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# Is Sustained Economic Growth in Russia's Future?

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Russia's economic history is one told through booms and busts. Since the collapse of the Soviet Union, Russia has witnessed growth intermitted by crises in 1998 and 2008. Each crisis wiped out the preceding economic progress, ultimately keeping Russia in a state of overall stagnation. From 1991 to 2008, Russia's economy transformed from a communist economy to a fledging capitalist economy. Despite its transformation, however, Russia's economy battles with the prototypical problem of an authoritarian structure—achieving sustained growth. However, growth in Russia is not about overcoming the remnants of its communist society, nor is it about adopting liberal capitalism. Jack A. Goldstone addresses this problem in his essay “Efflorescences and economic growth in world history: rethinking the “rise of the west” and the industrial revolution,” where he reexamines the distinction between pre-modern and modern economies, ultimately calling for a separation of liberal Western economics from modern economic growth.

Goldstone critiques the normative approach of analyzing economic growth in world history that specifies two norms—modern economic growth stemming from Western nations and pre-modern unsustainable growth from non-Western nations. This distinction rests on the assumption that pre-modern societies could not achieve sustained growth because of structural and political problems in how those countries were managed.

Moreover, this approach claims that Western nations were better suited structurally, politically, and culturally to evolve and achieve sustained economic growth, thus making them modern economies. Goldstone purports that such a normative approach is a fallacy. Employing a historical analysis, he asserts that every nation goes through periods of growth, stability, stagnation, and crisis. He proscribes their ability to achieve sustained growth to their own unique cultural contents and organizational frameworks—or their own “peculiar local phenomena,”—which allows a nation to better utilize its human capital and resources to achieve sustained growth. To arrive at this analysis, Goldstone uses the theoretical lenses of efflorescence. Goldstone's notion of “efflorescence” is a more multidimensional, holistic concept of economic growth, compared to the binary theories of growth that postulated a zero-sum growth or no-growth environment. Moreover, efflorescence allows for the equalizing of both Eastern and Western nations, refuting that the liberal Western economic model definition of economic growth. By seeing all pre-modern history as punctuated by efflorescences, Goldstone argued, “growth and prosperity were not monopolies of the modern or Western (or even “capitalist”) worlds.”<sup>1</sup> If all economies went through periods of efflorescence, and it was a “peculiar local phenomena” that allowed them to achieve sustained growth, the question is no longer how much a country emulates Western liberal economies, but rather, which intrinsic aspects of a country will promote a transition away from unsustainable growth to modern economic growth?

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<sup>1</sup> Jack A. Goldstone, “Efflorescences and Economic Growth in World History: Rethinking The ‘Rise Of The West’ and The Industrial Revolution,” *Journal of World History* 13, no. 2, (2002), 47, 377-378.

This lens is particularly helpful when understanding Russia's political economy in boom and bust cycles. This paper clarifies that Russia witnessed periods of efflorescence after the 1998 Asian financial crisis and then again after the 2008 global financial crisis. Specifically, there were factors of Russia's economy that promoted efflorescence and those that stifled efflorescence, leading to unsustainable growth. After transitioning from a communist society to a semi-capitalist economy, Russia experienced a period of economic growth, which was ultimately undermined by its Oligarch-conducive policies. Later its economic growth advanced and then declined because of the economy's dependence on natural resources, namely oil and gas.<sup>2</sup> Then, in 2010, Russia witnessed a rise of a peculiar phenomenon. The phenomenon stemmed from a mixture of Russia's growing middle class and the demands they imposed on the political system, and Russia's apparent top-down approach to innovation and investment in its human capital. First, this paper will reanalyze Russia's political economy through an explanation and exploration of Goldstone's efflorescence theory. It will then clarify the drivers for and against sustained efflorescence in Russia, which stem from the country's own peculiar local characteristics rather than from the absence of liberal capital reforms.

## GOLDSTONE'S EFFLORESCENCE THEORY

In his seminal work on Efflorescence Goldstone makes a distinction between the historical

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<sup>2</sup> This economic phenomenon is known as "Dutch Disease," and will be enumerated on at later points in the analysis.

understanding of modern and pre-modern nations. This is important for Goldstone because it allows for the "rethinking of the 'rise of the West,'" which takes the strength from those advocates that assume modernization has a Western façade. By studying economic growth from the 10<sup>th</sup> century to the early 18<sup>th</sup> century, Goldstone disproves the historical fallacy of the rise of the West. He finds that the trends observed in Europe which were "proof of 'early modern' character," such as technical innovations, and extensive trade networks, to name a few, were also manifested outside Europe prior to the eighteenth century.<sup>3</sup> There is no sufficient connection between the "rise of the West" and sustained economic growth. Goldstone begins by inventing the neologism "efflorescence" and deconstructing our customary methods of conceptualizing growth.

In the absence of an economic crisis, there may be growth, stagnation, or stability; each phase is cyclical and as important as the next. Efflorescence is the converse of a crisis: "a relatively sharp, often unexpected upturn in significant demographic and economic indices, usually accompanied by political expansion...institution building, and cultural synthesis".<sup>4</sup> Without the distinction of efflorescence, the toolkit for understanding economic growth stems from two classifications. First, there is Kuznetzian/Schumpeterian Growth where growth is defined by internally driven and self-sustaining rapid increases in indices such as income per capita, and total output. This process occurs through *creative destruction*, whereby older technologies and firms are replaced by more efficient

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<sup>3</sup> Goldstone, "Efflorescences and Economic Growth in World History: Rethinking The 'Rise Of The West' and The Industrial Revolution," 6.

<sup>4</sup> Ibid, 9.

substitutes. Second, there is Extensive/Smithian Growth, which is growth that lacks significant technological improvements, as in the Kuznetzian model. Instead, higher incomes per capita and total output increase because of a country's comparative specialization expanding trade and the mobility of specific resources. According to the theory, this growth is not sustainable and will eventually be counterbalanced by the leveling off population growth, and/or the depletion of resources—known as Malthusian constraints. Goldstone opines that those two distinctions of growth create a zero and one binary of growth or stagnation. Efflorescence, can account for a country's growth that does not fit the characterizations provided by only an Schumpeterian-type or Smithian-type of growth.

Equipped with Goldstone's theory, this paper re-contextualizes the story of Russia as one of various efflorescences, which have cyclically emerged and then contracted. Analyzing Russia through the lens of efflorescence theory can help identify the various reasons why efflorescence waned in Russia, and ways in which it may evolve to a more sustainable efflorescence and thus achieving "modern" economic growth. However, before one can speak of the Russian experience with efflorescence, it is first necessary to understand how efflorescence occurs. According to Goldstone, efflorescence tends to occur under the following conditions:

- (1) During periods when international trade and sustained contact lead to a mixing of cultures and ideas;
- and (2) in places that are centers of international trade, in which people, goods, and

techniques are focused on meeting multiple commercial demands. One could add as a third factor that (3) such efflorescences also seem more likely during periods of reconstruction following a collapse or massive challenge or change in government or society that unleashes new energies or social groups or provides integration and order over larger territories.<sup>5</sup>

Conversely, efflorescence is unlikely in societies isolated from cross-cultural influences or in societies that depend on a few commodities, which make the countries vulnerable to global shifts and limit their ability to diversify toward "multiple commercial demands"<sup>6</sup>. It is also unlikely during periods of unchallenged political order, where elites reject creative reconstruction and instead enforce conformity to existing practices.

Many times in Russia, periods of oscillating efflorescence were due to fluctuations in the oil and natural gas markets. Russia faces a significant threat from negative impacts on its economy stemming from overreliance on a small set of commodities, specifically oil and gas. In the occurrence of the economic phenomenon termed "Dutch Disease,"<sup>7</sup> overreliance on natural resources distorts the economy because the country slackens its other means of revenue generation (tax, infrastructure, investment) and depends on the revenues from a single set of commodities.

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<sup>5</sup> Ibid, 31

<sup>6</sup> Ibid.

<sup>7</sup> The term stems from the 1960s and 1970s, a period when the Dutch economy became too specialized in the export of natural resources, ultimately crowding out other industries.

Structurally, it is difficult to claim that economic “backwardness,” stemming from Russia’s authoritative policies and its integrated economic structure, was the main cause for Russia’s unsustainable growth and waning efflorescence. In fact, after the collapse of the Soviet Union, some domestic reforms such as liberal market reform and cultural change from tacit compliance to glasnost—a period of free speech and expression—brought on temporary efflorescence. However, Russia’s domestic reforms, such as *perestroika* under Soviet Union President Mikhail Gorbachev played a notable role in creating an entrenched oligarchic community in Russia, which still holds significant power and works to reinforce conformity to a natural resource, their pecuniary base.<sup>8</sup> As Goldstones makes clear, elite entrenchment diminishes efflorescence. These conditions constitute aspects of Russia’s “peculiar path.” Efflorescence opens the door to understanding Russia’s growth trajectory more effectively, which may have posed illusive if the country was analyzed under a strict Schumpeterian or Smithian framework, or under the belief that modernization needs to mimic Western economies. Thus, by separately examining Russia’s efflorescences after the 1998 and 2008 crisis, we uncover the mechanisms driving and destroying a sustainable efflorescence in Russia.

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<sup>8</sup> Perestroika literally means “restructuring.” It was a policy implemented to introduce market-like reforms into the Soviet System. Its most prototypical reform was privatization with vouchers. These vouchers are chiefly responsible for what we now term “Russian oligarchs.”

## 1998 AND 2008 CRISES

Russia underwent a seven-year period of efflorescence after the creation of the Russian Federation in 1991. Faced with a challenging economic situation, the economy made incremental movements toward positive GDP growth from 1991 to 1997. In transitioning from a fiscal deficit representing -12.6 percent of GDP in 1994 to a fiscal surplus of 1.4 percent of GDP in 1997, Russia’s efflorescence changed the economic landscape, increasing the quality of life for its citizens and reconstructing its position in the global economy.<sup>9</sup> The growth from 1994 to 1997 relates directly to factors one and two of Goldstones causes for efflorescence: increased international trade, heightened international connections, and a period of reconstruction following the collapse the old regime. Both the World Bank (WB) and the International Monetary Fund (IMF) supported the formation of the Russian Federations, which also helped attract foreign investment. Moreover, to address its fiscal deficit, the Russian government engaged in financial innovations such as creating Government Short-Term Commitments (GKO)—short-term, zero-coupon Russian government treasury bills—which provided non-inflationary means toward financing budget deficits.

Unfortunately, this period of efflorescence ended abruptly. Unlike the trends for successful efflorescence that Goldstone outlines, Russia’s international trade did not meet enough commercial demands. The geographical distribution of Russian foreign trade changed after the collapse of the Soviet Union. In 1985, around 55 percent of Soviet exports and

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<sup>9</sup> Iris van de Wiel, “The Russian Crisis 1998: Economic Research,” (The Netherlands: Rabobank, 2013).

imports were within the Eastern Bloc, or Comecon countries.<sup>10</sup> By 1991, only 23 percent of exports and imports were with the former Comecon member states. However, after 1991, trade with advanced economies such as Europe, Japan, and the U.S. were growing but not enough to compensate for the falloff in trade with past allies. Moreover, oil, natural gas, metals, and minerals, accounted for 65 percent of total exports in 1993 indicating that Russia's export sector was nascent.<sup>11</sup> Additionally, the change in the government after the collapse of the Soviet Union brought about new institutional problems, namely corruption. The broader fragility of Russia's economy would become more apparent over time.

Owing to burgeoning global financial interconnections, the Asian Crisis of 1997, which started with the collapse of the Thai baht currency in July, kick-started a global economic crisis.<sup>12</sup> Russia felt the reverberations of the Asian Crisis as investor speculation against the Russian ruble caused a devaluation of the currency. Between defending their currency by spending almost USD 6 billion of foreign exchange reserves and the tumble in world commodity prices, Russia experienced its most severe crisis in August of 1998.<sup>13</sup> Eventually, defending the currency failed and the ruble devalued. Russia defaulted on

its GKO and coupon-bearing Federal Loan Bonds (OFZ), and announced a 90-day moratorium on payments to foreign creditors by commercial banks: effectively, a sovereign default.<sup>14</sup>

Adding to the destruction, Russia's dependency on world energy prices exacerbated the damage. From 1991 to 1997, rising oil and energy prices led to Russia's efflorescence. However, in the wake of the Asian crisis, the natural commodities market plummeted with energy prices, sliding from 1997 onwards, further burdening Russia's economy. The torrents of economic mayhem affected Russia throughout 1998 and by the beginning of 1999, actual GDP, and GDP growth were both below their pre-1996 levels.

Luckily, by the late-1990s investor sentiment started to relax, capital flight slowed and world commodity prices bounced back. The price of crude oil, which played a big role in pulling the Russian economy out of efflorescence between 1998 and 1999, conversely stoked efflorescence after 1999. The price rose to an average \$10 USD per barrel higher than the previous 5 years. The commodity boom bolstered the rate at which the Russian economy was able to recover from the 1998 crisis. During the third quarter of 1999, Russia's annual GDP grew by 11.5 percent and then by 12.1 percent in the fourth quarter of 1999.

If the 1998 crisis was the first and only crisis to have impacted Russia, foreign analysts and Russians alike would have easily overlooked the apparent signs of a fragile economy. Emphasis would have been placed on Russia's rapid recovery, and its high dependency on oil and energy would have been praised as a successful

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<sup>10</sup> The Comecon countries are: Soviet Union, Bulgaria, Czechoslovakia, the German Democratic Republic (East Germany), Hungary, Romania, Poland, Cuba, the Mongolian People's Republic (Mongolia), and Vietnam.

<sup>11</sup> Glenn E. Curtis, "Foreign Economic Relations" in *Russia: A Country Study* ed., (Washington: GPO for the Library of Congress, 1996).

<sup>12</sup> This was purportedly due in large to massive currency speculation by New York hedge fund manager George Soros, after he shorted the currency that year.

<sup>13</sup> "National Wealth Fund Statistics," Russian National Wealth Fund.  
<http://old.minfin.ru/en/reservefund/index.php>

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<sup>14</sup> Wiel, "The Russian Crisis 1998."

hedge. Analysts could have claim that it is inevitable for a nascent market economy recovering from the collapse of a communist society to face initial hardship. However, Russia's deep structural economic weaknesses were revealed by crisis in 2008. In 2009, Russian Specialist, Jeffery Mankoff, criticized Russia's internal economic mechanics that persisted since the 1998 crisis:

[A] foreign policy based on the revenues from high-energy prices is necessarily hostage to fluctuations in the global energy market, as indeed it was during the Soviet Union's economic boom of the 1970s and the subsequent bust of the 1980s. Moreover, Russia's economy is still inflexible and uncompetitive.<sup>15</sup>

The 2008 crisis proved that future efflorescence in Russia would be unsustainable if the country saw no structural changes. The Russian economy could not sustain growth because it suffered from internal weaknesses and an over-reliance on one commodity. However, structural reform can be a very tough pill to swallow, especially if structural inefficiency allowed for quick recoveries from two financial crises.

Russia may have suffered the most of all the BRIC (Brazil, Russia, India, and China) countries at the onset of the financial crisis, but Russia grew faster before the crisis, and its recovery was quicker thanks to its oil dependency. As Clifford Gaddy and Barry Ickes succinctly exemplify:

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<sup>15</sup> Jeffrey Mankoff, *Russian Foreign Policy: The Return of Great Power Politics*. (USA: Rowman & Littlefield, 2009), 48.

This is worth repeating...Russia is still significantly richer in 2010 than it would have been had it grown at a rate as fast as the next-fastest BRIC [country] since 1999. Russia clearly would not have gained from having "diversified" away from energy in 1999.<sup>16</sup>

Russia's growth was in large part due to its massive reserve fund, and the revenues that it had built through natural resource sales. The reserve fund, a product of the stabilization fund put in place after the 1998 crisis, gave Russia access to foreign currency that it could spend to fight off capital flight and bolster the depreciating currency.

Unlike other countries that were forced to invoke significant monetary policy mechanisms which lead to inflation and devalued currencies, Russia could offset most of the pain by drawing upon its reserves fund. This allowed the country to curtail unnecessary monetary policy, which could prove problematic after external shocks subside and business-as-usual returns. During the financial crisis, Russia's increase in expenditures outpaced the revenues raised by the government, leading to a budget deficit by 2009. Additionally, Russia spent 22 percent of its total reserves, or USD \$1.3 billion from 2008 to 2009. This illustrates that in order to counteract the 2008 crisis, Russia spent an excessive amount of its reserves and diminished its fiscal balance.

To recover, four years of building a healthy fiscal balance disappeared, and a year worth of reserves evaporated. The

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<sup>16</sup> Clifford G. Gaddy and Barry W. Ickes. "Russia After The Global Financial Crisis." *Eurasian Geography and Economics* 51, no.3 (2010), 291.

sheer amount spent to offset the crisis is a cause for concern. Without oil revenues replenishing its reserves, Russia could not justify spending such large sums.

Moreover, during the second half of 2008, Russia's stock market had shed more than 90 percent of its value. By 2009, after such large fiscal injections consumer spending still shrank by 7.9 percent, indicating that Russian's were worried about the future of their economy.<sup>17</sup> For the first time since 1999, Russia again ran a budget deficit.

In light of this, we see that the reserves built via the high dependency on oil only points to a more integral flaw. The effects of the 2008 crisis highlighted Russia's Dutch disease, and its vulnerability to the sways of the international environment. Because oil revenues are accumulated through export sales, Russia's government budget depends on oil prices, and international demand/supply dynamics. Ultimately, Russia's dependency on oil helped to revive the economy from a crisis, but it also jeopardized it when those commodity prices tumbled. Gaddy and Ickes point out this observation as well when he states:

First, the crisis has reminded us of how thoroughly dependent Russia is on oil and gas. Looking at the period before the crisis, during the crisis, and now in the rebound, the picture is unambiguous. Very few important developments, positive or negative, cannot be traced back to fluctuations in the volume of wealth—the rents—that accrue to Russia from these resources.

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<sup>17</sup> Mankoff, *Russian Foreign Policy: The Return of Great Power Politics*.

(Resource) addiction's most pernicious feature is that it is self-reinforcing, which means that it continually deepens and reproduces backwardness and inefficiency in the Russian economy.<sup>18</sup>

Ultimately, both crises of 1998 and 2008 draw out the pertinence in understanding how efflorescence occurred in Russian. After the 1990 collapse of the Soviet Union, Russia experienced a brief efflorescence that was stumped because its export was still immature. After the 1998 crisis, Russia's dependence on oil allowed for another efflorescence, but overreliance on oil and gas revenues limited its expansion along multiple economic indicators, ultimately creating a short-term efflorescence, restricting it in the long run.

Nevertheless, disagreement still exists on whether the 1998 and 2008 crises illustrate Russia's dependency on a few commodities. Many of the country's analysts and economists question whether Russia, in fact, suffers from "Dutch disease." To find answers they often evaluate the future of Russia's natural resource sector to consider its ability to rely on oil and gas exports and what relationship that has on Russia's willingness to diversify its economy.

## OIL AND ENERGY

If one does not look deeply into the problem, Russia's dependency on its natural resources may appear positive rather than negative. It may be true that the Reserves Fund and National Wealth Fund have had beneficial impacts on Russia's

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<sup>18</sup> Gaddy and Ickes. "Russia After The Global Financial Crisis," 282.

economy. However, a closer look at the long-term perspective exposes the negative effects of overreliance on such funds. Russia's exports in the oil and gas sector accounts to 70 percent of its exports or 28 percent of its GDP. To place that in context, India's oil sector, for example, is only 18 percent of all exports. Comparatively, for the U.S., capital goods, industrial goods, and consumer goods together make up 65 percent of all exports.<sup>19</sup> Because Russia can generate revenue and saving from oil and gas sales, it is dis-incentivized to innovate new avenues of wealth creation.

This level of dependency has proven to be problematic before. Firstly, Russia's economic growth closely tracks worldwide oil demand and price. Secondly, when oil price is stable but other exports and sources of revenue are not developed, the economy approaches decline. In 2012, Russia's economic growth was 3.4 percent, the lowest level since 1990 minus the global recession of 2008-2009. This was primarily because the volume of Russia's exports other than oil and gas had declined amid worldwide recessions.<sup>20</sup>

High correlations between crude oil prices and Russian trade and exports exemplify structural risk. For example, trade mainly mirrored the movements of Urals oil prices in 2011 and 2012 rising to \$400 million in 2011 when oil prices reached \$120, and falling together by the middle of 2012 when oil sank below \$100.<sup>21</sup> Additionally, the trend in export follows that of global oil demand. The figures illustrate Neil Rubinstein's claim

that "when oil prices have been high, Russia has grown its economy and balanced its budget; when they have been low, growth has reversed, and deficits have returned."<sup>22</sup>

Furthermore, in 2003, 40 percent of Russia's revenues were based on oil and gas taxes. That number increased by 8 percent through 2010.<sup>23</sup> Thus, with this trend we see that when demand for oil decreases, revenues also decrease because fewer taxes are collected. Additionally, the reliance on oil has linked Russia to the global world more integrally in many ways. As presented, both crises of 1998 and 2008 were based on external tremors. More threats from external sources may lie ahead. By investing in a diversified economy, Russia can decouple its growth from natural resource rents, allowing it to have sectors of its economy insulated from external shocks.

Though Russia's dependency on oil does not pose immediate threat to its economy, a series of future problems will affect its growth in the long term. Crude oil prices are on a slow decline in recent years. Decreasing oil and gas demand in Europe, Russia's number one importer of oil and gas, is also a cause for concern. Fiscal and monetary instability in Europe led to an economic slowdown for Russia in the second half of 2012. Additionally, Europe is continuously looking for new sources of energy to deter its reliance on Russian oil and gas. In response, Russia has turned to strategic relations with China. The growing population and expanding economy of China has prompted the need for higher

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<sup>19</sup> Securing America's Future Energy (SAFE) and Roubini Global Economics, "Oil Security Index," *www.OilSecurityIndex.org*, October 2013.

<sup>20</sup> The National Institute for Defense Studies, "East Asian Strategic Review" (Tokyo, The Japan Times, Ltd., 2013), 254.

<sup>21</sup> *Ibid.*

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<sup>22</sup> Neil Robinson, ed., "Russia's Potential Role in the World Oil System" in *Political Economy of Russia* (USA: Rowman & Littlefield, 2012), 156.

<sup>23</sup> Robertson and Graeme, "Russian Protesters: Not Optimistic But Here to Stay," *Russian Analytical Digest*, 20, no.115 (2012).

natural resource consumption. However, between China's slowing economy and its own endeavors for acquiring natural resources abroad, the short-term likelihood of China bringing a big boost to the Russian economy is low.

At the writing of this report, based on the rising stockpiles of crude oil in the U.S. and higher-than-expected production of oil in Libya, crude oil prices have been on a continuous decline since November 2013.<sup>24</sup> This decline in oil prices mirrors a stagnating Russian economy. Based on Roubini Global Economics' projections, Russia's GDP growth for 2014 will be as low as 2 percent and its current growth is about 1.4 percent.<sup>25</sup> In the past, Russia has been consistently lucky with the strength of oil prices. However, in this case, strength can be equivalent to overreliance. It is important not to ignore how Russia's efflorescences have emerged cyclically due to changes in the oil price. It is understandably beneficial to recover quickly from a crisis, but it is just as bad to have a country's growth stripped from it because of resource prices. If Russia is to aim for sustained economic growth and efflorescence that maintains stride long enough to become a modernizing economy, diversification is needed. The question is, as asked in Thane Gustafson's book, *Wheel of Fortune: The battle for power and oil in Russia*, is Russia "a classic petro-state," with its "hypertrophied hydrocarbon industries inflicting a 'resource curse' on non-energy industries suffering from Dutch disease."<sup>26</sup> The answer to such a

question continues to be elusive because of the recent changes in Russia's economic growth plan.

Currently, Russia is investing in infrastructure, using the National Wealth Fund as a source of revenue. Here it is important to note the change in strategy. Instead of using those reserves to avoid diversified investment, Russia appears to be changing its approach. Additionally, Russia is attempting to provide incentives for companies to explore the East Siberian and Far East Greenfields as well as the offshore arctic Bluefield for untapped oil reserves where oil is harder to access but of higher quality.<sup>27</sup> Here we see a positive relationship with its oil rents whereby Russia rolls over surplus into productive investments. Nonetheless, this trend is nascent and it cannot be guaranteed to persist. Moreover, oil is only one particular bottleneck Russia may be facing in regards to maintaining efflorescence.

Goldstone addresses that self-sustaining growth is not dependent on a "cluster of innovations," or by alleviating a particular bottleneck, "rather it is a matter of developing a particular approach to production and technological innovations." Additionally, he claims, "it is long overdue to incorporate changes in social attitudes...into our conceptions of what underlay the sudden onset of self-sustaining and accelerating growth."<sup>28</sup> In accord with his statement, I turn to the regime of Vladimir Putin and to the developments in Russia's civil society after the 2011 protests.

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<sup>24</sup> ICN.com, "Oil Set For First Three-Week Slide In 2013: Commodity Market Commentaries,"

*Oilngold.com*, April 19, 2013.

<sup>25</sup> "Russia Country Analysis," Roubini Global Economics. Accessed on December 2013, <https://www.roubini.com>.

<sup>26</sup> Thane, Gustafson, *Wheel of Fortune: The Battle for Oil and Power in Russia*, (USA: Harvard University Press, 2012).

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<sup>27</sup> Ibid.

<sup>28</sup> Goldstone, "Efflorescences and Economic Growth in World History: Rethinking The "Rise Of The West" and The Industrial Revolution," 31.

## POST-PROTEST AND PUTIN'S RUSSIA

In his theory of efflorescence, Goldstone points out that efflorescences are usually accompanied by massive challenges against the social order or challenges against governments. Thus, the social fabric of a country is as important to efflorescence as any other indicator. In this regard, Russia has a recent trend worth noting. By late 2011, civil society started to visibly stir in Russia. Protests began to pop up in Moscow and other major Russian cities. Many Russian specialists watched attentively as protesters amassed, calling for a structural change and the stepping down of President Putin. In December, Putin reinforced the idea of a tandem leadership between himself and then President Dmitry Medvedev—announcing that he would be swapping positions with Medvedev for Presidency over Vice-Presidency. Not long after this announcement, discontented protestors took to the street to express their views on domestic corruption. Chants for “*Rossija bez Putina* - Russia, without Putin,” could be heard en masse roving down the busy streets of Moscow. Financial instability amongst the population has caused some citizens to worry about the conditions of their country. Moreover, due of the rising middle class, the amount of educated civilians who are aware of corruption rose. By December 2011, it became apparent that the changing dynamics of Russia's civil society would pose significant challenges to the government. These events will have much to do with the potential durability of efflorescence in Russia post the 2008 crisis.

It is important to place these challenges amidst the phenomenon of creative destruction. This concept, as previously referenced, pertains to the elimination of older technologies as more efficient alternatives are developed. As

society unleashes new energies that aim to provide a new structure more capable of sustaining efflorescence, older structures are challenged and dissolved. However, Goldstone warns that many times a country falls into Caldwell's law, which states that when new productive practices or forces cause growth in an economy, they will also create interest groups vested by the political and social elite. These interest groups constrict future creative destruction because they desire to reap the benefits from the monopolies they have acquired. Thus, such groups generate stagnation, and decline of efflorescence. For Russia, Caldwell's law depicts the country's schism between its citizenry—Oligarchy vs. the budding middle class. Goldstone explains that when this occurs, “only a major social or political upheaval is then likely to create new opportunities for major episodes of growth.”<sup>29</sup> Many indeed thought this particular upheaval was occurring in Russia during 2011. Graeme Robertson stated, “Russia had woken up.”<sup>30</sup> His words were mirrored by a series of academics and analysts who saw 2011 as the time for civil society in Russia to start its engine toward Russia 2.0. Unfortunately, such changes are much harder to initiate than initially thought.

In 2012, Putin regained his presidency. A vast amount of the protestors had been arrested before and after the State Duma elections and Putin's inauguration. By June 2012, legislation was passed to sharply raise the fines imposed for engaging in unauthorized demonstrations, and in October Russia's criminal code was amended to classify such

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<sup>29</sup> Ibid.

<sup>30</sup> Graeme Robertson, “Russian Protesters: Not Optimistic But Here to Stay.” *Russian Analytical Digest* 20, no.115 (2012).

activities as acts of treason.<sup>31</sup> As it became more difficult for massive social uprising to form, confidence in reforms diminished. Cases such as the “Pussy Riot” arrests have frightened many youths who do not want to be jailed. Harsh fines have made protesting a sport for the wealthy.

Evghenia Sleptsova, a Russian economic analyst writing on Russian Growth, states, as well as many others, that “Putin’s model of governance, whereby the population gives up part of democracy in return for economic stability, [is] adding to the political risks.”<sup>32</sup> In order to enjoy the fruits of economic growth, people are coerced to deal with the system. This method appears counter intuitive and ineffective in light of Goldstone’s efflorescence theory. Goldstone warns against conforming to existing practices enforced by elite command. By siding with the status quo, Russia begs for its own stagnation. Indeed, such stagnation has already arrived.

The government acknowledged its own sluggishness during fiscal year 2013, and has abandoned its hopes of 4 percent GDP growth, forecasting downward to 2.5 percent.<sup>33</sup> Thus, Robertson’s statement is brought back in the form of a question: *will Russia wake up?* Analyst Sleptsova stated that:

By slashing the long-term growth forecast the government effectively admits that growth will continue to track the stagnant oil prices and demand, and does not expect any significant economic break-through or diversification of the economy.

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<sup>31</sup> The National Institute for Defense Studies, “East Asian Strategic Review 2013.”

<sup>32</sup> Evghenia Sleptsova, “Russian Growth: Slowing Down and Not Much Acceleration in Sight.” *Roubini Global Economics.com*, November 11, 2013.

<sup>33</sup> *Ibid.*

Therefore, as stagnant hydrocarbon revenues and restrictive fiscal policy will constrain public investment, and private sector investment will continue to be suppressed by weak rule of law and corruption, investment will serve as a drag on growth.<sup>34</sup>

It must be said, however, that it is unfair to tell this tale as if the Russian government is not ostensibly aiming to suppress stagnation-causing policies. Putin has implemented a series of small fixes, which have boosted Russia’s 2013 World Bank rating up 20 points from 112<sup>th</sup> to 92<sup>nd</sup>, signifying that Russia is taking steps toward improving its business climate. Moreover, Putin ambitiously states that he wants that ranking to rise to 20<sup>th</sup> place by 2018. Additionally, Russia plans to spend 13.6 billion rubles on public infrastructure. However, many see these changes as only minimal—maintaining stagnation, but not spurring efflorescence. Specialists at *The Economist* are also skeptical. They state that “profound reforms” will now be needed. Mirroring the statement of Sleptsova, they call particularly for reforms to the courts, legal system, judiciary system, and law enforcement.<sup>35</sup> With an anachronistic examination of economic growth, it may seem that such changes will only stem from Schumpeterian growth and the adaptation of liberal democratic reforms. However, this author cautions against overt cynicism and instead encourages moderated caution in regards to the Russian government’s ability to implement the needed reforms.

Ultimately, the question is, how threatened is the Russian system by its inability to allow creative destruction to run

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<sup>34</sup> *Ibid.*

<sup>35</sup> “The S word; Russia’s economy,” *The Economist*, November 9, 2013.

its course? Currently, Russia is taking steps that prove it can liberate itself from an overreaching government and a corrupt oligarchic system. One interesting movement in this direction has been the reappointment of Alexey Kudrin, former liberal Finance Minister from 2001. Putin appointed Kudrin to the Presidium of the Economic Council on October 31 2013. In 2012, Silvana Malle, former head of the Non-Member Economies Division at the OECD Economics Department stated, "Alexey Kudrin have been pointed out as possible leaders of alternative parties"<sup>36</sup> During the 2008 economic crisis, Kudrin played a key role in steering the country through the global financial crisis, famously quitting his position as Russia's military budget ballooned against his will. Furthermore, developments such as the government voting to allow *free* mayoral elections in Russia's largest cities, illustrate that creative destruction can be implemented from the top down.<sup>37</sup>

## CONCLUSION

By examining Russia under the lens of Goldstone's historical economic efflorescence, a less ambiguous and evolving picture of Russia's current situation surfaces. Over the years, Russia has established a consistent reliance on its key resources and over-utilization of political power to ride out its crises. These tactics were not predominantly all bad choices. They have allowed Russia to grow on many occasions. However, the bigger picture is also visible. The purpose of

efflorescence is to foster sustained economic growth and to evolve into a flourishing and modernizing economy. It is during this final transition that Russia's methods lose their appeal. High reliance on oil encourages resource addiction, allowing Russia to finance many of its problems and recover quickly from shocks. However, such reliance also causes Russia to strengthen only a few commodities sectors instead of diversifying. In an evolving world, such tactics are risky. Oil may not disappear, but developed countries throughout the world are investing in new technologies. Europe is pedantically watching its reliance on Russia, and China is voraciously scouring the globe for its own means to development. However, in contrast, this essay has also illustrated aspects that may lead to sustained efflorescence in Russia.

In recent years, a tendency for the government and private corporations to turn to various investments, such as their military modernizations, investments in infrastructure, and the expansion of oil exploration technologies may enable Russia to overcome some of its bottlenecks. In Russia, as with all nations, it is important to heed Goldstone's insight: every economy overcame economic stagnation in a way specific to its own resources and conditions. The future investments Russia plans to make, and the investments it has already made, point to a new and interesting occurrence of top-down reforms. This method is yet to be fully tested; however, it does not automatically call for skepticism.

Russia's future falls heavily on three developments: First, Russia needs to follow its proposed projects to limit its resource dependency. Second, Russia must address its legal system to stave off corruption, and implement reforms that may lead to creative destruction. Finally, as

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<sup>36</sup> Silvana Malle, "The Policy Challenges of Russia's Post-Crisis Economy," *Post-Soviet Affairs* 28, no.1, (2012), 82.

<sup>37</sup> Yulia Latynina, "How Yevgeny Roizman Became Mayor," (The Moscow Times, September 18, 2013). <http://www.themoscowtimes.com/opinion/article/how-yevgeny-roizman-became-mayor/486235.html>.

the social attitudes, and the civil conditions in Russia evolve we can heed Goldstone's claim:

It just so happened that in the background of ...efflorescences – that of eighteenth-century England—there lurked a particular *cultural content* ... that combined with that otherwise normal efflorescence to create wholly novel breakthroughs...<sup>38</sup> (Emphasis added.)

Cultural content was the creation of a “scientific culture” in England, which led a rich culture in experimentation eventually leading to the invention of the steam engine. This *cultural content* will always be different and specific to a country. For Russia, a cultural content may be budding in its civil society's changing temperament. Larger swaths of Russian citizens now express new desires and demands; they want a new way to structure their lives based on less corruption, more freedom to protest, advanced avenues for entrepreneurship by shrinking oligarchic monopolies, and enhanced access to the global economy which brings with it a vast array of goods. It is possible that among those many demands lay the fodder for structural change in Russia.

Regrettably, over time, the ability of Russia's civilians to cause upheavals against the system seem to be combatted by strict laws and centralized power. As the world around Putin gives birth to more protests and rebellions, he appears to become more cautious of domestic ruckus. Depending on the tide of civil society, Russia could be compelled to meet the demands of its

middle class. Those citizens, who want more than abstract GDP growth, will demand for the diversification of their economy. As civil unrest strains the power-sharing structure between the government and the oligarchs it is undeniably important when considering Russia's ability to break from its “otherwise normal” oscillations between efflorescence and stagnation, to look for the creation of a “cultural content.” Such content will define Russian society in a way best suited for advanced growth. This will be both a structural change and consequently, a change in the collective mentality.

As Russia continues its struggle to sustain efflorescence, analysts should consider a Russia-specific phenomenon as the solution. It is only in this way that observers will understand more holistically the potential for sustained, and enduring efflorescence in Russia.



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<sup>38</sup> Goldstone, Jack A, “Efflorescences and Economic Growth in World History: Rethinking The “Rise Of The West” and The Industrial Revolution,” 376.