

Strategy for the Development Of the State to the Year 2010

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I. Introduction

One of the most important functions of the nation's supreme authorities, is to establish strategic goals. The discussion of a strategy for the development of the Russian Federation in the period up to the year 2010, and beyond, may be defined as a most urgent task for the State Council, working under the nation's President. A strategy of social and economic development will broaden the system of purposive guidelines and serve as an incentive for a shift of emphasis onto qualitative parameters of economic growth, thus becoming an important supplement, and a new basis, for the current and medium-term macroeconomic program, which the Federal government is developing and carrying out in practice. Such a strategy is to establish criteria for evaluating the intermediate results of the implementation of the government pro-

gram, and to make it possible to review the activity of institutions on the federal and regional level, from the standpoint of strategic principles and goals for the development of Russia.

This strategy should be based on lofty long-term goals, which are simultaneously worthy of Russia, and achievable. One such strategic goal would be the transformation of Russia into a dynamically developing economic power, which provides average European standards of living (under uniquely Russian climatic, other natural, and geographic conditions), on the basis of strong labor and business initiative, and a rational and consistent economic policy.

The objective preconditions for achieving this goal are high rates of economic development, which markedly surpass the rates in neighboring countries and the world community as a whole. Thus, the creation of conditions for effective economic growth, based on investments in the technological and structural modernization of the domestic economy, which raises the level of welfare of the citizens of Russia, becomes a most important goal of the Russian state.

The qualitative parameters of economic growth assume primary significance. We need not merely achieve "high growth rates," nor "production for production's sake." Growth rates should result from the achievement of specific, palpable benchmarks in the popular welfare, the successful solution of the urgent tasks of technological and structural modernization, and the realization of more of Russia's competitive advantages in the world arena.

II. Social Consolidation as the Basis of the State's Development

The key factor, hindering the consolidation of our statehood, is the deep divide in Russian society, which runs along socio-cultural and economic axes. The main sections of society are diverging further and further, in their values, their level of welfare, life styles, models and norms of behavior, and so forth. This "scattering" makes it extremely difficult to create democratic institutions of the state and civil society, insofar as the very basis of democracy disappears—social consensus about the basic values and principles of life.

The formation of two diametrically opposite, contrasting values models may be observed in society. One of them, the traditionalist model, is characterized by an orientation to the



Khabarovsk Gov. Viktor Ivanovich Ishayev. The report "Strategy for the Development of the State to the Year 2010," was prepared under his leadership.



Street vendors try to sell a few vegetables to cash-strapped Muscovites. “The social divide not only causes instability, but . . . is one of the main limits, today, on the mobilization of the enormous potential, embodied in our existing human capital.”

principle of “living like everybody else,” state paternalism, and collectivism. The other, the modernization model, is characterized by the priority of individualism, the achievement of personal success, material and pragmatic values, etc. But, there is no concomitant formation of a generalized social type of the worker and entrepreneur, whose orientation is toward risk for the sake of high incomes, and readiness to limit current consumption for the sake of future welfare, and so forth.

Socio-culturally and economically, two unequal social layers have formed in Russia — those who are adequately provided for, and the poor. The former, who have maintained or improved their pre-reform standard of prosperity, comprise 25-30 million people, or one-fifth of the population. Of them, 8-10 million people (5-7% of the population) have effectively attained Western standards of consumption of food, clothing, daily life and household products, and services. Living in poverty, where average per-capita incomes do not cover the subsistence minimum, are an estimated nearly 60 million people, i.e., around 40% of the population. The monetary incomes of 25-30 million of these people are below even the price of the minimum market basket of consumption, which defines destitution. Within the “poverty layer,” persistent poverty as a mass social phenomenon is observed to be spreading, along with its typical norms and stereotypes of behavior.

As a result, our social space more and more takes on the features of “Third World” societies. The social groups of the better-off population, with their modernized values, are surrounded by the main mass of the population, with its needs poorly covered, and with its traditional values, but with stan-

dards of culture and consumption that are still higher than in “Third World” countries. Under such conditions, the consolidation of society and creation of effective economic motivation mechanisms remain problematic in the extreme. The preconditions for society’s splitting, and for social conflict, are inevitably reproduced.

The social divide not only causes instability in society, but also blocks motivation. This is one of the main limits, today, on the mobilization of the enormous potential, embodied in our existing human capital. People cannot, and, in significant part, do not want to secure a decent life through efforts in labor or business. According to sociological surveys, only one-third of the population in Russia would like to be independently employed (in Western Europe, this level is 42-65%).

In such a social milieu, the state is objectively “superfluous,” or even hostile to the main social groups. The traditionalist layer of society is alienated from the state, due to the shutdown of its entire system of social functions — guarantees in the area of social welfare, wages, education, health care, housing, security, and defense against social injustice. For the modernized segment of society, which, in significant measure, no longer needs the social functions of the state, the state appears to be an extra burden (taxes, administrative functions). In Russian society, the state always played a key role as the arbiter among diverse, often competing social groups, mitigating the acuteness of social conflicts and bringing to society the needed social order and a format for common social goals. The identification of social groups — their creation, structure, and relative hierarchy — also largely took

place through their relationship with the state.

It has always been a very important function of the state in Russia, to maintain a balance and a dialogue among the various social layers and groups within the population. The social paternalism of the state played a special role in this regard, as the state carried out a broad spectrum of social functions, which established the legitimacy and stability of the institutions of the state themselves, under Russia's unique conditions. The scale of this paternalism is expressed by the ratio of state and individual spending on social needs (health care, education, housing and services), which was an order of magnitude higher in the U.S.S.R. than, for example, in the U.S.A.

The experience of recent years shows that the creation of a strong and effective state remains possible only on the basis of social consolidation and the expansion of social support for the goals and actions of the authorities. Attempts to strengthen the state, relying solely on the consolidation of the business and political elite, are doomed to fail—above all, due to the underdevelopment of legal criteria and procedures to reconcile the interests of various economically active persons and institutions. Social consolidation is also a necessary condition for the strengthening of democratic institutions and the consistent development of civil society.

In accordance with the “bipolar” structure of Russian society today, two fundamentally different approaches have developed to the role of the state in society and, above all, with respect to the social functions of the state.

The first of these approaches is based on state paternalism, with massive support from state resources for the living standard of needy layers of the population. The limitations of this approach are already clearly evident: Social spending by the state, including on subsidies for housing and services, has reached 10% of GDP, or 25% higher than in the pre-reform period (1990). This means that any attempt to solve the problem of poverty through state resources alone, has no real chance of success. It would unavoidably require a massive increase of the tax burden on goods-producers and, essentially, would lead to a new period of stagnation for Russian society, but under much worse social and economic conditions. Such stagnation will not be a mode in which society and the state could survive, but rather a dead end, “a quiet death under social anesthesia.”

The second approach is to make an accelerated transition to a “minimum-subsidy state” model, based on the principle that the state is responsible for providing only a minimum of social services, while the citizens must earn enough to pay for everything else. This model proposes to redistribute social spending in favor of the most vulnerable groups of the population, while simultaneously reducing social payments to better-off families.

In reality, this second version only works under conditions of sustained economic growth, and when a large middle

class already exists. Attempts to implement it at present, will lead only to the further alienation from the state of a substantial part of the traditionally oriented social groups, which will inevitably reduce the legitimacy of the state authorities and weaken them.

On the whole, neither of these two versions can serve as the basis for strengthening Russia's statehood and overcoming our systemic social and economic crisis. . . .

A real aim for the state's development, one which possesses great power of consolidation, is a rising standard of living, security, and a decent life for the citizens of Russia. . . . A criterion of the state's development should be the level of organization, preparation, and utilization of all of its forces and sources to achieve this goal. . . .

The success of a strategy for the state's development according to the principle of “the majority's welfare,” will be decided by the rate at which a large middle class is formed. This layer should encompass at least 50-55% of the population, while the portion of the population whose income is below the subsistence minimum should be reduced to 10-15%. The state simply cannot unite the far-flung pieces of a shattered society for a prolonged period of time, unless the natural social bulwark of society begins to be established at an accelerated rate—a broad layer of people who are fairly well-off. The formation of a middle class will provide the necessary stability for all social development, and will serve as a basis for overcoming the most negative consequences of social fragmentation.

The establishment of a middle class requires a new model of consumption, resting on a Russian national standard of welfare, which corresponds to the normal consumption levels of this social group. This does not mean a “consumption minimum,” but rather norms of consumption, corresponding to a decent standard of living, which can be achieved for the majority of Russian citizens and therefore will serve as incentives for economic activity, both labor and entrepreneurial. Such a standard of welfare includes: quality housing, a second home,¹ a high level of provision with durable consumer goods, a car, access to health care and education, etc. Implementation of the “majority's welfare” strategy requires that such a Russian national standard, that is, the economic and social preconditions for its introduction as the standard generally enjoyed, lie at the basis of long-term economic development. . . .

In order for investments really to become a significant factor in end-product demand and “a locomotive of growth,” domestic machine-building must play a substantial role in their material implementation. This calls for its accelerated modernization on the basis of the available innovation and technological potential, as well as imports.

It should be emphasized, that only a model of economic

1. The Russian *dacha* is a country house, often extremely modest, with a bit of land, usually gardened.

growth, oriented toward improving the welfare of the majority of the population, can actually cure the social and economic crisis, the acuteness of which is masked today by a conjunctural wave of revival of production. If, however, economic policy were to bank on "growth for growth's sake," the aggravation of the social situation in the country could bury both the growth of production, and the state itself.

III. A Concept of Development

III.1. A Growth Economy

The strategic goals of Russia's development in the middle term, can be achieved only on condition of *the re-creation of a growth economy*. Here, not only the quantitative, but the qualitative features of economic growth are extraordinarily important.

A positive future for Russia can only be based on preferential development of the manufacturing sectors of industry. It is their growth, which determines the level of investment activity and technological modernization of production, on the one hand, and, on the other, the growth and structure of the population's consumption. Consumption standards for the population, in turn, determine the formation and reproduction of labor motivation and, consequently, the possible contribution of social factors to raising the efficiency of production.

The development of domestic manufactures and construction can bring about a fundamental increase in the quality of life for Russians and create possibilities for positive changes in the conditions of life, through the large-scale supply of accessible housing, effectively increased car-ownership, and the development of infrastructure at a surpassing rate.

The primary sector of the Russian economy, namely the extractive industries and, especially, the export-oriented sectors, are an important material resource for economic growth and maintenance of the level and growth of export income. The latter is of particular importance in the period of restoring the technological potential of the manufacturing sector of industry, construction, and transport. In order for the primary sector of the economy to provide a material basis for economic growth in Russia, and to maintain a net export surplus in the medium term, it is also necessary to develop complex raw-materials processing in the framework of the extractive industries, and to increase the share of processed goods in exports.

Conditions for the Revival of the Economy

Medium-term economic growth requires the following three preconditions, at minimum:

- the greatest possible utilization of the production capacities already existing in the country, which have retained their technological qualities;

- keeping within Russia the financial resources, generated in the framework of the Russian economy, to be converted into the main source of demand for domestic production. The current annual \$15-20 billion level of capital flight is equivalent to the loss of 450-600 billion rubles of end-product demand, or 6-8% average per annum growth of production; the flow of financial resources abroad has been one of the main reasons for the depression, lasting many years;

- the creation of conditions in the Russian economy, for normal investment activity and the process of expanded production.

It is from the standpoint of creating these conditions, that all questions of economic policy should be viewed and the concept of Russia's future economic development be formulated.

Opportunities for Growth

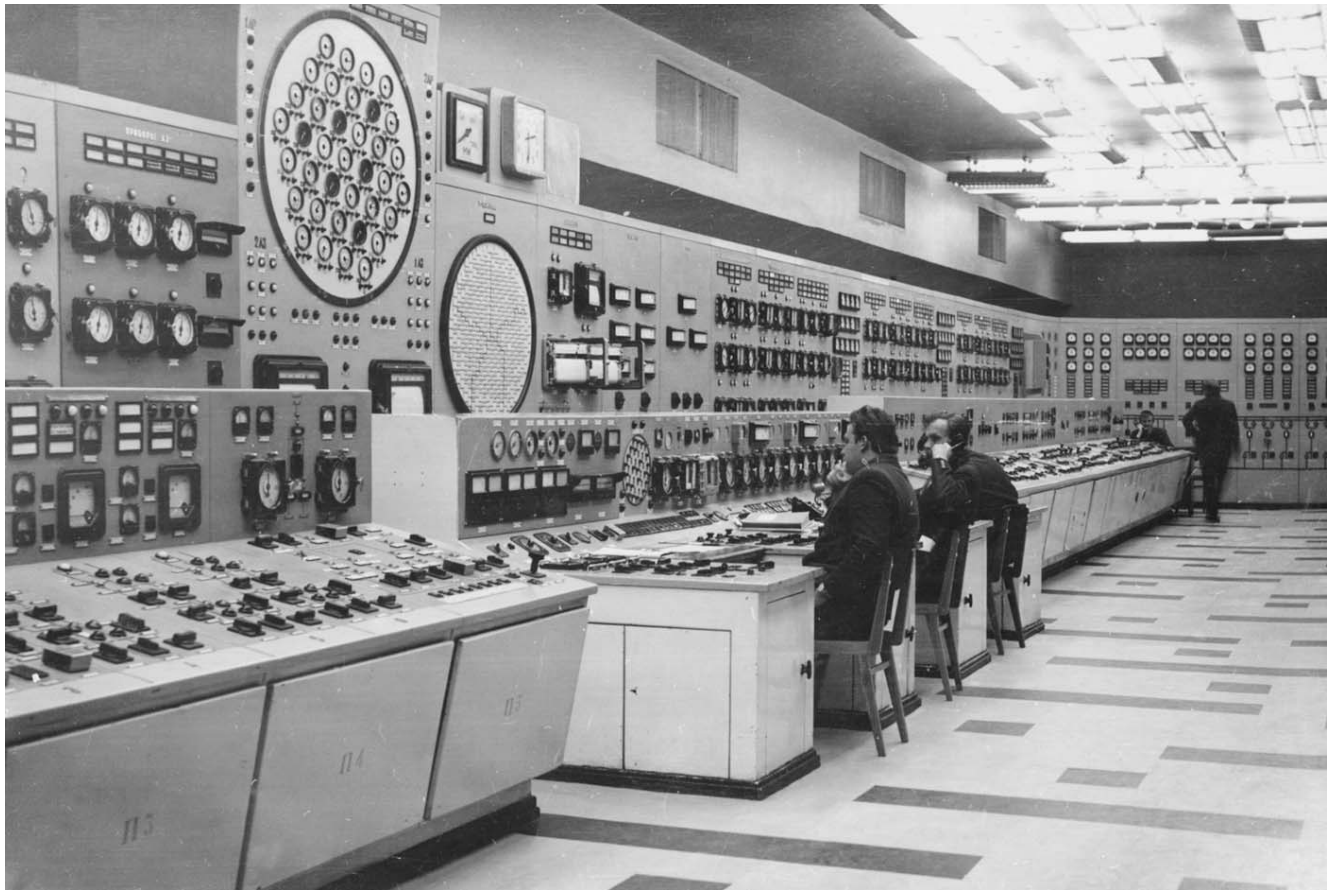
The main precondition for a concept of development is the proposition that 5-7% per-annum economic growth for the basic output of production, and 10-15% in certain sectors of manufacturing, is not only necessary in Russia, but is possible.

For the years immediately ahead, this possibility is defined by a number of positive factors, including some that arose as a result of the collapse of production over many years.

First, there is the existence of idle capacity. This means "physical" capital, i.e., buildings, installations, machine tools, and systems, heating and electricity grids, which have been either utilized at less than capacity, or mothballed, during the deep economic crisis. Some of them, for various reasons, cannot be brought back on line, but a significant part has been preserved and may be included on the roster of functional physical capital, in the event of a rise in the level of effective demand. The increase of total functional capital through bringing these capacities on line, is a "free" resource for economic growth, insofar as, in the initial stage, there will not need to be significant investment in new capacities for an increase in production.

Second, there is the mitigation of resource limits on economic development. At present, Russia's economy does not face harsh limitations with respect to energy, metals, or other raw materials, or the carrying capacity of the transportation system. The only serious constraint is the shortage of skilled labor, since many companies, especially in manufacturing, lost their most skilled workers, technicians, and engineers during the years of stagnation. It will take substantial effort and a long time, to rebuild this cadre of skilled personnel. As far as material resources are concerned, however, no special efforts and means will be required, to initiate work in anticipation of economic growth.

The situation in 1999 confirms the possibility of utilizing idle production reserves for purposes of organizing economic growth. Then, even though investment levels were virtually unchanged, domestic producers substantially increased the



The control room of Novo-Voronezhskaya nuclear power plant, during the Soviet era. In the intermediate term, reviving the economy, depends on elements such as maximum use of existing production capacity within the country.

volume of domestic industrial output, taking advantage of the lowered competitiveness of imported products on the domestic market, as a result of the devaluation of the ruble.

Third, we have a relative reduction of costs in many branches of manufacturing, against a backdrop of relatively slower growth of the prices for technical industrial products in 1998-1999. Improved conjunctural conditions for traditional Russian exports on world markets, simultaneously made it possible to considerably strengthen the financial position of the export sectors. This led to the formation in a number of sectors of substantial revenues, which may become the financial basis for economic growth.

Consequently, the Russian economy possesses the main preconditions for a continued economic upswing, namely available production capacities, “soft” resource constraints, and financial resources in search of effective application. *The main task of economic policy, is to bring these growth factors together.* This will make it possible to realize a non-capital-intensive development option in the majority of sectors of the national economy and industry. It has been calculated that, in the next two to three years, production can be increased by a minimum of 25-30% more, solely through the utilization of

already-existing production capacities. The orientation toward servicing foreign demand as the priority, however, effectively precludes sustained economic growth. Continuation of the basic components of recent years’ economic reproduction profile can, at best, provide no higher than 3% per annum economic growth, while the standard of living stagnates for a decade, further reducing Russia’s role in the world economy and politics.

At the same time, *the surviving resource potential will not last forever.* Any delay in the elaboration and implementation of an adequate social and economic policy will inevitably reduce the opportunities for positive economic growth, for which that resource potential creates the conditions, and reduce the achievable results.

III.2. Problems and Limitations of Growth

Insufficiency of Domestic Demand

The situation in the Russian economy at present, features—in one part of the economy—incomes in excess of what can be effectively utilized, while another part of the



Russian President Vladimir Putin (right) meeting at the UN with German Chancellor Gerhard Schröder in September 2000. The Ishayev report says that Russia's foreign debt cannot be paid at the expense of economic growth, but must be restructured in negotiation with Russia's creditors. Russia and Germany are in the process of negotiating debt-for-investment arrangements to ease Russia's debt burden and create conditions for Russian industrial projects to have German participation.

economy suffers from an acute need for financial resources in order to develop production.

The greater part of potential supplemental demand, at present, is based on the revenues of the export-oriented sector, which were enhanced by the devaluation. In real terms, that sector is not prepared to initiate demand, neither through the compensation of its operatives' labor, nor through stepped up investments, and especially not on the domestic market, on a scale corresponding to the growth of its revenues. Therefore, the additional revenues of the export-oriented sector, received as a result of the devaluation of the ruble (as well as the improvement of the price conjuncture on world markets), effectively become a resource only for capital flight.

A significant share of the companies in the real sector of the economy, meanwhile, have an exceedingly low level of profitability and are poorly endowed with their own working capital. Under conditions, where the banking system is in no condition to carry out the functions of facilitating capital flows among sectors, which makes bank credits prohibitively expensive and precludes real opportunities for long-term borrowing, the shortage of working capital in the real sector of the economy predetermines a low level of demand.

Therefore, the strategic prospects for economic development will largely be determined, by whether or not the supplemental revenues of economically active entities are directed into the domestic market, above all into investment.

Foreign Debt

If foreign debt payment obligations are met in full (they should average U.S.\$16 billion per annum throughout the first decade of the 21st Century), the result will be the stagnation of production and further reduction of the population's standard of living.

The most natural way out of the situation, both for Russia and for its creditors, is to restructure the foreign debt through a process of negotiations. The other option for solving this problem—the formal declaration of default on the foreign debt—would have unpredictable consequences.

We believe that the negotiation process should be based on the following points.

First, the Russian economy, as distinct from the Russian state, is already solvent at the present time. . . .

Second, the revival of economic growth in Russia, based on the utilization of resources, freed up by the steep reduction of capital flight, on the preservation of the Russian economy's competitive advantages, resulting from the major devaluation, and on the broad development of foreign economic ties by the elimination of discriminatory and

other barriers to domestic exports, can transform the Russian state, as well, into a solvent party in international relations.

Third, the creditors have an interest not in conflict with the Russian state, but in repayment of the debts, and in keeping Russia as a significant market for sales and investments.

Consequently, the main efforts of the government and the Central Bank ought to be concentrated on limiting the illegal export of capital, as well as on limiting imports, by means of exchange rate and customs policies. . . .

In our estimation, debt restructuring that would allow payment of one-half of the obligations, connected with the debt of the U.S.S.R., would be completely acceptable both for Russia and for its creditors. . . .

'Tied-up' Resources

We must not underestimate the problems, arising from the ways in which a relative balance has been maintained in the reproductive processes that took shape during the years of crisis. The "surplus" of energy resources and construction materials (produced in excess of the level of domestic consumption) is "tied up" to a significant degree, and is not readily usable.

First, deliveries for export are "tied up". . . .

Second, the existing system for reproducing capacities within the export sectors, places the burden on exports, of

being the source of financing for investments in maintaining the extraction of the resources or meeting the standards of quality, necessary for successful competition on foreign markets.

Third, it is necessary to keep in view a phenomenon, which may be called the “enclavization” of the domestic economy. Despite the existence of potential demand on the domestic market, some companies cease producing products to meet that demand, and shift (when possible) to making deliveries abroad. . . .

Investment Constraints

During the years-long investment crisis, the capital-goods sectors not only were deprived of standard levels of demand, but also, in significant measure, lost any strategic reference points for their development. This prolonged period of functioning in a survival mode, brought about an inevitable quantitative and qualitative degradation of their production capacities. The sub-sectors, which comprise the technological nucleus of machine-building, turned up in the worst position, alongside those that produce capital goods for most sectors of manufacturing and for agriculture.

At present, the production capacities of the capital goods sectors as a whole are unable to provide capital goods for installation in the overwhelming majority of sectors of our national economy, nor to address the task of structural and technological modernization. At the same time, the possibilities for non-capital-intensive growth are fairly limited; within two or three years, all the free resources may have been used up. Consequently, further growth will be impossible without a significant gear-up of investments and bringing new capacities on line.

This state of affairs defines the imperative of making pilot investments in the capital-goods sectors themselves. The only economic agent, capable of initiating such an investment process, is the state, being conscious of its role in determining the country’s historical prospects, and carrying out a reform policy as a long-term program of social and economic transformations.

Price Relationships

The economic growth of the past two years was determined, in a decisive way, by favorable price relationships. . . .

Since the beginning of 2000, the opposite tendency has been observed. In particular, the rise of fuel and energy prices began to outstrip the growth rate of prices for the end-products of industry. . . . State regulation is needed, in order to limit price rises on the products of natural monopolies. . . .

The Undeveloped Financial System

Once again, we are now at a stage, where a financial system, adequate for a market economy, must be built from scratch. . . .

Improving the financial system requires laws, which provide for:

- stricter obligations for the fulfillment of economic contracts, by the introduction of material and criminal responsibility of property-owners and top managers, including forfeiture of their personal property;
- guaranteed and timely compensation of the labor of hired workers in the private sector of the economy, at a level no lower than the subsistence minimum;
- effective management of joint-stock property, on the basis of expanded rights for those property-owners, holding less than 10% of voting shares, as well as simplification of the procedure for imposing sanctions on managers of a joint-stock company, who violate the legal rights of shareholders;
- effective management of the state debt, by the adoption of an amendment to legislation on the budget, mandating a reduction of the ratio of state debt to GDP;
- raising the level of confidence in the banking system, by an adequate level of guarantees for the deposits of the population, as well as funds on deposit in business accounts at commercial banks;
- a gradual transition to a no-subsidy regime in the housing and municipal services sector;
- a gradual achievement of a surplus in the Pension Fund, while unconditionally providing the subsistence minimum for all categories of pensioners.

III.3. Stages of Development

Analysis of the resource and production capabilities of our economy indicates that an effective economic growth trajectory for the medium term may be naturally divided into three periods.

1. A period of high growth rates and the gear-up of investments, based on bringing idle capacity into the process of economic circulation. . . . This period will last no longer than three years. During this period, economic growth rates of 8-10% per annum may be achieved.

2. A period of substantially lower economic growth rates, due to the exhaustion of existing reserves and the delay in bringing new capacities on line. . . . The duration of this period and the extent to which growth rates are reduced, are directly linked with the degree to which we succeed in building up investments during the first period. It is estimated, that this period may last on the order of two or three years, during which the economic growth rates may fall to 2-4% per annum. The quality of economic growth will rise, however, insofar as it will result from developing the highest-technology types of production. This significant lowering of the economic growth rate could be avoided, only if super-high rates of capital investment (over 25% per annum) were to be achieved during the next three years.

3. Starting in 2005, a steady development trajectory may

be achieved, whereon economic growth rates are maintained at a level of no less than 5% per annum, for a decade. The subsumed task will be to ensure the stability of the Russian economic system, in the face of conjunctural fluctuations on world markets, and to create conditions for expanded reproduction on the basis primarily of domestic accumulation and investment. . . .

[Section III.4., Formation of an Effective Regional Structure in the Economy, is omitted from these excerpts—ed.]

IV. Main Elements of Economic Policy

IV.1. Strengthening the Market Basis of the Economy

The institutional reforms of the late 1980s and early 1990s had outright negative results, or less positive ones than had been expected, due to their inconsistency.

The market economy is in the initial stage of creation in Russia. A number of important markets, market institutions, and other instruments are lacking, as is the necessary legal and informational back-up for them. In a “natural” mode of functioning, markets are incapable of ensuring effective expanded reproduction in the sectors of the Russian economy that are involved with them.

State regulation has been oriented primarily toward the creation and reconstruction of the sphere of exchange and finance. Mechanisms for the coordination of sectoral and regional strategies have not been developed, not to mention constructive strategies on the national economic level. The absence of consolidated strategic goals and values causes disorientation on the part of economically active entities, whose strategies and actions go off in different directions.

The underdevelopment of the sphere of exchange led to a situation, where in recent years there was more or less active development of small and medium-sized companies, but there were no institutions, which would have brought to life the superior qualities of large companies. Only in the past one or two years, have real processes of vertical integration in manufacturing been observed.

The crisis of confidence in the economy has not yet been overcome. Complex networks of cooperation have been disrupted, while the surviving ones are overloaded or running at excessive levels of cost. . . .

For the modernization of the economy, there must be a new stage of institutional reforms, and a new approach to developing and implementing them. There must be a shift of emphasis in approaches to the management of economic processes. *Under Russian conditions, it is insufficient to confine ourselves to classic regulatory interventions on the*

markets, and attention must be paid to their quality of functioning.

There are two components of action to influence the quality of how markets function: (a) saturation of the economy with the necessary market institutions and instruments, and (b) the provision of legal and informational underpinnings for the markets.

Above all, this should be a question of an accelerated creation of markets, necessary to ensure economic growth. In Russia, for example, there is virtually no commercial credit market and no commercial bond market, and the inter-bank credit market is too segmented and weak to provide the requisite redistribution of financial resources. Experience demonstrates, that without state support, there is no basis to expect these markets to start functioning effectively in the near future. The state is capable of fostering the development of a whole array of institutions (an institution for commercial debt evaluation, an institute for expert financial review of economic projects) and instruments, the existence of which would substantially facilitate the development of the relevant markets.

On the whole, it is premature, at present, to talk about a policy of economic deregulation, which has become so fashionable in recent years. It is necessary first to achieve effective functioning of the market, and at least some relative manageability. What would be really useful in this regard is not deregulation, but the de-bureaucratization of state institutions of government. . . .

Strategy for the State Sector

Development and implementation of a comprehensive and consistent strategy for the development of the state sector. Today, there are practically no mechanisms for determining the goals of state sector development, nor its management as an integrated economic formation. Nor is there an understanding, that the state sector of the Russian economy is necessary, not so much for commercial purposes, as for the establishment of strategic markets, the creation of jobs, the expansion of the tax base, including in contiguous sectors of the economy, the maintenance of the relationships necessary for economic reproduction, and other such goals. There need to be procedures for determining sectoral development priorities, product specialization, a coordinated marketing policy for state companies, and, on that basis, state investment programs.

It is important to emphasize that the state, as such, is not an ordinary investor, but a special one. For the state, the result of implementing a project is not only, and not so much, the profit from the project itself, but rather the summary, total benefits from the implementation. In that sense, the state has an interest in infrastructure development projects, in investments to develop strategic markets, and in carrying out comprehensive investment programs. Here, the benefits for the state are the indirect effects—job-creation, expansion of the

tax base, and the growth of production in contiguous sectors of the economy. . . .

The Tax System

The tax system should be reviewed, from the standpoint of incentives for economic growth. Russia is now at the stage of economic development, which requires investment in the technological potential of almost all spheres of business. . . .

Investment Policy

There needs to be a coherent and balanced *investment policy*. There is none at the present time; there is only an array of disparate projects, measures, ideas, and notions about such a policy. A real upsurge of investment is impossible, without the intervention of the state, oriented toward reducing risks in the main segments of the investments market. Under today's conditions, the excess liquidity in the banking system can be transformed into investment projects in the real sector, only with the state's participation, with the exception of investment projects, proposed by already-formed major industrial finance groups. Therefore, it is necessary to activate previously elaborated projects for investment incentives (for example, the creation of an investment guarantee fund for small businesses). Analogous plans could be drafted in the framework of regional or sectoral development programs. . . .

With respect to foreign investments, it is time already today to begin to implement a regimen of limiting their access to those sectors and types of manufacture, where domestic goods-producers are strengthening their positions and have good prospects for increased production and higher competitiveness. A regimen of limited access for foreign capital will also, in part, help . . . to reduce capital exports (for the part of "foreign" investments that are of Russian origin). Thus, reinforcing the entrance barriers of domestic investment markets will help reduce the scale of capital flight and tax evasion.

Capital Markets

A program for the development of capital markets should be an important component of the institutional transformations, directed toward achieving economic growth. Under conditions of economic growth, the capitalization of these markets, specifically the market for corporate securities, objectively rises, since their future profitability grows at a surpassing rate, while investment risks decline. This growth of capitalization may again, as was the case in 1993-1997, lead to the appearance of a multitude of small market operators, which will impede the process of forming major, concentrated investment organizations. As a result, investment resources for the real sector will once again become relatively expensive. Conversely, incentives for concentration processes on the capital markets should make such resources become gradually cheaper, and thus promote investment in the real sector,

the increase of the total volume of such investments, and the improvement of the investment climate as a whole. . . .

For these purposes, it is necessary to foster the concentration of investment intermediaries, to provide more incentives for the creation of investment banks and funds, and activate the creation of the Russian Development Bank, for the purpose of accumulating insurance reserves, temporarily free resources from off-budget state funds, pension fund assets, and other financial resources. . . .

IV.2. The Promotion of End-Product Demand

Production capacities, a skilled labor force, and the absence of significant resource constraints, are unquestionably the most important reserves and factors for consolidating positive economic growth. At the same time, these may turn out to be dead capital, unless they are summoned to life and made productive, with real effective demand. Thus, *the key problem for future state economic policy is the expansion of the possibilities for managing end-product demand*.

At present, these possibilities are extremely small, and are practically limited to state demand. But the experience of developed countries shows that there are mechanisms of state influence that may be used, both on household end-product demand, and on investment demand from corporations.

Regulation of Incomes

For household demand, this mechanism is linked, in particular, with the establishment and regulation by law, of minimum wage levels. . . .

Growth of Investment

The growth of investments and creation of an investment climate in the country is a strategic development task and a condition of the utmost importance for the modernization of our national economy.

At the same time, it must be emphasized that, at the present stage, despite the importance of investment in basic capital, *the priority remains the growth of investments in working capital*. The build-up of working capital is the basic material precondition for high rates of economic growth during the first stage.

A favorable investment climate is created for working capital, first and foremost by the reduction of commercial risks, and the interest rates they determine. Lowering interest rates creates conditions for a more rational use of a company's own funds, thus raising its economic efficiency.

The main reason for high risks in the economy is the economy's low level of confidence in the state and its leadership, and business people's low level of confidence in each other.

The commencement of some motion in the economy cre-

ates confidence in the future, which is the main component of the investment climate. But, that is not sufficient. The state can and should influence the investment climate, by assuming part of the risks, as well as by means of institutional decisions, which raise investor confidence.

Credit for the Economy

The tendencies that took shape after the August 1998 crisis rather starkly reveal both the existence of internal resources for financing economic growth, and the ability of the Russian economy to react positively to such opportunities, when they are uncovered. The question is only how to use these resources.

The first resource is the “excess” liquidity, which we estimate to have reached on the order of 100 billion rubles. If we presume a continued positive foreign trade balance, it will continue to grow, unless the companies possessing this liquidity, carry out investment programs and raise wages for their employees. From the standpoint of economic growth, it is extraordinarily important to induce companies to implement investment projects. In any event, however, companies not involved in production for export will remain outside the framework of such projects. Thus, even in the case of favorable conditions, the possible economic growth will be skewed to one side. Therefore, it is extremely important to unleash the potential of the “surplus” liquidity, for purposes of extending credit to the real sector of the economy.

At present, major banks are prepared to finance production projects as well as various schemes for consumer credit, being hindered only by the lack of mechanisms for identifying and selecting such projects. This is especially the case for Sberbank [the state Savings Bank] of the Russian Federation. This bank, which has a huge network of branches and has accumulated on the order of 75% of all of the population’s savings, is ideologically oriented chiefly toward extending credit to the real sector. Nonetheless, as of mid-Summer 2000, 60 billion rubles of the 80 billion rubles sitting in correspondent accounts in the Central Bank belonged to the Sberbank.

The surfeit of liquidity in the banking system led to a shutdown of the Central Bank’s plans for the refinancing of banks, which extend credits to the real sector, . . . and forced the monetary authorities to seek new ways to manage this

untied liquidity.

According to some estimates by banking specialists, government pressure on the banks to reorient toward lending to the real sector led to a marked deterioration in the quality of credit assets in the banking system. . . . Nonetheless, there are banks with portfolios full of effective projects, for which credit access is a problem. . . .

The inaccessibility of credit for real-sector companies, with respect both to interest rates and the duration of loans, is due to both microeconomic (potential failure of a project to break even) and macroeconomic (rate of inflation and the ruble’s exchange rate) risks. Accordingly, the state’s actions to increase lending to the real sector should be directed toward reducing and hedging these risks. The “surplus” liquidity is a resource, which should be brought into action along these lines.

A principled approach to the solution of this problem may be envisioned as follows.

The state, in the person of the Central Bank, allocates a certain part of the “excess” reserves for purposes of conducting credit auctions among commercial banks, which will issue credits to businesses in the real sector. In doing this, the state proceeds from the priorities of economic policy and the current monetary situation. Insofar as there is a great variation of profitability from sector to sector, such auctions should naturally be conducted by sector (for example, for light industry companies, for the food industry, for the automobile industry, and so forth).

In the first stage of the process, the companies draw up business plans, and submit them to a commercial bank with supporting arguments. Thus, the commercial banks acquire packets of those business plans, which the banks consider to be better than breakeven propositions, and for which they are prepared to become guarantors, accepting financial responsibility in the event of the project’s failure.

In the second stage, the commercial banks take these plans to the credit auction.

The third stage is the actual credit auction, where the Central Bank issues a certain total amount of credit, at certain minimum and maximum rates of interest and loan durations. Within these established parameters, the auction provides for competition among the various business plans, supported by the commercial banks. The result is that the most effective projects win out, the ones whose implementation will make it possible to pay a higher price for the credit extended.

Under current conditions, it is extremely important for the interest rates on such credits to be closely linked with the macroeconomic goals of the government, with respect to processes of inflation. For long-term credits, the interest rates should be corrected for the effective rate of inflation, in order for the real interest rate (corrected for inflation) not to exceed the efficiency of a given project, on the one hand, and, on the other, not to become free credit.

The second resource is a further reduction of capital flight.

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Russian cosmonaut Aleksandr I. Lazutkin, Mir-23 flight engineer, in a joint mission in 1997 with U.S. astronauts. The report emphasizes that the state should have exclusive economic responsibility for development in the military-industrial complex, the agro-industrial complex, and infrastructure. In the MIC, "The greatest opportunities for the development and distribution of dual-use technologies are to be found in the telecommunications and aerospace sectors, as well as specialty steel and special transport systems production."

This will be possible, only if the role of the Ministry of Taxation is strengthened, and if it works closely with the Central Bank in the area of currency control and systematic work on eliminating fictitious bank transactions and so-called cashing operations, as well as reducing the volume of cash transactions.

If these measures succeed, the additional available financial resources will be divided into two parts: increased budget revenues at all levels, and increased liquidity of businesses. The former should be used chiefly for purposes of reducing the tax burden on the real sector of the economy and making payments on the state debt, while the latter should play a direct role in financing economic growth, either directly as a result of the companies' own activity, or through the mediation of some of the above-indicated schemes.

Regarding a resource, which a market economy would normally draw upon, namely the population's savings, there are several difficulties involved with its utilization as a source of investment capital. First of all, let us look at the problem of the price gap for energy on the domestic market—the well-known system of cross-subsidies, under which industry bears the brunt of expenditures for energy, while the population pays only a fraction of the cost of the energy it consumes (gas, heat, and electricity). Currently, government policy is oriented toward gradually increasing the cost of energy for the population, approaching its cost of production and delivery. This means that in the near future, the population will be spending more on current expenses, and saving less. Moreover, this tendency will be especially strong for the lower-

income layers of the population. Taking into account, too, that around 75% of the population's savings are on deposit in Sberbank, of which some two-thirds are pension deposits, it is apparent that the population's savings cannot be counted on as a main source of investment resources. . . .

Credit for the Population

Another way of using "excess" resources is to provide incentives for the development of consumer credit. The most technologically accessible form of incentive for consumer credit is the following.

The Central Bank may open a line of credit to Sberbank, earmarked for extending credits to the population. Naturally, this type of consumer credit may be extended only for the purchase of domestically produced consumer durables, modest housing, and the development of dacha plots of land. Sberbank organizes this work, taking into consideration that, in the initial stage, the consumer credits should be issued primarily to citizens who have guarantees from the firms and organizations, where they are employed. . . .

On the whole, a large volume of consumer credit in the economy boosts the living standard which each individual citizen may achieve, simultaneously becoming an incentive for him to work more productively and raise his own regular income, in view of the higher current payments he incurs for debt service, insurance, etc. In this sense, one can say that consumer credit is a generator of additional incomes in the economy, and that its development leads to an overall increase in labor productivity.