

Section 1. The Socio-political Background

1.1. Economic policy in 2002 and the prospects for national elections

Political developments

In 2002 Russia saw its political elite consolidate along with the strengthening of main government institutions. The processes were developing following the logic of the Western-type market democracy. This is proved both by the nature of recent economic discussions and political developments.

Last year, the political forces and institutions furthered their consolidation, and their structures continued to crystallize. That became notable both in the central and leftist parts of the political spectrum. The centrist factions in the State Duma ('Edinstvo', 'Otechestvo-Vsya Rossia', 'Regiony Rossii') gave a rise to the pro-presidential party 'Edinaya Rossia', whose target is to win the majority in the Parliament. That appeared a natural result of the evolution of its parent structures, as well as the post-revolutionary development of the Russian society as a whole¹. Once the problem with a leader for the coming years has been unambiguously solved, the political structures differing just by names of leaders under whom they were established naturally undergo mergers. At the same time this party has launched a peculiar search for its ideological doctrine.

Meanwhile, the leftist wing of the political spectrum split into proponents of a close collaboration with the presidential power and those in favor of keeping CPRF's opposition image. The difference between these two stances lies mostly in tactics. Both leftist groups recognize the supremacy of the effective Constitution of RF and are not keen to change the fundamentals of the constitutional system (at least, in the foreseeable future). Furthermore, CPRF has already experienced certain evolutionary processes, with S. Glazyev moving to its forefront (apparently, not without some support of the authorities). Having drifted over the past decade from Ye. Gaidar and V. Chernomyrdin's governments through the alliance with A. Lebed to G. Zuganov's camp and having de-facto replaced Yu. Maslykov as a 'Chief Economist' of CPRF, Mr. Glazyev, in all likelihood intentionally, is not the party member. His economic concepts are dirigist (and in this sense anti-liberal), but not at all communist. Thus the party experiences a serious change in its ideology in the core practical area – that is, an economic sphere. Though appearing obsolete and advocating the realities of the accelerated industrialization of the early 20th century, Mr. Glazyev presents an economic platform that does not appear rigorously communist.

Against the background of the noted political processes, the Lower House of the Parliament (Duma) has undergone a consolidation: its was right after the 1999 Duma elections when the centrists and leftists formed a broad coalition to acquire the much-needed leadership in the crucial Duma committees². It was then when the government's 'peculiar' *modus operandi* arose: in the Parliament, the Cabinet had to deal with the leftists and centrists who controlled the overwhelming majority of committees, while its practical economic policy was

¹ At the initial stage of establishment of the structures currently incorporated into 'Edinaya Rossia', the major principles they proclaimed were their de-ideologization or centrism (the later obviously is a synonym to de-ideologization).

² For more details, see: Russian Economy in 2000: Trends and Outlooks. Issue 22. M.: IET, 2001, p. 8-9

based upon the liberal ideology. Between 2000 to 2001 such a situation regularly generated artificial obstacles to the government socio-economic policy, for the CPRF members – heads of the respective committees (especially those on economic policy, social policy, and constitutional legislation) had enough tools to block the governmental and presidential initiatives. In 2002, the former agreements were revised in the Duma. That resulted in the centrists and right-wing forces' acquisition of control over practically all the committees. That was the re-grouping towards the structure of power, which is inherent in mature democratic societies, where a government rests upon the majority in a parliament. Such shifts appear very important, as they signify *an actual growth of the importance of the role played by the Parliament* in Russian political life. Should this particular trend be continued, the government resting on the parliamentary majority would form a standard (tradition) in the country, rather than an episode, even though the respective provisions have not been stipulated in the Constitution.

Further consolidation of Russian political system to a significant extent will depend on the 2003 Duma election. The supreme power is unlikely to flow towards the leftist part of the political sphere (presented by Communists and their allies). As long as the future ruling coalition is concerned, it is the performance of both the right wing and centrists' that becomes crucial: either post-election government will be 'purely presidential' (and therefore opportunist for centrists are ready to 'swallow' and follow any ideology), or the government will be formed by center-right coalition and become more fastidious ideologically, more consistently resting upon the Western-type market democracy values.

The leftists' performance will be equally important. Should G. Seleznev's left-centrists succeed, the current 'party of power' would see new allies, however, they will urge it to drift leftwards. As far as tactic and program challenges are concerned, for the 'pro-Putin centrists' such an alliance would be much more natural than a potential collaboration with the Union of Right Forces. This can be explained by an ultimately low role played by the ideology underlying both centrist blocks. In the event CPRF proves its strength (which appears quite likely), one may expect consolidation of power in the right-center sector along with the presidential Administration will try to push the Communist Party further towards social-democratic values.

One of the possible and important outcome of the December 2003 election may be the establishing of 'party in power' in Russia, i. e. the one enjoying majority in the Lower House. That will not mean immediate formal reallocation of powers from the President to the Parliament: if such a party arises, its ruling position will not be explained by popularity of ideas it would promote. Rather, its popularity would rest upon Mr. Putin's personal rating. But, having won majority in the Duma, such a party would unlikely remain just an obedient 'voting machine' in the hands of the presidential Administration. Enjoying the majority in the legislature, most likely the party will be keen to attempt to realize its own corporate interests and take a far tougher stand in its negotiations with the executive branch. It was yet in 2002 that, upon strengthening themselves at the communists' expense, the centrist factions were eager to demonstrate their independence of the Kremlin and the Government and began to increasingly bargain with them about bills passed to the Duma.

While comparing with the Western standards, Russian democracy is often referred to as an immature one. However, while comparing the national political system with those of the Western world, one should consider specifics of the given phase of the democratic development. The contemporary Russian political landscape does not fully matches modern Western standards. But, if one draws a comparison with the stages of development of the Western so-



cieties that are qualitatively comparable with the current situation in Russia, it becomes possible to single out a whole range of similarities and regularities.

At this point, we wanted to draw attention to two conditions, which the democratic systems followed over the past decades. First, the specifics of democratic societies that have just recently abandoned totalitarianism or authoritarianism. Secondly, when such systems functioned under a tough conflict between the right-wing and leftist parties. A typical reflection of the first case is Italy. Over the past decades, the country has been fostering the 'one-and-a-half-party democracy' with a leading governing party staying in power – either alone, or in a block with smaller allies – while the second-rated party (communists) was always in the opposition. Such a regime is likely to take place in Russia over some time, too.

As the Italian experience shows, while creating the political stability in a country, 'one-and-a-half-party democracy' can ensure a sustained economic growth. However, this regime also has a built-in restrictor, for it creates bullion for a widespread corruption. If the same party stays in power over a lengthy period of time, this does not contribute to the development of democratic control mechanisms, while characteristic features of authoritarian system are lacked, too. The ability of such a regime to ensure economic growth is dependent on the extent to which the civil society has succeeded in keeping its relative independence of the power and ensuring an elementary public control over bureaucracy.

Back to the comparison of Russia with the mature Western democracies, another specifics of the former country is the maintenance of substantial differences between the right-wing and leftist forces. This particular difference has already overgrown the stage of an absolute antagonism when these groups had no field for discussion, because they found themselves in absolutely different coordinate systems, adhered to absolutely opposite values and concepts of the country's development. When the right-wing forces were dealing with building fundamentals of market democracy in the country, communists could outcry about 'overthrowing the anti-national regime' and nurse their nostalgia about the USSR and the enthusiasm of Stalin era. These days, the situation has changed both at the program level³ and in the parties' practical policy area. However, despite some convergence of their stances and their ability to hold a dialogue, the gap between them still remains very big. It roughly resembles the one characteristic of the Western nations in the 1930-50s. Hence, a greater toughness in the relationship between the Government and the opposition compared to that currently typical of the mature democracies.

Nonetheless Russia's basic values have already become the same as those of the Western democracies. Different political forces in the country accept certain values, and this trend manifested itself during the past two Duma election campaigns. More specifically, it took the form of appealing to the European experiences; while in 1995 the 'Social Democracy' bloc proclaimed «If you want to live like in Europe – vote for Social- Democrats», in 1999, the URF campaigned under the slogan 'To live in Europe without leaving Russia'. Discussion intensively involves cross-country comparisons, the World Bank papers (the reference pool for dirigists), New Zealand experiences (which is important for liberals), etc. So, one can argue that *de-facto* the discussion on 'Mother Russia's unique path' is over. This has, at least, one important effect: given that in the past decade the use of Western experiences to a great extent was the matter of common sense, rather than an indicator of a party/ideology affilia-

³ For the comparative analysis of programs of the parties having seats in the Duma, see: Russian Economy in 1999: Trends and Outlooks. Issue 21.M.:IET, 2000. P. 313-19

tion, nowadays the choice has been made in favor of the Western values, and the economic policy options lie in this particular frame.

The above becomes visible while analyzing the ongoing debates on such crucial matters as: the ways to consolidate economic growth, on joining the WTO and prospects of rapprochement with the EU; on deregulation; on reforming natural monopolies and an anti-monopoly policy as a whole. Some of these debates will be considered in a greater detail below. At this point, we just need to note that each of the aforementioned topics could not be discussed under the said conflict between 'universalists' and 'russophiles' of the 1990's.

This particular trend of 'integration' of economic ideas into the world space is also reflected by its analogues in other key spheres of public life. *First*, that is the Government's eagerness to create a relatively open economy. This desire manifests itself both in the debate on a 'Common European economic zone' and in the negotiations on Russia's accession to WTO. *Secondly*, this is the emergence of an 'open policy' analogous to the 'open economy'. These two phenomena are closely interrelated. Many crucial events in the international affairs that happened last year also concerned Russia.

Economic and political stabilization is also reflected in the increasing government's attempts to develop long-term projections. Since 2000 the government regularly developed and updated programs on socio-economic policy for one and three years, while the year of 2000 saw the beginning of the process of developing medium-term projections. In 2002 Cabinet twice (in spring and in December) discussed three-year budgetary projections. The latter became another sign of the country getting out of an enduring financial crisis and that the problem of debt was transforming from the political into primarily technical deal.

Discussion on economic growth

It was economic growth that formed the core issue of economic and political debates in 2002. All prominent policy makers and economists, including V. Putin, have contributed to the discussion. There were important grounds for the discussions, as the country experienced a deceleration of growth rates over the past three years.

Since the early 2002, growth rates came to the forefront of the discussions. In the beginning, the common belief was it was related to the stagnation noted over winter 2001—02. It is worth noting that the seasonal stagnation happened between autumn through winter has been noted in Russian economy over some years, however, time and again the analysts put the same question as to whether such a cease is just a seasonality, or the country faces a full-scale recession. The urgency and importance of the question was yet aggravated by the fact that in 2001 the world economy had witnessed the signs recession. That raised concerns about development of the Russian economy.

By spring 2002 Russia's economy once again demonstrated some growth, but at a lower rate than over the prior years: 9 % in 2000, 5.5 % in 2001 and by 4 % in 2002. The rate of investment was only 2.5 % — much lower then in previous years and below the GDP growth rate. There were no substantial structural changes in the economy; moreover in the 2nd half on 2002 one could observe stagnation in the production of investment and consumer commodities, while the growth in production of raw materials continued. But the demand for final goods (both for consumption and production) was still growing rapidly which could become the source of acceleration of economic growth in the future – but only of if is re-oriented inwards, from imports to domestically produced commodities.



Though the growth rate of the economy nevertheless was higher than the respective performance of the EC and North American economies (4 % while it was about 2 % in USA and below 1 % in EU), the government was strongly criticized by various groups of politicians and economists. This criticisms implied that such rates would not allow Russia to catch up fast even with the poorest EC nations (Portugal) and the country was surely losing the competition to the fast-growing China. V. Putin also urged the Government to develop 'more ambitious goals'. So the debate highlighted the problem of growth as a political, rather than economic, challenge. It was the evaluation of the Government's performance and the problems of the Government's policy options and individuals carrying them out that formed a major issue.

However, with all due appreciation of the importance of economic growth, the debate cannot be limited just by its merely political nature. In 2002, a key challenge for the coming years (or even decades) was formulated clearly – that is, bridging the gap between Russia and the most advanced nations. The economic history of the past two centuries provides numerous examples of such challenges that are known as «catch-up development». The solution to this problem may form an idea that would unite the society. However, the fundamental specificity of the challenge facing the country now is the need in a breakthrough from the industrial to post-industrial society. None of the nations have ever faced such a challenge⁴.

The recognition of this particular challenge as a key one allows immediate singling out some characteristics of the growth Russia currently needs. First, the country is in need of a sustained growth in the mid- and long run; and it is crucially important to prevent the rise of populism that may cause short-term effects, i. e. ensure attractive growth figures in the short run, to be followed by a severe crisis. Secondly, growth must be accompanied by progressive structural changes. The later, thirdly, suggests the development of institutional system that increases and adaptation capacity of the national economy as well as of individuals to constantly mutating challenges.

Economic growth is a complicated problem, especially if one considers a country that has just started abandoning a long-lasting period of revolutionary turmoil and needs a deep structural transformation of its economy. Different political and economic groups that participate in a discussion on growth seek after solutions to their own, substantially different, goals.

The problem of growth forms a real battlefield for different groups longing for power. It is the leftist forces with whose stand such a struggle can be associated at the least. They of course have their own notion of a 'proper' (i. e. ensuring economic growth) set of measures, however, it was not CPRF that plays first violin in criticizing the economic policy of the Government. Rather, the groups associated with the existing administration and the ruling party were among the most active critics of the Government – those groups that have already found themselves in the power structures but keen to strengthen their position and to extend the sphere of their influence.

The discussion in 2001-02 emerged around four basic avenues for promotion of economic growth.

The dirigiste model is based upon fundamentals of the traditional industrial policy, including selecting sectoral priorities and the state support (financial and nonfinancial alike) of these sectors. This model was advocated by representatives of both the leftist forces and some government institutions, as well as by economists associated with them. This particular

⁴ For a more detailed review of post-industrial challenges facing modern Russia, see: May V. Postkommunisticheskaya Rossia v postindustrialnom mire: problemy dogonyashego razvitiya // Vorposy ekonomiki, 2002. N 7.

government institutions, as well as by economists associated with them. This particular model is based upon an étatist ideology and the belief in government's ability to be wise and non-biased in selecting the industrial priorities and shaping a long-term strategy of growth. Protectionism as the method to support domestic producers from competition on the part of stronger foreign firms appears equally important in this model. Thus, the model suggests pursuing a pro-active «industrial policy» in its traditional (sectoral) sense.

Fostering the development of financial and industrial groups, increasing an investment (and overall organizational) role played by conglomerates of the largest companies. It is suggested that such establishments secure concentration of resources (more specifically, financial and intellectual ones) as well as lower transaction costs (as they integrate financial, production and R&D organizations 'under the same roof').

The radical lowering of budget burden on the economy (reform of forming and spending of budget funds) and bringing the budget burden in line with parameters inherent in economies with the analogous level of development.

Institutional reforms aimed at the encouragement of entrepreneurial activity, pursuance of a proactive public policy on establishing favorable conditions for investors — domestic and foreign alike. This necessitates the shaping of an adequate system of institutions, including the respective laws and an efficient law enforcement system. The merit of this particular model lies with an implicit recognition of the fact that the current growth lies both with an increase of investment and with reforming a number of institutions that allows to attain growth along with a simultaneous increase in the current level of well-being. Or, in other words, it is administrative barriers that do not allow the economy to fully benefit from the existing capacity.

It is the later institutions-setting model, which Mr. Kasyanov's Government evidently opt for. This particular model to the greatest extent appears adequate to the post-industrial challenges. However, the model is the least spectacular, from the public policy perspective. The conservative macroeconomic policy, tax reform, the process of deregulation, negotiations on accession to the WTO and its integration into the Common European economic zone, the development of a new labor and pension laws, and a gradual infrastructural monopolies' reform, — all these and other areas of the Government's activity have been carried out, though inconsistently, since 2000. They solidified economic fundamentals and ensure the pursuance of structural reforms.

Such a policy forms an easy target for the critique on the part of those who believe in 'economic miracles' or prove to be merely interested in a change of the Cabinet. There arise various proposals either on intensification of the industrial policy that implies setting sectoral preferences and a financial and non-financial support of the state, or on a drastic decrease of the budget burden on the economy, or on a notable devaluation of the ruble as a means of protecting domestic producers from foreign competitors.

Consolidation of growth has several aspects important for policy-taking. First, it is the specifics of the modern technologies at the age of the post-industrial breakthrough. Secondly, there are some specifics of growth, which coincides with the needs of a serious structural transformation. Thirdly, in the age of globalization economic development and growth cannot help but reacted to the state of affairs in the world economy (and it would be strange to hope for high growth rates when the whole world is in recession). Fourthly, growth is also affected by specifics of the post-revolutionary situation. All these four factors have a direct impact on



the modern economic growth in Russia, while their interlacing to a significant extent pre-determines challenges which Russia nowadays.

While designing a growth policy, one has to recognize that the key problem is the post-industrial nature of the noted challenges. In the post-industrial world, the mechanisms of tackling challenges associated with catch-up development appear substantially different from those of the industrial era, while the critics of the economic policy of 2000-02 were used to appeal to the latter. There are two main specifics of modern technologies: a sharp increase of dynamism and variety (up to individualization) of needs, on the one hand, and rapidly possibilities for satisfying them, on the other. This in turn means a sharp narrowing of time horizons for projection regarding priority avenues of technological development of national economies and industrial sectors. Given that under the industrial era one could pinpoint growth-related priorities and, having reached them, join in the group of advanced nations, these days priorities change quickly. Nowadays nation can try to become No.1 in terms of the computers per capita output, or to develop programs to build the best aircraft or telephony – however, by the date of their successful implementation, it will find out that the world will have already gone far ahead in a direction about which no-one could even imagine while designing his comprehensive computerization program.

As the year of 2002 witnessed a political battle around the problem of economic growth, there also were (and will be undertaken in the future) attempts to identify long-term sectoral priorities, on which the state could focus resources. All such attempts failed, for there are no such obvious criteria for singling out sectoral priorities. Further debates on the issue may lead to the situation in which one would single out sectors with maximal lobbyist capacity as priority ones.

The specifics of the post-industrial breakthrough suggests bringing to the forefront the task of ensuring flexibility of an economic system, adaptability of economic agents and their sensitiveness to modern challenges. These qualities substitute for a concentration of resources as a key element of a catching-up policy.

As well, one should not forget that Russia currently faces primarily the need in pursuing a serious structural transformation, rather than (and even not to the same extent) the challenge of ensuring growth. Meanwhile, as the most advanced nations' respective experiences show, it often happens that the period of structural reforms is combined with a slowdown of growth rates or even with stagnation (as it was noted, for instance, in a number of Western economies in the 1970s). This in part can be attributed to the fact that the traditional statistical methodology have a trouble in fixing new sectors (especially services), while partly this can be explained by the need in accumulation of resources for a new technological breakthrough⁷. Naturally, the above should not be perceived as a tribute to stagnation, however, one should take into account the fact that state administrative methods can relatively easy ensure an economic growth without structural shifts (like in Belarus under the reign of A. Lukashenko), but this kind of growth does not make nation more reach or its economy more efficient.

The structural difference between post-industrial and industrial societies lies in the proportion of services in GDP and employment, with this proportion prevailing in the former type of society. Russia has already demonstrated that it has moved along this particular avenue, although one should ensure a greater consistency of this process. A breakthrough (not

⁷ See: Melyantsev V. Informtsionnaya revolyutsia, globalizatsia I paradoxy sovremennogo ekonomicheskogo rosta v razvitykh I razvivayushokhsya stranah. M: ISAA MGU, 2000, p.14

a repetition) strategy must orient the economy towards an accelerated development of the service sector and primarily high-tech services, though here, again, it would be dangerous to try any further sectoral concretization.

As concerns industrial policy, in any case it should not be the center both 'picking winners' or appointing 'national champions'. Both approaches would imply a preservation of the existing proportions. It is the strategy of a constant adjustment of the structure, under which the government is keen to flexibly protect national winners by political (including foreign policy) means in the world competition.

The emphasis on the high-tech does not mean oblivion of other, relatively promising, sectors. In Russia, those could be, for instance, the car- and aircraft- making industries. But with all their importance (from the political, technological and social perspective), these sectors are unlikely to form the 'points of breakthrough' into the post-industrial world.

There also is a range of sectors that form priorities in the logic of post-industrial society, but they lie beyond the economic sphere, and the state should focus on them. These sectors are:

- *Education.* Russia enjoys visible comparable advantages in this particular sphere, because the level and quality of education in the country are in excess of the respective parameters noted in the countries with the analogous level of economic development. At the same time it is investment in education that constitutes the critical factor ensuring an economic spurt.
- *Healthcare.* Apart from its humanitarian component, this particular sector is likely to have a considerable multiplying effect. With all the conditionality of the example, it is worthwhile noting that in the current situation the sector's role can be the same as that of the railway construction in the industrialization of the late 19th century.
- *Military reform,* including a prompt transition from the conscription to a contract-based army. In the meantime, the youth is keen to escape the military service, which has a substantial distorting effect on the state of the labor market, as well as on the demand for educational services (including going abroad to study and work).

One can complement the above reform agenda with the judicial system and public administration reforms that made a hot issue for many experts and on which the respective documents were developed in 2002. The actual development of the situation increasingly leads everyone to the conclusion that it is the reform of political institutions that currently forms the bottleneck of economic development. Under imperfect political institutions (the judicial, law enforcement, and public administration systems) the further improvement of economic legislation faces with the effect of 'diminishing returns', i. e. providing increasingly less benefits. Economic legislation just provides certain rules of game, whose implementation depends primarily on law enforcement practices, on the efficacy of political institutions.

In addition to the advice to carry out a traditional industrial policy, there exists another set of recommendations on encouraging economic growth by the means of monetary policy – either by resistance to, or by support of the real appreciation of national currency. Proponents of the 'weak Ruble' refer to a stronger protection of the domestic producers, while those advocating the 'strong Ruble' argue that such a protection inhibits the structural reconstruction of the economy and conserves backwardness. In reality situation appears slightly different.



First, the monetary authorities have very limited capacity to influence the real exchange rate when there is a strong inflow of foreign currency to the domestic market. High prices for Russian exports push the Ruble upwards, while the Central Bank can just restrict its growth to a limited extent and only under some additional conditions. Say, in 2002 the Ruble real exchange rate remained stable, despite favorable prices for Russian exports, because of the Euro appreciation against the USD. Thus, despite a considerable foreign exchange inflow, Ruble did not strengthen against Euro, thus maintaining the competitiveness of Russian producers (as the major part of imported goods arrives to the country from Europe).

Secondly, from the perspective of its impact on an economy, the appreciation of a national currency by itself cannot be judged positively or negatively. Growth is usually coupled with the appreciation of a national currency, but it is the sources of the process that appears extremely important. The positive impact of the Ruble appreciation on growth can be noted only in the case of foreign investment inflow, i. e. when there is a rise in labor productivity and, consequently, in the competitiveness of domestic output. On the contrary, the strengthening of the Ruble as a result of a windfall export revenue inflow is a dangerous phenomenon, which is capable just of undermining the domestic output and giving the rise to the Dutch disease.

Given that post-industrial challenges set strategic contours of a growth policy, the specificity of the post-revolutionary development determines the set of tactical problems that the government has to take into account. The post-revolutionary economy has two important specific features: first, the presence of the so-called renewing growth regularities that manifest themselves practically in any economy that has undergone a severe slump for non-economic reasons (wars, revolutions) and is restoring its pre-crisis level. Secondly, the high level of transaction costs arising due to the impotence of a number of political institutions (primarily judicial, administrative and law enforcement systems), as well as because of the absence of (or the presence of a negative) credit record (credit history) of the majority of economic agents, including the government itself.

As concerns modern Russia, it is the fading nature of growth⁸ in which the renewal regularities substantially manifest themselves.

The problem here is that in parallel with the renewal of the pre-crisis level of output, one needs to launch a new growth aimed at a structural renewal of the economy. This requires a very complex set of the above measures, while the lack of coincidence in time of the fading of renewal rates and the start of a new growth may form a source of political crisis related to the elites' reluctance to reconcile to the period of relatively low rates. There may arise a temptation to resort to a number of exotic and extremely dangerous measures as it had already occurred once in the USSR in the late 1920's⁹.

To accelerate economic growth, one also needs a substantial decrease of transaction costs that are high in a post-revolutionary country. This problem is inherent in all the nations abandoning the period of socio-political instability, while it is impossible to predict *a priori* how much time is needed to restore investors' confidence in the functioning of the national institutional system. It is evident that lowering transaction costs necessitates securing a steady

⁸ For a more detailed analysis of these particular processes, see Ye. Gaidar

⁹ At the time renewal processes came to their exhaustion thus affecting growth rates and generating their rapid fall, and the government tried a radical change of the course. As a result, high growth rates were ensured by means of a large-scale violence as a key factor of economic life and at the expense of millions of lives, including the extermination of economists who had analyzed regularities of the economic development of the post-revolutionary Russia.

functioning of the aforementioned political and legal institutions — that is, the civil service, juridical and law enforcement systems, etc. It is equally important to ensure the government avoiding decisions that a normal private investor may conceive dubious.

In 2002, the executive power basically was keen to follow this particular logic, i. e. to ensure stability and predictability of its behavior and the refusal of measures that could be viewed as exotic. In this regard the Government's performance was fairly positive, because, despite serious pressures from different sides, it has not resorted to populist measures and continued to pursue a policy aimed at systematic institutional transformations. As well, the monetary policy remained balanced, which allowed avoiding a serious appreciation of the Ruble exchange rate through 2002.

At the same time, in the course of development of reforms and their implementation, which could contribute to overcoming the fading dynamics of the recovery process and to a generation of progressive structural shifts, there appeared a visible deceleration. With a certain progress in implementation of the 2000 Strategic Program was there, its rates were far lower than over the prior period.

Institutional reforms continued to be carried on: specifically, a crucial law on technical regulation was passed, which ensured lowering administrative barriers and opening new opportunities for cooperation with foreign partners. But the government failed to pass another important deregulation bill on self-regulating entities. Despite a vigorous work of the governmental commission on lowering administrative barriers, which considered functions of existing regulatory and control state bodies and ruled on simplification of their structures and regulation of their functions, the pace of de-bureaucratization proved to be lower than desired. That can be attributed to the vitality of excessive administrative regulation practices, rather than to the process of designing laws, and this is connected with the level of efficiency of the law enforcement system as a whole.

As well, in 2002 the government has succeeded in passing important, though compromise, decisions in the area of the land, labor and pension laws.

Tax reform area appears ambiguous: the lowering of taxes has not resulted in lowering the effective rates, but led to the convergence between them and nominal rates. Under the new system, a certain part of loyal taxpayers have already seen a tax burden relief, but a significant part of producers that had practiced tax dodging have not experienced real relief. This causes businesses' dissatisfaction, which forces the Government to continue to lower taxes as a prerequisite of the rise in growth rates.

There also is a range of negative phenomena in implementation of institutional and tasks aimed at stimulating economic growth: more specifically, there appeared a slowdown in the areas that are of critical importance for investment and entrepreneurial activity, such as the natural monopolies (especially the gas and electricity sectors) reform, the reform of social sub-sectors, the budget expenditures reform, the banking sector, and the military reforms. Should there be no vigorous attempts to reform these particular sectors, the current economic growth would remain unsteady and structural reforms would be unlikely.

From the tactical point of view, another pressing problem is the Government's ability to make decisions that entrepreneurs (investors) would conceive as fair and not requiring any further justification. Since 2000, practically all the Government's actions have remained clear and acceptable to the business community. However, right in the end of 2002 there appeared a dangerous precedent that can undermine the country's reputation: the auction on the sale of the control stake of Slavneft oil company raised questions about the ability of the Government



to maintain its neutrality towards big businesses and to create equal conditions and transparent procedures with regard to economico-political decisions. The problem does not lie with the fairness of the price Sibneft paid for the Slavneft and even not with the amount of losses the federal budget suffered because of debarring some large economic agents from participation in the auction. Rather, the main problem is that public opinion (and especially entrepreneurs' opinion) recognized the results of this particular deal as unfair, which has blackened modern Russia's business reputation.

The suspension of the progress in reforms in combination with low rates of economic growth has formed a reason for an exacerbation of the polemics on economic growth issues that had started as early as in the late 2002 already within the government. The polemics took place in the frame of the logic of institutional reforms. While concluding results of the prior year and the first three years of Mr. Putin in office, the RF Ministry of Economic Development and Trade made a series of statements on an insufficiently intense liberalization of the national economy: that implied the maintenance of a high level of tax burden (some 35 % of GDP), a slow and inefficient deregulation (lowering administrative barriers), failures to undertake special measures aimed at attraction of foreign investment (more specifically, the laws on special economic zones), the suspended natural monopolies reform, among others. It is the above that was recognized as a source of the slowdown in growth rates and the failure to fully capitalize on advantages Russia enjoyed resulting from political stabilization.

It was the RF Ministry of Finance supported by the RF Ministry of Taxes and Levies that opposed the former views. The financial agencies advocated a more conservative approach to the institutional and tax reforms. They proposed to suspend (or decelerate) the rate of changes in the tax system for a year or two, not to exploit special privileges (primarily various economic zones) to encourage investment activity, and to take a very conservative stand towards the further liberalization of the currency regime and any decisions that may resemble tax amnesty (for instance, Minfin was against the abolition of control over incomes in the case of investing into housing). In other words, to grant both businesses and the state with an opportunity to adapt to a new system, these agencies proposed maintenance of *status quo* for some time.

The thesis of some decline in the implementation of institutional reforms appears fair, but one cannot draw absolutely unambiguous conclusions on the impact of such a slowdown on economic growth rates. As it was discussed above, the currently emerging challenges have a far more complex nature.

Foreign economic factors of consolidation of economic growth: WTO and EU

There are important factors of the strategy of acceleration of growth rates, which ensure its sustainability, that lie in the foreign trade sphere. That suggests an increase of efficiency of tariff policy (including the promulgation of a new Customs Code), completion of the process of WTO accession, and the progress in shaping the Common European economic zone (CEEZ).

Current level of Russian economic development does not require any 'international guarantors' of adequacy of its economic policy. Rather, it raises a question about competitiveness of Russian economic policy and its ability to be more attractive than the developed market economies' policies. The comprehension of this fact makes it clear that a direct and full copying of foreign institutions will not be able to help the country overcome its backwardness from the leading economies.

The year 2002 witnessed the crucial stage of the process of Russia's joining WTO. The negotiations intensified notably and became focused primarily on technical aspects, while the Government concentrated on completion of the legislation whose adoption constitutes a prerequisite of membership in WTO. Finally, the US and EU made important political decisions regarding recognition of Russia as a market economy. This also forms a substantial step on the way to accession to WTO.

Single nations' positions posed some additional obstacles to the process. Thus, having recently joined WTO, China now seeks Russia's consent with regard to simplification of its citizens' business operations in the Russian territory. There also are some attempts to tie up the membership in WTO with political problems Russia experiences in its relationship with single countries (for instance, Georgia). However, all these problems do not form serious constraints to the said process.

The problem of accession to WTO also has an important domestic political dimension – that is, a clear comprehension of objectives in this regard. There are four such objectives:

First, the accession for accession, for the purpose of having the possibility to participate in international institutions. This requires protection of domestic producers from foreign competition. In this case one should uphold maximal protection measures without any acceleration of joining WTO, as the latter can last as long as needed.

Second, support to Russian exporters, who, thanks to WTO, will receive new instruments to protect their interests, including the possibility of fighting against antidumping procedures. This concerns specifically the domestic metallurgical sector, chemicals, and some others.

Third, encouragement of development of new sectors (primarily those for highly technological services) that are of crucial importance to the nation's breakthrough into the post-industrial world. This logic is based upon recognition of the fact that the key to a successful accomplishment of the post-industrial breakthrough lies only with the orientation towards export, along with the development of new sectors in cooperation and competition with foreign producers.

Fourth, fostering competition and restricting the influence of domestic financial and industrial groups keen to broaden their economic and political control.

It is only with account of building the noted priority hierarchy that one can develop a further strategy of negotiations with the WTO members, as well as the relationship with main groups of influence within the Organization. It appears that it is the accomplishment of the third and fourth objectives that is critically important to Russia now. Indeed, the country sees the rise and strengthening of financial and industrial groups capable of solving certain strategic tasks – thus, they cannot form an object of a primitive fight. Though it has not been in the center of attention as yet, the major task is to establish favorable conditions for emergence and expansion of new sectors of the economy.

It is the post-industrial breakthrough, rather than a primitive protection of 'domestic producers', at which negotiations on accession to WTO and, consequently, on the matters of shaping the Common European economic zone should be aimed. The government policy in this regard should be focused on ensuring the penetration of perspective production and high-tech services to the world markets, rather than on protection of inefficient sectors. Such an approach suggests a fundamentally different, than the current concept of the accession to WTO.

As the membership in WTO forms an urgent issue, it has greatly intensified the domestic political discussion on the issue, which involved representatives of practically all business groups. It was heads of the biggest national industrial groups, who had joined the Russian Un-



Russian Union of Industrialists and Entrepreneurs a year ago, who sounded especially aggressive. Though the discussion would sometimes be not quite businesslike (including publicizing letters about a danger in joining WTO), the aforementioned stabilization allowed streamlining and institutionalization of the debates: Russian Union of Industrialists and Entrepreneurs established a special group to form a forum for big businesses to discuss the issue.

It is worth noting that there emerged a broad public consensus regarding joining WTO and the basic need of opening the economy. Disagreements in this regard mostly concern the pace of such a liberalization and protection of priority sectors (with each business group advocating different sectors), rather than the vector of liberalization of the foreign trade regime.

Diminishing custom duties and WTO accession do not appear unambiguously mutually related matters. Given that the purpose of the former in all likelihood should become the Russian consumers' well being, the latter proves to be the most effective means of assistance to Russian producers designed to protect them from other nations' attempts to restrict the freedom of trade.

Building relations with the EU forms a special task. Upon its expansion, roughly as much as a half of the Russian foreign trade turnover would fall on EU, and this should be taken into account while developing strategic matters of the socio-economic development.

The last 2-3 years witnessed further development of the national political and economic elites in recognizing prospects for the Russia-EU relationship. The Russia-EU dialogue has been reactivated after 2000, and the process of a real convergence has begun. The latter is based upon the concept of the Common European economic zone originally officially formulated by V. Putin and R. Prody in May 2001. Last year showed that the process is not easy walk, and there are numerous obstacles in this particular area.

Meanwhile, there are some groups of visible challenges, the solution of which would predetermine the nature of Russia-EU relationship in the foreseeable future. Those are, first, the principles of political and economic interaction, second, the prospects for the EU expansion and its will to consider Russia's interests, and, third, the contours of the Common European economic zone.

Recent discussions revealed the lack of readiness on both sides to promote Russia's political integration into Europe. For the EU, it would pose a serious problem due to the size of Russia and its geopolitical position. As long as Russia's development is concerned, its national interests dictate the inappropriateness of such an integration. There are both political and economic grounds underlying the latter.

From the political perspective, Russia remains a large and mostly national state, i. e. the state of the modern world which is keen to ensure an ultimately clear geopolitical position, with clearly set borders and domestic political structure. At this point, Russia appears close to the US, while being further from Europe whose states undergo an increasing transformation towards a 'post-modern' state¹⁰. The distinctive characteristics of the latter are a vague national sovereignty and transparent borders. The above helps understand why recently Russia's political dialogue with the US has been far simpler than with EU.

¹⁰ See: Emerson M. Slon i Medved: *Evropeysky Soyuz, Rossia i ikh blizhayshee zarubezhye*. M: Institut Evropy RAN, 2001. P. 8-9

From the economic perspective, Russia cannot adapt as the basis of national legislation European *acquis communautaire*, which constitutes a mandatory condition of a full membership in EU. *Acquis* impose on member states and candidate states financial obligations that appear incompatible to the present level of Russia's economic development and the need to address the aforementioned challenge of post-industrial breakthrough, though the country can use them as a landmark for building its new institutional system, though to a very limited extent and following only those parameters that encourage, rather than inhibit, economic growth¹¹. For instance, should the EU social, labor, environmental and especially agricultural law standards be introduced to Russia, that would just create additional obstacles to economic growth. At the same time, it may become fairly appropriate to use the EU legal procedures in such areas as bankruptcy and banking law, standardization system, and technical regulation.

The effective Russian law undergoes a gradual adaptation along this particular avenue. In 2002, the law on technical regulation was promulgated, which should contribute to a substantial facilitation of cooperation between the domestic and European companies. The same can be said about the Code of Corporate Behavior designed and adopted last year by the Federal Securities Commission and professional operators on the securities market.

So, instead of a full-fledged Russia's integration into EU in the foreseeable future, it is intended to pursue a convergence policy, apparently along with the shaping of CEEZ as its core element. Meanwhile, there are three major avenues on which the progress will be seen: first, the convergence of the legal systems (the Europeans believe Russia should adopt the EU one); second, shaping conditions of free trade with goods and services; third, solving some problems in which the common European cooperation appears urgent or appropriate.

As noted above, it is just a limited circle of matters to which the EU legislation may be applicable, while Russia would benefit greatly from the creation of conditions of expansion of the free trade sphere. Despite the existing doubts about competitiveness of a considerable part of Russian products, the mutual opening of markets would be quite beneficial, considering strategic interests of Russia and the need to attain a new level of technological development. On the one hand, that would allow to limit monopolistic trends that have recently strengthened in the economy, while on the other hand, it would help overcome the domination of oil and gas in Russian exports, for private companies (those outside the monopolistic sectors) would find their niche both in terms of sales of their products and development of production cooperation. At any rate, that was the scenario according to which the situation in the Central and Eastern European economies evolved in the early 90's: at the time, they found EU markets to a significant extent open to them, which formed a major factor to contribute to their growth at the first stage of post-communist development.

Recent practices have shown that EU is reluctant to open its markets to Russian competitors, which became visible both in the course of negotiations on CEEZ and even with regard to accession to WTO, when the EU nations decided to grant Russia with the market economy status as a specific condition of the latter. As concerns Russia's accession to WTO, the respective rulings were passed by the US (in spring 2002) and EU (in autumn 2002), but

¹¹ This problems is considered in a greater detail in: Aslund A., Warner A. EU enlargement: Consequences for the CIS countries. A paper presented to the conference 'beyond Transition: Development Perspectives and Dilemma' (CASE, Warsaw, 2002). Mimeo; Mau V., Novikov V. Otnosheniya Rossii i ES: prostranstvo vybora ili vybor prostranstva?// Vorposy ekonomiki, 2002. #6



the negotiations themselves and the nature of these decisions testify to serious concerns the EU had about the rise of Russian rivals. That in turn makes the prospects of liberalization of trade and economic relations and development of CEEZ fairly vague.

Having crossed out Russia from its documents on non-market practices, European Commission raised a number of claims in the area of market procedures, thus making them aimed against Russian exports. More specifically, this concerns the practices of using non-national (surrogate and even world) prices in anti-dumping investigations against countries with market economies. As well, the adjusted procedures allow imposition of sanctions both on single producers and the country as a whole, even if its economy is recognized as a market one. Thus a whole range of sanctions applied to non-market countries has been introduced in regulations that concern market economies. That was made fairly intentionally after making the political decision on granting Russia with the market economy status.

Nonetheless, the year of 2002 saw a continuation of the work on developing the concept for CEEZ and studying into factors and mechanisms of its functioning. Under the auspices of the 'High level commission' established specifically for this purpose and co-chaired by V. Khristenko and C. Patten, there started a work on developing conceptual and economic reports, including reviews on the state of single sectors and prospects for their functioning in the common European market (more specifically, the reports covered the ferrous and non-ferrous metallurgy, car-making industry, among others). The European Union ruled to extend the European Investment Bank's mandate towards Russia, and contacts and cooperation in energy and environmental problems were underway, though without serious effect.

In 2002, the prospects for Russia-EU dialogue were also challenged by the problem of Kaliningrad Oblast: after the EU expansion, the Oblast is to become an exclave Russian territory within EU. Last year, the predominant problem was visa regime for those commuting between the Oblast and 'mainland'; however, it is economic development of the region that would move to the forefront soon. Some experts proposed occasionally to consider the Oblast a 'pilot' region for furthering the relationship between Russian and EU. So far the realization of this concept has failed due to both political and economic reasons. However, both sides will have to consider their willingness to ensure a more intense integration in this regard, which can create the basis for further convergence of Russia's and European economic systems. So far, both sides have demonstrated a certain mistrust and circumspection towards each other. However, providing no formal membership of Russia's in EU, should a political decision in favor of economic integration be distinctly made, Russia will no longer be able to consider the integration of the Oblast's economy into the European one as a step towards separation of the Oblast, while EU will no longer view such an integration as a way for Russian rivals to illegally penetrate to European markets.

Challenges and priorities of the economic policy in 2003

It is the upcoming parliamentary (scheduled for December 2003) and presidential (March 2004) elections that form a key political factor that will affect Russia's economic policy in 2003. While Western experiences in this regard allowed a detailed study into problems of a politico-business cycle, they still appear rather new for modern Russia and do not allow to draw theoretically significant conclusions. On the one hand, the past decade has not yet provided statistically significant data for a serious quantitative evaluation. On the other hand,

other hand, the phase of intense systemic reforms in principle provides insufficient fundamentals to identify steady regularities. The coming elections will form a crucial factor of an economic policy over the upcoming period, but so far the impact of elections on an economic policy at best can form a subject for speculative analyses.

With account of high chances for Mr. Putin's victory, any strengthening of populist tendencies in the macroeconomic policy in 2003 appears unlikely. So far the future institutional policy, i. e. reforms aimed at encouraging modernization and economic growth, leaves more questions than answers. The specificity of the current politico-business cycle in Russia lies with the deceleration of institutional and structural reforms, rather than a deterioration of macroeconomic parameters prior to the elections.

First, these reforms require the support of the Parliament. In the upcoming period, prior to the elections, the Duma members will be extremely cautious to take any decisions that may even remotely have a negative effect. The presidential Administration, with their current mission to ensure a formal parliamentary majority («the ruling party») as a result of the elections, will unlikely to insist on adopting unpopular (or not popular enough) laws. On the contrary, it is quite likely that the year of 2003 would see the rise in law-making populism – at least, in the institutional area, if not in the macroeconomic one.

Secondly, following its bureaucratic, rather than ideological, grounds, the power currently emerges in such a structural model that can pose an obstacle to institutional reforms. The political groups that form a 'protonucleus' of the 'ruling party' have no clear ideology and reform strategy, which in this particular case appears as if 'implanted' by the President or the Government. Should such political groups acquire power (or have guarantees of their coming to power), their interest in conducting serious transformations (even those promoting economic growth¹²) would fall sharply. Should a 'one-and-half-party' political regime emerge, this problem would become especially aggravated.

Third, it was already in 2002 that the government showed the first signs of a natural tiredness and the tendency to having a break after the two-year period of intense institutional reforms.

It is the President who could reverse the trend to slowdown in the institutional reform pace, because, first, a high personal popularity allows him to avoid populism in the pre-election period, and, second, the group of the most pressing decisions practically lack those that may cause negative social and political effects. On the contrary, the delay with long-awaited and much-needed reforms by itself can affect the economic situation. That is why, to postpone the reforms until the next electoral cycle can worsen the socio-political climate in the country. The problem is that institutional reforms usually require a long period of time to have their positive effects visible. That is why ensuring significant outcomes of the President's second term, including an accomplishment of the key mission – consolidation of economic growth – requires a timely implementation of the respective program of institutional reforms.

In one year before the elections the Government will have to carry out a very neat policy of encouraging economic growth under progressive structural shifts. The Cabinet will

¹² Under certain circumstances, such a stance can prove to be even useful, particularly when an economy has already gained a certain momentum and any excessive interference of the power would be undesirable. However, so far Russia's economy has not reached such a state, that is why it is yet premature to speak about preservation of institutional reforms.



have to balance between encouragement of demand for domestic products and an increasingly growing importation of technological equipment, between maintenance of the present level of mineral export revenues and increase in exportation of machine-engineering (and in the future — new high-tech) goods. These tasks will require addressing a number of serious economic-political challenges.

In 2003, the government economic policy will allow to single out two groups of challenges that is, working out conceptual decisions on some strategic matters of national development, on the one hand, and implementing recently developed economical and political measures, on the other.

The former group of problems comprises a critically important concept of overcoming the economy's dependence on mineral exports, among others. This mission was assigned to the RF Ministry of Economic Development and Trade yet in 2002, however, it involves a huge volume of work on formulation of the respective complex of measures.

Another critical challenge is identification of a strategy in the budgetary policy area after passing the peak of foreign debt repayment in 2003. Since the problem of the Russian debt no longer forms the political issue, and it becomes primarily technical one, the debt management would not unambiguously demand pursuing a budget surplus policy. The Government will be confronted with an alternative: to proceed with forging a surplus budget, thus accumulating a reserve (stabilization fund), or to refuse this idea and lower the tax burden.

These conceptual options appear closely interrelated. The need in stabilization fund is determined by a significant role mineral export revenues play in the federal budget. That is why lessening the national economy's dependence on mineral exports would be accompanied by a less significant part played by the financial reserve and an extension of the room for the budgetary maneuver aimed at lowering the tax burden.

The government should show their commitment to the concept for the budgetary expenditures reform. This particular challenge has two aspects, and they both appear important: first, the structural reform of the budget sector and increase in the efficiency of budgetary resources; second, reduction in the budget pressure on the economy, which also demands rationalizing budget expenditures. The reform in this particular area should have been launched yet in the wake of the tax reform, however there was no progress in it. With the account of the upcoming elections, the start of the reform yet in 2003 is unlikely, however the elections may not preclude the Government from developing the reform concept.

The Government will have to develop a clear formula to begin realizing the concept for administrative reform, including reforming the civil service. The year of 2002 witnessed an intense preliminary work on evaluation of departmental and ministerial functions and development of an optimal system of their structure and interaction. The completion of the conceptual and organizational work in these areas would allow the new presidential term to start with a new operational structure of the civil service.

Finally, a substantial progress should be ensured in the military reform area, primarily in the change of recruitment principles. This is important both from the political, military, and economic perspective, for the task of post-industrial challenges is hardly compatible with a long distraction of young people from a vigorous creative activity. The discussions held in 2002, in pair with the growing openness of the defense expenditures in the 2003 budget, form the basis for making more resolute steps than before towards a professional army. Further-

Furthermore, an action plan to change the conscription procedures could form an attractive component of the incumbent President's pre-election program.

The list of practical tasks that should be addressed in 2003 comprises the following priorities:

- The completion of the negotiations on joining WTO and passing the necessary legal acts. A further procrastination of the negotiations is pregnant with the postponement of the accomplishment of the task for an uncertain period of time, due to the prospects of reforming the Organization itself;
- The infrastructural monopolies reform, that is, the continuation of reforming the Ministry of Railway transportation, adoption of a legal base of the RAO 'UES Russia' reform;
- Development and promulgation of laws regulating local self-governance and especially those securing its financial fundamentals;
- The continuation of implementation of the deregulation programme, including the adoption of a law on self-regulating organizations and streamlining the regulatory and control instances' functions. On the conceptual level, this mission is closely related to the administrative reform;
- Development of the legal base and enhancement of the financial institutions' operational efficiency; the continuation of the banking sector reform, to increase its reliability.

There will be much more to accomplish in 2003, however, the above is what we believe should form the list of priorities of the reform agenda. At this point, it should be emphasized that 2003 is the year of making decisions on a considerable number of conceptual problems, which can also be attributed to the specificity of the economico-political cycle in modern Russia: with the account of high chances for re-election of the incumbent President, in the pre-election year the emphasis may be made on developing the agenda for next presidential period.