

The Russian Far East: Post-Crisis Dynamics of Social-Economic Development

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Abstract— The authors review trends of economic development of the Russian Far East during 2010-2017, study the response of the national and regional economies to the crisis of 2014, and analyze the conditions and problems that exist in the main sectors of the region's economy. We demonstrate that there were no significant structural changes in the Far East's economy and industrial potential remains the region's chief strategic resource. We note that growth stability in the mining sector almost entirely depends on foreign demand and exchange rate stability, while processing industries depend heavily on domestic Russian demand, which has been degrading recently in its private component while public demand has been mostly stable. We show that remaining complications in access to foreign sources of capital and technologies make uncertain the future growth of the region's economy as a whole.

Keywords— *economic development, the Russian Far East, investment, industrial production.*

1. INTRODUCTION

Economic dynamic, as any other kind of temporal change, is non-monotonous. Economic activity is inherently cyclical. According to N.D. Kondratiev, wavelike (repeatable or reversible) processes "...at any given moment have a direction and, therefore, constantly change it... where a phenomenon, which is in a given state at a given moment, by changing [its state] can eventually return to its original state" [1]. A serious treatment of economic activity as a cyclical process must start from the assumption that the trajectory of an economy's states is shaped not only by random, chaotic deviation from the mean but more so by certain deterministic factors driving the regular cycle.

The cyclic nature of economic activity is axiomatically accepted today for the global and national economies, but the existence and nature of the economic cycle at the regional level is more of an open question. The answer to that question is not immediately obvious for two main reasons. Firstly, due to the extremely open nature of a sub-national region's economy which interacts with both the economy of the region's nation and that of the outside world. Secondly, a region's economy is influenced by the redistribution of financial resources through the central government's budget. The exact parameters of this redistribution differ over time and depend on the national economic, political, geostrategic, and social priorities.

Overall, however, economic activity in a region should be well correlated with the national economy. In other words, the cycles of main macroeconomic indicators of a region should mostly coincide with those of the nation with any differences being due to a region's specific structural features[2].

2. SOCIAL-ECONOMIC DEVELOPMENT IN 2010-2017

The trajectory of Russia's economy in 2010-2017 was unstable. This instability was due to the shock of the global financial crisis of 2008, as well as later shocks of falling oil prices, massive devaluation of the ruble, financial and technological sanctions and Russia's "counter-sanctions" [3]. Far Eastern economy's reaction to these shocks differed from that of the national economy. The difference was due to the structural specifics of the Far Eastern economy and behavior of state owned enterprises and private investors in the region (Table 1).

Table 1. Main economic indicators of the Russian Federation (RF) and Far Eastern federal district (FED), %

	2017/2010		2017/2013	
	RF	FED	RF	FED
GDP (GRP)*	112.3	105.9	101.5	102.9
Industrial output	109.3	128.9	100.3	111.0
Fixed capital investment	109.3	97.4	91.6	105.0
Exports	72.0	100.2	54.3	66.1
Housing construction	134.5	119.5	111.5	90.6
Real household income	100.0	105.7	89.1	93.4

Note: * - data for 2016.

Sources: [6;7]

The difference in the reaction of the Far Eastern economy from the national average trend is due primarily to the higher than average share of mining industries in the region's GRP. This share had experienced marked growth throughout the period: while the national GDP structure remained mostly stable through 2010-2016, mining industries in the Far East had increased their share of the region's GRP from 24.3 to

28.2%. The start of new projects and increased output from existing mineral and fuel mining projects had made the structure of the economies of Yakutia, Magadan oblast, and Chukotskiy autonomous okrug noticeably “heavier” (Ошибка! Источник ссылки не найден.).

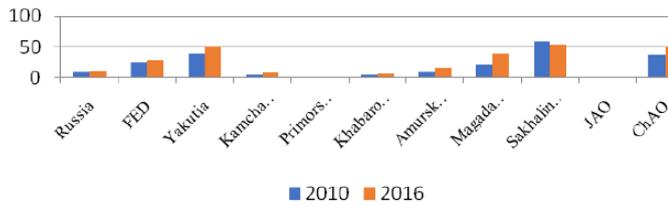


Fig. 1. Share of mining industry in GRP, %

This can be seen as one of the paradoxes of “managed development” of the Far East. After almost half a century of efforts to diversify the region’s industry, to modernize the industry’s structure, including such diversification and modernization as a key goal in the many state programs and strategies of regional development, the monospecialization in the mining sector still remains the key feature of the region’s economy.

High growth of the mining sector was due to both technological factors internal to the sector itself (new deposits started, upgraded production on existing deposits) and growing demand on export markets. These factors, along with the initial high share of the mining sector in the region’s economy, had decreased the depth of the trough and shortened the recovery period for the Far Eastern economy in the crisis of 2009-2010. They had also smoothed the contraction of the region’s industry after 2014 (Ошибка! Источник ссылки не найден.2).

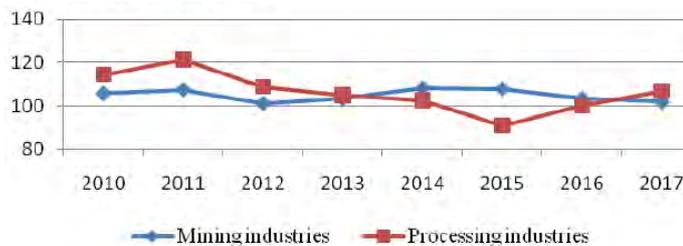


Fig. 2. Growth rates of mining and processing industries in FED, % year on year

Mineral fuels comprise the bulk of production of the Far East’s mining sector. Over 2010-2017 crude oil and gas condensate production in the region had increased by 54%, natural gas – 28%, coal – 34%.

The processing industries in the Far East include aircraft, ship, and machine building enterprises, as well as maintenance and repair industries. The share of processing industries in the region’s GRP is relatively small – the sector accounts for only 5.4% of GRP (as of 2016). Large scale production in these industries is concentrated in Khabarovskiy and Primorskiy

krais, therefore the situation in those two regions determines the overall state of the industry in the Far East.

The high growth rates of the processing sector in 2010-2011 were mostly due to the positive dynamic of timber processing industries and the state procurement of aircraft and ships for civil and defense purposes. However, starting in 2012 the output of these industries was in gradual decline until it had reached negative growth rates in 2015. The main contraction occurred in the most diversified regions: Khabarovskiy and Primorskiy kraia. Likewise, the return to positive growth in the Far East’s processing sector in 2017 was due to impressive growth in those two regions (over 120% over the output level of 2016). The chief factor limiting growth in the processing sector today is the lack of investment due to restricted access to international sources of capital and high domestic interest rates for borrowed funds.

Additional stimulus is needed to spur the region’s economic growth. Traditionally such stimulus came via increased investment in new large-scale projects. High economic growth rates in 2010-2011 in the FED were due to high investment growth (Ошибка! Источник ссылки не найден.3). In total in those two years, 1848.2 bln rubles were invested in the region.

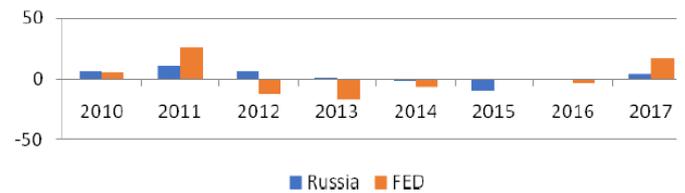


Fig. 3. Annual growth rates of fixed capital investment in Russia and FED, %

During that period the Far East lead the other federal districts in the area of investment growth. This boom of investment was mostly due to the federal efforts to breach the region’s gap in transport and energy infrastructure which became the limiting factor in further development of available natural resources and their export to the Asian Pacific region. After the completion of construction projects for the APEC Summit in Vladivostok in 2012, as well as most of the major transport and energy infrastructure construction projects, the investment boom in the Far East had quickly died out and 2012 had already ended with negative investment growth in the region. This contraction was further prolonged after 2014 due to the negative influence of two external factors: the fall of oil prices and worsened conditions on international capital markets for major Russian corporations. The decline was reversed only in 2017 when investment in the FED grew 17.1% from the level of 2016. Most of that growth was due to the growth of investment in Amurskaya oblast (136.6%), Republic Saha (Yakutia) (135.4%), and Sakhalinskaya oblast (117.3%).

The growth of investment was mostly due to pipeline construction projects (especially the “Power of Siberia” pipeline), space port “Vostochniy”, and infrastructural investment for the territories of accelerated development

(TORs). TORs, along with the “Free port Vladivostok”, are the projects the federal government relies on the most as future drivers of investment in the Far East. However, according to Russian experts these expectations might turn out to be exaggerated. The main limitations for the inflow of investment through TORs and the “free port” regime are an overly complicated system for the support of investment projects, and an excessively large number of TORs [4, 8].

Foreign experts also agree with this assessment. According to Son Won Yen, a professor at Incheon National University (Republic of Korea), the Korean business community has so far been reserved in its assessment of prospects of cooperation in the Russian Far East [5]. The reasons for this include:

- the large number of TORs given the limited public resources for infrastructure development;
- high levels of corruption and criminality;
- a difficult to untangle system of interrelations between federal, regional, and municipal governments, as well as the newly created “development” agencies;
- lack of skilled labor.

Foreign economic relations are another important aspect of the Far East’s development. The most favorable period in this area recently was 2010-2011 when the Far East’s total volume of trade with foreign countries grew from 16.9 bln USD in 2009 to 34.4 bln USD in 2011. Exports during the same period had increased from 11.9 to 25.2 bln USD (2.1 times) and imports – from 4.9 to 9.2 bln USD (1.8 times).

This increase in foreign trade occurred against the backdrop of the ruble’s growth against major currencies and growing real household incomes. A major factor contributing to the growth of the region’s trade was an increase in demand on Far East’s traditional export markets in Northeast Asia. However, in 2013-2014 the overall economic contraction and decline of domestic demand, falling oil prices, and ruble’s depreciation had led to a drastic decline of the Far East’s trade.

Needed to note here that neither growing exports nor imports had become a driver of the region’s economy’s growth. Likewise, foreign trade receipts didn’t lead to the accumulation of income in the region itself (Fig. 4).

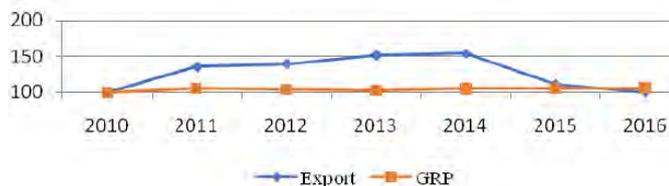


Fig. 4. Indices of exports and GRP growth in the Far East, %, 2010=100

The reason for this lack of foreign trade income effects for GRP are weak interindustry links inside the region’s economy which prevents the growth of external demand for the products of mining industries from transferring into growth of aggregate regional demand.

CONCLUSION

The overall economic situation in the region is still determined by growth inertia of dominant industrial sectors - no significant structural shifts in the regional economy have been achieved over the preceding period. The region’s economy is still focused on two markets: foreign markets of mining products (timber, mineral ores and fuels), and domestic markets of products of the processing and defense industries. Growth dynamics in the mining sector, therefore, depends on the stable demand on foreign markets and stability of the exchange rate. Processing industries heavily depend on domestic demand, the private sector’s component of which had been significantly degraded while the public demand for the defense industry’s products had been generally stable.

Relative stability on foreign markets of raw materials allows for low but positive growth rates in the mining sector. However, degradation of domestic private (and even public) sector demand, along with remaining complications in access to foreign sources of capital and technologies, make uncertain the future growth of the region’s economy as a whole.

Intraregional demand had entered a depression due to the finalization of most of the large infrastructure projects, slow progress in starting new infrastructure development initiatives, and especially – the falling real household incomes in the region. This attributes also to the uncertainty of future growth of the region’s economy.

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