

Russia and the Other Former Soviet Republics in Transition

LESSON 3: ECONOMICS UPDATE

In the beginning of the 21st century, the economies in many former Soviet republics experienced significant growth. Still, many have not returned to the levels of output found during the Soviet era. Today, 20 percent of the people in the region live on less than \$2 a day.

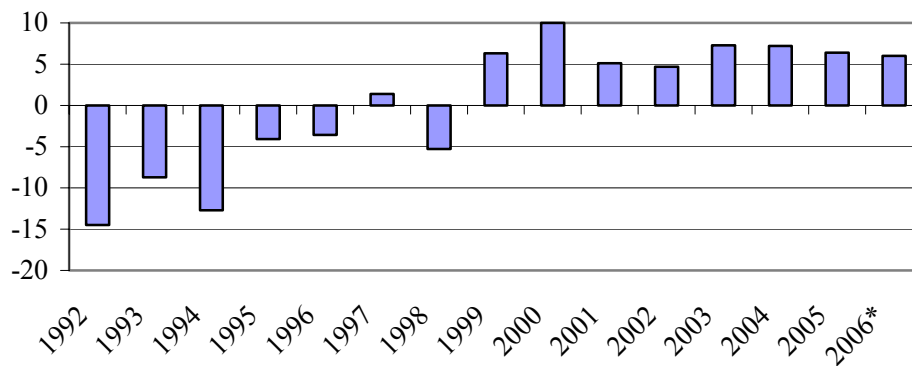
Most former Soviet republics continue to struggle to develop the institutions, laws, policies, and practices necessary for a successful market economy. Most continue to have difficulty protecting property rights, collecting taxes, assuring contracts, and establishing sound banking systems. Attempts to promote economic development through the Commonwealth of Independent States (CIS) have largely been unsuccessful, leaving individual states to determine their own economic course. Some states, like Belarus and Kazakhstan, have sought closer economic ties with Russia, while others have looked to Europe or the U.S. This update addresses these issues and can be incorporated into Lesson 3, Activities 1 and 2, of *Russia and the Other Former Soviet Republics in Transition*.

Russia's Economy

In 1997, it looked as if Russia might turn the corner economically after years of decline (see Chart 1). However, as an economic crisis swept through Asia, international banks and investors began to worry about the flaws in the Russian economy, including rampant corruption, industrial decay, agricultural decline, unpaid wages and pensions, a lack of fiscal discipline, an ineffective tax-collection system, a fragile judicial system, and tenuous rule of law.

Chart 1

Russian Federation: Real GDP% Change



*Estimate

Source: IMF, World Economic Outlook, April 2006.

[\(click here for enlarged version of chart\)](#)

In the summer of 1998, fears about the Russian economy led international banks and investors to withdraw their money from the country. This caused a 50 percent decline in the value of the

Russian ruble coupled with an immense loss of savings and wages for the Russian people. The 1998 financial crisis caused concerns about Russia's political stability and economic viability.

Despite continued political intrigue, the war in Chechnya, and economic hardship and inefficiency, the country's economy grew at an average annual rate of more than 6 percent between 1999 and 2006 (see Chart 1). The devaluation of the ruble strengthened the competitiveness of Russian companies. Higher prices for Russia's oil exports significantly boosted Russian finances. Real wages have risen more than 60 percent since 1999.¹ Inflation, which was 84 percent in 1998, had fallen to 13 percent by 2005.² Nevertheless, 16 percent of all Russians still live below the national poverty line.³

Since 2003, President Putin has tightened his hold on the economy by confronting Russia's oligarchs, who control a majority of the Russian economy. Although Putin has repeatedly stated that large-scale re-nationalization of privatized property will not occur, he has replaced some of the country's most powerful industrialists, restoring government control over key economic resources. For example, in October 2003, the government charged Mikhail Khodorkovsky, the head of oil giant Yukos company and Russia's richest man, with fraud and tax evasion. In 2005, Khodorkovsky was sentenced to nine years in a Siberian prison camp and most of the Yukos senior managers left Russia fearing arrest. The company was dismantled, with its most profitable assets going to Rosneft, a state-owned energy company. In another example, Putin has moved to stifle criticism in the Russian media, forcing some media tycoons to flee the country.

Although the Yukos affair contributed to fears about the safety of investing in Russia, the country's strong economic growth and vast wealth in oil and other natural resources continue to attract investors, particularly given high global oil prices and instability in the Middle East. Putin has also pushed through important reforms to raise investors' confidence in the country's commitment to a market economy. These reforms include establishing an updated labor code; removing administrative barriers to business; completing a judicial reform package; passing laws to break up monopolies; restructuring the pension system; putting in place a flat 13 percent income tax that has raised income tax revenues considerably since 2001; and passing a law that allowed the private purchase of farmland for the first time since the 1917 Bolshevik Revolution. These reforms have brought some benefits. Indeed, foreign direct investment in Russia rose by 38 percent in 2005, reaching \$16.7 billion.⁴

In 2006, Russia had a large budget surplus, significant foreign currency reserves, a shrinking debt, and a growing stabilization fund designed to protect the budget against a fall in oil prices. The former communist state hopes to become a member of the World Trade Organization (WTO) by 2007.

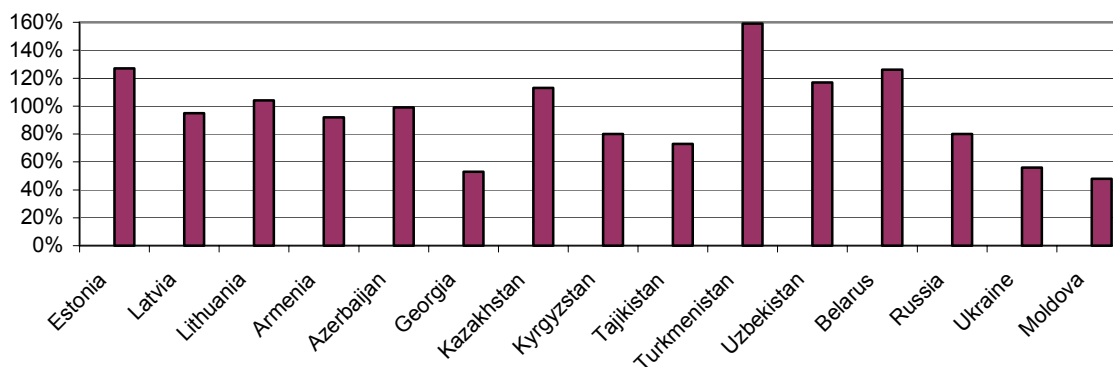
Transition and Reform in Other Economies

Within other former Soviet republics, no single economic model predominates. Some, such as Belarus, maintain communist-style command economies; others, such as Ukraine and Georgia, have initiated halfhearted reforms. Still others have made significant progress in establishing strong market economies, especially the Baltic states. As in Russia, the presence of significant oil and gas deposits has been a major factor in economic growth in several countries.

As seen in Chart 2, roughly half the countries in the region—Estonia, Lithuania, Azerbaijan, Kazakhstan, Turkmenistan, Uzbekistan, and Belarus—have reached the levels of economic output that they had in 1990. A variety of different factors explain these relatively more successful results. Here, we look at snapshots of transition and reform in the other former Soviet republics.

Chart 2

Economic Output in 2005 Compared to 1990



Source: IMF World Economic Outlook, 1999, 2001, 2006.

[\(click here for enlarged version of chart\)](#)

Central Asia. Most Central Asian countries have not enacted significant economic reforms. For example, Uzbekistan continues policies that suppress the private sector. Despite this, the country has returned to output levels similar to Soviet days because its agricultural- and mineral-based economy was less disrupted by the collapse of the Soviet Union.

Turkmenistan has also implemented very few market reforms. Its impressive double-digit GDP growth of the past several years is mostly due to vast natural gas and oil reserves. Despite this growth, almost 50 percent of Turkmenistan’s population lives in poverty.

Kazakhstan has also benefited from considerable oil and mineral deposits. In order to attract foreign direct investment, the country has implemented some economic reforms. In addition, its agricultural sector has recovered, with grain production growing at an average of 27 percent annually.⁵ Poverty in Kazakhstan has been steadily declining, amounting to 17 percent in 2005.⁶

Reforms in Tajikistan and Kyrgyzstan have been weak or non-existent. Neither country has significant oil and gas deposits, and neither has returned to the output levels found during Soviet days. Also, Tajikistan faced a civil war in the early 1990s.

Ukraine and Belarus. In Ukraine, reform efforts have been weak, and in Belarus, they have been practically non-existent. Indeed, Belarus has reformed the least of all the former Soviet republics. Its high annual economic growth can be attributed to a favorable external environment, especially with cheap Russian energy supplies; growing demand in regional markets; and increased consumer spending sparked by higher wages.

Ukraine started initiating some modest reforms in the late 1990s. However, in order to sustain its economic growth, the country still needs to restructure and privatize key sectors, tackle corruption, and ease excessive government regulation.

The Baltic States. Latvia, Lithuania, and Estonia are the best examples of strong reform efforts in the other former Soviet republics. They have concentrated on linking their economies to Europe. They have done the most to set the groundwork for sustainable economic development. Indeed, because of their economic and political reforms, all three joined the European Union in May 2004. Of the three Baltic states, Estonia and Lithuania have been the most successful in initiating reform and sparking growth.

The Caucasus and Moldova. The Caucasus region is rich in mineral resources and fertile agricultural land. Azerbaijan's impressive double-digit growth of the past five years was driven mainly by oil and gas sales. Despite this growth, almost half of the country's population lives in poverty.

In Georgia, economic growth has been hindered by ethnic conflicts, rampant corruption, and the lack of reforms. However, since the new government took power in 2003, Georgia has made some progress in implementing market reforms. The country hopes that its role as a transit territory for oil and gas pipelines will bring long-term economic growth.

In contrast to the rich lands of the Caucasus, Moldova has no major mineral deposits and its economy heavily depends on agriculture. The lack of reforms and its dependence on outside sources of energy have made Moldova the poorest country in Europe.

The CIS. Since the demise of the Soviet Union, several attempts have been made to spur economic growth via trade among the former Soviet states. One attempt has been to integrate the former Soviet republics' economies through the Commonwealth of Independent States (CIS). The organization, however, has made no progress in economic cooperation and is increasingly seen as ineffectual. In 2005, Turkmenistan reduced its ties with the CIS, becoming an associate member. For their part, Georgia, Ukraine, Azerbaijan, and Moldova revived their own declining regional organization in 2006, renaming it the Organization for Democracy and Economic Development (ODED-GUAM). The group declared that it would seek to counter the regional influence of Russia, and would facilitate closer economic and security integration with Europe.

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¹ The World Bank, "Russian Federation: Reducing Poverty through Growth and Social Policy Reform," February 8, 2005, http://194.84.38.65/mdb/upload/PAR_020805_eng.pdf, p. xi, (accessed July 11, 2006).

² International Monetary Fund, *World Economic Outlook*, (Washington, D.C., April 2006).

³ The World Bank, "Russian Economic Report," April 2006, p. 24, http://ns.worldbank.org/ru/files/rer/RER_12_eng.pdf, (accessed July 10, 2006).

⁴ Jason Bush, "The Rush to Invest in Russia," *Business Week*, January 23, 2006.

⁵ The World Bank, “Kazakhstan: Country Brief 2006,”

<http://www.worldbank.org.kz/WBSITE/EXTERNAL/COUNTRIES/ECAEXT/KAZAKHSTANEXTN/0,,menuPK:361879~pagePK:141132~piPK:141107~theSitePK:361869,00.html> (accessed July 7, 2006).

⁶ Ibid.