THE WORLD CRISIS AND THE RAW-MATERIAL ORIENTED TRANSITION ECONOMIES

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The world crisis, which naturally aggravated many problems, increased the raw-material dependence of the transition economies of at least some of the CIS countries.

A comparative analysis of the economic progress achieved in the last decades revealed that natural riches slow down economic growth.[1] This

[1] See: R. Prebisch, *The Economic Development of Latin America and its Principal Problems*, Lane Success, New York, United Nations, 1950; A.O. Hirschman, *The Strategy of Economic Development*, Yale University Press, New Haven, 1958.

phenomenon, known as the resource curse, was accepted as a fact and became a subject of economic studies, especially after J.D. Sachs and A.M. Warner[2] published their articles dealing with the negative statistical dependence between natural riches and economic growth rates.

The authors, who looked at the "natural resources curse" as a factor of investments, corruption, the country's openness, and trade conditions, agreed that natural riches should be described as a negative factor.

There are numerous examples confirming the above: between 1965 and 1988 the per capita GNP of the resource-dependent countries dwindled by approximately 1.3 percent every year, while in the countries with low and average incomes it grew annually by 2.2 percent.[3]

Nigeria, the oil-related income of which increased between 1965 and 2000 from $33 to $245 per capita in comparable prices while the GDP remained the same ($325 in comparable prices), is one of the most striking examples among the OPEC countries.

Between 1970 and 2000, the share of the poor (with incomes below $1 per day) in the country's population increased from 36 to 70 percent.[4]

Many countries have been able to disentangle themselves from the natural resource curse and are demonstrating adequate development rates. Such are the United States and Botswana, among others.

The opinions about the fairly contradictory empirical regularities of the "natural resource curse" differ.

Theoreticians rely on an analysis of all sorts of economic and institutional aspects of what is known as Dutch disease (economic restructuring) caused by a country obtaining additional profits.

In fact, Dutch disease (Dutch syndrome) is a wider concept than the "natural resource curse" since the money might not only come from the raw-materials sector or market fluctuations but also in the form of foreign aid.

Much has been written about Dutch disease.[5] Most authors explain it by the contracting production of finished industrial goods responsible for external benefits. Others attach special importance to rent, economic policy mechanisms, and exchange rate fluctuations.

V. Matveenko,[6] who has relied on the one-sector model to analyze the correlation between raw-material dependence and economic growth rates, and K. Kuralbaeva and O. Eysmont,[7] who studied the dependence between the GDP growth rates of a resource exporter and the share of the resource sector in the economy using the two- and three-sector model, stand apart among the CIS authors.

The majority prefers simpler explanations: world oil and other raw material prices are never stable—the alternating booms and declines are fairly short. The volatility of the raw material markets is the main curse of raw-material exporters.

Everything that has been written today can be divided into two groups. One of them looks at the short-term consequences of the raw-material curse, the other at its long-term repercussions.

The transfer from a planned to a market economy has its specifics, and the symptoms of Dutch disease betray themselves gradually. This is why an adequate analysis is very hard to achieve.

Even before the crisis, CIS analysts spent much time talking about the resource curse and

[2] See: J.D. Sachs, A.M. Warner, "The Curse of Natural Resources," *European Economic Review*, Vol. 45, May 2001, pp. 827-838.

[3] See: T. Gylfason, "Natural Resources, Education and Economic Development," *European Economic Review*, Vol. 45, May 2001, pp. 847-859.

[4] See: X. Sala-i-Martin, A. Subramanian, "Addressing the Natural Resource Curse: An Illustration from Nigeria," *NBER Working paper* 9804, 2003.

[5] The term is associated with the discoveries of vast natural gas fields in the late 1950s-early 1960s in the Dutch sector of the North Sea. In Norway, oil production grew almost 7-fold between 1970 and 1980; in the Netherlands 2.5-fold, and in the UK nearly 2-fold. The resultant upsurge of natural gas export made the natural currencies more expensive, which negatively affected the other export-oriented branches. Dutch disease is mainly associated with the growth of the real exchange rate caused by increased export in some branches, which negatively affects other branches and the economy as a whole.

[6] See: V.D. Matveeenko, *Resursozavisimost' i ekonomicheskoe razvitie: primer Rossii,* St. Petersburg Economical-Mathematical Institute, RAS, 2005.

[7] See: K. Kuralbaeva, O. Eysmont, "Istoshchenie prirodnykh resursov i dolgosrochnye perspektivy rossiyskoy ekonomiki," *Nauchnye doklady EERC,* No. 99/07, 1999.

whether their countries were affected by it. Today the time has come to look at the roots of the countries' raw-material dependence in order to grasp the meaning of what is going on and address the short- and long-term tasks.

Several of the CIS countries, especially those rich in natural resources, are the largest exporters of mainly energy resources.[8] They are Azerbaijan, Kazakhstan, Russia, Turkmenistan, and Uzbekistan.

All of them (with the exception of Russia) belong to Central Asia and the Caucasus (the CAC region). Three more countries export exchange goods: Armenia deals in copper; Georgia in ferroalloys and copper; and Tajikistan in cotton and aluminum. The raw-materials share in their export, however, is negligible.

During the crisis their incomes dropped; Kyrgyzstan is the only exception: gold, its main exchange commodity, is even more expensive than ever before.

In fact, all the CIS countries depend on raw materials for their exports[9]; none of them managed to radically restructure their industrial production to export goods with high surplus value. Their finished goods are uncompetitive on the world markets.

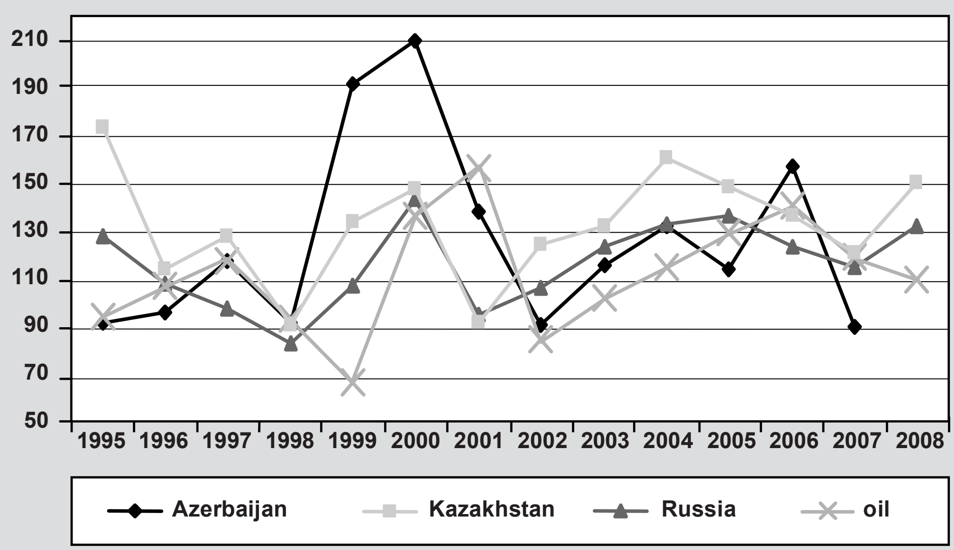
For example, according to the RF Ministry of Economic Development, in 2008 fuel deliveries to the Far Abroad comprised 72.4 percent of Russia's exports.

[8] The aggregate energy potential of the CIS countries is about 11 percent of the world's proven oil resources; more than 41 percent of the world's natural gas resources (first place in the world) and 25 percent of the world's coal resources (first place in the world). Russia, with 77 percent of the CIS total oil extraction, Kazakhstan (11 percent), and Azerbaijan (about 9 percent) are the largest CIS oil producers. By 2008 Russia had moved into first place in the world in natural gas extraction (79 percent of CIS production); it is also the largest gas exporter. Turkmenistan, with 8 percent in the CIS, holds second place; Uzbekistan produces slightly less gas.

[9] Export of armaments, which is considerable in some countries (Russia being one of them), is beyond the scope of this article.

Figure 1

Dynamics of Export to the Far Abroad
(% of the previous year)



Source: The CIS Committee for Statistics, *International Financial Statistics,* 2008-2009.

Azeri export is dominated by oil products (96 percent); energy resources account for nearly 40 percent of Uzbekistan's exports.[10]

The same is true of the other countries. The raw-material price fluctuations still strongly affect their basic macroeconomic indices.

During the global financial crisis of 1997-1998, when the raw material prices plummeted to an unprecedentedly low level, these countries showed the symptoms of Dutch disease, their dependence on raw materials making them especially vulnerable. Later, when the exchange prices on their main export items started climbing, they hastened to report high GDP and industrial production figures and export growth rates, thus demonstrating total oblivion of other development factors.

For the CIS countries, the present crisis has been a precise repetition of the situation when lower raw material prices caused an economic decline in resource-dependent countries.

[10] [www.stat.uz].

This means that a very short period of the world's high and climbing raw-material prices caused the rapid economic growth in the raw-material exporters.

Statistics have demonstrated that in the countries mentioned above the high GDP and industrial production growth rates coincide with high raw-material prices, particularly for oil.[11]

Figs. 2 and 3 illustrate the positive correlation between oil prices and macroeconomic indices.

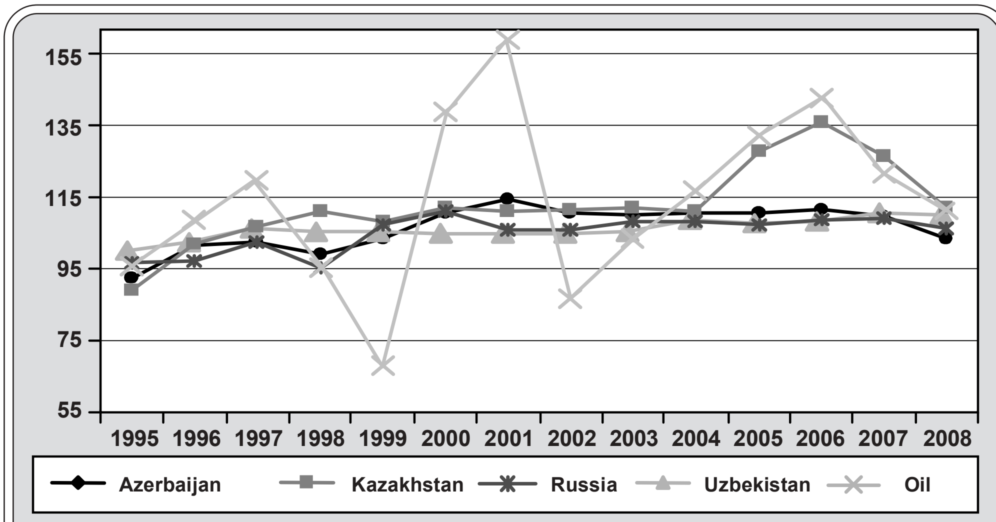
The crisis revealed the strong and weak sides of the economic policy pursued by the raw-material exporters—Russia and the CAC. In some cases, Dutch disease alleviated the crisis-caused pains.

Table 1 shows some of the signs of the resource curse and Dutch disease which the crisis pushed to the fore.

[11] Natural gas and coal mainly follow the oil-price dynamics.

Figure 2

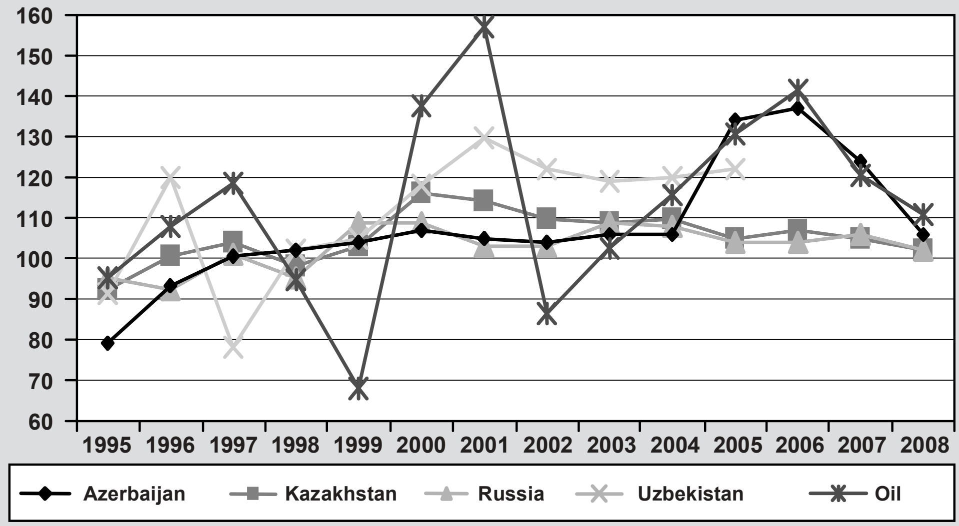
Dynamics of Growth in GDP and Oil Prices
(% of the previous year)



Source: The CIS Committee for Statistics, *International Financial Statistics,* 2008-2009.

Figure 3

Dynamics of Industrial Production
(% of the previous year)



Source: The CIS Committee for Statistics, *International Financial Statistics,* 2008-2009.

Table 1

Typical Symptoms of Dutch Disease and Their Manifestations in the CAC

Typical Features of Dutch Disease	Manifestations	CAC Specifics
Slower economic growth that goes on for a long time	Negative statistical dependence between rich natural resources and economic growth rates	Hard to identify because of the short period of observation and the impact of the transformation-related decline
Production factors move over from the manufacturing sector to the resource and services sector	Marginal labor productivity and capital in these sectors overcome marginal labor productivity in the manufacturing sector	Rapid development of the services and construction spheres. Transfer of the workforce to the services sector. Including in the form of migration to other countries

Table 1 (continued)

Typical Features of Dutch Disease	Manifestations	CAC Specifics
Contraction of external benefits created by the manufacturing industries	Contraction of the scientific and R&D sectors	Fairly small amount of capital in the manufacturing sector and its low efficiency
De-industrialization	Contracting share of the industrial branches and the total number of jobs in the industrial sector. Investments in industry and its share in the GDP decrease	Industrial labor skills gradually disappear. The economy becomes mainly agrarian and raw-material. Formerly industrial regions become depressed while the workforce is concentrated in the services sector
Concentration of investments in the raw-material sector	Less money in the manufacturing sector negatively affects its profitability and competitiveness	Direct foreign investments are mainly intended for the extracting branches. The undeveloped economy negatively affects the market infrastructure
The exchange rate of the national currency becomes unstable	The position of both exporters and importers grows shaky. The manufacturing branches become less competitive	The national currency exchange rate is regulated. Monetary policy is toughened; import dues are raised
The gap between rich and poor widens	Wages are raised to different extents. Rent and the monopoly on strategic exports differentiate incomes even more	Decline caused by the transformations becomes more obvious. The shadow sector increases its money flows
Budget expenses are deliberately inflated	The surplus budget money dampens the state's initiatives in the sphere of institutional reforms	Inflated programs of budget and quasi-budget funding. Disguised funding of non-profitable enterprises
No stimuli for economic diversification	Fewer chances to be competitive in the world commodity market with a high share of added value.	Economic restructuring was never realized while China and other regional players increased their

Table 1 (continued)

Typical Features of Dutch Disease	Manifestations	CAC Specifics
	Protectionism toward national economy branches	demand for raw materials
Low asset turnover	The correlation between energy consumption and the GDP in the resource-dependent countries as a rule is much higher than in the developed countries	High energy-consumption of the GDP. High energy consumption of production is combined with inadequate domestic energy supplies
Undeveloped financial market	Since the resource sector has enough investment sources it becomes much harder to transform personal savings into investments. Savings are accumulated in foreign currency or are exported from the country	Banks are unwilling to lend money to the real sector. Companies have to invest their own profits, which are thus accumulated in the mining and raw-material exporting branches
Changeability	Wide cyclical vacillations caused by the instability of profit sources (resource prices, foreign loans)	Sharp decline of macroeconomic indices during a crisis
Squabbles over the rent and corruption	Concentration of political and economic power in the hands of small groups. Lower quality of social capital	Clans that control resources
Unjustified confidence in the future	Light-hearted treatment of the "easy money." Increased financial dependence	Large part of these incomes might be spent ineffectively. High external debts
Growing structural unemployment and migration	Interdependence between the practically undiversified economy that tends toward the resource sector and unemployment and workforce migration	Greater money flows from migrants and their effect in the form of a positive balance of payments
Worsened quality of human capital	Lower quality of education. Crisis of technical education. Additional income lowers the	Lower interest in education. General decrease in the

Table 1 (continued)

Typical Features of Dutch Disease	Manifestations	CAC Specifics
	demand for human capital. The educational system deteriorates	quality of human capital that was relatively high in the past
High volatility of trade balance	This creates a situation in which import decreases because of the drop in export	Dependence of many of the economic branches on import
Transformation into a raw-material appendage and a market not only for developed but also for developing economies	Trade between Russia and the CAC, on the one hand, and China, on the other, developed into a typically colonial structure: we sell them raw materials, they export their machine-building equipment to us	Chinese partners in fact impose their fuel and raw-material prices on the exporter companies

Certain Crisis Specifics in Russia and the CAC

Financial Resources

Crises assume special forms in developing countries that depend on exporting their raw materials. The large amount of taxes accumulated in special funds during the years of a favorable market situation keeps the economy afloat for some time since the funds effectively cushion the impact of the crisis.

Considerable banking assets absorb the shock and are used to continue funding facilities and projects no matter what is happening to the budget. In this case, weak Dutch disease symptoms create positive effects.

Crisis Asymmetry

In Russia and the CAC, which are rich in natural resources, the crisis mostly affected the raw-material and financial sectors because of the inertia of their economies and their lopsided integration.

The slowed-down economic advance of developing and transition economies during a crisis is explained by their "overheated" state on the eve of the stock market collapse caused by high raw-material prices. The following factors confirm this: high economic development rates; income growth; sky-rocketing prices for real estate and other groups of products, and a loan boom.

Strong Institutions are Much More Important than Rapid Reforms

The expert community has agreed that during a crisis countries need tough and consistent state governance to ensure timely responses inside and outside the country and to coordinate the country's policies and its economic demands.

Back in the mid-1990s, when discussions about possible post-socialist development paths stirred up a lot of interest, renowned Polish economist Grzegorz Kolodko pointed out that a gradual transfer to the market without total destruction of the old economic institutions would help to avoid a slump.

The liberal economists insisted that shock therapy and their own market theory were the only alternative in the conditions of moving away from the communist paradigm.

It has become clear, however, that in a crisis those countries that preserved strong state institutions can rely on them for their stability.

Strong and Large Corporate State Sector

We all know that the private sector is dealt the heaviest blow in a crisis and that it is for the state sector to stabilize the situation. In the countries under review, the key economic centers were transferred under state control to avoid their precipitous collapse; more likely than not the state is a market player of sorts that supports consumers, producers, and investors.

Let us repeat: the state sector alleviates a crisis.

The CAC's Greater Geopolitical Role

Alternative fuel transportation routes and diversification of fuel consumers add weight to the CAC while its steadily growing export attracts larger foreign investments.

Asia (China, India, and some other countries in particular) will soon need a greater amount of hydrocarbon resources, which will push the CAC into the key geopolitical positions. Therefore the consumers want economic stabilization in the region as promptly as possible.

Monetary Policies

Russia's pre-crisis policy of strengthening the ruble considerably increased the volume of foreign currency loans in Kazakhstan: investors were encouraged by the high oil and other raw material prices. This created a money flow into liquid assets and, consequently, a loan boom. The resultant overheated economy, however, made the Russian and Kazakhstan banks and companies dependent on the money flow, which changes its direction during a crisis.

Openness or Isolationism

The liberal market economy favors an open economy, however in the post-Soviet countries liberalization boiled down to access to the external capital markets.

On the eve of the crisis, Kazakhstan and Russia were the two main rivals where economic openness was concerned. Much was said about integration into the international financial markets, which presupposed the active involvement of foreign capital.

A favorable situation in the commodities markets accompanied by the high growth rates of raw-material economies improves the country's image and its international rating even if its domestic accumulations remain negligible. This makes loans in the foreign markets especially tempting. As a result, the amount of money borrowed abroad reaches unbelievable proportions, both in the corporate and the banking sectors. Used as liquidity and involved in trade operations the borrowed money is never spent on serious restructuring.

In the past, the isolated nature of the CAC financial systems (of Uzbekistan, among others) was often criticized; examples of other countries' experience were used as an argument.

The situation is far from unambiguous: pre-crisis "minuses" turned out to be crisis "pluses." Indeed, the banking system of Uzbekistan with its very limited volume of foreign loans and total reliance on its own accumulations remained afloat and avoided shocks.

None of the developing or post-crisis economies can close the development gap and move forward without external borrowings: their effective use, though, is a much more challenging task.

Inertia of the Social Response

The social response to the crisis and its consequences differ from one CIS country to another. In Central Asia, for example, people trust the authorities much more than in Russia and the other Soviet-successor states in the European part of the former Soviet Union. This has been confirmed by statistical studies that involved 14 post-Soviet states.

The factors that affect the people's subjective ideas about the authorities are numerous: the degree of information openness; the specifics of national mentality; society's psychological mood, etc. All of them help alleviate the shock of a crisis.

The Crisis Revealed that the Economies were Highly Interdependent

It turned out that the Russian and CAC economies were more closely tied to each other than was earlier believed. Trade turnover has slackened, but money transfers, migration, and unofficial shadow deliveries are still going on as an important part of economic cooperation. The crisis has made this even more tangible.

The oil and gas transportation and transit routes can be described as an important factor that continues attracting foreign money despite the crisis.

A Crisis of Genre? Recommendations from International Institutions

What the heads of the international financial institutions have to say about the crisis in the CIS countries sounds ambiguous. Today, the IMF, the U.N., and the WB agree that the CIS economies should have been diversified; that the CIS countries should have been more cautious with respect to foreign borrowing; that they should have moved away from resource export; and that they should have kept their financial sectors in check. This contradicts their earlier recommendations: openness and complete liberalization of the commodities and financial markets.

For a long time we were taught, in full accordance with the comparative advantage theory, that it was much wiser to buy cheap products in the world markets and sell what we had in (relative) abundance, that is, raw materials, mainly oil.

The crisis has taught us that economic stability is better than liberalization that brings about destabilization.

On the eve of the crisis, Russia and Kazakhstan, very much as usual, were offered as liberalization beacons for their less liberalized neighbors; their banks had higher credit ratings; the future was assessed in optimistic terms, etc.

Today, however, Uzbekistan is described as a country that has suffered less from the crisis than its CIS partners. On 19 July, 2009, IMF Managing Director Dominique Strauss-Kahn concluded his visit to Uzbekistan by pointing out "the economy's resilience to the global crisis, which largely reflects the authorities' prudent policies."[12] He said further that Uzbekistan's banking system, unlike those of the other countries, remained free from the negative impact of the world financial crisis and was working more effectively than ever before. The government, said the high-ranking international bureaucrat, had posed itself the task of ensuring even much higher growth rates. In any case, in 2009 the country's economic growth would be one of the world's highest, he concluded.

This leaves us wondering: Are strong institutions more important than precipitous reforms?

For a long time the Soviet-successor states shaped their economies under the strong influence of the Western liberal conservative economic school based, very much like the socialist theory, on fossilized dogmas: large-scale and hasty privatization; the a priori conviction that the state sector could not be effective by definition; minimal state interference; and the efficiency of the market's invisible hand. Today, these postulates are criticized from all sides, including by the leading Western economists.

Today, both Russian and Kazakhstan experts have agreed: the countries need sovereign rather than "split" financial policies. China, which has realized its own, and highly original, conception of economic reforms, turned out to be less scarred by the crisis than many.

Uzbekistan is among the countries whose economy contains a certain share of raw-material branches. It even displays the symptoms of Dutch disease, which means that it should follow in the footsteps of those countries that have already overcome their backwardness through correct policies. We have in mind China, Indonesia, Malaysia, and certain others.

The above does not mean that rich natural resources interfere with economic advance, however they do create greater risks and call for more careful economic steerage.

In fact, the resource-rich states can and should keep the potentially negative impact of their relative resource abundance on economic growth under control. Countries with an inefficient processing sector should not rely solely on the market mechanism, otherwise their future can be described as deindustrialization and slow economic growth.

This means that economic science and politics should address the numerous urgent tasks and rely on corresponding research.

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[12] [http://www.imf.org/external/np/sec/pr/2009/pr09221.htm].