

## Foreword

# Russia and the global economy

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Saying, at the end of 2019, that the world economy faces numerous uncertainties and risks may sound facile. And identifying these uncertainties and risks and understanding their deep roots and nature is no easy task. Quite often, observing current political developments and statistical trends limits our focus to short-term political and economic scenarios: what may happen in the next quarter or couple of quarters, or next year. Longer-term scenarios go beyond a standard macroeconomic forecasting toolkit. They require a multidisciplinary in-depth diagnosis on how the mechanisms which determine global economic growth and global economic and political order have already changed and may change in the future.

In principle, one can identify three kinds of challenges which the world economy and global governance system will face in the medium-to-long term.

First, there is the question of *growth leaders*. When one looks at the economic history of the last two centuries, rapid economic growth associated with the subsequent waves of industrial revolution originated in the UK and part of Western Europe (the first half of 19<sup>th</sup> century) (Maddison, 2007). Through the 19<sup>th</sup> century, the US joined this group, en route to becoming the unquestionable leader in the 20<sup>th</sup> century. A few other countries followed the leaders, albeit with a certain time lag, mainly by replicating the leaders' growth models. These included Japan and imperial Russia (at the end of the 19<sup>th</sup> century); Japan, Canada, Australia, and the so-called Asian Tigers (in the second half of the 20<sup>th</sup> century). Overall, the number of countries and territories, and percentage of the world population, involved in rapid economic growth remained limited. As a result, global income and wealth inequality (between citizens of the world) increased rapidly because access to the fruits of industrial revolutions was limited to just a fraction of the global population (Bourguignon, 2016).

The situation started to change in the 1980s when the group of emerging-market and developing economies—according to terminology used by the World

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Economic Outlook (WEO) of the International Monetary Fund (IMF)—gradually took the lead in global economic growth. This tendency accelerated in the first two decades of the 21<sup>st</sup> century (Fig. 1). At the same time, the group of advanced economies (AEs), especially Japan and Western Europe, has grown slower, due to population stagnation or decline. This two-speed economic growth helped to reduce global income inequalities even if national income inequalities increased within a number of large economies, especially in the US (Dabrowski, 2018).

However, a closer examination of growth trends in major world regions (Table 1) shows that this was Emerging and Developing Asia, in the first instance, China, India and a few other Asian countries such as Indonesia or Vietnam, which contributed to this change in growth geography. The share of other emerging-market and developing (EMDEs) regions in the global output either increased marginally (Sub-Saharan Africa, SSA), or stagnated (Emerging and Developing Europe, EDE; Middle East and North Africa, MENA) or declined (Latin America and Caribbean, LAC; Commonwealth of Independent States, CIS).

Looking ahead, dynamics of the new growth geography (the one observed in the last 40 years) cannot be continued for one single reason—demography. The group of countries with a shrinking working-age population (Europe and Japan) has been recently joined by China, which has entered a new era of a rapidly declining labor force as a legacy of Deng Xiaoping’s one-child policy. This factor has already contributed to a declining growth rate in the second half of the 2010s (although still high compared to AEs) and will continue to undermine Chinese growth dynamics in future. As result, the Chinese economy will be unable to

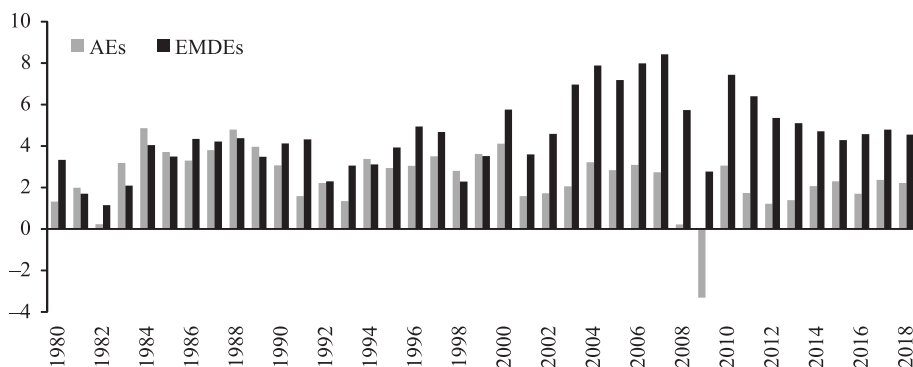


Fig. 1. AEs and EMDEs: GDP in constant prices, 1980–2018 (annual change, %).

Source: World Economic Outlook database, April 2019.

Table 1

Gross domestic product based on PPP of major country groups, share of world total, 1980–2018 (%).

| Country group / Region | 1980 | 1992 | 2000 | 2010 | 2018 |
|------------------------|------|------|------|------|------|
| AEs                    | 63.2 | 57.9 | 56.8 | 46.3 | 40.8 |
| EMDEs                  | 36.8 | 42.1 | 43.2 | 53.7 | 59.2 |
| CIS                    | n/a  | 7.1  | 4.3  | 5.0  | 4.4  |
| EDA                    | 8.9  | 12.6 | 16.7 | 25.8 | 33.3 |
| EDE                    | 4.1  | 3.2  | 3.3  | 3.4  | 3.6  |
| LAC                    | 12.1 | 9.5  | 9.2  | 8.7  | 7.5  |
| MENA                   | 9.1  | 7.3  | 7.2  | 8.0  | 7.4  |
| SSA                    | 2.5  | 2.5  | 2.4  | 3.0  | 3.0  |

Source: World Economic Outlook database, April 2019.

continue its role as the main engine of global economic growth.

Which countries and regions can take over the role of China? This is a big question. Perhaps partly India, whose population continues to grow but where there are numerous institutional, cultural and structural barriers which harm economic expansion. Other countries and regions which have large labor surpluses (Southern and Central Asia, the Middle East and Africa) suffer even more from these kinds of barriers. In the Middle East and Africa, political instability and violent conflicts are the major obstacles to economic development.

As a result, the world economy could face a prolonged period of mismatch between large labor surpluses in some regions and labor shortages in others, leading to lower global growth. Theoretically, large-scale labor migration could solve this problem. However, given social, cultural and political factors, rapid increase in migration flows does not seem realistic.

Second, *changes in economic geography* in the last 40 years challenged the system of global economic and political governance, which was formed in the aftermath of WWII. Emerging-market economies—especially the largest—began demanding a larger role in global political and economic institutions. Meeting such aspirations has been easier in those organizations in which each member country has one vote, such as the United Nations (UN) General Assembly, most UN specialized agencies and the World Trade Organization (WTO). It has been much more difficult in the case of the IMF and the World Bank, which are governed by the quota system. Obviously, privileged incumbents are not happy to share their voting power with newcomers.

For example, it took the U.S. Congress five years to ratify the last quota revision (in favor of emerging-market economies, particularly China) that had been approved by the IMF Board of Governors in December 2010. Proposals to increase the number of permanent members of the UN Security Council have never been approved by incumbents possessing the veto power.

The Group of Twenty (G20), initiated in 1999 at the ministerial level and upgraded in 2008 to a summit of leaders, represents one attempt to circumvent the limitations of existing global institutions and engage the largest emerging-market countries in global governance.

Historically, the aspirations of emerging powers came up against the reluctance of incumbent powers to share their privileged positions, often leading to economic, political and military conflicts, sometimes of tragic consequences. Looking at the list of contemporary conflicts, whether this is a looming US–China trade conflict or violent conflicts in the Middle East or the former Soviet Union, some of them can be explained by such geopolitical rivalry. In all cases, they involve substantial economic costs and add to global risks and uncertainty.

The third kind of risk and uncertainty originates from *the wave of populism* (of various political stripes) which erupted in the second half of 2010s in several countries. While a diagnosis of this phenomenon remains the subject of heated and ongoing debate (the role of economic vs. non-economic factors—see Dabrowski, 2019) it seriously undermines international cooperation and global governance. Countries in which populist parties and movements control national politics are less cooperative in addressing global challenges (such as climate change, the managing of migration, trade liberalization, or macroeconomic and financial stability) and delivering global and regional public goods. They declare

the national interest their top priority and often interpret it in a narrow and short-sighted manner. In extreme cases, they breach existing international commitments and challenge global and regional political and economic orders.

Russia is a large country but not an economic superpower. It has the largest territory in the world and is one of the two largest holders of nuclear weapons (the US being the other). It is also one of the five permanent members of the UN Security Council with veto power. However, demographic and economic parameters detract from Russia's influence. Its population accounts for only 2% of the world total population—and this share is systematically decreasing, due to negative population growth in Russia compared to the rising global population. With a population of 147 million, Russia occupied ninth position in the world rankings in 2018—behind China, India, the US, Indonesia, Brazil, Pakistan, Nigeria and Bangladesh, according to the IMF WEO database of October 2019.

According to the same source, in 2018 Russia's share of global total GDP calculated in purchasing power parity (PPP) terms amounted to 3.1%, with declining tendency over time (in 2008, it amounted to 3.9%). Its share of global trade was even lower, at 2.0%.

In 2018, Russia was the sixth-largest national economy in PPP terms after China (18.7% of the world's GDP), the US (15.2%), India (7.7%), Japan (4.1%) and Germany (3.2%). By comparison, the share of the EU-28 was 16.3%. However, when GDP in current US dollars was taken into account, Russia occupied 12th position behind the US, China, Japan, Germany, the UK, France, India, Italy, Brazil, South Korea and Canada. Russia's GDP per capita in PPP terms amounted to 45.8% of that of the US and 55.0% of Germany. When calculated at the current exchange rate the relative GDP per capita of Russia was only 18.0% of the US and 23.7% of Germany.

The above income per-capita level places Russia in the group of emerging-market economies, according to the IMF WEO classification, or upper-middle income countries, according to the World Bank classification. Obviously, its economic weight is smaller than the geopolitical one. The same concerns Russia's smaller impact on a global economic governance, in comparison with global political governance. Partly this is also a legacy of the almost half-century absence of the Soviet Union in the Bretton Woods institutions. Nevertheless, Russia is not a simple acceptor of rules like so many other small and medium-size economies. It has, and may continue to have, some impact on determining these rules.

In addition, economic growth and prosperity depends, via trade, investment, migration, and global governance channels, on the foreign policy and geopolitical choices pursued. As an open economy, Russia benefits from rapid global economic growth (mainly via high hydrocarbon prices), trade and financial liberalization, and global economic and financial stability. On the contrary, as demonstrated by the experience of the 2008–2009 global financial crisis and 2014–2015 decline in commodity prices, it can fall victim to global economic and financial turbulence.

This special issue of the *Russian Journal of Economics* entitled “*Russia and the global economy*” concentrates on the challenges faced by the Russian economy, which originate from both domestic economic policy and external environment. Six papers published in this volume address various aspects of the Russian economy (growth, trade, investment, energy, institutions and macroeconomic policy), its role in global and regional trade, its trade and investment relations with the largest economic partners (the EU and China), problems of

global governance (G20) and income inequality in the surrounding region.

The issue opens up with the paper of Marek Dabrowski on “*Factors determining Russia’s long-term growth rate*,” which analyzes reasons for lower growth rate in the second half of the 2010s, as compared with the 2000s and the early 2010s, and growth perspectives over the next decade. Employing neoclassical growth theory, the author looks at supply-side growth factors: labor, capital investment and total factor productivity growth. Adverse demographic trends (shrinking working-age population and its aging) are the main reasons explaining permanent growth slowdown, only partly mitigated by an open migration policy and pension reform (increasing the retirement age). Unfavorable labor supply trends could be compensated by higher productivity but, in Russia’s case, productivity ceased contributing to economic growth from the end of 2000s. There are several reasons why productivity does not grow or grows slowly: the increasing share of state ownership, the poor business climate, dysfunctional governance, insecure property rights, difficulties in diversifying the economy away from hydrocarbon dominance, and political conflict with the US and EU.

In his paper on “*Russia in world trade: Between globalism and regionalism*,” Arne Melchior confirms the open nature of the Russian economy. Since the mid-1990s, the share of exports and imports in Russian GDP has grown rapidly, especially at times of high hydrocarbon prices. Part of the analysis is devoted to changes in the sectoral and geographical pattern of Russia’s trade, for example, the rise of China and other Asian countries and the complete reversal of the historical pattern of Russia-China trade (Russian manufacturing exports to China have been replaced by commodities, mainly energy resources).

The second part of Melchior’s paper estimates potential benefits and costs of further trade liberalization both for the whole of Russia and its domestic mega-regions, using a simple general equilibrium model. The author reaches three important conclusions. First, Russia can gain substantially from further trade liberalization. Second, the most beneficial variant would be global trade liberalization, for example, within the WTO. In such a variant, all Russian mega-regions would benefit. In the case of regional free trade agreements, for example, with countries of the former Soviet Union, the potential effects would be smaller, although still positive. Third, further trade liberalization, especially on a global scale, could help to diversify the Russian economy, in particular boosting manufacturing exports.

The third paper, authored by Alicia Garcia-Herrero and Jianwei Xu (“*How does China fare on the Russian market? Implications for the European Union*”), concerns both trade and investment relations between Russia and its two largest partners—the EU and China. While the share of China in Russia’s exports and imports has increased several times since the 1990s, the EU remains Russia’s largest trading partner, lender and investor. The expansion of trade between Russia and China reflects, to a large degree, the rapid economic growth of the latter. Looking ahead, increasing competition between European and Chinese exports to Russia should not be surprising as there is ample evidence that China has been moving up fast the technology ladder over the past few decades. Competition over investment and lending is more limited but the situation could change rapidly with China and Russia giving clear signs of a stronger-than-ever strategic partnership.

This paper is followed by Georg Zachmann’s analysis of the potential competition between the EU and China in energy trade with Russia and energy related invest-

ment in Russia (“*The EU–Russia–China energy triangle*”). The author claims that there is no direct competition between the EU and China for Russian oil and gas. Russian exports to the EU and China are supplied from various oil and natural gas fields and by different transportation infrastructure. Second, both China and the EU have an interest in curbing excessive Russian energy rents. Third, although the EU, Russia and China compete on the global energy technology market, they specialize in different technologies: Russia in nuclear energy, China in photovoltaic panels, and the EU—in wind and gas turbines, network infrastructure and energy management systems. Thus, competition is more about which technology will be installed, rather than which country it will come from. Regarding foreign energy investment in Russia, its authorities seem to be more worried about Chinese energy investments with strategic/political goals than EU investments. Finally, the ideas to build intercontinental electricity exchange (between East Asia, including China, Siberia and Europe) are not feasible yet because of the limited capacity of the internal Russian grid.

The two remaining papers are not directly related to an analysis of the Russian economy but address important issues, which are of great importance for Russian economic policy.

Suman Bery, Filippo Biondi and Sybrand Brekelmans in their paper “*Twenty years of the G20: Has it changed global economic governance?*” present a historical evolution of this relatively new, and the most representative, global forum for policy coordination. They examine how inclusion into the G20 of a group of large but much poorer (as compared with G7) emerging-market economies has changed the process of global policy coordination. The G20 leaders created a supportive political environment for strong national and global actions soon after their first meeting in the Fall of 2008. Apart from generating confidence in financial markets, their early measures were supportive in such areas as trade, finance, enhanced resources for the IMF and provision of swap lines to key financial centers. G20 collective action in 2009 prevented a global depression, helped avoid trade protectionism and adjusted somewhat global imbalances. However, once the global financial crisis subsided, political incentives to continue an active role in global governance reforms weakened. Nevertheless, the authors hope that the G20 could increase its influence in the coming decade, as sovereign economic and political interests assert themselves more overtly, and as global treaty-based organizations adjust to the redistribution of global economic power.

Finally, Ben Slay and Tahmina Anvarova present a comprehensive overview of three major studies on income inequalities in middle-income countries of Europe and Central Asia (“*Inequalities in middle-income Europe and Central Asia: A tale of three studies*”). These are: the EBRD’s “Transition report 2016–2017”; the World Bank’s 2018 study “Toward a new social contract: Taking on distributional tensions in Europe and Central Asia,” and UNDP’s “Regional human development report 2016. Progress at risk: Inequalities and human development in Eastern Europe, Turkey, and Central Asia.” While the three studies differ in terms of objectives, conceptual frameworks, country coverage, data and indicators, and policy recommendations, they also share important commonalities—particularly in terms of creating ‘regional’ inequality narratives for transition economies, reconciling official data with common perceptions of inequalities in the region; improving data quality, quantity and availability, and changes in tax and social policies. All three reports call for increasing the *de facto* progressivity of national tax systems.

They also propose increased investment in access to education, more effective enforcement of anti-discrimination legislation and more aggressive implementation of market and governance reforms to improve commercial environments for small and medium-sized businesses, particularly in depressed areas.

Five of the six papers have been contributed by authors affiliated with the Bruegel, a Brussels-based international think tank, which deals with various issues related to the global and European economy. Three papers (those of Dabrowski, Garcia Herrero and Xu, and Zachmann) were presented at two seminars (in Brussels on September 9, 2019 and Moscow on November 7, 2019) organized within a joint project of Bruegel and the Delegation of the European Union to the Russian Federation, with the support of the EU–Russia Expert Network on Foreign Policy (EUREN) on the EU–Russia–China economic relations. The paper of Slay and Anvarova was presented at the roundtable on ‘Global vs National Income Inequalities’ on April 9, 2019, organized within the 20<sup>th</sup> April International Academic Conference on Economic and Social Development of the Higher School of Economics in Moscow.

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