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Russian Journal of Economics 2 (2016) 219–245

Russian Journal of Economics

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Russia's economy: Before the long transition ☆

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Abstract

This article explains the main stages and results of economic development in Russia since the early 1990s. It describes the process of the formation and the basic features of a three-sector economic model, as well as the reasons for its stability and existing constraints on economic growth. The authors consider the most likely scenario for the evolution of the current economic model under steadily declining export revenues. They also investigate fiscal and social risks and alternatives in economic policy.

JEL: E20, E22, E24.
Keywords: three-sector economic model, economic development scenarios, fiscal policy, social policy, middle class.

1. Russia on the economic world map: Achievements and failures

Since the early 1990s, Russia's average GDP per capita, measured based on purchasing power parity (PPP), has increased by 2.5 times, reaching approximately $24,000 (according to IMF estimates), which places it among *middle-income countries* (Fig. 1). Judging by this indicator, Russia has developed at a similar rate as Central and Eastern European (CEE) countries, undergoing a market transformation over the same period. Whereas high growth rates during the 2000s helped to narrow the gap between Russia and developed countries, this growth was checked in 2014 and 2015, and the gap widened. The change in tra-

☆ The updated English version of the article published in Russian in *Voprosy Ekonomiki*, 2016, No. 6, pp. 5–35. It is a journal version of the report presented at the XVII April International Academic Conference of National Research University Higher School of Economics on Economic and Social Development (Moscow, April 19–22, 2016). The research leading to these results has received funding from the Basic Research Program at the National Research University Higher School of Economics.
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Peer review under responsibility of Voprosy Ekonomiki.

http://dx.doi.org/10.1016/j.ruje.2016.08.001
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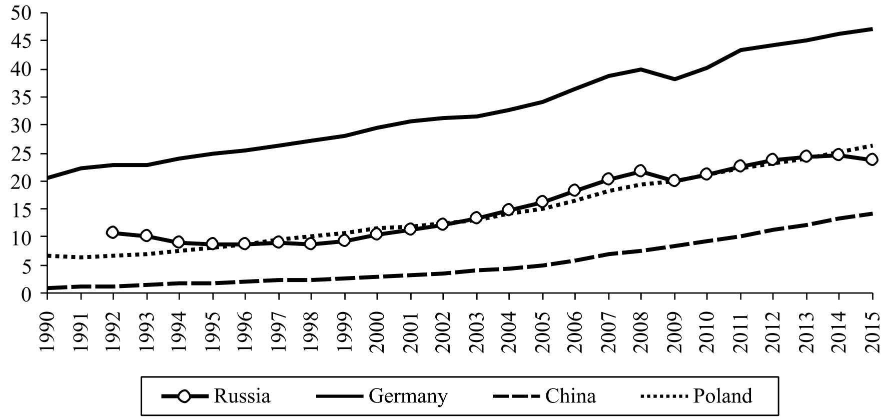

Fig. 1. GDP in terms of PPP per capita (thousand international dollars).

Source: IMF.

jectory does not seem critical at the moment, but if Russia continues to lag behind "Europeans," it will soon be overtaken in terms of GDP per capita by rapidly developing emerging economies such as China.

Although Russia is now in line with CEE countries on the key GDP per capita parameter, it is still subjectively perceived as a poorer country. This is because Russia has a higher level of social inequality, which has not decreased but increased, even during periods of rapid economic growth (Fig. 2). As of the beginning of 2016, Russia's population could be divided into two large groups based on their economic status. The first, accounting for 40% of the population, can be conventionally attributed to the middle class (according to the Social Policy Institute of the National Research University Higher School of Economics).

The middle class spends less than half of their income on necessities, has the opportunity to accumulate savings, and can make consumer choices, including the purchase of paid education, healthcare, cultural, and private pension services. The remainder (60%) of the households (Group 2) are essentially deprived

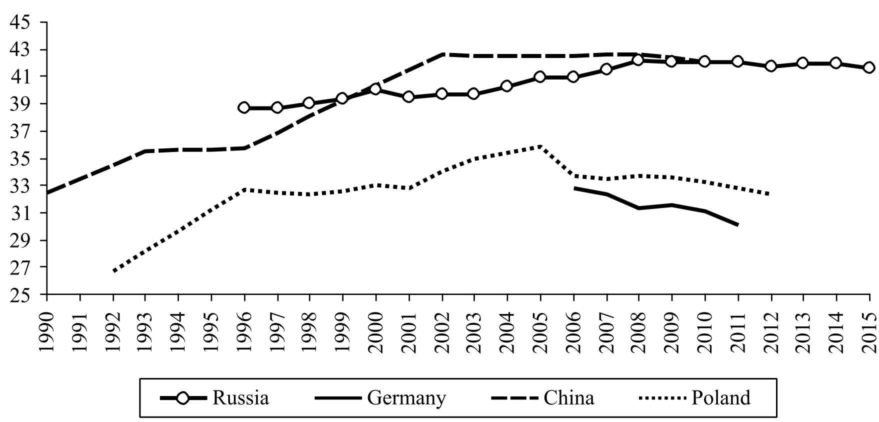

Fig. 2. Household income concentration index (the Gini coefficient; 0–100).

Sources: World Bank; Rosstat; calculations by HSE.

of these choices. Citizens view this high level of differentiation to be unfair, which serves as a potential source of social conflict, especially in the event of unfavorable developments in the economy.

Another challenge for Russia is inflation. Although it did drop below 7% from 2011 through 2013, it reached double-digit rates again in 2014 and 2015, due mainly to the devaluation of the ruble (Fig. 3). High inflation devalues savings, while the associated inflation expectations reduce the attractiveness of investment, slowing down development in the domestic financial market. According to foreign investors, the high inflation rate is the *main obstacle* hindering investments in Russia — even amidst the acute political confrontation in the global arena.

Weak competition in key markets is a powerful driver behind the rising inflation and declining growth in productivity. In terms of this parameter, Russia lags behind both European and developing countries; its position has hardly improved over the past 10 years (Fig. 4).

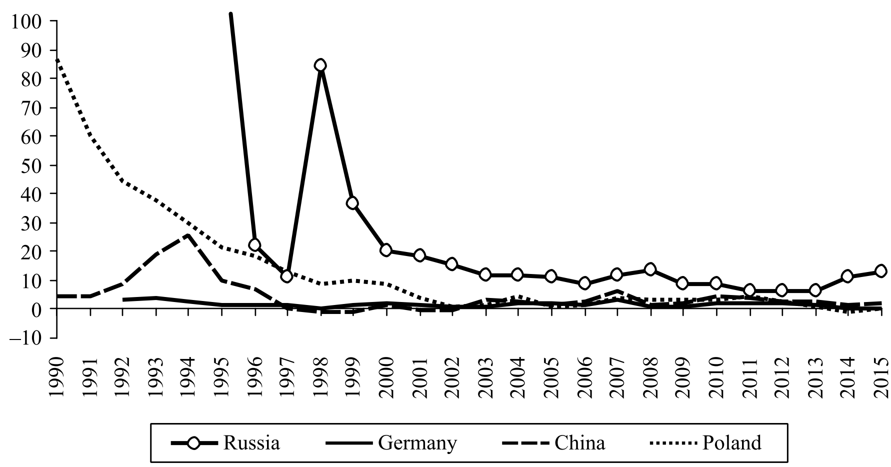

Fig. 3. Inflation rate (%).

Sources: IMF; Rosstat.

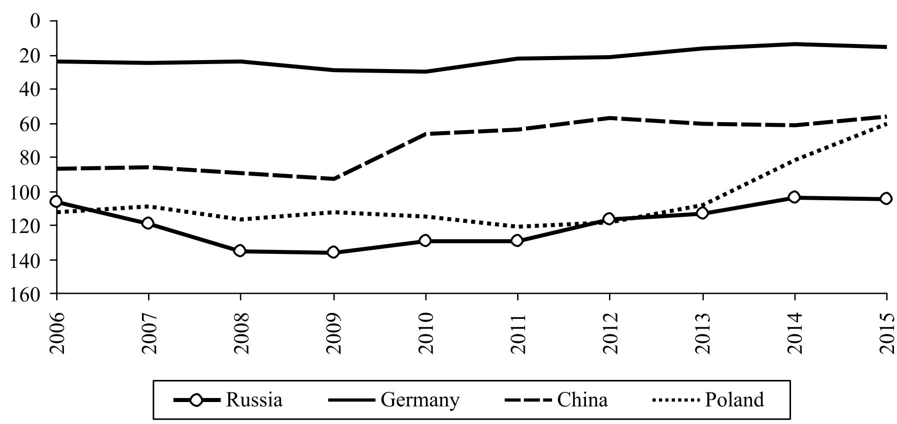

Fig. 4. Global Competitiveness Index. Competition section (rank).

Source: World Economic Forum.

This impotent competition is a consequence of the state holding the lion's share of the economy, especially the major companies, many of which are monopolies. Russia is at the top of the global rankings according to this parameter (Fig. 5). The regularly developed privatization plans have been poorly implemented and are accompanied by a reverse process of concentrating interests and control in the hands of companies in which the state has a stake.

Characteristically, the state's extensive involvement in the Russian economy and the high concentration of property go together with the large informal sector. Different estimates place it between 30% and 40% of GDP (Fig. 6).

The structural limitations listed above were diagnosed by Russian experts and economic officials long ago; however, the attempts to remove them using economic policy measures, which have been implemented since the early 2000s

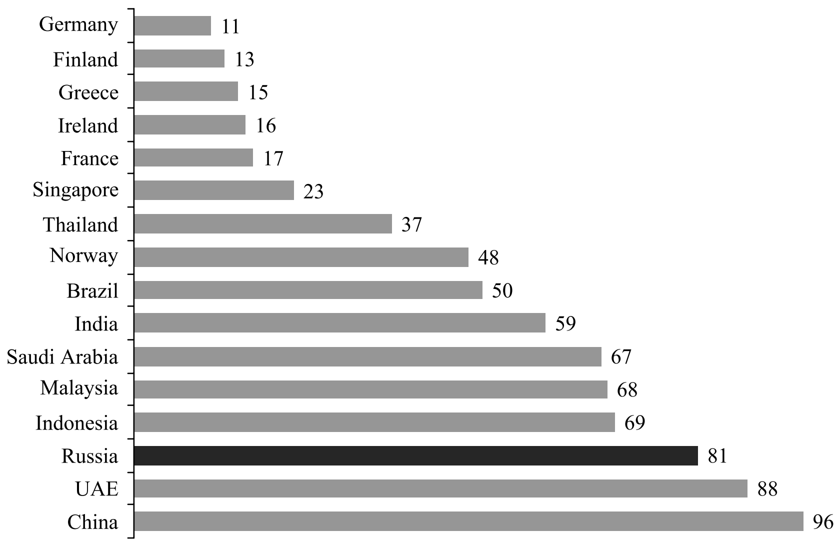

Fig. 5. State-owned share in the 10 largest companies in 2011 (%).

Source: Kowalski et al. (2013).

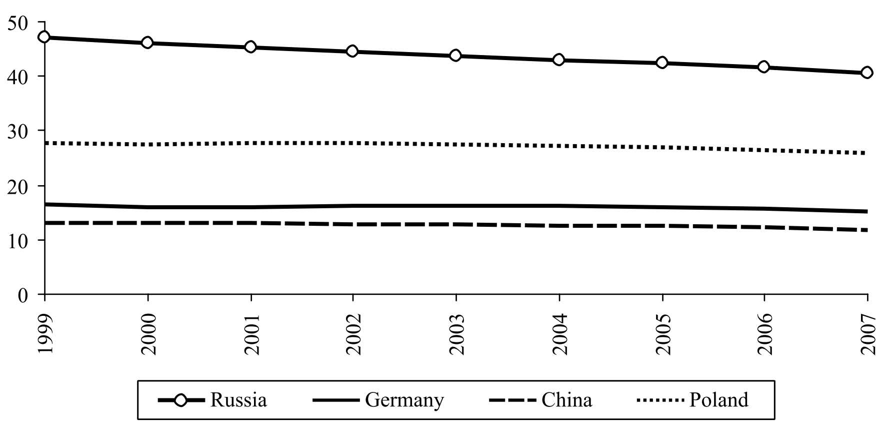

Fig. 6. Size of the shadow economy (% of GDP).

Source: Schneider et al. (2010).

(Gref's Plan), have not yielded noticeable results. Relative success was achieved only by Russia's upward movement in the World Bank's Doing Business rating, which focuses on evaluating the quality of formal procedures associated with business activities (Fig. 7). It was accompanied, however, by an apparent slowdown of investment processes in the economy and the deterioration of its prospects in the eyes of investors.

As a result, the capitalization of Russian companies, which had grown in lock step with windfall commodity profits during the 2000s, has declined continuously since 2011 despite all efforts to improve the investment climate (Fig. 8). Notably, this process started much earlier than the decline of oil prices and the imposition of sanctions by the West that cut off access to cheap credit for major Russian companies. In fact, we have observed a slight recovery in the growth of capitalization since 2015.

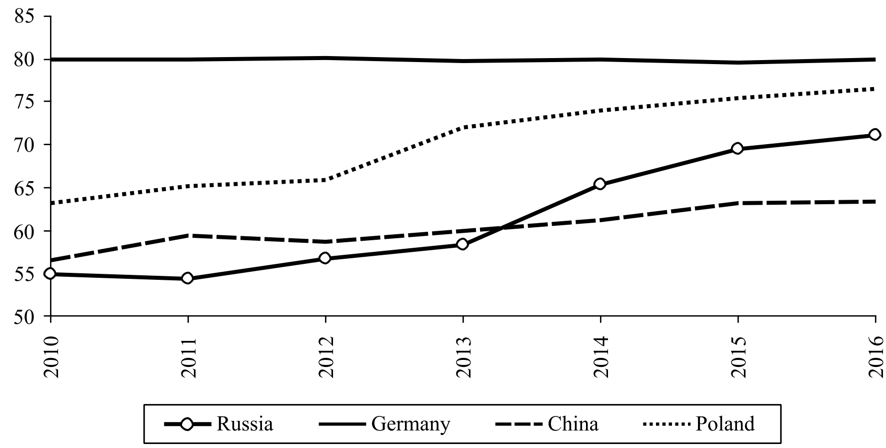

Fig. 7. Doing Business rating (% of the best result, 0–100).

Source: World Bank, Doing Business.

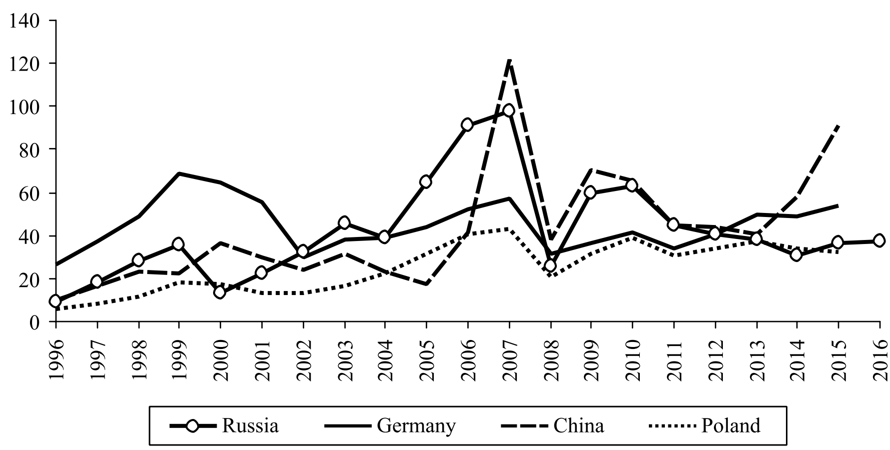

Fig. 8. Market capitalization of national companies (% of GDP).

Note: 2016—data as of April 1.
Sources: IMF; World Bank; U.S. National Inflation Association; IMD, CEIC Data; calculations by HSE.

2. Road behind: A backward glance

2.1. Oil prices

The history of Russia's political economy is closely correlated with oil prices. The Soviet Union started to become a major hydrocarbon exporter in the 1970s and 1980s. In 1986, however, oil prices dropped abruptly, serving as one of the main reasons for the downfall of the Soviet economy and the significant difficulties during the transformation crisis after the beginning of market reforms. Oil prices remained low throughout almost all of the 1990s. In August 1998, they fell to as low as \$8 per barrel, averaging only \$12 per barrel. In 1999, oil prices began to recover, and their growth rate increased to 12%–15% from 2003. Those fat years were interrupted by the global financial crisis in 2008 and 2009, which caused a short-lived, two-thirds reduction in oil prices. From 2011 to the first half of 2014, they remained at their highest levels (\$110–115 per barrel), but this was followed by a new and dramatic fall, first to \$50, and then to \$30–40 per barrel (Fig. 9). According to international agencies (EIA, 2016), this bout of low oil prices may stretch on for a few years.

2.2. Perestroika and reforms

In the 1980s and 1990s, Russia underwent exceptionally important historical events, the implications of which still define the nature of its development. The dismantling of the Soviet system began with political liberalization rather than the economic reforms undertaken in China. The political disintegration of the USSR led to the disintegration of the Comecon and, almost immediately afterwards, the common Soviet market. This caused a sharp decline in the demand for the basic investment goods of Russian businesses that, along with the liquidation of a significant portion of the military-industrial complex, crashed the economy, resulting in the loss of a whole number of industries, including strategic ones such as civil aircraft engineering, civil electronics, and light industry. As the economy opened up and restrictions were lifted from entrepreneurial activities for businesses as well as individuals, the shortage of consumer goods and services increased, thereby devaluing labor income and, to a greater extent,

Fig. 9. Urals crude oil prices (\$/bbl).

Source: Reuters.

household savings. This created a negative social and political backdrop, which distorted the perception of market transformations and thwarted the implementation of the necessary reforms.

The privatization plan realized in the early 1990s quickly spawned a class of "new proprietors" but resulted in a negative attitude among the population and firm anti-market stereotypes within large social groups. Capitalism (and the market economy as a whole) failed to be equated with fairness.

As household income plummeted, the most important social reforms of the 1990s failed. In the end, new conditions developed that defined the paternalist model of the social sphere as a steadfast institute.[1] Economic and social dualism appeared in Russia with a market economy based on private property, on the one hand, and a social sphere relying on state-backed guarantees and access to social services provided by state and municipal institutions, on the other.

An important feature of the paternalist model is its "multi-shot" approach, i.e., the provision of social goods regardless of need. Whereas economic losses from this "blind redistribution" were relatively low in the initial stage (1990s to early 2000s), since the mid-2000s, when the middle class accounted for over $^1/_3$ of the population and $^2/_3$ of the pay-as-you-go pensions began to be paid to citizens who remained employed, preserving the paternalist model has turned out to be unbearable for the economy. The other side of this issue is the mediocre quality of social goods (insufficient support for single, unemployed retired persons and families with children, the low quality of most educational institutions, etc.).

The state, forced to mobilize constantly growing funds for the social sphere, increased the load on economically active subjects in the form of both taxes and customs duties, as well as "coercive charity." This pushed a significant portion of entrepreneurs into the "shadows," *increasing the share of informal contracts and labor relations as the economy continued to grow*. The size of the informal sector can be estimated based on its share of employment: over the past 15 years, it has increased by 1.5 times and is now between 25% and 30% of overall employment (Fig. 13).

This was, however, accompanied by positive processes. The open economy, the broad coverage of professional education, and political freedom gave birth to the fast-growing middle class whose representation in the total population has increased from 15% to 40% since 2000. The measures that encouraged the rise of the middle class included an all-important one, i.e., the low, flat tax rate for individuals, which removed psychological barriers preventing them from increasing their income and economic (labor or entrepreneurial) activity.

By the end of the 1990s, nearly the entire economy was built on the principles of private entrepreneurship. The first ten years of Russian capitalism, however, carried two "birth marks": speculative business and offshore capitalism.

The greater part of business income was not derived from technological innovations or new investments in technology. Its sources were either natural or political rent (artificial monopoly) or—especially during the 1990s—reselling cheaply purchased assets. This type of capitalism can be called speculative (with reservations).

[1] An alternative model existed de facto in the 1990s when households were forced to provide part of the funding for education and healthcare in the form of bribes for actual services. It was this corrupt form of financing that induced key social groups to reach out for the "right" (i.e. free) acquisition of social goods.

The impotence of the law enforcement system posed elevated business risks during the 1990s. This situation led to offshore capitalism in which the new proprietors frequently moved both legal titles and transactions to foreign jurisdictions.

With extremely limited resources at its disposal, Yeltsin's government took on the role of a liberal player who was only entitled to establish the "rules of the game," but forced to engage in coalitions with private players to implement its policies. Both the federal and local governments featured examples of oligarchical control over individual areas of the executive and legislative branches.

The oligarchy ("buy yourself a bit of the state") of 1990s Russia was characterized by two features. First, its interests were of a short-term nature in which control exercised over the "state elements" was aimed at obtaining or protecting certain assets or obtaining special legal treatment for a particular business. Second, a significant part of oligarchical business was removed from Russia. This prevented the oligarchs from taking a firm position in the Russian political arena or securing stable social support, even from the emerging middle class and all the more from small and medium businesses. Oligarchs made coalitions with individual government officials based on the current situation at hand.

2.3. The "Putin era"

Elected president in 2000, Vladimir Putin and his administration had to address all of those phenomena. On the one hand, they took measures to encourage private endeavors by both businessmen and hired workers by simplifying customs procedures and introducing a low, flat income tax rate. The legal protections for transactions and property also improved. On the other hand, to consolidate the state's role, resources had to be concentrated in its hands after being taken from private players who competed with the state. The oligarchs were deprived first of political power, then of electronic mass media as the key channel in shaping public opinion, and finally of assets based on the right to manage natural rent.

In the first half of the 2000s, a choice was made in favor of the actual renationalization of core fuel and energy assets. Resources and revenues in the sector were redirected to the state (to the federal budget and state-controlled companies). This served to achieve three objectives:

- restore the function of executive branch institutions, primarily law enforcement. By the end of Putin's first presidency, the federal government was no longer forced to make arrangements with anyone concerning any domestic matters (this does not mean that the authorities ceased all consultation — for example, in 2006, the Public Chamber was formed and was initially composed of persons largely independent from the state);
- increase funding for social programs and public-sector employee wages to a required minimum;
- establish government reserves against the potential for falling revenues and/or resources to secure the modernization of the economy and other "national projects."

The period between 1999 and 2012 is often called a period of recovery growth. However, it was only partly based on old facilities and institutions.

This recovery relied upon sustainable long-term growth in export prices for raw hydrocarbons, which secured $2.2 trillion in export revenues for Russia between 2003 and 2012 (Fig. 10). The rapid rise in the effective demand of house-

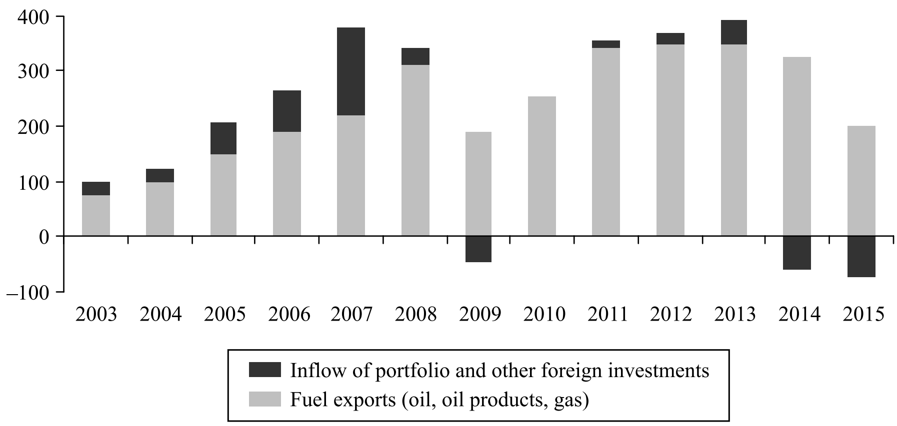

Fig. 10. Inflow of resources into Russia from energy exports and foreign investments ($billion).

Source: Bank of Russia.

holds for goods and services, the growing state-funded sectors (education, healthcare), and the production of investment goods and services during that period were side effects driven by the enormous export revenues flowing into the economy. Relying on increasing oil prices, Russia's budget became more stable, which improved the country's ratings and opened up global capital markets to Russian businesses and banks.

Was the actual economic development scenario best for Russia? Discussions on this topic do not often go beyond the political system. No doubt, economic scenarios require a complex and comprehensive analysis, and even so, their reliability will remain quite relative. Nevertheless, we will try to compare two scenarios (a hypothetical "oligarchical" and the actual "Putin" scenario) based on qualitative factors.

In the "oligarchical" scenario, oil and gas revenues would largely have been redistributed in favor of private businesses and mostly removed from Russia; wages and household incomes would be 20% to 30% lower than they are now; competition in the economy would be more effective. One could have expected a better cultural and technical level of production and management quality. The price and technical competitiveness of Russian producers would have been stronger in the event there had been effective demand for their products abroad (domestic demand would most likely have been lower compared to the "Putin" scenario). At the same time, Russia's integration into the global economy (as measured by the share of international trade and financial transactions in the GDP) could not have exceeded the actual integration. Due to a lower effective demand from households, the substitution of domestic products with imports would have been lower.

The actual scenario lags far behind in terms of the level of competition in the economy and in terms of the share of efficient businesses. However, it turns out to be more attractive in all other respects. The policy that was pursued during Putin's first and second terms and Dmitry Medvedev's term as president produced outstanding results: labor productivity, per capita income, and the standard of living far exceeded Soviet figures; the gap between Russia and the most developed countries narrowed in terms of production and social technology; a large middle class emerged that provided the foundation for a new stage of economic and social growth. Under the "oligarchical" scenario, households would have been considerably poorer with the middle class accounting for no more than 25% of the population. However, other structural flaws in the social and economic system of the 1990s were preserved and even took shape as standing institutions during the 2000s.

Firstly, the *state's paternalism in managing the social sphere* remained, inherited from the Soviet era, and even experienced a second wind. The mechanisms of personal responsibility and personal finance, while existing in form, are organized in such a way that would-be recipients of social goods make no decisions concerning their deposits. All contributions to social security funds are linked to employees but are made by the employer and are perceived by recipients as goods gratuitously provided by the state (Fig. 11). Households expect the state to guarantee and improve the quality of their social goods. These expectations form the basis for the electoral demands of social groups. Any attempts at reforms that envision a higher level of responsibility from the population are being undermined via political mechanisms. In addition to formally guaranteed social goods, the state and local governments de facto began to co-finance the maintenance and repair of housing.[2] The middle class also became more interested in the newly restored compulsory financial security of social goods as the general government budget increased.[3]

The extensive reproduction of the "state's social paternalism" is having negative social and economic implications. Russia still lacks a *mechanism for the mobilization of private funds to finance social goods*, let alone the capitalization of respective household savings.

Secondly, offshore capitalism has been preserved. Whereas in other countries, attempts to move to foreign jurisdictions are pregnant with tax-related problems, the remaining high business risks are still a primary driver in Russia. Assets are often removed as a form of insurance.

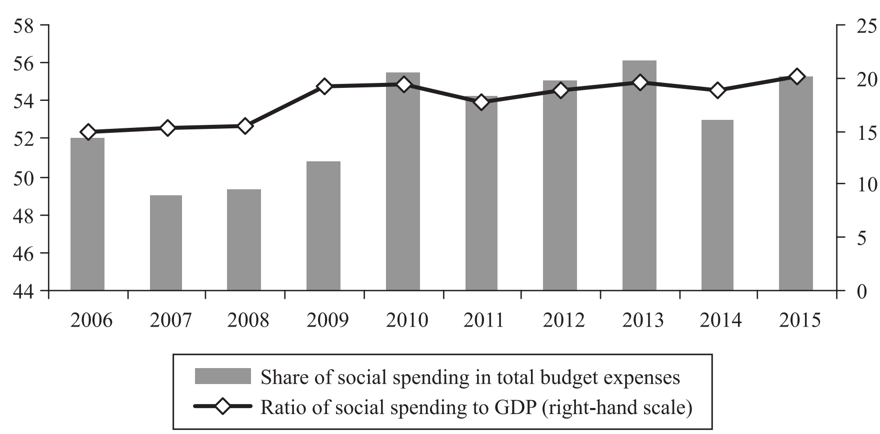

Fig. 11. Social spending of the budget system (%).

Source: Russian Ministry of Finance.

[2] In 2014 and 2015, with the adoption of a provision in the Russian Housing Code that established the responsibility of home owners for capital repairs, an absolute majority of the regions accepted the proposed amounts of respective contributions, which only covered between 20% and 50% of the estimated minimum cost.

[3] This includes state non-budgetary funds.

At the same time, businessmen removing money from the country look for tax havens and countries that offer the simplest rules for registering a business. The use of foreign jurisdictions to minimize risks is characteristic of less developed economies and political systems than in Russia. As the risk of losing property remains high, Russian businessmen have taken up the practice of selecting projects and transactions that offer returns with a high risk premium.

Thirdly, the *inflation rate* remains *high* (exceeding 10% annually in 13 of the past 15 years).

These three factors are causing Russian entrepreneurs to demand *exaggerated requirements to returns*. While the generally accepted level of expected annual returns to start a new project is between 10% and 12% in developed economies, the psychological barrier in Russia would necessitate returns closer to 20% or even 30%. Reliable sources of returns this high include natural rent (natural monopolies) and artificial monopolies in which the state is not trying to restrict the monopoly (e.g., by regulating prices). High returns (and a high risk of losses) are also a trait of innovative businesses producing completely new types of products. Additionally, very high returns may result from a medium-term (several years) market imbalance, illustrative of the initial stages of market formation with weak regulation and high information asymmetry.

3. Three-sector economy and its expected evolution

During the fat years, the economy developed three macro business sectors that were integrated differently into the system of relationships associated with deriving and using oil and gas rent and other resources. Table 1 represents the breakdown of economic sectors by macro sectors based on the prevailing type of business (of course, each case has its numerous exceptions). Moreover, part of

Table 1
Breakdown of economic sectors by macro sectors.

Sector	Macro sector
A. Agriculture, hunting, forestry	Small and medium non-commodity businesses
B. Fishery, fish farming	Small and medium non-commodity businesses
C. Mining and minerals	Commodity businesses
D. Manufacturing	Large non-commodity businesses
including coke and oil products	Commodity businesses
E. Electric power, gas, and water production and distribution	Large non-commodity businesses
F. Construction	Large non-commodity businesses
G. Wholesale and retail	Small and medium non-commodity businesses
including wholesale fuel	Commodity businesses
H. Hotels and restaurants	Small and medium non-commodity businesses
I. Transportation and telecommunications	Large non-commodity businesses
including pipeline transportation	Commodity businesses
J. Financial transactions	Large non-commodity businesses
K. Real estate transactions, leasing, and services	Small and medium non-commodity businesses
L. Public administration and military security; social security	Budget sector
M. Education	Budget sector
N. Healthcare and social services	Budget sector
O. Other utility, social, and personal services	Small and medium non-commodity businesses

Sources: Rosstat; HSE.

the economy remains outside the market and is mostly served by state-owned and municipal institutions — the so-called budget sector.[4]

The first sector (which we call "Commodity Businesses") includes companies specializing in the production, processing, and transportation of and trade in, hydrocarbons. These companies began to generate tremendous profits thanks to growing oil prices in the early 2000s. Between 2002 and 2004, the government introduced a taxation system for excess profits received from the rent (export duties and mineral extraction tax, MET) and thus directed a greater portion of oil and gas rents to the budget, which was partly saved in sovereign funds and partly redistributed to other sectors of the economy. In addition, the state imposed an extra tax burden on commodity businesses to ensure the observance of social obligations (supporting employment and the social sphere) and to finance costly social projects. However, even with these deductions, the average profit margin in this macro sector was approximately 20% during the fat years and noticeably higher (by 2 to 3 times) than other sectors (Fig. 12).

The second sector (conventionally called "Large Non-Commodity Businesses") includes large companies in non-commodity industries that sell their products primarily in the domestic market. The ruble's growth in real terms during the period of increasing and high oil prices led to a decrease in the *price* competitiveness of their products compared to imported goods. However, the "casualties" were not so numerous. Domestic textiles and light industry effectively disappeared, unable to compete with cheap Asian substitutes of comparable quality. Other sectors survived in which competing imports came from countries with high labor costs. A number of companies succeeded by leveraging the favorable exchange rate of the ruble to make technology upgrades and improve their competitiveness.

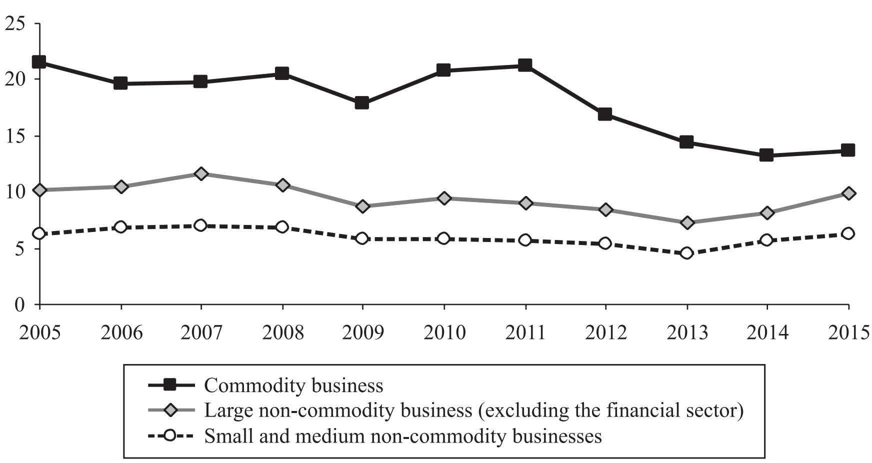

Fig. 12. Profit margin on sales in macro sectors.

Sources: Rosstat; calculations by HSE.

4 The conventional nature of this terminology is that up to $^1/_3$ of the revenues of education, healthcare and research and up to half of cultural revenues have a market, rather than budget, basis. Nevertheless, it is the budget funding that determines the economic type of these respective entities; market revenues act as a sort of additive to the budget as the "main course."

Those companies achieved average returns of between 9% and 12%, due to the increased domestic demand generated by the high oil and gas profits flowing into the economy. The additional income for large companies, especially in infrastructure sectors, was made possible by their monopoly status. Nevertheless, the profit margin that could have been achieved in the market by companies in the second macro sector was viewed by Russian businessmen as low in comparison to returns in commodity businesses and inadequate to outweigh the risks associated with the imperfect state of the legal and regulatory framework. In other words, businesses refused to invest in non-commodity projects.

Where the state deemed it necessary to implement such projects (housing and road construction, engineering, agriculture), private businesses were usually engaged through co-financing or state-guaranteed schemes. These forms varied from special economic zones to public-private partnerships (PPP).

In fact, a model was developed over 10 years in which the state acted as the agent to redistribute resources between industries in the first and second macro sectors. By withdrawing part of the oil and gas revenues from the first (commodity) sector, the state redistributed a certain portion of these funds to the non-commodity sector, ensuring its participation in investments (construction business) or simply maintaining an industry (part of the engineering sector). The large scale of business in the second sector enabled those companies (not unlike those in the first sector) to enter global markets to raise credit but also created conditions for capital to be removed from the country (Table 2).

Finally, the third sector includes small- and medium-sized businesses, mostly in trade and services (which we call "Small and Medium Non-Commodity Businesses"), which also obtained growth opportunities thanks to increasing domestic demand but without access to state-funded aid programs or financing through borrowings/offerings in the global financial market. The small size of their assets prevented those companies from engaging in offshore schemes.

According to estimates, the average profit margin in this macro sector has not exceeded 5%–6% over the past decade, i.e., it has not even offset the inflation

Table 2
Features of macro sectors.

	Commodity businesses (I)	Large non-commodity businesses, (II)	Small and medium non-commodity businesses (III)
Potential returns	20% and above	9%–12%	5%–6%
Expected returns	20% and above	20% and above	20% and above
Sources of superfluous demand / additional resources	Rent	Monopolism. Public-private partnerships	Tax evasion
Withdrawals by the state (in excess of standard taxes)	Progressive duties and MET. Extra tax burden	Excise duties. Extra tax burden (including as part of a PPP)	Corruption
Offshoring opportunities	Yes	Yes	No

Source: HSE.

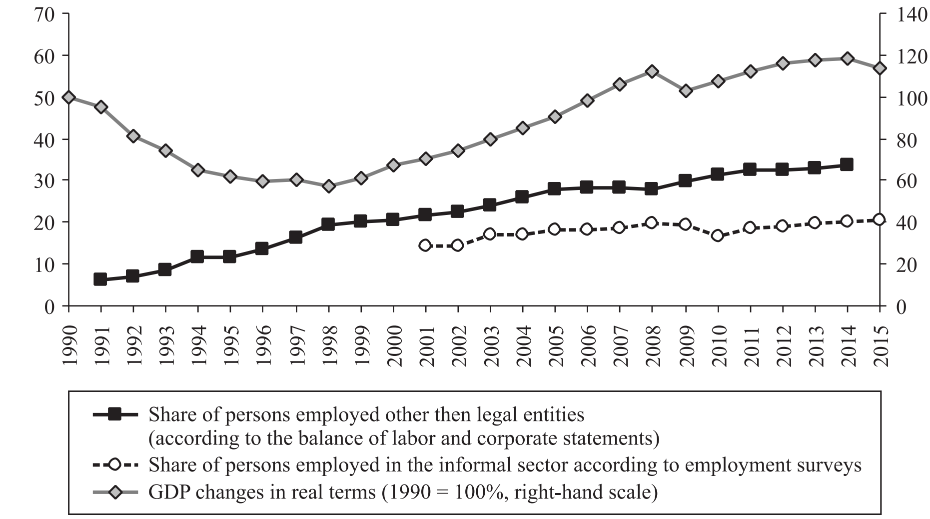

Fig. 13. GDP growth and informal employment (%).

Sources: Rosstat; HSE.

rate. However, the returns of commodity companies served as a desirable benchmark for small and medium (as well as large) non-commodity businesses. To improve their profit margins, companies in the third sector, which lacked sufficient resources to engage in offshore schemes, used simpler methods to move their revenues into the "shadows" domestically. While they carry the greater part of the corruption burden, they are also the least protected. The share of informal employment in Russia can be used as a measure of turnover in "gray" small and medium businesses (Fig. 13).

Regions carry the majority of the social payments burden but lack sufficient income. This is an objective factor that induces regional authorities to pressure businesses to acquire the necessary resources for "custom" social projects, mainly in civil construction, sports and cultural promotion, and religious organizations. This burden may reach several percent of a company's revenue. Because we are considering informal relationships, the best tool for analysis would be long-term relationships between regional administrations and businesses that are "socially responsible" and "understand the needs of the state." As a result, the burden is transferred to the buyers of goods and services, while the authorities begin to care about protecting the positions of "allied businesses." This puts pressure on competition at the regional level, even in the sectors where a monopoly is hard to imagine on a technical level (construction materials, road construction, retail).

Based on the proposed approach, the indication that the "resource-based capitalism" model is nearing exhaustion is the reduction of profit margins in the commodity sector, which began in 2012 and 2013 against the still high oil prices that soon stopped rising. As a result, the benchmarks for expected returns began to fall, killing incentives and cooling down other sectors of the economy.

Thus, the economic crisis currently affecting Russia was mostly caused by the exhausted potential of the "three-sector model," namely, by stemming proceeds to the economy from rising resource rents. In the course of its redistribu-

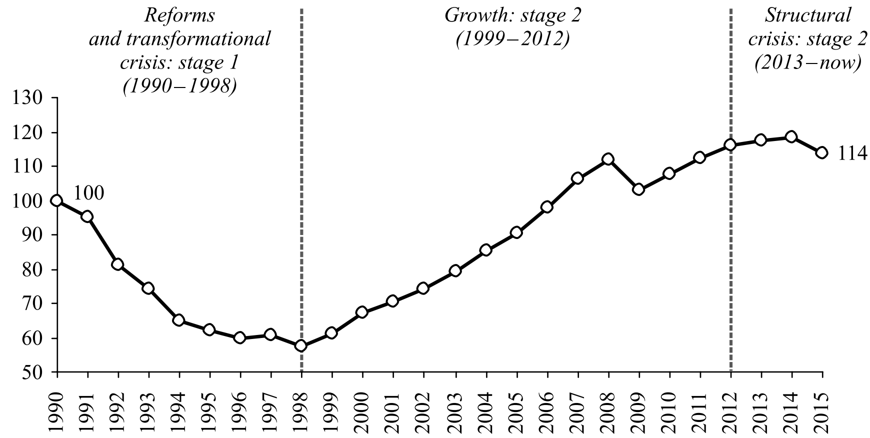

Fig. 14. Russia's gross domestic product, 1990—2015 (1990 = 100%).

Source: Rosstat.

tion, it had been "greasing" the economic mechanism, enabling entrepreneurs to run their businesses under high-risk conditions, limited competition, and extra taxation, employees to increase their income, and the state to support the functions of long-obsolete social policy institutions.

The sharp drop in global hydrocarbon prices and the economic sanctions that "cut off" Russia from cheap Western capital aggravated the economic downturn, but their effects were not that strong. The profit margins of companies in the first macro sector decreased considerably in 2012, while GDP growth rates slowed down in 2013 (Fig. 14), i.e., when oil prices were at their historic highs and no sanctions were in effect.

The peculiarity of the period between 1999 and 2012 is the (partial) recovery growth in the beginning (during the first 4 or 5 years) and the subsequent development under continuously increasing hydrocarbon prices in the global market, which pumped continually rising rents into the economy (2003—2012, except for the short crisis period in 2008 and 2009). Over these 13 years, the economy and society formed specific institutions that imparted a certain stability to the generally fluid situation, particularly in the minds of decision-makers, from ordinary citizens to business executives and government officials.

At the same time, the core institutions of the market economy gained firm ground during this period of growth. With respect to business:

- private entrepreneurship lost its redistributive nature, and businessmen started to make real investments;
- most companies managed to upgrade their technologies and substantially improved their technological competitiveness;[5]
- the economic and legal culture of market players improved considerably.

Russian companies were willing to operate in a competitive environment, which is an essential difference from the situation in the 1990s.

[5] While at the same time, only a small portion of companies faced tough domestic competition and therefore had to cut their costs. Labor productivity in the Russian economy still lagged noticeably behind developed market economies.

With respect to human capital:

- a large middle class (up to 40% of the population) developed whose consumer activity and its ability and willingness to choose the best quality goods and services formed an efficient consumer market within Russia;
- practically all working-age youth were covered by professional training programs (75% in higher education). This ensured a higher degree of labor mobility, increased the requirements of jobs and wages, and facilitated the quick introduction of new technologies and new types of goods and services;
- the inflow of migrants, preserved thanks to the wide gap between Russia and other former Soviet republics, brought cheap labor into the economy with basic and medium skills "on easy terms," practically without any burden of contributions to pension and medical insurance funds. The 10% share of migrants in the employed population also serves as a damper in case of fast-paced developments in the labor market.

On the whole, Russia's human capital is potentially highly competitive. At the same time, its system of reproduction will be subject to erosion in the near future as a result of reduced social spending by the state. However, the negative impact of this process will only manifest itself in the economy after 2025.

4. New reality and transition to a new equilibrium

4.1. Basic prerequisites for the transition

The events in Russia since 2012 and 2013 are not a cyclical crisis or the "crisis of an outcast," but rather the economy beginning to switch to a new path, i.e., development without a constant inflow of oil and gas rents. The economic and social systems need to rebuild themselves to find a new equilibrium. The task itself is not nearly as difficult as it may seem. An absolute majority of countries have been able to develop successfully under the conditions currently faced by Russia. The main result of finding a new equilibrium would be that all businesses would operate at normal expected returns. We will now have a look at the basic prerequisites for transitioning to that new equilibrium.

First, inflation would need to decrease to 3%–4%, i.e., down to a psychologically important level that would make it insignificant when projecting future prices.

Second, there would need to be opportunities for large- and medium-sized businesses to acquire resources for new projects through loans and equity offerings on the stock market. This would require sizeable domestic sources of "long-term" money. While large companies can compensate for this by regaining access to the global financial market, medium-sized businesses have no alternatives to "Russian money."

Third, the practice of extra taxes in the form of "charity charges" imposed on businesses would need to be abandoned.

Fourth, there would need to be a noticeable reduction in political and quasi-political risks for businesses. A psychological indication of their absence would be a two- or three-year period during which a significant number of conflicts between the state and businesses would be resolved in favor of the latter.

Fifth, the existing control and supervision system would need to be partially dismantled, which is comparable to the "court and law enforcement" system in terms of its strain on businesses.[6]

We cannot hope for the state to conduct quick and consistent reforms to regulate the economy (or, for that matter, to radically revise the existing system of relations with the business community). Economic policy is the result of actions made by a number of elite and professional groups and cannot be implemented "at the wave of a hand" even by the country's leader.[7]

Below, we consider a scenario of the most inert economic and social policy. Truth be told, this scenario is currently taking place. The easiest solution (especially when pressed for time) is to act in the same way as before. This at least provides an important positive effect for economic players, i.e., consistency and predictability.

What has changed? There is no constantly growing surplus of natural rent (in the form of export revenues) and no opportunity to redistribute it to support the second macro sector and to finance social programs. Does this mean that the "bad" institutions mentioned above will immediately cease to exist or begin to change? Hardly so, because Russia has certain reserves that will allow the economy to "operate as before," based on the old institutions. This is what everybody (starting with the government) is doing.[8]

This behavior was considered rational in 2008 and 2009 when the objective was to survive a bad two- to three-year period. The current situation is completely different. Even if the sanctions are lifted (reopening access to cheap capital for large businesses) and oil prices rise, the circumstances of 2003–2012 will not be repeated. Therefore, we will discuss a development model in which the "reserve factor" no longer exists, or the government has successfully stopped drawing on it. What would happen then?

As large non-commodity businesses stop receiving regular reinforcements, respective sectors (primarily infrastructure, construction and engineering) will "freeze up." Reduced funding for social programs (by 30% in real terms according to the HSE) will push down consumer demand and "freeze up" the agricultural sector, food production, and retail.

In this situation, it is important to recognize when and by what indicators major players will realize that the old institutions are no longer functional. This does not pertain to formal decisions made by the government, but instead, we mean an actual change in mass behavior, including expectations of the respective behavior of others. The government's decisions may provide a signal, but that may be insufficient on its own. At the same time, the government may issue no signals at all, while mass players will receive their own signals based on their own transactions and observing the behavior of others. The following factors will be prevalent in the coming two to three years.

1. Declining inflation (to single-digit values with a high probability of being 6%–7%): It is not enough to change business behavior under typical conditions;

[6] According to the HSE, under the control and supervision system in its present state, business losses account for about 2% of GDP every year. According to experts from business associations (OPORA Rossii), these losses are much higher.

[7] The implementation of Putin's Presidential Decrees of May 2012 is an example of this.

[8] An extreme form of the "status quo" policy is the budget cuts in 2015 and—with a high probability—in 2016.

however, taking into account the significant decrease in demand, even the expectation of a 7% inflation rate may provide a signal to lower profit margin requirements when assessing new projects. More affordable credit is a real signal for the business community.

2. A serious deterioration in conditions that lead to Russian businesses removing their assets from the country: One may call this a blessing in disguise. The global attack of mass media and governments on offshore accounts is only one of many signals. This factor will also contribute to a decrease in the "required returns" for large Russian businesses.

Thus, *the prerequisites for dismantling the "bad" institution of exaggerated requirements for returns and the inclination towards short-term projects on the part of large Russian companies will only be met if the government continues its current macroeconomic and monetary policy without sharp turns or a need to politically engage the elites.*

At the same time, the state's policy needs to be altered both at the federal level by modifying the judicial system and its interactions with the prosecutor's office and investigative agencies and at regional levels by abandoning "coercive charity" and, ultimately, projects funded by means other than the budget. Taking into account the informal nature of the institutions formed within these systems, one can expect the transition to a new state to take at least 7 to 10 years.

The policy also needs to be changed with respect to the third group of prerequisites for a new equilibrium. This includes forming national institutions for "long-term" money, accumulating insurance payments made by households, and investing them in long-term projects by placing the funds in the open market. This would require a decision on the part of the government and parliament to increase the retirement age and change to a funded pension system. This decision will be politically possible in 2018, but its ultimate impact will not be manifested in the economy for several decades.

Are there alternative scenarios in the medium term? If we discard speculative suggestions and mention only the views that have recently received wide support at the social and political level, we could name two scenarios.

The first is to "wind up" the economy *with cheap credit*, even at the expense of continued double-digit inflation rates and a deeper devaluation of the ruble. Practically speaking, this is a scenario for non-commodity businesses that aims to preserve the old, well-known institutions for their reinforcement but in an altered form and with a new source. We will not test the probability of this scenario in terms of "credit pumping" effects. We should note, however, that it would be realized at the expense of hired workers and retired persons (thereby destroying the electoral basis for the current administration), while its immediate market effect (i.e., a fall in effective demand of households) would render credit stimulation of supply futile.

The second scenario is more consistent: it suggests *anchoring resources within the economy* through mandatory sales of foreign currencies and a ban on capital exports. This model is capable of leading to a new equilibrium in a closed export-based economy. However, after 10 years, it would result in catastrophic technological backwardness for Russia.

In our opinion, the above scenarios pose unacceptable risks for the development of our country. However, their probability is rather low, as they would contradict the interests of the most influential groups among the economic and political elites. Thus, the main trend now is inertial development, i.e., attempts to "extend the life" of the dying institutions, as abandoning them would pose insurmountable difficulties. A probable prediction would be ten years of stagnation or slow growth in GDP (no more than 1%–2% annually). At the end of that period, China would catch up with Russia in terms of per capita income, while our country would still lag behind Western Europe. On the other hand, there is a higher probability that Russia would have attained a new economic structure and more efficient market institutions.

According to the positive scenario, the government would undertake political responsibility for any necessary reforms, which would be commenced immediately after the 2016 election. In this case, the transformation would take less time (seven or eight years), bringing about an earlier start to economic growth.

4.2. Budget-related issues

The existing model of "resource-based capitalism," accompanied by perceivably worsening external conditions, continues its existence via inertia by using previously accumulated reserves (the Reserve Fund and the National Welfare Fund). The federal budget, however, is becoming a bottleneck against the backdrop of the recession and persistently falling oil prices. Notably, the regional budget crises have been around since 2013, which has already led to the increase in total debt for the regions to RUB 2.7 trillion as of early 2016 and to decreased spending in real terms below 2009 levels.

Because the 2016 budget was calculated based on an average annual oil price of $50 per barrel, its further decline is causing budget income items to fall out. According to the HSE Centre of Development Institute, with an average annual oil price at $40 per barrel, the volume of those items will reach RUB 1 trillion. The deficit envisioned in the 2016 budget is RUB 2.36 trillion (Table 3), while RUB 3.6 trillion remained in the Reserve Fund in early 2016. If spending cuts of RUB 0.5 trillion are approved and the borrowing plan is met, there will be RUB 1 trillion in the Reserve Fund. If the National Welfare Fund (around RUB 4 trillion, including currently unencumbered liquid assets) is later used to finance current spending, it can be stretched throughout 2017 and part of 2018.

Today, many representatives of elite and non-elite groups are striving to preserve the customary model. In the short run, this will lead to a heightened struggle for access to budget resources between subjects in various sectors and will

Table 3
Budget deficit and possible sources of its funding in 2016 (RUB billion).

	2016 budget law	$40 per barrel scenario
Oil price ($/barrel)	50	40
Revenues, total	13,739	12,702
Expenses	16,099	15,599
Deficit	2,360	2,897
% of GDP	3.0	3.9
The need to fund the budget deficit out of sovereign funds	2,137	2,674

Sources: Russian Ministry of Finance; calculations by HSE Centre of Development Institute.

Table 4
Comparison of effects of 2008–2009 and 2014–2015 crises.

	2009	2015	Difference, p.p.
Sales profit margin (y-o-y, p.p.)	–2.0	0.6	2.6
Real average wages in the economy (increment, %)	–3.5	–9.5	–6.0
Real GDP (increment, %)	–7.8	–3.7	4.1
Budget revenues as % of GDP (y-o-y, p.p.)	–3.8	–1.4	2.4

Sources: Rosstat; Russian Ministry of Finance; calculations by HSE Centre of Development Institute.

involve officials protecting their interests. The social sector is still losing, and consequently, *the main burden of the transition rests upon households* (Table 4).

However, the budget needs to be balanced over the medium-term perspective. The increasing social pressure and the budget situation are highly likely to force the government to switch to a flat rate of social payments and progressive taxation on individual incomes. This measure will bring in extra revenue, but taking into account the inevitable escape to the "shadows," it will not be able to offset even half of the current budget deficit. At the same time, a majority of the population will view the social and economic system of Russia as fairer.

However, the long-term effect of such a measure would be negative, as it would lead to a sharp increase in pressure on the middle class, its growth would slow, and the trend in effective demand would be considerably reduced (especially for innovative products and services as well as for social services). It will also restrain the formation of national "long-term" money.

A far safer measure would be to raise consumption taxes to promote future growth (from excise duties to local sales taxes). If the Federal Tax Service is authorized to manage customs duties and social fund payments, collectability will improve considerably.

The overall economic situation (recession—stagnation—very slow growth) will not allow to balance the general government budget at the expense of increased revenues in the medium term. Below are four budget cost items to potentially be cut.

Economic subsidization. The current budget measures taken to support industries and regions are of a chaotic "anti-crisis" nature and are not linked to actual export prospects. Only two items should remain: transportation infrastructure and agriculture. Funds for technical upgrades of production and support for high-tech exports should function independently (as non-budget ones).

Costs of the state. Although past experience shows that cuts should start from functions and not from people, the overinflated and inefficient executive administration needs to be cut down sharply. The main effect of this measure is not so much to reduce direct spending as it is to increase tax revenues from businesses.

Social spending. From a medium-term perspective, extension of the retirement age and abandoning pension payments for employed retirees will allow budget transfers to the Pension Fund to decrease. The transition to a targeted system of social aid will also cut expenses to a certain degree (as a share of GDP).

Defense and security. Because of the budget deficit, the state will have to cut spending on these items. It would be undesirable to radically reduce the state armament program, as it would render pointless the spending already made. However, its implementation may be stretched.

To keep its globally competitive strength, Russia, in the medium term, will need to increase budget spending in real terms on education and science[9], high-tech medicine, and transportation infrastructure. While making these changes, contributions for comprehensive medical insurance will need to be increased. Based on the weak political influence of lobbyists in these sectors, we may assume that such a budget maneuver in their favor will happen after 2020. For the government to choose the best strategy, it should focus in the near term on promoting science and high-tech medicine, where it is required to promptly offset a sharp decrease in foreign exchange expenses.

Because the greatest portion of the social burden and socially significant infrastructure is carried by the regional administrations and also taking into account the need to resolve the issue of regional deficits and debt over the long term (Fig. 15), the federal center will have to abandon the practice of "one-time treats" to the regions (to address the most acute problems) and permanently redistribute a portion of the revenues (1.0%–1.5% of GDP) to the regional level. Due to the high inequality between Russian regions, this can hardly be conducted by transferring tax sources to the regions, taking into account the social risks. This is the amount by which it would be necessary to increase the transfers redistributed between the regions.

Thus, the main fork that we will have to pass in the transformation of our economic model is related to determining the future share and structure of the budget sector in the economy. This will determine the choice of how to balance the budget (Akindinova, 2016).

In terms of ways to reduce and restructure budget expenditures, the following should be noted: under current institutional restrictions, a reduction in the budget "pie" will allow larger and stronger lobbyists to drive out weaker ones without regard to rational arguments about the comparative efficiency of different types of spending. Taking into consideration the current power of lobbyists in state corporations and the defense sector, as well as contractors affiliated with the government elite, we should expect them to earnestly resist possible "optimization."

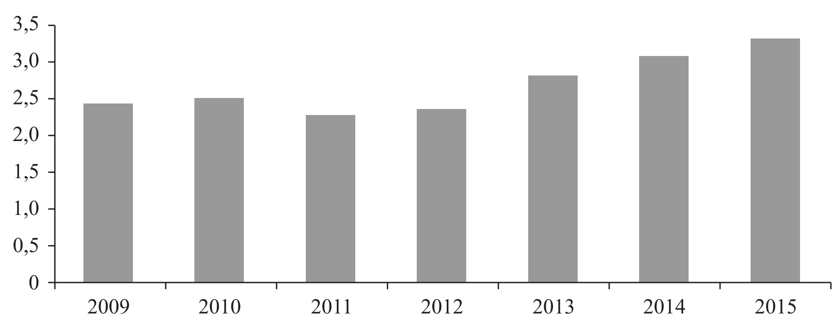

Fig. 15. Debt outstanding by regions and municipalities in 2009 through 2015 (% of GDP).

Sources: Russian Ministry of Finance; calculations by HSE Centre of Development Institute.

[9] Currently, funding for higher professional education in Russia accounts for 0.7% of GDP compared with 1.0% to 1.5% of GDP in developed countries. In the area of fundamental research, our backwardness has reached a critical threshold: Russian scientists are participating in the development of less than 5% of subject areas and prospective research carried out in the world.

While the state enjoys a reserve of loyalty from the population that will allow social programs to be cut, it should be understood that reducing the scope and quality of budget-funded services is likely to cause future degradation in the educational and cultural level of the people as well as increasing disease and death rates. For example, balancing the pension system without reform at the expense of the gradual devaluation of pension obligations may result in a return to rampant poverty.

While the scope of spending obligations for the budget system relative to GDP cannot be reduced by 3 to 4 percentage points in the near future, a long-term balanced budget can be achieved only by raising taxes. Other options are possible in the short run.

The privatization of state-owned shares in companies has long been anticipated, although the unwillingness of government officials and managers to give up real control is preventing an effective scheme from being worked out. In any event, budget revenues from privatization will still be one-time in nature.

The Ministry of Finance may also enter the market with new borrowings, although the high rates would generate spending obligations for years to come. At the same time, current budget expenditures would have to be financed at the expense of domestic investment resources (which are already insufficient). From a short-term perspective, this policy may work, as banks and companies enjoy a high degree of liquidity that they are not investing due to the negative business climate. However, if these funds are invested in government securities, they will not be invested in the economy in the future.

As reserves are nearing depletion, another option is beginning to appear more and more probable: using a certain form of monetary financing instead of cutting expenses and raising taxes. Apart from the obvious inflation consequences, this may lead to an inefficient distribution of resources. As a result of institutional restrictions, strong lobbyists will be the first to receive funding. In 2016, the amount of the money issue is conventionally limited by the size of the Reserve Fund: the Finance Ministry sells foreign currencies to the Bank of Russia, which prints rubles to cover the budget deficit and can sterilize liquidity by reducing the loan previously issued to the banking system. When the amount of the issue becomes a subject of bargaining or "political feasibility," no benchmarks or trust in the macroeconomic policy will remain. Subject to the heightened risk of capital flight, this policy will almost certainly be accompanied by restrictions on foreign exchange transactions.

Whereas in 2014 and 2015 there were still ample opportunities for macroeconomic and, in particular, fiscal policies to maintain "stability" against reduced export revenues, the sanctions and counter-sanctions have nearly exhausted the margin of safety at this point. We are facing a difficult choice between the vital interests of large groups of the population and privately owned businesses. If major state corporations, the defense lobby, and contractors affiliated with the state are not willing to concede their positions, then the monetary mechanisms will only allow us to buy some time but will *make the macroeconomic risks unacceptable*.

4.3. Social processes

The transformation of the economic model will be accompanied by drastic changes in the population's expectations and behavior. The population values labor income, pensions, consumer prices and social goods, guaranteed by the state. Housing and utility expenses occupy an intermediate position: legally, they belong to the first group but are actually perceived to be part of the state's social obligations by both the population and the regional authorities who must respond to them.

Labor income and pensions have already taken the hardest blow from the crisis beginning of the transformation. They have dropped by 8% to 11% in real terms. Apparently, in 2016 and 2017, household income will further drop by a few percentage points from its 2013 level. At the same time, the 40% of the population with the highest incomes have lost more. This is due to the fact that part of their spending is linked to foreign exchange rates (tourism, cars, durable goods), and income is mostly denominated in rubles. Their subjective perception of the crisis is stronger than that of the 60% of the population whose foreign exchange income is incidental. Most households with the highest income, however, have maintained the basic parameters of their lifestyle by switching to cheaper goods and services. This points to the unexpectedly high quality of Russia's consumer market, which succeeded in adapting to the price shock caused by the ruble's devaluation and maintained an absolute majority of consumers.[10]

While the price (inflation) shock in consumer goods and paid services markets has already occurred and has been overcome by the population, negative processes will continue in the area of social benefits provided (guaranteed) by the state. As noted above, due to the budget crisis and stagnation or very low economic growth rates, the social sphere can only hope to keep its nominal funding at best. Thus, in the coming five years, we will have to address the *gradual devaluation of the state's social obligations*. According to our estimates, the funding of the social sphere in real terms will drop by 25% to 30% by 2018, i.e., its actual resource security will fall back to 2007 levels.

We will now consider what types of behavior could be observed within high- and low-income groups under the inertial scenario. They react differently to the challenges posed by a devaluation of the state's social obligations, which is not only limited in terms of resources but still provides excessive (in terms of income group coverage) social guarantees. The baseline scenario is that the state will preserve the principle of the free provision of social goods through state-owned and municipal institutions (pay-as-you-go pensions, through the Pension Fund) until 2018.

We can expect with a high degree of certainty that the retirement age will be increased (abruptly or gradually, depending on the budget situation) and that pension payments to employed retired persons will be abandoned with exceptions for the most obvious cases of "aid to those not in need" (e.g., almost comprehensive scholarships for students in the amount of RUB 1,000).

In this case, the quality of state-provided social goods (education, healthcare, utilities) will decline gradually. By 2018, this process will become evident for an absolute majority of the population. It seems apparent that the better-off population group will not object to cutting down gratuitous social guarantees that they

[10] Tourism is apparently the only exception. Here, the market has really and dramatically contracted in terms of the number of consumers. However, the demand that was thus freed up moved into the service sector of the cities.

currently use infrequently (except for secondary schools). However, we should expect a "leftist" protest from the more numerous group.

It will be practically impossible to stand against mass social demands backed by constitutional provisions. All the state can do in this situation is to prevent the "client protest" from uniting with the "professional protest," i.e., the protest of doctors, nurses, and teachers. The state must realize the provisions of Putin's Presidential Decrees of 2012 regarding higher wages for public-sector employees (currently, this process has effectively stopped). This will help prevent the consolidation of protests from 2018 through 2020, which would otherwise undermine the social and political support for the current government.

At the same time, taking into account the lack of necessary resources, the state's ability to make concessions will be extremely limited. This will lead to even mass groups of the population actually beginning to solve the arising problems on their own while maintaining their demands to restore state social paternalism. Due to the deeply rooted Soviet-era perceptions of a welfare state, the "scissors" between "leftist" slogans and "rightist" behavior will remain for a long time to come.

Starting in 2017 and 2018, households will increasingly begin to replace the lacking resources of the educational and healthcare systems with their own funds. This process may take on the "wild" form of household corruption, tested as far back as the 1990s and early 2000s (when citizens paid cash for "special treatment" for the normal performance of duties by medical and educational workers) or a "civilized" form with a benevolent non-interference by (or even the approval of) the government. Examples of the latter include the so-called development funds of schools, which actually require contributions to be made (through moral coercion from others) with exemptions granted by the parenting committee.

A negative consequence of the inertial scenario will be an abrupt differentiation in the quality of affordable education and healthcare for different social strata within the population. Households belonging to the top half of the middle class (15%–20% of the population and almost all of them—residents of major cities) will dictate the form of private educational and medical services at above-standard quality.

Indirectly, due to better school training, children from these families will enter the best universities, thereby monopolizing the main lifts of social mobility. In other words, this would undermine the positive results of Putin's social policy, that have formed the basis for his social and political support.

We can state that *even the intermediate result of the inertia scenario on social policy will be extremely unfavorable for the government.* The realization of this risk may lead to the implementation of another, *reformative scenario*, which is based on creating legitimate institutions for citizens to co-finance social goods. The effective operation of these institutions will prevent the degradation of quality in education and healthcare in the medium term, and maintain equal access for citizens to social goods.

Key parameters of the reformative scenario are:

- transition to targeted social aid based on identifying the truly needy and providing sufficient support for their social rehabilitation. This should include targeted aid to single retired persons affected by chronic diseases, single parents with children (providing for the full socialization of children), etc.;

- priority development of a system of private pension funds, voluntary medical insurance funds, and other forms of social savings based on a citizen's own contributions. We need a national program to develop such forms, including guarantees for them from authorized state institutions;
- the active implementation of co-financing by citizens for social services, subject to exemptions for families with low income (respective payments can be made by social security agencies). An example of this policy is separating "child support" from education and upbringing and financing this service through solvent parents;
- the development of competition in social services markets. Admission to the market of and support for specialized non-commercial organizations and private firms to ensure real competition with state-owned and municipal institutions. This will require mechanisms to offset the current hidden subsidization of "allied" institutions, primarily with respect to property allotment. Competition will not only bring higher quality social goods into the market but will also reduce the price for the end consumer.

Reliance on the middle class forms the basis for several of the scenarios described above. Here, we would like to note a conflict or a potential institutional trap. Potential tax reform provides for a progressive tax burden on citizens with higher incomes. However, this contradicts the opportunity to develop new social institutions that rely on savings or voluntary contributions from citizens.

Thus, within several years, Russia will face a choice between a "fair market economy" and efficiency in the social sphere, on the one hand, and, ultimately, faster growth, on the other. This is a difficult choice, as the sense of social fairness is a value in itself. This sense is what most Russian citizens now lack.

5. Political outline of the transformation: Expert survey

The report by Yasin (2012) proposed three scenarios for transforming the current model: inertial, a decisive leap, and gradual development. In our opinion, these scenarios still maintain their relevance. However, another one was added after the 2014–2015 period, i.e., a mobilization scenario that provides for a further "crackdown" on the relations between government and society.

To evaluate the set of proposed options in terms of their probability and potential implications, we have surveyed a number of experts working in the adjacent sectors of economics, sociology, and political science. There were only 32 people. However, all of them are qualified professionals representing academic institutes and private companies.

To obtain more representative results, a more far-reaching survey could be conducted. Nevertheless, we are positive that the coverage of a greater number of people provides a basis for judging their opinions and attitudes but not about what can be expected. A small number of qualified experts provide better results in terms of assessing various policy options and their consequences. Table 5 contains a list of assessed policy options.

In columns 2 and 3, the experts were asked to estimate the possibility of an option being chosen based on two criteria: 1) probability of choice and 2) its preference in the opinion of the expert for economic development. A short questionnaire asks for an assessment of each option's three types of implications for

Table 5
Expert survey results (32 respondents surveyed).

Option	Economic policy option (2–3 years)		Economic implications of the policies (3–5 years)	
	Probability (1%–100%)	Preference (1%–100%)	Option	Probability (1%–100%)
Inertial (continuation of policies from the 2003–2013 period)	45.3	26	recovery	11.2
			stagnation	53.6
			recession	35.2
Mobilization (“crackdown”)	28.3	12	recovery	8.0
			stagnation	34.8
			recession	57.3
Decisive leap (rapid and drastic changes)	6.7	70	recovery	52.9
			stagnation	22.7
			recession	24.4
Gradual development	19.6	67.0	recovery	47.3
			stagnation	37.0
			recession	15.7

the economy: recovery (average GDP growth exceeding 1% per year); stagnation (GDP fluctuations close to zero growth (±1%); recession (average GDP reduction exceeding 1% per year on average). An assessment of the implications is represented by the opinions on realizing each of these outcomes within 3 to 5 years.

Option 1: the expert survey placed the possibility of choosing the inertial scenario at 45.3%. At the same time, the preferability of this option was estimated at 26%. As for the implications of this option, stagnation was assessed with the highest probability at 53.6%, followed by recession (35.2%). Thus, experts estimate the probability of negative implications from the inertial scenario at almost 90%.

Option 2: the mobilization scenario (“crackdown”), requiring greater austerity in relations between the government and society, is estimated as 28.3% probable by the experts and as 12% desirable. Thus, the choice of this scenario is quite likely; however, its preferability is the lowest. In terms of implications, the second scenario was expected to most likely lead to a recession (57.3%), followed by stagnation (34.8%). The probability of an unfavorable outcome in this scenario was similar to the inertial one, approximately 90%, while the probability of success was only 8%.

Option 3: a decisive leap towards radical structural and institutional changes and subsequent “modernization from the bottom up” was characterized by the lowest probability (6.7%) and the highest preferability (70%). The probability of recovery was estimated at 52.9% and that of a recession or stagnation taken together at a little lower (47.1%).

Option 4: gradual development was considered 19.6% probable and 67% preferable. Its implications were assessed at recovery — 47.3%, stagnation — 37.0%, and recession — 15.7%. Thus, the probability of success (recovery) for this scenario is slightly below 50% with the total probability of stagnation or recession at 52.7%. The experts moved with caution here; the recovery option is roughly as probable as the two other outcomes.

The probability of success in the third scenario is viewed as the highest, but the probability of it being implemented is the lowest. The fourth scenario is more likely to be chosen than the third one, but is less preferable. This can be interpreted to mean that the third scenario is the best, but poses higher risks than the fourth one.

5. Conclusion

By offering a choice between several scenarios, we hope to decrease uncertainty and provide clear benchmarks for those making decisions today for themselves, for their families, for their businesses, or for the country. For political leaders, this is only an assumption about the success or dangers that will be invoked by their decisions. Our choice of the gradual development option is based on the high probability of its (comparatively) successful outcome. This is based on the conclusion that for Russian society and its leadership, the best results are associated with the development of the market economy and the rule of law introduced to support it. At the same time, economic competition ensures market equilibrium, while political competition ensures a balance between institutional standards and values, ruling out excessive rent income for individual social and economic groups (strata) over a long period of time. Moreover, the inclination towards graduality at this stage is based on the concerns that new attempts at radical and excessively large-scale transformations would entail radical countermeasures.

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