

# Structural Changes in Russian Economy and Objectives of Investment Policy

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Received: March 10, 2015 Accepted: March 31, 2015 Online Published: April 30, 2015

doi:10.5539/ass.v11n11p193

URL: <http://dx.doi.org/10.5539/ass.v11n11p193>

## Abstract

Issues of Russian economy development in the period of economic reforms, tendency of sectorial structure change of national production on different stages of market reformation, reductions of production volumes of advanced technology products in the industries with a high value added are examined in the article. The influence of government policy on the state finances of Russia is considered, the criteria applied for the estimation of reforms realization success are exposed. The analysis of lack of internal credit resources reasons in an economy, forming of national and corporate external debt, and also strengthening of technological dependence of the Russian producers on foreign partners and insufficient stability of the Russian economy in a global competition is conducted.

**Keywords:** economic development, world crisis, Russian economy, government economic policy, investment policy

## 1. Introduction

Modern Russian model of the national economy is a result of its development after the collapse of the Soviet system and its integration into the global economy. During the first phase of its radical transformation in the late XX century the objectives to ensure the irreversibility of market reforms, to create a broad stratum of owners through privatization of state property and the development of small and medium-sized businesses were set.

In the process of Russian integration into global economy there were structural changes, associated with changes in the share of different industries in the production of gross domestic product as well as the decrease of production and scientific potential of the country. Analysis of development of structural changes in Russian economy is essential for assessment of perspectives of its development and for development of recommendations for state economic policy.

## 2. Theory

Issues of forming a single network society were brought up by M. Castells in the late XX century (1996). Research on problems of national economies functioning in conditions of globalization, their integration into a single world economic system was carried out in the works of Stanley Fischer (2003), Guillermo De la Dehesa (2006), George Soros (2002). Research of critics of free integration of national economies into the global economy is reflected in *Free Trade under Fire* by Douglas A. Irwin (2005). Contradictory consequences of Russian economy reforms and its detection to the outside market are analyzed in the works of Russian economists (Gallyamova, Toumashev, & Malaev, 2014; Safiullin, Ismagilova, & Safiullin, 2013), who revealed the presence of significant disproportions that adversely affect the stability of national economy.

Sharpened contradictions between the old branch and territorial structure of the economy and new, market-based in its nature, economic and institutional conditions of foreign economic activity, worsening problems in public finance, growth, external and domestic debt of the country.

Active government industrial policy became unpopular in Russia and in the former Soviet bloc during the years of market reform of Russian economy. The slogan "The best industrial policy - is the lack of industrial policy" was largely sorted well with the practice of economic life of countries of emerging economy. The role of public administration was reducing, public investment in the real sector was declining, the function of the state was limited to consideration of problems of formation of a favorable investment climate and the objectives of

maintaining macroeconomic stability, ensuring the stability of national currency and ensuring a balanced budget. In accordance with the Federal Law "On the Central Bank of the Russian Federation (Bank of Russia)" among the purposes for which the Bank of Russia is responsible, maintaining sustainable growth of the national economy is not included, which distinguishes it from the function range of tasks of the emission center of the United States - the Federal Reserve System is responsible not only for the fight against inflation, but also for economic growth.

Under these conditions there was determined the major tendency of new branch structure of national economy on the basis of local return on equity criteria on the level of individual enterprises. Changes in the structure of Russian production were shown in the reduction of production of high-tech products in industries with high added value, such as machinery, machine tool industry, radio electronics, civil aircraft industry, tool engineering, and in the increase of relative share of raw, export-oriented industries - oil and gas industry, production of fertilizers, rolled sheet and plate steel, ferrous and non-ferrous metals. Revenues from exports allowed to buy imported consumer goods, as well as trade and financial sectors. A large amount of arable land was suspended, a number of livestock was reduced in agriculture, which allowed to export part of grain produced in the country, previously used for the production of animal feed.

The period of the 2000s was favorable for Russia in terms of external economic conditions, the dynamics of world prices for oil and gas as key components of Russian exports. Increase in world prices for hydrocarbons, ensuring the flow of hard currency into the Russian economy, significantly increased budget revenues and allowed to increase domestic demand. This opened potential resource opportunities for the implementation of major investment projects to develop high-tech industries, for the formation of economics of major modern corporations, on the example of closely integrated with the state South Korean economic giants that provided leadership to South Korea in automotive industry, shipbuilding industry, steel industry, the production of household appliances and electronics.

The Russian government chose a different strategy based on integration of national economy into the world economic system as a raw cluster on free market principles, limiting protectionism, folding currency regulation and currency control, focusing on the fight against inflation. If in the 90s macroeconomic stabilization policy was based on the limitations of the ruble mass by its binding to the gold reserves, "real" money, then at the end of the first decade of the twenty-first century the authors of Russian reforms considered reserve currency to be inflationary and harmful for the economy. It was decided to "sterilize" petrodollars incoming to Russia. This didn't so much restrained inflation as limited the possibilities of domestic credit. Funds that could be used to create the state development banks, which could provide the real sector with long-term loans, were derived from the Russian economy. Russian regions, banks and enterprises that suffered shortage of funds had to increase foreign borrowings to finance current expenses. External corporate debt began to increase as the state external debt of Russia decreased. The total external debt was increasing until the beginning of 2014, when due to the imposed sectorial sanctions against Russia domestic financial institutions have lost the opportunity to be credited for more than 30 days (Fischer, 2003).

Table 1. The State and the total external debt of Russia (in billion. US \$)

Дата	State foreign debt	Total external debt
2000, 1 January	158,7	178,2
2001, 1 January	143,7	160,0
2002, 1 January	133,5	146,3
2003, 1 January	125,7	152,3
2004, 1 January	121,7	186,0
2005, 1 January	114,1	213,5
2006, 1 January	76,5	257,2
2007, 1 January	52,0	313,2
2008, 1 January	44,9	471,0
2009, 1 January	40,6	479,9
2010, 1 January	37,6	467,2
2011, 1 January	36,0	488,9
2012, 1 January	34,7	545,3
2013, 1 January	54,4	636,4
2014, 1 January	61,7	727,1
2014, 1 October	48,3	678,4

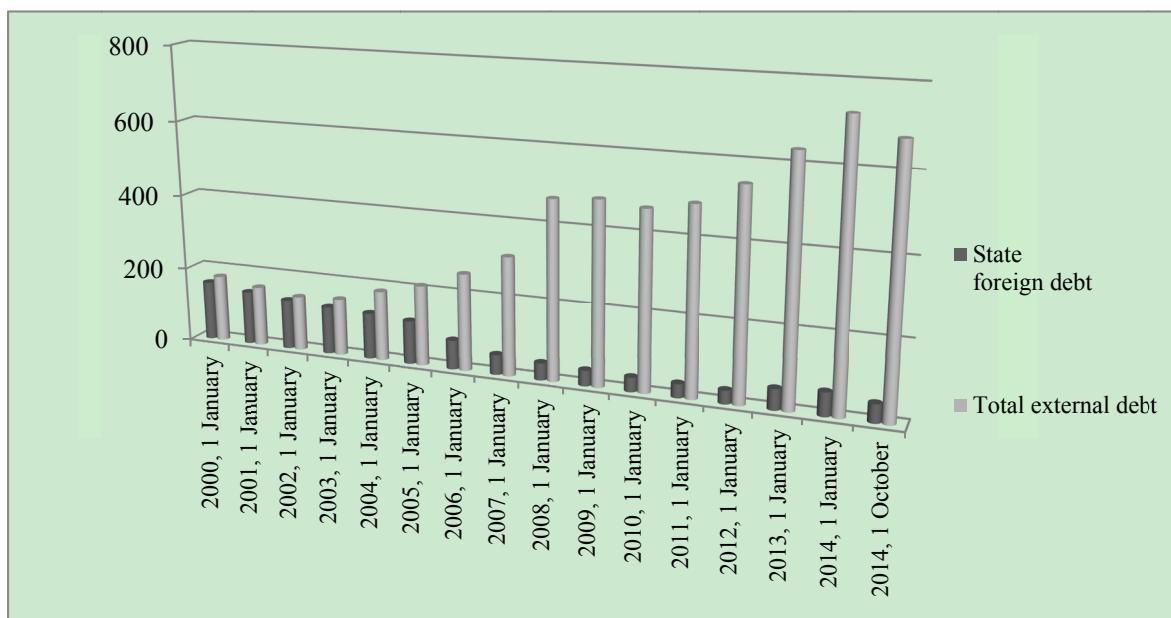


Figure 1. The dynamics of state and total external debt of Russia, (\$US, billion)

Rise in price of credit resources inside the country affected the cost of the real sector. Russian consumers began to pay their attention to foreign suppliers of consumer goods from China and South-East Asia countries, which could offer cheaper goods. National business in the market of investment goods focused on the acquisition of ready to use foreign technologies of complete cycle and not on cooperation with the Russian science. The effect of default of 1998 was lost, production in the Russian Federation became less profitable, import began to increase rapidly, and production non- primary industries moved to China.

### 3. Results

Analyzing the results of structural changes of Russian economy we must see objectives pursued by initiators of economic reforms, and the criteria proposed by them to characterize the stability of the position of the country in terms of its integration into the global economy. They differ from those of standard approaches, in accordance with which the success of the country was evaluated in the period of coexistence and rivalry between the two socio-economic systems and military-political blocs. Traditional assessment of success in economic competition included commensuration and comparative analysis of macroeconomic parameters - total national and industrial production in absolute measures and calculations per capita – as well as a level of technological development in key sectors of the economy – energy industry, machinery, machine tools industry, electronics, creating new materials.

The real aim of the reforms, in line with which we should define success criteria for their implementation, was the closest possible rapprochement with Western civilization, whose economy is seen as the natural order of economic life. The aim was to become part of the technological chain of the West and to integrate national economy of Russia into international supply – supply chain. This was to optimize the structure of production, improve living standards and alleviate social problems. Providing part of rental gas income to increase the level of consumption of majority of population was aimed at creating conditions for political stability.

Assessing the development of Russian economy of the late 90s before the global financial crisis in line with the given criteria it is necessary to ascertain significant improvement. Gross domestic product of the Russian Federation has increased since 1999 from 22.5 trillion. to 41.3 bln. rubles in 2008, up to 1.8 times in nine years (in prices of 2008). Critical decrease of production in 2009 was followed by recovery growth and GDP was 43.4 trillion rubles in 2013 in prices of 2008, which is 1.93 times more than the initial. The task of doubling GDP in 15 years was practically solved, unless we consider its content. Thus, a substantial proportion of doubling the gross domestic product occurred on the financial sector, which carried out a six-fold increase in the gross value added to 3.34 bln. rubles in 2013. In 2002 banks added to GDP 3 times less than agriculture, and in 2013 they provided added value 1.4 times larger. In 2013 agriculture and industry produced a little more than 36% of the total gross value added of the country (Soros, 2002).

Field of services and production of hydrocarbons (which is not associated with the growth of the physical volume of production, but with grown up world market prices) took a larger share of GDP in comparison with Soviet times, manufacturing production reduced much, 18% of GDP is provided by the trade. Nevertheless, GDP per capita at par value of spending capacity reached 40% of the US, problems of satisfaction of needs of population in the available food, clothes were solved, life expectancy has increased, reaching the best indicators of the Soviet period, household appliances became available to public. High rates of housing construction were carried out, motorization developed rapidly, the level and quality of life became closer to European standards, all these formed the optimistic expectations of general public.

To what extent is the achieved welfare stable, is the degree of economic independence in conditions of global competition enough, and what are the prospects for the further development of the existing resource model of the economy? Available food in the internal market nowadays, available clothes and household appliances and electronics in Russian market are the result of industrial development of China and South-East Asia countries, and also the West that shared all its high technologies with them. Auto mobilization in Russia was based on a wide import of European, Korean and Japanese technics in the best case, Complete Knock Down assembly of foreign models in Russia.

Sberbank of Russia wasn't able to purchase controlling stock interest of auto group "Adam Opel AG" from an American auto giant "General Motors" in 2009 in order to modernize the production of automobiles using the technologies of American company. Russia failed to enter the number of countries without restrictions using the latest technological developments in exchange for natural resources.

Inconsistency of the concept of integration to the world economy through the development of technological centers in a narrow segment of the industry became obvious. The pace of economic development began to decline (Brzezinski, 2012).

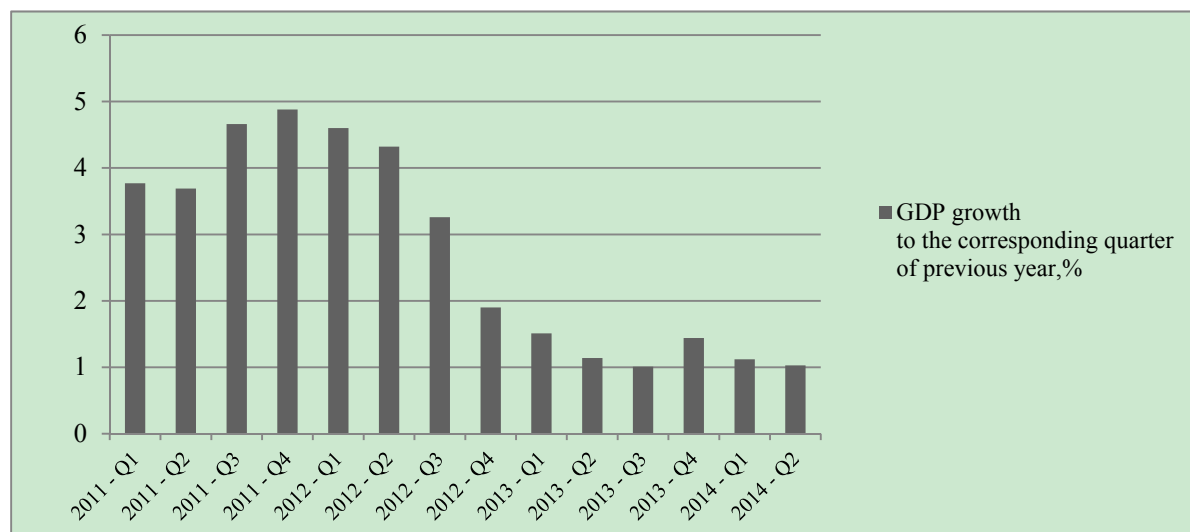


Figure 2. Dynamics of Russian GDP in constant 2008 prices excluding seasonal factors (2011-2014, quarterly, bln. Rubles)

Russia took the pursuer path, copying foreign developments, relying on the results achieved by foreign designers and constructors (Sakhapov & Absalyamova). At the same time, in geopolitical aspect Russia was accepted by many Western specialists as a strategic adversary and rival civilization, which again can be a source of anxiety and sometimes even threaten the safety of some of its neighbors (Brzezinski, 2012).

#### 4. Conclusions

Embedding of Russian economy into the global system was implemented in the form of its entry into the world economy as a raw cluster and local center of consumption.

During the years of reforms there has been a change in the structure of production potential of Russia. We are talking about the loss of some enterprises and the growth of technological dependence prior to successfully developing sectors of Russian economy from foreign technologies, materials and components.

In the context of globalization factors that provide stability of the country in international competition become crucial. Criteria for incorporation into another civilization without the formation of reserves for resource development are secondary.

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