Booms and Busts: Russia and Its Oil, 1970 to 2011 ... and Beyond

Clifford G. Gaddy
The Brookings Institution

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In 2008 Russia had the worst stock market in the world.

In 2009 it had the second-best stock market in the world.
BRIC's GDP Growth 1999-2010
(Growth in US dollars, 1999=100)
World Oil Prices, 1970-2011
(constant 2010 dollars per barrel, quarterly averages)
Russian Oil and Gas Value, 1970-2010

Real (2010) USD bns/yr


$0 $100 $200 $300 $400 $500 $600
• Late Brezhnev era, Gorbachev, Yeltsin, 1981-1999
  1) 18 years of shrinking rents.
  2) Loss of control of rents.

• Putin era, 2000-
  1) New rent explosion.
  2) Control of rents regained.
How Did Putin Do It?

- Did NOT re-nationalize Russian economy.
- Putin is not a “crypto-Soviet” leader.
- He knows that market economy is superior.
- Needs private owners, market economy, to make Russia competitive.
- Dilemma: How to harness the private owners and make them work for you.
• Putin inherits “Oligarchic Capitalism” from Yeltsin.

• 1996 - “Loans for Shares” mean oligarchs rule Russia.

• 1996 - Putin arrives in Moscow, a virtual nobody.

• 1997-98 - oligarchs on the brink of mutual destruction.

• 1997-98 - Putin acquires means to save the oligarchs ... and subject them to his System.
The Oligarchs’ Problem

• The weapon the oligarchs were stockpiling to use against each other was financial information, financial intelligence.

• This was the potentially most destructive weapon.

• It was “mutually assured destruction” - not between just two or three, but an entire group. And they had already started the war (the “Bankers’ War”).

• Ultimate brinksmanship, “Cuban Missile Crisis.”
Putin’s Attitude Toward Oligarchs

The stratum of truly leading entrepreneurs in Russia is “very thin and very precious . . . they are the bearers of capital, of intellect, of technologies.”

“The oil men are no less important than the oil; the state has to make the most of them both.”

-- Putin aide Vladislav Surkov, summer 2000
A Deal of Mutual Advantage

• For the oligarchs, Putin is their only hope for continued survival and wealth.

• For Putin, the oligarchs represent the mechanism through he can ensure maximum creation of rent and its effective distribution.
Details of the Deal

- Keep property
- Manage with virtually no interference
- Grow the companies
- Get personally richer
- Be protected against expropriation – or worse!

- Pay taxes – in cash, in full
  - Don’t try to change tax laws
  - Don’t collude with governors

- Share wealth informally
  - “Excess costs” (keep addicts happy)
  - Philanthropy

- Let Putin make strategic decisions (esp. foreign)
Putin’s System

• This is real meaning of “Kremlin, Inc.” or “Russia, Inc."
  – A tiny number of individuals – including private owners – who run entire economy
  – They are in turn controlled [monitored] by a nine-man board of directors: Putin + 2 first deputy prime ministers + six deputy prime ministers.

• Medvedev?
  – Not particularly important?
The Key to Putin’s System

• In contrast to a classic mafia-style “protection racket” (extortion), Putin offered something the oligarchs desperately needed: protection against each other!

• They were about to mutually self-destruct. He gave them a way out.

• That is why it has been so stable.

• (Lucky Luciano’s “National Commission”)
Next steps: Meet priorities for rent use

- Priority 1: sovereignty
- Priority 2: stability

For each:
- Step 1: regain
- Step 2: secure and protect
- Step 3: enhance
Sovereignty: Soviet Lesson for Today’s Russia

• USSR did not collapse because defeated militarily
• Collapsed because lost political sovereignty
• Lost political sovereignty when lost financial sovereignty
• Lesson: Restore financial sovereignty!
Achieving Sovereignty

• January 2000
  – $8.5 billion in foreign exchange reserves
  – $133 government external debt

• Mid-2008
  – $600 billion in forex reserves
  – Debt is around $30 billion

• Key date: January 2005
  – Paid off IMF debt 3.5 years ahead of schedule
"Reversing the Leverage": Russia's Foreign Debt and Reserves

![Graph showing government foreign debt and foreign exchange reserves from 2000 to 2008. The graph indicates a significant increase in reserves under PUTIN-II compared to PUTIN-I.]
Simplest indicator of sovereignty - therefore independence of foreign policy -- is size of foreign exchange reserves

• Although drawn down in crisis, Russia’s are still the third largest in the world

• (Only China and Japan bigger)
Stability: Sharing the Rent

- Total value of oil and gas shared in society in different ways

- Main distinction: formal and informal rent-sharing
Rent Sharing

Total Rent

- after-tax profit
- formal taxes
- informal taxes
- price subsidies
- excess extraction cost
- natural extraction cost

pre-tax profit

reported cost of production
Khodorkovsky

• Founding member of Oligarchs’ Club

• Initially, Poster Boy for Putin’s Deal

• Later decides there is better way:
  – Transparency
  – Formality

• Khodorkovsky’s alternative model unacceptable

• Arrested fall 2003
  – Now in GULAG
For the rest, a pretty good deal:

Consider *Forbes* “Billionaires List”

2000: 4 Russians,
      total wealth $12 billion

2008: 87 Russians,
      total wealth $470 billion
Most Important Issue for Russia: What Will Future Rents Be?

- Rent = Price x Quantity
- Russia does not control world price
- No one knows the future oil price
The Real World Price of Crude Oil, 1880-2010
(annual average prices in 2010 dollars)
Russia does control quantity, but there are issues:

- Western Siberia - “easy oil” - “legacy oil”
- Eastern Siberia, Far East, Arctic completely different
- No infrastructure
- Much colder, more remote (“Siberian Curse” thesis)
Running out of oil?

“Yes” and “No”

• YES: Definitely running out of “legacy oil”

• NO: Actual amount of oil in East could be huge. No one yet knows.
But if believe main price forecasts, not a bad future for Russia
The Real World Price of Crude Oil, 1870-2030
(annual average prices in 2010 dollars;
historical prices 1870-2010, IEA forecasts 2011-2030)
Soviet/Russian Oil and Gas Rents, 1970-2030
(Billions of 2009 dollars)
Implications for international behavior:
Bad news for those who think economic crisis will make Russia docile again ("Good Russia" of Yeltsin era)

- Fundamental economic health is NOT a prerequisite for Russia’s “assertiveness” or even “aggressiveness.”
- Only need political sovereignty
- Putin achieved that
- **He will not sacrifice sovereignty**
Selected National Stock Markets, January 2000-present

Current (April 15, 2011) dollar value of $100 invested in January 2000

- Inflation-proof bond: $132
- Japan: $62
- Britain: $86
- USA: $91
- Germany: $146
- Hong Kong: $141
- China: $244
- India: $362
- Brazil: $475
- Russia: $1,169

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