

The Economy of Russia and Other Post-Soviet Countries

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This study guide is aimed at introducing to its reader basic tendencies and problems of Russia and other post-Soviet countries along with the introduction of logics and analysis tools of the national economy.

In the first chapters of the unit II main features of Russian economic model, rates and proportions of Russian economy, investment and fixed assets, human capital, economic policy of modern Russia are considered. In other chapters real, financial, external, social sectors of Russian economy are analyzed.

In the other units (III-VI) of the guide other post-Soviet economies such as East European, Transcaucasian, Central Asian and the Baltics are described.

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INTRODUCTION

This study guide is aimed at introducing to its reader basic tendencies and problems of the post-Soviet countries along with the introduction of logics and analysis tools of the national economy (for that purpose the study guide begins from the unit I concentrated on analysis methods of a country economy).

Post-soviet countries are analyzed by regions (more definitely, by sub-regions), i.e. Russia (due to economic, demographic and geographic size it is analyzed as a separate economic region), the other three post-Soviet republics of Eastern Europe, Transcaucasia, Central Asia, and the Baltic states. Within each region (sub-region) there are a lot of differences between countries but a lot of economic similarities as well and that allows considering them together.

As for the whole post-Soviet territory, after the demise of the Soviet Union it is neither an economically nor politically integrated economic region of the world, which was the Soviet Union. It is rather a territory consisting of the separate sub-regions mentioned above. This point is justified by the Baltic countries that have already joined another economic region of the world – the European Union as well as Ukraine, Moldova and Georgia that are eager to join it.

In the meantime within the post-Soviet territory there are close economic ties growing into a formed economic integration between many other countries. This is the case for the Eurasian Economic Union, which has already united five countries (Russia, Belarus, Armenia, Kazakhstan, Kyrgyzstan), with a view of some other post-Soviet countries joining it.

Finally, it is useful to compare different post-Soviet countries (preferably of the same economic level, of course) with regard to their economic progress for the quarter of a century gone after the collapse of the USSR. Economic comparative studies provide a lot for the national economy analysis.

Authors hope that their book could help its readers to gain knowledge about the economy of Russia and the countries of the post-Soviet territory

as well as to develop skills in the economic country analysis. Your feedback could be helpful for us, so please forward it to the e-mail: bulatov@mgimo.ru.

UNIT I

THE FOUNDATIONS OF ECONOMIC ANALYSIS BY COUNTRY

CHAPTER 1

THE ECONOMIC MODEL OF A COUNTRY

The Notion of a National Economy

The economy of a given country is an economy defined by national borders. So the Russian economy is that which exists within Russia's borders and, similarly, the economy of the Union of Soviet Socialist Republics (USSR) was that which existed within the borders of the now defunct USSR.

Talk of a country's economy might also need to take account of separate parts or territories of that country that enjoy economic autonomy and thus differ significantly from the economy of the country as a whole (e.g. Greenland in Denmark, Hong Kong in China). International economic organizations include such territories in the statistics they publish on the countries in question, explaining that by countries they mean not only states but some territories as well.

In addition, there are administrative-territorial entities that consider themselves to be states but which are not regarded as such by other countries around the world, but are seen merely as regions (e.g. Taiwan, which calls itself The Republic of China). Such entities also exist within the territory of the former Soviet Union. When analyzing such economies, it is better to proceed according to whether your own country recognizes the entity in question as a separate state or not. Thus, for example, Russia recognizes the independence of Abkhazia and South Ossetia, but considers Nagorno-Karabakh to be a territory of Azerbaijan, and Transdnistria to be a territory of Moldova.

The Typology of National Economies

Around two hundred national economies exist in the world today. These can be divided into the developed and the less developed. These groups can be regarded as two economic systems or as two subsystems if we regard the global international economy as a single system.

Developed (advanced) economies are characterized by high levels of economic development. The International Monetary Fund (IMF) identifies 39 advanced economies out of 193 member countries of the IMF:

	1	USA
Euro area	19	Austria, Belgium, Germany, Greece, Ireland, Spain, Italy, Cyprus, Luxembourg, Malta, the Netherlands, Portugal, Slovakia, Slovenia, Finland, France, Latvia, Lithuania, Estonia
	1	Japan
Other advanced economies	18	United Kingdom, Republic of Korea, Canada, Australia, Taiwan Province of China, Switzerland, Sweden, Singapore, Hong Kong SAR, Norway, Czech Republic, Israel, Denmark, New Zealand, Puerto Rico, Macao SAR, Iceland, San Marino

Other organizations offer different definitions of which countries qualify as developed. The Organisation for Economic Co-operation and Development (OECD) includes its 35 members (among them Hungary, Mexico, Poland, Turkey, and Chile). The United Nations (UN) excludes Israel and the newly industrialized Asian economies, but includes all members of the European Union (EU), some of whom — Bulgaria, Hungary, Poland, Romania, and Croatia — are less well developed.

All other economies across the world are regarded as less well developed or, by the IMF classification of countries, as emerging markets and developing economies. The World Bank classifies economies as low-income, lower-middle-income, upper-middle-income, or high-income (most of which are developed economies) based on gross national income per capita.

These are usually divided into two subgroups: developing countries (those with a forming market) and emerging economies. Over 130 economies belong to the first group, with around two dozen in the latter group; these are mainly countries transiting from socialist to market economies. This

includes those former socialist countries of Central and Eastern Europe that do not qualify as developed, along with all the countries of the former Soviet Union (except the Baltic states) and Mongolia. China and Vietnam should in practice be seen as emerging economies, but their governments deny that capitalism is being formed there and so prefer to be classified as developing. Socialist Cuba and North Korea can be regarded as emerging.

Thus, in order to place a national economy in one or another group, it is necessary first to ascertain its level of economic development. This can be done by analysis of key economic indicators such as gross domestic product (GDP) or gross national income (GNI) per capita, and the structure of industrial output. Let us consider these indicators in more detail.

Gross Domestic Product and Gross National Income per capita

With the help of the added value method, GDP measures the quantity of goods and services produced within a country. By contrast, GNI shows the amount of income earned by the residents of a country along with their net primary income (that gained from output and property) with regard to their settlements with other countries. In most countries GDP is normally higher than GNI, but in some the reverse is true.

To make comparisons between different countries, GDP and GNI are usually expressed in US dollars, the most widely used currency. Even though our purpose here is to compare economic development of former Soviet countries, it would still be incorrect to convert figures in dollars to rubles — even at a nominal exchange rate — as exchange rates are exposed to fluctuations. Moreover, prices for goods and services differ from one country to another. To achieve an accurate comparison, a survey, the International Comparison Program, is carried out under the auspices of the UN every three years. This survey captures the prices of a basket of 3,000 named goods and services in different countries and compares the cost with the price of the same goods in the USA (corrected for differences in quality). Thus, by comparing the price of the basket of goods and services in one country with the USA, the value of that country's currency can be determined in relation to the dollar. This rate is called purchasing power parity (PPP). This PPP rate is a better indicator than a nominal rate in less developed countries as the prices for the majority of goods in these countries tend to be lower than in the USA.

In the years between surveys, national and international organizations extrapolate the PPP. The Federal State Statistics Service of the Russian Federation calculated Russian GDP PPP per capita in 2016 at US\$23,163 (at an exchange rate of P25.33 to the dollar).

However, in many countries, the national statistical organizations do not carry out such calculations. So, for comparisons between countries, World Bank statistics are usually used. However, the World Bank often calculates the PPP using GNI rather than GDP and places a strong emphasis on average annual calculations, thus avoiding strong annual fluctuations that can be seen with GDP PPP as a result of changes in currency exchange rates. According to the Bank, Russia's GDP PPP per capita of US\$24,451 in 2016 was at approximately the same level as countries at the bottom of the IMF list of developed countries, e.g. Lithuania (US\$29,996), Estonia (US\$29,365) and Latvia (US\$26,031). Among the former Soviet countries, the lowest GDP PPP per capita was recorded in Kyrgyzstan (US\$3,551) and Tajikistan (US\$2,980), putting them close to countries in Africa.

Industrial Structure of Output

The contribution of different sectors to GDP changes as a country experiences economic development. The primary sector (agriculture, forestry, hunting, and fishing—often referred to simply as ‘agriculture’), which has dominated for hundreds of years, reduces in significance. The secondary sector (industry, construction, power, gas, and water supply—usually referred to as ‘industry’) which shot up during industrialization is now decreasing as the third sector (services) increases as the country transitions to a post-industrial model. There are, however, some variations in this pattern.

Primary sector production decreases in developed countries, firstly because demand of the sector's products sees slow growth in these countries due to high saturation in demand for food and improved performance from the use of industrial methods in the sector. The contribution to GDP of this sector ranges from 1% (USA, Germany) to 3% (Spain, Finland). In less developed countries this sector contributes more to GDP, except for the countries with a poor natural environment. For example, the primary sector contributes 4% of GDP in Russia, where there is no issue of high saturation of demand for food supplies and performance in this sector is not high—demonstrated by the fact that this sector accounts for 7% of national employment, but only contributes 4% to GDP. In the most developed former Soviet countries, these figures are broadly

similar, and in the less developed countries they are much worse, especially in the central Asian republics. In Tajikistan, the primary sector accounts for 60% of employment but contributes just 30% of GDP.

The secondary sector has seen its contribution to GDP fall by 20–30% over the last decade, due to stronger growth in the tertiary sector and to the closing down of many industrial facilities. This latter phenomenon is often called ‘deindustrialization’. In developed countries, it is seen mostly in ‘simple’ or ‘dirty’ sectors, such as mining. The economic losses of the process are partly mitigated by growth in advanced technological sectors.

There is significant diversification in the way this trend plays out in the former Soviet countries. The contribution of the secondary sector varies from 17–22% in Moldova and Tajikistan to 42–62% in industrial Belarus and oil and gas producing Azerbaijan. However, the contribution of the secondary sector to GDP is falling in the majority of former Soviet countries. Moreover, in many countries of the Commonwealth of Independent States (CIS), deindustrialization is characterized by deterioration in the structure of industry due to a reduction in high-technology sectors (especially engineering) and their replacement with the ‘simple’ and ‘dirty’ sectors like mining. Thus, in Russia, the contribution of the secondary sector to GDP went down to 36%, due less to growth in the tertiary sector than to reduced production in manufacturing, especially engineering, and in the consumer goods industry. (Some estimates suggest that, without the falling in manufacturing production, the contribution of the secondary sector would have fallen far less, remaining at around 46%.)

A majority of countries have a functioning tertiary sector. But the structure varies. In developed countries its structure is appropriate to a post-industrial economy: it includes branches such as education, medical care, financial, business and professional services. In the USA, 50% of people employed in services are involved in the latter categories (financial, business, and professional). More conventional industries, e.g. trade and transport, account for 24% of the services workforce. In less developed countries the picture is somewhat different. In Russia, 40% of those employed in services work in the former sectors (e.g. education and medical), due to only a small number of people working in financial services. Other branches of the services sector also account for around 40% of those employed, due in part to Russia has a larger proportion of the services sector workforce involved in trade than in the USA. Over the whole economy, Russia has 15% of people working in trade, compared with 14% in the USA.

The Notion of a National Economic Model

The next step in analyzing a national economy is to identify the characteristics of the country's economic model. A country's model is its specific economic mechanism that distinguishes it from its neighbors and from other countries at a similar level of economic development.

We need to clarify some of the specifics of this notion. Why is it important to compare a country's economic mechanism with that of its neighbors and with other countries at a similar level of economic development in order to identify its specific characteristics? We do this because of the way different objective laws operate at difference levels of development (e.g. rates of economic growth in developed countries are lower than in countries that are catching them up. But these latter countries will see lower levels of growth when they achieve the level of development seen in the most developed countries.) Comparison with neighboring countries can sometimes be inappropriate if two countries are at different levels of development. But such countries often have a number of features in common. This is why we often compare Russia with other former Soviet republics. Finally, the analysis also benefits from a comparison of the country in question with the leading economies around the world. It is also useful to compare economies of similar sizes.

How can we identify the specific character of the economic mechanisms in a country in order to define the national economic model? To achieve this, it is appropriate to focus our analysis, not just on a country's economic mechanisms, but also on its social, ethical, and political mechanisms as these have a noticeable influence on economic mechanisms.

Methods of Analyzing Specific Characteristics of a National Economic Model

To analyze specific characteristics of a country's economic mechanisms, we can select different economic indicators independently from national and international statistics. If looking for already prepared sets of indicators, one of the most useful is likely to be the *Global Competitiveness Report* produced annually by the World Economic Forum (WEF), an international non-governmental organization. The report is based on national statistics and interviews with local entrepreneurs in 140 countries. It gives each country an overall competitiveness score on a scale from 1 to 7. A total of 114 indicators are used to calculate the score. As well as the

overall score, a further 12 sub-indices are produced giving greater insight into the individual characteristics of each country's economic structure.

To illustrate this, let us look at the example of Russia and compare Russia's sub-indices with those of other countries at a similar level of economic development.

Table 1.1 — Index of global competitiveness and its sub-indices in Russia and other countries with a similar level of economic development

	Russia	Poland	Turkey	Kazakhstan	<i>Memo:</i> USA
Index of global competitiveness (on a scale of 1 to 7, where 7 is the highest. The number in brackets gives the rank of a country on the list of 138 countries)	4.6 (38)	4.6 (39)	4.4 (5.3)	4.3 (57)	5.9 (2)
Institutions	3.7	3.8	3.8	4.0	5.3
Infrastructure	4.9	4.7	4.5	4.2	6.2
Macroeconomic environment	5.0	5.2	5.1	4.2	4.5
Health care and primary education	6.0	6.2	5.6	5.9	6.3
Higher education and training	5.1	5.0	4.8	4.6	6.1
Goods market efficiency	4.2	4.6	4.5	4.3	5.5
Labor market efficiency	4.3	4.1	3.4	4.6	5.6
Financial market development	3.4	4.2	3.8	3.3	5.7
Technological readiness	4.5	4.9	4.4	4.6	6.2
Market size	5.9	5.2	5.5	4.5	6.9
Business sophistication	4.0	4.1	4.0	3.6	5.8
Innovation	3.5	3.4	3.3	3.2	5.8

Source: The World Economic Forum. The Global Competitiveness Report 2017–2018; Geneva, 2017. pp. 164–303.

Table 1.1 shows the competitiveness score for a range of specific areas of the Russian economy. On the one hand, Russia stands out from other countries with similar levels of economic development for its good

infrastructure (which could have been even better if the roads had been improved!), higher education and training, and market size. On the other hand, Russia's shortcomings can be seen in low scores for institutions, the macroeconomic environment, the efficiency of goods market, and financial market development.

More detailed analysis of the indicators and sub-indices enables us to draw a number of conclusions. The low score for institutions in Russia is the result of low rates in the indicators of e.g. property rights (on this Russia ranks 116th in the world), intellectual property protection (93rd), protection of minority shareholder interests (111th), the reliability of police services (98th), the independence of the judiciary (90th), irregular payments and bribery (76th), and the heavy burden of government regulation (79th).

Although Russia scores reasonably well for its macroeconomic environment (it ranks 6th for government debt), the picture is overwhelmed by high inflation for which the country ranks 112th, though in 2017 it was low (about 4%).

The low score for the efficiency of the goods market reflects weak local competition (where the country ranks 72nd), antimonopoly policies (83rd), high levels of tax (101st) coupled with weak tax incentives for investment (104th), and low levels of openness to foreign goods and services and foreign direct investment (FDI) (72nd–123rd).

Russia lags far behind in the index of financial market development due to poor scores for developing financial services that meet businesses' needs (rank 94th), difficulty in accessing loans (110th), and regulation of securities exchanges (112th).

Business Structure as an Element in the Analysis of the National Economic Model

The way business is structured in a country has an impact in determining specific features of a country's economic model. The term 'business structure' is used in different ways. In this book, we will use it to refer to small, medium, large, or public businesses or sectors. The business structure is an important element in the analysis of a country's economy and its individual sectors. Thus, if a country has a significant public sector, we can assume that it is a country with significant levels of government intervention. If large private businesses account for a high proportion of GDP, we can assume that the country has a heavily monopolized economy.

The main practical difficulty in analyzing the business structure of a country can be shortcomings in the available statistics. For example, the definition of a small business differs from country to country. In the USA, statistics define a company with less than 500 employees as 'small' and 500–1000 employees as 'medium.' Russian statistics use 'small' to mean a business with less than 100 employees (also included here are unincorporated individual entrepreneurs and farm households) and 'medium' to mean a business with no more than 250 employees. Moreover, the System of National Accounts (SNA) values products produced in private households, but does not include them in the statistics for small businesses on the assumption that such goods are produced for private consumption, rather than for the market. However, in some countries, a significant proportion of agricultural output is produced in precisely such households. In Russia, such private households produce 38% of the country's agricultural products and act as small businesses in the agricultural sector, while farm households produce only 11% of the country's agricultural products. Finally, it should be noted that the role of small businesses is underestimated in the statistics since a proportion of their activity happens outside the formal economy and is thus not picked up by official statistics. As a result, the definition of a small business in less developed economies needs to be treated carefully, as their true contribution may be underestimated in statistics.

In some cases, national statistics do not identify large private businesses as such. Their importance in the economy is measured as an implicit share of as many as 10 leading companies in a given sector, or of as many as 500 companies in the overall figure for GDP. In addition, it should be noted that, for a number of reasons relating to technology and other issues, concentration is high in the industrial and banking sectors, and lower in construction, agriculture, and in the majority of the services sector. Furthermore, countries that are major exporters of raw materials and thus have mining as a major contributor to GDP tend to have a small number of companies in the mining sector. So, when looking at the share of GDP of large companies, the sectoral context is important. In addition, when looking at large companies, it is important to note links between companies or groups of companies in the form of share participation or other traditional links. Careful analysis of such structures enables us to identify the true 'power centers' of an economy.

When looking at the role of the public sector in an economy, a number of specific factors should be taken into consideration. One clear indicator of a government's role in an economy is the quantity of assets that it owns. But

the industrial structure of those assets should also be analyzed. Government-owned assets are often concentrated in transport and social infrastructure (roads, hospitals etc.). If the government owns a significant number of industrial assets, then it can be assumed to be playing a role in industrial output. Similarly, high levels of government ownership of banking assets will indicate direct governmental participation in the banking sector. In Russia, for example, more than 50% of bank assets belong to banks with public participation.

In addition, in emerging economies it is common for government and private businesses to share ownership of banks or companies. For example, the Russian government owns 52% of Gazprom, with the remaining 48% owned by private businesses. As a result, it can be difficult to accurately define the public sector's share of GDP. In Russia this share is estimated to be 20–25%. In Belarus, it is even higher.

The Influence of other Mechanisms on the Economic Model

The economic model of a country is heavily influenced by its social, political, and ethical structures (models).

Let's look first at the social model. This has the greatest influence on an economy such that, in many contexts, we refer not to a country's economic model, but to its social and economic model. This term is widely used in Russia. The main features of a country's social model are the level of living standards and quality of life enjoyed by the population. The UN Development Programme (UNDP) produces the Human Development Index (HDI) as a general indicator of levels of development. It is based on a range of indicators of living standards and is calculated as an arithmetic average of three sub-indices: life expectancy; level of education; and GDP PPP per capita. The ideal outcome is considered to be when every sub-index and the HDI itself reach 1, the highest value possible in current conditions.

According to the latest UNDP Human Development Report, in 2015, the top 51 places in the table of HDI (scoring from 0.949 to 0.800) were taken by the members of the EU (except for Bulgaria), other developed countries, and the Arab Gulf States (except for Oman), Brunei, Argentina, Montenegro, and Chile. Of the former Soviet countries, the Baltic states were in the last deciles (scoring 0.830–0.865) and Russia (0.804) occupied the 49th position in the leading group of 51 countries. Belarus and

Kazakhstan were further down the table (scoring 0.796 and 0.794 respectively). Other former Soviet countries scored badly: Ukraine, 0.743; Kyrgyzstan, 0.664; and Tajikistan, 0.627.

Table 1.2 — Russia and other countries of similar development level: some values of the social development level in 2015

	Russia	Poland	Turkey	Kazakhstan	<i>For reference: the USA</i>
Human Development Index (in points, where the highest value equals to 1, in brackets specified position of the country on the list of 187 countries)	0.804 (49)	0.855 (36)	0.767 (71)	0.794 (56)	0.920 (10)
including: Life expectancy (years)	70.3	77.6	75.5	69.6	79.2
Education level, incl. professional development and retraining (years)	12.0	11.9	7.9	11.7	13.2
GNI PPP per capita (dollars)	23,286	24,117	18,705	22,093	53,245
<i>For reference: the Gini index (from 1 to 100 – maximal income differentiation) in 2010–2015</i>	41.6	32.1	40.2	26.3	41.1

Source: UNDP. Human Development Report 2017; New York, 2016; pp. 200–202 and 208–209.

As Table 1.2 shows, Russia has a low life expectancy (1.3 years lower than the world average), a reasonable level of GDP PPP per capita (1.6 times the world average) and a high level of education (12 years in

education per adult, compared with the world average of 8.3 years). An analysis of indicators made of sub-indices of healthcare and elementary education in the index of global competitiveness (see Table 1.1) does not suggest that Russian healthcare is lower than it should be for its general level of development. We may conclude that, by global standards, Russia is not a poor country, it has a reasonably well educated population, but a low life expectancy.

The political situation of a country also influences its economic development, first of all through its democratic institutions. There are various ratings that seek to measure the strength of democracy. According to the index published by the Economic Intelligence Unit (measures on a 10-point scale), among the former Soviet countries, the Baltic countries score the highest (7.48–7.74), while Tajikistan (2.37) and Turkmenistan (1.83) are near the bottom of the list.

Table 1.3 — Levels of democracy in selected countries, 2014 (10-point scale)

Russia	Poland	Turkey	Kazakhstan	<i>Memo: the USA</i>
3.39	7.47	5.20	3.17	8.11

Source:

http://www.eiu.com/public/topical_report.aspx?campaignid=Democracy0115

From this we can conclude that Russia has weak democratic institutions compared to other countries of a similar level of economic development. In Russia we see a wider gap between the interests of the ruling elite and the interests of the country as a whole, which produces significant poverty, limited independence of the judiciary, and widespread government intervention in the activities of companies.

The strength of the ethical framework in a country also influences the economic sphere through such aspects as the importance of the work ethic, commitment to ethical standards, integrity in public life, and compliance with the law. It is not easy to compare the work ethic of Russian citizens with that of citizens in other countries of a similar level of development, but levels of integrity and compliance with the law can be inferred from widely available statistics such as rates of crime and corruption. The Corruption Perception Index, prepared annually by Transparency International, a non-governmental organization, reflects the perceptions of business people and experts as to the level of corruption in the state

apparatus. This shows a high level for Russia when compared to other similar countries. This is borne out in the indicator of ethical conduct among companies (taken from a sub-index of Economic institutions in the Global Competitive Index). The indicator for organized crime can be derived from the same sub-index.

Table 1.4 — Russia and the other countries of a similar level of development: indicators of corruption and organized crime in 2015

	Russia	Poland	Turkey	Kazakhstan	<i>Memo:</i> USA
The Corruption Perception Index (in points, where 100 would represent no corruption)	29	62	42	28	76
Ethical behavior of firms (country position on the list of 138 countries)	65	60	93	51	27
Organized crime (country position on the list of 138 countries)	85	51	77	53	70

Source: Transparency International; Corruption Perception Index (www.transparency.org); World Economic Forum. The Global Competitiveness Report 2016–2017. Geneva, 2016

On the basis of Table 1.4, we can conclude that corruption among state officials and non-ethical conduct by companies and organized crime have a negative impact on Russia's economic efficiency

The strategic concerns of a country

To sum up our analysis of economic models, it is useful to identify a country's strategic goals or targets. This can help clarify what a country needs to achieve successful economic development over the long term.

For example, in Russia, such targets are modernization, the development of the eastern and northern territories, economic reintegration with other former Soviet countries, overcoming the demographic crisis, improving the level of democracy, and an improvement in ethical standards (see Chapter 8).

Conclusion

We can draw three main conclusions from this chapter. Firstly, the economy of a country is defined by its national borders. There are around 200 national economies in the world, divided into two large social and economic groupings, developed and less developed countries.

Second, the level of economic development can be determined using a range of indicators, the most common being GDP (or GNI) per capita and the structure of a country's industrial output.

Third, an important stage in analyzing a country's economy is to determine its economic model, i.e., the characteristics of economic and social relations that are specific to the country and distinguish it from its neighbors and other countries at a similar level of economic development. To do this we analyze not just economic and social models but the political and ethical models of a country as well.

Questions

1. Why do we class Russia as a country with an emerging economy?
2. Is it a contradiction to say that Russia belongs to a group of countries with emerging markets?
3. What is the Human Development Index?
4. Define the economic model of a country (i.e. its national economic model).
5. How do political and ethical issues influence the economic and social models of a country?

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Transparency International. Global Corruption Report (www.transparency.org)

UNDP. Human Development Report (www.undp.org)

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World Economic Forum. World Competitiveness Report (www.weforum.org)

CHAPTER 2

THE PROPORTIONS OF A NATIONAL ECONOMY

There is a wide range of active agents participating in a nation's economy. Statisticians divide them into units, or institutional sectors as follows:

- households
- non-financial corporations (companies)
- financial corporations (primarily banks)
- non-profit institutions providing services for households (e.g. charitable organizations)
- government units (public institutions).

Economic theory traditionally divides the economy between two different levels: the microeconomic and the macroeconomic. Microeconomics describes activity at a micro or 'grassroots' level among households, corporations, industries and industrial markets. Macroeconomics refers to the national economy as a whole.

Naturally, any analysis of a national economy starts with the macro level. At this level activity among and between economic agents represents economic circulation. This is divided into the following phases:

- production
- income formation
- primary income distribution
- secondary income distribution (redistribution)
- consumption and saving
- capital formation (investment).

To analyze the interconnection between economic operators at the macro level, within phases of economic circulation, the System of National Accounts (SNA) is applied in almost all countries. To perform analysis at the micro level (specifically, at the level of industries), the input-output (inter-sectoral) balance—part of the SNA—is used.

In addition, the SNA is used to estimate the potential of a nation's economy, that is potential in the narrow sense of the volume of goods and services produced. Potential in the broader sense would be a calculation of an economy's resources.

Finally, the SNA is the main source of information about the dynamics and the proportional sizes of different parts of the economy. Let us look first at the questions of proportions.

The SNA as a data source for analysis of macroeconomic proportions

The SNA is a system of interconnected indicators that are used to describe and analyze the macroeconomic processes that occur at the different phases of economic circulation. The SNA is updated periodically; the 2008 standard has replaced the 1993 standard. Russian statistics have been using the SNA since 1992.

The SNA's calculation of production output (i.e. goods and services produced) is based strictly on value added, i.e., intermediate consumption charge-off. Thus, GDP, which is the main SNA indicator, is calculated on the basis of value added.

The SNA uses two types of price, market and basic (the latter only rarely). Market prices (the price paid by the end consumer) include all taxes, both direct (taxes on profits, property, mineral extraction etc.) and indirect (value added tax, sales tax, excise duties etc.). These are all referred to as taxes on products in the SNA. Basic prices include only direct taxes. Finally, the term 'net taxes' is used to mean taxes less subsidies on products.

The SNA works alongside another important statistical indicator that describes a country's external economic links, the balance of payments, which gives the external context of the SNA (see Chapter 13).

The SNA is made up of a number of statistics and tables. Let us demonstrate this by looking at the example of Russia.

Table 2.1 — Russia: The Goods and Services Account in 2015 (at current prices in P bn)

Resources		Uses	
Output at basic prices*	141,036	Intermediate consumption	68,671
Imports of goods and services**	17,136	Final consumption expenditure	59,067
Taxes on products***	8,739	Gross capital formation	16,761
Subsidies on products****	(-)299	Exports of goods and services**	23,863
		Statistical discrepancy	(-)1,752
Total resources	166,611	Total uses	166,611

Table 2.2 — Russia: production account in 2015 (at current prices in P bn)

Resources		Uses	
Output at basic prices*	141,036	Intermediate consumption	68,671
Taxes on products***	8,739	Gross domestic product at market prices	80,804
Subsidies on products****	(-)299		
Total resources	149,476	Total uses	149,476

*Without indirect taxes on products produced in the country (VAT, sales tax, excise and etc.) but including subsidies on products

**At national prices

***Indirect taxes

****Deducted from the total

Source: Federal State Statistics Service. National accounts (<http://www.gks.ru>)

Both accounts characterize the production phase, the only difference between them is that the second does not include any data for foreign trade. The following are examples of how these accounts are used for a country analysis.

- goods and services were sold at market prices of ₱149.5 trn (₱141 trn in basic prices, i.e., only taking direct prices into account, adding ₱8.7 trn of indirect taxes included in the product market price and subtracting ₱0.3 trn of subsidies that reduced the market price of products);
- a portion of the goods and services were sold abroad. About 17% of products produced in the country were exported ($23.9 \times 100 / ₱141$ trn without indirect taxes, which generally not collected on exports, but including subsidies, which are generally assigned to exporters);
- at the same time, a share of goods and services sold in Russia, are imports. Their share accounted for about 12% ($17.1 \times 100 / (68.7 + 59.1 + 16.8)$), although for a more precise calculation, indirect taxes should be included;
- GDP at market prices was ₱80.8 trn. This is calculated on the basis of value added and is, therefore, the difference between goods and services produced in the country at market prices (₱149.5 trn) and intermediate consumption during production (₱68.7 trn).

Table 2.3 — Russia: Generation of income account in 2015 (at current prices in ₱ bn)

Resources		Usage	
GDP at market prices	80,804	Compensation of employees including hidden payments for labor and mixed income*	38,132
			10,858
		Taxes on production and imports of which:	9,794
		taxes on products	8,739
		other taxes on production**	1,055
		Subsidies on production and imports of which:	(-)580
		subsidies on products	299
		other subsidies on production	281