

# Modernization and the Crisis<sup>1</sup>

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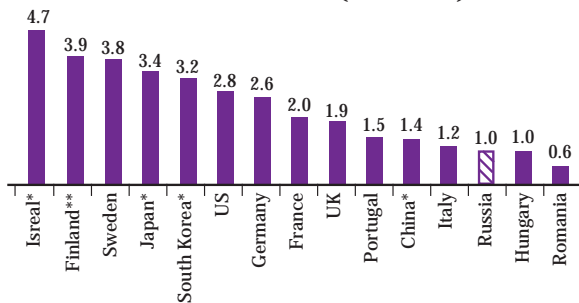
*The financial crisis of 2008-2009 has played a positive role in the world's development. It highlighted the weaknesses of the global economy, including imbalances, lack of financial discipline, and improper regulation. Addressing these weaknesses may help avoid, or at least alleviate, major upheavals in the future. Most countries are becoming increasingly concerned not only about their exit strategies, but about their long-term policy in the post-crisis environment.*

## The deeper you fall, the higher you climb

Russian economy shrank significantly over 2009; the real GDP fell by as much as 7.9%. The crisis once again raised systemic questions about the country's future development: how to lay more solid ground for future growth; how to improve its quality and speed-up structural changes, thus making the economy less susceptible to external shocks and increasing its competitiveness in the world market. Modernization and innovation, though important in the past, have now become the centerpieces of the new approach.

The long-term concept of Russia's socio-economic development envisages quite aggressive increases in indicators that relate to modernization. In particular, the program implies an almost 4-time growth of R&D spendings by the year 2020, when they are estimated to account for 4.3% of GDP. This will, hopefully, not only move Russia to better standing across countries (Fig.1), but will lay basis for longer-term modernization results. The expected share of Russia in the world's exports of high-technology products will equal 2%, a 7-fold increase from the current level.

**Figure 1. R&D expenditure in selected countries in 2008 (% of GDP)**



\* 2007  
\*\* 2009

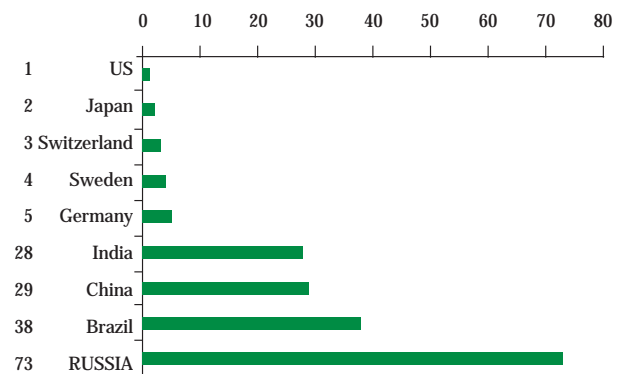
Source: Eurostat, national statistics.

Modernization as a process of renewal and improvement is, in fact, endemic to any form of development in a competitive environment. The current state of the economy, however, makes this process quite challenging.

<sup>1</sup> The article expresses private views of the author

The index of global competitiveness scores Russia well below other BRIC countries (Fig. 2).

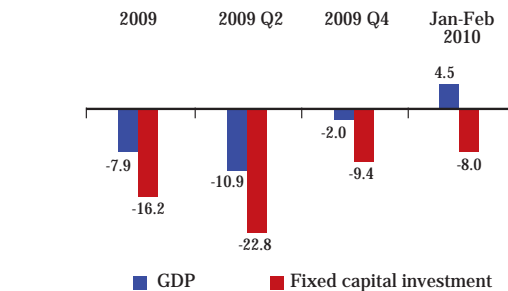
**Figure 2. The Global Competitiveness Index ranking (innovation factors) 2009-2010**



Source: World Economic Forum "Global Competitiveness Report 2009-10".

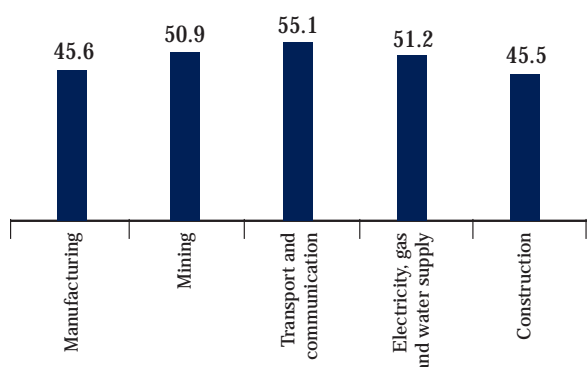
With the current level of fixed-capital investments being strongly affected by the crisis, the need to improve fixed-capital base remains acute (Fig. 3-4).

**Figure 3. GDP and Fixed capital investment in 2009 and Jan.-Feb. 2010 (growth rate, %, y-o-y)**



Source: Rosstat, Ministry for Economic Development.

**Figure 4. Depreciation of fixed capital by sectors (end of 2008, %)**



Source: Rosstat.

Most sectors seem to face the problem of asset depreciation, but trying to solve this problem on the across-the-board basis does not seem possible due to the budget constraints in the first place. Thus, priorities in the structural policy may serve as an important guideline for future action.

The «2020» concept, adopted by the Ministry of Economic Development of Russia, as well as other programs, outlines a number of sectoral priorities and directions: civil aviation, IT, space technologies and telecommunications, medical technologies, machine-building sectors, energy-efficiency in general, and some other areas. It is highly important that the sector-based approach not only contributes "new" elements per se, but also endorses a wider range of criteria: social returns, high multiplying effect on the rest of the economy, stimulation of further economic development, etc.

### Structural and financial logistics

A large number of institutional approaches and support mechanisms may be considered at different levels. Small enterprises may be the starting level, at which new solutions can be generated. Their individual impact may be small, but proper organization of the process in its integrity will increase the chances of having tangible results in the end (we all remember how modern computers have started).

A more structured approach aimed at creation of "high-tech ideas" (like the creation of the "silicon-valley" type research centres at Scolcovo, which has been announced recently) should be welcomed. Innovative clusters, particularly those that use mechanisms of private-public partnerships (PPP), may look like a promising direction. General coordination of activities at different levels, particularly at the starting phase, may be worthwhile.

It is particularly important to pay attention to the entire composition of technological chains, rather than to their separate components. The role of PPP increases, when the attempts of individual players are hampered by budget constraints (which is often the case), thus increasing the need to provide adequate (preferably long-term) funding. Tax benefits may play their stimulating role as well (R&D tax credits included).

### Can growth and restructuring coincide?

To undertake restructuring and maintain growth at the same time is a difficult task - one cannot change the sport suit while running and still keep the speed. However, some instruments may help solve these two tasks simultaneously. The reduction of taxes - the VAT in the first place - is one example. While lowering taxes in general may stimulate growth for most sectors of the economy, VAT reduction makes this stimulus more focused.

The main beneficiaries become the spheres with the higher degree of value-added. The broader base for their growth, vis-à-vis less progressive sectors, will increase their role in the economy and encourage growth at the same time, improving the quality of such growth. The latter is viewed as an important task and should be addressed on a continuous basis.

Tax measures can be supported by the monetary policy mechanisms, when debt or other instruments of high-tech companies are accepted as collateral in refinancing, thus enabling a targeted flow of funds into the economy. Incentives that may come from provisioning can also be considered.

For new policies to have tangible results, more focused, multi-faceted approaches are needed. Pro-active economic policy, availability of adequate financial support, targeted use of technical incentives, efficient coordination between entities and regulators, and, of course, generation of new good ideas - all these elements are crucial to making modernization a driving force of the future economic development.

The emerging elements of new approaches give a clear message that the long-term policy is about to take shape. With numerous hurdles yet in place, such policy should be focused and consistent to surmount the barriers and to lay basis for future success.