

*Center for Strategic and International Studies
Russia and Eurasia Program*

“A Development Strategy for Siberia”

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Speaker:

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Moderated by:

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Dr. Inozemtsev began by describing a brief history of the Russian development of Siberia. Siberia was developed for the last four hundred years as a sort of colony of Russia. There were many similarities in the development of Siberia with the process of colonization that the Europeans conducted in North America. The Europeans in N. America and Russians in Siberia began this exploration of new regions at a similar time. For example, the first Siberian cities were founded about thirty to forty years later than those of the first colonies in the U.S. But after this point the development of Siberia and the nascent United States went along very divergent paths. Today, Siberia is a huge, underdeveloped region in the Russian Federation. Therefore, the issue of how it may be developed into a more modern and industrially advanced part of the country must be addressed.

For many years, the central government extracted much wealth and income from this region. Nevertheless, Siberia did not play a pivotal role in Russia's economy nor was it the historical center of Russian power. This is because the population of the region was historically small, and the trade between Siberia and the center or with Europe was not very significant. Beginning in the 1930s, through the process of industrialization and the relocation of industries to the region during WWII, Siberia developed into an economic powerhouse for the Soviet Union. From the 1960s and 1970s onward, Siberia became the center for growth in extractive industries of raw materials. In the last years of the Soviet Union Siberia nevertheless was not a primary engine of the Soviet economy, though it did play an important role. In 1989 Siberia contained less than ten percent of the total Soviet Union population, and was responsible for approximately fourteen percent of GDP.

Two trends have shaped Siberia's development over the past thirty years. First, the dissolution of the Soviet Union led to the creation of the Russian Federation and other states, thus reducing the size of both the population and economy. While the Soviet Union had a population of 260 million and a large economy, the Russian Federation's population is about 140 million and the economy much smaller; only two years ago was Russia able to manage the same levels of oil and gas production as in the late 1980s. The dissolution of the Soviet Union thus created a greater role for Siberia. In today's Russia, the population of Siberia amounts to approximately nineteen percent of the total and comprises two-thirds of

Russia's total territory. The region also produces the majority of goods consumed in the Russian economy. Approximately 69 to 74 percent of all Russian exports originate from Siberia. However, official statistics put the figure at nine percent, because the major companies in Russia are centralized, with Gazprom headquarters in Moscow and Rosneft in St. Petersburg. As a result, official statistics attribute the export of gas to Moscow, even though the products originate from Siberia. Thus, the second trend is the growing importance of Siberia as a source of funding for the federal government. In the federal budget there are two primary sources of tax income: one from the exploration of natural resources and the other from customs duties for exporting oil and gas. These payments from Siberia to the federal budget made up fifty percent of government revenue in 2012. These two trends have made Siberia the primary engine of the Russian economy.

Siberia is essentially a colony incorporated into the Russian state, yet it is a rare example of a colony wielding greater economic might than the federal center. These territories supply the center with enormous wealth and prosperity. Consequently, Siberia would benefit from greater federalism and budgetary autonomy. However, Moscow has become more conservative in its approach to financial federalism. This development is closely intertwined with the issue of modernization. Russia's modernization prospects are not bright. The problem is not only technological: in the majority of countries that have modernized, the impulse for this process came from the central government and political elite who understood that modernization is key to becoming part of the global economy. However, in Russia there are no forces for modernization because the political elite of the Putin era have greatly benefitted from the present natural resource-based economy through their investments in valuable state-owned hydrocarbon companies. As a result, federalism has been restricted via measures such as the appointment of federal governors and the consolidation of the vertical of power. The federal government funds the regions from the center as opposed to risking losing economic control by promoting locally controlled development. In 2001, approximately 300 billion rubles were distributed from the federal budget to the regional governments across Russia as subsidies. Today, this figure is 1.4 trillion rubles. This figure rises every year as the government continues to send more money to the regions in order to create dependency on the center.

Another problem with the federal government's economic policy is the usage of funds for infrastructure projects that fail to recoup their costs. Two strategies of regional development were recently adopted, one for the Siberian Federal District (2011) and one for the Far East and Trans-Baikal Region (2010). One proposed infrastructure project is to build a bridge from the continent to Sakhalin Island (an 8.5 km distance). This is a technically simple feat, but very expensive. However, there is just one large city on Sakhalin--Yuzhno-Sakhalinsk--which lies 450km to the south of where the bridge would be built. Moreover, there are only 150,000 people per year who move between the island and the continent. If this bridge is built, it would require 1200km to go from Yuzhno-Sakhalinsk to Blagoveshchensk. This project would cost tens of millions of rubles and would only benefit a relatively small number of Russian citizens. Another proposed infrastructure project is the Bering Strait tunnel, which would link Chukotka to Alaska. The tunnel is estimated to cost over \$60 billion but would only boost trade by \$1.5 billion. Despite such projects' lack of financial viability, federal funding for infrastructure development continues.

The Russian government's plan now is to create a state corporation to develop Siberia, through which funds from the federal budget can be channeled. The maximum amount of money that would be allocated to this corporation is \$15 billion per year. However, Russia's export revenue in 2012 was about \$528 billion, with the Siberian share of this about \$450 billion. Thus what the government is

essentially proposing would still allow Moscow to take the \$450 billion in export revenue from Siberia while only giving back \$15 billion through this state corporation.

Dr. Inozemtsev proposed a policy that would reconfigure the financial relationship between Siberia and the center. This policy would not advocate for Siberian separatism or independence, but would find a way to accommodate Siberia into Russia more comfortably, and would promote modernization for both Siberia and Russia as a whole. He promoted the idea of allocating 25 to 30 percent of the revenue raised from hydrocarbon and raw metal extraction towards a regional development fund. This plan would allow for greater funding to launch development projects in Siberia and would deprive the central government of part of the income that allows it to stall on implementing modernization projects.

Russia needs to somehow narrow the scope of its development initiatives in the Siberian region and the Far East. Considering that the majority of the Siberian population is concentrated in large cities, these modernization projects should be focused on improving the economies of these populous urban areas. The best approach is to increase the effectiveness of the economy. There is no need to diversify away from oil, gas and raw mineral extraction, since Siberia has such large deposits of natural resources and raw minerals.

What should be done is a reevaluation of Russia's transportation policy. The idea that Russia should be a bridge between Europe and Asia is gaining currency, although Dr. Inozemtsev argues this idea is not feasible. On the basis of this concept, the federal government has requested that 1 trillion rubles be invested in Russian railroads, specifically the expansion of the Trans-Siberian Railway. The Trans-Siberian Railway is currently operating at capacity, transporting 120 million tons per year. But about 54 percent of all goods transported are not oil and gas, but coal and iron ore that are being sent to China and South Korea for processing. Rather than sink huge amounts of money into expanding the railway, Moscow should build plants to process iron ore and other minerals in Siberia, which would not free up half of the transported goods on the Trans-Siberian Railway.

There should also be a shift toward greater reliance on private business as opposed to state finances. Relying on private sector investment would be more cost-effective, since the state simply aims to extract cash. An emphasis on private investment may also stem corruption and the siphoning off of revenue.

Lastly, there is also an international element to the development of Siberia. Siberia and the Russian Far East are natural parts of the Pacific economy. Unlike the United States, which is a true continental power with one foot in the Atlantic and another in the Pacific, Russia has primarily focused on European markets, with around half of all exports now going to Europe.

Siberia should continue to concentrate on raw materials, but it should not be exclusively devoted to extraction and export. These materials should be processed on Siberian territory and then exported to world markets. In this scenario, China is not a natural ally to Russia, as it aims to increase raw material export from Russia to China. Russian exports to China are more commodity-oriented than exports to Europe. Russia should therefore build refining capacity and home while increasing trade with more technologically advanced countries in the Asia-Pacific region such as South Korea, Japan, and Australia, which could lead to modernizing Siberian industries and be a significant alternative to Chinese trade.

Discussion

The discussion opened with a question from Dr. Kuchins regarding Dr. Inozemtsev's proposal for the modernization of Siberia. This proposal would involve the reconfiguration of the federal funding, increasing the role of Russian private businesses as opposed to the Russian federal government, and emphasizing the development of human capital and private entrepreneurial forces in Siberia as opposed to than unprofitable infrastructural projects. Dr. Kuchins raised the issue of how best to carry out this policy. Given the predominant roles of the Russian federal government and state-run corporations, how exactly is Russia going to create an investment and production environment that would allow production to be carried out locally without federal management? Without federal management, Dr. Kuchins noted, this would amount to a virtual revolution in Russia.

Dr. Inozemtsev responded that the Russian federal government itself must acknowledge that more economic authority needs to be given to the regions. The federal government should also devote more resources and be willing to give more oil and gas field development licenses to private corporations. Currently, Gazprom and Rosneft—both state-owned companies—dominate these fields. In many cases private companies are more effective than state-run companies at implementing modernization and infrastructure projects. In 2011 the federal government hired a government construction company to build a new landing strip in the Novosibirsk airport, even though private companies could have produced the same quality landing strip at a far lower price. Instead, the project went drastically over budget and ended up costing over 4.5 billion rubles.

The next question dealt with the political implications of federalism and restructuring. How would the political restructuring of regions in Siberia and the Russian Far East affect the economic situation in those same regions?

Dr. Inozemtsev explained that the political restructuring of regions in Siberia and the Russian Far East is less important than the main goal of economic improvement. It is up to the regions themselves to realize their economic goals and understand what they can bring to the table. Kaliningrad, for example, could use its strategic location in Europe to become an airport hub for international flights traveling to regional cities in Russia, such as Yekaterinburg and Kazan, without the present mandatory flight transfer in Moscow. This could greatly benefit the Kaliningrad regional economy. Other regions should use similar methods to use the resources at hand to obtain economic profits.

A participant disagreed with Dr. Inozemtsev's argument that costly ambitious infrastructure projects such as the Bering Strait tunnel are impractical. The participant highlighted the success of the Trans-Siberian Railway as an example of large-scale projects that were dismissed initially as impractical and outlandish but ultimately proved their economic worth. The participant also suggested that Siberia should invest in processing facilities and transportation improvements to compete with Asian states. Russia has the potential to become a leader of the steel industry if it only had the processing facilities necessary.

The next question regarded ethnic tensions and migration in Siberia and the purported rise of radical Islamism in Russia.

Dr. Inozemtsev argued that migration will play a role in the future of Siberia as the region modernizes its economy. Currently, the number of people from non-Orthodox religions migrating to Siberia is increasing. Though the population of Siberia has increased in the past two decades, there is still a large

deficit in the workforce. This deficit could actually prove to be advantageous, as it allows the region to modernize its economy while the workforce is still small. It is much more difficult to modernize a regional economy when there are surplus workers and businesses have already invested in a labor-intensive status quo.

Considering that the Russian political elite appears uninterested in Russia's economic modernization because of the opportunities for rent-seeking of the current system and their own significant investments in state-owned hydrocarbon companies, what are the forces driving this modernization?

Overall, regional identities in Russia are not very strong, but in Siberia are on the rise. Expanding the region's economic self-sufficiency could strengthen Siberian regional identity, as Siberians would realize that Moscow is not the sole economic center of the country.

The following question focused on the ecological impacts of modernizing the Siberian economy. Are environmental factors such as climate change, the melting of permafrost, and the negative ecological externality costs of hydrocarbon production factored into the Siberian modernization agenda?

The ecological agenda is not a priority of the Siberian Development Plan. Despite this, ecological factors are taken into some degree of consideration. For example, Russia is not planning to melt permafrost to build additional roads in Northern Siberia.

The following pair of questions addressed issues of regional economic authority and foreign investment. Compared to China, where the individual regions are given the power to improve their own economies, do regions in Russia have the same power? Furthermore, can foreign investors become involved with these underdeveloped regions, or are they limited to negotiating with the more developed central regions of Russia?

Dr. Inozemtsev noted that because of the Russian unified tax system, there is no added regional taxation; regional authorities do not have the power to encourage private foreign investment and are therefore forced to receive permission from Moscow in order to make any major economic decisions. This is a poor policy on the federal government's behalf and should be altered.

A participant commented that universities are often major drivers of innovation and modernization. The commenter used Harvard University and the Massachusetts Institute of Technology as proof of regional economic improvements through university innovation. Why don't regional Siberian universities promote similar innovation in Siberia?

This system, though highly successful in the United States, would not function in Russia. An innovative economy is unfeasible in Russia due to constraints including the nature of the federal leadership and current economic circumstances. New technologies must be imported from Western and Asian states. Additionally, federal authorities should approach the issue from the demand side and encourage the demand for innovation. This will spur greater involvement of research institutions in economic development.

The final question addressed hydrocarbon extraction in Siberia and liquefied natural gas (LNG). How will Gazprom's proposed loss of its LNG export monopoly affect its investments in Siberia?

It is unlikely that the Russian federal government will abolish Gazprom's monopoly. The Putin administration has invested too much into the state-owned gas company and is unlikely to damage its investments and influence in Russia and abroad by eliminating the monopoly.