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IMF warns Russia of reform or recession

Russia has dashed hopes that the 2008-2009 economic crisis would spur needed economic reforms aimed at modernising the economy, a mission from the **International Monetary Fund** has concluded.

Current policies "are not ambitious enough and not focused enough", said Juha Kähkönen, head of the IMF mission that spent the past two weeks in Moscow meeting senior officials. The mission warned that failure to reform **Russia's oil export-driven economy** would leave the country vulnerable to another recession triggered by a drop in oil prices.

The fund has counselled Russian officials on the need to reduce the non-oil budget deficit from its current level of 11 per cent of gross domestic product to 4.7 per cent and increase interest rates to head off rising inflation.

The collapse of Russia's economy in 2008-2009, when GDP fell nearly 8 per cent, laid bare the shortcoming of an economy that remains heavily skewed towards consumption and has very low investment rates.

Many economists have warned that Russia faces stagnation unless it rationalises a budget process that is politically beholden to special interests and focused on social spending.

Alexei Kudrin, finance minister, said last year that tax breaks given to Russian companies alone were equivalent to 5 per cent of GDP. “We could cure our budget deficit without increasing rates just by getting rid of tax breaks,” he said at the time.

But rather than tackling politically tricky cuts, the government under prime minister Vladimir Putin introduced a payroll tax on businesses. The move has been widely criticised for driving small and medium-sized enterprises back into the shadow economy. Mr Kähkönen called the payroll tax “bad for growth”.

Most Russian economists say the central economic problem is fighting inflation, which is predicted to be 8 per cent this year, well outside the government target of 6-7 per cent.

The government has missed its inflation target in 10 of the past 11 years, said Sergei Guriev, rector of the Moscow-based New Economic School. “The most important problem with inflation is that missing the inflation target undermines the government's credibility. It is time to show that the government is capable of sticking to its own promises," he said.

He welcomed proposals **announced in March by President Dmitry Medvedev** aimed at improving the investment climate, such as appointing independent directors to the boards of state companies, but said "they have to be implemented to have any effect".