

# Putin and the Modernization of Russia – a Chimera?

Simon Commander, Irina Denisova and Natalya Volchkova, CEFIR  
June, 2012

*Vladimir Putin is once more the Russian President and a new government has been formed consisting of most of the same faces and mentality. Putin's victory looks complete – yet there is a very real risk that it will be Pyrrhic. Even if the 'managed' political and economic system - rooted in a lack of competition and openness - that has been his defining project can remain stable, it will continue to sap the country's vitality. In the election campaign, even Putin acknowledged the country's lack of modern and competitive industries, as well as a business environment plagued by corruption, cronyism and excessive regulation. Yet, in calling for further modernisation of the economy, Putin has also called for more of the same policies, notably a central role for the Russian state in supporting new industries and technological leadership; a newly established State Corporation for Siberia and the Far East is a case in point.*

However, this very model has so far achieved very limited results. Oil and gas still account for nearly 70% of total merchandise exports and around half of the federal budget. While relying on publicly funded and managed entities – such as *Rusnano* - to shepherd the economy into more diversified and more productive spaces, particularly in high-tech activities, has also yielded a relatively meagre harvest. *Rusnano* itself has already acknowledged the limited portfolio of innovative projects to fund.

In the arena that provides the most compelling metric of competitiveness – export markets – relatively few Russian firms compete in international markets and very few do in higher value added trade. Ricardo Hausmann (2007) has argued that the products that a country exports also reflect the proximity of products and their reliance on similar sets of inputs, such as physical assets and knowledge or skills. Near the start of Russia's transition it has been calculated that Russia had comparative advantage in only 156 out of 1242 product lines when using a 4-digit SITC

classification. Most were natural resources. In contrast, China had comparative advantage in 479 product lines. And as regards proximity, few of Russia's export products were closely connected to other products, meaning that there was limited scope for enhancing exports. Yet, by 2010 our research shows that there has been an increased concentration on natural resource exports. The contraction of manufacturing has, further, been associated with a fall in the number of Russian product lines with comparative advantage to 103. In contrast, the number for China increased in 2010 to 513. So, despite Putin's rhetoric, the Russian export basket has become even more concentrated since the mid-1990s. Moreover, the ability to shift into proximate products, as well as diversify into new ones, remains very restricted. This is due to several factors.

A common diagnosis is that failings in the business environment are to be blamed. This is not a new complaint. While the options for limiting these constraints may not be straightforward but the broad policy direction and options are well understood. The

challenge is in enforcement. In this – as also with improving governance and further reducing the role of public ownership – improvement is only likely to start with serious political commitment. That is still lacking.

But modernising the economy depends on much more than a good business climate. Critically, it depends on what sorts of skills and knowledge are available to the economy. Yet, even here where many have believed that Russia is relatively favourably situated, on closer inspection, the situation turns out to be far more problematic. In fact, our evidence indicates deterioration in the quality of both skills and education over time, including limitations on the supply of high quality management. Evidence from surveys suggests that Russian firms face problems in finding workers with the appropriate skill profile. While this may be the situation for existing firms, it seems likely that potential entrants to new, diversified activities may, if anything, face even steeper constraints. To understand whether this is indeed the case, the leading – 270 – recruitment firms in Russia were surveyed using face-to-face interviews in 23 locations in Russia, including Moscow and St. Petersburg. This included a small experiment looking at skills availability for work in more innovative activities, such as web technology aimed at social networking and marketing. The aim was to see whether innovative activities faced more binding constraints when trying to hire.

The results of this survey are unequivocal. Not only are there widespread skill gaps for all types of skills, but it takes firms a much longer time to fill vacancies for skilled personnel. This is particularly true for relatively innovative activities. Recruiting managers or high level professionals in the major Russian cities on average takes 3-5 times longer for innovative activity. Even in Moscow, recruiting a manager or high level professional would take between 3-4 times longer; the gap

was yet greater in the Urals, Siberia and the Far East.

Moreover, looking at the sorts of skills that are lacking for each type of potential recruit (e.g., a manager); recruiters also report an absence of basic or essential skills. For example, lack of problem solving and management skills were overwhelmingly the most commonly cited limitations for managers, with high level professionals most commonly lacking both problem solving and practical skills. Among the consequences, many firms decide to postpone launching new products and/or modernizing plant.

In short, our evidence shows not only widespread skill shortages but also major barriers on the availability of personnel for firms wishing to establish new or relatively innovative activity. At the same time, anecdotal evidence also suggests that among the thin layer of top talent – likely to be essential for high tech and other innovative activities – many prefer to emigrate. In contrast, Russia fails to attract talent from other countries, not least because of a restrictive migration regime.

The last decade has seen an emphasis on modernising and diversifying Russia. The results have been depressingly limited. Yet Putin and his government propose more of the same. In effect, they are continuing to take a huge gamble by relying on a mix of energy prices and publicly funded industrial policy to paper over the structural weaknesses of the economy. As this article has shown, what Russia currently produces and exports - and the underlying skills and knowledge - provide a very weak base for achieving the goals of modernisation.

▪

## References

Denisova, I., and S.Commander, S.Commander and I. Denisova (2012), 'Are skills a constraint on firms? New evidence from Russia', EBRD and CEFIR/NES, mimeo

Hausmann, R., and Klinger, B., (2007), "The Structure of the Product Space and the Evolution of Comparative Advantage", CID Working Paper No. 146

Volchkova, N., Output and Export Diversification: evidence from Russia, CEFIR Working Paper, 2011

### Irina Denisova

Centre for Economic and Financial Research (CEFIR)

IDenisova@nes.ru

[www.cefir.ru/?l=eng](http://www.cefir.ru/?l=eng)



Irina Denisova is a core member of CEFIR's team who initially worked at RECEP and joined CEFIR when it was founded in 2000. She is also a professor at the New Economic School, where she teaches courses in macroeconomics and labor economics, and a researcher at the Central Institute of Economics and Mathematics (CEMI).

Denisova received a Ph.D. degree from Manchester University in the U.K. after she had finished Post-Graduate Program in Economics at the Central Institute of Economics and Mathematics (CEMI), Russian Academy of Sciences (1987 -1990) and had graduated from the Department of Economics at Moscow State University named after Lomonosov (Diploma with Distinction in Economics) in 1987.

### Simon Commander

IE Business School, Madrid



Simon Commander is currently Managing Partner of Altura Partners, London which works mainly with governments and companies operating in emerging markets. He is Professor of Economics at IE Business School, Madrid where he teaches in the International MBA program. He has previously been a faculty member at London Business School and also worked at the World Bank in Washington DC and EBRD in London for extended periods of time. He holds a MA from Oxford University and a PhD from Cambridge University.

### Natalia Volchkova

Centre for Economic and Financial Research (CEFIR)

New Economic School (NES)

NVolchkova@cefir.ru

<http://www.cefir.ru/index.php?l=eng>



Natalia Volchkova is a core member of CEFIR's team and joined CEFIR when it was founded in 2000. She initially worked at RECEP (1998 — 2000) and at Massachusetts Institute of Technology as a visiting researcher (2001 — 2002). She is also a lecturer at the New Economic School, where she teaches courses in Macroeconomics 3, 6 and International Trade, and a researcher at the Central Institute of Economics and Mathematics (CEMI).

In 1999, Natalia Volchkova finished Postgraduate School at the Central Institute of Economics and Mathematics (CEMI) and got a candidate degree in economics. Before that she had studied at the New Economic School (1996 -1998), and in 1997, she graduated from Postgraduate School of Department of Physics at M.V.Lomonosov Moscow State University.