new, more efficient pipelines, an undertaking impossible without technologies to which only the West had access (Norquist, 2003).

The new economic strategy planned by the USSR was accompanied by half-hearted attempts to introduce pro-efficiency reforms and to limit the scale of military spending as part of Gorbachev's "perestroika" initiative. These plans fell through, however, for several reasons:

- (a) Systematically growing social frustration and irritation, mostly due to economic conditions, created challenges to the effective hegemony of the communist party in economic affairs and caused the unravelling of the bureaucracy apparatus (Gajdar, 1999).
- (b) A rapid decrease in world prices of energy resources limited export revenues. Due to a collapse in oil prices, which declined in real terms by 72% between 1980 and 1988, the USSR's foreign currency revenues from exporting oils and gas contracted between 1984 and 1988 by more than a half. The price collapse was accompanied by growing issues with maintaining production volume due to underinvestment in the gas and oil industry (Fischer, 1994).
- (c) The factor that ultimately killed off the Soviet economy was the intentional US policy of undermining its financial foundations. This policy, launched in the early 1980s by the Reagan administration, featured a number of carefully chosen moves: (1) forcing the USSR to increase military spending by opening a new arms race, (2) hindering access to new technologies, and (3) preventing increased exports of energy resources by blocking advanced plans of building oil and gas pipelines to Japan (cutting off loans and imposing sanctions on Western companies supplying the necessary technologies to the USSR; Norquist, 2003).

These actions of the US quickly drained the sources from which Soviet economy was financed. This forced the authorities in Moscow to look for further savings that directly impacted the quality of life of citizens, definitively disorganised central planning and led the Soviet Union to the brink of insolvency. The result was a severe economic crisis, followed by the breakdown of the USSR and the collapse of the communist system (Orłowski, 2010).

4. Economic strengths and weaknesses of the Russian Federation in 2021

Following the stormy transformation of the 1990s, the last two decades brought considerable changes in the way the Russian state is run. According to Western appraisals, once Vladimir Putin took power, Russia “shifted toward a centralized authoritarian state” (CIA, 2020). At the same time, the country became more aggressive in its foreign policy and, to some extent, managed to halt the decay of its military power (Kuźniar, 2011).

In the economic domain, the period 2000–2021, and especially its first half, brought an improvement in economic conditions compared to the very hard 1990s. The recession that accompanied the transformation was so deep and persistent that between 1989 and 1996 Russia's GDP fell by as much as 42%. The decline in production went hand in hand with peculiar structural changes, fundamentally different from those observed in Central Europe (Orłowski, 2020; Chaplyuk et al., 2016). First and foremost, a group of oligarchs, under the guise of privatisation, took hold of the country's most valuable assets, especially natural resources. This led to huge income inequality, discouraged investments by foreign capital and slowed down desirable changes in competitiveness and transformation of production structure, making the economy heavily dependent on exporting oil and gas (Gregory/Lazarev, 2004). The rapid decline of oil prices revealed the weakness of Russian finances and led to the 1998 crisis (Orłowski, 2020).

Putin's coming to power in 2000 coincided with improved situation of the Russian economy. The tenfold nominal rise in oil prices from 1999 to 2009 helped to radically improve the finances and accelerated economic growth. The close relationship between the global oil price and the pace of growth of the Russian economy is shown in Figure 3.

As the data show, exporting energy resources is today the most important factor on which Russia's growth and macroeconomic stability depends. This phenomenon remains, however, in direct opposition to the objectives found in the 2008 National Security Strategy, which said that the economy's dependence on export of oil and gas is a threat to growth and should be eliminated by 2020 (Tsygankov, 2011). It is also obvious that relying too much on exports of oil and gas hinders structural transformation in the economy, causing the symptoms of the “Dutch disease”: as the rouble exchange rate is excessively appreciated, the manufacturing industry loses its competitiveness. The mechanism of the “Dutch disease” explains the apparent paradox of the so-called “natural resource curse,” i.e. the negative impact of huge revenues from exporting natural resources on long-term economic growth (Algieri, 2011).

Estimating the current economic strengths and weaknesses of Russia is not easy. As of 2021, the Russian Federation is the world's sixth largest economy (eleventh according to current exchange rates due to the relative weakness of the rouble),

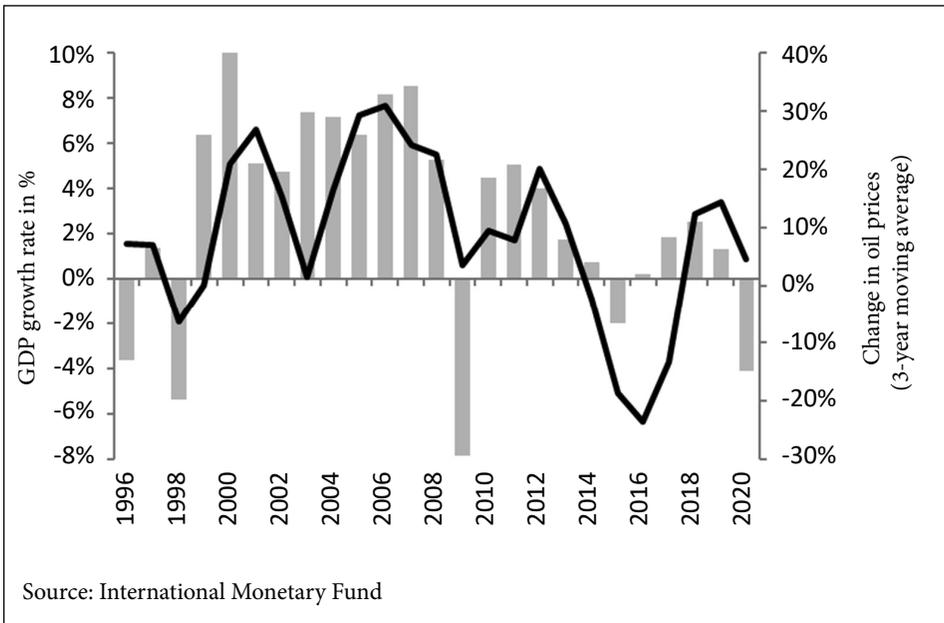


Fig. 3. Increase of Russian GDP (bars) and changes in oil prices (line) 1996–2020.

it has the fourth largest foreign exchange reserves (560 billion USD), the largest documented deposits of natural gas, and eighth largest deposits of oil. It should be noted, however, that the percentages showing Russia's current share in world economy (see Table 1) are markedly lower than in either 1913 or 1980, both due to the breakdown of the empire and global changes which caused new economic powers to arise. The economic results of 2000–2020 are ambiguous. Following a period from 2000 to 2008 of rapid GDP growth (by 7.8% per annum on average), falling inflation and appreciation of the rouble, since 2009 the economy has remained in stagnation, with GDP rising annually just by 0.6% on average as a result of the global financial and pandemic crises, decline in oil prices and Western economic sanctions. In 2000–2008, Russia pursued an economic policy that restricted the use of revenues from resource exports for current consumption in an attempt to counteract the effects of the “Dutch disease” (Orłowski, 2010). This policy was realised mostly through ensuring budget surpluses and accumulating high foreign exchange reserves to serve as padding against potentially declining oil prices. Such course was, however, abandoned after 2009.

In parallel with the rising GDP of Russia, the international position of the country improved as well. Following considerable erosion of the state institutions in the first years of transformation, the Putin government managed to regain control over the most profitable branches of the economy, formerly dominated by the oligarch class, creating a system of “state capitalism” characterised by voluntary or

coerced cooperation between the state and oligarchs (Goldman 2008). As a result, the financial situation of the state improved, allowing to intensify imperial policy and partially restore Russian influence in the majority of former Soviet republics (Kuzniar, 2011).

On the other hand, however, the Russian Federation economy is riddled with serious weaknesses that radically undermine its position in case of a more or less serious economic conflict with the West. Such factors are discussed below.

- (a) Despite the ambitions initially declared by Putin, no reforms were introduced that would permit the emergence of a normal, modern free market economy, based on a growing middle class, popularisation of mass ownership and development of entrepreneurship. Such a change would have required rooting out the crooked system in which the oligarchs control the most profitable branches of the economy. Instead, the government contented itself with agreeing on a share of profits from activities of oligarchs, battling only those who refused to bow down (Sutela, 2012; Goldman, 2008).
- (b) Additionally, the flat income tax (which reinforces income inequalities) was introduced in 2001, while the rich were given blanket permission to transfer their capital abroad. Although Russia's cumulative current account surplus was over USD 1.2 billion in the entire period from 2000 to 2019 (due to trade surplus), the foreign currency reserves increased only by USD 476 billion, which means that surplus in current account was accompanied by a net outflow of capital equal to USD 755 billion (the average annual drain of capital from Russia was over 3% of GDP). This is unlike Central European countries, which recorded a considerable net inflow of capital during the transformation period due to the high attractiveness to foreign investors (Orłowski, 2020).
- (c) Russia's relatively low investment attractiveness, resulting mostly from the unfavourable economic environment (corruption, no guaranteed rule of law, and government actions to protect domestic oligarchs, especially when investing in the highly profitable oil and gas sector), means that despite having a huge market the country did not attract foreign investments large enough to balance the drain of domestic capital. Although the cumulative value of direct investments made in Russia from 2000 to 2019 reached USD 600 billion, it was still less than the value of Russian investments abroad (USD 671 billion). Moreover, about one half of foreign investments in Russia were made by companies from countries commonly classified as "tax havens" (Cyprus, Jersey, Bahamas, British Virgin Islands), which arouses the suspicion that they are really reinvestments of some part of Russian capitals previously funnelled out of the country (Ledayeva et al., 2013).
- (d) The low taxes levied on oligarchs' income and permission for mass exodus of capital made Russia suffer from a shortage of domestic private savings, and therefore the capital necessary for development, despite huge profits from exporting oil and gas. At the same time, the high income of the government

- sector that could partially bridge the gap in private savings is treated as a tool of imperial policy and not used for economic development (Tsygankov, 2011; Chapliuk et al., 2016).
- (e) At the same time, a strong manifestation of the “Dutch disease” (excessive real appreciation of the rouble due to high revenues from exporting oil and gas), combined with a distorted privatisation policy, corruption, lack of incentives for investors and widely employed protectionist practices leads to slowdown in structural changes, low competitiveness, reduced innovation and technological backwardness of the manufacturing industry (Gregory/Lazarev, 2004).
- (f) The general effect is Russia’s dependence on exporting resources and semi-finished products, which in 2018 accounted for 68% of all export revenues (of which 52% were due to energy resources alone) and allowed to generate a huge trade surplus (Figure 4). Russia’s export structure is therefore typical for an undeveloped country that exports unprocessed and low processed goods while importing investment and consumption goods (which total 75% of imports). It is worth adding that in 2000 the share of resources and semi-finished goods in export was lower, below 60%.
- (g) It should also be noted that while oil production in Russia is managed by a number of large companies with some involvement of foreign capital, the natural gas market is dominated by the state-run giant Gazprom. Together with control over oil and gas pipelines, this makes oil and gas exports a convenient tool for pursuing imperial policy. On the other hand, the effect of this setup is underinvestment of the energy sector whose profits are partly gobbled up by the state and partly funnelled abroad by oligarchs (Goldman, 2008). The influx of foreign capital to the resources sector is strictly supervised and regulated (US Energy Information Administration, 2014).

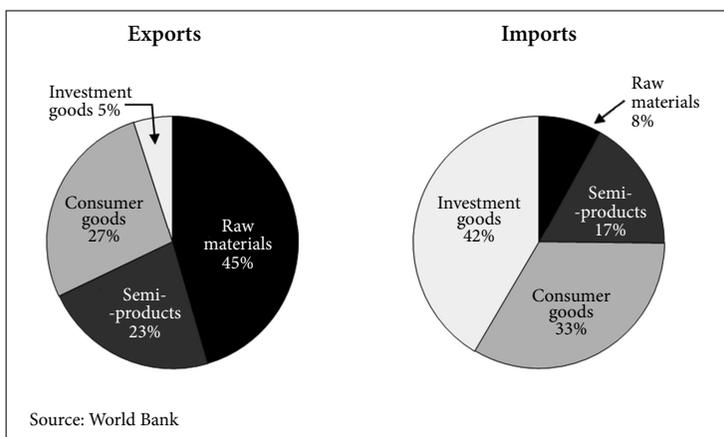


Fig. 4. Structure of Russian exports and imports by groups of products, 2018.

To wrap up, therefore, it should be noted that despite the ambitious plans laid by Vladimir Putin in his early years in power, in the years 2000–2020 the Russian Federation not only failed to modernise the economy and increase the competitiveness of non-resource sectors, but indeed achieved the reverse – the unfavourable structural change, shortage of domestic savings and dependence on exporting resources became even more acute than before.

5. Summary: three key weaknesses

Despite a number of huge assets, the economy of the Russian Federation today is ailing in a way surprisingly akin to that the Russian Empire did more than a century ago and the Soviet Union four decades ago. Key importance should be assigned to three weaknesses of a macroeconomic nature that were apparent in all three periods, although each time they were arising from different causes.

- (a) The first and most important weakness is the **shortage of savings compared to needs**, combined with an attempt to simultaneously finance economic development and imperial policy. In all the three periods, the shortage of savings had different causes (although always related to internal policy choices), yet similar consequences. In Tsarist Russia, it resulted from a conservative social and economic doctrine that favoured landowners; in the USSR, from the extreme costs of pursuing superpower policy while trying to avoid social unrest and banning foreign investments; in the Russian Federation, from the oligarchic model of capitalism and the massive evasion of the Russia's capital.
- (b) The second key weakness is the **low competitiveness of non-resource sectors** of the economy. Once again, this should be attributed, although with different intensity and for a variety of reasons, to persistent lack of sufficiently deep reforms of a technologically backwards economy. In Tsarist Russia, this stemmed from protectionism and the general civilisation backwardness; in the Soviet Union, from the ineffective system of communist economy; in the Russian Federation, from effects of the “Dutch disease,” protectionism and inconsistently pursued economic transformation.
- (c) The third key weakness is the huge **dependence on export of resources** (in Tsarist Russia grain and wood, in the USSR and Russian Federation mainly oil and gas), which is a consequence of the two previous weaknesses. What is common for the three periods is a foreign trade structure typical for underdeveloped countries, as well as the resource export dependence on foreign technology and capital. This makes the country especially vulnerable to economic blockades and technological change that may affect the operation of energy markets.

At the same time, the three periods have in common a drive to **maintain the position of a superpower while being economically weak compared to Russia's**

main rivals. The impasse could be broken by undertaking sufficiently deep reforms to modernise the country and economy. Each time, however, the rulers failed to take this decision, mainly for reasons related to internal policy. The inability to solve basic problems by bold political decisions was therefore a common trait of the Russian state, regardless of the reigning political and economic system.

It should be pointed out that over time these three key weaknesses of the Russian economy remained relatively little recognised by contemporaries and manifested themselves fully only in times of economic blockade (in the case of Tsarist Russia) or economic war (the USSR). Nevertheless, as these weaknesses were revealed, Russian economy collapsed during the First World War and during the breakdown of the Soviet Union.

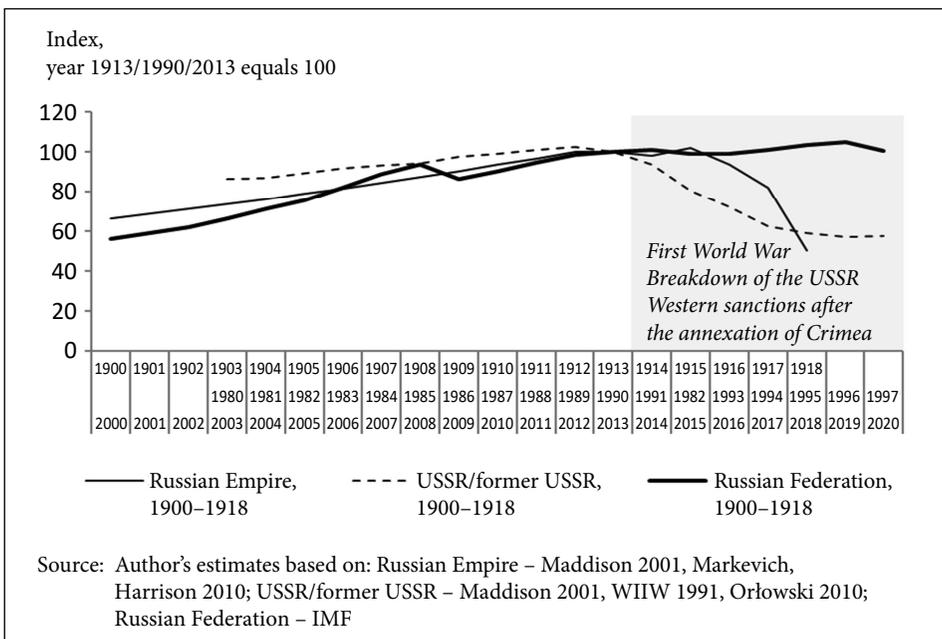


Fig. 5. Changes of GDP level in three periods of Russian history

Obviously, the disrupted economic development of the Russian Federation observed after the annexation of Crimea and the imposition of Western economic sanctions, while painful, does not lead to as disastrous consequences as was the case in the two earlier historical periods, due to the limited scale of the shock. Nevertheless, considering the specific weaknesses of the Russian economy, one could formulate a hypothesis that if the Russian Federation decides to head towards full economic war with the West, or if market and technological changes lead to considerable, permanent limitation of revenues from exporting oil and gas, the existing weaknesses could even now plunge Russia into a deep economic crisis. The economic, social, and political consequences of such a crisis are difficult to foresee.

Abstract

The article seeks to answer, from the economic point of view, the question about sources of instability of Russia's superpower status over the last 130 years. The analysis of economic strengths and weaknesses of Russia is based on a comparison of three periods: the Russian Empire in 1890–1913, the Soviet Union in 1980–1991, and the Russian Federation in 2000–2020. In spite of different sources of the problems, in all the three periods the Russian economy shows astonishing similarities that led to severe economic and socio-political crises. The three most important common problems are: (1) insufficient domestic savings to simultaneously finance economic modernisation and imperial policy, (2) low competitiveness, (3) dependence on the export of raw materials. Although the causes of these weaknesses were different in the analysed periods and rooted in dilemmas of internal policy, their occurrence always represented a major vulnerability for Russia that manifested itself fully during the trade wars and economic blockades. In the case of the Russian Federation, the vulnerability may be reinforced by both a confrontational policy towards the West and the technological and economic changes which could transform the functioning of global energy markets.

Bibliography

- Acemoglu D., Johnson S., “Unbundling Institutions,” *Journal of Political Economy*, 113 (5) (2005), pp. 949–995.
- Algieri B., “The Dutch Disease: Evidences from Russia,” *Economic Change and Restructuring*, 44 (3) (2011), pp. 243–277.
- Allen R.C., “The Rise and Decline of the Soviet Economy,” *The Canadian Journal of Economics / Revue canadienne d'économique*, 34 (4) (November 2001), pp. 859–881.
- Chaplyuk V., Andryushchenko G., Sorokina L., Kukhareno O., Petrovskaya M., “Problems of the Russian Economy,” *Mediterranean Journal of Social Sciences*, 7 (3) (2016), pp. 206–211.
- Cheremukhin A., Golosov M., Guriev S., Tsyvinski A., “Was Stalin Necessary for Russia's Economic Development?” NBER Working Paper No. 19425, 2013.
- Collins J.M., Severns E.A., “US/Soviet Military Balance. Statistical Trends 1970–1980,” Congressional Research Service, Washington, 1981.
- CIA, *The World Factbook* (2020), <https://www.cia.gov/library/publications/the-world-factbook> (accessed: 22 January 2021).
- Cornish N., Karachtchouk A., *The Russian Army 1914–1918*, Oxford, 2001.
- Davies R.W., *The Industrialisation of Soviet Russia*, vol. 1: *Socialist Offensive*, London, 1980.
- Easterly W., Fischer S., “The Soviet Economic Decline,” *The World Bank Economic Review*, 9 (3) (September 1995), pp. 341–371.
- Filatov I., Bradshaw R., “The Soviet Hyperinflation: Its Origins and Impact throughout the Former Republics,” *Soviet Studies*, 44 (5) (1992), pp. 739–759.
- Fischer S., “Russia and the Soviet Union Then and Now,” in: *The Transition in Eastern Europe*, vol. 1, ed. Blanchard O., Froot K., Sachs J., Chicago, 1994, pp. 221–257.
- Gajdar J., *Anomalie wzrostu gospodarczego*, Warszawa, 1999.
- Goldman M., *Petrostate: Putin, Power, and the New Russia*, Oxford, 2008.
- Gregory P., *Russian National Income 1885–1913*, Cambridge (MA), 1982.
- Gregory P., *Экономический рост Российской империи (конец XIX – начало XX в.). Новые подсчеты и оценки*, Moscow, 2003.
- Gregory P., Lazarev V., “Structural Change in Russian Transition,” Yale University Economic Growth Center Discussion Paper no. 896, 2004.

- Gregory P., Stuart R., *Soviet Economic Structure and Performance*, New York, 1986.
- Heller M., *Historia imperium rosyjskiego*, Warszawa, 2000.
- Jappelli, T., Pagano, M., "Saving, Growth and Liquidity Constraints," *The Quarterly Journal of Economics*, 109 (1) (February 1994), pp. 83–109.
- Kennedy P., *The Rise and Fall of the Great Powers*, New York, 1989.
- Kuźniar R., *Pozimnowojenne dwudziestolecie 1989-2019. Stosunki międzynarodowe na przełomie XX i XXI wieku*, Warszawa, 2011.
- Ledyaeva S., Karhunen P., Kosonen R., Whalley J., "Foreign Investment from Offshore Jurisdictions into Russia: An Analytical Overview," *Russian Analytical Digest* (November 2013), no. 140.
- Loayza N., Schmidt-Hebbel K., Servén L., "Saving in Developing Countries: An Overview," *The World Bank Economic Review*, 14 (3) (2000), pp. 393–414.
- Maddison A., *The World Economy: A Millennial Perspective*, Paris, 2001.
- Markevich A., Harrison M., "Great War, Civil War, and Recovery: Russia's National Income, 1913 to 1928," *The Journal of Economic History*, 71 (3) (September 2011), pp. 672–703.
- Mironov B. N., "The Development of Literacy in Russia and the USSR from the Tenth to the Twentieth Centuries," *History of Education Quarterly*, 31 (2) (1991), pp. 229–252.
- Norquist W., "How the United States Won the Cold War," *Journal of US Intelligence Studies*, Winter/Spring 2003.
- Orłowski W.M., *W pogoni za straconym czasem. Wzrost gospodarczy w Europie Środkowo-Wschodniej 1950–2030*, Warszawa, 2010.
- Orłowski W.M., "Trajectories of the economic transition in Central and Eastern Europe," in: *Social and Economic Development in Central and Eastern Europe*, ed. G. Gorzelak, London/New York, 2020.
- Pipes R., *Rewolucja rosyjska*, Warszawa, 2006.
- Plaggenborg S., "Tax Policy and the Question of Peasant Poverty in Tsarist Russia, 1881–1905," *Cahiers du Monde Russe*, 36 (1/2) (January–June 1995), pp. 53–69.
- Sutela P., *The Political Economy of Putin's Russia*, New York, 2012.
- Tsygankov A., "Preserving Influence in a Changing World: Russia's Grand Strategy," *Problems of Post-Communism*, 58 (1) (March–April 2011), pp. 28–44.
- UNESCO, *World Illiteracy at Mid-Century*, Paris, 1957.
- US Energy Information Administration, *Russia*, 2020 (accessed: 22 January 2021).
- WIIW, *Comecon Data 1990*, London, 1991.
- Wohlforth W.C., "The Perception of Power: Russia in the Pre-1914 Balance," *World Politics*, 39 (3) (April 1987), pp. 353–381.

Sources of data (tables and charts)

- Table 1 International Monetary Fund [IMF], *World Economic Outlook Database* (2020), www.imf.org/en/Publications/WEO/weo-database/2021/April (accessed: 22 January 2021).
- Maddison A., *The World Economy: A Millennial Perspective*, Paris, 2001, pp. 91–95, 256–257, 259–261 (data also available in the Maddison Project Database 2020, www.rug.nl/ggdc/historicaldevelopment/maddison/releases/maddison-project-database-2020, [accessed: 25 May 2021]).
- Kennedy P., *The Rise and Fall of the Great Powers*, New York, 1989, pp. 199, 201, 243.
- Fig. 1 Gregory P., *Russian National Income 1885–1913*, Cambridge (MA), 1982, pp. 448–449.
- Fig. 2 Maddison A., *The World Economy: A Millennial Perspective*, Paris, 2001, pp. 259–261 (data available also in the Maddison Project Database 2020, www.rug.nl/ggdc/historicaldevelopment/maddison/releases/maddison-project-database-2020, [accessed:

- 25 May 2021]). Orłowski W.M., *W pogoni za straconym czasem. Wzrost gospodarczy w Europie Środkowo-Wschodniej 1950–2030*, Warszawa, 2010, p. 82.
- Fig. 3 International Monetary Fund [IMF], *World Economic Outlook Database* (2021), www.imf.org/en/Publications/WEO/weo-database/2021/April, (accessed: 25 May 2021).
- Fig. 4 World Bank, *WITS World Integrated Trade Solutions Database* (2021), wits.worldbank.org/CountryProfile/en/RUS (accessed: 25 May 2021).
- Fig. 5 Maddison A., *The World Economy: A Millennial Perspective*, Paris, 2001, pp. 259–261 (data available also in the Maddison Project Database 2020, www.rug.nl/ggdc/historicaldevelopment/maddison/releases/maddison-project-database-2020, [accessed: 25 May 2021]). Markevich A., Harrison M., “Great War, Civil War, and Recovery: Russia's National Income, 1913 to 1928,” *The Journal of Economic History*, 71 (3) (September 2011), p. 680. Orłowski W.M., *W pogoni za straconym czasem. Wzrost gospodarczy w Europie Środkowo-Wschodniej 1950–2030*, Warszawa, 2010, p. 130. WIIW, *Comecon Data 1990*, London, 1991, pp. 58–59. International Monetary Fund [IMF], *World Economic Outlook Database* (2020), www.imf.org/en/Publications/WEO/weo-database/2021/April, (accessed: 22 January 2021).

Witold M. Orłowski, prof. dr hab., professor of economics at Vistula University in Warsaw. Research interests: economic growth theory, socio-economic development of Central and Eastern Europe, economic transformation, European integration. (w.orlowski@nobe.pl)

Submitted 12.02.2021, accepted 29.04.2021