

THE BROOKINGS INSTITUTION

GLOBAL ECONOMY AND DEVELOPMENT PROGRAM

**Inaugural Global Agenda Forum**

**The Rising Powers: Navigating the BRICs Century**

Featuring:

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Washington, D.C.

Tuesday, February 20, 2007

MR. LINN: Without further ado, let me turn to Clifford and say, what's in store for the Russian bear? Will Russia continue to grow? Will it continue supplying the world with energy? Or is it going to be running out of steam sooner or later, and what does that mean for all of us?

MR. GADDY: Thank you, Johannes, and thank all of you. I will attempt to address the questions that Johannes raised very briefly. I want to begin, however, by confessing that I have always been one of the many skeptics of the validity or at least the usefulness of this BRIC concept, and especially Russia's inclusion in this category. But as I say, many others have criticized the idea, and I am not going to repeat what they have said.

Let me turn to the questions. First, I would say the question of substance is, What are the prospects for Russia's growth until the middle of this century and beyond? What role can it play? Second, I would like to very briefly address the question of how Russia itself perceives this concept of the BRICs.

On Russia's performance, the first and most important thing is to put it in context. Go back about 7 or 7-1/2 years. That is when Mr. Putin takes over as prime minister of Russia in the late summer of 1999. At that time, the country's foreign exchange reserves were down below \$8 billion, and they were

falling fairly rapidly. Meanwhile, Russia's debt continued to grow. Its debt to the IMF alone was a little bit less than \$17 billion. Russia was pretty much bankrupt, basically in receivership.

Fast-forward to today. Russia has foreign exchange reserves not of a paltry \$8 billion; it has over \$300 billion. In addition, it has an oil stabilization fund, a petroleum fund like the Norwegians have, of over \$100 billion. The Russian government is continuing to add cash to these two categories at the current rate of \$170 billion a year. Meanwhile, it is interesting to note that the total usable, lendable resources of the IMF, are \$250 billion. So the tables have been turned. In fact, I would say that Russia's story is one of the great reversals of recent economic history.

It is no secret, or it should be no secret, where this has come from. I say in nearly every talk I give that the Russian economy rests on two pillars, oil and gas. Despite whatever quibbles people undoubtedly have about the growing "non-oil sector," it all depends on oil and gas. In fact, I argue that how the value from these commodities is distributed throughout the economy is the real story of the economy and I would argue of politics as well.

But the importance of oil and gas in this recent and current performance suggests that Russia's future, whether as a

BRIC or otherwise, for a number of years to come is going to depend on the future value of its oil and gas. If we look at the recent performance especially since 1999, it looks good. Since 1999, Russia has increased its output of oil by an impressive 50 to 60 percent. However, the total value of Russia's oil and gas has increased by something like eight to ten times. So there is clearly more there than this impressive production growth. It is, as we know, the increase in world prices.

This question of quantity versus prices is very much the Russian challenge. Here is a bit of what it is. You, Russia, have a lot of control in theory over the quantity of the product you can produce. There are measures you can take, investments you can make, that can increase this quantity in the medium- and long-term. But it requires huge effort and will be even greater in the future.

The problem is that whatever you do or whatever you choose not to do is going to be swamped by the effect of the world price, and that is a variable that you have no control over at all. You do not have market power in oil. Or maybe there is a way you can at least have a marginal influence on the world market price of oil. If there is, you probably ought to try to find out what you can do about it. I am just saying that rationally you might be better off exerting effort to have some

tiny influence over those who do have market power than to spend all your effort trying to build up quantity if you do not know what that is going to lead to. Concretely, what I am talking about is that you might be wise to try to cultivate some good relations with the Gulf oil producers. One week ago, Mr. Putin made the first visit of any Russian or Soviet leader to Saudi Arabia and the Gulf countries. He does need the Saudis to try to keep the price up. There are those who talk about the temptation that the Saudis may have to build up excess capacity to keep the price down to make competing alternative energy sources less competitive. But the real challenge for Russia is beyond even oil and gas. The most recent official Russian energy strategy says that its oil production will peak at 2010 and decline thereafter, ending up at much lower levels than now by 2025. By 2050 it may all be gone.

So what is beyond oil and gas? The Russian government, Mr. Putin and company, recognize that oil and gas are not going to carry the country through the middle of the century, let alone beyond. They have been talking recently about issues of diversification of the Russian economy, most recently in a big meeting he had with all the key players inside of Russia yesterday in Volgograd.

The question is how concretely to use this wealth, this windfall from the oil and gas boom that we have today, to

build for the future, to create an economy that continues to grow without the oil and gas. It is quite a challenge and so far has not been handled well. The basic picture of what has been done with the windfall up until now is that it has been overconsumed and underinvested. Investment in Russia is actually a dual-edged sword. There is a lot of investment in Russia that is very high-cost investment. Such investment is a way of sharing this windfall and this rent that I referred to. There is very little bang for the buck, and that picture does not seem to be getting much better. There is a lot of excess spending and investment, especially in construction. Therefore, even when they do talk about investment or diversification, much of it is a little bit of "Give me my share of the rents."

Next, if the oil and gas future is perhaps the most serious challenge to Russia's role for the rest of the century, I would say that a close rival is demography, the question of human capital. You are probably familiar with the shrinking Russian population, one thing that clearly distinguishes Russia from the other three members of this BRIC group. It is pretty bad across the board. The worst part of the situation is male life expectancy, male death rates, and especially in prime working ages. Russian males in prime working age - those between, say, 25 and 55 years of age - are dying at rates that are 4 to 4-1/2 times higher than Americans, 7 to 10 times higher

than some Western Europeans. The biggest discrepancy of all, and the most disturbing thing, is that it is worse at younger ages and not at older ages. Russia's death rate for 25- to 35-year-olds is a whole order of magnitude higher than Scandinavia's. In Russia, a 35-year-old has the same chance of dying as a Swedish 60-year-old. It is getting worse, by the way. A 30-year-old male has a 48-percent greater chance of dying now than in 1999. That is not exactly a feather in Mr. Putin's cap.

Let me just quickly end by talking about the Russian perception of the BRIC concept. At the time that Goldman Sachs launched this idea with their paper in the fall of 2003, I think there might have been some temptation for the Russians to think of the BRIC concept as meaningful for them. The BRIC idea says that your role in the world, your importance and your stature, depend on your economic performance, especially your performance in the global market economy. There was a brief window between the time Mr. Putin came in and roughly up to 2003, perhaps 2004, when I think Mr. Putin did see market economic performance as the key to Russia's future. This was, however, before the real oil boom. Since then - and this is not something that happened all at once; it has been a gradual realization - there is increasingly the sense that oil is the key to Russia's future. Back in the old days Russians talked about oil dependency as

being a bad thing. They used the phrase, "Russia is nothing but a raw materials appendage of the capitalist system." Today it is talking about being an energy superpower.

Frankly, Russia today does not think of itself seriously as a member of the BRICs. My colleague, Igor Danchenko, pointed out to me that the concept itself really is of no interest in Russia. If BRIC did not include Russia, he said, no one in Russia would pay it any attention. It is only because Russia is in it that Russians feel that they have to talk about it. Occasionally they will use it in a tactical political sense. But it is not a serious concept in their minds, and I think it is becoming less so. Thank you.

MR. LINN: Thanks very much, Cliff. Actually, I think this perspective that you brought in, namely, how does that BRIC concept look from the country's perspective, is very interesting and maybe each of our two other country speakers could briefly talk about this.