

Consolidation of the Russian State and Economic Policy Scenarios Under Putin

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From Liberalization to Institutional Change

Russia is currently on the edge of a third stage of economic and political reform. The first stage (1985-1991) was political liberalization. Transformation of the communist political and ideological regime with a turn toward democracy was at the heart of the whole Gorbachev period. This stage culminated with severe political crisis (the coup of August 1991) and the split of the Soviet Union.

The second stage (1992-1998) was that of economic liberalization. Price liberalization, continuous attempts at financial stabilization, and mass privatization of state-owned property were the main components of change in the Yeltsin period. This stage ended with the financial and economic crisis of August 1998, which also led to a political crisis and changes in government policy.

The third stage of transformation is on the agenda now. The Putin stage is supposed to be a time of broad institutional consolidation. Restructuring of enterprises, stimulating competition, rebuilding market infrastructure, and searching for investment are typically cited as the most critical economic issues. However, consolidation of state institutions is the most essential element of this next stage.

Consolidation of the state has broad implications for economic policy. Choices among different ways and scenarios will lead to different paths of economic activity. The task of this memo is to display the most important policy alternatives, and to estimate the probability of their implementation.

Nationalization of Property Versus Establishing State Control

Calls to reconsider the outcomes of privatization are continuously enunciated in Russia today. One solution could be renationalization, and the dangers of nationalization are widely discussed and contribute to the unfavorable investment climate. However, these dangers are largely exaggerated. State authorities at all levels have already taken a different path by establishing their control over the largest semi-state and non-state companies by approving and replacing management teams. Such an indirect way is more effective than formal nationalization of previously privatized properties. As the process

continues, representatives of the state as a corporate owner of large companies will become more active.

Effective Management Versus Privatization of State-Owned Property

It is generally understood that state-owned property is ineffectively run in Russia today. One solution is to further privatize assets, and another is to improve the management of state companies. Privatization of state-owned property will no doubt be an area of intensive struggle. However, we know that attempts at further privatization have been effectively opposed since the success with a big holding--Svyazinvest--which was sold for \$1,875,000,000 in 1997. Therefore, the trend seems to be in favor of managerial improvement, and the list of "strategic enterprises" not subject to privatization will be extended.

Combating Corruption Versus Administrative Restructuring

The need to combat corruption dominates the program statements of all political leaders in Russia today. According to official data, about 6,500 cases of bribe-taking were disclosed in 1999. Only 5-8% of those accused of taking bribes in Russia are normally imprisoned. But these numbers can be easily increased. There are also calls to make punishments for civil servants more severe. Russian society is being prepared by the mass media for a large-scale anti-corruption campaign. However, an alternative method is through fundamental reform of civil service aimed at weakening the dependency of economic actors on bureaucrats. The principles of administrative restructuring include:

- decrease in the number of economic activities subject to administrative restrictions;
- improvement of legislation that prohibits officials from direct intervention in economic issues; and
- institutional centralization of surveillance functions and curtailment of the number of institutions imposing immediate control over economic activity.

Reform of the civil service would probably be more effective than chasing corrupted officials (though the latter is useful as well). However, Russian political leaders probably prefer an easy and visible campaign to fight corruption for the purpose of thwarting political opponents and gaining popular support.

Commercialization Versus Monopolization of Protection Services

A consolidated state has to provide safety to economic actors. Given the fragmentation of the Russian state, protection services are delivered on market terms by a large number of legal agencies and criminal groups. State security agencies have been strengthened within

the last decade. The number of policemen reached 150,000 in Moscow alone, which is several times more than in other major cities in the world. The first way of dealing with this growing force is to further commercialize protection services and stimulate competition among different security agencies. The second way is to monopolize the rights of the state regarding protection--this route is expected to be more influential in the near future.

Monetary Consolidation Versus Printing Money

Restrictive monetary policy has led to a situation where many actors (regional administrations, commercial banks, and enterprises) issue their own money substitutes. As a result, more than half of transactions among business partners are carried out through barter and mutual offsetting. Persistent calls to print more money abound despite opponents of monetary emission, who point to the danger of inflation. The deficiency of the money supply is not the main problem here: it is battles over the definition of means of payment, which gives power and control. National integration can not be completed without attempts by the federal state to gain much more control over money and do away with a large part of money substitutes.

Increasing Debts Versus Collecting Taxes

The size and structure of the state budget is a crucial indicator of state capacity. The minimal state budget we have in Russia today is not sufficient to meet all state obligations, according to existing laws. The first way is to cover deficit and enlarge capacities by borrowing money from international and home institutions. Given that the amount of IMF transfers is limited, short-term state securities were brought back to the market on February 23, 2000. There is a danger that a new financial pyramid will be developed with ruinous outcomes similar to that of August 1998.

The second way is to improve tax collection. Inability to collect taxes is a clear manifestation of the weakness of the Russian state. According to official data, about one half of nominal tax payments are actually collected and only one third of nominal taxes are collected in "live money." Though rewarding, tax collection is a hard task, which requires significant changes in the taxation system.

Maintaining the Tax Burden Versus Decreasing Tax Rates

It is widely known that the Russian taxation system is complicated and changeable. It privileges the Tax Inspections Service in their relations with economic actors. What alternatives are there? The first way is to maintain the existing tax system, ensure political pressure on the largest debtors, and keep selective control over the mass of economic agents. The second way is to decrease the tax burden, limit the number of taxes, and simultaneously impose stricter control over tax payments and tax exemptions. The actual policy is controversial in this respect. Some taxes (e.g., profit tax and value-

added tax) are decreased. There are fluctuations in the rates of personal income tax over years as approved by Russian legislators. As for the wage funds taxes paid to the state social funds, they still remain unchanged, despite severe criticism.

Giving Subsidies Versus Creating Guarantees for Investors

The role of investment is crucial for economic growth. At the same time, state budget resources are severely limited, making the problem of resource allocation even more demanding. State authorities used to give direct subsidies: one alternative is to create guaranteed funds for attracting private investment. Limited state budget funds should also be used for developing production and service infrastructure. A second alternative is more efficient than direct subsidies for individual projects. However, state officials at all levels are reluctant to avoid this customary mode of financial support, since it gives power to the distributors.

Open Market Versus Support of Domestic Producers

A third alternative is to open markets for foreign capital or to stimulate exports and protect domestic producers. The new government will likely favor the latter policy. Protection of Russian producers is implemented by raising import tariffs, distributing state orders to domestic actors, and maintaining a lower exchange rate for the Russian ruble. After the 1998 crisis, domestic producers had opportunities to develop given the dramatic devaluation of the ruble and the curtailment of imports. Attempts are being made to extend this situation for a longer period.

Raising Social Assistance Versus Restructuring of Social Transfers

The Russian state's financial obligations in the field of social policy and social assistance exceed the capacities of the state budget. It is admitted that the targeting of social assistance is very imperfect in Russia because it does not diminish inequalities. There are continuous attempts to raise wages, pensions, and subsidies to the deprived categories of the population, which are not backed up by financial resources. A radical restructuring of the social sphere is required. It includes two main elements: first, the targeting of social assistance should be improved. It must replace distribution of payments to dozens of social categories, which produces significant leakage effects. Second, the resources of population should be tapped for meeting social needs through a system of accumulated private pensions, parity financing of education by the state and families, voluntary insurance programs, etc. The Russian government tries to postpone these "unpopular measures," but they will need to begin the reforms within a few years.

Searching for External Versus Domestic Enemies

While it is presumed that political leaders must have a program of action, Russian leaders since ex-premier Yevgeny Primakov have stopped talking about their programs. Vladimir Putin explicitly follows the same line. The Special Center for Strategic Studies was established by several academic institutions to attract the best intellectual forces and to present a clear-cut program for the future president of the Russian Federation. There is an impression, however, that the main task of this Center is to maintain the illusion that such a program exists. It gives Vladimir Putin the opportunity to use the "we have a good program but do not show it to anyone" argument. Putin's reluctance to be subjected to criticism before the election was evident. But highly probable, positive programs are not considered an efficient instrument for consolidation. Relatively stable economic growth would be a more impressive argument. Given the absence of economic growth, politicians usually prefer to identify and combat some common enemy.

Combating communism is an outdated claim, which was good for the year of 1991. NATO bombing of Belgrade in 1998 contributed to the national consolidation of Russia much more than five-year talks about the communist danger. The war in Chechnya has enforced this process even more effectively because it takes place on the national territory and Russian soldiers are involved in military conflict.

The main problem for the political leadership is to find a mobilizing target for the future. There is little interest in aggravating Russia's relations with the West. Thus, we should expect of Russian policymakers their further cooperation-and-distancing games with NATO. At the same time, there will be searching for proper subjects to fight inside society. Corrupted officials and terrorists could be considered as good targets for the near future.

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