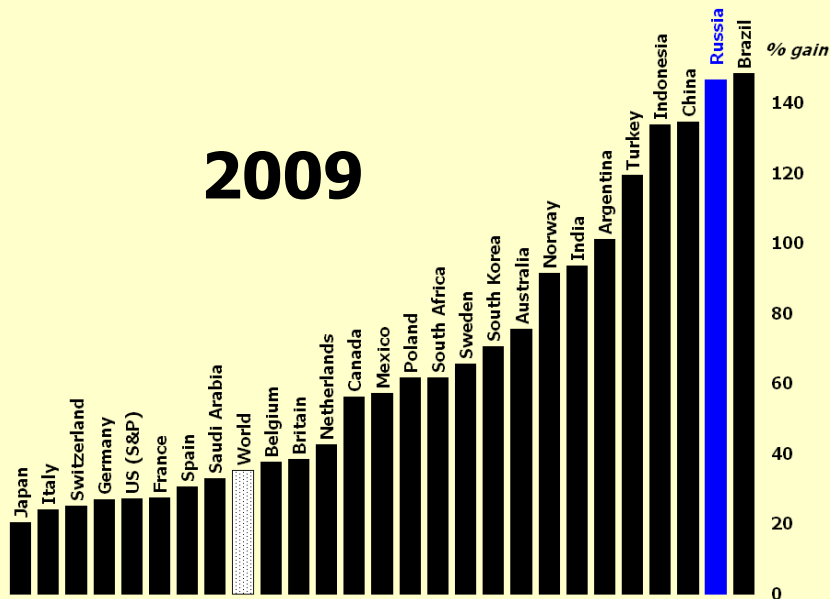
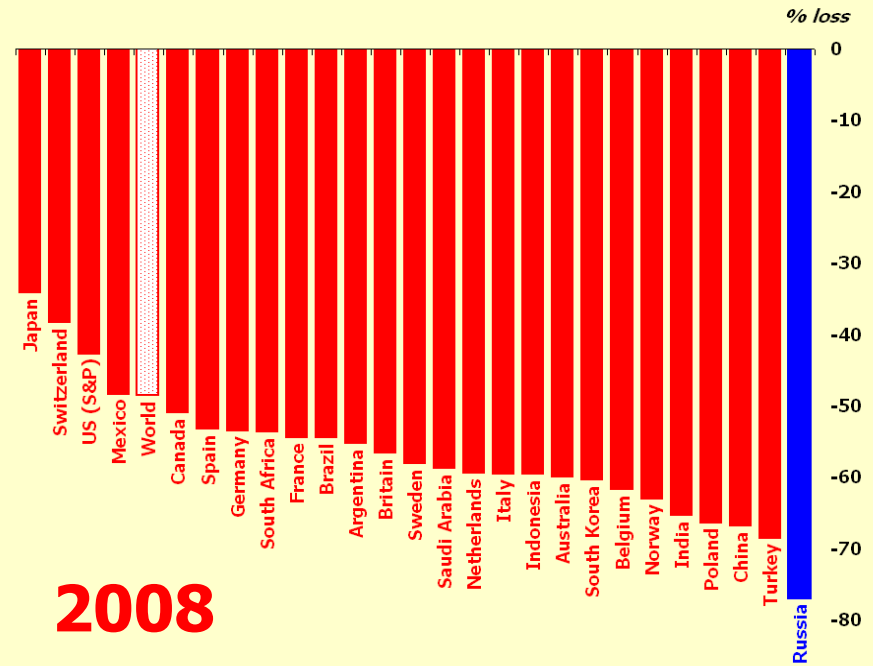


Booms and Busts: Russia and Its Oil, 1970 to 2011 ... and Beyond

Clifford G. Gaddy
The Brookings Institution

Brookings Mountain West Lecture
University of Nevada, Las Vegas
April 19, 2011

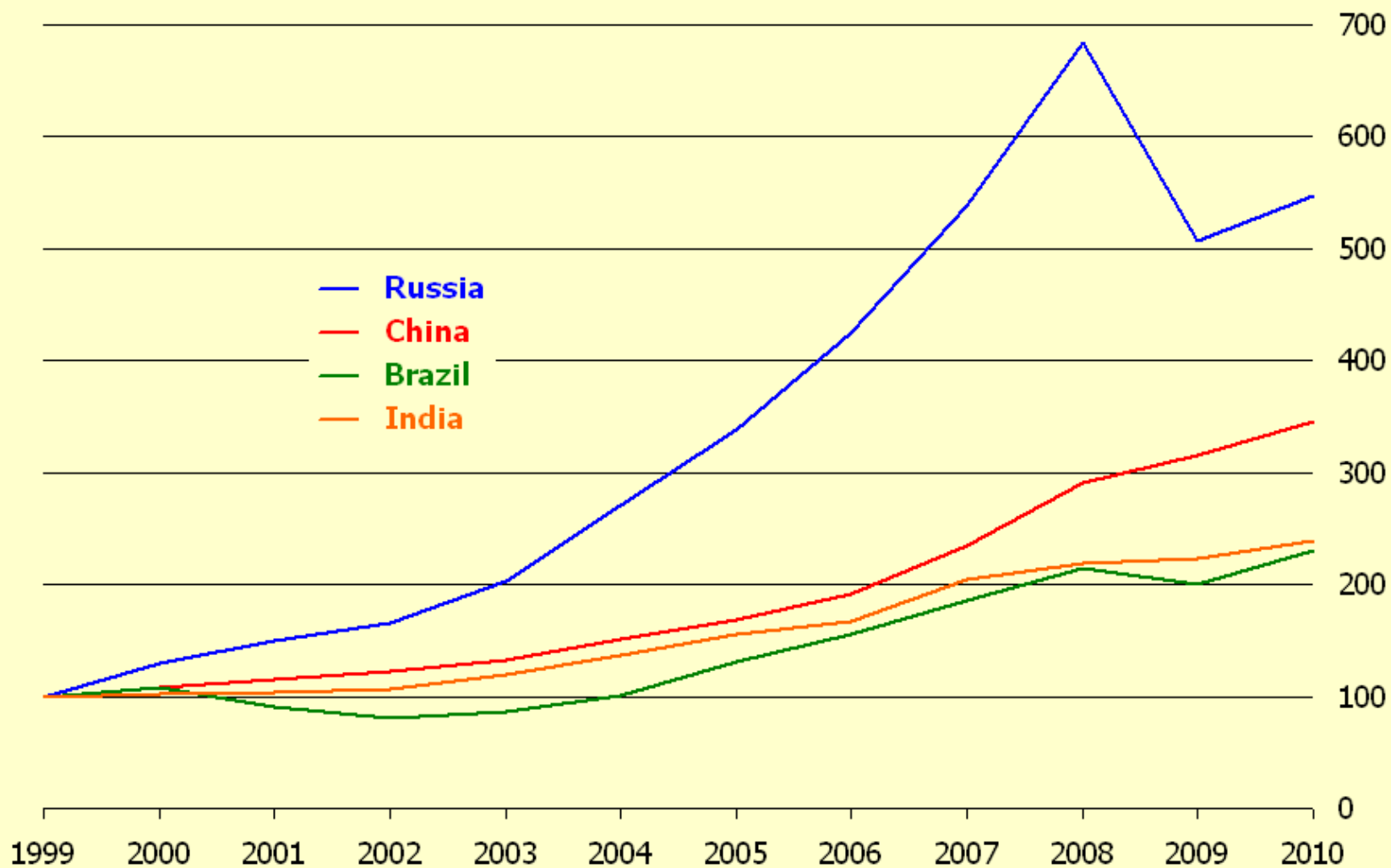
In 2008 Russia had the worst stock market in the world.



In 2009 it had the second-best stock market in the world.

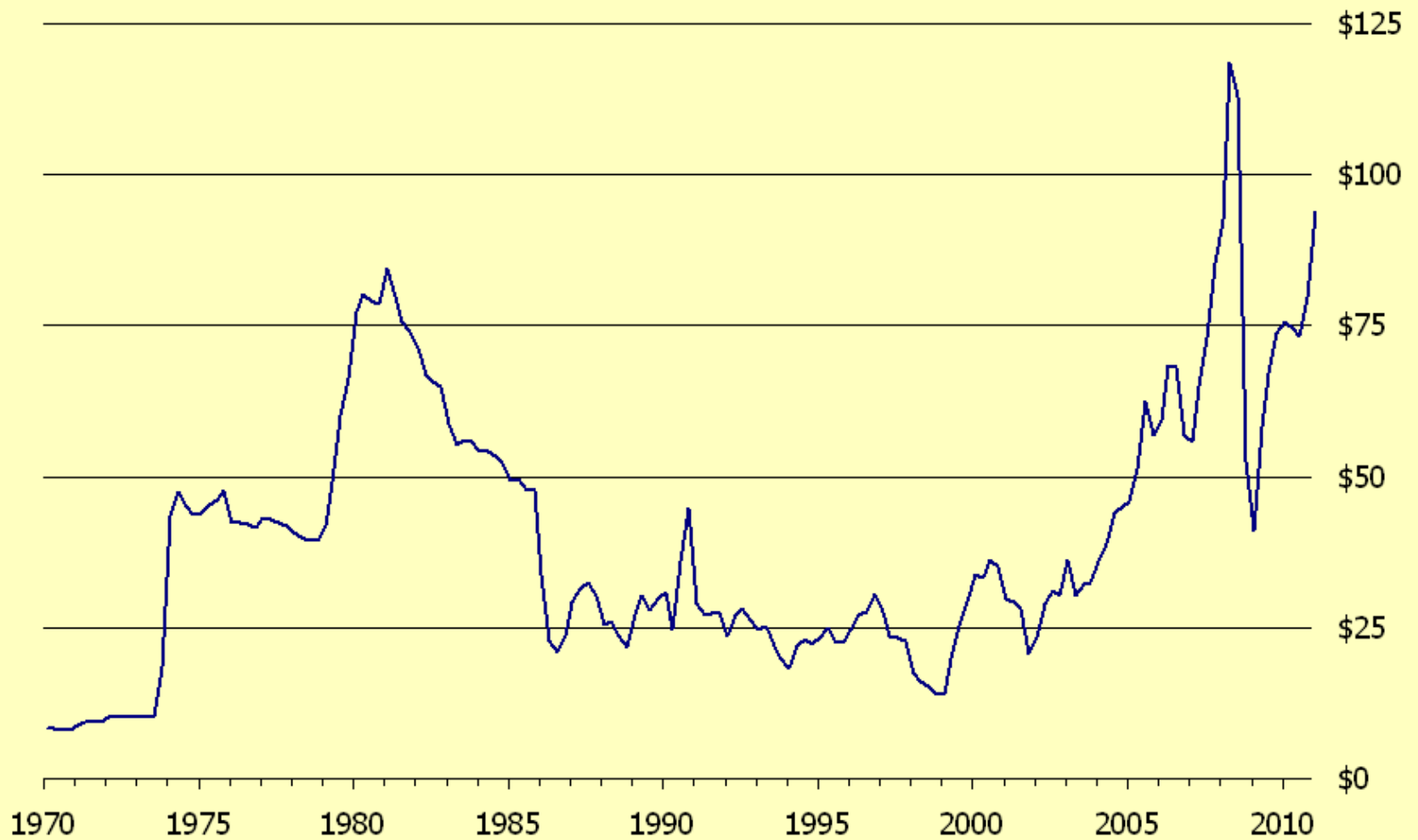
BRIC's GDP Growth 1999-2010

(Growth in US dollars, 1999=100)



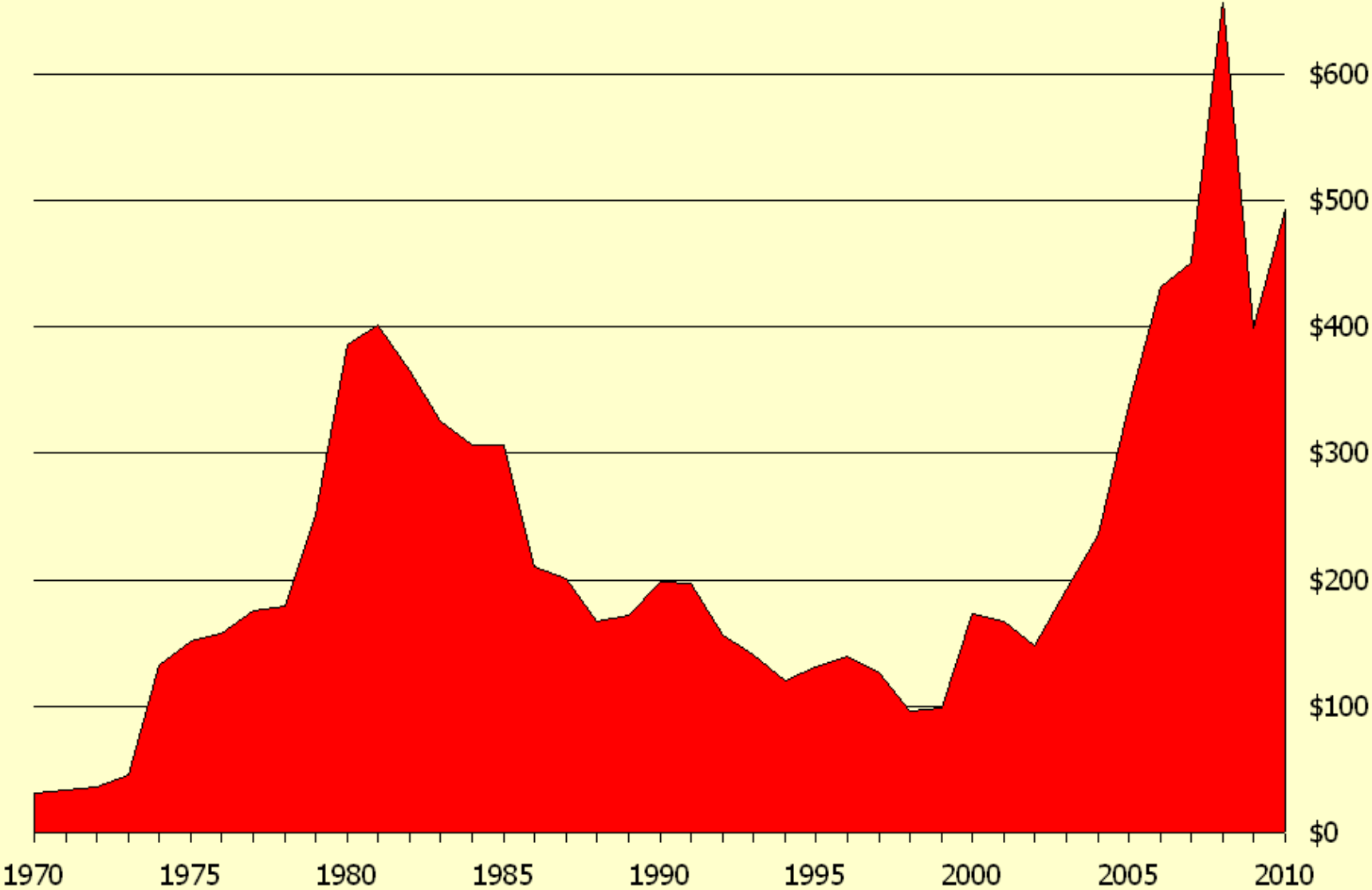
World Oil Prices, 1970-2011

(constant 2010 dollars per barrel, quarterly averages)



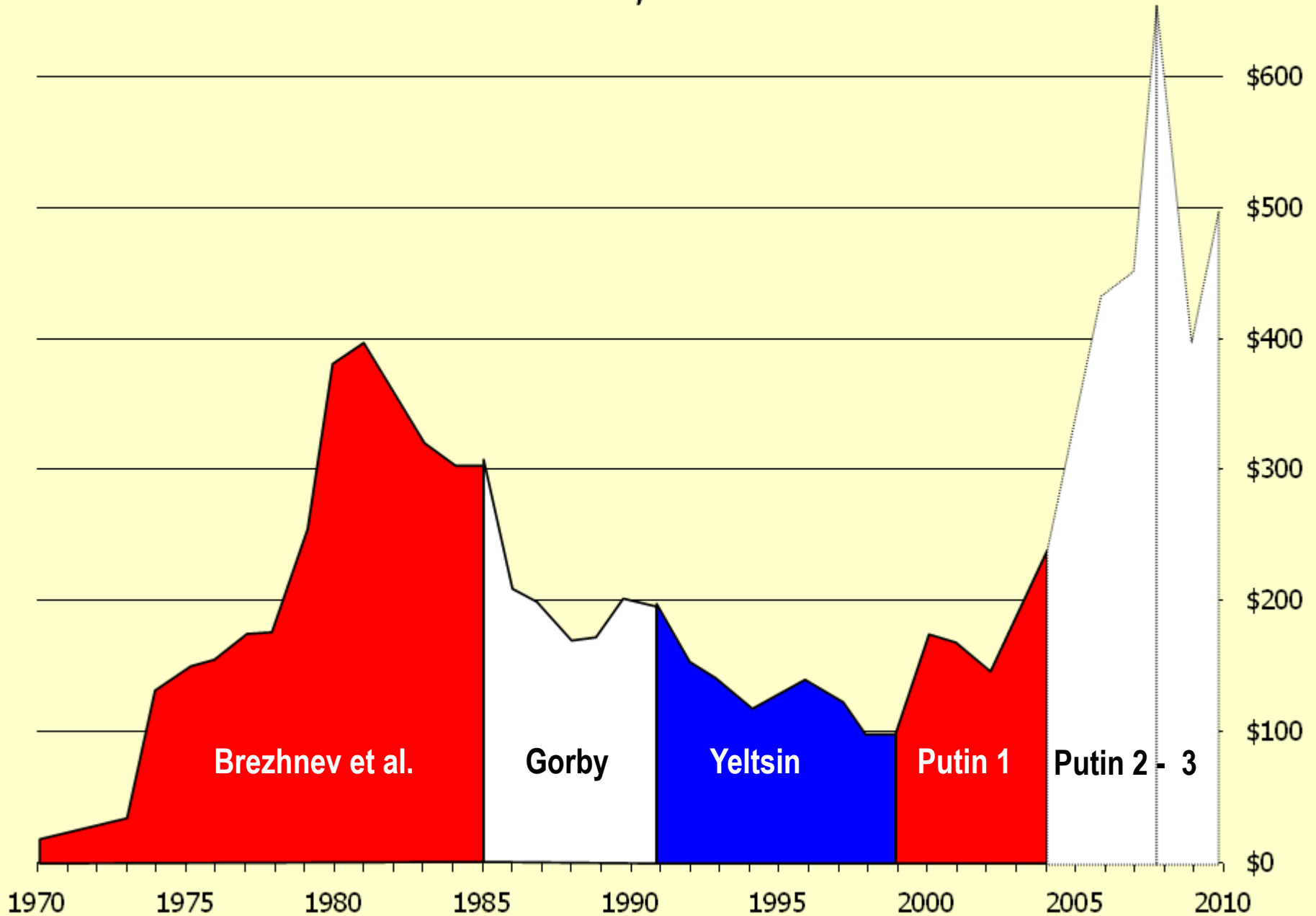
Russian Oil and Gas Value, 1970-2010

*Real (2010)
USD bns/yr*



Russian Oil and Gas Value, 1970-2010

*Real (2010)
USD bns/yr*



- 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 Don"



"The Underboss"



"The Consigliere"



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

USD Billions



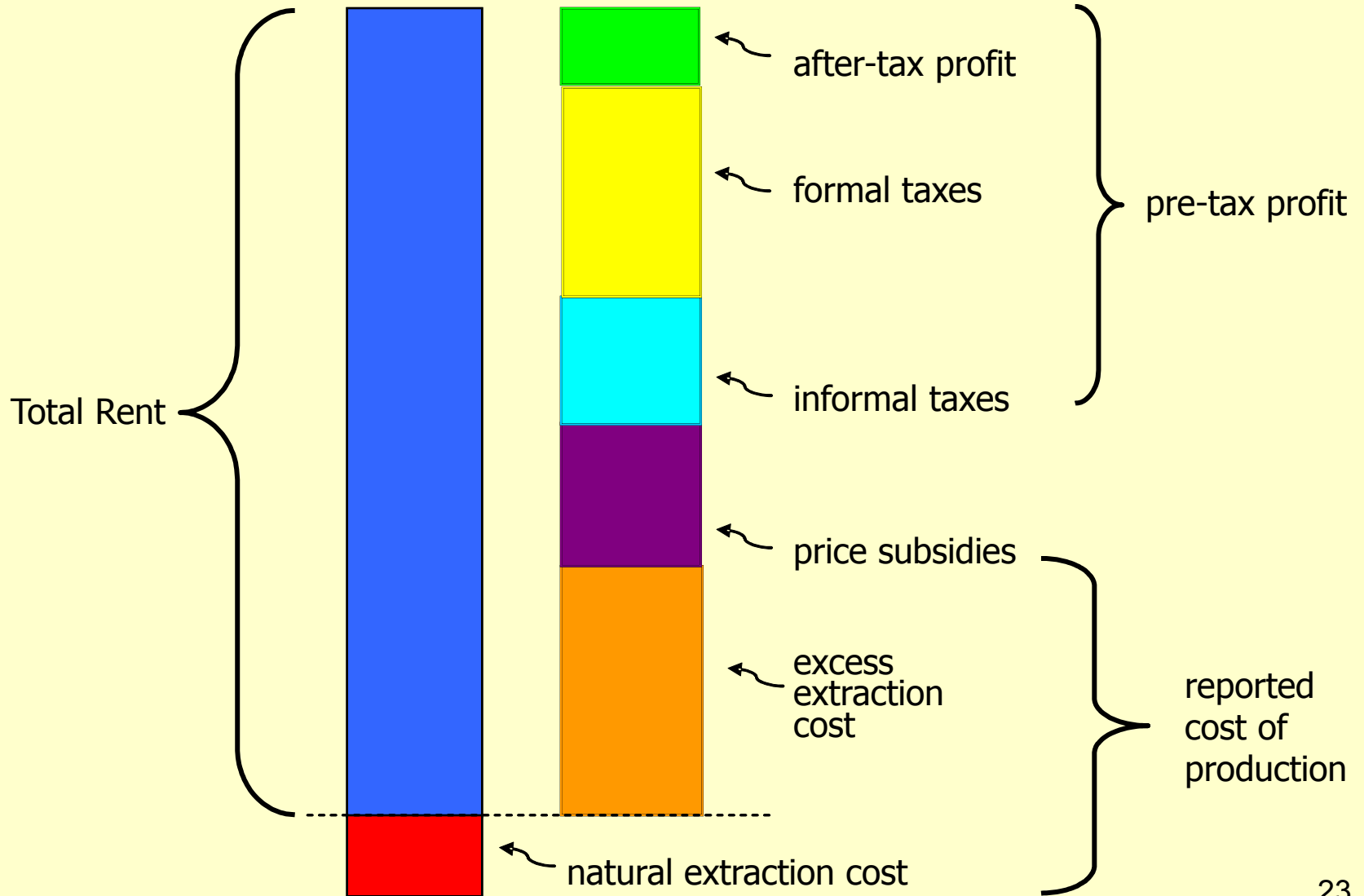
Simplest indicator of sovereignty -
- therefore independence of
foreign policy -- is size of foreign
exchange reserves

- 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



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

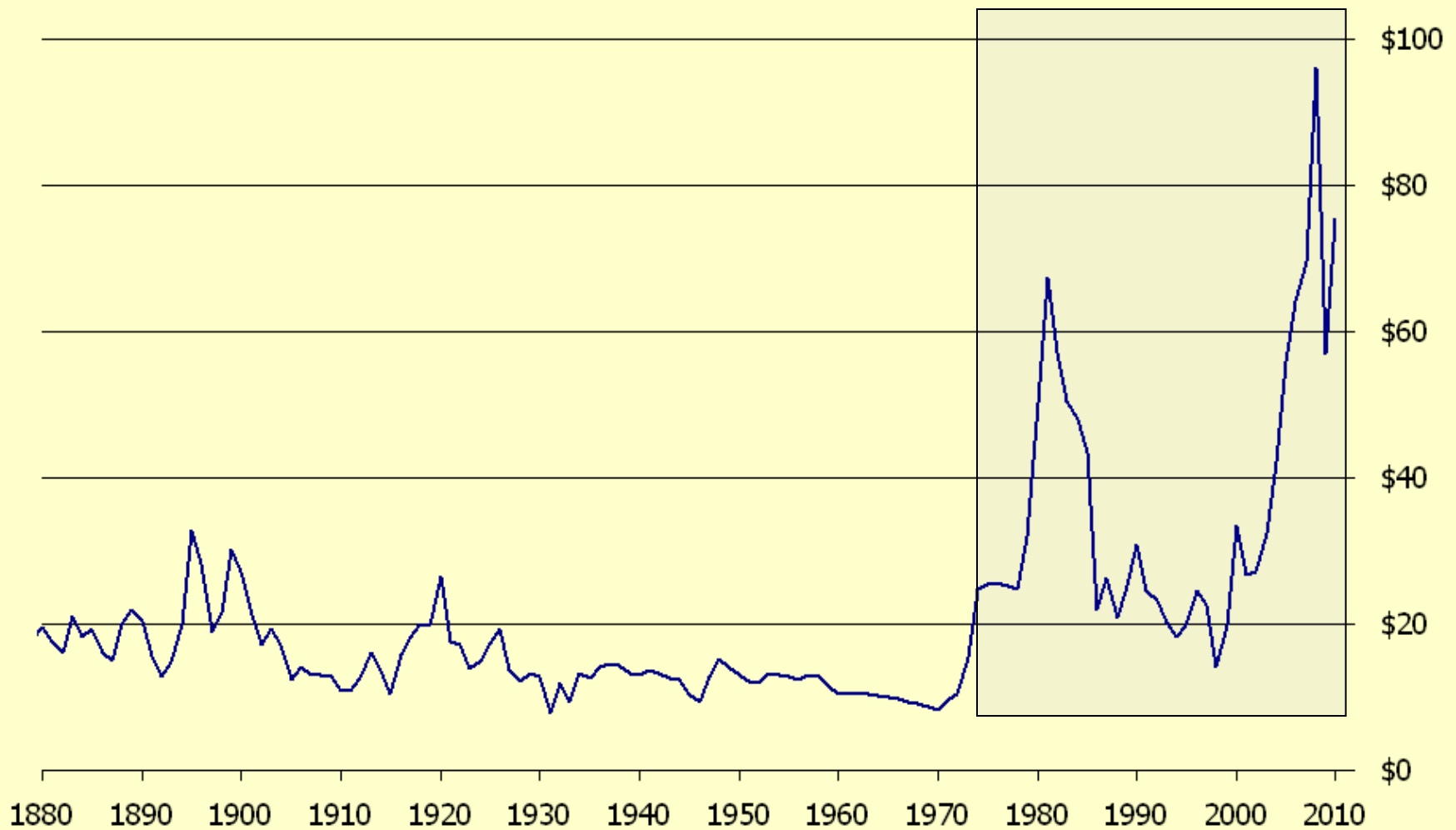
2008: 87 Russians,
total wealth \$470 billion

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?

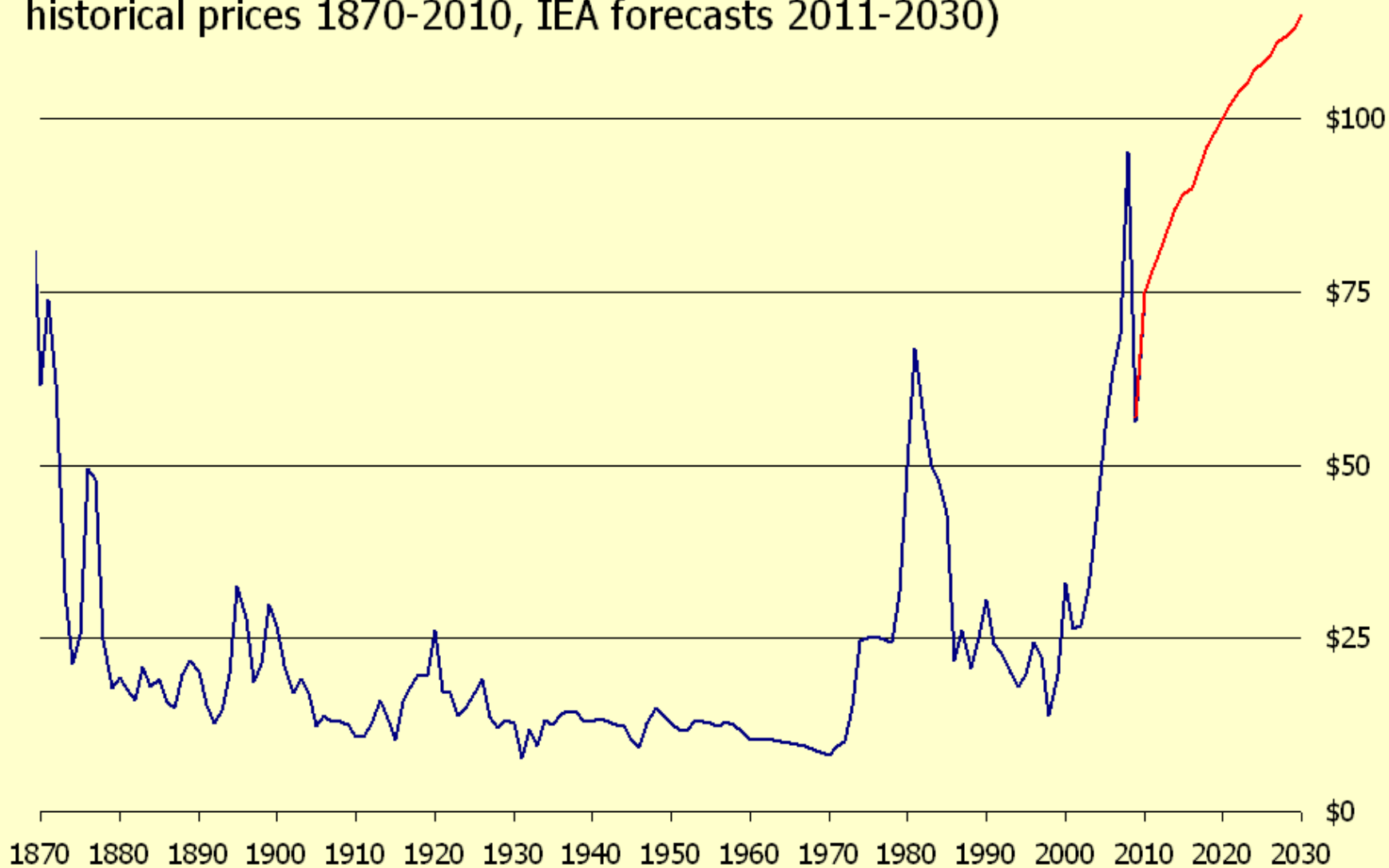
“Yes” and “No”

- 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

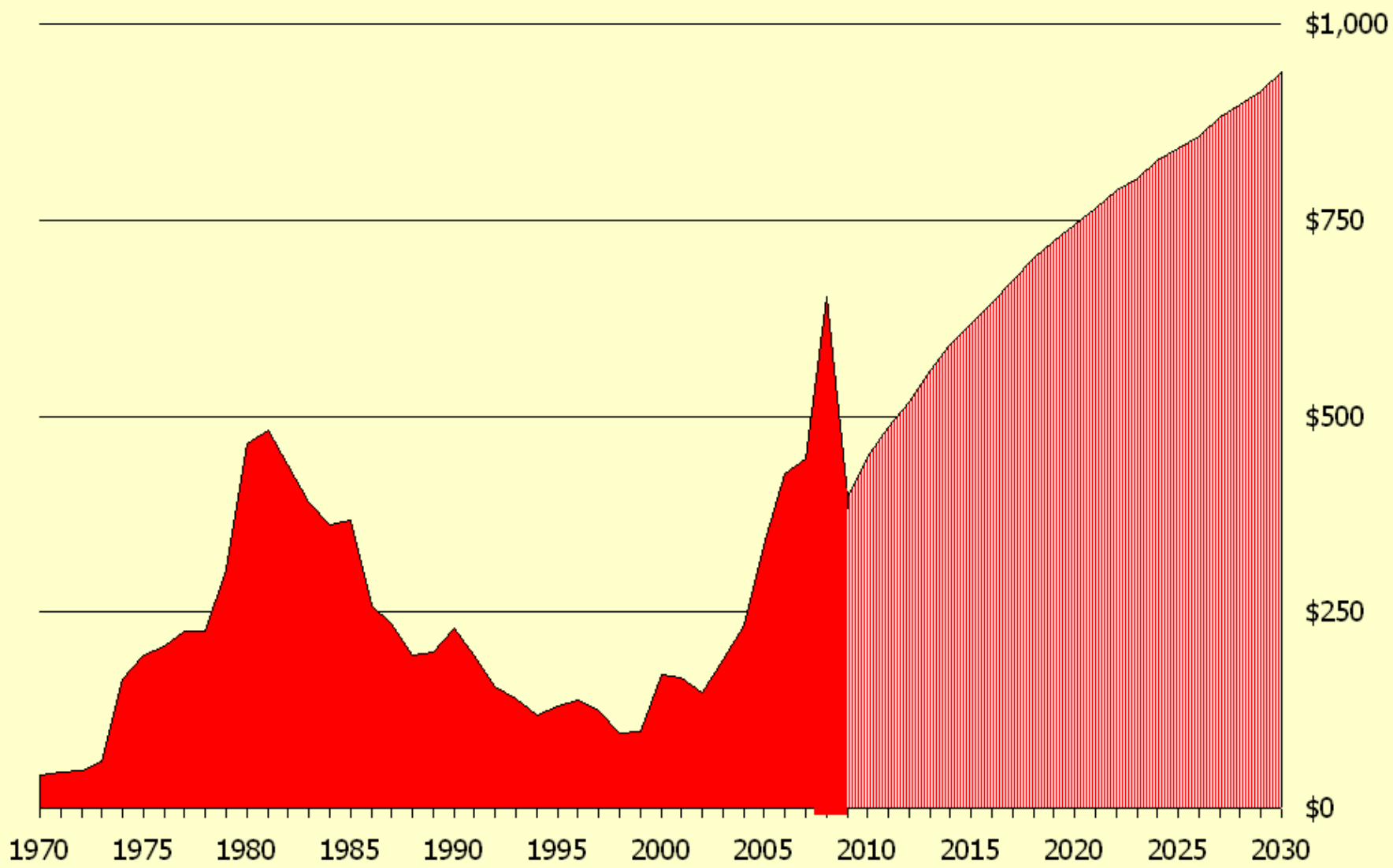
(annual average prices in 2010 dollars;
historical prices 1870-2010, IEA forecasts 2011-2030)



Soviet/Russian Oil and Gas Rents, 1970-2030

(Billions of 2009 dollars)

USD bns/year



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

