

# The Economic Resurgence of Russia, Ukraine and Kazakhstan

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# Will the CIS Countries Catch up with Central Europe?

Effects on long-term economic growth:

- Laggard Effect
- Trade Access
- Foreign Direct Investment
- Economic Model

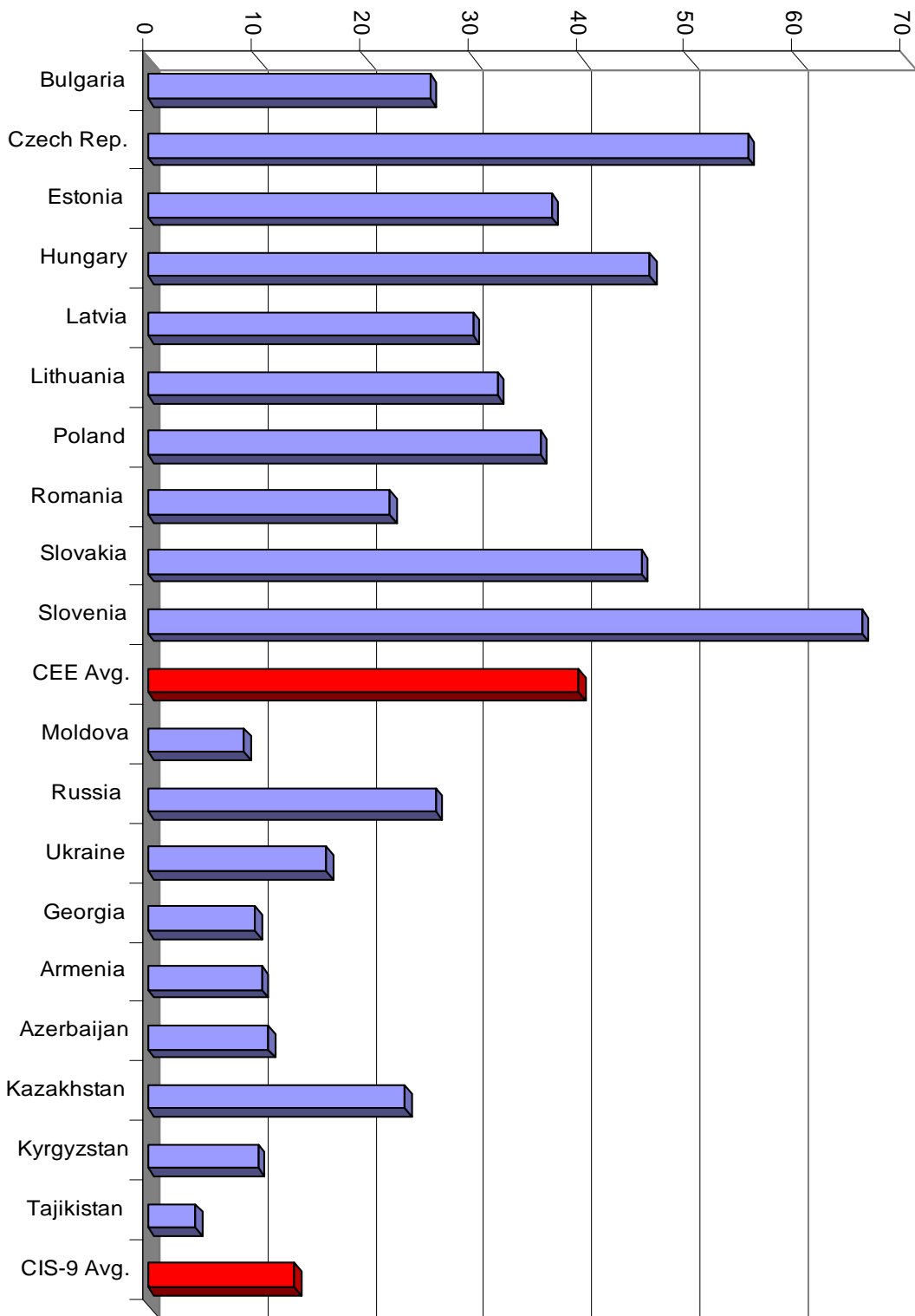
# Common Achievements

- Market economies
- Financial stability
- Privatization: two-thirds or more

## Laggard Effect

- CEE has on average 40 percent of the EU GDP per capita
- CIS-9 has 34 percent of the CEE GDP per capita
- Lower initial GDP levels are likely to make CIS countries grow 1.3% faster than CEE.

Per capita GNI (PPP-adjusted) in ratio to EU Average, 2001



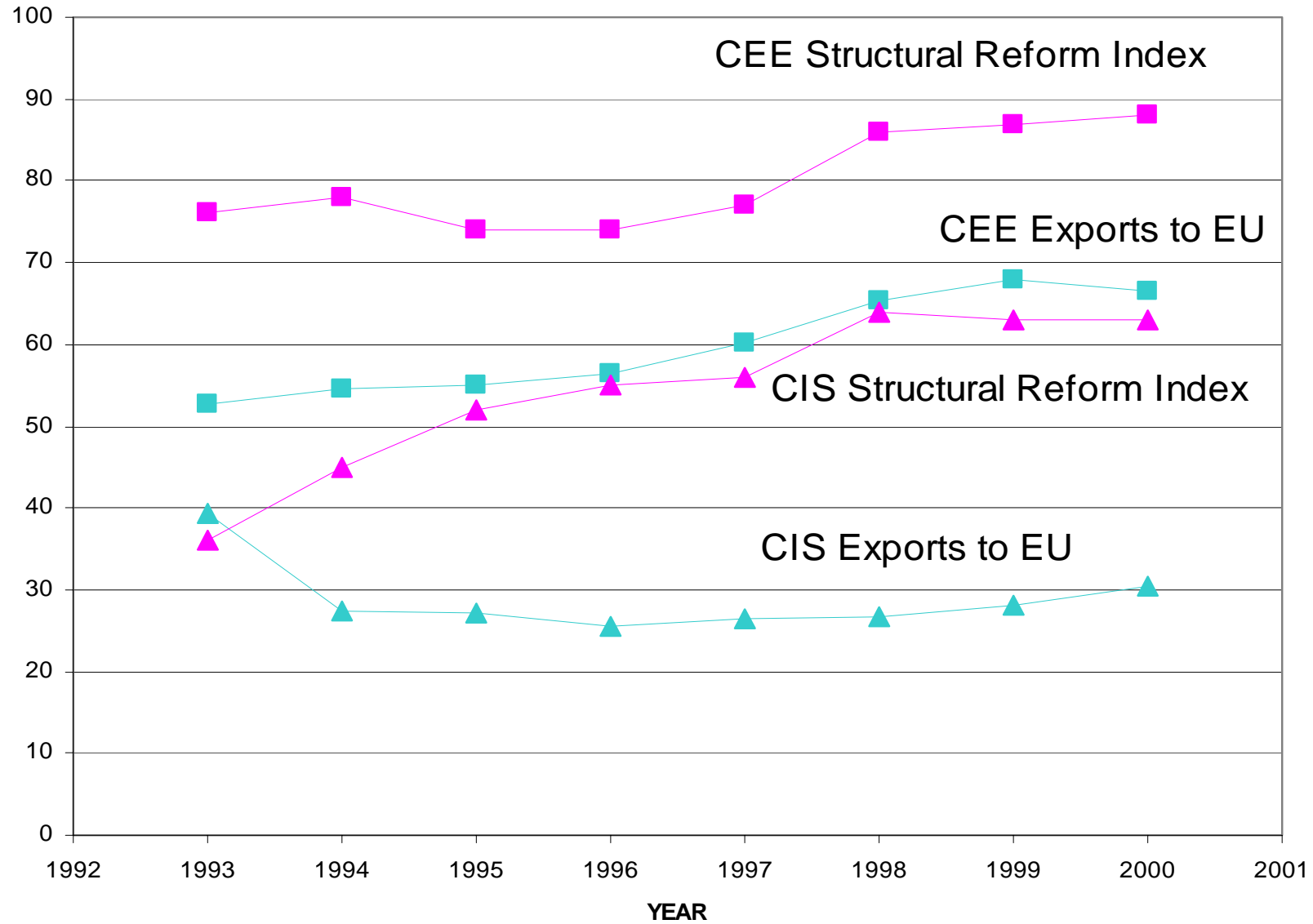
## Diverse Trade Development: Share of Exports to EU

- CEE: Rising from 50 percent in 1989 to 67 percent in 2000.
- CIS: Falling from 33 percent in 1989 to 31 percent in 2000, but it should be 58 percent (Collins & Rodrik 1991).

# Is Domestic Reform the Explanation?

- CEE has persistently done more reforms and its share of EU trade has developed in parallel.
- CIS has proceeded with reforms at a similar speed, but its share of EU trade has stayed flat.

# Exports to the EU as Share of Total Exports & Structural Reform Index (SRI)





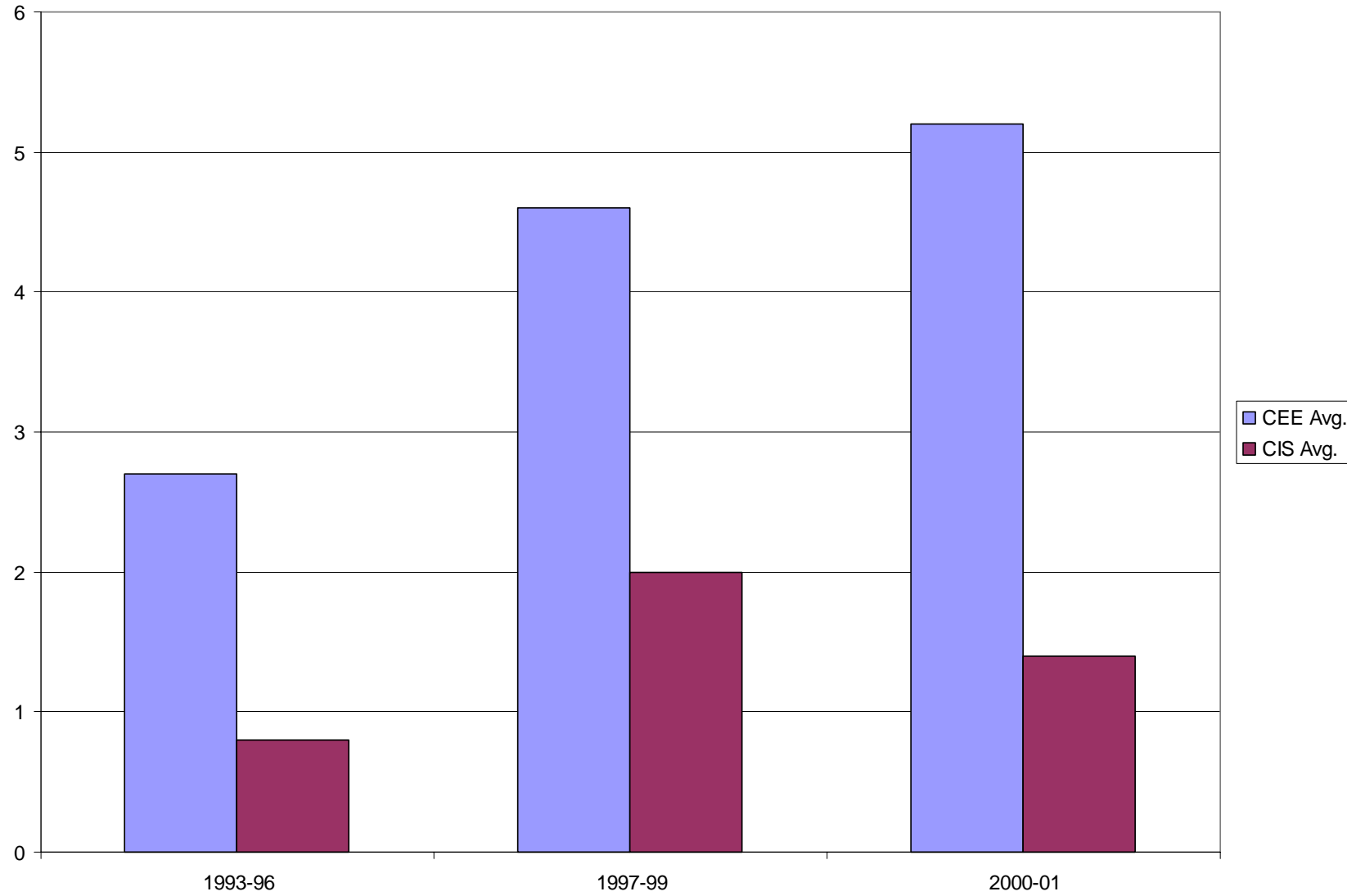
- For the CIS countries, the gravity model in reverse - the further away, the more trade with the EU.

**The EU has been remarkably liberal towards CEE, but pretty protectionist against the CIS. No benefits in sight.**

# Foreign Direct Investment

- CEE attracts steadily more FDI - 4.6% of GDP in 2001
- the CIS attracts constantly little FDI - 1.2% of GDP in 2001
- **A difference of 3% of GDP in FDI means a that CEE will grow 0.3% a year faster than the CIS.**

## FDI as a percentage of GDP



# Institutions Drive Growth

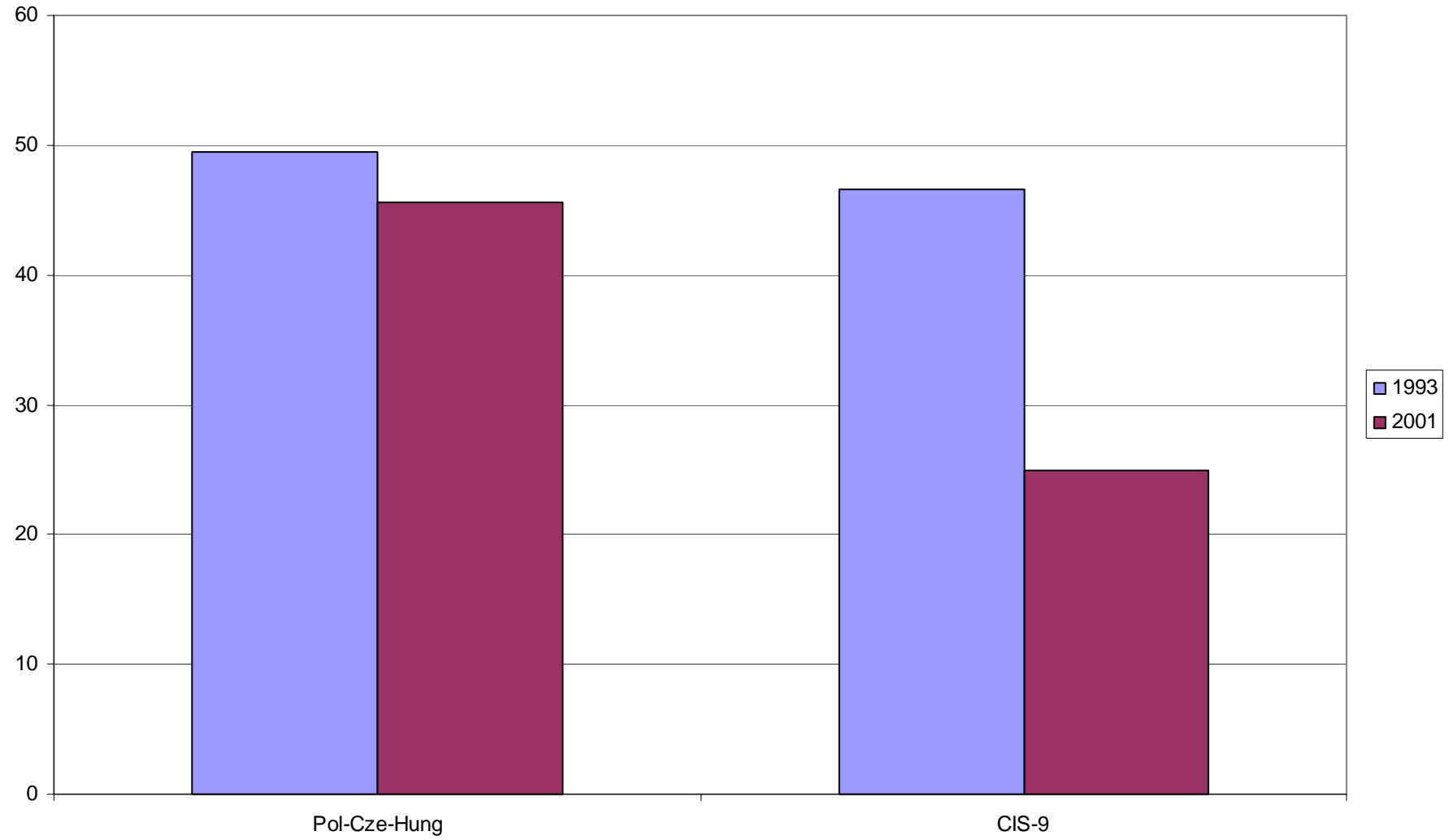
- Public redistribution as share of GDP
- Tax system
- Labor market regulation
- Environmental regulation
- Corruption

# Divide in Public Finances

- Public Expenditures (2001):
  - High: 46% of GDP in Pol-Cze-Hung
  - Low: 26% of GDP in 9 reformist CIS countries
- Budget Deficit (2001):
  - High: - 5% of GDP in Pol-Cze-Hung
  - Nonexistent: +0.1% of GDP in CIS-9

Source: IMF, EBRD

## Public Expenditure as a Percentage of GDP



# Corresponding Divide in Taxation

- Income Tax:
  - High: Max 40% in Poland
  - Low: Flat tax of 13% in Russia
- Payroll tax:
  - High: 48% in Poland
  - Low: 20% and regressive in Kazakhstan

# Divide in Unemployment

Unemployment determined by payroll taxes, social transfers and regulation (end 2002):

- High: 18% in Poland, Slovakia and Bulgaria
- Moderate: 8% in Russia



# Environmental Divide

Cost for Poland to introduce 320

EU environment directives:

**at least 4 % of current GDP  
for 20 years**

CIS: Not applicable

(World Bank: Mayhew 2000)

# Corruption

- The whole region is pretty corrupt.
- The CIS is substantially more corrupt than CEE.
- Corruption is falling in the CIS but not in CEE.

# Corruption:

## Bribe tax as share of Sales (%)

	1999	2002
Pol-Cze-Hung	1.1	1.0
CIS 9	3.0	2.3
Russia	1.7	1.4

Source: EBRD 2002

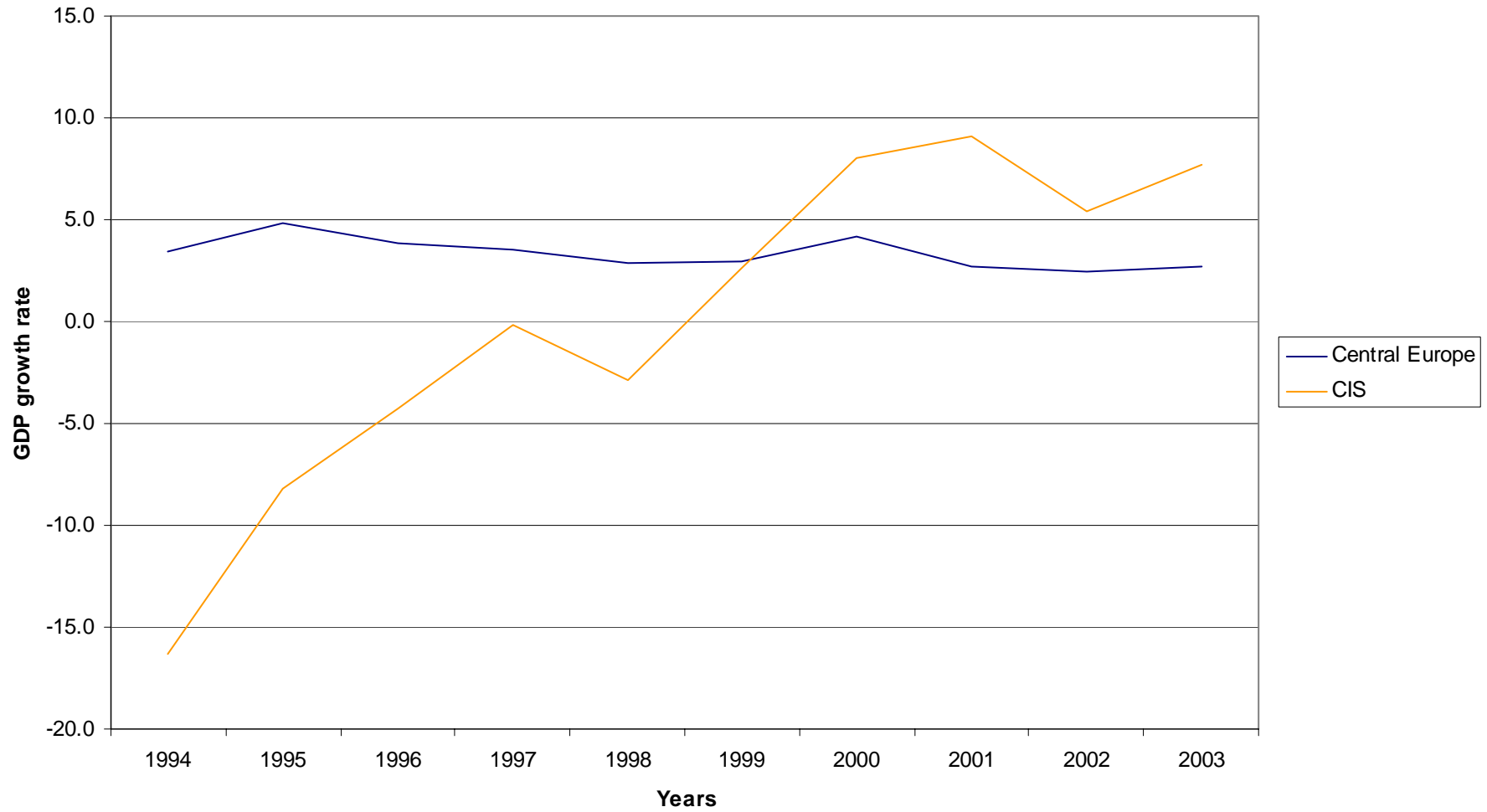
# Economic Growth 1999-2003

## **Annual average 6% in CIS9:**

- Russia 6.5% a year,
- Ukraine 6% a year from 2000,
- Kazakhstan 11% a year from 2000.

**Central Europe: 3% a year.**

## Average GDP growth rate, Pol-Cze-Hung vs. Rus-Ukr-Kaz 1994-2003



# Explanations for CIS Catching up

1. Lagging behind
2. Greater growth when reform finally takes off because of larger free capacity
3. Better incentives: low taxes and social transfers

**Over time, the economic system gains significance.**

# What Is Driving Ru-Uk-Kaz?

1. **Initial failure** to collect taxes, control inflation and corruption → low flat taxes, low public expenditures, low social transfers, and balanced budgets.

# What Is Driving Ru-Uk-Kaz?

2. **Politics:** Dominant big business forms stronger liberal lobby than many small firms ← Early privatization of big enterprises to domestic businessmen and limited early FDI appears beneficial.



# What Is Driving Ru-Uk-Kaz?

- 3. Vision of liberal market economy**  
inspired by the IMF (the Washington consensus), East Asia (notably in Kazakhstan), and regional cross fertilization.

# Conclusions

- CIS countries benefit from catching up effect, lower public expenditures and lower taxes, but suffers from corruption and poor market access.
- The CIS is moving to a growth-oriented model with low taxes, social transfers, public expenditures and open economies as East Asia.